Investment & Financial Services Association Ltd
ACN 080 744 163

17 June 2004

Mr Elton Humphrey
Secretary
Senate Economics Committee
Parliament House
CANBERRA ACT 2600

Dear Mr Humphrey

Reference:

Family and Community Services and Veterans' Affairs Legislation Amendment (Income Streams) Bill 2004

The Investment and Financial Services Association represents Australia's leading investment managers and life insurance companies who are responsible for investing approximately $685 billion on behalf of over 9 million Australians.

Market linked income streams

The provisions to recognise market linked income streams for the *Social Security Act 1991* (SSA) would insert a new section 9BA into that Act to define market linked income streams, and amend section 1118 to recognise market linked income streams as partially asset test exempt income streams. Corresponding amendments would be made to the *Veterans' Entitlements Act 1986* (VEA). The effect of these changes would be that an income stream which meets the conditions set out in SSA section 9BA will asset tested at 50% of its account balance.

A market linked income stream is, in effect, an allocated income stream with two significant limitations. Rather than a flexible annual drawdown of income, annual income in a market linked income stream is fixed by a formula to be set out in regulations to be made under the *Superannuation Industry Supervision Act* 1993 (SIS). A market linked income stream also cannot be commuted to cash, except in limited circumstances, whereas an allocated pension can be commuted at any time.

The market for 'complying' retirement income streams is highly regulated, with key product features effectively set by concessional treatment social security, superannuation and taxation legislation. Legislative conditions have required complete loss of access to capital into longevity risk pools, or loss of access to capital during life, and that the level of annual income not fall during the life of the product.

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The requirement that the annual level of income not fall during the life of the product has effectively limited the complying income streams market to guaranteed products, usually backed by fixed interest securities. This has meant that, until this legislation, retirees who need complying income streams have not had access to better returns available from a balanced investment portfolio.

A market linked income stream would not be a viable commercial proposition without the asset test concession, because retirees would have to give up the ability to commute a lump sum, yet receive no benefit for this loss. IFSA research (see Table 1) has established that retirees place very significant value on the ability to commute income streams to lump sums, even actual commutations are rare. Consumers appear to see this feature as an effective measure of their ability to control their retirement income, and they are reluctant to give it up. This preference is borne out in income stream sales data: 75% of new income stream purchases are of allocated pensions.

Market linked income streams would offer many of the features valued by retirees, but not available in current complying income streams:

- regular account statements, showing balance
- can choose initial investment mix
- can choose initial investment mix
- can change investment mix
- can switch to another fund manager easily

A full listing of these attributes by preference is at Table 1. Market information on income stream purchases is at Table 2.

IFSA has made recommendations supporting market linked income streams (also known as growth pensions) in a number of submissions to the former Senate Select Committee on Superannuation and the former Senate Select Committee on Superannuation and Financial Services.

In June 2002 we submitted the following remarks to the former Senate Select Committee on Superannuation and Financial Services:

> *The current tax and social security treatment of retirement income streams also contributes to inadequate retirement incomes. The current rules for complying income streams – broadly, those that qualify for the higher pension Reasonable Benefit Limit (RBL) and that are exempt from the social security assets test – heavily favour interest-based investments. This distortion has been canvassed in IFSA's submission to Government supporting the recognition of Growth Pensions – copies were provided to the Senate Committee on 4 May 2001. It arises from the restrictions placed on complying products – chiefly that income paid cannot vary, except for indexation.*
>
> *If this distortion were removed, and retirement income streams which include growth assets were recognised, IFSA has calculated that a retiree with $100,000 to invest in a 15 year income stream would receive around $30,000 more in real terms than $100,00 invested in a 15-year CPI-indexed guaranteed pension or annuity.*
>
> *The distortion towards interest-bearing investments affects capital markets, reducing the allocation of retirement savings to economically productive*

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equity (and other) investments. This impact reduces the efficiency of the economy overall, and the impact will become larger as higher future levels of retiree savings are forced into interest-based investments.

In its 2003 Report on Planning for Retirement, the Senate Select Committee on Superannuation recommended:

Recommendation 6
The Committee recommends that the Government consider the appropriateness of the current restrictions on the purchase of complying annuities, to encourage the availability of so-called growth pensions.

Assets test exemption - reduction to 50%

The Treasurer's statement of 25 February 2004 describes the 100% assets test exemption for complying income streams as "a very generous concession" and indicates that the rationale to reduce it to 50% is intended to "better balance the objectives of the age pension with the need for incentives to purchase particular income streams". It is true that, under the 100% exemption, a number of retirees with assets of the order of $1 million were able to use complying income streams to reduce their asset test exposure sufficiently to be paid a significant amount of age pension.

The current 100% assets test exemptions are intended to apply to those income streams where retirees have given up any access to capital. All complying income streams must meet the condition that the income stream cannot be commuted to a lump sum except in very limited circumstances set out in the legislation.

