COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

# SENATE

## COMMUNITY AFFAIRS LEGISLATION COMMITTEE

**Reference: Family and Community Services and Veterans’ Affairs Legislation Amendment (Income Streams) Bill 2004**

FRIDAY, 18 JUNE 2004

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## WITNESSES

## SENATE

## COMMUNITY AFFAIRS LEGISLATION COMMITTEE

### Friday, 18 June 2004

**Members:** Senator Knowles *(Chair)*, Senator Greig *(Deputy Chair)*, Senators Barnett, Denman, Humphries and McLucas

**Participating members:** Senators Abetz, Mark Bishop, Boswell, Brown, Buckland, Carr, Chapman, Collins, Coonan, Crossin, Eggleston, Chris Evans, Faulkner, Ferguson, Ferris, Forshaw, Harradine, Harris, Hogg, Lees, Lightfoot, Ludwig, McGauran, Mackay, Moore, Murphy, Nettle, O'Brien, Payne, Tierney, Watson and Webber

**Senators in attendance:** Senators Humphries, Knowles, McLucas and Sherry

**Terms of reference for the inquiry:**

Family and Community Services and Veterans' Affairs Legislation Amendment (Income Streams) Bill 2004

**Committee met at 10.11 a.m.**

**CAVALLI, Mr Sam, Director, Financial Markets, Seniors and Means Test Branch, Department of Family and Community Services**

**DOLAN, Mr Alex, Assistant Secretary, Seniors and Means Test Branch, Department of Family and Community Services**

**CHAIR**—I declare open this hearing of the Senate Community Affairs Legislation Committee. The committee is taking evidence on the Family and Community Services and Veterans' Affairs Legislation Amendment (Income Streams) Bill 2004. I welcome Mr Dolan, who will provide a short explanation of the bill. After the conclusion of evidence from other witnesses, Mr Dolan will be kind enough to return to answer any further questions. I also welcome Mr Cavalli. We invite your opening statement, Mr Dolan.

**Senator SHERRY**—My understanding was that the witnesses would give a presentation and we would be asking questions when other witnesses arrive.

**CHAIR**—We can accommodate whatever you like—we could receive the presentation now, hear other witnesses and then question Mr Dolan and Mr Cavalli as a consequence of that.

**Senator SHERRY**—Thank you. The other witnesses are in fact at another committee I have just been at and are ready to transfer over here.

**CHAIR**—We are efficient today.

**Mr Dolan**—We have provided to the committee a short submission which is intended to provide an overview regarding the changes to income streams. My opening statement is intended to provide an introduction—this can be a complex area and it may be useful to go through some of the changes and some of the terms to help senators across some of the issues before we start questioning. I will provide a brief introduction to the drivers behind the change. Then I will give an overview of the income streams environment: the new market linked income streams, the changes to the assets test and so on—the changes in the bill.

Regarding the government's changes and the intentions behind those announcements, a key priority is for the government to ensure that retirement income policy is best prepared for and best able to manage the implications of an ageing population for Australia. In February of this year, the government announced a number of retirement income policy changes, including the changes to be looked at today, as part of the document *A more flexible and adaptable retirement income system*.

The ageing of the population means that people are living longer and are likely to spend more years in retirement. The government has determined that income streams are a good way of ensuring that the superannuation benefits that people accumulate through their working life can provide an income to support them in their retirement. Therefore, there are some concessions under the social security and tax systems which are designed to encourage people to purchase income streams as a way of ensuring they have income to support them in their retirement.

The income stream changes that the committee is looking at are aimed at increasing the choice for retirees in terms of increasing the range of products from which they may choose. The changes are also aimed at helping to ensure that the retirement income system remains fair and affordable for taxpayers. That, of course, relates to the change in the level of assets test exemption. The government aimed to ensure the changes better balance the objective of the age pension—that is, to assist people who are unable to fully support themselves in retirement—with a need to provide incentives for people to purchase income streams to support them in their retirement, as I indicated earlier. That is a very broad, schematic outline as to the drivers behind the income stream changes.

I now turn to an overview of the income streams environment. I am sure the senators would be aware that there are a lot of terms around the place regarding different income stream products—commutable, non-commutable and all that. In our submission to the committee we provided a table which was intended to help the senators at least understand how the income streams fit within the overall framework of retirement incomes. It puts some terminology on the table, I think.

In broad terms, at the top of the table we have the first box, 'Superannuation'. People have their superannuation benefits and they eventually reach the age at which they may access those benefits. Superannuation can be taken as a lump sum or can be converted into an income stream. Within the income stream, people have a choice. They can take what is known as a commutable or non-complying income stream. Those commutable income streams are almost like a managed fund, in a sense. Your assets are available any time; they are income tested and they are fully assets tested. They appear on the right-hand side of the table that you are looking at, Senator, in the green boxes: 'Commutable income streams'. There is also an allocated income stream under that which provides people with market based returns, annual payments based on the account balance. These are products that are payable continuously or until no funds are left. These are a range that we call commutable income streams. They are not subject to the changes, because they are not assets test exempt, but they tend to be the most popular product that people purchase.

The other choice that people have is to purchase a non-commutable income stream. A non-commutable income stream means that you have very limited access to the assets. You cannot simply just pull out the capital at any time. It is less flexible. In a sense, that lack of flexibility around the access to the capital is a way of ensuring that the money will last you throughout the term of the product for your retirement. It is a way of ensuring that you will have an income stream throughout your retirement. That is why there is that non-commutability to it. It is about ensuring that the capital is locked away so it lasts you throughout your retirement. Of course, there is very limited access to assets; these are income tested. However, under the proposed legislation products purchased from 22 September 2004 would have a 50 per cent assets test exemption, but currently they are assets test exempt.

Within the range of non-commutable income streams, currently you have got lifetime and life expectancy. The difference there is that the lifetime income stream provides you with a guaranteed payment until you die, basically; it is for your lifetime. It is an insurance based product that provides you with a fixed annual payment, and those payments are guaranteed. The other type of non-commutable income stream is what is called a life expectancy. That lasts for a term equal to your life expectancy; so it is a defined term. That is payable for the customer's life expectancy. Again, under the current regime of products it provides a very stable guaranteed flow of income.

That is the broad range of products available today. In summary, people have superannuation and they can take it as a lump sum or an income stream. Either you can take what you call a commutable income stream—the green boxes—where you can get your cash back and it is more flexible or you can put your money into a non-commutable income stream, which is less flexible in terms of access to capital. The current range of products provides a guaranteed flow of income and, at the moment, has a full asset test exemption—a 100 per cent exemption. The asset test concession is designed to encourage people to buy these products, because they are designed to last throughout retirement. The changes proposed in the legislation under consideration today would increase competition in the non-commutable income streams, in the blue boxes. It would give people a greater range of products to—

**CHAIR**—We do not all have the colour versions. It is not in technicolour at this end.

**Mr Dolan**—We have some additional copies we can give you. To recap, the green boxes that you see on the right-hand side are the commutable income streams where you can take you cash out at any time. They are more flexible. They do not have an assets test concession. They are not the subject of the legislation. They are not changing. The blue boxes refer to the non-commutable ones, which are subject to the legislation under consideration. They are less flexible—you cannot access your assets; you cannot draw your capital out as easily—but they have an asset test concession designed to encourage people to purchase them. Is what I have said so far reasonably clear? Are there any questions?

**Senator SHERRY**—I have some questions, but I was going to refrain until we come back a bit later.

**Mr Dolan**—The changes proposed by the government would, in respect of the blue boxes, introduce a new sort of product, called a market linked income stream. Unlike the existing range of non-commutable income streams, these new income streams would offer market based returns, which would not be guaranteed. They potentially give people more choices and more competition than in the income streams market. At the same time, the government has for products purchased after 20 September 2004 proposed that there will be a 50 per cent asset test concession and not a full asset test concession. They are the two key changes. That is a broad overview of the schema of the income stream changes.

