



The Alliance
for a Fairer
Retirement
System

www.fairerretirement.com.au

4 February 2020

Retirement Income Review Secretariat
The Treasury
Langton Crescent
Parkes ACT 2600

By email: retirementincomereview@treasury.gov.au

Dear Retirement Income Review Panel

Retirement Income Review Consultation Paper

The Alliance for a Fairer Retirement System (the Alliance) was formed to advocate for the principles of adequacy, sustainability, certainty and fairness in retirement policy. It exists to represent millions of senior Australians, shareholders and self-funded retirees planning a sustainable retirement and, as such, is keen to explore options to fix problems with the existing superannuation, taxation, Age Pension means testing and broader retirement income systems. The Alliance welcomes the consultation paper (the Paper) issued by the Panel in November 2019 and the opportunity to provide feedback on the questions posed by the Paper. We are supportive of a retirement income system based around the three integrated pillars set out in the Paper: that is, the government-funded Age Pension; compulsory superannuation; and voluntary savings.

Executive summary

The Panel should examine the systems in other countries. There's significant variation and the (OECD) *Pensions at a Glance* report provides an important evidence base. For example, in NZ pensioners have an incentive to work and are rewarded, while Australian pensioners, once past a threshold, lose 50c in the dollar. Another example is Canada. It has a combined basic and targeted public pension system. Eligibility age for the public pension in Canada is 65, but recipients can defer their pension and receive a higher payment, up to a maximum increase of 36 per cent at age 70. They can also access their pension from 60 and receive a lower payment. This sliding payment scale gives greater flexibility compared to Australia.

Purpose of the system and role of the pillars

The purpose of the Australian system is not well understood. Australians suffer from low levels of financial literacy. Evidence for this is the \$17.5 billion of unclaimed superannuation. Individuals have a role to play by voluntarily saving for retirement, but the capacity to do this depends on stable policy settings, less complex policies, and ones that provide incentives.

The Age Pension was introduced in Australia in 1908 and it's become the bedrock of the retirement system. But it's in the taxpayer's interest to encourage all retirees to become more self-reliant. The burden on a declining taxpayer base would be significantly eased if all retirees could be encouraged or compelled to save more for their retirement so more full pensioners could be part-pensioners and more part-pensioners could be self-funded. To



support this, there is a need to encourage more voluntary contributions to superannuation, which requires educating the community of the benefits. Both the government and superannuation funds have a role to play here. There is little encouragement to have individuals make concessional contributions voluntarily as they are seen as a cost to government revenue.

In relation to voluntary savings, a self-funded retirement income requires long-term planning and stability. When people have been making long-term plans within those rules over many years, ad hoc policy changes erode the trust of Australians in the system and do not meet the need for a sustainable retirement savings plan.

The changing Australian landscape

There is now an increase in the number of Australians unemployed in their 50s and 60s. People aged over 50 face challenges in returning to work. These include poor health, caring responsibilities, a lack of suitable and accessible employment and age bias. One in five aged 55 years or over claim age is a major barrier to finding a job or getting more hours. This combined with an increase in the pension age has seen older individuals become the fastest-growing cohort on Newstart. At present there are 180,000 Australians over 55 on Newstart.

The Age Pension system is also predicated on home ownership. Those entering retirement who own their home without a mortgage are generally likely to have a comfortable retirement. Yet home ownership rates are declining. Based on current trends, an increasing number of Australians will enter retirement not owning a home or with a significant debt. Given the Age Pension system is predicated on assumptions of debt-free home ownership, it's clear support provided to renters is insufficient, leaving more older Australians disadvantaged. The system needs to adapt to current and future trends in demographics, the labour market and home ownership.

Principles for assessing the system

An important objective for government is to encourage older Australians to save for retirement and to support the majority of retirees (58%) who take pride in being either fully or partly self-funded in retirement. This majority includes many self-funded retirees and almost half of the current 1.1 million self-managed superannuation fund (SMSF) trustees who are either in the pension phase, or who will move into that phase shortly. The principles adopted by the Alliance for a Fairer Retirement System when it was founded in May 2018 were: adequacy, sustainability, certainty and fairness. The Alliance supports the four principles proposed by the Panel: adequacy; equity; sustainability; and cohesion. But certainty is also a critical factor and must be included in any review.

Adequacy

Adequacy is the measure of the degree to which the retirement system enables people to achieve a sufficient standard of living in retirement relative either to the standard they enjoyed while working, or as compared to an objective budget standard for retirees. No single retirement income target will be appropriate. The Panel should consider how the distribution of retirement income for various cohorts compares to similar cohorts during appropriate periods prior to retirement and the contribution to those retirement incomes from each of the pillars.

Cohorts could include those split by income distribution and other variables such as gender, home ownership, whether single or couple status, geographical location and other relevant variables. Older single women have emerged as the fastest growing demographic of people experiencing homelessness and housing stress in Australia today.



The Age Pension has evolved from a safety net to a foundation of the system. There has been a decline in home ownership, changing labour trends and increases both in divorce and those entering retirement as singles rather than as couples. New pressures are being placed on the system that it is not designed to deal with. Changes are required.

Equity

The retirement system should treat people in the same circumstances equally, but a range of inequities exist at present. One example is that superannuation is tied to paid employment, so those who are out of the workforce, or have interrupted employment, or those who are self-employed where contribution to superannuation is not mandatory, experience very different outcomes. They may earn less during their working lives and have less in retirement. They are also less likely to be able to either voluntarily contribute to superannuation or other savings.

Furthermore, the age when individuals are more likely to make voluntary contributions to superannuation is 50 onwards. The financial pressures of mortgages and child-rearing start to ease at a point when earnings frequently increase. The amount individuals can voluntarily contribute has been decreased over some years — it is now \$25k per annum. This raises questions as to whether it is equitable to reduce the capacity of workers to ‘catch up’.

Older Australians can still receive a certain amount of income and receive an Age Pension. This can be from investments and property rental or as a salary from employment, as well as other means. The Work Bonus is intended to be an incentive for pensioners to work. It operates in addition to the pension income test free area. The first \$300 per fortnight will not count under the income test. This doubles for couples, where both are working. However, the income test is a strong disincentive to continue working. The high effective tax rate of 50c in the dollar means the loss of pension makes more than one day’s work in retirement uneconomic.

In order to receive the full Age Pension, a home-owner couple can hold assets of up to \$394,500 which may or may not be in superannuation. The pension is withdrawn at the rate of \$3 per fortnight for every \$1,000 above that threshold and is reduced to zero when assets reach \$863,500. That rate of reduction (called the taper rate) is \$78 per year per \$1,000 of assets, or 7.8%. In other words, retirees can increase their pension by more than those assets can earn by reducing the level of those assets.

While the taper rate is designed to limit the Age Pension to pensioners with fewer resources, it creates a ‘sweet spot’ around \$400,000. It’s the opposite of what the government should be aiming for. In order to earn the same as those in the ‘sweet spot’, self-funded retirees would need to hold \$1,120,000 in assets. The current taper rate creates an incentive for part-pensioners to divest themselves of assets. In the pursuit of savings, successive governments have created perverse incentives for retirees to impoverish themselves.

