The Institute of Public Accountants

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Partnership beyond numbers

Innovative Superannuation Income Streams Regulations

12 April 2017

IPA - Deakin SME Research Centre

The Institute of Public Accountants (IPA) is one of the three legally recognised professional accounting bodies in Australia. The IPA has been in operation for over 90 years and has grown rapidly in recent years to represent more than 35,000 members and students in Australia and in more than 80 countries. The IPA has offices around Australia and in London, Beijing, Shanghai, Guangzhou and Kuala Lumpur. It also has a range of partnerships with other global accounting bodies. The IPA is a full member of the International Federation of Accountants and has almost 4,000 individual accounting practices in its network, generating in excess of $2.1 billion in accounting services fees annually. The IPA's unique proposition is that it is for *small business*; providing personal, practical and valued services to its members and their clients/employers. More than 75 per cent of IPA members work directly in or with small business every day. The IPA has a proud record of innovation and was recognised in 2012 by *BRW* as one of Australia's top 20 most innovative companies.

In 2013, the IPA partnered with Deakin University to form the IPA Deakin SME Research Partnership, a first in Australia. This partnership has grown and evolved into the IPA assisting Deakin University in establishing the IPA-Deakin SME Research Centre in 2016. The goal of the Centre is to bring together practitioner insights with cutting edge SME academic research, to provide informed comment for substantive policy development.

The IPA-Deakin SME Research Centre comprises:

Chair Andrew Conway FIPA
(Chief Executive of the IPA and Professor of Accounting *honoris causa* Shanghai University of Finance and Economics)

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12 April 2017

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Dear Sir/Madam

Treasury Laws Amendment (Innovative Superannuation Income Streams) Regulations 2017

The IPA-Deakin SME Research Centre is pleased to submit the following opinions on the *Treasury Laws Amendment (Innovative Superannuation Income Streams) Regulations 2017*. The Research Centre is a joint initiative of the Institute of Public Accountants and Deakin University. It exists to increase the awareness of government and the community more generally on issues related to individuals and small business by contributing to policy debates.

The IPA is a professional accounting body with members that are recognised for their practical, hands-on skills and broad understanding of the total business environment. Representing a membership of more than 35,000 individuals in Australia and in more than 80 countries, our members and student members are working across a broad range of professional employment and practice, including; industry, commerce, government, academia and private practice. More than 75 per cent of our members work in or with small business and SMEs and are recognised as the trusted advisers to these sectors.

At the outset, we wish to note that we are broadly supportive of reforms considering ways to help individuals manage their retirement savings. Since 1992, Australia has an excellent superannuation system but an equally adequate retirement income system remains the missing piece in the superannuation jig saw puzzle to date. We support the notion of lifetime superannuation income streams that will enable retirees to better manage consumption and longevity risk in retirement by enticing superannuates to choose products that provide benefits over time rather than merely giving people the lump sum option which could be used for non-retirement funding purposes.

We are concerned, however, that the proposed regulations have several fundamental limitations that will not make it attractive for individuals and consequently may jeopardise the financial viability of these products which will heavily rely on large-scale take-up by the public. We believe that several modifications are required and accordingly a start date of 1 July 2017 may not be realistic.

Our observations on the various elements of the new set of income stream standards that are of specific interest to the Research Centre are as follows:

Benefit payments can only commence after a relevant condition of release is satisfied

Nothing has come to our attention that would cause us to object to the proposed first element of the new set of income stream standards that income streams provided can only start making payments once the primary beneficiary has retired, has a terminal medical condition, is permanently incapacitated or has attained the age of 65. We do suggest that consideration be made to align the age to either the Preservation age, age 60 (being the age where tax-free benefits can start accruing on retirement savings) or the Pension age.

Recognition of deferred income streams and an annual payment requirement

Nothing has come to our attention that would cause us to object to the proposed second element of the new standards that will require payment of the income stream benefit to be made at least annually unless the income stream is a deferred superannuation income stream and payment of the benefits have not yet started. We agree with the definition of a deferred superannuation income stream as being a benefit supported by a superannuation interest if the contract or rules for the provision of the benefit provides for payments of the benefit to start more than 12 months after the superannuation interest supporting the benefit is acquired, and to then be made at least annually afterwards.

No unreasonable deferral of income stream payments

The proposed third element of the new standards introduces a rule so the amount of benefit payments is determined using a method that ensures there is no unreasonable deferral of benefit payments after the start of payments from the income stream. We are concerned that the definition of 'not unreasonably deferred' could become open to interpretation. We suggest a tightening of its definition with fixed parameters such as restrictions of no more than x% variance on annual total payments from year to year, except in cases of closure via total commutation. We would also encourage consideration of aligning income stream payments to the minimum annual pension payment percentage factors for account-based pensions, which are based on age, contained within Schedule 7 of the *Superannuation Industry (Supervision) Regulations 1994* (SISR 1994).

