UniSuper

Means test rules for lifetime retirement income streams

Submission by UniSuper

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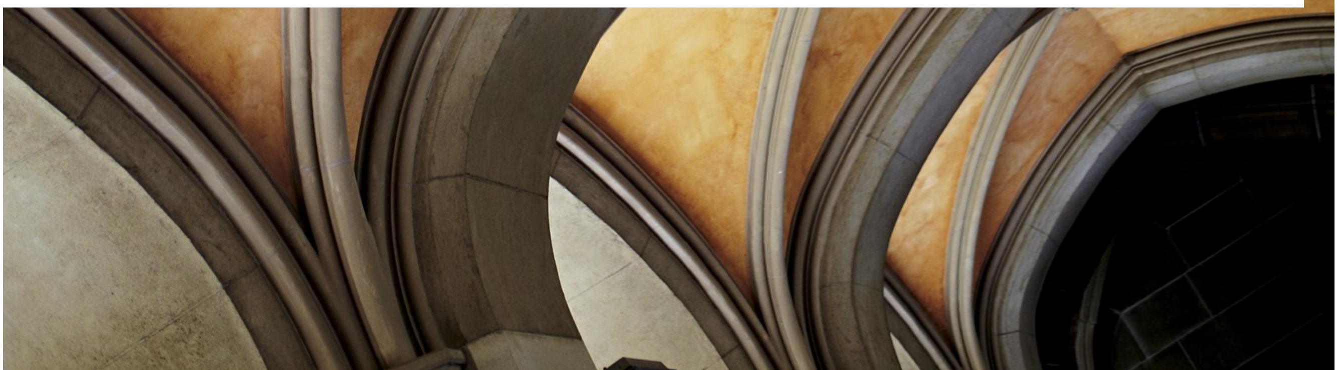


UniSuper

About UniSuper

UniSuper is the superannuation fund dedicated to people working in Australia's higher education and research sector. With approximately 400,000 members and around $63 billion in assets under management, UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes.

UniSuper Management Pty Ltd would welcome the opportunity to discuss the submission further and to provide additional information in respect of the comments made in this submission. Should you have further queries, please contact Benedict Davies on 61 3 8831 6670 or benedict.davies@unisuper.com.au

General observations

These rules are to be welcomed to the extent that they bring certainty about the social security treatment of deferred retirement income streams. However, extending the proposed means test changes to other retirement income streams or – potentially – to CIPRs, raises a number of issues:

1. These rules do not appear to be concessional relative to the existing rules. If these rules are less concessional (as implied by having to grandfather the current rules), we would question how these rules meet the broader policy objective which we understood was to encourage innovative income streams, such as GSAs, as well as longevity products more generally.

2. A lack of concessionality (or perception thereof) will also have implications for the proposed CIPRs framework. While the full detail of CIPRs is yet to be formally established (e.g. Is a CIPR a product or framework?), it is difficult to comment on the likely effect of these rules on potential member interest in CIPRs or on the decision of whether funds even develop CIPRs – very few super funds will choose to develop CIPRs without incentives.

3. Rather than grandfather the current rules, we believe that the new rules should sit alongside the current rules, rather than replace them.

4. These rules do not appear to achieve neutrality with existing arrangements for defined benefit pensions which are subject to a harsher income test. We suggest extending the 30% income test deduction rule to defined benefit pensions.

UniSuper

Proposed new means test rules for pooled lifetime income streams

UniSuper strongly believes that Trustees should be given more flexibility to develop new retirement income products to address the needs of their members.[1] We maintain that Trustees, rather than policy makers, should be at the forefront of developing appropriate retirement income strategies and products for their membership.

For any of these new products to be successful, however, government policy does have a significant role to play. Means testing policy is one of the most important policy levers at hand. After all, four in five retirees currently receive some Age Pension support (and that number is not expected to change much into the future.[2])

UniSuper supports the principle that giving up access to capital should be a key trade-off to enable an income stream to receive concessional treatment.[3] Historically, products requiring members to forego access to their capital have received recognition of that sacrifice. This has been done in two ways: one, through exempting all or part of the purchase of lifetime income streams from the assets test; and two, through income test rules that try to assess the earnings component of purchased lifetime income streams rather than the capital (i.e. the return of capital principle with a deduction amount).

