Turn on the TAP
A professional development seminar clarified the detail of recent changes to Australia’s retirement income arrangements – some beneficial, some doubtful and some plain confusing.

The government disapproved of the name “growth pension” because, as it pointed out, the pension does not necessarily grow. So the superannuation industry renamed the product ‘term allocated pension’ and the government was satisfied – happy, in fact, that the growth-asset-oriented ‘TAP’ dealt with some of the nagging shortcomings of Australia’s retirement income system.

But many shortcomings remain, BT Financial Services’ Sue Merriman told a Securities Institute professional development seminar on “Retirement Income Changes — Advising Your Client”. Explaining recent changes to the regulations constraining the pension system, Merriman criticised the confusing and contradictory rules imposed on self-managed superannuation funds.

Responding to industry concerns, the government announced a review of self-managed funds – but only after new rules were introduced in May 2004. “The whole process has been absolute nonsense and is still nonsense because of uncertainty about the future,” Merriman said.

One of the most significant retirement income changes was the treatment of income streams in the context of the social security assets test. Exemption from the test for complying income streams had been cut from 100% to 50%.

“That’s huge,” she said. “It cuts out the million-dollar clients, and that’s what the government intended. They should not have access to the age pension. But it also cuts back people with much lower levels of assets.”

The reduction in the assets test exemption was one cause of the possible demise of ‘lifetime annuities’, Merriman said. An existing perceived drawback in lifetime annuities was the limit of 10 years in which a death benefit could be paid as a lump sum. This had now been raised to 20 years or the retiree’s life expectancy – whichever is the lower – but this was at the cost of lower pension rates “because actuaries need to factor in that additional guarantee”.

“This is not a business which is profitable for life companies,” Merriman said. “It ties up capital for the long term. The providers of lifetime annuities have been reduced to four or five and we may find even more dropping out of the market. There is less competition, so the future is not looking good. Possibly lifetime annuities will disappear completely.”

New restrictions on the type of pensions that could be offered by self-managed funds were a major concern, Merriman said. Those with fewer than 50 members could no longer offer life-expectancy-based pensions or lifetime-based pensions. There had been no consultation between the government and the industry about this and other changes; the Treasury claimed they were “integrity measures” that required no discussion.

The government’s review of self-managed funds, due to report in April 2005, would examine issues such as RBL compression strategies, estate planning and investment and mortality risk. “Whatever the result, we will have to live with it for some years,” Merriman said, urging interested individuals to make submissions. “It is important that we get something sensible coming out of that review.”

One relief in the future for self-managed funds was that the government appeared to have no problems with the funds offering allocated pensions or the new TAPs, which became available from 20 September 2004.

“The TAP must be seen as a new product,” Merriman said. “Its critical feature from the investor perspective is that investment risk lies with the investor, unlike existing complying income streams where that risk lies with the provider and the income stream is guaranteed and independent of market movements.”

It also differs from an allocated pension in that it continues for a fixed term based on the client’s life expectancy. The client can choose a term between the current actuarial life expectancy and that of someone five years younger. However, beyond that flexibility, there is no choice of income as there is with an allocated pension’s minimum and maximum annual limits; a TAP table of “payment factors” stipulates a multiple to be applied to the retiree’s account each year, yielding a fixed payment for that year and ensuring that the account will be exhausted at the end of the term.

In the event of the death of a TAP recipient, the balance of the account can be passed to a nominated beneficiary as a tax-free lump sum, as a continuing income stream or as the price of a new pension. Almost everyone would be satisfied by one of these three options, Merriman said.