ING

3 March 2009

AFTS Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600
Email: AFTSubmissions@treasury.gov.au

Australia's Future Tax System: Retirement Income Consultation Paper

Introduction

Thank you for the opportunity to provide ING Australia's submission to Australia's Future Tax System: Retirement Income Consultation Paper.

ING Australia Limited (ING Australia) is one of Australia's leading fund managers, life insurers and superannuation providers with more than $45 billion in assets under management. ING Australia is a joint venture between the global ING Group, which owns 51%, and one of Australia's major banks, ANZ, which owns 49%.

ING Australia provides a broad range of financial products and services through an extensive network of professional financial advisers and financial institutions, including its own advice groups.

ING Group is a global financial services company of Dutch origin with 150 years of experience, providing a wide array of banking, insurance and asset management services in over 50 countries. ING is one of the 20 largest financial institutions worldwide and ranked in the top 10 in Europe.

We applaud the Government's decision to bring forward its retirement incomes policy review particularly against the backdrop of the Global Financial Crisis and its impact on government finances, economic activity, unemployment and business and consumer confidence. With plunging account balances being experienced by superannuation members thanks to a significant dive in financial markets over the last six months we believe it is appropriate that the Government conduct this review to shore up confidence in superannuation as a retirement savings vehicle that has served Australians well over the last 20 years, but also to use it as an opportunity to cement our retirement incomes system as world class.

Executive Summary

Our submission is framed to specifically address, where possible, the questions posed in the Australia's Future Tax System - Retirement Income Consultation Paper (the Consultation paper) and recommends refinements to improve access to, and remove complexities from, the retirement income system. We also propose reforms to facilitate the manufacture of innovative products to help Australians meet their contemporary and future retirement income needs.

The following policy options are proposed:

1. The Self Employed

ING *Australia supports the introduction of compulsory superannuation contributions by the self employed (consistent with the ASFA proposal)*

ING Australia supports ASFA's suggestion that:

- a compulsory contribution is gradually introduced for self employed people:
  - starting at 1% of taxable income in 2010-11 and
  - rising to 5% of taxable income in 2015-16.;
- the contribution would be made as a proportion of the person's taxable income, averaged over three years;
- the contribution would not be required in the first two years from start-up of a business;
- the contribution would either be made from after-tax income and be fully tax deductible, or the person could choose to make it as a non-concessional contribution and claim the Co-Contribution (if their income was under the limit); and
- the contribution would be compelled as part of the tax return process with an additional amount raised from the individual (which could be rolled over into a complying superannuation fund) if the required contributions had not been made to a complying superannuation fund.

2. Personal Injury exemption to Non-Concessional contributions Cap

Widen the personal injury exemption on the non-concessional contributions cap

ING Australia supports widening the personal injury exemption on the non-concessional contributions cap to include certain other payments, eg total and permanent disability (TPD) payments .

3 Financial Literacy

Improved education on the retirement income system and the three pillars would go a long way towards promoting better engagement of Australians with their super and the retirement income issue.

4 Lift the Superannuation Guarantee

Increase the Superannuation Guarantee, via a phased approach, to 12 percent when economic conditions permit

ING Australia submits it is necessary to increase to the level of Superannuation Guarantee contributions as soon as practicable. In particular, consideration should be given to increasing the level of Superannuation Guarantee contributions, via a phased approach (ie over a number of years), to 12 percent when economic conditions permit.

5 Soft Compulsion to increase contributions

Endorse a soft compulsion approach to increasing contributions

In the meantime, ING Australia would support a soft compulsion approach where employees are required to contribute a small percentage of their ordinary time earnings, however could opt out of higher contributions should they so choose.

6 Co-contribution Scheme

ING Australia supports retention of the successful super co-contribution scheme. Further we suggest the Government consider moving to a more appropriate flexible eligibility criteria which might include a test:

- *Based on family income; or*
- *Alternatively, as income is not an appropriate measure of adequate superannuation, an assets test (based on accumulated super) could be introduced.*

7 Salary sacrifice contributions

Salary sacrifice should continue to be a key vehicle allowing individuals to build retirement benefits. However, ING believes some changes could be implemented to further widen the availability and benefits of salary sacrifice. This can include:

- *Making it compulsory for employers to offer salary sacrifice. Currently employers can refuse an employee's request to salary sacrifice, thereby limiting an individual's ability to build retirement benefits. Employers would need time to implement this change, so a future commencement date would be practical.*