Let me talk a little bit more about the new type of product that would be available under the proposed legislation—that is, the market linked income streams. The market linked income streams would be non-commutable. That is, you could not buy the product and then take your money out as easily as you can with the type of income stream in the green boxes. They are less flexible and you cannot take your money out. They do not provide guaranteed payments. They provide market driven payments. It is expected that they will provide higher returns over time but those returns may be more volatile than those under the current range of products. The current range of products, to provide a guaranteed range of income, tend to be invested in very secure investments, which offer low returns. A market linked income stream, by offering retirees access to market driven returns, can be a more risky product, which can therefore offer higher returns at the cost of some volatility. People have the choice about the products they wish to purchase. As I said, people who want a predictable income can still purchase from the current range of complying income stream products.

There are some other changes in the legislation that will provide people with more flexibility and choice in the products they can buy. You can select a term of the product equal to your own life expectancy when you buy it, or you can select a term that is slightly longer—that is, your life expectancy plus five years. At age 65 you can choose your life expectancy or your life expectancy plus five years, in approximate language. That gives you more scope to purchase a product that gives you a longer term than does the current range of products available in the market. You can also choose to have a product that will match not only your lifetime but the lifetime of your spouse. So your spouse may live longer and therefore you can purchase a product that can last for a longer period of time to support not only your life in retirement but also your spouse's retirement over their life expectancy.

That will increase the choice, the flexibility and the term of the products that people can choose. They will be able to choose products that go for a longer period of time than they can now in respect of these term based products. People will be able to purchase market linked income stream products from any age and obtain the 50 per cent assets test concession from the date of purchase. In summary, the changes that the government has proposed to the range of noncommutable products available are a broader range of products and more flexibility around the setting of the term and when you can purchase them—an increase in choice and flexibility.

The second change in the legislation is to change the assets test exemption to a 50 per cent exemption for products purchased after 20 September 2004. It is a prospective change only. The overriding principle underlying the change has been to ensure that social security payments are targeted to those most in need through the income and assets tests. The social security assets test is based on the principle that people with substantial assets, apart from their home—homes are exempt from the assets test—should use those assets to meet their day-to-day living expenses before calling upon community resources for income support through the social security system. That is a long established principle of the assets test—if you have substantial assets the expectation is that you use those assets before calling on the age pension.

The change to a 50 per cent exemption for noncommutable income stream products is to ensure that there remains a significant incentive for people to purchase those products because, as I said, with noncommutable income stream products you lock away your capital, but they provide you with an income stream over your retirement. An assets test concession provides an incentive for individuals to purchase those products. The change from a full assets test exemption to a 50 per cent exemption is about ensuring the age pension is targeted to those that need it most and there is a balance. The government said in putting forward the legislation that, while an assets test concession was appropriate, a full assets test exemption was too generous and it should be cut back to 50 per cent.

Even with a 50 per cent exemption people can invest up to $900,000 in a complying income stream and still receive some age pension if they have no other assessable assets. So it is still a substantial concession. Couples can receive the full age pension if they have up to $425,000 invested in a noncommutable income stream product and have no other assessable assets, excluding their home. So the 50 per cent assets test exemption still remains a significant incentive for people to purchase noncommutable income streams. I think it is worth noting that the average assets of an age pensioner are significantly below $425,000, which was the figure that I referred to. You could have up to $425,000 in assets and still receive a full age pension if those are your only assessable assets. Most age pensioners have assets well below that point.

**CHAIR**—Do you know the average?

**Mr Dolan**—It is about $75,000, and the average superannuation balance was estimated to be around $83,000 in June 2005 by the Treasury retirement income modelling unit. Average asset holdings are significantly below the figure I referred to as to where some significant concession will be available. As I indicated before, any assets test exempt income stream, any noncommutable income stream, purchased before 20 September 2004 will continue to have a 100 per cent assets test exemption thereafter. It is a prospective change only. It does not affect customers who currently purchase these products.

There are some other changes under the legislation which relate to aligning the characteristics of the current range of noncommutable income streams with the new market linked income stream products. Those changes are basically around increasing the flexibility around setting the term of the product, which provides greater choice in terms of people purchasing a current type of life expectancy income stream, which is one of the current range of products.

Finally, in respect of the lifetime income streams, these are the income streams that pay you until you die—for your lifetime—the legislation proposes to increase the guarantee period. What the guarantee period means is that if you die before up to 10 years currently then the remaining amount can go to your estate. That is something to be agreed between the insurance company and the individual, but the legislation allows for a guarantee period of up to 10 years to be provided. Under the legislation now under consideration it is proposed that that guarantee period could be up to 20 years. That increases the attractiveness for people to purchase a lifetime income stream which is the little blue box on the left-hand side of the current range of noncommutable income streams. That gives you a bit of an overview. If there are any questions on the presentation, I am in your hands as to how you would like to proceed.

**CHAIR**—Thank you, Mr Dolan and Mr Cavalli. We will come back to you later.

[10.33 a.m.]

**RUBINSZTEIN, Ms Nicolette Liesbeth, General Manager, Strategy, Colonial First State**

**STANHOPE, Mr Bill, Senior Policy Manager, Investment and Financial Services Association**

**CHAIR**—I welcome representatives from the Investment and Financial Services Association. You are reminded that the giving of evidence to the committee is protected by parliamentary privilege. However, the giving of false or misleading evidence may constitute a contempt of the Senate. The committee has before it your submission. Do you wish to make any alterations to that submission?

**Mr Stanhope**—I think we will let the submission stand, although I make the comment that the final terms of reference were only available late last night after I had written the submission. We think the submission addresses the key issues and describes growth pensions, but the terms of reference are actually a little narrower than we expected. So we are happy to deal with those in questions if you have any questions that you would like to ask.

**CHAIR**—Do you wish to make any comments?

**Mr Stanhope**—We do. I would like to make my comments in two main parts, because the provisions of this bill are quite separate in their history and application. Their main coincidence is that they apply from 20 September 2004. IFSA has advocated market linked income streams that started out with the amazingly catchy title of complying and account based income streams, which was shortened for the benefit of argument to growth pensions, and are now known as market linked income streams in the legislation, which is a reasonably accurate description.

Market linked income streams will, as an offering in the public, be most similar to an allocated pension which, you will see from the data we provided in our submission, is far and away the most popular form of income stream amongst Australian retirees. The reason for that popularity, the features, will be described by Nicolette Rubinsztein whose company offers these products in the market. To comment on the concessional treatment side as to why those products are popular: the majority of Australians retiring are not particularly affected by taxation—a great number of them benefit from the senior Australians tax offset—nor are they particularly affected by the social security assets test, the threshold for homeowner couples being $212,500. Unless you are in an area above the lump sum reasonable benefit limit, which is $580,000 in superannuation, or you have assets excluding your family home, if you are a homeowner couple, of say more than $212,500, there is very little reason to give up the sorts of flexibility that an allocated pension offers in order to go into a complying income stream. In fact, the word ‘complying’ suggests that there are limitations and, indeed, there are.

We have pushed for market linked income streams because the offerings that had concessional treatment in the Australian retirement income streams market were effectively limited to interest based securities. They were almost entirely backed by interest based investments. The reasons for that were essentially provisions in the Social Security Act in sections 9A and 9B, which prevented the income varying in any year except by indexation. So income could not fall which meant that income levels had to be guaranteed. A guaranteed investment, not surprisingly, looks most like a fixed interest investment, that is what those products tended to be backed by and those were the returns available to Australian retirees.

With a market linked income stream, Australian retirees in that group who either need to do something about the tax treatment of their superannuation or the asset test treatment of their superannuation will now be able to invest in a balanced portfolio of investments and that will improve both the amount and the quality of their returns over their retirement. As we pointed out in our submission, we went out to the marketplace in 2001 as part of looking at retirement income streams generally. You should be aware that IFSA represents almost all the commercial providers of income streams, which are the main income streams that Australians can actually choose in retirement. There are some income streams that people can choose in other superannuation environments, but the ones that are on market are principally offered by our members. We were interested in how they made decisions and we spoke to 200 near retirees, people who had just retired and 400 people who were immediately pre-retirement. Their age span was from 45 to 69 from memory.