	Income test	**Assets test**	**Observation**
Current lifetime retirement income streams e.g immediate annuities	100% assessed with the possibility of large i.e. 100% deductions in early years	100% assessed with a declining balance over time 0% after life expectancy	Large up-front deductions of income in early years Harsh assets test in early years
New lifetime retirement income streams e.g. deferred annuities, newly commenced traditional annuities, capital-access restricted annuities, GSAs	70% assessed (or 30% exempt)	70% assessed (half at LE)	Under the new rules, retirees who purchase a retirement income product (e.g. immediate lifetime annuity) are likely to receive a lower age pension (compared to the current rules) over the lifetime, especially during the early stage of retirement before they reach life expectancy. This is unlikely to encourage retirees to take-up these longevity-type products.
Defined benefit pensions	90% assessed (or capped 10% exemption)	0% assessed (0% at LE)	Likely to have the greatest amount of income assessed in every year

[1] http://fsi.gov.au/files/2014/08/UniSuper_Management_Pty_Ltd.pdf
[2] Treasury (2015), 2015 Intergenerational Report Australian in 2055, https://treasury.gov.au/publication/2015-intergenerational-report/
[3] Submission by UniSuper to Treasury's Review of retirement income stream regulation (31 July 2015) https://treasury.gov.au/consultation/review-of-retirement-income-stream-regulation/

While the current means test rules for lifetime income streams are *somewhat* concessional, our analysis and that of others[4] suggests that the rules proposed in this document are less concessional. The income test appears harsher in the early years and the assets test shelter is largely irrelevant given that the income test is generally the operative test.

Further, if the proposed rules are compared to historic rules, e.g. the former “complying income stream” regime which had a 100% assets test exemption, they seem even less generous.

While we recognise that the rules in this Position Paper have been developed giving consideration to important issues such as fiscal sustainability and integrity, it is not clear that other objectives, such as giving some incentive for retirees to commit a portion of their retirement savings to innovative income streams, have been given sufficient consideration.

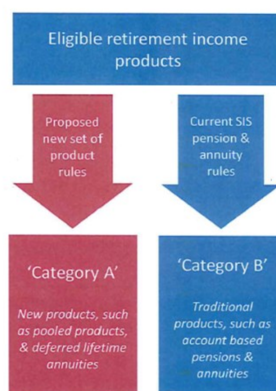
These rules are to be welcomed to the extent that they bring means-test certainty to those developing deferred annuities, but we remain unconvinced that this is a concessional or a neutral framework or the framework necessary to encourage pooled lifetime income streams such as GSAs. This also has implications for CIPRS.

Our concern remains that these rules are likely to only have a limited effect – limited to designing products to comply with the rules rather than effecting the bigger issue facing retirees i.e. how much (if any) of one’s retirement savings ought to be allocated to a lifetime income stream.

We would also question the decision to grandfather the current rules. While it makes administrative sense to grandfather already commenced pensions (which are generally not commutable), we had previously understood that the new rules (“Category A”) were going to sit alongside the existing SIS pension and annuity rules, and would provide an alternative to the existing rules (“Category B”).

Proposed alternative retirement income product rules

- The new rules would sit alongside the existing SIS pension and annuity rules, providing an **alternative to the existing rules** rather than a replacement.
- Any products currently eligible for the earnings tax exemption would remain eligible.
- Products could be purchased in tranches throughout accumulation, however, tax exemption and proposed access schedule will not commence until income payments commence or product enters deferral stage.
- Proposed that **SMSFs and small APRA funds** not be allowed to offer their own Category A products (but may purchase them from other providers).
- Possibly restrict to **lifetime products** only as these meet the objective of providing genuine longevity risk insurance.



As a result, we believe that the new rules should sit alongside the current rules, rather than replace them (as original implied in the above diagram from an earlier industry consultation).

[4] Nick Callil (2018), Social Security Means Testing of Lifetime Retirement Income Streams – 5 February 2018, Willis Towers Watson

If the current rules for traditional lifetime income streams (e.g. purchased pensions and annuities) are replaced, we are concerned that retirees could suffer a “double hit” with both an Age Pension reduction and lower income stream payments as existing lifetime income stream provider redesign their offering to “chase the concession” purportedly on offer.

By way of example, UniSuper currently offers a Commercial Rate Indexed Pension (“CRIP”) which has the following features:

- a payment based on long term indexed bond rates; &
- has a guaranteed minimum payment period being the lesser of 10 years or life expectancy at commencement and is indexed in line with the Consumer Price Index (CPI).

Historically, this SIR 1.06(2) pension received a variety of means test treatments, each change less generous e.g. 100% assets-test exemption; then a 50% assets test exemption; currently no assets text exemption but, more importantly, under the Income Test, the deduction rule applies offering an offset of income for the return of capital in the early years. If this rule were changed – and more income were assessable – then a lower Age Pension at least in the early years will result. Based on observed market prices for current lifetime income streams, we estimate that the price difference between an income stream with a 10-year guaranteed period and one with a feature equivalent to a Category-A capital access schedule is a first year payment reduction somewhere between 10% & 20%.