- *Extend choice of superannuation (for eligible employees) to salary sacrifice. Currently choice of superannuation fund only applies to the 9% superannuation guarantee and the employer can choose the fund for salary sacrifice contributions.*

8 Spouse Contribution

ING supports the principle of encouraging voluntary contributions to superannuation, but believes the current spouse contribution policy should be reviewed. This can include:

- *Increasing or indexing the current amount of the tax offset and the cut-off thresholds as these amounts have not been indexed in about 10 years. The 'real' value of this policy has effectively reduced over time.*

- *Alternatively, a possible option is to abolish spouse contributions and divert the revenue savings to an expanded co-contribution scheme (as mentioned above).*

9 Life Insurance Deductibility

Life Insurance purchased outside of superannuation should be deductible, as it is if purchased within a superannuation fund.

ING Australia submits that tax laws should be amended to allow a tax deduction for life insurance premiums paid by all taxpayers.

10 Contributions Tax Rebate

Rebate 15 percent contributions tax paid by low income earners to their superannuation fund to increase their retirement incomes

ING Australia supports a rebate for superannuation contributions tax paid by low income earners in order to increase retirement savings for those Australians in most need. The Australian Tax Office would pay an amount equivalent to 15% of the concessional contributions made on behalf on an individual to their superannuation fund. This payment would be made once the individual's income tax return had been assessed and would be means tested.

11 Mature Age Worker Tax Offset

ING Australia believes the Government should re-consider mature age worker tax offset Could be paid as super contribution to build retirement benefits (or combine with co-contribution scheme)

12 Retirement incomes product development

The Government should commit to removing regulatory restrictions which hamper the development of new styles of retirement income stream products and in fact provide incentives for market participants to develop such products.

INGA can provide details of regulatory impediments to offering appropriate retirement income stream products.

13 Develop longevity index for Australia

The Government in association with the Australian Bureau of Statistics in consultation with the Institute of Actuaries of Australia should develop and publish an independent longevity index for Australia.

14 Government issue long-dated bonds

The Government issue long-dated bonds, including CPI-linked bonds.

15 Limits / restrictions on lump sums

Consider limits / restrictions on lumps sums to encourage income streams and to also reduce longevity risk.

16 Remove 10% test for deductibility of personal super contributions

ING Australia proposes the removal of the 10% test for deductibility of personal super contributions

The removal of this test would provide flexibility to individuals to contribute at any time during the year. The deduction would be limited to the concessional contribution cap of $50,000 p.a. (and the transitional cap of $100,000 up to 2012) which applies from 1 July 2007.

17 Work Test from age 65 to 74

ING Australia supports removal of the work test from age 65 to 74 (inclusive) to encourage more individuals to use superannuation to provide retirement income .

18 Retain transition to retirement income streams

ING Australia believes transition to retirement (TTR) income streams should be retained to provide flexibility for eligible individuals and to build retirement benefits.

19 SG Age Exemption

Raise 9% SG age exemption from age 70 to 75, or remove altogether, to encourage older individuals to remain connected with workforce.

The retirement income system

Q1.1 In considering the future of Australia's retirement income system, which objectives are relevant in setting retirement income policy? Does the current system of the Age Pension and compulsory and voluntary savings meet these objectives? If not, how should the system be changed to meet these objectives?

ING Australia, along with most of the submissions made to the first round of the review, supports the three pillar retirement income system of a government funded age pension and compulsory and voluntary savings.

We also agree with the consultation paper's possible objectives for a retirement income system so that it should be:

- *broad and adequate*, in that it protects those unable to save against poverty in their old-age and provides the means by which individuals must or can save for their retirement;
- *acceptable* to individuals, in that it considers the income needs of individuals both before and after retirement, is equitable and does not inappropriately bias other saving decisions;
- *robust*, in that it appropriately deals with investment, inflation and longevity risk;
- *simple and approachable*, in that it allows individuals to make decisions which are in their best interests; and
- *sustainable*, in that it is financially sound into the future and detracts as little as possible from economic growth.

For these objectives to be achieved we believe that enhancements need to be made to the current system to ensure that it maximises opportunities for all Australians to save for their retirement while providing an appropriate safety net for those entering retirement who have not reached a position of adequacy. To enable this to occur, we have made recommendations in the following sections of this submission that are intended to better hone our retirement incomes system to meet the objectives cited above, including through the removal of complexities, increasing access to the SG system, and by encouraging longer engagement with the workforce.

A broad and adequate retirement income system

Q2.1 As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self-employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?