At table 1, we have a list of the features in the order that people indicated. This is a one to 10 importance scale, 10 would be off-the-scale positive, zero would be off-the-scale negative and five is neutral. So we see that Australians want to see the balance going to their estate if they die early. They want some other features, that I have listed in the body of the submission, which a growth pension provides but which a guaranteed annuity, either fixed term or lifetime, does not provide: they are regular account balances, selection of the investment mix, change to the investment mix and the ability to switch fund manager or provider. Those features are effectively limited in the guaranteed annuity market simply because of the nature of the products. They all involve a promise from the offerer, almost invariably a life insurance company, to the receiver.

So market linked income streams represent quite a significant broadening in the retirement income stream offering. Because they do not involve those guarantees they also represent a very significant broadening in the number of funds both in the for-profit sector and elsewhere which can offer those products, because there is no requirement to put in a guarantee, and practically in the Australian system to put in a guarantee you either need to be offered by government or to be run through a life insurance office. That is the practical outworkings. I am happy to take questions on the detail there.

So now any superannuation fund, either the retail sector or elsewhere, can offer one of those products because they do not have to provide any guarantees. In fact, in legislation that is being introduced in response to the Treasurer’s 25 February statement the requirement for actuarial certification on allocated pensions and market linked income streams is being removed because there is no promise being made that an actuary would need to assess solvency and adequacy against. In the recent changes to the do-it-yourself superannuation market, allocated pensions and now market linked income streams will similarly be allowed to be offered by those providers because there is no promise being made, simply an undertaking to invest and to provide the returns. So market linked income streams offer quite a significant broadening of the market and they will be a better product by the measures that consumers bring to the marketplace than the preceding offers.

We have had extensive discussions with government in the development of the legislation and I would like to place on record our thanks to both the Treasury and the Department of Family and Community Services for some at times spirited but certainly very constructive discussion which has seen some consequences including slightly longer terms for market linked income streams and other forms of complying income stream, which is important to allow flexibility. If you think about something based on life expectancy, life expectancy is the point at which half the population is still alive, so clearly some people do not want their income streams exhausting at that point. We have been able to achieve quite a significant lengthening, we believe, in the terms that people can choose and, importantly, a choice in the length of term between life expectancy and the life expectancy of somebody five years younger than you. We have also achieved some significant improvements in terms of who can take one of those income streams. We have now got the capacity to take income streams as a couple or as an individual, with slightly different consequences in terms of the restrictions that fall upon people. All of these have been positive changes, and we are very pleased with the productive and collegial spirit that the policy makers brought to bear on those discussions. I think we have been able to get a much better set of rules into the market that are reflected in the bill you have got before you. Those are the comments I want to make off the bat about market linked income streams. I am happy to take questions as we go through.

I might make a couple of introductory comments about the asset test exemption and then I would like to hand over to Nicolette Rubinsztein to talk a little bit about what the market linked income stream offering will be in the marketplace to give you are flavour for that, given that your terms of reference talk about take-up. The Treasurer’s statement on 25 February described the 100 per cent asset test exemption for complying income streams as a very generous concession and reduced it to 50 per cent in order to better balance the objectives of the age pension with the need for incentives to purchase particular income stream. In our campaign to get market linked income streams we had done some analysis of the size of the benefit conferred by 100 per cent asset test exemption, and we are certainly on the record in various places suggesting that that benefit was so large as to create a market distortion.

What we do not want to comment on is the level at which people should no longer receive an age pension per se. That is a question for the community, for policy makers and for politicians and should be discussed in broad public debate. What we would point out—and we do point it out in our submission—is that, since the current government introduced the male total average weekly earnings benchmark to the age pension, a difference has emerged: when the rate of maximum age pension is increased using the MTAWE benchmark, nothing happens to the thresholds for the asset test. They continue to be indexed at the consumer price index. So, as the maximum rate of pension rises, the relative impact of the assets test increases because the threshold at which it starts is indexed more slowly.

Given our view that who should receive the age pension is a matter for community debate, we do not really want to comment on whether a particular level is right or wrong; but we are certainly strongly suggesting that there is a need to review the asset test thresholds to look at their relativity. When they were introduced, they affected about six per cent of age pensioners; now they affect—I am reaching into my memory here—something more than 20 per cent, or could do given how people are able to avoid the assets test altogether using 100 per cent exemptions. Those balances are being changed by the 50 per cent asset test exemption, and I am happy to answer questions on how that might be.

While parliament and the community have decided that pensions should be benchmarked to roughly 25 per cent of community incomes, I think it is then appropriate to ask: what is the consequence of that for the point at which the asset test should cut in? Obviously, the point at which the asset test cuts out rises as the maximum rate of pension rises because there is more pension to withdraw—that is a simple mathematical outworking—but where it starts is probably the point that has the most impact on behaviour. Given that your new reference goes a little in that direction, we think it is worth while making that comment and suggesting that you might want to consider a recommendation along those lines. That concludes my introductory comments. I will hand over Ms Rubinsztein to talk about the product offering, and then we are happy to take questions.

**Ms Rubinsztein**—Bill suggested it would be a good idea for me to talk a bit about what it might actually look like in the market. We currently offer an allocated pension, and it will look very similar to the allocated pension and, in fact, will be packaged up with the allocated pension. People will invest in a pension product and have a choice between an allocated pension and the growth pension. So it is almost like two different options within the same product. For example, the one we currently have in the market—First Choice—has about 60 different investment options. So the investor will be able to choose from international equities, Australian equities and different fund managers. There is a lot of flexibility from that point of view.

We anticipate that there will be a strong demand. We intend to offer a product from 20 September. We think there will be a strong demand because of this need for retirees to invest in growth assets to fund their retirement. The best way of evidencing that is on page 6 of our submission, which shows the current retirement income streams market and what money is being invested in what products. It shows how popular allocated pensions are at the moment relative to fixed term annuity. It is a difficult table to look at, but if you look at the third column—‘total market share product’—you will see that the total for allocated income streams is 75 per cent. So 75 per cent of the retirement incomes market is invested in allocated pensions and only 25 per cent is invested in fixed term annuities or life annuities. That is basically because people do not want to lock themselves into a low-return product in a low-interest environment, and they are opting for the more flexible and more attractive allocated pensions.

That is also supported by the table that Bill mentioned, which is on page 5, which lists the different preferences that people have when they are looking for a retirement income stream. Going down that list you will see that the growth pension or the market linked pension meets a lot of those attributes they are looking for. That is why we anticipate they will be very popular and will meet a big need in the market for retirees. I will leave that as a brief comment; you may have questions.

**Senator McLUCAS**—Mr Stanhope, on page 3 of the department’s submission—I know you were here when the department gave their explanation—there is a second dot point that I would like to understand. I do not think there is a conflict here but I just need an explanation.

It states that a home owner couple can receive a full pension if they have up to $425,000 invested in a noncommutable income stream. Can you explain what seems to be an inconsistency between that point and the first dot point on page 3 of your submission?

**Mr Stanhope**—It is not an inconsistency. The point that FaCS are making here—it might be worth going out to the broad and then coming to the particular—is that currently, under the 100 per cent assets test exemption, you can simply continue to pour money into a complying income stream and all of that money is exempt—every dollar. So there is no point at which the pension cuts out. We are not offering a comment on the point at which it should cut out. We are simply making the point here that, with the current assets test on assessable assets—this is the distinction: not all assets are assessable; the family home, for instance, is completely exempt—the 100 per cent assets test exemption is, by definition, nothing assessable and the 50 per cent assets test exemption is, by definition, 50 per cent assessable. So, for assessable assets, the assets test commences for a home owner couple at $212,500 and cuts out at the rate of $19.50 for every whole $250,000 until the pension is exhausted. The point of that exhaustion on assessable assets is $473,000 or thereabouts.

The point they are making here is that, if you use a 50 per cent assets test exemption, it takes that number up to something like $900,000 in total assets. I think—although I am not making an advocacy point here—the argument that the Treasurer was making when he introduced the new measure was to draw a line somewhere concerning at what amount of assets people should be able to call on the public fisc for income support in retirement.

**CHAIR**—While Senator McLucas contemplates her next question, could I ask you: how much competition do market linked pensions really provide? You have talked about it a bit, but perhaps you would like to expand on that.