The level of assets above which retirees should not receive any age pension payment is a question for the community and government. Current rules areas follows.

- The current assets test would prevent a homeowner couple with assessable assets of $473,000 or more for receiving any Age Pension.
- The threshold at which the assets test applies to this couple is $212,500.
- The assets test excludes the family home, and higher threshold apply for non-home-owners.
- Above the thresholds, the age pension is reduced by $19.50 for each $250 in assessable assets.
- The assets test thresholds are indexed each year, on 1 July, based on movements in the Consumer Price Index (CPI).

While IFSA does not wish to comment directly on the level of assets at which the pension should be withdrawn, it is worth noting that the assets test is biting progressively harder. This occurs when the maximum rate of age pension is increased to match the community standards benchmark of 25% of Male Total Average Weekly Earnings (MTAWE). The CPI indexation of thresholds is then reduced relative to the rate of age pension, and consequently the impact of the assets test is more severe compared to the new community benchmark.

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IFSA does suggest that, as a corollary to the reduction in the assets test exemption for complying incomes streams, the changes in the assets test relative to the maximum rate of age pension be examined.

Thank for the opportunity to provide these brief remarks. In the short time available, I have not been able to explore all issues.

Yours sincerely

Bill Stanhope
Senior Policy Manager

TABLE 1

IFSA Retirement Savings – Desires and Drivers Research Project, Chant Link & Associates, 2002

Exhibit 1. Retirement Income Stream Product Attribute Preferences

Attribute	Mean Importance
Balance goes to your estate if you die early	9.2
Guaranteed income for as long as you live	8.7
Income indexed against inflation	8.2
Guaranteed level of payment each week or month	8.1
Receive regular account statements, showing balance	7.9
May help qualify for age pension entitlements (asset test exempt)	7.8
Can vary income taken to suit requirements within limits	7.7
Can choose initial investment mix	7.7
Can change investment mix	7.7
Can switch to another fund manager easily	7.6
Can withdraw some of the capital any time	7.2
Can withdraw all of the capital originally invested at any time	6.8
Invests in low risk types of investments only	6.2
Guaranteed income for a set number of years	5.6
Can invest for growth/higher risk/higher return investments	5.2
No account statements, but you are paid a set amount each week or month	5.0

Note: Zero to 10 for importance, 5.0 being neutral; 10 highest positive.

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TABLE 2

Retirement Income Streams – Market Information

Investment & Financial Services Association Ltd

IFSA RETIREMENT INCOME STREAMS REPORT[1]

for the period ended 31 December 2003
(information provided by Simon Solomon & Associates, Consulting Actuaries, from the "Pension and Annuity Market Report")

	FUNDS UNDER MANAGEMENT (FUM)				GROSS SALES			
TYPE OF RETIREMENT INCOME STREAM	TOTAL $ MILLION	TOTAL MARKET SHARE %	CHANGE IN FUM OVER LAST 3 MONTHS %	CHANGE IN FUM OVER LAST 12 MONTHS %	SALES IN LAST 3 MONTHS $ MILLION	CHANGE IN SALES OVER PREVIOUS 3 MONTH PERIOD %	SALES IN LAST 12 MONTHS $ MILLION	AVERAGE PURCHASE PRICE IN LAST 3 MONTHS[4] $
ETP RETIREMENT INCOME STREAMS[2]								
ALLOCATED INCOME STREAMS								
ALLOCATED PENSIONS	29,642	63.9	3.9	4.5	1,572	7.1	5,644	111,000
ALLOCATED ANNUITIES	5,139	11.1	-0.6	-9.8	35	-37.5	291	138,400
TOTAL ALLOCATED INCOME STREAMS	34,781	75.0	3.2	2.1	1,607	5.4	5,935	111,500
ANNUITIES								
TERM CERTAIN (NO RCV)	Total for this category	Total for this category	Total for this category	Total for this category	90	-27.4	418	72,900
TERM CERTAIN (PLUS RCV)					97	-58.5	578	100,900
LIFETIME					15	-77.3	122	92,200
TOTAL ANNUITIES	4,123	8.9	0.2	2.2	202	-52.2	1,118	85,900
TOTAL ETP RETIREMENT INCOME STREAMS	38,904	83.9	2.8	2.1	1,809	-7.1	7,053	107,900
NON-ETP RETIREMENT INCOME STREAMS[3]								
TERM CERTAIN (NO RCV)	Total for this category	Total for this category	Total for this category	Total for this category	277	23.7	939	72,900
TERM CERTAIN (PLUS RCV)					160	-12.1	774	118,700
LIFETIME					12	-56.7	78	69,200
TOTAL NON-ETP RETIREMENT INCOME STREAMS	7,489	16.1	-1.1	-1.3	449	3.7	1,791	84,400
TOTAL RETIREMENT INCOME STREAMS	46,393	100	2.2	1.6	2,258	-5.1	8,844	102,300

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