The Self Employed

On the issue of self employed persons, the Consultation paper notes that the self-employed have different characteristics and generally fall into two main categories:

- *those with minimal business assets; and*
- *those who have business assets which they can sell to potentially finance their retirement.*

In making the observation that the self employed make up 12 percent of the workforce the Consultation paper goes on to say:

> *Although they are not required to make superannuation contributions, many self-employed individuals do so voluntarily. Approximately two-thirds of owner-managers in unincorporated enterprises (a proxy for the self-employed) make superannuation contributions (ABS 2008). The self-employed may be eligible for tax deductions and the government co-contribution for the superannuation contributions they make*.

And

> *The self-employed may prefer to have access to liquid savings rather than superannuation, given the higher risks associated with being self-employed. Requiring compulsory superannuation saving may also influence the business decisions of the self-employed especially in the establishment phase of their business.*

As a result of the uncertainties that accompany being self employed, including issues around having liquid savings, some self employed having little business assets and having unstable income flows during businesses infancy, the self employed have traditionally been left out of the compulsory SG system to provide them with greater flexibility when it comes to operating and building their business.

While we can appreciate the reasoning behind the current exclusion, it nevertheless still creates a situation where a significant proportion of the self employed are making little or no contribution towards their retirement income.

ASFA has made recommendations to this review that could assist in dealing with concerns about self employed persons that are not making adequate contributions to support their retirement income.

We support ASFA's argument that it is desirable to have all self employed persons brought into a compulsory regime to correct this problem. For the self employed that already make contributions towards their super there would appear to be little impact on them from the ASFA proposal.

For those self employed that do not make contributions, the ASFA proposal positively responds to the need for the self employed to maintain liquid savings during the business establishment phase (years one and two) while introducing incremental super savings that escalate over time. The proposal to assess contributions on the basis of taxable income averaged over three years and for the contribution to be made out of after tax income and be fully tax deductible or for it to be made on a non-concessional basis appear to smooth out the potential for financial impacts on the self employed that could disrupt their cash flow or operations.

Policy Options

ING Australia supports the introduction of compulsory superannuation contributions by the self employed (consistent with the ASFA proposal)

ING Australia supports ASFA's suggestion that:

- a compulsory contribution is gradually introduced for self employed people:
    - starting at 1% of taxable income in 2010-11 and

  - rising to 5% of taxable income in 2015-16.;

- the contribution would be made as a proportion of the person's taxable income, averaged over three years;
- the contribution would not be required in the first two years from start-up of a business;
- the contribution would either be made from after-tax income and be fully tax deductible, or the person could choose to make it as a non-concessional and claim the Co-Contribution (if their income was under the limit); and
- the contribution would be compelled as part of the tax return process with an additional amount raised from the individual (which could be rolled over into a complying superannuation fund) if the required contributions had not been made to a complying superannuation fund.

Personal Injury Exemption on the Non-Concessional Contributions Cap

From 1 July 2007 a non-concessional contributions cap of $150,000 was introduced. Currently the Non-Concessional Contributions Cap exempts personal injury payments that have come from:

- a structured settlement payment;
- a court order from a personal injury payment;
- a workers compensation payment paid as a lump sum.

ING Australia believes that the current definition may restrict access to the superannuation system by people with serious personal injuries purely on the basis of the method of payment they receive. For example, even though a worker paid a lump sum for a workplace injury might have the same injury as a person who receives total and permanent disability (TPD) benefits (through a trustee / insurer), only the worker who received the lump sum can get access to the exemption from the cap. Despite the analogous injuries suggested in this example, it does not appear appropriate, or fair, that the two persons are treated differently in relation to their access to the cap exemption.

We believe that extension of the personal injury exemption so that it applies to include other payments, such as total and permanent disability benefits, would provide a greater suite of options for the seriously injured to plan for a time in their lives when they may need to draw down a pension and also assist in remove complexity from the system consistent with Q5.1 below.

Policy Option

Widen the personal injury exemption on the non-concessional contributions cap

ING Australia supports widening the personal injury exemption on the non-concessional contributions cap to include certain other payments, eg total and permanent disability (TPD) payments .

Q2.2 Noting that the adequacy of the Age Pension is being considered by the Pension Review, what is an appropriate concept of adequacy for the retirement income system? Should it be to ensure there is a minimum level of income in retirement, to replace a proportion of income earned prior to retirement, or some other alternative?

ING Australia supports the need to increase greater self provision of retirement income needs by individuals and couples. Despite this there will continue to be an ongoing role for the aged pension, both to supplement retirement incomes for people where they have not achieved adequacy through other means or to assist people who risk poverty in their later years through manifestly inadequate retirement savings. The challenge for Government will be to achieve a fair and equitable distribution of aged pension payments that balances the ability of the community to fund such payments with appropriate support for those in genuine need. This could be achieved by better targeting of pension payments over time.