**Mr Stanhope**—In the space in which they will operate, there will be quite significant competition amongst product providers. Nicolette has indicated that Colonial First State will be in the market on day one. I know that Macquarie Bank will be in the market on day one, because they have made public comments to that effect and given that David Shirlaw, their technical director, has been one of the stalwarts of this campaign for some years longer than I have been advocating it. So there will be quite a lot of competition in the market. We would envisage every financial services company having a product in this face sooner or later. The ‘sooner or later’ just reflects the difficulties of rolling disclosure documents and timing changes of new product releases.

We also anticipate that other sectors of the superannuation industry—in particular, say, the industry funds—will be able to offer this product and will be able to offer it themselves. Currently they cannot do that. As we understand it, industry funds services previously had a tie-up with Challenger, which had a life office—because you needed a life office to offer a complying product. There are four major life offices in Australia that had products in the market; there are a number of other providers that were able to find a guarantee somewhere on an income stream and offer a product in the market.

**CHAIR**—So significantly more players will be in the field this time.

**Mr Stanhope**—Vastly more. Every superannuation fund, including small APRA funds and self-managed superannuation funds, will be able to offer a market linked income stream.

**CHAIR**—So all of the industry funds?

**Mr Stanhope**—Any fund that can offer a pension—that generally depends on how the trust deed is written—and chooses to enter this market can offer one of these products. They do not need a guarantee. They do not need a statutory reserve fund. There is no balance sheet risk; there is only the risk management that ordinarily needs to be done on fund management. There are none of those complications in a market linked income stream, as indeed there are none in an allocated pension. All you need is the wherewithal and the systems to run the administration.

**Ms Rubinsztein**—Perhaps I could just add to that. From a product development point of view, it is quite easy for anyone who offers an allocated pension to then, in addition, offer a growth pension. Within a year or so you would expect everyone who has an allocated pension in the market to also have a market linked pension—and I think that will mean there will be in excess of 100 providers. That is significant competition.

**Proceedings suspended from 10.58 a.m. to 11.04 a.m.**

**Senator SHERRY**—I want to clearly understand what IFSA's position has been on the issue of growth pensions. My understanding is that you have argued and lobbied for it over the last couple of years. You obviously support the concept; that is clearly understood, isn't it?

**Mr Stanhope**—I wish it was only a couple of years!

**Senator SHERRY**—To understand my position, I cannot recall ever seeing a submission from IFSA that whatever the costs were involved in the growth pension introduction should be offset by a change in the assets test. It is just a matter of fact: I cannot recall you putting that position.

**Mr Stanhope**—Our formal submission was lodged in February 2001, although the idea of an account based complying pension had been canvassed since 1995. Given that we were playing into an arena where the Treasury portfolio in particular was very worried about fiscal risk and very concerned that people would leak from asset tested assets and investments into exempt assets because, as you have seen from the consumer preference features we have put in front of you, these are likely to be much more popular, in that submission we presented analyses and continue to present analyses showing that a consumer who was minded to make a decision on the basis of the benefit conferred by the asset test would already be making it. So our first argument with Treasury on costs was: 'Too many people are going to like it,' to which our repost was, 'If they need to do this, they are already doing it.' Treasury eventually accepted that argument, and that argument is nowhere writ more large than in the forward estimates from the Treasurer's 25 February statement which suggests that allowing market link complying income streams in the four-year forward estimates period is going to cost a massive $1.2 million. So there is clearly no offset to be had. It is true—

**Senator SHERRY**—But the measure has been linked to the assets test charge.

**Mr Stanhope**—There is no link.

**Senator SHERRY**—I am not saying that you have linked it, but there is a link in terms of the budget presentation of the measure.

**Mr Stanhope**—They are coincident in time—that is certainly true. It is on the public record, and we do not resile from it. We have talked to government and to Treasury at some length about cost offsets and about a revenue neutral proposal. As you can see from the cost of that, market linked income streams are in fact revenue neutral. Before you arrived, Senator, we paid tribute to the very constructive discussions we have had with policy makers to give what we thought were desired features in a market linked income stream and retain that revenue neutrality. In some cases we have agreed to go on debating another day about some flexibility features because they are seen as a risk to revenue, but all of those features have been contained within the market linked income stream proposal and, as you can see, they cost virtually nothing.

It is also worth noting that market linked income streams compared to guaranteed products will generate more assessable income and in fact in the way that the legislation is written will retain a higher asset tested amount. As long as you have any asset test applying to these products, because it based on balance over life of product, there will be a higher asset test balance for some years compared to a complying income stream where the asset test amount is simply run down in a linear fashion between commencement and expiry. So there are some internal cost offsets; there are some external cost offsets; and, as you can see, they wind up being neutral. So there is no link, and it is very clear from the Treasurer's 25 February statement. There is no link other than the coincidence of timing between the two measures.

**Senator SHERRY**—The department in its own presentation this morning said, 'Provide a 50 per cent assets test exemption for a new product—market linked income streams—from 20 September 2004. Change the assets test concession from 100 per cent to 50 per cent for certain noncommutable income streams purchased from 20 September 2004.' The department is establishing a link; do you accept that?

**Mr Stanhope**—That is a long bow. I think you will find that the department was actually saying that from 20 September all complying income streams will have a 50 per cent asset test exemption—full stop. On 20 September a new category of complying income stream will be available. It will have the asset test exemption that is available on that day.

**Senator SHERRY**—But why then have the department referred to both measures together in their submission? I will be asking the department this but, if you say this is a long bow and there is no link, why have the department linked these two together in this way?

**Mr Stanhope**—I do not think there is a link; I do not think they are saying there is a link. I think they are simply pointing out the asset test features of that product. Bear in mind that the Department of Family and Community Services tend to see the market in terms of the way they treat the products in it. They have different names for some things. They have a curious definition of defined benefit fund in the Social Security Act. So it is not surprising to have the Department of Family and Community Services mention the asset test status of a particular product available from a particular day, because for them it is one of the defining features.

**Senator SHERRY**—Do you have any data? And again I will ask the department this, but you may have data as well. We were given a chart—it is actually quite useful. It is a coloured chart showing the different types of income-stream products. Do you have any data on the take-up rates of each of the types of income-stream products?

**Mr Stanhope**—Yes. As you might know, we publish that data every quarter. In fact, we have attached the December 2003 data to our submission. I made a comment before you arrived about the market provision of current compliant products. Basically it is IFSA member companies and then public sector provision. There is a little bit of corporate provision here and there in the defined benefit world. In the take-up that we see now, 75 per cent of the market belongs to allocated products. In that data I have to say it is very hard to distinguish between a product that is being purchased for a social security advantage and a product that is not.

So in that data you will see that we have distinguished between zero residual capital value—sorry, Senator McLucas, we speak an entirely different language here—and positive residual capital value. One of the conditions for the asset text exemption of 100 or 50 per cent is zero residual capital value. You have to give up all of your access to capital in order to get the asset test concession. As we suggested in our submission, that is a criterion that makes some sense to us. So we cannot tell you exactly what is going on in the annuity space, but the best guess there—and here it is a guess made by Plan for Life, by Simon Solomon and Associates—is that if you have a positive residual capital value then you are not trying to get a social security advantage, although some people might obviously be using a zero RCV annuity who do not need a social security advantage.

In our research in 2001 we found five large clusters of people out there in terms of the way they thought about retirement income streams. There is certainly a group, quite a small group, who valued guaranteed income and guaranteed income for life almost above all other features—about five per cent of that target group, from memory. So there are people who still want to purchase those products come what may. You will notice that, even though we have shown in the table which we put out from that research that losing your capital on death, if you die early, is something that consumers dislike very much, the flip side of that chart—I did not produce the negatives for you, but this is right down at the bottom—is that if you die early then the balance of your superannuation or annuity goes to a life insurance company. Although I represent them, I can understand that sentiment. That is about 1.4 or 1.5 per cent of the market, depending on which year you choose. There is a small group that purchase there; there is a group that purchase in the middle, looking for guarantees because they prefer them; and there is a group that clearly prefer the sorts of features that market linked income streams would provide, because they are now purchasing allocated pensions.

As Nicolette said, and as we said in our submission, it is in a sense the same offering; it is simply that there is a dotted line down the middle of your portfolio. Those units—all of these investments are unitised—cannot be commuted to cash and you can only draw down on them in line with the formula that is in the legislation. The rest are more flexible. You can see in table 1 of our submission that people quite value income flexibility and the ability to commute some capital.

