FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

Regulation of Retirement Income Streams Review

FPA SUBMISSION | 10 April 2015

General Manager
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: superannuation@treasury.gov.au

10 April 2015

RE: Review of Retirement Income Stream Regulation – Consultation Papers (February 2015)

Dear Sir/Madam,

The Financial Planning Association of Australia (FPA) welcomes the opportunity to offer further comments on the Treasury's *Review of Retirement Income Stream Regulation* discussion paper and consequent consultation papers.

We are encouraged by the Treasury's response to industry feedback, although we have some concerns regarding the proposal to allow the purchase of Category A products in the accumulation phase using multiple premiums.

Our submission addresses the majority of the questions in the three Consultations Papers. We encourage the Treasury to consider this submission alongside our previous submission in order to provide context for our answers.

Thank you again for the opportunity to participate in this process. If you have further questions please do not hesitate to contact me on 02 9220 4500 or dante.degori@fpa.asn.au.

Yours sincerely,

Dante De Gori
General Manager Policy and Conduct
Financial Planning Association of Australia

Regulation of Retirement Income Streams Review

FPA SUBMISSION | 10 April 2015

Consultation Paper 1 - Broadening the annuity and pension rules

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

We agree that a principles-based approach would be the best outcome, but we also agree with Treasury that if a principles-based approach were adopted then rules will eventually be established through prudential standards, selective enforcement, and litigation.

The question of whether to proceed with a purely principles-based approach, or to adopt a mixed approach which establishes broad principles which are informed by rules, depends on the balance between protecting the essential values of the system (i.e. that funds in superannuation are used to provide a retirement income) and encouraging flexibility.

The question also depends on the importance of addressing longevity risk through superannuation as opposed to providing a retirement income. It is possible to design superannuation systems that do not manage longevity risk, that allow for individuals to manage longevity risk if they choose, and that consider longevity risk management to be an inherent aspect of providing a retirement income.

The Government's policy appears to be moving towards including longevity risk management within compulsory superannuation, as evinced by this Retirement Income Streams Review and through the Financial System Inquiry. In this context, it may be appropriate to extend the flexibility of the system to a principles-based system in the legislation, with regulatory oversight, guidance, and rule-making powers to preserve the retirement income characteristics of the resulting products. The ASFA guidelines cited in Paper 1 would form an excellent starting point for the regulator to create guidance and rules.

On the other hand, if the intended flexibility is only being implemented to include specific deferred annuities and other quite specific forms of longevity risk management products, then it would be better to broaden the existing rules rather than implement a principles-based system.

Question 2: Would the restrictions proposed above 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?

In our view, these restrictions would be effective in providing for the bulk of the capital to be drawn down, as the decreasing value of the maximum commutation amount will create a disincentive to creating products which appear to be deferred income products but actually function to keep funds inside superannuation for a death benefit.

If there are no exceptions to the maximum value of the commutation following the depreciation schedule, then the member will not seek a financial product that in their view does not offer a good chance of deriving value from the payment schedule of the product itself, rather than its ability to be commuted or leave a death benefit at a later point.

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

We are concerned that the linear calculation for determining the maximum value of the remaining capital for Category A financial products will create a disincentive to adopt deferred annuity products.

Category A will *require* the product provider not to pay out any amount above the maximum value of the remaining capital, and as such the formula will function as a legislated minimum premium for the longevity insurance – regardless of when the eventual benefits are paid out and the value of these payments. To some extent this is the nature of pooled annuitisation, but the legislated linear calculation of the minimum premium is somewhat concerning.

Furthermore, the linear calculation means that product providers cannot offer a product which tailors the commutation amount to the risk of providing the longevity insurance. This will also affect whether or not the product is attractive to retirees.

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

Aside from changes to minimum drawdown requirements which promote consumption smoothing and flexibility to suit the needs of clients, we would not change the existing regulatory regime for account-based pensions. As such, Category B remains necessary.

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

Our view is that a depreciation schedule that adjusted to the expected longevity of the individual would be the best outcome. A sharp drop in the maximum value of the commutation amount once the individual approaches that age would provide a fairer solution for retirees, as well as preserving the integrity of the system itself.

