24 September 2014

Mr Michael Wellham
Benefits and Regulation Unit
Personal and Retirement Income Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: superannuation@treasury.gov.au

Dear Mr Wellham,

REVIEW OF RETIREMENT INCOME STREAM REGULATION

TAL Dai-ichi Life Australia Pty Limited (TAL) welcomes the opportunity to provide comment on the Review of retirement income steam regulation discussion paper.

There are a number of regulatory barriers currently restricting the availability of relevant and appropriate income stream products in the Australian market. TAL supports the provision of policy incentives to encourage retirees to purchase retirement income products, particularly lifetime and deferred annuities. We submit this could be done through measures to address the affordability of retirement income products as well as disincentives for lump sums.

We note the purpose of this discussion paper is to review the rules in the superannuation law (the annuity and pension rules) in order to identify any rules that may restrict the availability of retirement income stream products and that other areas of regulation and Government policy (such as taxation) are out of scope. We have therefore confined our responses below to the stated scope of the discussion paper but strongly encourage the Government to take a more holistic approach when considering how best to assist Australians to manage the financial risks they face in retirement. Also note TAL is not providing any comments in relation to Account Based Products.

If you have any questions or comments in relation to our submission, please contact Darren Wickham, General Manager – Product & Pricing (Group & Investments) on (02) 9448 9021 or darren.wickham@tal.com.au.

Yours sincerely

Jim Minto
Group CEO and Managing Director

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RESPONSE TO CONSULTATION QUESTIONS

1. What types of income stream products would enable retirees to better manage risk in the retirement phase (in particular longevity risk and investment risk)?

There are three distinct phases of retirement (active, passive and frail) and no single product can satisfy the needs of each of these phases. Different product features will be appropriate in each phase. Longevity risk products should be used as part of the post retirement strategy where the need for longevity protection is the greatest. Products should be designed with the principles of integration of the 3 pillars (the Age Pension, compulsory private savings and voluntary private savings) in mind so that there is a smooth transition from one phase to the next whilst optimising the outcomes with risk management.

Lifetime and Deferred lifetime annuity products are examples of innovative product solutions which provide longevity and investment risk management when it is most needed.

We believe there will be new solutions needed that allow account based pensions to be paid from funds with the member optionally purchasing a longevity rider with sponsorship by the fund. This will allow assets to remain in the system and members to have retirement incomes delivered by their superannuation fund. We believe this should be a default options with opt out. Longevity riders should be bought on an opt in basis.

Once surety is provided against longevity, retirees can plan with greater certainty and flexibility to manage their financial affairs. Given this desirable outcome, any barriers restricting such innovative solutions should be removed. Ideally, regulation should be product neutral.

2. Do annuity and pension rules constitute an impediment to the development of new products and if so, what features of the rules are of most concern from a product innovation perspective?

Noting the limited scope of this discussion paper, TAL believes the annuity and pension rules are too inflexible and the Superannuation Industry Supervision (SIS) Regulations should be broadened to enable a wider range of income-stream products to enjoy tax-free or concessional tax status.

The requirement to have regular payments (or a minimum annual drawdown for a short-term annuity) creates a barrier for deferred lifetime annuities and the requirement to have variability of annual payments limited to adjustments made under an indexation arrangement creates a barrier for "with profits" (or "participating") and other pooled annuity products.

Using the principle of product neutrality:

- Using a portion of superannuation assets to purchase a Deferred Lifetime Annuity whilst leaving the remaining assets invested in an account based pension should be subject to the same tax treatment as would apply to the hybrid ("variable annuity") product described in paragraph 12 of the Discussion Paper; and
- An investor should be no worse off than having an account based pension, drawing down the minimum payments and then using all remaining funds to buy an immediate annuity when they reach 85 years old.

3. What changes could be made to the annuity and pension rules to accommodate a wider range of income stream products while having regard to the need to protect against abuse of earnings tax exemption and to promote appropriate and prudent retirement income objectives?

TAL notes that if the Australia's Future Tax System (AFTS) review recommendations were implemented, (specifically a uniform 7.5% tax to apply to investment earnings pre and post retirement), then many of the anomalies between products would be resolved.

As noted in question 2, relaxing the SIS pension rules in relation to indexation and payment frequency would assist in allowing providers to innovate with new products.