Q2.3 What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?

Financial Literacy

Over and above refinements to the system, we believe that improved education on the retirement income system and the three pillars would go a long way towards promoting better engagement of Australian's with their super and the retirement income issue, in turn giving them a better understanding of the retirement system and in doing so removing perceived complexities.

This could be part of a financial literacy program. School leavers should have some minimum level of financial knowledge so they understand the importance of superannuation and know how they can provide for their retirement. This awareness can either prompt them to act directly or seek a financial planner.

Policy Option

Improved education on the retirement income system and the three pillars would go a long way towards promoting better engagement of Australians with their super and the retirement income issue.

We do not believe that the role of Government should change as an individual's income increases over their working life.

An acceptable retirement income system

Q3.1 Do the settings of the retirement income system, such as the level of SG and access to concessions, adequately consider the needs and preferences of individuals both before and after retirement?

Currently, compulsory superannuation guarantee contributions are required at 9% of the "ordinary time earnings" of an employee, subject to a maximum wages threshold.

Numerous pieces of research have suggested that accumulation of contributions at the rate of 9% is unlikely to be sufficient to provide an adequate income in retirement. This in turn is also likely to put pressure on Governments to pay adequate age pensions to eligible people, creating a potential social security crisis.

Treasury in the Consultation paper also places a cost on increases to the SG for Government:

> *If the increase were phased in at 1 per cent every two years, the cost to revenue in 2014-15 (the year it would reach 12 per cent) is estimated to be $1.9 billion per year. Although superannuation tax revenue would rise, this would be more than offset by a loss of personal income tax revenue. There would be a longer-term saving on Age Pension outlays.*

Clearly there is a recalibration of the system required to lift retirement savings to avert the aforementioned social security crisis, however, this needs to occur with an eye to economic affordability for both Government and business.

Policy options

Increase the Superannuation Guarantee, via a phased approach, to 12 percent when economic conditions permit

ING Australia submits it is necessary to increase to the level of Superannuation Guarantee contributions as soon as practicable. In particular, consideration should be given to increasing the level of Superannuation Guarantee contributions, via a phased approach (ie over a number of years), to 12 percent when economic conditions permit.

Endorse a soft compulsion approach to increasing contributions

In the meantime, ING Australia would support a soft compulsion approach where employees are required to contribute a small percentage of their ordinary time earnings, however could opt out of higher contributions should they so choose.

The Super Co-contribution

In order to assist low to middle income earners save for their retirement the super co-contribution was introduced on 1 July 2003.

If you meet the eligibility requirements for the scheme (including the 10 percent income test and have a total income that is less than $60,342 indexed annually) then the Government will fund $1.50 for every $1 contribution made by the super fund member, up to a maximum co-contribution of $1,500 per year.

Soon to move into its six year, the longevity of the scheme would appear to be an indicator of its success. ING Australia suggests that the Government should retain the co-contribution scheme and consider moving to a more appropriate test with a view to expanding its applicability.

Policy Options:

ING Australia supports retention of the successful super co-contribution scheme. Further we suggest the Government consider moving to a more appropriate flexible eligibility criteria which might include a test:

- *Based on family income; or*
- *Alternatively, as income is not an appropriate measure of adequate superannuation, an assets test (based on accumulated super) could be introduced.*

Salary sacrifice contributions

Salary sacrifice is an arrangement whereby an employee agrees to forego part of their wage or salary, and have additional employer contributions made to superannuation. Salary sacrificing into superannuation is a tax effective means to accumulate wealth for retirement.

Policy Options

Salary sacrifice should continue to be a key vehicle allowing individuals to build retirement benefits. However, ING believes some changes could be implemented to further widen the availability and benefits of salary sacrifice. This can include:

- *Making it compulsory for employers to offer salary sacrifice. Currently employers can refuse an employee's request to salary sacrifice, thereby limiting an individual's ability to build retirement benefits. Employers would need time to implement this change, so a future commencement date would be practical.*

- *Extend choice of superannuation (for eligible employees) to salary sacrifice. Currently choice of superannuation fund only applies to the 9% superannuation guarantee and the employer can choose the fund for salary sacrifice contributions.*

Spouse contribution

Spouse contributions allow individuals to make after tax contributions to superannuation on behalf of their spouse. The contributing spouse receives a tax offset up to $540 where the recipient's spouse income is less than $10,800 (part benefit up to $13,800).