	Payment from income stream provider	**Age Pension**
Current lifetime income streams with 10-year guarantee periods	Base case income payment	Base case Age Pension
New lifetime income streams with capital access schedule	Reduced pension of approximately 10%-20% compared to base owing to cost of offering access to capital	Certain lower pension in early years and possibly lower pension over full life expectancy

CIPRs and MyRetirement remain a work-in-progress

The Position Paper comments, somewhat obliquely, on the CIPRs / MyRetirement initiative. At the time of writing, we believe it remains an open question: why would trustees develop CIPRs?

After all, CIPR-like arrangements are already an option for retirees e.g. an account-based pension and an annuity, or taking a broader view of retirement income / savings by factoring into a retirement plan the role of the Age Pension and/or access to equity in the family home.

An earlier Discussion Paper by Treasury[5], argues that the CIPR framework would *enable trustees to provide individuals with an easier transition into retirement through the offering of a standardised retirement income product.*

On the face of it, the ability to offer a “standardised” product is not a particularly compelling reason for trustees to develop new products. A trustee’s product offering, after all, should be based on identified needs of its members rather than fitting members to standardised products. We maintain that CIPRs should be considered as a framework, rather than a standardised product, and trustees should develop their own retirement income framework within which they would develop a range of suitable products for their membership. In our view, retirement income product development should not be about standardisation or ease of development, but based on identified needs of members and a trustee committed to the principle of improving retirement outcomes for members.

While the full detail of CIPRs is yet to be formally established, it is difficult to comment on the likely effect of these rules on potential member interest in CIPRs or on the decision of whether funds even develop CIPRs – very few super funds will choose to develop CIPRs without incentives.

Therefore, we believe that means test treatment of CIPRs should only be addressed after the broader framework has been legislated along with a timeframe for their (voluntary) introduction.

[5] Treasury (2016), Development of the framework for Comprehensive Income Products for Retirement, https://consult.treasury.gov.au/retirement-income-policy-division/comprehensive-income-products-for-retirement/

Neutrality with defined benefit pensions

While this Position Paper does not propose changes to the treatment of defined benefit pensions, change does need to be considered in light of the existing means test treatment of defined benefit pensions. While we would agree that “[t]here is a strong policy case for a single set of rules that will apply neutrally to all pooled income streams”, we are not convinced that neutrality would be achieved vis-à-vis defined benefit pensions.

If we take the stylised fact that:

> “As a general rule, the income test is more likely to apply to pensioners with modest investment holdings or income from earnings, foreign pensions or defined benefit income streams, where the assets test is more likely to apply to pensioners with more substantial investment holdings or significant other assets.”[6]

then neutrality between innovative income streams and defined benefit pensions requires consistent *income test* treatment. Under these proposals, innovative income streams will have 70% of the payment assessed (or 30% of it exempted). This is different to defined benefit pensions which have up to 100% of the payment assessed (or a maximum of 10% exempted). Historically, defined benefit pensions had similar treatment to the income test proposed in this Position Paper i.e. deduction based on tax free amounts. In a “classic” defined benefit scheme - with a two-for-one employer-employee contribution rule – approximately one third of the benefit would have been financed by post-tax member contributions. There remains a strong case that these contributions which are a return of capital should be deducted from the pension payment.

UniSuper members in receipt of defined benefit pensions (2015)		
Tax free percentage	**Number of defined benefit pensions**	**Percentage of defined benefit pensions**
Less than 10%	2,515	35.3%
10% - 20%	1,707	24.0%
20% - 30%	880	12.4%
30% - 40%	876	12.3%
Greater than 40%	1,147	16.1%

In the case of UniSuper, approximately 65% of our members have tax-free amounts greater than 10%. By way of example, the above table from our submission on the Social Services Legislation Amendment (Fair and Sustainable Pensions) Bill 2015 highlights the number of members who in theory could have faced a choice between a lifetime income stream with a 30% income exemption versus one with a 10% exemption. While there are also assets test and comparative pricing differences, we remain concerned that a member who has yet to commence a pension is faced with mixed signals from policy makers. As these rules do not appear to achieve neutrality with existing arrangements for defined benefit pensions, we suggest extending the 30% income test deduction rule to defined benefit pensions.

[6] Department of Social Services (2018), Means Rest Rules for Lifetime Retirement Income Streams, p. 5 https://engage.dss.gov.au/wp-content/uploads/2018/01/Position-Paper-Means-Test-Rules-for-Lifetime-Retirement-Income-Streams-January-2018.pdf