The family home, as an exempt asset, creates a number of distortions. It is perfectly rational for retirees to seek to protect both their home and what many see as their entitlement to the Age Pension. Many retirees are reluctant to take out a home equity loan to supplement their income because it capitalises the interest and the home may be required to pay the Refundable Accommodation Deposit in an age care home in the future. For both the pensioner and the taxpayer this behaviour leads to a less than optimal allocation of resources. The Age Pension rules encourage retirees to arrange their affairs to become residential property asset rich, but income poor.

The cohort outside the current system include the self-employed, those in the gig economy and older, retired Australians — none of these has the benefit of compulsory superannuation. ABS statistics show 8% of the 12.6 million employed in August 2018 were classed as independent contractors and a further 8.8% were classed as



other business operators. Small business owners frequently rely on selling a business to fund retirement, yet not all business owners can sell their business. Those in the gig economy frequently suffer from fragmented employment, making savings a challenge. Non-compulsory saving can also prove difficult for many. It is vital, therefore, that policy settings take account of the impact on all retirees and not only those who have benefited from superannuation.

Sustainability

Changes to retirement policy must contribute to fiscal sustainability by incentivising self-sufficiency.

There has been a great deal of concern expressed that there are some large private superannuation funds attracting large tax concessions and cash refunds of franking credits. This is an issue of equity, but it's used as an argument about sustainability. The Alliance is of the view that the small number of very large funds distorts the overall system. The policy settings need to address this distortion rather than jettison a system that is proving to systematically work towards providing adequacy and self-sufficiency for a growing number of Australians in retirement.

Tax concessions attached to superannuation are consistently seen by governments and Treasury as expenses (liabilities) rather than investments. Yet, despite an ageing population, a maturing superannuation system means Age Pension expenditure remains stable. A wealthy country such as Australia should not view the Age Pension as a liability.

In 2019 for the first time, more than 50% of those retiring had some level of self-funding. Measuring confidence is more difficult, but Australians will only make voluntary contributions if they have confidence in the system. ATO statistics for 2016-17 show that member contributions (\$66.3 billion) represent 42% of total superannuation contributions. However, this is driven by contributions in the self-managed superannuation fund sector, where 83% of total contributions are member contributions (\$34.7 billion). Most member contributions are made voluntarily and are a sign of strong engagement, while most employer contributions are mandatory Superannuation Guarantee contributions.

Cohesion

Historically, governments have not been concerned with the cohesion of the system. The Ministers and government departments responsible continue to operate in a siloed fashion. This leads to unintended consequences. It is important all pillars are considered when setting policy.

The Age Pension is paid by the government from general revenue. It is a significant cost to the taxpayer and successive governments have focused on containing those costs. The government response to cost pressures has been to seek to limit the number of people who are eligible for the Age Pension through means tests and by raising the retirement age.

The key to improved retirement incomes for pensioners and lower costs for the government is increased savings. The problem is the means tests themselves create savings disincentives. Little attention has been paid to how the rules influence behaviour in relation to the Age Pension.

It appears the government is more concerned with containing the short-term costs of superannuation tax concessions than the long-term benefits of having more retirees with generous retirement savings, living independently of the taxpayer. Governments are more concerned with limiting the costs of the pension than with

encouraging people to save for their retirement. Paradoxically, by also trying to contain superannuation costs, governments have introduced disincentives to save. This only adds to Age Pension costs.

The fact that different rules apply to different pillars in the system makes it extremely difficult for individuals to understand how the system interacts with aged care. For example, a different calculation is used to means test aged care than is used to test for the Age Pension. One is developed by the Department of Health and one by Treasury, revealing a siloed approach that is to the detriment of delivering outcomes.

However, given the long lead-times between reaching eligibility age and claiming an Age Pension or part pension, it is suggested this is evidence that the system is not delivering. If the system was better understood, individuals would start the organisation of paperwork much earlier so payment coincided with eligibility. The Alliance recognises there are various reasons why people do not apply for the full or part Age Pension, including viewing it as welfare which makes them reluctant to engage, or being above the threshold test at first. Nonetheless, the lag should be considered when determining whether the system delivers.

When faced with the need to access help through the aged care system, older Australians would likely see this as something separate from the retirement income system and more as part of the health system. However, the application of means testing to determine eligibility firmly grounds access to aged care in the retirement income system. This should not be surprising as access to subsidised health care in the form of bulk billing and subsidised medicines are also tied up with the retirement income system through Age Pension means testing.

The rules governing superannuation, aged care and the Age Pension are dense and labyrinthine and for the vast majority of Australians too complex to navigate without access to formal financial advice. Low levels of financial literacy compound the problem. Australia is unusual in having a lump sum provision in its superannuation scheme settings. This means that when an individual goes from work to retirement they are suddenly responsible for making decisions about a large sum of money. In other countries the individual does not take on the risk of managing a large sum of money at this time. The risk remains with the provider not the recipient.

There is a significant unmet need for access to formal financial advice to assist with managing longevity risk, market risk, inflation risk and estate planning. While it is clear from speeches at the time of the introduction of superannuation that it is not intended to be part of an estate but expended in retirement, the fact that individuals do not know when they are going to die results in a level of risk-aversion, which sees them planning for their funds to last 5—10 years beyond life expectancy. As a result, given people die at different ages, superannuation does become part of estate planning in various instances. Without access to formal financial advice, Australians are at risk not only of not having sufficient capital for any years beyond life expectancy, but of not being able to manage other risks adequately and achieve a desired retirement income.

The Alliance is of the view that there is insufficient integration between the Age Pension and superannuation. Leakage from superannuation will increase the costs of the Age Pension. The longer money stays in superannuation, the more Age Pension costs can be reduced. Age Pension rules are overly complicated and if simplified there would be less opportunity to undermine savings behaviour leading to perverse outcomes.

The availability of lump sums in retirement has another behavioural effect. It may actually encourage people to take on more debt during their working life. In effect, tax-free lump sum withdrawals allow people to mortgage their superannuation by promising to repay the debt on retirement when lump sums withdrawals from their superannuation become available. This may or may not be a valid use of these tax concessional savings, but it does not enhance retirement incomes and is likely to increase the cost of the Age Pension.



The Alliance
for a Fairer
Retirement
System

Our detailed comments on the questions posed in the Paper are on the following pages.

John Maroney
Chief Executive Officer
SMSF Association

Judith Fox
Chief Executive Officer
Stockbrokers and Financial Advisers Association

Ian Henschke
Chief Advocate
National Seniors Australia

Graeme Bottrill
National President
Australian Investors Association

Wayne Strandquist
National President
Association of Independent Retirees

John Cowling
Chief Executive Officer
Australian Shareholders Association

Philip Kewin
Chief Executive Officer
Association of Financial Advisers

Ian Irvine
Chief Executive Officer
Listed Investment Companies & Trusts Association

Michael Lorimer
Managing Director
SISFA

Rob Grover
President
Gold Coast Retirees Inc

Ron de Gruchy
President
WA Self-Funded Retirees Inc



The retirement income system

Q1 Are there aspects of the design of retirement income systems in other countries that are relevant to Australia?

Yes. The Alliance believes that there is value in examining the systems and outcomes achieved in other countries and incorporating best practice into the Australian system over time to enhance our existing system.

While it is not possible to easily compare each of the systems due to significant variation in the operation of different pension schemes, there are examples of innovations from other countries that could be incorporated into the Australian system.