Policy Options

ING supports the principle of encouraging voluntary contributions to superannuation, but believes the current spouse contribution policy should be reviewed. This can include:

- *Increasing or indexing the current amount of the tax offset and the cut-off thresholds as these amounts have not been indexed in about 10 years. The 'real' value of this policy has effectively reduced over time.*

- *Alternatively, a possible option is to abolish spouse contributions and divert the revenue savings to an expanded co-contribution scheme (as mentioned above).*

Tax Deductibility of Life Insurance

Currently, taxpayers do not obtain a tax deduction for insurance premiums for procuring life insurance contracts where the policies are obtained outside the superannuation environment. Although a deduction can be claimed in respect of income protection policies, the deduction is not generally available where the taxpayer is not engaged in an income earning activity when the policy is obtained or the premium is paid.

This unavailability of a tax deduction acts as a disincentive for obtaining policies in order to protect the community sufficiently against pre-mature death and disablement.

It is not clear to us as to why a difference in tax treatment of the deductibility of premiums between the superannuation and non-superannuation environment is being maintained. This distinction also discriminates between persons who are able to access life insurance cover via superannuation and those who can not.

The availability of a tax deduction for premiums outside superannuation would allow consumers to decide how they wished to secure life insurance cover, especially where they may wish to retain maximum possible superannuation benefits without it being dissipated by life insurance premiums.

ING Australia believes that there are significant social, community and governmental benefits in wide-spread use of life insurance to protect the community. This would also save resources required to pay disablement and age pensions by the Federal Government in many cases.

Policy Option

Life Insurance purchased outside of superannuation should be deductible, as it is if purchased within a superannuation fund.

ING Australia submits that tax laws should be amended to allow a tax deduction for life insurance premiums paid by all taxpayers.

Q3.2 Is the current level of superannuation income tax concessions appropriate and sustainable into the future? Are the current concessions properly targeted, and if not, how should they be reformed?

Encouraging low income earners to contribute to superannuation

Apart from owner-occupied homes, superannuation is Australia's principal tax-preferred savings vehicle. Tax concessions for superannuation arise at three levels: capital contributions, investment income on the capital contributed and assets accumulated, and benefit payments.

Tax-deductible contributions are taxed at 15% at the fund level. This provides tax concessions to those taxpayers whose taxable income exceeds $34,000, but no tax concessions to those taxpayers who are at lower income levels.

Investment income on the assets invested and accumulated is taxed at the concessional rate of 15%. Here again, the tax concession advantages people at higher income levels. Benefits, both lump sums and pensions, received from a superannuation fund after the recipient reaches age 60 are completely tax-free.

In addition, the Government makes co-contribution at 150% of a member's tax-paid contribution to a fund, subject to a maximum of $1,500 per contributor.

It may be noted that, apart from the Co-contribution, the current superannuation system does not provide any particular tax benefits to those people who are at lower income levels.

The "Architecture of Australia's tax and transfer system" document ("the Document") issued by the Treasury states that the value of the superannuation tax concessions provided to contributions and earnings is estimated to be over $27 billion in 2008-09, increasing to over $31 billion in 2010-11.

The Document also acknowledges that, based on the 2008-09 tax rates, around 1.2 million individuals do not receive a personal income tax benefit from the tax rates applied to their concessional superannuation contributions. Further, a further 1.2 million people receive only a marginal benefit from the superannuation contributions.

ING Australia submits that steps need to be taken to provide a measure of tax concession in respect of superannuation contributions for people at the lower income level.

Policy Option

Rebate 15 percent contributions tax paid by low income earners to their superannuation fund to increase their retirement incomes

ING Australia supports a rebate for superannuation contributions tax paid by low income earners in order to increase retirement savings for those Australians in most need. The Australian Tax Office would pay an amount equivalent to 15% of the concessional contributions made on behalf on an individual to their superannuation fund. This payment would be made once the individual's income tax return had been assessed and would be means tested.

Re-consider Mature Age Worker Tax Offset

The mature age worker tax offset has been available since 1 July 2004. Eligible persons (defined by the ATO as Australian residents aged over 55 years at the end of the income year and having received a net income from working, within limits) benefit from a maximum tax offset of $500 when they lodge their tax returns.

Given the offset is currently paid automatically many eligible workers probably do not even know if/why they receive it, it appears a questionable incentive to remain connected to the workforce.

ING believes the offset might be better targeted at mature aged workers by being paid as a super contribution to build retirement benefits, or combine with the co-contribution scheme.