Restrictions on accessing capital supporting the income stream

The fourth element of the standards apply restrictions, once the primary beneficiary enters the retirement phase, on the amount of capital from the income stream that can be accessed through a lump sum commutation or a commutation of an amount that is then rolled over within the superannuation system.

We understand that the intention of the drafting of these amendments were to restrict estate planning strategies as well as the immediate consumption of retirement savings, which ultimately places greater pressure on the Aged Pension pillar of the retirement income system. However, we note that these types of products are restricted to members of large Australian Prudential Regulation Authority (APRA) Regulated funds, and as such the prevalence of tax and estate planning and the intergenerational transfer of wealth is lower than with Self-Managed Superannuation Fund (SMSF) members who generally have higher superannuation account balances (Thorp et al. 2017).

We suggest that the calculation for the maximum commutation amount be increased in line with the lump sum option. A recent survey from Household, Income and Labour Dynamics in Australia (HILDA) that found that retirees who take their retirement savings out of the super system were in the minority (Wilkins 2016). Even for this minority, there was no evidence that the superannuation savings are used primarily for immediate consumption purposes such as overseas trips and cars. In addition, there was no evidence to suggest that many retirees were using their superannuation savings to pay off debt - especially since only a minority of households have debt around the time of retirement, and generally have assets outside of superannuation which more than match that debt (Bird et al. 2017).

Table 1: Maximum commutation amount – income stream purchased by a single payment (by year)

Year	2026	2027	2028	2029	2030
Age at next birthday	65-74	75	76	77	78
Access amount	$20,000	$20,000	$20,000	$20,000	$20,000
Life expectancy	19	19	19	19	19
Remaining life expectancy	10	9	8	7	6
First half of life expectancy	Yes	No	No	No	No
Maximum amount	$20,000	$9,474	$8,421	$7,368	$6,316
% of access amount	100%	47%	42%	37%	32%

Year	2031	2032	2033	2034	2035
Age at next birthday	79	80	81	82	83
Access amount	$20,000	$20,000	$20,000	$20,000	$20,000
Life expectancy	19	19	19	19	19
Remaining life expectancy	5	4	3	2	1
First half of life expectancy	No	No	No	No	No
Maximum amount	$5,263	$4,211	$3,158	$2,105	$1,053
% of access amount	26%	21%	16%	11%	5%

We find the formula (contained in new subregulation 1.06B(2) of *SISR 1994*) which calculates the maximum amount that could be payable on commutation of the income stream on death to be inequitable with huge penalties once an individual lives past the first half of life expectancy. Using Example 1.1 of the Explanatory Memorandum, the extent in the variation of this unfair penalty on the maximum commutation amount calculated can be easily seen in Table 1. We suggest that ordinary Australians would rather forego taxation incentives on purchase than being penalised to this extent at death and recommend that an alternative formula be devised.

We also note that the formula neither allows consideration for inflation nor investment returns. We suggest that a further penalty awaits individuals who purchase long-dated innovative retirement products as there is no allowance for the time value of money. Using a modest inflation rate of 2% per annum, Table 2 shows further deterioration of the maximum commutation amount from Example 1.1 of the Explanatory Memorandum.

Table 2: Present value of the maximum commutation amount – income stream purchased by a single payment (by year)

Year	2031	2032	2033	2034	2035
Maximum amount	$5,263	$4,211	$3,158	$2,105	$1,053
Present value	$3,989	$3,128	$2,300	$1,504	$737
% of access amount	20%	16%	12%	8%	4%

Table 3 shows a similar tale when an income stream is purchased by instalments by expanding the calculations of the present value of the maximum commutation amount from Example 1.2 of the Explanatory Memorandum.

Table 3: Present value of the maximum commutation amount – income stream purchased by instalments (by year)

Year	2035	2042	2043	2044	2045	2046
Age at next birthday	73	80	81	82	83	84
Access amount	$20,000	$20,000	$20,000	$20,000	$20,000	$20,000
Life expectancy	26	26	26	26	26	26
Remaining life expectancy	13	6	5	4	3	2
First half of life expectancy	Yes	No	No	No	No	No
Maximum amount	$20,000	$4,615	$3,846	$3,077	$2,308	$1,538
Present value	$14,003	$2,813	$2,298	$1,803	$1,325	$866
% of access amount	70%	14%	11%	9%	7%	4%

Other income stream standards

Nothing has come to our attention that would cause us to object to these amendments that a) ensures that the commutation of the new income streams will remain subject to the preservation rules in *SISR 1994* and b) ensures that a benefit is only transferable to another person, being an eligible dependant on death of a beneficiary, and that the capital value of the benefit cannot be used as security for a borrowing.

Hybrid income streams

Nothing has come to our attention that would cause us to object to these amendments except where otherwise elsewhere identified in this response.

