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Application of the new means testing rules for lifetime income streams

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Much has been written over the past couple of years regarding what was imminent change to the means testing of lifetime income streams. With the passing of 1 July 2019 these new rules have become operative. The following analysis highlights the benefit that application of these new rules can bring to clients and highlights a significant opportunity for advice.

A quick recap of the new means testing rules

Income test assessment

The new rules assess 60% of payments from lifetime income streams commenced on or after 1 July 2019 under the income test. For example, where a lifetime income stream pays income of $5,000 p.a., $3,000 p.a. will be assessed under the income test.

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Asset test assessment

For new lifetime income streams commenced on or after 1 July 2019, that meet the Capital Access Schedule (CAS) in the SIS Regulations (introduced as part of the 'Innovative Superannuation Income Streams' Regulations), and where the individual has reached their 'assessment day' (generally the day the income stream is purchased), 60% of the purchase amount will be assessed as an asset until the life expectancy of a 65 year old male, currently age 84, or for a minimum of five years. After this, the assessment reduces to 30% of the purchase amount for the rest of the person's life.

If the new lifetime income stream provides a surrender value and/or death benefit above the CAS, the assets test assessment will be based on the greater of:

- The amount assessed as above (60% until age 84 with a minimum of five years and 30% thereafter);
- Any current or future surrender value above the limits in the CAS; and
- Any current or future death benefit above the limits in the CAS.

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The Centrelink means tests and strategy zones

Centrelink calculates a person's Age Pension entitlement under two means tests – the income test and the assets test – with the test producing the lower result used to determine the person's entitlement.

Applying an assumption that all assets held are financial assets and deemed under the income test, the asset ranges where the income test and the assets test determines a client's pension can be calculated.

Chart 1: Age Pension income and assets test strategy zones[1, 2]

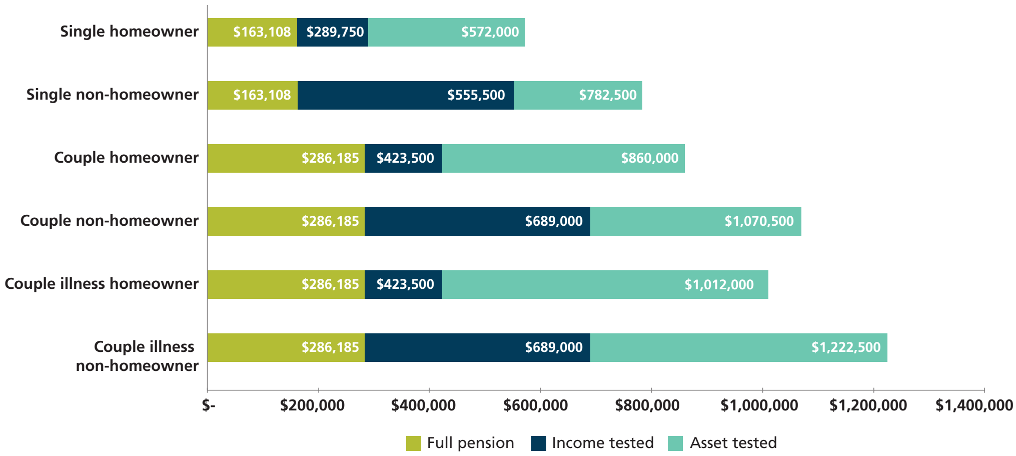

Chart 1 shows that a couple who own their own home will be able to hold total assessable assets (deemed) of up to $286,185 and still receive the full rate of pension. If their financial assets are between $286,185 and $423,500, the income test would determine their pension entitlement and income test friendly strategies may assist in enhancing their pension. Once assets reach $423,500, their pensions will be determined using the assets test and assets test friendly strategies may assist in enhancing their pension. Where assets exceed $860,000 Age Pension is reduced to nil.

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Utilising the post-1 July 2019 assets test assessment of lifetime income streams to improve client Age Pension outcomes

Increasing a client's asset tested part Age Pension

Where a client is receiving an asset tested part Age Pension each $1,000 of assessable assets over the lower assets test threshold reduces their Age Pension entitlement by $3 per fortnight, or $78 p.a. It follows that where such a client reduces their assessable assets by $1,000 (but not below the lower assets test threshold) their Age Pension entitlement will increase by $78 p.a.

So, where an assets test sensitive client invests $100,000 in lifetime income stream assessable assets immediately reduce by $40,000 (where just 60% or $60,000 is assessable). This reduction in assessable assets has the effect of immediately increasing Age Pension by $3,120 (40 x $78 p.a.), or 3.12% of the $100,000 invested in the lifetime income stream, in the first year.

It is important to note that this relative increase in Age Pension will change in future years of any comparison based on the fixed assessable value of the lifetime income stream until the step down in assessable asset value from age 84 (where just 30% of the purchase price will be assessable) and the changing assessable value of any comparable asset (such as an account-based pension, for example, with its assessable value changing with investment earnings and income drawdowns).

> Where an assets test sensitive client invests $100,000 in lifetime income stream assessable assets immediately reduce by $40,000 (where just 60% or $60,000 is assessable).