Canada, for example, allows access to its Canada Pension Plan (CPP) as early as age 60 (reduced 0.6% for each month before 65), or as late as 70 (increased 0.7% for each month after 65). The average life expectancy for Canadians is roughly the same as Australia at 80 for men and 84 for women (2018). It also allows recipients of the Old Age Pension (OAS) and the Guaranteed Income Supplement (GIS), which provide a basic pension for those with limited income from the CPP, to defer payment of these income streams until the age of 70, compensating those who do with a higher payment.

This flexibility contrasts strongly with the rigidity of Australia's pension. The Age Pension in Australia is now 66 and rising to 67 by 2023, despite the ABS data showing that the average age of retirement for recent retirees (those who had retired in the last 5 years) was 62.9. Even though Australians can access their superannuation at 60, Age Pension access is rigidly set at 66 and soon rising to 67.

There is a need for greater flexibility in the system to account for those who have not been able to accumulate adequate private savings, but who struggle to engage in the workforce past the age of 60. Evidence shows that many Australians are forced into retirement at an earlier age due to ill health. For example, a National Seniors survey found the main reason for retirement was ill health. Similarly, Association of Superannuation Funds of Australia (ASFA) data in 2014 found 72% of retirees had their working lives end abruptly, with only 28% easing out of the workforce.

We may be living longer but more and more evidence is emerging that we are not living healthier. More people aged between 60 and 70 report fair or poorer health than other Australians. It's predicted by 2035 one in four men and one in five women in their 60s will have poor or at best fair health. As late demographer Professor Graeme Hugo said the baby boomers are far more likely to have co-morbidities than the generation that preceded them.

Both New Zealand and Canada also address the issue of system sustainability differently than Australia. Rather than taking a direct approach to restricting access to pension entitlements, as is done using the means test in Australia, both countries make use of the tax system to recoup the cost of delivering the basic public pension.

In Canada, the cost of delivering the OAS is recouped using a pension recovery tax set at 15% rather than through means testing. Currently, the maximum payment is CAN\$7,362 regardless of marital status. The recovery tax applies to any income received above the threshold, which is currently CAN\$75,910 per year (2018). Above CAN\$123,058 the cost of the pension is fully recovered.

In New Zealand, NZ Superannuation (NZ Super) is fully taxable. NZ Super provides a maximum payment of NZL\$24,721.84 per year for a single person living alone but only receives a pension of NZL\$21,379.80 per year, because with no specific seniors tax concession, retirees pay tax of 10.5% up to \$14,000 and 17.5% above



\$14,000. In contrast with Australia's means testing arrangements, there are no penalties for continuing to work. This provides those with limited savings with an incentive to remain in the workforce, which is evident in the significantly higher labour force participation rates among older people in New Zealand.

There are many other examples of differences in the retirement income systems of other countries that could be explored. The degree to which each system is effective in providing fairness and sustainability is a question that requires further in-depth comparison by the Panel.

Common elements of pension systems in the OECD

The Organisation for Economic Co-operation and Development (OECD) provides a useful analysis of the different pension systems across the OECD in its regular Pensions at a Glance report.¹ We have provided a summary of the key elements as context for discussion.

Eligibility

A first important defining factor is eligibility. Eligibility for a public pension across the OECD is determined either by residence or with respect to the amount of contributions made to a scheme throughout one's lifetime.

Residence-based schemes

Eligibility for the Australian pension is determined primarily by residence. For those that meet the residence requirements, the pension delivers a flat rate regardless of an individual's previous salary (those that do not meet the full residence requirements can be eligible for a partial pension).

Residence-based public pension schemes also operate in Canada, Chile, Denmark, Finland, Germany, Greece, Iceland, Israel, Netherlands, New Zealand, Norway, and Sweden.

Interestingly, most of these are among the highest ranked retirement income systems, according to the 2019 Melbourne Mercer Global Pension Index.²

Residence-based public pension schemes can be broken down further into basic or targeted.

- Four OECD countries — Greece, Israel, Netherlands and New Zealand — provide a residence-based basic pension which is not means tested. This means the amount received has no bearing on income or wealth. In contrast, Australia, Chile, Finland, Germany, Norway and Sweden have targeted residence-based pension schemes with some form of means testing to determine the level of pension a person can get, based on a retiree's income or the level assets held.
- Five countries, including Canada, Denmark, Iceland, Norway and Sweden deliver both a basic and a targeted scheme. In these systems, everyone gets a basic pension if they meet the residence requirements. There is a separate means tested pension that sits on top of this for those who have limited income.

Contribution-based schemes

In contrast, contribution-based pension schemes determine retirement income based on earnings. Most OECD countries operate pension schemes that are essentially contributory social insurance systems.³

Earnings-based contribution schemes, can exacerbate inherent socio-economic inequalities in retirement because those unable to earn enough income will not have sufficient savings, especially when there is no universal public pension available to provide a safety net in retirement or if a public pension is inadequate as a safety net.

¹ OECD (2019), *Pensions at a Glance 2019: OECD and G20 Indicators*, OECD Publishing, Paris, <<https://doi.org/10.1787/b6d3dcfc-en>>

² <https://www.mercer.com.au/our-thinking/mmgpi.html>

³ <https://agedcare.royalcommission.gov.au/publications/Documents/consultation-paper-1.pdf>

All OECD countries, except New Zealand, have some type of contribution-based scheme. This is used either instead of, or as a complement to, a residence-based scheme.

A significant trend in many countries has been moves to switch from defined benefit arrangements to defined contribution programs. This has placed more responsibility on the individual in the management of retirement income.

Most OECD countries rely on contributory schemes tied to employment to fund their pension systems.

- Austria, Belgium, Czech Republic, Estonia, France, Germany, Greece, Ireland, Japan, Korea, Lithuania, Luxembourg, Portugal, Slovak Republic, Spain, Switzerland, Turkey and the United States all have contributory schemes that are mandatory and provide a defined benefit.
- Australia, Chile, Denmark, Estonia, Israel, Italy, Latvia Mexico, Norway, Poland and Sweden have some form of mandatory defined contribution scheme.
- Australia is one of only eight OECD countries with a defined contribution scheme that is privately funded. Countries with a similar scheme include Chile, Denmark, Estonia, Israel, Mexico, Norway and Sweden.

Does Australia have a good retirement income system?

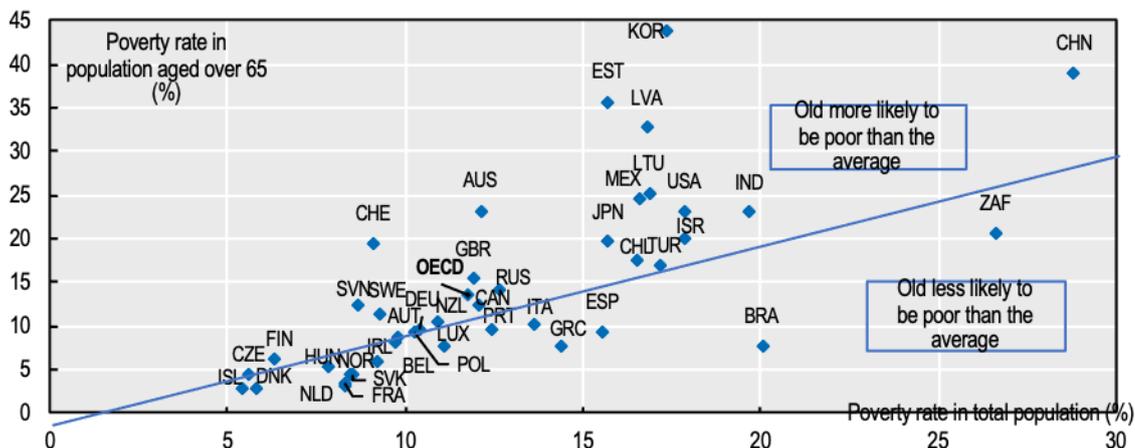
The Australian retirement system, with its combination of a residence-based public pension and compulsory private savings is one that should be protected and enhanced.

