From: deLancey Worthington [mailto:actuary@bigpond.net.au]
Sent: Friday, 30 July 2004 11:58 AM
Cc: 'Allen Truslove'; 'Christine Moran'; 'Cohen Watson'; 'Jeff H'; 'Meg Heffron'; 'P Crump'; 'Warren King'

Subject: Inquiry into Superannuation Industry (Supervision) Amendment Regulations 2004 (No.2) - Michael Burt's Projections of Assets Remaining on Various Pensions With a Purchase Price of $600,000.

Here are my comments on the prepared notes read by Treasury at Monday's hearing in Melbourne. The actuarial figures provided by Michael Burt are inconsistent and are deliberately selected to skew the argument.

I have calculated projections of remaining assets from pensions as calculated by Michael Burt in the Senate inquiry.

Working backwards I determine the first year's minimum allocated pension is based on age 65, no surprises there.

The first year's growth pension is calculated using the factor for a term of 27 years. This is the maximum term for a female aged 62 at commencement. This matches standard actuarial methodology of women being on average 3 year's younger than their spouse.

The complying pension of $24,000 is a mystery. Indexation rate? Assume 5%. Reversion? Assume full reversion. The $24,000 then is very close to the Australian Government Actuary's formula amount which is supposed to match life office annuity rates. In reality very few retirees would select 5% as an indexation rate. It exceeds their expectation of inflation. Most retirees would select a rate that matches inflation to maintain their standard of living and to provide more income in their early years post retirement when they can enjoy it. I would have selected an indexation rate of 3% rather than 5%. Choosing 5% defers the taking of income and requires assets to be retained for the considerably higher later payments. Despite this the rate of $24,000 is equivalent to what could be obtained from a life office annuity. For comparison I have included a lifetime pension with an indexation rate of 3%. To be consistent with the numbers in my presentation the pension rate is 4.8% of the purchase price or $28,800. This is competitive with current annuity rates.

To arrive at the quoted assets remaining after 25 years (or was that 25 years and 364 days) the superannuation fund assets would need to accumulate at the following net rates of return

Allocated pension 5.5%
Growth pension 8.3%
Lifetime pension 6.7%

Why the large disparity between the assumptions? I would expect the same asset allocation and administration structure for each pension.

Nominal levels of pension in first year:

Allocated pension $38,220
Growth pension $34,700
Lifetime pension (5% indexation) $24,000
Lifetime pension (3% indexation) $28,800

Nominal levels of income at age 90:

Allocated pension $30,530
Growth pension $59,670
Lifetime pension (5% indexation) $81,273
Lifetime pension (3% indexation) $60,300

Real levels of income at age 90 adjusting for inflation of 3% per annum:

Allocated pension $14,580
Growth pension $28,500
Lifetime pension (5% indexation) $38,820
Lifetime pension (3% indexation) $28,800

Nominal levels of income at age 95:

Allocated pension $17,510
Growth pension $0
Lifetime pension (5% indexation) $103,730
Lifetime pension (3% indexation) $69,900

Real levels of income at age 95 adjusting for inflation of 3% per annum:

Allocated pension $6,010
Growth pension $0
Lifetime pension (5% indexation) $44,380
Lifetime pension (3% indexation) $28,800

The lifetime pensions are much better at providing a long term, stable level of income in retirement. They build up reserves to ensure the longevity of the pensions. The pension rates are competitive with life office annuity rates. There is no sinister plot to take a low retirement income and keep assets for the next generation. They are behaving in the manner required in the SIS legislation to protect members' benefits. "Excessive" reserves are taxable on their investment earnings.

On the regulator's assumptions of a moderate rate of return the lifetime pension can easily provide an income into old age that is at the same level as would be provided by a life office. They do a better job with the assets of generating investment income than a life office as they can provide the same level of income for a longer period on average.

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