FSC FINANCIAL SERVICES COUNCIL

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Subject: Review of retirement income streams regulation

The FSC welcomes the three consultation papers addressing retirement income products and the minimum draw down requirements.

This submission responds to the questions in all three papers. The FSC supports the Government's response to these issues being developed in advance of the Government finalising its response to the Financial System Inquiry (FSI). Doing so would provide the industry certainty around the sorts of products that may be available to being included as Comprehensive Income Product for Retirement should that recommendation be adopted.

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks, trustee companies and public trustees. The Council has over 125 members who are responsible for investing more than $2.3 trillion on behalf of 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the third largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

Please feel free to contact me on 02 8235 2566 if you have any further questions or comments in relation to this submission.

Yours sincerely

BLAKE BRIGGS
SENIOR POLICY MANAGER

Income Streams Review: Consultation Paper 1

Principles based regulation

1. Do you consider that a purely principles-based approach is practicable? If so what principles should apply? If not, why not?

The FSC supports a principles-based approach as it allows for flexibility and product innovation. Categories A and B defined in the consultation paper would address many of the issues preventing products from coming to market, however the FSC has some concerns that the proposed categories are restrictive and may not permit hybrid products.

A multiple category approach will inevitably create complexity for the industry and consumers and may cause consumers to buy multiple products at retirement with the associated cost. Whilst the Category A and B approach may achieve the desired outcome, the FSC would also support a single category, open architecture model with integrity provisions that allows for a single retirement product that includes the product features proposed under the categories A and B.

One of the problems created by the suggested Category A and B approach is the concept of requiring two products, one which provides an immediate income and the other which is deferred. A product which combines an immediate and deferred component may be a preferable option however it is practically difficult to achieve this outcome.

This issue may be overcome should there be sufficient flexibility in the regulations to allow an issuer to offer a combination of product categories (or features) in the one pension account so that a members can move between categories. The regulations would therefore need to allow for the flexibility to hold both a Category A and Category B product as part of one complying pension product for a member's account. This would be akin to a rider benefit similar to insurance as a rider on a superannuation account.

The FSC notes that the tax incentives and means-tested Age Pension have significant implications for fiscal sustainability and must be targeted. Current integrity measures within the retirement system ensure that a principles based approach to retirement products will ensure that they remain adequately targeted.

The relevant integrity measures include:

i. Superannuation concessional and non-concessional contribution limits;
ii. Age Pension Means Test:
   - Income Test
   - Assets Test;
iii. Pension rules under the SIS Act (in particular s105 and s106) which maintain the boundary between accumulation and pension phase and determine eligibility for the Earnings and Benefits Tax exemptions;
iv. Minimum draw down rules which ensure that superannuation assets in pension phase are converted into an income stream; and
v. Taxation of death benefits paid to persons other than superannuation dependents.

Within these integrity provisions the two categories defined by the Government appropriately navigate a product neutral pathway between protecting the integrity of the retirement system and providing regulatory settings that allow a greater diversity of retirement products to come to market.

The FSC submits that, whilst a single category approach may be possible, additional integrity measures would be necessary. The FSC would welcome the opportunity to discuss this option further with the Government.

Category A

2. Would the restrictions proposed combine to ensure that a complying product would provide for the bulk of the capital to be drawn down over the course of the person's retirement?

The FSC is supportive of the categories defined in the consultation paper.

In regards to Category A products, the FSC submits that the income stream will return the capital to the retiree over the course of their retirement. The FSC supports this requirement being imposed on Category A products in the manner defined in the consultation paper.

3. Do you have any concerns with how these rules would operate? Do you foresee any unintended consequences?

As raised in section 1 the FSC is concerned that it is not clear how the two categories of products would interact. Further, there is no apparent mechanism for an individual to transition between Category A and Category B products should their personal circumstances change. The FSC would support additional flexibility for consumers in this regard.