This depreciation schedule would also allow product providers to charge a premium higher than the depreciation schedule in order to facilitate pooling. Whether retirees will be prepared to pay extra to mitigate the counterparty risk and the pooling risk is partly the challenge of product providers, and also a challenge for financial planners.

Question 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 FPA has no comment on this question.

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

Our view is that there is no need for a maximum drawdown rule so long as the funds leave the superannuation system and either a minimum drawdown and/or a Category A system was implemented.

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

Our view is that prudential regulations should be in place in order to ensure that counterparty and pooling risks are within safe boundaries. As long as those matters are addressed then it does not matter who offers the product.

Question 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 FPA has no further comment beyond the observations we have made in response to Question 1.

FINANCIAL PLANNING
ASSOCIATION *of* AUSTRALIA

Regulation of Retirement Income Streams Review

FPA SUBMISSION | 10 April 2015

Consultation Paper 2 - Purchase options for income stream products

Question 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?

In our view, the current rules prevent the development of income stream products with greater longevity insurance during the accumulation phase, but not during the drawdown phase. The is due in part to the restrictions on what can be done with funds inside superannuation, but also because the existing regulatory settings prevent multiple premiums being used to purchase an annuity product.

To be precise, it is not that product development is impeded by the existing settings – our view aligns with Paper 2 that there is nothing to prevent an existing product (for example, an account-based pension) being rolled over into a new annuity product at any time. Within the existing rules, account-based pensions could be designed to last to the individual's expected life span and leave a residual capital value remaining to pay for an annuity product. The retiree could pay a nominal amount at the start of the account-based pension for a contractual option to commence an annuity at an agreed annual rate, and pay for the annuity with the remaining capital from the account-based pension.

As such, there are no legal barriers to product development with respect to annuity products and other longevity risk products. These products can be developed; it is just that there are legal barriers towards these products receiving the same tax-concessional treatment as account-based pensions and other income stream products. From a policy perspective, it is debatable whether or not longevity risk products ought to receive the same tax-concessional treatment as account-based pensions.

Furthermore, the inability to pay for annuities and similar products over a longer period of time is a barrier to *consumer demand* for these, as well as the perception that annuities are poor value due to retirees being 'locked out' of their capital. To some extent, the existence of a Category A product would resolve these concerns.

Question 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?

In our view, changing the law to facilitate the purchase of annuity products during the accumulation phase should be understood alongside the proposed changes to allow multiple premiums to purchase a single retirement income product. The combined effect of these changes is to allow Australians to start contributing to their longevity risk cover at an earlier age, and allow product issuers to distribute their longevity risk management products more widely.

Whether this is a desirable outcome, especially where these products are distributed in a non-advised setting, is debatable. The Treasury should be concerned about the potential to bundle these products with default, retail, and/or corporate superannuation fund offerings.

Question 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?

We have no view about whether it is feasible for funds to separate the amount paid towards an annuity or pension product during the accumulation phase. However, if funds put towards an annuity or pension product during the accumulation phase were within the contribution caps and were not given tax-exempt status, then it would be difficult to justify the financial case for purchasing these products during the accumulation phase as opposed to the drawdown phase.

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

Question 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?

If individual premiums were used to pay for tranches of a product, then a *de minimis* rule must be implemented to ensure that very low balances are detected and returned to members. If premiums cease on a product purchased during the accumulation phase, the amounts ought to be protected from fees and charges that would reduce the value of the return to the member. Similar rules should apply in the drawdown phase.

Consultation Paper 3 - Revising the minimum drawdown amounts for account-based pensions

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

In our initial submission we recommended that the rules allow for a carry-forward provision for minimum drawdowns. That model involved some degree of complexity, but it did resolve the arbitrariness of relying upon Government mandate to adjust the drawdown rate in accordance with unusual market conditions. It also granted members some degree of flexibility while still complying with the spirit of the law.

Our view is that added flexibility can assist advisers to provide for the needs of their clients without having to recommence the account-based pension. This flexibility is worth the added complexity.