**Senator SHERRY**—I have some final questions on another issue. Ms Rubinsztein may be able to help us on this, because I notice she works for Colonial First State. The likelihood is that you would purchase these products through a financial planner, isn't it?

**Ms Rubinsztein**—From our point of view, most of our sales for allocated pensions come through financial planners.

**Senator SHERRY**—Good.

**Ms Rubinsztein**—But the flipside is that other providers, like industry funds, we expect will ultimately also provide growth pensions.

**Senator SHERRY**—Let us go to your direct experience and knowledge. What would a person be charged by a financial planner, both in terms of the commission and the cost of the product, for these types of products?

**Ms Rubinsztein**—I will just give you our experience. With our own product, on the allocated pension the average initial charge by the financial planner is about one per cent of what they invest. We have two products in the market. If they invest in a growth portfolio the ongoing fee is about 1.7 per cent. Of that, 0.6 per cent is paid to the financial adviser. We have just launched another product for people with over $100,000. The average fee there is about 0.9 per cent. That will be very popular, we think, for people wanting allocated pensions or growth pensions, because typically a large part of that market does have over $100,000 to invest. So the average ongoing fee is 0.9 per cent. That product does not include any payment for the financial adviser. It is like a lot of other products in the market now where the investor agrees the financial advice payment with the financial adviser and will do what we call 'dial-up' the payment.

**Senator SHERRY**—I thought there was a dial-down provision.

**Ms Rubinsztein**—Of those two products that I described, one includes the payment for the financial adviser and one does not.

**Senator SHERRY**—I do not want to unfairly pick on your products.

**Ms Rubinsztein**—We are proud of our products.

**Senator SHERRY**—In terms of fees and charges, I do not think the industry should be proud of some of the commissions I see around the place. Just so that I understand: the adviser charges whatever the percentage is on top of that 0.9 per cent?

**Ms Rubinsztein**—Yes.

**Senator SHERRY**—As I said, I do not want to unfairly pick on Colonial First State. There would be products in the market that are more expensive in terms of percentage.

**Ms Rubinsztein**—Yes.

**Senator SHERRY**—Frankly, I think you are close to the lower end, from what I have seen, but there are products that are more expensive in terms of percentage.

**Ms Rubinsztein**—That is true.

**Senator SHERRY**—From your first-hand knowledge, why do people go to a planner to get advice on these types of products? Why do they not just buy them retail, off the shelf, so to speak, without going to a planner?

**Ms Rubinsztein**—Because a lot of them do not understand the rules about what benefits they get and do not get from them.

**Senator SHERRY**—Would you accept that if you gave the average punter one of these charts when they have reached retirement and you gave them the written material detailing the options available they would find it complex, difficult to understand?

**Ms Rubinsztein**—Yes.

**Senator SHERRY**—That is why they go to an adviser.

**Ms Rubinsztein**—Yes.

**Mr Stanhope**—Perhaps I might add a comment, having had experience in government, producing both *Investing money: your choices* and *Understanding retirement income streams*. IFSA is currently discussing a third edition of *Understanding retirement income streams* with the department. Our small attempts to describe these rules in language that a newcomer like Senator McLucas can understand show how arcane these rules are. There is a major place for simplifying these rules.

**Senator SHERRY**—But, in one sense, with a new product being added onto existing products—I am not criticising the product itself—there is more complexity. In the jargon we get, there is more flexibility, greater choice and a larger range of products, but there is also more complexity.

**Mr Stanhope**—We are actually engaged at the moment in a debate with industry about what the market name for these products will be, bearing in mind that we do not particularly want to call them market linked income streams.

**Senator SHERRY**—Don’t tell me you want to hide the fact that they are subject to the market and actually can go down as well as up?

**Mr Stanhope**—No. I think the term that is the most popular at the moment is a ‘term allocated pension’, because, although ‘allocated pension’ is a slightly abstract term—it is slightly abstract in the way that a Ferrari is slightly fast—it is at least a term that people understand and it has been well described. By describing that with an additional limitation, we might overcome something there. But, Senator, you do touch on a key problem in the Australian retirement income system—that complex advice is required. There is a place for advice for people who have more complicated circumstances and have taxation issues and so forth. Those people, in our surveys, clearly show that they value advice, they need it and they derive great benefit from it. I know, Senator, that you have no particular issue with that form of advice. We certainly see a higher need for advice because of complexity that, probably, if you think about the system from scratch, is probably unnecessary.

Here is a little ‘for instance’ tale about market linked income streams. One of the terms with the formula we will have is an account balance over a ‘payment factor’. I think ‘factor’ is probably a term that people might have some difficulty with, but that term began its life as ‘pension valuation factor’ simply because that was one of the terms in the industry. We stood up on our hind legs and suggested that perhaps we could have a term that is actually simpler, had less than three words and did not convert to a four-letter acronym. We have been trying to do that for some time. We had a similar debate about the words ‘commutation’ and ‘reversion’—I can see a smile on Senator McLucas’s face already. These terms do not relate well to account based products. They are not terms that consumers understand but, in the rush to get legislation through, of course, there was not time to rewrite the provisions of the Income Tax Assessment Act, the Superannuation Industry (Supervision) Act and regs, so we have had to go with those two terms, which are being mangled in their application to these products, as they are mangled in their application to allocated pensions. We wish it could be different, and we wish that the need for that kind of advice—purely based on the complexity, not on outcome—could be reduced.

**Senator SHERRY**—It seems to me that for the average person, now that most people have superannuation, the accumulation of the superannuation into defined contribution schemes, which is generally what happens now, is relatively simple. I accept that super is complex, but maybe they get to $100,000 when they retire. They have then got to go and make, for their retirement, very, very complex decisions about what to pick and choose out of this range of products, and inevitably they are effectively forced to seek advice. I would have thought that the average person would dare not seek advice.

**Mr Stanhope**—It is certainly possible to have an aged pension and tax outcome that was not in your best interests or in line with your preferences. I want to make one kind of parenthetical comment about all this, and you began with it, Senator, so I think it is appropriate that I end with it: we have established in our submission that the features of this product are the features that consumers want. Some of the other complexities in the market are perhaps designed by features the regulator or an earlier market wanted or which arose because of market history. But in this case we have a product that, whilst it has public policy limitations on it in terms of non-commutability, a single drawdown and a fixed term, it nonetheless has significant features that consumers clearly want. So, in that sense, it is a very significant addition to the suite of products available to people.

For the people who want those product features, as Nicolette described, they will simply get one offering. They may actually be in a position to have a rather simpler product as a consequence of a market linked income stream, because they do not have to understand a guarantee and why a guarantee means you do not have an account balance as such, and so forth.

**Senator SHERRY**—Could I just ask for something on notice?

**CHAIR—**We will be reporting by Monday.

**Senator SHERRY—**I would not expect that they would get it back to us by Monday, but it relates directly to this issue.

**CHAIR**—Okay, but be quick because we are really running behind time.

**Senator SHERRY**—Mr Stanhope, could you provide me with a survey of your members—and I obviously would not expect you to have it here now—of the level of fees, charges and commissions that apply to the various different post-retirement products that we have been discussing? I do not expect it by Monday. Secondly, could you provide a survey of what they are going to charge for this new income stream product?

**Mr Stanhope—**On the second point, I do not think companies know what they will be charging yet and I do not think I can provide that information. On the first point, regular information, at least every second year, is available right now on our web site, from the research that Michael Rice from RiceWalker conducts. That, in our view, is the most authoritative research on fees there is, because Michael does his work from balance sheets and profit and loss statements. I would refer you to that. I am happy to ask Michael about what he has for 2003, because we did not commission work then, but our 2002 work is on our web site for the committee to pull down if they wish.

**CHAIR**—Thank you very much, Mr Stanhope and Ms Rubinsztein, for your time today.

[11.27 a.m.]