The Australian retirement income system provides a basic pension as a safety net that is available to all regardless of earnings capacity. The Age Pension for a **couple** is 43% of the average wage for an adult. The Age Pension for a single is 28% of the average wage for an adult.

Australia's Superannuation Guarantee provides a complement to the public pension to increase retirement income and replace it for those with adequate means encouraging self-reliance. Its compulsory nature ensures that private contributions are made to individual savings which increases retirement income and offsets the cost of delivering the Age Pension. Unlike many other contributory schemes in the OECD, payments are made to individual superannuation accounts rather than into public pension plans.

However, it is not without its faults. Poverty rates in Australia are high compared to other OECD countries. Almost one-quarter of those aged over 65 in Australia were in poverty, compared with only 12.2% in Canada, 10% in New Zealand and 3% in Denmark.

Figure 1: Income poverty rates by age: older vs. total population, 2016 or latest available year

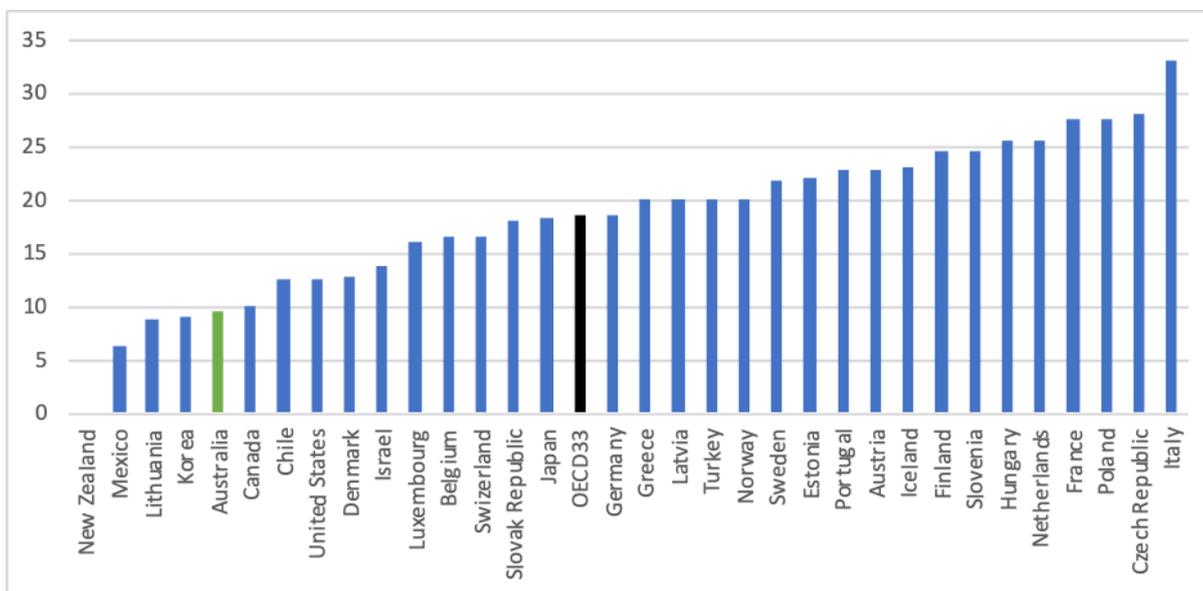


Source: OECD 2019

Retirement income replacement rates are clearly a problem. Average earners have an income replacement rate of 41.0% compared to 58.6% in OECD.

- *Compulsory superannuation is still immature.* Unlike Canada which was one of the first countries in the world to implement a comprehensive retirement income system, Australia's system has not had sufficient time to fully develop since the introduction of compulsory superannuation.
- *Compulsory superannuation contribution rates are low by comparison to the OECD.* Australia's mandatory contribution rate is the fourth lowest of any OECD country relative to average earnings. Australia's overall mandatory public pension and private superannuation contributions of 9.5%. Countries, such as the Netherlands and Denmark, have higher compulsory contribution levels, a minimum of 15% and 12%, respectively. The OECD average was 18.4%.⁴

Figure 2: Effective rate on average earnings for mandatory (private and public) pension contributions



Source: [OECD 2019](#)⁵

- *Coverage of compulsory superannuation is limited.* Exemptions from the Superannuation Guarantee combined with low-incomes and broken work patterns undermines the capacity of compulsory superannuation as an adjunct to the public pension for some retirees.

While some politicians claim that compulsory superannuation should not be increased further because it will damage the economy, Australia's compulsory superannuation rate of 9.5% is lower than most other countries.

This is indicated in the graph above, which shows on average earnings for mandatory (private and public) pension contributions.

Despite the doom and gloom predictions about the ageing population, Australia has reason to be more hopeful.