In Australia's choice environment sales of deferred annuities could be expected to be restricted if a death benefit were not available. Providers should be able to offer deferred products with and without a death benefit and, within the parameters defined, Categories A and B allow for this outcome.

A common means employed by life offices of overcoming an individual's fear of dying before there is an adequate return from the product is to guarantee a minimum return in the form of a death benefit. This has been shown to be effective when the death benefit is approximately equal to the nominal value of the premium and the FSC would support this restriction being imposed across Category A products.

4. Would it be possible to replace the minimum drawdown requirement with a diminishing capital value requirement, that is, have only Category A products?

The FSC submits that there is a need in the market for a broad range of product types and that it is not appropriate to replace those products that are subject to minimum draw down requirements. Whilst the FSC is concerns around the complexity than can arise from having two product categories, this does not warrant the effective abolition of Category B products.

Further, providing for only a diminishing capital value requirement would complicate the interaction between the products, consumer behaviour and market volatility. The implications of this are not well understood. As was observed during the financial crisis, diminishing capital in falling markets drives behavioural responses that can be both unpredictable and have negative consequences for retirement outcomes.

5. Would the depreciation schedule described be appropriate? If not, why not, and what would be a better alternative?

The FSC has no significant concerns with the depreciation schedule as defined in the consultation paper. The FSC would welcome, however, the opportunity to continue to consult with the Government on this issue to ensure the depreciation schedule remains suited to the types of products coming to market.

6. How could or should an equivalent freeing up of the income payment rules apply in the case of a defined benefit type interest where members accrue an entitlement to a fixed income and there is no explicit purchase price?

The FSC supports these products being non-commutable.

7. Is there a need for a maximum drawdown rule? How could this be designed?

The FSC submits that the debate around the introduction of a maximum draw down rule is broader than the issues included in this consultation paper. The FSC is of the view that this debate is better had within the tax discussion paper consultation process.

Practically the types of products being considered through the retirement income discussion papers would not likely breach any maximum draw down rules except for individuals with very modest balances, who would not likely be captured by a maximum draw down rule should one be implemented.

8. Do you agree there should be restrictions on who can offer products that fall under this category? If so, what restrictions?

Category A products, where those products include a promise of capital return over time, should be regulated by APRA and require capital backing, consistent with other APRA regulated products of a similar nature.

The FSC recommends that, should the government wish to proceed in relation to GSAs that do not have a capital backing, APRA be required to develop a regulatory framework and supervisory arrangements to manage the extent of cross-subsidisation between cohorts of members in terms of age, gender, entrance date and exit date.

Category B

9. If you do not support the approach outlined in this paper, how else could the annuity and pension regulations be re-cast so as to accommodate a wide range of retirement income products, provide appropriate levels of integrity and certainty, and not act as a barrier to future innovation?

The FSC supports the approach outline in the consultation paper.

Other issues

ATO Compliance
The FSC also submits that, as with the current regulations, treatment should be based on the terms applicable to the pension, rather than the specific cash flows. The ATO’s view appears to be that if an administration error occurs and a pension is short paid in a year, the pension is non-complying with rather disastrous consequences. Instead, the rules should be based on the terms governing the income stream.

Group Self Annuitisation
GSAs currently in the market are investment options and not insurance products that are ‘purchased’, like an annuity. The FSC would welcome further discussion as to how any rules developed through this consultation may impact GSA design.

Income Streams Review: Consultation Paper 2

Impediments

1. Is it the case that the existing pension and annuity rules are impeding the development of innovative income stream products which provide greater longevity insurance in (a) the accumulation and (b) the drawdown phase?

The FSC submits that the existing pension and annuity rules are impeding the development of income stream products and the introduction of products that would increase longevity insurance for consumers.

The basis for our position is outlined in our submission to the preceding retirement incomes discussion paper and remains current.

