UniSuper

Innovative superannuation income streams

Submission by UniSuper

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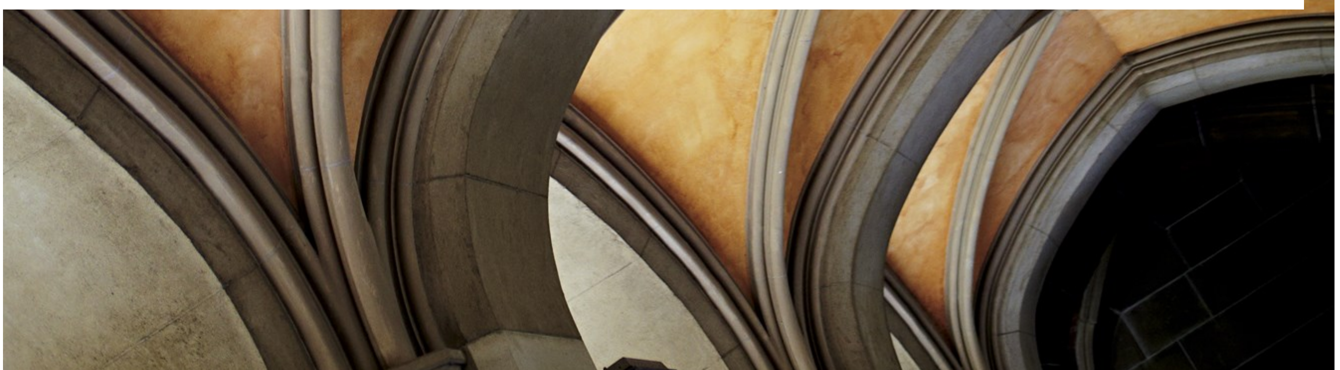

About UniSuper

UniSuper[1] is the superannuation fund dedicated to people working in Australia's higher education and research sector. With approximately 400,000 members and around $55 billion in assets under management, UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes.

UniSuper Management Pty Ltd would welcome the opportunity to discuss the submission further and to provide additional information in respect of the comments made in this submission. Should you have further queries, please contact Benedict Davies on (03) 8831 6670 or benedict.davies@unisuper.com.au

[1] This submission has been prepared by UniSuper Management Pty Ltd (ABN 91 006 961 799), which acts as the administrator of the Trustee, UniSuper Limited (ABN 54 006 027 121).

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Executive Summary

- UniSuper supports the broad thrust of the proposed regulations, particularly the introduction of collective defined contribution (CDC) income streams
- Consideration needs to be given to clearly outlining the differences between CDCs and group self-annuitisation (GSA)
- The success of new income streams will depend on how quickly a scheme develops scale. Consequently, consideration should be given to allowing trustees to offer these new income streams, particularly CDCs, as a category of default fund, similar to MySuper
- The new language employed throughout the regulations, which avoids the use of the term "purchase", is welcomed. However, prompt guidance from the ATO on the new terminology in the form a public ruling would be welcomed
- Further guidance on the social security implications of these new income streams is essential
- The proposed definition of a CDC should be based in part on the scheme's rules as well as the scheme's mortality experience
- Valuation of CDC interests for member-specific taxation issues (e.g. transfer balance cap) should be based on scheme-specific lump-sum conversion factors
- Valuation of CDC interests for fund-based taxation should continue to follow existing rules (e.g. Division 295 of ITAR '97); however, additional guidance may be needed for actuaries who provide certificates to complying funds.
- Access to capital is a key concern of retirees. Therefore, consideration should be given to extending the capital access schedule over a slightly longer period using the life expectancy of a person five years younger than the primary (or reversionary) beneficiary as is currently the case with market-linked income streams

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General observations

UniSuper has a long history of providing retirement incomes to its members and we currently offer the "full-suite" of pension products allowed by law. We are strongly committed to developing new retirement income stream products and we have undertaken considerable research of pooled risk schemes.

We support the broad thrust of the proposed regulations, particularly the introduction of collective defined contribution (CDC) income streams. We do, however, think some additional consideration needs to be given to clearly outlining the differences between CDCs and group self-annuitisation (GSA).

On our understanding, collective defined contribution schemes aim to offer a seamless transition from receiving income from work to receiving income in retirement. CDCs, therefore, are based partly on defined benefit schemes while aiming to offer cost certainty to employers (i.e. clearly spelled out fixed contribution obligations) and greater stability around retirement outcome than defined contribution schemes. As such, CDCs are more akin to a lifetime GSA in that an interest in a CDC income stream is linked to employment at *any* age and is funded by direct regular employer and member contributions.

A GSA income stream, on the other hand, is more likely to be acquired at an older age as a post retirement income product from a single pot of money that has been accumulated within a defined contribution (DC) superannuation scheme.

While the two products are similar in the way that the rate or amount of the income stream depends on the amount available for the provision of the benefits to the member and other members collectively (which would depend on the returns on a collective pool of assets and mortality experience of all members), there are however, likely to be key differences, particularly about how the interests in these products are acquired.

To avoid "regulatory arbitrage", we believe that GSAs, undefined in the draft regulations, should either be defined or a fuller explanation provided in the explanatory statement.