- Australia is ageing much more slowly than the OECD average.⁶

⁴ Pensions at a Glance 2019

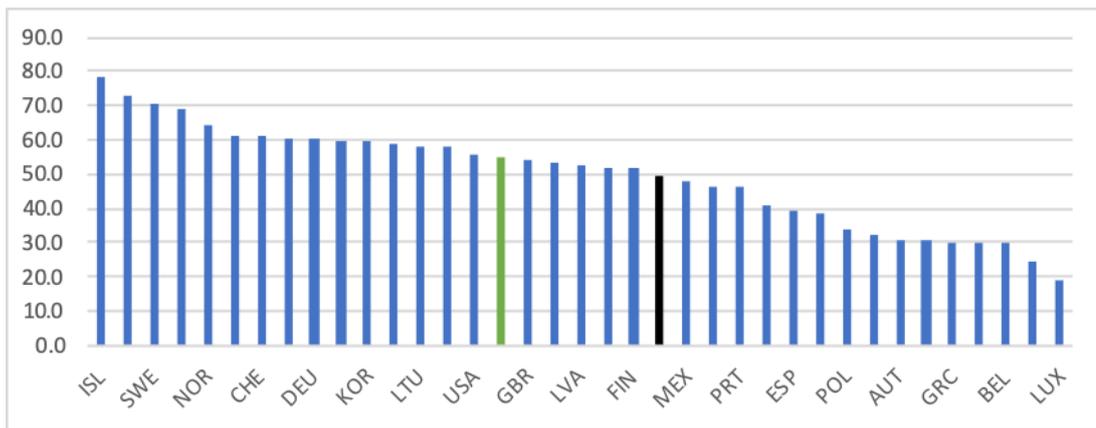
⁵ Pensions at a Glance 2019

⁶ <https://www.oecd.org/australia/PAG2017-AUS.pdf>



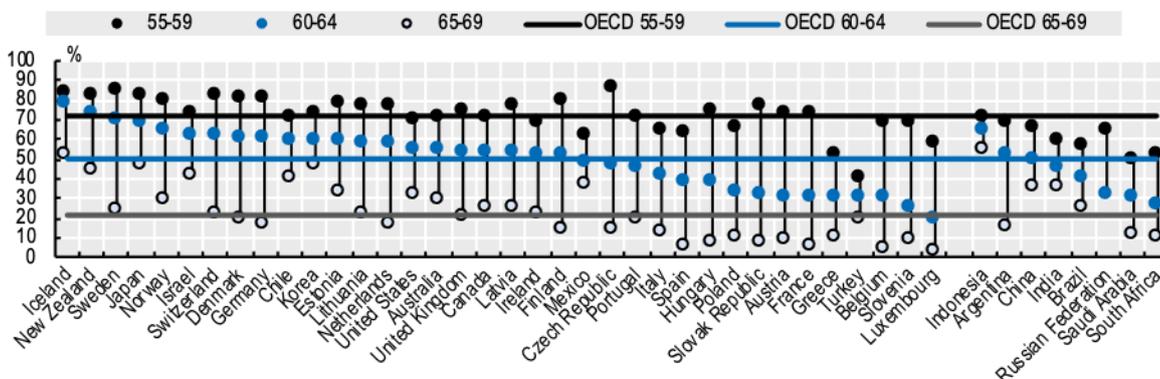
- The old age dependency ratio is lower than OECD average and is projected to be much lower than the OECD average by 2050. Mainly due to immigration of young adults.
- Australia has limited government involvement in pensions and a slower ageing process – this translates into low public spending on pensions now and into the future.
- The public pension has a strong means testing regime with 42% of pension recipients having their pension entitlement reduced by means testing.
- Australia is one of ten OECD countries that are projected to spend less on pensions as a proportion of GDP by 2050.⁷ In comparison, the cost of the pension in New Zealand is expected to increase as a proportion of GDP from 4.8% in 2015 to 6.3% in 2030 and 7.9% in 2060⁸, whereas the cost of the pension in Australia is expected to fall from 4% of GDP in 2015-16 to only 3.7% of GDP in 2060. Projections are subject to a range of different assumptions.
- Workforce participation among older Australians is above the OECD average. While workforce participation among 55 – 59 and 60 – 64 is not high, workforce participation among people aged 65-69 is tenth highest at 28.5%.

Figure 3: Employment rates of workers aged 60-64 in 2018



Source: OECD 2019

Figure 4: Employment rates of workers aged 55-59, 60-64 and 65-69 in 2018



Source: [OECD 2019](#)

⁷ Pensions at a Glance 2019 Table 8.5

⁸ <https://treasury.govt.nz/sites/default/files/2016-11/ltfs-16-htm.pdf>



Purpose of the system and role of the pillars

Q2 Is the objective of the Australian retirement income system well understood within the community? What evidence is there to support this?

Q3 In what areas of the retirement income system is there a need to improve understanding of its operation?

Q4 What are the respective roles of the Government, the private sector, and individuals in enabling older Australians to achieve adequate retirement incomes?

The Alliance is of the view that the purpose of the Australian retirement system is not well understood within the community. There has been considerable research noting that Australians suffer from low levels of financial literacy.⁹ The OECD International Network on Financial Education defines financial literacy as ‘a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve financial wellbeing’. Financial literacy is therefore an essential component in being able to understand the interaction of the three pillars of the retirement system.

However, the *Australian Financial Attitudes and Behaviour Tracker, Wave 6, 2018* shows that only 35% of Australians know the value of their superannuation, only 40% understand the concept of diversification and only about a third of investors understand the concept of ‘the higher the return, the higher the risk’.¹⁰ According to the Productivity Commission, Australians are even less financially literate when it comes to superannuation and retirement planning than other financial matters.¹¹

The lack of financial literacy in the population is exacerbated by the fact the employers are responsible for administering superannuation contributions and, as a result, individuals have little engagement with their retirement savings. The evidence for this is the \$17.5 billion of unclaimed superannuation.¹²

A further problem is that most Australians do not focus on retirement until they near retirement age. That is, younger members of the population, particularly those under the age of 50, take little interest in their superannuation or follow legislative changes to superannuation and Age Pension policy to assess the impact of those changes on their retirement savings. They may commence voluntary savings, but those savings could be to fund life choices such as a deposit for a home or travel rather than for retirement.

Compounding this disengagement is the lack of a stated purpose of superannuation in the legislation. On 9 November 2016, the government introduced the Superannuation (Objective) Bill 2016, which set out a clear objective for superannuation: ‘to provide income in retirement to substitute or supplement the Age Pension’. However, the Bill failed to pass in parliament. The constant amendments to policy settings in relation to superannuation in particular also create confusion.

The policies governing the three pillars and their interaction are so complex that specialists and experts are required to steer most Australians through an understanding of the regulatory framework. This is a major disincentive to enabling the community to understand the retirement income system. Individuals need certainty

⁹ The Household, Income and Labour Dynamics in Australia (HILDA) Survey tells the stories of the same group of Australians over the course of their lives. Starting in 2001, the survey now tracks more than 17,500 people in 9,500 households. A series of questions assessing basic competencies in financial concepts such as inflation, portfolio diversification and risk versus return, developed by Annamaria Lusardi and Olivia Mitchell, was put to the 17,500 HILDA respondents in 2016. Only half of the men surveyed answered all five questions correctly (49.9%) and only 35.4% of women answered the questions correctly.

¹⁰ <https://financialcapability.gov.au>

¹¹ *Superannuation: Assessing Efficiency and Competitiveness, Productivity Commission Inquiry Report*, Productivity Commission, No. 91, 21 December 2018, p 254. The report cites multiple research showing poor levels of financial literacy levels in Australia.

¹² Data released by the ATO for 2017–2018 revealed the total amount of lost and unclaimed superannuation was \$17.5 billion.



in relation to policy settings concerning the three pillars in order for them to become more informed as to how those pillars interact. Such certainty requires not only stability of policy settings over a number of years, but also less complex policies governing the interaction of the three pillars.

The Alliance is strongly of the view that there is a need to improve the community's understanding of the individual pillars and their interaction. The government and the private sector have roles to play in enabling older Australians to achieve adequate retirement incomes.

- Superannuation funds should develop education programs and run these throughout the year, rather than relying on the half-yearly or annual superannuation statement to inform members. Education can be provided in multiple media (for example, text, video, online quizzes etc).
- A range of not-for-profit member-based associations have traditionally played a useful community role in educating and informing their members in relation to the three pillars, including legislative and regulatory changes.
- Financial advisers also play a role in educating their clients about superannuation in particular, but also other pillars of the retirement income system.
- The government has a role to play in putting in place policy settings in relation to the three pillars and not amending them for a number of years, which would aid considerably in developing an understanding of a complex system. Policy settings need to take account of the need for long-term planning in order to have confidence in the retirement income system and constant legislative reform, particularly in relation to superannuation, erodes this confidence and makes it extremely challenging for the community to understand the system.

Importantly, there is a need for education from multiple providers. Education on the retirement income system should not rest with only one provider.

Individuals have a role to play by voluntarily saving for retirement, both through voluntary contributions to superannuation and other forms of saving. However, the capacity to do this depends on stable policy settings, less complex policies and policies that provide incentives that do not distort the system.

Q5 The Panel has been asked to identify the role of each of the pillars in the retirement income system. In considering this question, what should each pillar seek to deliver and for whom?

Q6 What are the trade-offs between the pillars and how should the appropriate balance between the role of each pillar in the system be determined?

