Submission to the Income Stream Review: Consultation Papers

April 2015

National Seniors Australia

About National Seniors Australia

National Seniors Australia is a not-for-profit organisation that gives voice to issues that affect Australians aged 50 years and over. It is the largest membership organisation of its type in Australia with more than 200,000 members and is the fourth largest in the world.

We give our members a voice – we listen and represent our members' views to governments, business and the community on the issues of concern to the over 50s.

We keep our members informed – by providing news and information to our members through our Australia-wide branch network, comprehensive website, forums and meetings, bi-monthly lifestyle magazine and weekly e-newsletter.

We provide a world of opportunity – we offer members the chance to use their expertise, skills and life experience to make a difference by volunteering and making a difference to the lives of others.

We help our members save – we offer member rewards with discounts from thousands of businesses across Australia. We also offer exclusive travel discounts and more tours designed for the over 50s and provide our members with affordable, quality insurance to suit their needs.

Contact

Head Office

National Seniors Public Affairs, Level 18, 215 Adelaide Street Brisbane QLD 4001

P: 1300 765 050   F: (07) 3211 9339

E: policy@nationalseniors.com.au

W: www.nationalseniors.com.au

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Introduction

National Seniors believes that the primary objective of superannuation should be to provide income which supports a comfortable retirement. Increasing life expectancy is creating a need for innovation to manage longevity risk and generate stable income streams within the retirement phase of superannuation.

National Seniors is concerned that the lack of income-stream-based investment options exposes people to higher risk levels in the superannuation retirement phase.

Many Australians simply do not understand the true level of risk to which they are exposed within many retirement phase investment options. National Seniors' research indicates that 51 per cent of seniors do not understand the relationship between asset classes and risk. [1]

Current regulatory barriers including less favorable taxation treatment, lack of awareness of risk, limited product options and the potential mismatch with retirees' desire to spend more in early retirement[2] is keeping the uptake of income stream products with a lower risk profile artificially low, resulting in only about five per cent of retirement savings allocated to annuities[3] .

National Seniors believes that investors including those utilizing Self-Managed Superannuation Funds (SMSF) should have the option to purchase Deferred Lifetime Annuities (DLAs) and benefit from the same favorable taxation treatment as provided to other retirement investment options.

Seniors report that they wish to have the option to invest in products that allow access to capital including through Commutation and Death Benefits. Seniors are willing to accept upper limits on these benefits to eliminate the possibility of exploitation and taxation avoidance.

National Seniors supports the requirement to have some level of minimum drawdowns to avoid account-based pensions becoming a taxation haven. However National Seniors members continually report that they have suffered financial losses as a result of the prescribed minimum drawdowns on account based income streams which do not provide flexibility to respond with lower drawdowns in periods of declining market returns.

The current lack of innovative investment options and flexibility in the minimum drawdown rates can have the unintended consequence of putting more seniors at risk of running out of money and having to rely on Government pensions later in their retirement.

National Seniors has provided comment on the three consultation papers, highlighting issues which are of greatest importance to our members.

[1] Productive Ageing Centre (2012) *Financial Wellbeing: Concerns and choices among older Australians* National Seniors Australia.

[2] Reserve Bank of Australia (2014) *Submission to the Financial System Inquiry* Australian Government.

[3] Mercer (2014) *Post Retirement Market Trends in Australia* Marsh & McLennan Companies.

Consultation Paper 1 Broadening the Annuity and Pension Rules

National Seniors fully supports the application of a principle-based approach opposed to a rules-based approach. The current rules are too restrictive and are preventing the development of products which can both meet the objectives of the rules and provide retirees with longevity risk protection.

DLAs and pool annuities are identified by National Seniors members as investment products they would like to access to help manage their longevity and investment risks.

> *"This (DLA) is something I have been arguing for through my financial advisers. The problem is that we do not know how long we are going to live and, therefore, how long our super savings are going to have to last for"* - National Seniors member (2015)

> *"The purchase of a Deferred Annuity could act as a hedge against increasing draw down percentages with age in times of economic decline"* - National Seniors member (2015)

However both products currently do not attract favorable taxation treatment under the current rules and are thus not a viable option for seniors. A principle-based approach would enable the development of DLAs, pool annuities and hybrid products which would help manage longevity risk.

Category A Products

National Seniors has no objections to the restrictions proposed to Category A Products which could have a deferred period and full variability of annual payments. The proposed simple straight line depreciation schedule over the term of the products is easy for consumers to understand and incorporate into their investment strategy.

National Seniors believes that the proposed Category A Product regulation will enable the development of the deferred investment products suitable for managing longevity risk. The proposed regulation also appears flexible enough to enable individuals, SMSF and traditional superannuation funds to invest in Category A Products ensuring all investors have access to these products.

National Seniors believes that there should be restrictions on who can offer Category A products and adequate disclosure requirements. Only Australian Prudential Regulation Authority regulated bodies should be able to offer Category A Products.