1 Rates and thresholds current at 1 July 2019

2 On 14 July 2019 the government announced, and subsequently effected, a reduction to deeming rates, backdated to 1 July 2019. This change is not reflected in this article.

Example 1: Diane and Des

Diane and Des, both age 66, are a couple who own their own home. They have $300,000 each in deemed account-based pensions, $50,000 in cash and term deposits they are keen to maintain in case of a rainy day and $20,000 of non-financial assets.

Diane and Des are drawing retirement income (from all sources) of $60,000 p.a., including combined Age Pension of $14,812 p.a. (a part Age Pension determined by the assets test).

Using the Challenger Age Pension Illustrator (available via Challenger AdviserOnline), Diane and Des' adviser models an alternative strategy involving a 25% ($150,000 combined) allocation from their account-based pensions to lifetime annuities.

This alternative strategy provides guaranteed income for life for both Diane and Des, irrespective of how long they live or how investment markets perform.

This alternate strategy also has the effect of reducing their assessable assets by $60,000 ($150,000 x 0.4). And, because Diane and Des are assets test sensitive this has the effect of increasing their Age Pension from $14,812 to $19,492 (an increase of $4,680) in the first year alone. This additional $4,680 of Age Pension in the first year reduces by this same amount the income required to be drawn from their retirement assets, helping to sustain them over time.

Image 1 on the next page shows an extract from the Challenger Age Pension Illustrator highlighting the additional Age Pension payable to Diane and Des over years one to five of this alternative strategy, and the cumulative additional Age Pension over five and ten years.

Because Diane and Des are assets test sensitive, reducing their assessable assets by $60,000 has the effect of increasing their Age Pension from $14,812 to $19,492 (an increase of $4,680) in the first year alone.

Image 1: Challenger Age Pension Illustrator (Diane and Des)

Under the lifetime portfolio year 1 Age Pension entitlements changed by: +$4,680 / +$180 fortnight

Current portfolio		**Lifetime portfolio** including $150,000 of Flexible income or Enhanced income annuities	
Total assessable assets:	$670,000	**Total assessable assets:**	$610,000
Total assessable income:	$19,832	**Total assessable income:**	$18,998
Applicable pension test:	Assets test	**Applicable pension test:**	Assets test

Estimated fortnightly Age Pension: $570	**Estimated fortnightly Age Pension: $750**
40% of the maximum Age Pension 	53% of the maximum Age Pension 

Estimated Age Pension (today's dollars)	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**5 year cumulative**	**10 year cumulative**
Current portfolio	$14,812	$17,412	$19,817	$22,105	$24,237	$98,383	$247,473
Lifetime portfolio	$19,492	$21,351	$23,132	$24,757	$26,304	$115,036	$266,856
Lifetime portfolio difference	**$4,680**	**$3,939**	**$3,315**	**$2,652**	**$2,067**	**$16,653**	**$19,383**
% Change	**32%**	**23%**	**17%**	**12%**	**9%**	**17%**	**8%**

Source: Challenger Age Pension Illustrator as at 05/07/2019. See appendix for assumptions.

Reducing a client's assessable assets below the assets test cut-off to allow them access to a part Age Pension

Where a client has assessable assets above the assets test cut-off levels (see Chart 1, but above $860,000 for a couple (homeowners) for example) they will not be entitled to an Age Pension. Some of these clients will significantly value eligibility for the Age Pension, for the income it provides or the additional benefits available (such as the availability of the Pensioner Concession Card).

It is important to remember, however, that no Age Pension is payable until assets are below the assets test cut-off and, therefore, there is no additional Age Pension benefit that comes from the reduction of assets to this level – only from this point does Age Pension start increasing with reduced assets.

It is important to remember that no Age Pension is payable until assets are below the assets test cut-off and, therefore, there is no additional Age Pension benefit that comes from the reduction of assets to this level.

Example 2: Edith and Eric

Edith and Eric, both age 66, are a couple who own their own home. They look a lot like Diane and Des above but have managed to scrimp and save just a bit extra in super. They have $400,000 each in deemed account-based pensions, $50,000 in cash and term deposits they are keen to maintain in case of a rainy day and $20,000 of non-financial assets.

Edith and Eric are also drawing retirement income (from all sources) of $60,000 p.a. but they are not currently entitled to any Age Pension (because their current level of assessable assets of $870,000 just exceeds the assets test cut-off level of $860,000).

Edith and Eric have mentioned to their adviser that they are keen on accessing the Age Pension sooner rather than later. So, in addition to some alternative strategies (including gifting, funeral bonds, pre-paid funeral expenses and others) Edith and Eric's adviser also presented a 'tactical' application (allocating just $40,000 or 5% of their portfolio) of a lifetime income stream to help them gain earlier access the Age Pension.

Allocating $40,000 to lifetime income streams immediately reduces their assessable assets by $16,000 getting them below the assets test cut-off and getting them a small part Age Pension and the Pensioner Concession Card.

Allocating $40,000 to lifetime income streams immediately reduces their assessable assets by $16,000 getting them below the assets test cut-off and getting them a small part Age Pension and the Pensioner Concession Card.