The Alliance believes that it is common to view the Age Pension's role as a safety net, to assist people to maintain a standard of living if their income in retirement is insufficient to provide for this.

Currently the policy view is that the Age Pension is targeted at the neediest group of elderly in the community by the use of means tests. Unlike other countries which have a universal pension based on residency or employment history, in Australia, the Age Pension is only paid to those who do not have the personal resources to pay for their own retirement. People with more resources have their Age Pension progressively withdrawn. The pension is withdrawn completely when their assets or income exceed certain limits. The Age Pension assumes that those who can provide for themselves should do so, as the Age Pension is designed as a safety net to prevent extreme poverty and destitution in old age. For that reason, it is sometimes regarded as a welfare payment, not a right of citizenship.

However, the Alliance is of the view that the role of the Age Pension has become the bedrock of the retirement system. This is, of course, a broader concept than a safety net. This is because the Age Pension has evolved since its introduction in 1908. The eligibility age for the Age Pension was set at 65 for males and 60 for females more



than 100 years ago, which meant over the course of the twentieth century that a significant majority of retirees received a full Age Pension as life expectancy increased. The Age Pension has therefore evolved from a safety net to a foundation of the retirement system. As noted in the research paper, *The Age Pension in the 21st Century*:¹³

The average duration for a male has grown by nine years since the benefit was established – and much of this improved longevity has occurred in the last 40 years. ... In addition, the numbers reaching the retirement age have grown significantly. When the benefit was introduced, only 49% of men were expected to reach age 65. Today, it is expected that 90% of the male population born today will reach this age. For women, 56% were expected to reach age 65 at birth, compared to 94% today.

At present, only 30% of the population of an age over 65 years is independent of government support. The remaining 70% is comprised of 42% on the full Age Pension and 28% on a part Age Pension. Recent research¹⁴ shows that over the next twenty years only 30% of Australians will rely on the full Age Pension, with another 30% relying on a part Age Pension and 40% being fully self-reliant. This means that 60% of Australians will be dependent on some form of government-funded pension over the next two decades. This confirms that the Age Pension is a foundation of the retirement income system rather than a safety net. Our view is supported by the recent Treasury paper, *The superannuation system in aggregate*, where the chart 'Population ageing and Age Pension recipients' on page 4 shows that the Age Pension expenditure remains stable, even as the superannuation system matures and the amount of drawdown triples.

In relation to the Age Pension, there are different means tests for homeowners and renters and different means tests for couples and singles.¹⁵ The effect of the means tests is to create three groups of retirees. Group A receive the full pension because their personal resources are below the means tested thresholds, which are updated annually. Group B receive a part-pension. It is reduced because their personal resources are above the means tested threshold but below the upper limits. Group C receive no pension at all. This group is self-funded, independent of government support.

As the Age Pension is paid to Australian residents over the age of 66 (soon to be 67) it represents a significant cost to the taxpayer. Increased life expectancies, the number of Australians retiring in the next decades and smaller families, have created demographic trends that need consideration. It is now not uncommon for there to be two generations of the one family on the Age Pension. According to the Treasurer, the number of people eligible for the Age Pension will rise from 3.7 million to 8.7 million by 2060. At the same time, in 25 years, there will be 2.7 people of working age for every person aged 65 and over. This compares with 4.5 people in 2014-15 and 7.3 people four decades ago.¹⁶

The Alliance is of the view that it is in the taxpayer's interest to encourage all retirees to become more self-reliant by accumulating more of their own resources to pay for their own retirement. The burden on a declining taxpayer base would be significantly eased if all retirees could be encouraged or compelled to save more for their retirement so that more full pensioners could be part-pensioners and more part-pensioners could be self-funded. In turn, this supports the Age Pension being viewed as a safety net rather than the foundation of the retirement income system. However, the Alliance is of the view that the incentives built into the current system encourages Australians to view the Age Pension as an entitlement, further embedding the Age Pension as the foundation of the system, which is counterproductive to minimising costs to the government. We comment further on incentives in our response to Q22 and Q23.

¹³ *The Age Pension in the 21st Century*, Paper prepared by Michael Rice for the Financial Services Forum 2018, p 19

¹⁴ Michael Rice and Nathan Bonarius, *What is the right level of superannuation guarantee?*, Rice Warner, 3-4 June 2019, p 13

¹⁵ www.humanservices.gov.au/individuals/services/centrelink/age-pension

¹⁶ The Hon Josh Frydenberg MP, 'Superannuation review enables us to plan for changing demographics', *The Australian*, 28 September 2019



To support this policy, there is a need to encourage more voluntary contributions to superannuation, which requires educating the community of the benefits. Both the government and superannuation funds have a role to play here. There is little encouragement to have individuals make concessional contributions voluntarily as they are seen as a cost to government revenue. This view ignores the cost of the Age Pension, which is an annuity payment. This could be reduced by shifting the policy view to encouraging Australians to make voluntary contributions in order that they become self-funded in retirement and shifting the policy view to seeing tax concessions in superannuation as an investment rather than a liability. As noted earlier, Australians frequently are not in a position to make voluntary contributions until their 50s, when the costs of mortgages and school fees reduce, yet over the past decade the amounts that can be contributed have been significantly reduced.

In terms of superannuation, as the gig economy and casualisation of the workforce expands, more Australians will be excluded from the compulsory scheme. When low levels of financial literacy are taken into account, it is likely that these Australians will not establish superannuation funds and make voluntary contributions. This in turn will exacerbate the dependency on the Age Pension. The pillar of superannuation works for those in permanent employment, but not for those who are self-employed or who experience interrupted work.

In relation to voluntary savings, a self-funded retirement income requires long-term planning and stability. Policy settings need to remain stable over a number of years in order not to jeopardise retirees' savings programs by introducing piecemeal approaches to superannuation and tax systems. When people have been making long-term plans within those rules over many years, ad hoc policy changes erode the trust of Australians in the system and do not meet the need for a sustainable retirement savings plan. Retirement savings in superannuation are unique in that they constitute fixed investments made with a time horizon of 40 or 50 years. Australians planning their retirement need to know that governments will not amend the policy settings in relation to superannuation, such as the tax treatment of this long-term asset, unhindered and as if it is consequence-free. Fairness encompasses the feeling that a citizenry acting in good faith will be reciprocated with good faith actions by the state.

Self-funded retirement also requires incentives that do not distort the system.

The changing Australian landscape

Q7 Demographic, labour market, and home ownership trends affect the operation of the retirement income system now and into the future. What are the main impacts of these trends? To what extent is the system responsive to these trends? Are there additional trends which the Review should consider when assessing how the system is performing and will perform in the future?

There is an increase in the number of older Australians who become unemployed in their 50s and 60s. People aged over 50 face a complex range of challenges in returning to work. These include poor health and long-term conditions, caring responsibilities, a lack of suitable and accessible employment opportunities and perceived age bias, such as recruitment processes favouring younger candidates, or being passed over for training opportunities. One in five Australians aged 55 years or over claim that age is a major barrier to finding a job or getting more hours of paid work.¹⁷

This combined with an increase in the age at which Australians can access the Age Pension has seen older individuals as the fastest-growing cohort on Newstart. At present there are 180,000 Australians over 55 on Newstart.