While not specifically changes to the SIS rules, changes to the following would also assist:

- APRA Prudential Standard in relation to Minimum Surrender Values;
- Clarification / Simplification of Age Pension Assets and Income Tests in relation to products such as DLA's.

Another possible change is to reclassify DLAs as a risk product and not an investment product. Currently if an annuity is in the payment phase then it would be treated as an annuity product for tax and other purposes, however, if the payment phase has yet to commence (i.e. in the deferral period), then the purchase price is incorrectly treated as an investment product rather than an insurance premium. Re-classifying the product during the deferral period would then not only remove the tax disadvantage in the payment phase, but would also remove tax during the accumulation phase and this would provide an incentive to purchase such products during the accumulation phase. This could be subject to limits to protect against abuse.

4. Would such changes lead to new products being brought to the market?

It is widely recognised that tax payable on deferred lifetime annuity assets during the deferral period is an impediment to product development in the market but removal of this barrier in isolation may not lead to new products being brought to the market. There are other barriers that would need to be overcome before Life Insurers enter this market confidently.

One such barrier is the availability of suitable investments for insurers to match their liabilities. While the government has recently issued some longer dated bonds, we believe the Government can further assist by issuing indexed linked bonds with longer terms (40 to 50 years).

5. Should people only be able to purchase a DLA with superannuation money?

Given the general population underestimate their own longevity; there is a great need for longevity insurance. Deferred lifetime annuities are suitable for this purpose, whether purchased with superannuation or non-super assets.

6. Should people only be able to purchase a DLA for an up-front premium or should other purchase options also be allowable? If an annual premium approach is allowed, what should be the consequences if the premium payments cease?

While single up-front premium DLAs may have advantages in the form of improved efficiency, this is inconsistent with how post-retirement benefits are currently funded through annual superannuation guaranteed contributions. Thus TAL believes models where a series of payments (post retirement) or annual payments (during the accumulation phase) should also be supported to overcome the fundamental problem that Australians do not want to annuitise their assets.

In practice, the early purchase of post-retirement income stream products should result in better economic outcomes for individuals and Government. Purchasing a longevity product during the accumulation phase should be encouraged.

If an annual premium (during accumulation phase) model was adopted and premium payments were to cease – presumably due to cessation of employment – then the consequences would be little different to some people retiring with higher superannuation balances than others; they would enjoy smaller annuity payments, all else being equal.

7. Should there be an upper limit on the amount that can be invested in a deferred lifetime annuity?

TAL does not support an upper limit. Each individual's circumstances are different and placing limits may create unexpected consequences.

8. Should there be a minimum deferral period for a DLA? If so, what would determine that period?

A deferred lifetime annuity with a deferred period of zero is essentially an ordinary lifetime annuity. There does not seem to be any justification for such restrictions.

9. Should there be a maximum deferral age or period? If so, what should it be?

TAL does not support a maximum deferral age or period. While such a requirement would be consistent with the rationale of ensuring superannuation money is used to fund retirement, it may not be needed if the design of the product is such that there is no advantage to the holder from indefinitely deferring payments. Where the product is non-commutable and provides for no, or only a limited death benefit (an amount paid to the product holder's dependants or estate on death), it is unlikely a person would purchase a deferred lifetime annuity that commenced from an age where there was only a minimal chance of receiving a return on their money.

10. Do the payment features described in paragraphs 51 and 52 strike the right balance in allowing people to insure against longevity risk while avoiding the unnecessary restrictions on product development?

TAL agrees that deferred lifetime annuities should be non-commutable. The reason for restricting commutability is to remove anti-selection. Any kind of withdrawal benefit paid during the deferral period will erode the mortality credit, encourage anti-selection and increase the cost of the product to consumers.

In relation to annuity payments, the product is positioned as longevity insurance and once payments commence should continue until death of the annuitant.

11. Should providers of DLAs be able to offer a death benefit? If so, should there be restrictions on the size of the death benefit that could be offered? If so, what restrictions?

Flexibility within the product design can increase the attractiveness of the product. Disallowing such provisions would create inconsistency across policy types (e.g. compared to account based pensions), and could be viewed as a disincentive to the purchase of such products.