9 August 2006

The General Manager
Superannuation, Retirement and Savings Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Sir,

Re: A Plan to Simplify and Streamline Superannuation

Annuity providers represent approximately $ 12.4 billion of funds under management (based on Plan for Life March data) primarily in retirement savings. Providers are (inter alia) represented by IFSA and have contributed to IFSA's submission.

The annuity providers also recognise that any submission by an industry body does not necessarily fully reflect their views since it must take into account the views of a number of different participants each with different product offerings.

In summary annuity providers;

1. Do not require any legislation to be introduced or amended in relation to annuities written or proposed to be written after 30 June 2007
2. Require no change to current Social Security or tax treatment applying to commutation of grandfathered complying annuities
3. Would not be comfortable with a transition to the proposed regime that allowed commutation of existing complying income stream contracts which would include annuities
4. Require clarification that life expectancy annuities written after 30 June 2007 meet the "proposed simple standard" contained in Section 3.2.2 of the Detailed Outline produced by Treasury in May 2006
5. Require guidance in relation to products which meet the proposed "minimum annual pension payments' and the intention that "no provision to be made for an amount to be left over once the pension ceases."

Clarifying Legislation

Most annuity providers have associated entities that are also providers of term allocated pensions (“TAPs”). The issues surrounding TAPs are distinct from annuities because inter alia;

- They were introduced in September 2004 and as a result outstandings are relatively small
- They are market linked
- They are not guaranteed
- They can be readily amended to fit within the proposed arrangement without upsetting the position of issuer or investor.

Annuity providers are happy for a legislative solution for both TAP issuers and investors. We would not be comfortable with a solution that allowed commutation of existing complying income stream contracts which would include annuities. The reasons for this include;

- Potential for poor advice and costs for retirees who are existing annuity holders pushed into more aggressive and less appropriate products
- Potential loss of Centrelink benefits by those already legally entitled to them
- Potential prudential and liquidity issues while annuity providers consider likely commutation effects
- Uncertainty for annuity providers who have given guarantees to annuity buyers both past and future
- The obvious inequity for those parties who traded the opportunity of Centrelink benefits for other products.

Although annuity providers could at the end of the day rely on existing contractual arrangements this is not an outcome that is necessary. Staying with existing legislation and policy (outside the changes requested by the TAP providers) would mean none of the ill effects outlined above need be considered in practice.

Life Expectancy Annuities

Section 3.2.2 of the Plan Outline made specific reference to *guaranteed lifetime* annuities but made no reference to *guaranteed life expectancy* annuities which are the predominant form of annuity contract sold in Australia.

We appreciate one of Treasury's aims is to move from a *product* based approach in retirement savings legislation to a *rules* based approach and therefore the silence on guaranteed life expectancy annuities may not be an intended consequence of the proposed 'simple standard."

In order to more fully articulate the features of life expectancy annuities;

- Payments of a minimum amount are made at least annually which could be in excess of the proposed minimums
- Annuities with a residual capital value ("RCV") of zero make no provision for an amount to be left over when the pension ceases
- The annuity could only be transferred on death to a dependant or cashed in by the estate.

Life expectancy annuities issued after 30 June 2007 should meet the new minimum standards proposed in the Outline in all respects.

Provision for an Amount to be Left Over

As with all transitional periods there is a level of uncertainty as to how products that exist under the current legislation will fare under the new arrangements since their likely treatment is not clear.

To date annuities are sold in a format of either having 100% RCV or zero RCV. The short term RCV market generates about $1bn of inflows per annum (higher when interest rates are high or stock markets are volatile and vice versa). They are a valuable financial planning instrument for several reasons including being:

- Attractive for conservative retirees who are nervous about locking in rates for a long period (eg concerns inflation will go up or interest rates will rise)
- Attractive for retirees wanting a capital guarantee (consistent with thinking at older ages)
- Suitable for retirees who have short term access to other funds (eg proceeds from downsizing their house)
- Suitable for retirees who move to part time work
- Suitable for retirees who are not disciplined with their spending when they have ready access to capital
- Useful for estate planning as there are nominated beneficiaries (eg those who are diagnosed with a terminal illness)

Current Situation

Currently an investor can purchase a RCV 100 guaranteed annuity with superannuation proceeds. The residual capital is the amount payable as a lump sum at the end of the prescribed annuity term and can range from 0%-100% of the initial investment amount. A lower RCV results in higher regular payments and vice versa.