¹⁷ Australian Bureau of Statistics, 4102.0-Australian Social Trends, Sep 2010: Older People and the Labour Market (September 2010)



Furthermore, while the unemployment figures look historically good at 5.3%, given that any individual working one hour or more per fortnight is not classified as unemployed, there is a segment of older Australians who are working insufficient hours to generate an adequate income who are not included in the official figures. Those working insufficient hours are not in a position to voluntarily save and their superannuation contributions will also be insufficient to cater for a retirement income. They may also be unable to pay off a mortgage or may be renting.

The Age Pension system is predicated on home ownership. Those entering retirement who own their home without a mortgage are generally likely to have a comfortable retirement on the Age Pension.¹⁸ Yet home ownership rates are declining.

- Outright home ownership has declined from 42.8% of households in 1995–96 to 30.4% of households in 2015–16.¹⁹
- Between 1971 and 2016, home ownership for households of those aged 25–34 years declined from 57.0% to 44.6%.²⁰
- In the 35–44 years age range, home ownership rates fell from 71.4% to 62.2%.²¹
- Current trends are expected to translate into a 10 percentage point fall in home-ownership rates for over-65s by 2046.²²
- According to data from the Australian Bureau of Statistics (ABS) Survey of Income and Housing, home-ownership rates among Australians aged 55–64 years dropped from 86% to 81% between 2001 and 2016.

There is also evidence that more Australians are entering retirement with a mortgage. For those households nearing or in retirement (those aged 55 years and over), ownership without a mortgage has fallen from 77.0% in 1995–96 to 62.0% in 2015–16.²³

In 2015–16, just over one-quarter of Australian households were renting in the private rental sector. Close to 15% of older Australian households are renters, and this group is over-represented among both public housing tenants and long-term renters in the private market.²⁴ Research indicates that ‘The unmet demand for public housing from private renters aged 55 years and over is expected to climb from roughly 200,000 households in 2016 to

¹⁸ John Daley and Brendan Coates, *Housing affordability: Re-imagining the Australian Dream*, p 73, ‘Retirees who have paid off the mortgage are insulated from rising housing costs, a substantial safety net if they exhaust their retirement savings. Home-ownership is particularly attractive for retirees because in effect only the first \$203,000 of the value of the home is included in the Age Pension assets test.’

¹⁹ Alicia Hall, Statistics and Mapping, and Dr Matthew Thomas, Social Policy, *Declining home ownership rates in Australia*, Parliament of Australia, based on BS Census data, 1971 to 2016

²⁰ Ibid

²¹ Ibid

²² John Daley and Brendan Coates, *Housing affordability: Re-imagining the Australian Dream*, p 70

²³ Alicia Hall, Statistics and Mapping, and Dr Matthew Thomas, Social Policy, *Declining home ownership rates in Australia*, Social Policy, Parliament of Australia, based on BS Census data, 1971 to 2016. ‘Between 1987 and 2015, the real mortgage debt of older mortgagors aged 55+ blew out by 600%. Real house price and income growth lagged behind, tripling and doubling respectively over the period.’

²⁴ Ibid —‘Yates and Bradbury, in a Luxembourg Wealth Study working paper, described home ownership as the fourth pillar of social insurance in Australia, with the other pillars being the Age Pension, mandatory private superannuation saving, and voluntary saving. They have done so on the grounds that high levels of owner occupation and the lower housing expenditure needs of outright owners have allowed housing wealth to be treated as a ‘cornerstone’ of retirement income in Australia, and for the Age Pension to be set at a low rate. With declining levels of home ownership, Yates and Bradbury suggest that this fourth pillar of social insurance is ‘crumbling’. Older households that were not able to access or sustain home ownership when they were younger are more likely to face high housing costs in their retirement than similar households who are homeowners. As a result, these households are more likely to have inadequate levels of income to meet their non-housing needs. Based on modelling for the Australian Housing and Urban Research Institute conducted by Yates and others, projected declines in home ownership among younger Australians will, over the next quarter century or so, result in: “[a] disproportionate increase in the number of older households with relatively high levels of housing costs because more will be renting and/or more will still be paying off their mortgage (because of delayed entry into the housing market).”... While older tenants in social housing benefit from lower rents and secure tenure, older households in the private rental market have higher housing costs as a proportion of income than any other group in the population. As the Productivity Commission notes, they are also likely to be disproportionately affected by the insecurity of tenure inherent in private rental because this form of tenure is a necessity rather than an attractive choice for them.’



440,000 households in 2031, a 78% increase. Those 75 years and older are anticipated to push their share of unmet demand up from 27.5% in 2016 to 34.2% in 2031.²⁵ The National Rental Affordability Index²⁶ shows a severely unaffordable private rental market for single aged pensioners and Newstart recipients.

Based on current trends, an increasing number of Australians will enter retirement not owning a home or with a significant debt attached to the home. Given that the Age Pension system is predicated on assumptions of debt-free home ownership, it is clear that support provided to renters is insufficient, leaving more older Australians disadvantaged. The system needs to adapt to current and future trends in demographics, the labour market and home ownership.

Principles for assessing the system

Q8 Are the principles proposed by the Panel (adequacy, equity, sustainability, and cohesion) appropriate benchmarks for assessing the outcomes the retirement income system is delivering for Australians now and in the future? Are there other principles that should be included?

Q9 How does the system balance each of the principles and the trade-offs between principles (e.g. sustainability and adequacy) under current settings? What is the evidence to support whether the current balance is appropriate?

An important objective for government is to encourage older Australians to save for retirement and to support the majority of retirees who take pride in being either fully or partly self-funded in retirement. This majority includes many self-funded retirees and almost half of the current 1.1 million SMSF trustees who are either in the pension phase, or who will move into that phase shortly.

The principles adopted by the Alliance for a Fairer Retirement System when it was founded in May 2018 were: adequacy, sustainability, certainty and fairness.

Adequacy measures the degree to which the retirement system enables people to achieve a sufficient standard of living in retirement relative either to the standard they enjoyed while working, or as compared to an objective budget standard for retirees. No single retirement income target will be appropriate for all groups.

Sustainability requires that government expenditure on the retirement income system through the Age Pension and superannuation tax concessions must be affordable over the long term. Changes to retirement income policy must contribute to fiscal sustainability by incentivising self-sufficiency. Placing any disincentives on saving for retirement would threaten the sustainability of the system.

Older Australians require certainty to plan for retirement with confidence and they should have sufficient time to alter their arrangements in response to proposed policy changes. Short-term thinking completely contravenes the need for policy certainty in retirement planning and creates undue anxiety.

Fairness (or equity) requires that the retirement system treats people in the same circumstances equally.

The Alliance has subsequently agreed that it supports the definition of cohesion in the Consultation Paper.

²⁵ Rachel Ong, Gavin Wood, Melek Cigdem and Silvia Salazar, *Mortgage stress and precarious home ownership: implications for older Australians*, Australian Housing and Urban Research Institute, August 2019

²⁶ <https://www.sgsep.com.au/projects/rental-affordability-index>



Accordingly, the Alliance supports the four principles proposed by the Panel: adequacy; equity; sustainability; and cohesion.

Adequacy

Q10 What should the Panel consider when assessing the adequacy of the retirement income system?

Q11 What measures should the Panel use to assess whether the retirement income system allows Australians to achieve an adequate retirement income? Should the system be measured against whether it delivers a minimum income level in retirement; reflects a proportion of pre-retirement income (and if so, what period of pre-retirement income); or matches a certain level of expenses?