**ANDERSON, Dr Michaela, Director, Policy and Research, Association of Superannuation Funds of Australia Ltd**

**HODGE, Mr Robert, Senior Policy Adviser, Association of Superannuation Funds of Australia Ltd**

**CHAIR**—I welcome representatives from ASFA. You are reminded that the giving of evidence to the committee is protected by parliamentary privilege. However, the giving of false or misleading evidence may constitute a contempt of the Senate. We have before us your submission. Do you wish to make any alterations to that submission?

**Mr Hodge**—I do not believe we put in a submission.

**CHAIR**—No, you did not. I am sorry. You are quite right. That is why you are here—to talk to us and provide information, at the conclusion of which senators will ask you some questions.

**Dr Anderson**—We will, in fact, provide you with some written material at the conclusion. We will email it to you, if that is okay with you.

**CHAIR**—Yes, that is fine. Is there nothing that you can provide today?

**Dr Anderson**—We will provide it today, but we will email it so that we can correct omissions and typos in what has been handed to me, because of the short notice.

**CHAIR**—Would you like to make any comments now?

**Dr Anderson**—We would like to try to address the committee's terms of reference, to examine the impact of changes to assets test exemption on retirement income adequacy and the take-up of income streams. We would like to try and give you some views that we have put together on some of the effects. For those with assets within the range over which the age pension reduces, we believe the market linked income stream might be of interest, given its relatively strong returns over the longer term and its concessional treatment under the assets test.

However, the combination of the introduction of the market linked income stream and limiting the assets test exemption to 50 per cent rather than the 100 per cent applying to the pre 20 September 2004 complying pension is a mixed blessing for these retirees. They will be able to achieve a level of income not dissimilar to what they might have achieved under the old arrangements, but they will have to take on more investment risk and will have less flexibility and access to capital as more capital has to be locked away to get the assets test benefits. I should note here that we are not just talking about the assets test exemption in isolation. The changes here have been accompanied by other changes and what we are doing is actually looking at the sum total to the best of our ability. The recent changes in the superannuation rules applicable to non-arm's length superannuation arrangements will further muddy the waters, and we do not really address those here today.

For the group that we saw as having assets in the range over which the age pension reduces, there is a shifting of responsibility to the retirees in that the retiree will have a higher private income but lower age pension entitlement, with the retiree bearing increased investment risk as well. We think there is unlikely to be a rush of current recipients of complying pensions commuting their pension and converting to a new market linked product unless they could retain their 100 per cent assets test exemption, which is probably unlikely.

In a second group, that is currently the majority of retirees with financial assets including super and other means tested assets of less than $149,500 for a single person and less than $212,500 for a couple, a market linked complying income stream is unlikely to be of much interest. They do not have the luxury of an RBL problem to worry about. There is little or no tax payable on retirement income, regardless of how the financial assets are invested, and a full age or veterans pension is available. If a superannuation product is to be made use of by such retirees, generally an allocated pension will provide more flexibility for those willing to take on some market risk. For those who want an assured income stream in retirement, a traditional life expectancy or lifetime pension will have some attractions.

For a third group, at the upper end of the market, it will no longer be possible for millionaires, apart from those who are millionaires only because of their million-dollar residences, to have access to the age pension. Even couples who have put all their financial assets into a complying pension will not be eligible for an age pension once their financial assets reach the $946,000 figure. However, millionaires with an RBL problem might find the market linked products an attractive option for at least part of their superannuation retirement savings.

Looking at a fourth group, for single home owners with a financial asset between approximately $150,000 and $450,000, and couples with assets between approximately $215,000 and $700,000, a market linked product might have a potential role to play in maximising retirement income. However, decisions about what exactly to do will not be easy. This is where we see the interaction of the 100 per cent going to 50 per cent and the new products and everything else that is going on. In most cases it will not be a decision about relying solely on a market linked product or solely on an allocated pension. Generally, retirees will need to assemble a mix of an allocated pension, a market linked product and an age pension. The attitudes of the retirees to the target income level, the need for availability of capital and the attitudes to risk and variability of income will need to be considered in constructing a retirement income strategy.

In summary, the mix of factors impacting on a retiree’s decision concerning income streams makes it impossible to isolate the direct impact of the change in the asset test exemption level—the take-up rate of asset test exempt income streams. We support the measures, particularly the reduction from 100 per cent to 50 per cent, if they better target the public pension. But they do complicate decisions for some groups of people, and potentially for a growing group of people as the balances of superannuation funds at retirement grow. The bottom line is that there is a group of people whom it will not affect and a group of people who will be millionaires who can no longer use certain strategies; but the group in the middle, who will have to think very hard, will need a very good financial planner.

**CHAIR**—Dr Anderson, would you generally agree in principle that people try to arrange their finances so as to qualify for the pension or part-pension?

**Dr Anderson**—That would be a generally acceptable statement. If it can be done, I think most people would.

**CHAIR**—Is it a desirable thing for Australia, as we are getting an older population, that people are trying to almost fiddle the system? Let us face it, we all know people who are fiddling the system, who are very wealthy and yet entitled to the pension.

**Dr Anderson**—I think most people—there may be some exceptions to this, people who are trying to fiddle the system—given our level of retirement savings, are actually just trying to get a decent retirement income together.

**CHAIR**—I understand and appreciate that.

**Dr Anderson**—I think there are a few people at the edges who are perhaps not deserving of the community's support but are still trying to get it, but the majority of people are just trying to get something to live on in retirement.

**CHAIR**—I was in the parliament when the previous government introduced deeming, and I remember the outcry then. People used to be able to keep all their money at home under the mattress and were horrified that they were actually going to have to invest their money and get a certain return and that, if they did not, they would be deemed to be earning that return anyway. I see this piece of legislation as akin to tidying up some loopholes in that area where some people are getting something to which they are not entitled.

**Dr Anderson**—I do not think we have said we are not supportive of it.

**CHAIR**—I understand that.

**Dr Anderson**—All we have said is that it is a measure that will change the playing field and therefore people will need to look carefully at the way they arrange their finances now that it is perhaps even harder to mix what you need. That is our only real comment about it—that people will need to go and get advice on how to mix things not to rort the system but to get a decent retirement income.

**CHAIR**—To maximise their income. Is that all that bad? If they are actually maximising their income—which they might not be doing now—and creating a lesser dependence on the public purse, surely the cost of going to a financial planner or seeking some other advice is not necessarily a huge price to pay at the end when they can maximise their income.

**Dr Anderson**—No. I just think we will need to have very good independent planners out there to assist in this process. As I said, there is a group of people that this will not affect. For the majority of people, their savings are not going to cause them any concern. Those people should not need to have to go to a financial planner. They are going to get the age pension because they have not been able to save enough. They should not have to go to a planner. There is probably a public policy awareness issue where it is very clear that for the people who do not have problems in deciding how best to arrange their finances they do not have to incur costs of financial planning. But for another group who really need help it should be very clear that they need financial planning. I do have a problem with a public policy that is so confusing that even those who are in a fairly simple situation need to go to a financial planner and have that cost.

**Senator SHERRY**—You commented on millionaires. The change to the assets test will not just affect millionaires, will it?

**Dr Anderson**—No.

**Senator SHERRY**—I wanted to clarify that.

**Dr Anderson**—I was just looking at certain groups of people with certain asset levels and what it would do. It certainly has an impact on people with a higher assets level, it has very little impact on a lot of people at the moment because they just do not have the assets, but there is a group in the middle who will need help.

**Senator SHERRY**—Coming to that group in the middle, you referred to the assets test for homeowners—the single and then the department figure. The assets test obviously does not include your own home. Does it include the value of your car and other—

**Mr Hodge**—Yes, it includes personal assets.

**Senator SHERRY**—I thought that was right. So it includes those, plus obviously assets from shares and bank deposits—those sorts of things—then the superannuation asset. Is that correct?

**Mr Hodge**—Yes, it is financial assets. I understand there is a deeming rate applied to personal assets.

**Senator SHERRY**—Let us take a single person and the figure of $149,5000. A person may have some personal assets of $40,000 or $50,000, a car and other bits and pieces. Then you add their superannuation asset. Let us say the personal assets are worth $49,500 for the sake of the discussion and they have a superannuation asset of more than $100,000. Is a superannuation asset of more than $100,000 a significant asset in terms of the income it produces?