A minimum payment of the interest rate (usually around 4-6% per annum based on current levels of interest rates) is made when a 100% RCV is selected. This is then analogous to an Allocated Pension with minimum drawdowns. The primary difference is that the investor would need to decide whether to roll over the amount or take an ETP after the nominated fixed term.

For example, a pensioner invests $100,000 in a 100% RCV 3 year fixed term annuity paying 6% per annum. The pensioner will receive the investment income each month. As a result the pensioner receives $500 a month for three years. At the end of the term, the pensioner can roll the original $100,000 into another fixed term annuity, transfer it to another income stream (eg allocated pension) or cash in the benefit.

These RCV style contracts are typically short term (1-5 year term) contracts and operate similar to a term deposit with most investors choosing a 100% RCV. Longer term (6-25 year term) annuities are typically purchased with a 0% RCV.

New Pension Payment Standards

To satisfy the new pension payment standards a pension must provide:

- payments of a minimum amount at least annually
- no maximum payment (including allowing a pensioner to cash out the entire amount)
- no provision to made for an amount left over when the pension ceases
- that the pension could be transferred only on the death of the pensioner to a dependent or cashed as a lump sum to their estate

The proposed minimum payment amounts are:

Age	Percent of Account Balance
55-64	4%
65-74	5%
75-84	6%
85-94	10%
95+	14%

RCV 100 Annuities under the proposed Pension Standards

There seem to be two key requirements for RCV 100 annuities to satisfy the new pension payment rules for RCV annuities :

1. the payment of a minimum pension amount
2. the requirement that no amount is left over

RCV annuities could satisfy this proposed standard if:

- The contracts were ongoing and didn't expire
- Pensioners could be offered fixed rates for various terms or an ongoing “cash” rate for funds “at call”
- Minimum payments would be made in accordance with the above pension standards (if required, a lower than 100% RCV could be chosen to meet minimum payments at older ages)
- At the end of the term, the contract would automatically continue. The investor could choose another term and rate or alternatively continue on at the ongoing "cash" rate.
- Pensioners can withdraw at any time (similar to the situation with allocated pensions).

Therefore one must pose the question where the RCV annuity meets the minimum drawdown requirements is it then necessary for there be “no provision for an amount to be left over?”

Provision for an amount to be left over

Whilst an annuity provider could, in theory, structure an annuity in this manner, it could be extremely cumbersome with significant system development and other costs to otherwise achieve the same structure that currently exists.

We propose that short term RCV annuity contracts should continue in their current form aside from making sure there was a minimum pension payment each year. This avoids the need to artificially create a product that has no defined maturity date to satisfy the requirement that no amount is left over.

The existence of a residual value should be considered a benefit for the pension holder since it is indicative of the preservation of the pension holders’ own resources rather than a reliance on benefits from the Department of Family & Community Services.

We believe Treasury should further consider how a product that has met with considerable acceptance and use under the current regime should be ruled out of the pension environment notwithstanding that it will meet the minimum drawdown requirements. This is especially the case given the ability of the holder of a pension to draw out the pension as a lump sum at any time.

Support for this Submission

The issues raised in the submission are supported by the following organisations;

Sign:

Print Name: PETER NICHOLAS

Title: DIRECTOR, SAVINGS + RETIREMENT

AMP Life Limited (AMP Financial Services)

Sign:

Print Name: ROBERT WOODS

Title: DIRECTOR

Challenger Life No.2 Limited

Sign:

Print Name: **Clive Levinthal**

Title: **General Manager. Life, Super and Investment Products CommInsure**

Colonial Mutual Life Assurance Society Limited (CommInsure)

Sign:

Print Name: Richard Collis

Title: General Manager Distribution

MetLife Insurance Limited

Sign:

Print Name: JIM BAILER

Title: HEAD OF PRODUCT - MASTERKEY

MLC Limited