Policy Option:

ING Australia believes the Government should re-consider mature age worker tax offset Could be paid as super contribution to build retirement benefits (or combine with co-contribution scheme)

A robust retirement income system

Q4.1 At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?

ING Australia supports maintaining the preservation age and age pension age at this stage. Also see our response to Q1.1 above.

Q4.2 What is the role of individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?

INGA supports and also proposes further measures for government policy to encourage retirees to use their retirement savings to provide income for their retirement.

Demographic changes with increases in longevity of individuals will place further burden on the social security system. Investors will also demand greater financial security and an appropriate lifestyle in retirement.

Investors face the following principal risks on retirement:

- **Market (investment) risk –** short-term investment performance may be significantly lower than expected in the long run and may threaten subsequent pension withdrawals;

- **Longevity risk** – outliving one's retirement assets;

- **Inflation risk** – risk that inflation is higher than expected during retirement and higher pension withdrawals are required to maintain purchasing power / desired standard of living;

- **Spending (lifestyle) risk** – risk that they will not have enough money to achieve their desired lifestyle in retirement.

Recent events with negative investment returns, increased market volatility and reduction in interest rates have only further highlighted these risks and current retirement income products address some but not all of these risks.

ING proposes that the Government support measures which provide investors with the ability to convert their retirement savings into retirement income stream products to fund for their retirement. The Governments involvement in this area should include:

- Streamlining regulations to promote the development of innovative retirement income stream products by market participants to address longevity, investment market and inflation risk faced by retirees;
- Developing a longevity index for Australia;
- Issuing long-dated Government bonds, including CPI-linked bonds;
- Consider limits / restrictions on lump sums to encourage the aforementioned income streams and to reduce longevity risk.

Allowing market participants to develop innovative retirement income solutions

The majority of retirees that rely on account-based pensions to provide a comfortable lifestyle have significant exposure to the following risks:

- **Market (investment) risk** – Retirees do not know what the investment returns (and the sequence of the investment returns) of their retirement assets will be (after inflation and investment management fees) over their lifespan. There is a risk that short-term investment performance may be significantly lower than what may be expected in the long run and this may threaten subsequent systematic pension withdrawals. The sequence of returns becomes a critical factor in determining whether or not retirement assets will last a lifetime, particularly during the early stages of retirement.

- **Longevity risk** – Retirees do not know how long they will live. Longevity risk is the risk of living longer than planned for and outliving one's retirement assets. This risk is to some extent mitigated by the government age pension which puts a floor on the standard of living that can be expected by retirees.

- **Inflation (purchasing power) risk** – Retirees do not know what the rate of inflation will be over their lifespan. Inflation risk is the risk that inflation is higher than expected during retirement and as a result higher pension withdrawals are required to maintain purchasing power / desired standard of living.

- **Spending (lifestyle) risk** – risk that they will not have enough money to achieve their desired lifestyle in retirement.

The account-based retirement income products in Australian retirement market are currently failing to address these key customer needs.

There is a need for a retirement product that cost effectively addresses the four key factors that could affect retiree's ability to generate pension income during retirement: asset allocation, the sequence of market returns, withdrawal amounts and longevity risk. There is a need for a retirement product that allows for predictable pension payment rates for life even if the retiree's retirement assets have been depleted.

This new type of retirement product should provide for the benefits of an account based pension (exposure to growth assets, control over investments, flexible withdrawals and access to capital), provide the risk mitigation benefits of lifetime annuities (mitigation of the following risks – market, longevity and inflation) and provide market protection similar to a put option.

The baby boomers are entering the retirement market and as a result the post-retirement superannuation market in Australia is expected to grow at about 6% p.a. more than the pre-retirement superannuation market.

The US market has experienced significant success with “guaranteed pension for life” style variable annuities. The ING Group has significant expertise in variable annuities in the United States, Japan and Europe and intends to leverage this expertise to developing innovative product solutions that provide minimum guaranteed living benefits tailored to the Australian superannuation environment.

New retirement income products

INGA is in the early stages of formulating the product design of a group life policy that will offer the latest generation of living benefit known as the Guaranteed Minimum Withdrawal Benefit (GMWBs). INGA is also formulating its approach to regulatory capital and risk management.