We would also like to see further guidance on any further regulatory framework for CDCs, including:

- Guidance on the role envisaged for employers e.g. could a CDC be default fund?
- Social security considerations e.g. will these new income streams be 100% assets tested, subject to deeming under the income test?
- Guidance on the role (if any) of the prudential regulator e.g. will there be a prudential standard as there is currently for defined benefit schemes?

The role of trustees, actuaries and regulators

While a key theme of these regulations and the EM is a concern that income will be unreasonably deferred, we suggest that another equally valid concern should be imprudent and unsustainable pension promises.

To that end, we believe that there is merit for some prudential oversight of pooled income stream products, such as GSAs and CDCs, similar to that which applies to defined benefit schemes. While this oversight should be more flexible and less prescriptive than existing prudential standards for DB schemes, we believe that the success and sustainability of these products would require a regulatory framework that clearly sets out trustees' duties such as:

- having a policy or a set of rules for setting the income targets and how the amounts paid under the income streams are adjusted based on the experience of the scheme; and
- obtaining periodic valuations prepared by an actuary and assessing the probability of meeting income stream targets.

While many current providers of defined benefit schemes are generally well placed to undertake these responsibilities, as these are new income streams, building confidence is going to be important.

The proposed valuation of CDC interests should be based on scheme-specific lump-sum conversion values which are typically used on member statements. This approach is more likely to bring about product neutrality because lump-sum conversion values better reflect the real choices faced by members i.e. take a specified income or take a lump-sum alternative to purchase a traditional pension (or a combination thereof).

Valuation of CDC interests for fund-based taxation, however, should continue to follow existing rules (e.g. Division 295 of ITAR '97). Additional guidance may be needed for actuaries who provide certificates to complying funds. For example, the Actuaries Institute Professional Standard 406 Unsegregated Pension Liabilities in all likelihood would need to be revised in light of these new products.

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Comments on the regulations

Comments on purchase price

We welcome the new language employed throughout the regulations which avoids the use of the term “purchase” which in certain instances can be problematic (particularly so for defined benefit schemes). For an income stream to have a “purchase price”, it is sometimes understood that the product must be purchased with a “clearly identifiable amount paid as consideration”. The use of new language, notably “is payable” (ITAR 307-200.05(a)), “will be payable” (ITAR 307-200.05(b)) and “amount of consideration paid” (ITAR 307-205.02(1)(a)) is likely to introduce some flexibility.

We do, however, believe that the ATO will still have a key role to play by quickly, clearly and definitively providing a public ruling on these new terms to complement their earlier ruling TR 20013/5 *When a superannuation income stream commences and ceases*.

Comments on proposed definition of CDC income streams

As previously stated, we welcome the recognition of CDCs and the proposed definition in the tax regulations. We do, however, propose a slightly broader definition of CDCs as follows:

A ***collective defined contribution scheme income stream*** is a superannuation income stream supported by an individual’s superannuation interest if:

> (a) the interest is in a superannuation fund; and
> (b) once payments of the income stream start, the income stream is to continue for the remainder of the individual’s life; and
> (c) the amounts paid under the income stream depend on the rules of the scheme, including in respect of how benefits are determined and adjusted by reference to:
>
> > (i) the age, life expectancy, occupation, or other factors relevant to mortality to the extent considered by the scheme for each member and the membership of the scheme as a whole; and
> > (ii) the assets available in the scheme for the provisions of benefits.

We believe it is important to link the definition back to the scheme’s rules because it is ultimately the “pension promise” that will determine the ongoing viability of a CDC income stream i.e. if the payments are too low, there would be unreasonable deferral; if the payments are too high, there would be an increasing likelihood that the payments would decline in both nominal and/or real terms.

We also think that “the returns on a collective pool of assets in the fund” is too narrowly defined. For a CDC scheme, it is the amount available in the collective pool of assets that is the most important for the provision of an income stream. This amount is driven not only by investment returns but also the mortality experience of individuals participating in the scheme, as well as the withdrawal experience of the scheme (if relevant to the scheme’s design).

Comments on the capital access schedule

Access to capital is of prime importance to many retirees. While there are a number of ways to ensure some ongoing access to capital, the main method envisaged in the draft regulations is, to use an older term, residual capital value (RCV).

The capital access schedule operates to give a maximum of 100% of the income stream's RCV for half of the beneficiary's life expectancy.

Another option would be to offer guarantee periods, such that the first 10 years of pension payments (or remaining amount thereof) would be paid either to the pensioner's beneficiaries or his or her estate should the pensioner die within the first 10 years.

Based on current pricing of lifetime income streams, this alternative option does not appear to be constrained by the maximum rules. However, were interest rates to increase to the sort of rates seen in the 1980s and early 1990s, the "yield" on lifetime income streams would be substantially higher and the capital access schedule would need to be revisited.

The capital access schedule makes use of life expectancies from published life tables, rather than from each scheme's own experience. While this simplifies the administration, it potentially comes at a disadvantage to members of those schemes who on average live longer. UniSuper, for example, has more than 30 years' experience of offering lifetime income stream and we have substantial data on the life expectancies of our members. We also know that those who elect to receive a lifetime income streams live, on average, longer than would be predicted from life tables. Therefore, we suggest consideration should be given to using the life expectancy of a person five years younger than the primary (or reversionary) beneficiary, as is currently case with market-linked income streams.

This would allow for a slightly longer period during which a higher maximum commutation amount was payable and that would likely be of interest where members who expect to live longer self-select into lifetime income streams.