**Dr Anderson**—No, it is not a lot.

**Senator SHERRY**—Is that why you said that potentially there is going to be a growing group of people affected by this because the superannuation asset balance will grow over time?

**Dr Anderson**—That is looking forward very many years. As people accumulate more some of the group that we are saying are not affected will become the middle group.

**CHAIR**—The average asset is only $75,000 at the moment.

**Dr Anderson**—Yes. At retirement it is not going to get you very far without the public pension.

**CHAIR**—That is right.

**Senator SHERRY**—But that is partly because superannuation has only been compulsory since 1987 at a rate of three per cent, moving to nine per cent on 1 July 2002, I think it was.

**Dr Anderson**—But, even in a fully fledged system, it does not give flash payouts at the end.

**Senator SHERRY**—I understand that.

**Dr Anderson**—That is why we keep pushing for more contributions and all those things.

**Senator SHERRY**—I understand that. Is that why you say that there is potentially a growing group of people affected?

**Dr Anderson**—Yes.

**Senator SHERRY**—I just wanted to be clear on that. You also said that there is more risk, less flexibility, potentially higher private income and a lower age pension. What is the net gain then? If a person ends up in a riskier situation with a higher private income—and they are obviously going to pay fees for these things—and there is an offsetting lower age pension, where is the net gain to the individual?

**Mr Hodge**—Our numbers show a group in the middle where there is no net gain. That is the point. In effect, their income remains the same but the balance of the income changes to an increased private income and a lower public income. One of the concerns for that sort of trade-off is that the risk of certainty of income is moved from the guaranteed source of the pension out to the private individual. There is a trade-off here. Traditionally, a complying income stream purchased from a life company would have an underlying rate of return of, say, four per cent. To achieve the same net income under the 50 per cent asset test, there is a group of people who would have to move from a guaranteed complying income stream from, say, a life company to one of these new market linked income streams where they could increase their rate of return from, say, four per cent to eight per cent over the long term. That increased revenue would compensate for the reduction in the pension availability through the change to the assets test.

**Senator SHERRY**—That is subject to the fees, the transaction costs—whatever they are—in terms of the complying pension.

**Mr Hodge**—The assumption is that a decision is made at the commencement time, when looking at the appropriate product to go into to maximise your retirement income.

**Senator SHERRY**—You gave as an example a figure of eight per cent. Did you mean eight per cent average over time?

**Mr Hodge**—Yes.

**Senator SHERRY**—But that is not guaranteed, is it?

**Mr Hodge**—No, that is correct.

**Senator SHERRY**—It could be minus eight per cent five years down the track.

**Mr Hodge**—That is why we use the term ‘average’. Because they are subject to market fluctuations, the income, unlike a guaranteed income stream from a life company, is not constant.

**Dr Anderson**—We have to bear in mind that Australians generally do not like the kind of product that gives you the guarantee. What we are really trying to do is get people to take income streams. There are a number of threads coming in here. You can pull it apart and say that there are no gains, but there are gains in different areas. Our understanding is that people will be more inclined to take an income stream, which is something we really want them to do with these market linked—

**Senator SHERRY**—As a sales pitch, for example, it would be easy to say, ‘This product returned 15 per cent last year.’ The individual does not understand that is not going to return 15 per cent every year. You talk a lot about averages, but people will look at past performance and the product will be sold on past performance. Then people get disappointed and we get a political kickback later on from people who say, ‘My rate of return has gone down this year,’—it is negative or zero—‘and we want the government to help us out.’

**Mr Hodge**—Hopefully, the new disclosure regime, which is in force now, will provide better information on how these products work and what the risks in these products are. I do not think it would be possible under the new financial services reform legislation to sell a product purely on past performance without making strong note of the capacity of returns to fluctuate and even be negative in any given year.

**CHAIR**—Thank you both very much for attending this morning.

[11.50 a.m.]

**CAVALLI, Mr Sam, Director, Financial Markets, Seniors and Means Test Branch, Department of Family and Community Services**

**DOLAN, Mr Alex, Assistant Secretary, Seniors and Means Test Branch, Department of Family and Community Services**

**BONEHAM, Mr Patrick Gerard, Senior Adviser, Superannuation, Retirement and Savings Division, Department of the Treasury**

**Senator SHERRY**—I want to go to the additional revenue financial impact costings that were in the budget, I think on page 161. Mr Boneham would be aware that I asked about this in Treasury and was referred to FACS. I was not present at that committee. You have in 2005-06, $25.7 million in additional revenue, this is from the 50 per cent assets test exemption, 100 per cent to 50 per cent, the two dot points. Then in 2006-07 it goes to $53.8 million and in 2007-08 it goes to $86.6 million. Could you give me some information—what are the assumptions on the number of people affected in each year by this?

**Mr Dolan**—Yes I can. Some of the previous organisations that have presented to you this morning have indicated that, obviously, there are assumptions in respect of doing costings in terms of determining where people may make their choices. At the moment, looking at that table provided to you at the beginning, people choose between the asset tested allocated income streams and the current range of asset test exempt products. Now, as a result, from 20 September 2004, there will be a changed regime. So the question is to work out how people may move.

What we actually have within the Centrelink customer records is fairly detailed information on age pension customers who hold allocated products, complying income streams. We looked at the characteristics of people who may be advantaged by making a particular switch. We looked at particular customers who might be in particular circumstances that might make it advantageous for them to switch and then we assumed that they may do so. We looked at it at a fairly disaggregated level to come up with the costing. Bill Stanhope of IFSA may have indicated that there may be some offsetting sort of things in terms of one alone costings. We had to assume that some people would switch from allocated income streams to market linked income streams, because market linked income streams offer many of the characteristics of a current allocated product, in terms of offering market driven returns, but with the benefit of a 50 per cent asset test exemption. So assuming that some people would switch from those sorts of products into the market linked income streams we also assumed—

**Senator SHERRY**—Approximately what sort of number did you assume would switch?

**Mr Dolan**—In 2005-06, about 5,000 people. We are not talking huge numbers here. About 100,000 people come onto the age pension every year, and we are talking about people at the upper end of the scale—those with significant assets to make it worth while. So, in terms of context, we are talking about relatively small numbers compared to the age pension population. I think it has to be borne in mind, as I told the committee earlier, that most new age pensioners coming onto a pension have average assessable assets of about $75,000. So we are talking about a relatively small group here—those with sufficient means.

**CHAIR**—What is the anticipated return, though, of switching?

**Mr Dolan**—For the customers who would otherwise purchase an asset test at the income stream it would be a benefit of 50 per cent asset test exemption, and so there might have been some age pension benefits for them. By ‘switched’ I mean they take the money out of an allocated product or choose not to buy an allocated product in the first place, then purchase with those proceeds a market-linked income stream. That is what I mean by ‘switched’. Does that answer your question?

**CHAIR**—No, I am looking more at what is going to be the benefit in the return.

**Mr Dolan**—That element would be a cost to government, because those people would receive a higher age pension than they would otherwise. They would be benefiting from a 50 per cent asset test exemption, whereas the allocated income streams they would otherwise be purchasing are fully asset tested. That is why, in developing the costing, there is a range of offsetting considerations here.

**CHAIR**—Thank you.

**Mr Dolan**—We assume there would be people who would move from an asset test exempt income stream to a market-linked income stream, because both of them would have the same asset exemption, 50 per cent, under the new regime and they would be getting some higher returns from the market-linked income stream, on average, than under the current range of income streams. We are talking about 12,000 or 13,000 people there, in round numbers, so again relatively small numbers compared to the total.

**Senator SHERRY**—But they are affected by the reduction in the age pension?

**Mr Dolan**—Some would have a downward variation, but then those are people with significant assets—and, as I said in the opening statement to the committee, the change in the asset test exemption for non-commutable income streams was about ensuring the age pension was targeted to those more in need.

**Senator SHERRY**—Yes, I understand.

**Mr Dolan**—So that is a consequence. So they might have a higher income—

**Senator SHERRY**—I just want to get the facts; I am trying to get the statistics. I do not necessarily agree with your opening comments, but I understood why you made them. I am just trying to get the data at the moment.