The benefits provided by the new style of retirement income products will belong to a broad category known as Guaranteed Minimum Withdrawal Benefits (GMWBs). A GMWB is designed to ensure that the owner will receive an agreed level of pension payments – regardless of the value of the investments held in respect of the account-based pension. The agreed pension is a specified percentage of a notional value called the “protected pension base”. The agreed pension can be payable for a specified period or for the lifetime of the insured. In either case, the payments will cease when the insured (or in some cases, a reversionary beneficiary) dies. The lifetime version of this benefit is commonly referred to as the Guaranteed Lifetime Withdrawal Benefit, or GLWB.

Offered through superannuation and allocated pensions, the proposed guarantees provide the following features / benefits:

- Security of income in late retirement
- Market linked returns provide potential for growth
- Flexibility and transparency
- Pension income protection from
  - Market risk
  - Longevity risk
- Strong credit risk of the life insurance issuer of the guarantees

Addressing investment and longevity risks

The fundamental nature of the proposed new retirement income products is to address the investment and longevity risks inherent in a traditional allocated pension / account based product.

In a traditional product, the member will draw down funds as required. However, in determining the amount that can be drawn down, there is always the risk that either:

- The investment performance will not meet expectations (with the result that the funds invested run-out before expected); or

- The member lives “too long”, so that even if investment performance meets expectations, the funds run out at the life expectancy rather than actual life.

Obviously this puts members in either of these scenarios in an undesirable position. Not only that, but the combination of these risks means that, even where investment performance and life duration ultimately turns out to be as expected, members will tend to draw down less than they theoretically could (in order to create a “buffer”), with the result that their living standards are less than expected.

The proposed new style of retirement incomes products should aim at addressing these risks (by providing for a guaranteed minimum withdrawal benefit), with the result that members can confidently set a realistic draw down amount without having to worry about poor investment performance or outliving their assets.

Flexible regulatory framework

The regulatory and tax framework should be flexible enough to encourage market participants to develop innovative retirement incomes products that address the longevity and market risks faced by retirees.

Specifically the APRA regulations, the Life Insurance Act and SIS requirements should be flexible enough to accommodate this new type of retirement income product.

The regulatory capital requirements should allow for these types of offerings to be developed and not differentiate between whether the risk is offered via one structure over another. Specifically a guarantee offered via a life company guarantee should have the same regulatory capital requirement as a guaranteed offered via a super fund or a managed investment scheme.

The ATO should allow for the insurance assets backing these investments to be deemed to be in the concessionally taxed superannuation and pension environments.

INGA can provide details of regulatory impediments to offering appropriate retirement income stream products.

Development of market for longevity risk

The new retirement income products insure the member against longevity risk but there is no real market transfer price for pricing longevity risk. The risk is largely borne by the insurer based on expectations of mortality and improvements which will eventuate over time.

In order for market participants to be able to better price for longevity risk, a secondary market for longevity risk is required.

In portfolio theory, longevity should provide a natural hedge to insurers of death benefits and also provide a diversification benefit for investment providers as the returns should be largely uncorrelated with other asset classes.

Currently there is limited information on longevity risk and risk pooling is not available in the capital markets.

There have been developments with the launch of longevity indices in the United States. The current indices are relevant to Australia to the extent that they help create a secondary longevity market and life expectancy in Australia may be closely correlated with life expectancy in other developed countries.

As Australia's retirement income market and demand for retirement products that provide longevity protection are expected to grow, the Government in association with the Australian Bureau of Statistics in consultation with the Institute of Actuaries of Australia should develop and publish an independent longevity index for Australia which can then be tradeable.

Issue of long-dated CPI-linked Government bonds

As the liabilities of the new retirement income stream products are long in nature, 30 years or more, assets that match this maturity are required.

Overseas governments issue long-dated 30 years credit-worthy government bonds. These provide a better liability match for the retirement incomes products.

The Government should issue long-dated including CPI-linked (indexed) bonds to fund infrastructure investments which could then be purchased by market participants in the primary market and traded in the secondary market to match the liability profiles of the new retirement incomes products.

Policy options

Retirement incomes product development

The Government should commit to removing regulatory restrictions which hamper the development of new styles of retirement income stream products and in fact provide incentives for market participants to develop such products. INGA can provide details of regulatory impediments to offering appropriate retirement income stream products.

Develop longevity index for Australia

The Government in association with the Australian Bureau of Statistics in consultation with the Institute of Actuaries of Australia should develop and publish an independent longevity index for Australia.

Government issue long-dated bonds

The Government issue long-dated bonds, including CPI-linked bonds.

Limits / restrictions on lump sums

Consider limits / restrictions on lumps sums to encourage income streams and to also reduce longevity risk.

A simple and approachable retirement income system

Q5.1 In what ways does the retirement income system impose undue complexity and cost on retirees and workers? How could this complexity be reduced?