Provision of new income streams by small funds

Given that both small APRA-regulated and SMSFs cannot provide defined benefit pensions, these amendments that enable new innovative retirement income streams are not applicable to over one third of the total assets currently in the Australian superannuation system (APRA 2017, ATO 2017). Account balances within SMSFs are on average three times greater than balances within large APRA-regulated funds of which these amendments only apply to. Therefore, it would not be unreasonable to expect that only a small minority of ordinary Australians will have the financial capacity to defer income streams as there would be a heavy reliance on their superannuation savings immediately in retirement. Consequently, it is recommended that the harsh provisions which restrict estate planning options are removed.

Collective defined contribution scheme income stream value of an interest

Nothing has come to our attention that would cause us to object to the amendments proposed setting out the method for determining the value of an individual's superannuation interest that supports a collective defined contribution scheme income stream for the purposes of paragraph 307-205(1)(a) of the *ITAA 1997*.

Valuation of new income streams for ITAA 1997 purposes

In principle, we support the proposed method for determining the value of an individual's superannuation interest that supports a deferred superannuation income stream although we are concerned that the 'above threshold rate' in subsection 1082(2) of the *Social Security Act 1991* to calculate the notional earnings amount may not be the best or most appropriate measure.

As younger individuals are generally more tolerant to risk than older individuals, it might be more appropriate to choose a higher rate that is more relevant. Table 4 shows that the deeming rates under the Social Security Act are historically low compared, for example, to the returns generated from the Australian share market over the past 20 years.

Table 4: Historical deeming rates and All Ordinaries Accumulation Index returns (1996-2016)

Year	Below threshold rate (BTR)	Above threshold rate (ATR)	All Ords
1996	5.0%	7.0%	14.0%
1997	4.0%	6.0%	11.4%
1998	3.0%	5.0%	8.5%
1999	3.0%	4.5%	19.3%
2000	3.5%	5.5%	5.0%
2001	3.0%	4.5%	10.1%
2002	2.5%	4.0%	-8.1%
2003	2.5%	4.0%	15.9%
2004	3.0%	5.0%	27.6%
2005	3.0%	5.0%	21.1%
2006	3.0%	5.0%	25.0%
2007	3.5%	5.5%	18.0%
2008	4.0%	6.0%	-40.4%
2009	2.0%	3.0%	39.6%
2010	3.0%	4.5%	3.3%
2011	3.0%	4.5%	-11.4%
2012	3.0%	4.5%	18.8%
2013	2.5%	4.0%	19.7%
2014	2.0%	3.5%	5.0%
2015	1.8%	3.3%	3.8%
2016	1.8%	3.3%	11.6%
Average	3.0%	4.6%	10.4%

If the above threshold rate from Example 1.3 of the Explanatory Memorandum is replaced with the returns generated from the Australian share market between a) 2003-2007; b) 2012-2016; or c) the average return in the last two decades, as Tables 5 shows, the value of a superannuation interest varies dramatically.

Table 5: Value of a superannuation interest that supports a deferred superannuation income stream, purchased by instalments, on the retirement phase day, by deeming rate and All Ordinaries Accumulation Index returns (1996-2016)

Compounded amount	ATR (2018-2021)	All Ords (2003-2007)	All Ords (2012-2016)	All Ords (1996-2016)
Ist instalment	11,875	24,396	16,395	11,875
2nd instalment	11,445	21,049	13,801	11,445
3rd instalment	11,032	16,496	11,529	11,032
Total	34,352	61,941	41,725	34,352

Valuation for Total Superannuation Balance purposes

Similar to our comments on the valuation of new income streams, we are concerned that the above threshold rate' to calculate the accumulation phase value of a deferred superannuation income stream interest may not be the best or most appropriate measure. Consideration should be made for a different rate which is more consistent with the risk/return that individuals may exhibit at similar stages of their life.

Preservation rules – new condition of release

Nothing has come to our attention that would cause us to object to the amendments containing a new condition of release that permits an interest in a deferred superannuation income stream that meets the standards of new subregulation 1.06A(2) of the *SISR 1994* to be acquired by a fund member or RSA holder, with preserved and restricted non-preserved superannuation benefits.

Transitional arrangements

We have highlighted several fundamental limitations of the proposed legislation that in our opinion will be restrictive and thus unattractive for individuals to choose innovative retirement income stream products. We anticipate that this may jeopardise the financial viability of these products which will rely on large-scale take-up by the public. We believe that several modifications are required and accordingly a start date of 1 July 2017 may not be realistic and propose an alternate commencement date of 1 July 2018.

We thank you for the opportunity the proposed amendments. If you wish to discuss any of our comments or would like further information then please don't hesitate to contact Vicki Stylianou at vicki.stylianou@publicaccountants.org.au or on mobile 0419 942733. We would be pleased to comment on any other matters on request.

Yours sincerely

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Vicki Stylianou

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