FINANCIAL SERVICES INSTITUTE *of Australasia*

12 April 2017

By email
superannuation@treasury.gov.au

Dear Manager, Retirement Benefits Unit,

Re: Treasury Laws Amendment (Innovative Superannuation Income Streams) Regulations 2017

FINSIA welcomes the opportunity to comment on the reforms outlined in the exposure draft of superannuation income stream regulations by the Minister for Revenue and Financial Services, the Hon Kelly O'Dwyer MP.

FINSIA is a membership association that represents 10,000 professionals across the Australasian financial services industry. Our members are employed in the capital markets, retail and business banking, funds and asset management, and financial advice sectors.

FINSIA is committed to professionalising the industry, and by so doing, raising levels of trust and improving community outcomes.

In making this submission, FINSIA consulted with senior members in the funds and asset management sector.

Previous research

A chief concern of FINSIA members is whether the superannuation system is meeting its mandate by ensuring adequate standards of living in retirement. Commencing in 2012, FINSIA commissioned a three part investigation into the challenges for creating and maintaining sustainable retirement income.

This research, which focused on asset allocation through the life course, found that:

> Sequencing risk — the realised sequence of investment returns, and the very real possibility of receiving the *worst possible investment returns in their worst order* — is the single most important factor in determining the size of a superannuant's retirement savings. Defined contribution schemes leave investors vulnerable to fluctuations in asset values when their portfolios are at their largest, in the years immediately preceding retirement.[1]

> Post-retirement, the conventional wisdom that a retiree can withdraw 4% of their savings per annum and expect their savings to last the course is challenged by data revealing the annualised performance of different investments in five international markets in the past century. In Australia a 4% withdrawal rate over 30 years on a

[1] Basu A, Doran B, and Drew M, 2012, *Sequencing Risk: A Key Challenge to Sustainable Retirement Incomes*, FINSIA, Sydney.

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50:50 growth/defensive asset allocation is associated with a 20 per cent chance of financial ruin.[2]

> Dynamic asset allocation strategies, both in the lead-up and through the retirement phase, can nudge the balance of probablities in favour of the retiree. This research, while concerned with asset allocation approaches across the lifecycle, proposes an approach for securing sustainable reitrement income.[3]

Member consultation

In member consultation FINSIA found support for the overall approach of the innovative superannuation income streams reforms, with their focus on design rules and improving the tax treatment of income from assets supporting these products.

These reforms, and the concurrent review to develop a framework for Comprehensive Income Products for Retirement, are to be commended for signaling a shift in focus from accumulation of superannuation savings to adequacy of income in retirement. FINSIA is supportive of this principle. Modelling from our members shows that addressing longevity risk significantly improves living standards. For example an investment in a GFA can be expected to increase the annual level of income that retirees can drawdown for life by 15 to 30% (depending on their superannuation balance at retirement).

The four proposed design rules — when benefits commence, that payments are made throughout a beneficiaries lifetime, that payments are not unreasonably deferred, and restrictions on commuting benefits to lump sums — provide clarity on principles and should foster innovation in product design.

It was noted that a significant current impediment to take up of annuity and pension products is their tax treatment. For this reason, the proposal to institute an income tax exemption for superannuation funds and life insurance companies on assets they hold to support these income streams is welcomed by FINSIA members. To encourage innovation and product take up, FINSIA members believe it is important that the new regulations create an even playing field across all current and future products, by ensuring that the legislation is product neutral.

On the consumer side, treating income streams from these products as superannuation benefits under the ITAA 1997 appropriately recognises the role of these products in providing retirement income. However, FINSIA members noted that the proposal may result in SMSFs being disadvantaged as a result of the small superannuation fund provision. FINSIA notes the important role that SMSFs currently play in the retirement market as a reason for Treasury to give consideration to the implications of the proposed reforms on SMSFs.

FINSIA members also feel that it is important that appropriate checks and balances should are put in place to account for selection bias, which is likely to cause the holders of these types of products to experience lower mortality than the general population.

Significant challenges remain

However, it must be stressed that education, quality of advice, and behavioural biases remain significant systemic challenges in securing adequate retirement income. FINSIA has published research on superannuation drawdown behaviour that underscores the need for reforms to improve the design of post-retirement products and the quality of advice given to investors about navigating the post-retirement phase.

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[2] Drew M, and Walk A, (2014), *How Safe are Safe Withdrawal Rates in Retirement? An Australian Perspective*, FINSIA, Sydney.

[3] Drew, ME, AN Walk and JM West, 2015, *The Role of Asset Allocation in Navigating the Retirement Risk Zone*, FINSIA, Sydney.

This research surveyed the account drawdown behaviour of 2600 retirees with a median age of 65. It found that drawdown behaviour mirrored the legislated minimum withdrawal rates.

This research observed that:

> Retirees with account-based pensions are essentially self-insuring for longevity risk. Managing such risks at the individual level is costly and inefficient, requiring a large proportion of savings to be retained, with only those who reach a particularly old age spending all of their savings.[4]

Given what is observable about consumer behaviour currently, question marks remain about whether these reforms will increase adoption of pension and annuity vehicles. For this reason FINSIA supports the adoption of tax treatments that create an even playing field, encourage product innovation and provide an incentive for retirees to invest in innovative superannuation income streams.

FINSIA welcomes the opportunity to contribute to further policy development in this area.

Please refer any future enquiries to Caroline Falshaw, Head of Industry Affairs and policy: c.falshaw@finsia.com

With kind regards,

Chris Whitehead F Fin

CEO and Managing Director

[4] Sneddon T et al, 2016, 'Superannuation drawdown behaviour', *JASSA: The FINSIA Journal of Applied Finance*, iss. 2, p. 52.