Remove 10% test for deductibility of personal super contributions

The current requirement that an individual must receive less than 10% of their income from employment plus any reportable fringe benefits in order to be eligible for a tax deduction for personal superannuation contributions, adds complexity and uncertainty to the retirement income system.

The removal of this test would greatly encourage any individual whether or not they are self employed to invest for their retirement. The practical application of the 10% test means that individuals who are predominantly self-employed however may earn a small proportion of their income from employment, have to wait until just before the end of the income year to contribute to superannuation to ensure that they meet the 10% test. Where the 10% test is inadvertently breached, complexity arises around the requirement to provide a section 290-180 variation notice to the superannuation fund.

Policy Option

Remove 10% test for deductibility of personal super contributions

The removal of this test would provide flexibility to individuals to contribute at any time during the year.

The deduction would be limited to the concessional contribution cap of $50,000 p.a. (and the transitional cap of $100,000 up to 2012) which applies from 1 July 2007.

The Work Test from Age 65 – 74

The Government will only allow contributions from people aged 65 – 74 if they have met a work test which requires the person to have worked at least 40 hours within a consecutive 30 day period. The exception to this is mandated employer contributions (where they apply). There is a requirement that the person needs to provide written confirmation that they have met the work test.

The work test works against the principle of encouraging people to make contributions to their super to increase their retirement savings. It might also prove difficult for a fund manager to verify the written confirmation from a person they have met the work test for little benefit.

Policy Option:

ING Australia supports *removal of the work test from age 65 to 74 (inclusive) to encourage more individuals to use superannuation to provide retirement income .*

A sustainable retirement income system

Q6.1 The Age Pension serves two roles, as a safety-net for individuals who are unable to sufficiently save for their retirement and as an income supplement for many individuals who do save. What should be the role for the Age Pension and means testing in a future retirement income system and what impact does this have on its sustainability into the future?

See our comments above in relation to better targeting at Q2.2.

Q6.2 In what ways does retirement income policy affect workforce participation decisions and what, if any, changes might reduce disincentives to work? Does the sustainability and cost of the retirement income system affect the workforce decisions of younger generations of workers?

Transition to retirement income streams

Transition to retirement rules provide that on achieving your preservation age you are allowed to work reduced hours while also supplementing your income by drawing down on your superannuation.

The ability of working people that have reached their preservation age to scale down their work as a lead into retirement while not reducing their income provides a more flexible approach by recognising it does suit some people better to transit into retirement rather than exit full time employment on one day and be fully retired on the next. It acknowledges that some workers may prefer or will need to maintain an income and keep building their retirement incomes past their preservation age with the advantage of saving tax.

As such, we believe that the current transition to retirement arrangements are effective in keeping pre- retirement workers engaged with the workforce and provides them with options to best manage their existing finances while growing retirement income.

Policy Option:

ING Australia believes transition to retirement (TTR) income streams should be retained to provide flexibility for eligible individuals and to build retirement benefits.

SG Age Exemption

The Consultation paper notes that some submissions to the review:

> *raise a concern that individuals aged over 70 years are not paid the SG and those aged 75 years or older are unable to make superannuation contributions and must pay tax on their non-superannuation investment income.*

There appears to be no logical reason for excluding persons aged 70 and above from receiving the SG past limiting an employers liability to make the payments. We submit that the proportion of employees in the workforce within this age category would be low compared with other age groupings. Their departure from the workforce would in most cases see them being replaced by a worker that would likely be eligible for the SG. If older workers continue to offer their considerable skill and experience in the workplace then we believe they should still be eligible for the SG.

Policy Option:

Raise 9% SG age exemption from age 70 to 75, or remove altogether, to encourage older individuals to remain connected with workforce.

Q6.3 What impact could financial intermediation have on the effectiveness of retirement income policy?

We have no comment on this question.

Other Matters:

Following on from this review we expect there will be reforms made to the retirement incomes system by Government of some sort or another.

Changes to the superannuation system in particular will require fund managers to implement system changes that require a significant time to effect. We request that Government, in proceeding with reforms, is mindful of lead times needed by fund managers to implement these changes in an orderly manner and request that the industry is consulted to ensure that reasonable implementation timetables are established.

Once again we appreciate the opportunity to participate in this review. If you would like to discus any aspects of this submission, please do not hesitate to contact Allan Hansell, ING Australia's Senior Manager for Government and Regulatory Affairs on (02) 92347698.

Yours sincerely

Ross Bowden
Executive Director
Wealth Management
ING Australia