Image 2 below shows an extract from the Challenger Age Pension Illustrator highlighting the additional Age Pension payable to Edith and Eric over years one to five of this alternative strategy, and the cumulative additional Age Pension over five and ten years.

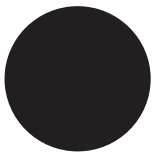
Image 2: Challenger Age Pension Illustrator (Edith and Eric)

Under the lifetime portfolio year 1 Age Pension entitlements changed by: +$1,992 year / +$77 fortnight

Current portfolio		**Lifetime portfolio** including $40,000 of Flexible income or Enhanced income annuities	
Total assessable assets:	$870,000	**Total assessable assets:**	$854,000
Total assessable income:	$26,332	**Total assessable income:**	$26,110
Applicable pension test:	Assets test	**Applicable pension test:**	Assets test

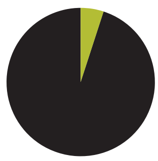
Estimated fortnightly Age Pension: $0

0% of the maximum Age Pension



Estimated fortnightly Age Pension: $77

5% of the maximum Age Pension



Estimated Age Pension (today's dollars)	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**5 year cumulative**	**10 year cumulative**
Current portfolio	$0	$2,670	$5,972	$9,040	$11,952	$29,634	$127,439
Lifetime portfolio	$1,992	$3,645	$6,752	$9,703	$12,459	$34,550	$132,745
Lifetime portfolio difference	**$1,992**	**$975**	**$780**	**$663**	**$507**	**$4,916**	**$5,306**
% Change	**Big**	**37%**	**13%**	**7%**	**4%**	**17%**	**4%**

Source: Challenger Age Pension Illustrator as at 05/07/2019. See appendix for assumptions.

It is important to note that where clients have much higher levels of assets the required allocation to a lifetime income stream to access the Age Pension might represent too significant a portion of their assets and compromise other retirement income objectives.

Example 3: Edith and Eric (but with higher assets)

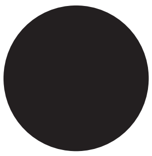
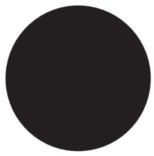
Assume that Edith and Eric had managed to save $500,000 each via super so have combined assessable assets of $1,070,000, well above the assets test cut-off level of $860,000. A 25% ($250,000 combined) allocation from their account-based pensions would still not see them immediately access the Age Pension.

Image 3 below shows an extract from the Challenger Age Pension Illustrator highlighting the additional Age Pension payable to Edith and Eric over years one to five of this alternative strategy (with no Age Pension paid until year five), and the cumulative additional Age Pension over five and ten years. Clients with this level of assets are likely to be self-funded retirees for quite some time during their retirement.

Image 3: Challenger Age Pension Illustrator (Edith and Eric)

Under the lifetime portfolio year 1 Age Pension entitlements changed by: $0 year / $0 fortnight

Current portfolio		**Lifetime portfolio** including $250,000 of Flexible income or Enhanced income annuities	
Total assessable assets:	$1,070,000	**Total assessable assets:**	$970,000
Total assessable income:	$32,832	**Total assessable income:**	$31,442
Applicable pension test:	Assets Test	**Applicable pension test:**	Assets Test

Estimated fortnightly Age Pension: $0		**Estimated fortnightly Age Pension: $0**	
0% of the maximum Age Pension		0% of the maximum Age Pension	

Estimated Age Pension (today's dollars)	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**	**5 year cumulative**	**10 year cumulative**
Current portfolio	$0	$0	$0	$0	$0	$0	$32,084
Lifetime portfolio	$0	$0	$0	$0	$1,968	$1,968	$47,981
Lifetime portfolio difference	**$0**	**$0**	**$0**	**$0**	**$1,968**	**$1,968**	**$15,897**
% Change	**0%**	**0%**	**0%**	**0%**	**Big**	**Big**	**50%**

Source: Challenger Age Pension Illustrator as at 05/07/2019. See appendix for assumptions.

Conclusion

For assistance modelling these types of scenarios, access the Challenger Age Pension Illustrator and the Challenger Retirement Illustrator, available AdviserOnline.

For further assistance regarding the technicalities of means testing or lifetime income streams please contact Challenger Tech, and for any other enquiries please contact your Challenger Business Development Manager.

Appendix: Assumptions used in Images 1, 2 and 3

- Centrelink rates and thresholds as at 1 July 2019.
- Source is the Challenger Age Pension Illustrator as at 05/07/2019.
- Challenger Guaranteed Annuity (Liquid Lifetime) quote as at 05/07/2019 and based on the flexible income option, monthly payments, CPI indexation, nil adviser fees and maximum withdrawal and death benefit periods.
- Assumes lifetime annuities form part of defensive assets. To maintain an overall asset allocation of 50/50 growth/defensive (including the allocation to the defensive lifetime annuity), the asset allocation of the account-based pensions has been adjusted accordingly.
- Account-based pension growth assets return 7.70% p.a. and defensive assets, 3.70% p.a. before management fees of 0.80% and 0.60% respectively. In addition, platform fees are assumed to be 0.50%. Cash and term deposits return 4% p.a.

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