Category B Products

The ability to access capital within investment products in the form of death benefits and commutations is very important. National Seniors accepts that this product category could not provide deferral income and would be required to comply with the current restrictions of the prescribed minimum drawdown payments.

Category A and Category B products should be available to the market as both would provide Australians with investment options better suited to manage longevity risk and enhance individuals' ability to self-fund their retirement.

National Seniors believes that applying the same death benefit provisions to account-based pensions, annuities and DLAs will promote consistency and competition in the post-retirement market.

Before any new products are offered to the market the Commonwealth Government must ensure that new disclosure requirements are developed (in consultation with investors and consumer groups) which clearly list all the unique risks and limitations of the new investment options.

Consultation Paper 2 Purchase Options for Income Stream Products

The existing pension and annuity rules are impeding the development of innovative income stream products which provide greater longevity insurance in both the accumulation and drawdown phase.

National Seniors believes that removing the impediments that restrict the purchase of income stream products including DLAs through multiple premium payments over an extended period may encourage the development of innovative retirement income stream products.

The ability to purchase DLAs and similar products by a lump sum payment and via multiple premiums in both the accumulation and retirement phase is important.

National Seniors members report that they can receive unexpected payments such as inheritance or redundancy payments within the pre and post retirement phase of superannuation which they wish to use to purchase DLAs or similar products.

Individuals should be able to purchase DLAs and similar products and be granted the same favorable taxation exemptions regardless of the original source of the funds and the time at which the product is purchased.

Whilst few Australians properly engage with their superannuation until the cusp of retirement they should still be allowed to purchase annuity products in the accumulation phase.

National Seniors believes that removing consumers' current lack of understanding of longevity risk and the risks of insufficient superannuation savings would encourage the development and take up of deferred investment products.

National Seniors is comfortable with limiting the earning tax exemption on income stream products purchased in the accumulation phase until they commence an income stream. National Seniors believes that superannuation funds and SMSF would be able to manage this complexity and ensure that where an income stream product is purchased in the accumulation phase, the earning tax exemption only applies after the member commences an income stream.

The uncertainty of income streams (including the risk of unemployment or decline in income from other investments such as shares) which members are using to pay for the premiums which purchase annuity products must be considered. National Seniors believes that a *de minims* rule which allows the return of the premium already paid to the policy holder up to a specific amount if they no longer can continue to make payments is an necessary option when annuity products are purchased with tranches regardless of the retirement phase.

National Seniors believes that the proposal to not allow tax deductions for premiums paid for the purchase of income stream products would limit the development and take up of these products. Any additional budgetary costs are likely to be offset by the increased number of self-funded retirees (who no-longer will have to transition onto the pension later in life) as a result of access to deferred income products.

Consultation Paper 3 Revising the Minimum Drawdown Amounts

The current minimum drawdown requirements appear to be achieving their policy objectives, and the application of a set percentage is easy to understand and incorporate into retiree household budgets.

However, National Seniors members report that the current payment amounts are too high compared to market returns and therefore draw down too much capital which put them at risk of running out of money in later years.

> *"Numerous of us older self-funded retirees are very concerned about the current minimum The problem is, the Government requires annual withdrawal of 7% going to 9% for those of us at advanced ages it is both prudent that a substantial portion of the invested funds be very liquid, namely in cash and you know, however bank interest paid is around 3%. The current requirements process denudes savings to a point where the capital becomes unsustainable."* - National Seniors member (2013)

> *"With us all living to a much greater age and if our pension is to see us out so that hopefully we remain independent, then a review of these compulsory drawdown percentages is urgently required."* - National Seniors Member (2015)

National Seniors agrees that there should be no automatic adjustment of the minimum drawdown payments. It is essential for the government to retain the ability to intervene if it considers an adjustment is warranted, for example, in a financial crisis.

A sound approach would be for the government to determine a number of key variables which would trigger a government or ministerial review of the required drawdown payments.

Examples of those key variables could include a percentage drop in the ASX, a sharp increase in inflation or a rapid drop in the interest rates. The more in depth review, undertaken by the government/minister, would then also consider the actual assets and risk exposures of investments held in account-based pensions.

National Seniors supports the introduction of additional age bands into the current schedule and corresponding adjustments to the required drawdown payment percentages. This approach would add a degree of smoothing useful to retirees.

National Seniors also supports the introduction of a a carry-forward drawdown option where members can choose to draw down up to 50 per cent of the minimum drawdown rate for any year, noting that they would then have to draw down a higher percentage in subsequent years.

National Seniors believes that lower drawdown rates across all age bands are required, providing a link to lower-risk, low-return investments such as term deposits, government bonds and annuities. The table below provides an example of the proposed drawdown payments.

Age	**Minimum Payment Percentage**
Under 65	2
65-70	4
70-74	5
74-80	5.5

This lower percentage rate approach encourages individuals to take a more conservative investment strategy thereby reducing longevity and investment risk.