Purchase of annuities in accumulation

2. Given that fund members often do not start to engage with their superannuation until a few years prior to retirement, are changes to facilitate the purchase of annuity products in the accumulation phase desirable? Would changes be likely to encourage the development and take-up of such products in the absence of additional incentives?

A significant proportion of the annuity products currently purchased are done so by individual before retirement. Allowing products to be purchased before retirement improves an individual's ability to manage market risk and achieve better pricing.

The FSC sees merit in being able to offer deferred annuities with multiple and single premiums paid during accumulation or after retirement. This is consistent with the views of superannuation providers who wish to offer whole of life solutions that include a seamless transition into retirement.

The ability to buy deferred annuities with multiple premiums before a condition of release and/or age 60, when other risk insurances are no longer required or are much less economic, would be a useful option to provide a better fit with retirees' needs.

GSAs currently in the market are not annuities and are investment options. The FSC's response to this consultation paper does not consider how the purchase rules may effective different forms of GSAs, however the FSC would welcome the opportunity to further consult with Treasury on how GSAs may interact with proposed regulations.

3. Would it be feasible for funds to ensure that where an income stream product is purchased in the accumulation phase, the earnings tax exemption only applies after the member commences an income stream?

The FSC broadly supports the earnings tax exemption being applied in the period between when a member retires and before the member commences an income stream, even where the product is purchased before retirement. This design feature, however, would be complex in a pooled structure and require specific consultation during the development of draft legislation.

The FSC recommends that, to achieve the same outcome in a much simpler manner with reduced implementation costs, these products become tax free from when the member turns 60 years, rather than the date from which the individual member retires.

The FSC submits that this rule would reduce the fiscal impact of these products to the Commonwealth, noting that for some near-term retirees the preservation age is transitioning from 55-60 years. Further, should the preservation age be raised in the future the tax free age for these products should automatically be increased in line with the preservation age.

The FSC also notes that consideration of this issue is occurring in the context of the tax discussion paper. The broad parameters of the tax discussion paper include the tax treatment of superannuation earnings in retirement and whether they should be aligned with the treatment of earnings in accumulation phase. The consultation also includes the appropriateness of the current preservation age.

The FSC submits that the regulation of the tax treatment of retirement products purchased before retirement include adequate flexibility to accommodate possible outcomes of the tax discussion paper.

4. Is the purchase of a single income stream product in tranches a workable option?

The FSC supports periodic premium payments that provide a tranche of the ultimate annuity.

If a premium stream is agreed and then premium payments cease, a reduced annuity benefit would be determinable.

De minimis rule

5. Would a de minimis rule set by the Government which allowed the return of premiums and earnings to policyholders be necessary to facilitate the purchase of annuity products in tranches in the accumulation phase? Would the same rules also be appropriate in the drawdown phase?

Under a multi-premium structure, the FSC supports those purchasing the deferred annuity having an option to cease premium payment. If payments cease very early resulting in a deferred annuity which is uneconomic to administer, there should be a de minimis provision for the provider to return the premiums to the policy holder’s superannuation account, up to a statutory maximum of say $2000. This could be done at either the request of the policy holder or as a decision of the provider.

Income Streams Review: Consultation Paper 3

Smoothing and flexibility

1. Does smoothing or increasing the flexibility of the minimum drawdown requirement warrant increasing the complexity of the system?

The FSC sees merit in increasing the smoothing of the minimum draw down requirement by increasing the number of segments and reducing the payment rate for older Australians.

The recent Intergenerational Report demonstrated that Australians are living longer lives and that increasingly time spent in retirement is healthier and more active. The forced payment of larger portions of retirement savings in later years, as is required under the current rules, may therefore be increasingly counterproductive for future generations of retirees and increase age pension consumption.

The FSC recommends that the Government consider the revised minimum payment amounts, which both take into account increasing longevity and are simpler for consumers to understand:

Age	**Minimum payment percentage**
Under 70	4
70-74	5
75-79	6
80-84	7
85-89	8
90-94	9
95 or more	10