**Mr Dolan**—Yes.

**Senator SHERRY**—Do you have any more data on that 2005-06 year?

**Mr Dolan**—There would be some people who would no longer purchase an asset test exempt income stream and would instead purchase an allocated income stream—if they had a substantial amount of assets; they could be millionaires.

**Senator SHERRY**—This is the millionaire category, is it?

**Mr Dolan**—Some of those would be—not all of them, but some of them would be. Some of them would receive a lesser payment and some of them would receive no pension payment if their assets were significantly high. We are only talking about—that group as a whole—1,700.

**Senator SHERRY**—So we have a group of about 5,000; a second group of about 12,000 to 13,000; and a group of about 1,700. Now, I am a bit intrigued that by the third year, 2007-08, there is a significant increase—from $25.7 million to $86.6 million. That is a big jump in three years. Can you give me some indication of why that is, and what the numbers are?

**Mr Dolan**—The increase reflects the cumulative effect, because you have got new customers being affected year by year, so the estimates would reflect an accumulation of customers each year. The 2005-06 figures I provided to you relate to that year. There would also be customers in the years following, and so the savings, the financial effects, would accumulate over time.

**Senator SHERRY**—What are the numbers of customers in that 2007-08 year then?

**Mr Dolan**—Not remarkably different, because the customers are new customers each year. There is not a lot of difference, really, and it is because we are assuming a fairly steady stream of customers. It is more the accumulation that you add this year, then plus that plus the other.

**Senator SHERRY**—Okay, so we can assume—

**Mr Dolan**—I am talking about customers coming on, making the choices in each year.

**Senator SHERRY**—Right.

**Mr Dolan**—The figures I gave you were people in 2005-06 making decisions as to the products to purchase.

**Senator SHERRY**—And they continue in the system?

**Mr Dolan**—Yes. And in 2006-07 you have similar characteristics of products except that in 2005-06 I said there were 5,000 people who would go from asset allocated products to market linked. Some of that was a movement of stock. People who already hold allocated products would switch. That is about 3,000 of the 5,000. That 3,000 obviously would not appear in future years because those who hold probably made that switch. So the numbers are fairly continuous over the estimates. It is just that you get a cumulative effect because each year people—

**Senator SHERRY**—So each year we are getting approximately a similar number of new people adding on, or maybe a slight increase because of the age demographic.

**Mr Dolan**—That is right.

**Senator SHERRY**—Okay. We heard commentary about the potentially growing group of people because of the impact of the accumulation of compulsory superannuation. Do you have any comment to make about that? Is that going to in fact increase the number because of the increasing assets growth in that area?

**Mr Dolan**—What particularly are you seeking a comment on?

**Senator SHERRY**—Dr Anderson from ASFA referred to a potentially growing group of people. I asked her why it was potentially growing. Other than the issue you have referred to, it is partly explained by the growth in superannuation assets because of compulsory superannuation. They could not identify the exact number.

**Mr Dolan**—The retirement income policy changes announced by the government were, as indicated in the opening statement, about ensuring that the retirement income system is best able to manage an ageing population. So in broad terms the changes around introducing new market linked income stream products and the changes to the asset test exemption are about ensuring that the retirement income system provides growing numbers of retirees with more choice in terms of the income stream products they can purchase and also ensuring that the age pension remains sustainable by reducing the exemption.

**Senator SHERRY**—That is not really answering my question. I will rephrase it. The average level of superannuation saving will grow. We can take it as fact that it is going up on average over time.

**Mr Dolan**—Yes.

**Senator SHERRY**—It is in large part driven by compulsory superannuation since it was introduced in the late 1980s, and there might be other factors in terms of the superannuation growth contribution. Will that mean a growing number of people affected by the assets test? It seems to me that it must do.

**CHAIR**—And, conversely, how about the people going the other way?

**Mr Dolan**—The assets test is set down by the parliament and the parliament decides how much age pension to pay and to whom. Over many years the parliament has passed legislation that sets down the income and assets tests, and those set down the parameters around which age pension is paid to people. If people are reaching the age pension age with more income and more assets then by definition they will have greater means coming into retirement, and so that means that more retired people in future will have, under the way the income and assets tests are determined, less need for the age pension because they have greater independent means. That is the answer to your question, but the answer is in the context of the construction of the income and assets tests to ensure that the age pension goes to people who need the pension.

**Senator SHERRY**—I understand that, but I am trying to elucidate from you that it is a fact that the average growth of superannuation will have an impact on this over time. It seems to me to be pretty obvious.

**Mr Dolan**—That is a question of logic. That could well be the case. If people retire with more assets than now then more would be affected by the assets test. At the same time, under way the age pension is constructed they would have less need for the age pension.

**CHAIR**—But isn’t that the whole purpose of ensuring that people do retire with more money, so that they are less reliant on the age pension?

**Mr Dolan**—That is right. That is the way the income and assets tests are constructed. The age pension is not an entitlement, it is paid to people on the basis of need determined by income and assets tests, and if people retire with greater private means they have less need for the age pension. That is the way the age pension has been constructed for many years.

**Senator SHERRY**—But this measure is tightening the assets test. It is a change in the rules, isn't it?

**Mr Dolan**—You mentioned the word 'tightening'. No change to the assets test is envisaged; this is a question of people retiring with more assets.

**Senator SHERRY**—Are the rules are not changing from 100 per cent to 50 per cent for certain noncommutable income streams?

**Mr Dolan**—The market linked income streams leave unchanged the basic assets test. But the government has decided—and has put forward the legislation—to maintain concessions for people to purchase non-commutable income streams but to reduce the assets test concession, which will have the effect of better targeting age pension to those in need, while providing some concessions.

**Senator SHERRY**—As a consequence, a group of people who, it is argued, are better off in terms of these pension products lose a portion of the age pension. That is a fact.

**Mr Dolan**—They may do so, but they would also have greater means and greater private resources, assets and income in retirement. If they have less age pension it is because, under the way the age pension is constructed, they would have less need for age pension because they have greater access to private means.

**Senator SHERRY**—You have given us broadly the numbers and the explanation for the savings of the cost measures over the years. Did you do any figures beyond 2007-08?

**Mr Dolan**—Those are the figures that have been published. They are in the forward estimates.

**Senator SHERRY**—I know that, but that is not what I asked. I know those are the figures that were published; they are in front of me in black and white. My question was: did you do figures beyond 2007-08? Do you have figures beyond 2007-08?

**Mr Dolan**—The only figures that have been agreed with Finance and gone through at that level of costing detail to ensure precision would, I think, be those that are in the forward estimates.

**Senator SHERRY**—Do you have figures beyond 2007-08? Yes or no? If you say yes, I will ask for them, and I am sure you will take it on notice and probably not provide them. I am trying to find out whether you do have figures or not—as a matter of fact.

**Mr Dolan**—Some analysis certainly would have been done but I will have to take that on notice.

**Senator SHERRY**—Do you have any breakdown of the figures in respect of Defence and DVA, which are included in the same financial impact statement in the budget? On page 161, for the Department of Veterans' Affairs there is also a saving, presumably for the same sorts of reasons.

**Mr Dolan**—That is right. Social security legislation and veterans' affairs legislation work together. The way we normally do changes under social security is that, where there is a consequential impact on Veterans' Affairs customers, some impact assessment is made of that under the same assumptions.

**Senator SHERRY**—Did the numbers you gave earlier include the impact on people under DVA, or not?

**Mr Dolan**—I think so, yes. I believe they did. If I am incorrect, we will correct that. That gave an overall figure and we would either have taken a percentage of those figures for DVA or else DVA would have been included. If that is incorrect, I will correct it.

**Senator SHERRY**—Could you clarify that on notice and come back to us?

**Mr Dolan**—Yes.

**Senator SHERRY**—If the figures you gave only referred to the Department of Family and Community Services and there are additional figures for the Department of Veterans' Affairs, could you provide those figures on notice? If that is the case, I assume there is rough proportionality. You can take that on notice.

**CHAIR**—Are there any further questions?

**Senator SHERRY**—I have a few questions that I would be happy to put on notice. Some of the questions have been covered and some have not. I am happy to put them on notice.

**CHAIR**—Thank you for your attendance and for contributing to the hearing.

**Committee adjourned at 12.09 p.m.**