SECURITIES INSTITUTE

18 June 2004

Mr Elton Humphrey
Secretary
Senate Standing Committee on Community Affairs
Parliament House
CANBERRA ACT 2600
community.affairs.sen@aph.gov.au

Dear Mr Humphrey

Re: Comments to Senate Standing Committee on Community Affairs

The Securities Institute of Australia ("the Institute") welcomes the opportunity to make a submission to the Senate Standing Committee on Community Affairs ("the Committee") inquiry into the Family and Community Services and Veterans' Affairs Legislation Amendment (Income Streams) Bill 2004.

This Bill gives effect to two measures announced earlier this year by the Government in its statement, *A more flexible and adaptable retirement income system*. These measures change the social security and veterans' affairs means test assessments of income streams to:

- Extend assets test exempt status for a new product, `market-linked income streams' from 20 September 2004. This product will offer market returns but the purchaser will not be able to withdraw his or her capital before the term of the product has ended (i.e. it is non-commutable); and
- Change the social security assets test exemption from 100% to 50% for non-commutable income streams that are purchased from 20 September 2004 and meet the requirements for exemption from the assets test.

The extension of assets test exempt status to the market-linked income stream (MLIS) products aims to increase competition in the provision of income stream products as well as provide Australians with flexibility in structuring their retirement savings.

The Institute is keen to assist in the Government in designing an MLIS product that has a positive application for as many Australians as possible. Overall the Institute supports the MLIS product. We agree with the Senator The Hon Helen Coonan, Minister for Revenue and Assistant Treasurer's recent comments that "a market-linked income stream fills a key missing niche in the pension market".

There are significant benefits of MLIS products, for example these products can achieve better returns and higher levels of income overtime and generally have lower administration costs. MLIS products also allow retirees to control their capital and take the required income stream, thereby maximising their future income cash flows as well as tailoring income streams to meet their retirement circumstances and needs.

In addition, MLIS products do not distort the market. The current regime tends to force retirees into insurance-based interest-bearing incomes streams (which may have lower returns and could be more volatile) due to the tax characteristics and social security treatments of these products.

MLIS products combine flexibility of allocated pensions with tax concessions and social security benefits of complying pensions. Most importantly, MLIS products can be available through a superannuation fund or self-managed superannuation fund.

However, while the Institute supports MLIS products, we have some concerns in relation to this particular product.

Longevity Concerns

One of the biggest concerns for many retirees is longevity – that is, living longer than 'average' and hence potentially surviving longer than their investment funds. Since the concept of 'life expectancy' is that 50% of people will still be alive at this point in time, it often also means that full government assistance will be required to support these people in the years following their 'life expectancy'.

Additionally, it is worth noting that most life insurance companies provide for the longevity of their life annuitants by assuming they will, on average, live up to a number of years beyond the currently published life expectancy tables. (The number of years varies from life insurance company to life insurance company, however, it is traditionally in the range of 5-8 years timeframe).

Therefore, the Institute supports allowing a longer term for this product. We suggest consideration be given in terms of actuarial life expectancy at the time of purchase with an additional 8 years. This should better correspond to life expectancies which are continuously improving rapidly because of medical advances and better lifestyle choices.

Allowing a longer term will reduce the level of income that is payable from these income streams. This might have an impact on the popularity of this type of income stream for some retirees. However in our members' experience the vast majority of retirees are deeply concerned about their money running out before they die. Therefore, the lower level of income, to ensure a longer term, is not as important an issue as ensuring that retirees have access to a meaningful level of income during all their remaining years.

Fluctuating Income

The Institute is concerned about the variability of income that is likely to result with this product. Many retirees like the idea of 'no surprises' when it comes to their income. However, the level of income from this product will fluctuate depending on the earnings that the underlying investments receive. This issue is particularly compounded for people who are near the cut off area for Centrelink's asset test.

Asset Test

The intention of the Bill is to change the asset test exemption from 100% to 50% for 'purchased' asset test exempt incomes streams. The aim is to ensure that the age pension is paid to those who need it most. This change would make MLIS products 50% asset test exempt.

This level of asset test exemption might encourage some investors to place a large sum of money into this type of product in order to ensure that they fall under the assets tests thresholds (which are different for NewStart than for the Aged Pension). However, if the underlying investments of a MLIS product have a few years of out-performance, then it may be that an investor finds themselves falling outside the Centrelink assets test and then sometime later falling within it. As noted above, this level of variable income would not be welcome by many retirees.

The Institute suggests that the Government's deliberation of the 50% asset test exemption should not be considered as linked to the reforms in relation to MLIS products generally.

Non-ETP MLIS

The current income tax laws would not allow this product to be used with non-superannuation based monies. Annuities provided by life insurance companies can be purchased by investors of any age with non-superannuation investors. The Institute believes that MLIS products should be available for all types of investors, including those who have not been in a position to make superannuation investments or would like to use this type of investment to generate a level of income for themselves with their investments over a period of time. (It should be remembered that this type of product is non-commutable.)

Conclusion

The Institute believes that MLIS products have a number of benefits, including flexibility, transparency, simplicity, and 'choice', and as such offer a valuable alternative to existing income stream products. We consider that this initiative will encourage individuals to take a longer-term view of their retirement savings, and thereby goes to delivering the Government's objectives of providing a more flexible and adaptable retirement income system.

If you have any queries about any issues raised in this submission, please contact me on (02) 8248 7651 or the Institute's Policy consultant, Tony Negline on 0412 109 256 or via email negline@bigpond.net.au

Yours sincerely

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