The Alliance views adequacy as the measure of the degree to which the retirement system enables people to achieve a sufficient standard of living in retirement relative either to the standard they enjoyed while working, or as compared to an objective budget standard for retirees. No single retirement income target will be appropriate for all cohorts and for those receiving retirement income above the Age Pension level, the major driver will be how much of lifetime earnings has been deferred via a combination of mandatory and voluntary saving to provide higher retirement incomes.

The Panel should consider how the distribution of retirement income for various cohorts compares to similar cohorts during appropriate periods prior to retirement and the contribution to those retirement incomes from each of the pillars. Cohorts could include those split by income distribution and other variables such as gender, home ownership, whether single or couple status, geographical location and other relevant variables.

Compulsory superannuation is based on contributions based on an individual's earnings. There is evidence that most of those earning high incomes during their working lives will have sufficient income to fund a comfortable retirement, while many of those on lower incomes during their working lives or who have experienced interrupted working lives struggle to generate sufficient superannuation to fund a comfortable retirement and will primarily rely on the Age Pension. As a relative measure, superannuation produces uneven levels of retirement incomes that reflects uneven levels of income during working lives.

We encourage the Panel to refer to retirement income spending research, such as from Milliman.²⁷ They found that people spend less as they age. However, this finding is not incorporated into the design of the retirement income system nor is this well understood by most Australians.

The Age Pension is an absolute measure. The Alliance is of the view that it should not be based on a proportion of income earned during a working life and that the retirement system is not the place to address inequity in earnings.

More than one in four older Australians live in poverty.²⁸ People aged 65 years and over make up 7% of the homeless population.²⁹ Department of Social Services data reveals that more people aged 55-64 are on Newstart than those aged 25-34 and they are on the payment for much longer. They are also spending their retirement savings before they retire because they can't live on Newstart without experiencing financial hardship.

²⁷ Jeff Gebler, *Retirement Expectations and Spending Profiles*, Milliman, 27 April 2018, <https://au.milliman.com/insight/Analysis-Retirees-spending-falls-faster-than-expected-into-old-age>

²⁸ Australian Human Rights Commission, *Age discrimination: Exposing the hidden barrier for mature age workers* (2010), p 17

²⁹ Department of Social Services, Australian Government, *The Road Home: The Australian Government White Paper on Homelessness* (2008), p 5



Older single women have emerged as the fastest growing demographic of people experiencing homelessness and housing stress in Australia today. According to the 2016 Census, there has been a 31% increase in the number of older women experiencing homelessness from the 2011 figures.³⁰ This has been accompanied by a 97% increase over ten years of the number of older women renting in the private rental market at a time of increasing unaffordability and instability in that market.³¹ This has been linked to a number of compounding and systemic factors. Most women in this older age group today did not benefit from compulsory superannuation at the beginning of their working lives, they were more likely to have been paid at a lower rate than their male counterparts and were likely to have taken time out of the paid workforce to have children and fulfil caring roles.

The Age Pension has evolved from a safety net to a foundation of the retirement income system (see our earlier comments on Q5, page 9) while there has been a decline in home ownership, changing labour trends and increases both in divorce and those entering retirement as singles rather than as couples. As such, new pressures are being placed on the system that it is not designed to deal with. Changes in the design of the system are required to deal with these pressures.

Q12 What evidence is available to assess whether retirees have an adequate level of income?

The Association of Superannuation Funds of Australia (ASFA) Retirement Standard³² benchmarks the annual budget needed by Australians to fund either a comfortable or modest standard of living or live on the Age Pension in retirement. This Standard provides benchmarks for new retirees, both singles and couples and is updated quarterly to reflect changes to the Consumer Price Index (CPI). There is also a Retirement Standard for older retirees, designed to provide a picture of how spending requirements change as people enter their late 80s and early 90s. It too provides benchmarks for singles and couples and is updated quarterly to reflect inflation. Both budgets assume that the retirees own their own home outright and are relatively healthy.

The Standard also benchmarks the superannuation balances that are required to achieve a comfortable or modest retirement for singles and couples. The lump sums required for a comfortable retirement assume that the retirees will draw down all their capital and receive a part Age Pension.

National Seniors Australia in conjunction with Challenger issued a report in 2019³³ documenting the consumer experience of different comfort levels in retirement for those with private assets and to understand how different financial situations in retirement affect a retiree's sense of comfort. The individual sense of comfort underpins the perception of adequacy — the report notes that some of the themes that emerged were that

- Financial comfort is relative and not defined by a single asset value.
- Living within means and accommodating changed circumstances are required to achieve comfort levels.
- Having 'enough to last' and preserving capital are strong focal points for achieving comfort.

The key findings of the report were:³⁴

- Approximately one-third of respondents regretted not putting aside more money for their retirement and another third said that saving more was not an option for them.
- Over half of respondents worried either frequently or occasionally about outliving their savings and investments and a further 13% used to worry but no longer do so.
- Worrying about outliving savings and investments was more likely for women, for those in poorer health and with less savings.

³⁰ National Older Women's Housing and Homelessness Working Group, *Retiring into poverty, A national plan for change: increasing housing security for older women*, August 2018

³¹ Petersen and Parsell 2014: 6; ABS 2016 census data, customised table TableBuilder

³² <https://www.superannuation.asn.au/resources/retirement-standard>

³³ National Seniors, McCallum, J., Hosking, D. & Rahn, A., *Feeling financially comfortable? What retirees say*, 2019, Brisbane

³⁴ *Ibid*, p 4



- A disconnect was evident in some respondents' low tolerance of loss but continued investment of savings in the market.

The question of saving for retirement needs to take account of the increase in the number of older Australians who become unemployed in their 50s and 60s (see response to Q7 above). Australians in this age group who are on Newstart are often forced to eat into their savings, given the challenge of finding employment and sustaining a reasonable standard of living on Newstart. As the Age Pension is paid to Australian residents over the age of 66 (soon to be 67), it compounds the reduction in savings for this group.

Equity

Q13 What should the Panel consider when assessing the equity of the retirement income system?

Q14 What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement? What evidence is available to assess whether the current settings of the retirement income system support fair outcomes in retirement for individuals with different characteristics and/or in different circumstances (e.g. women, renters, etc.)?

The Paper notes that equity considers the systemic issues that affect whether the outcomes, subject to an individual's circumstances and life experience, are fair and adequate, including whether individuals in similar circumstances achieve similar outcomes in retirement and whether public support is appropriately targeted to those who need it most. The Alliance is of the view that fairness requires that the retirement system treats people in the same circumstances equally.

A range of inequities exist in the retirement income system at present. One example is that superannuation is tied to paid employment, so those Australians who are out of the workforce, or have interrupted employment status, or those who are self-employed where contribution to superannuation is not mandatory, experience very different outcomes from those in ongoing paid employment.

There is one particular inequity regarding the indexation of the Centrelink Age Pension against the indexation of two old Commonwealth superannuation pension schemes. The two schemes are the CSS and the PSS schemes, which were closed in 1990 and 2005 respectively. The Age Pension is indexed by whichever is the higher of the CPI and the PBLCI (Pensioner Beneficiary and Living Cost Index), which is then benchmarked to 27.7% of the MTAW (Male Total Average Weekly Earnings). Despite efforts over the past 15 years to amend this benchmark, the CSS and PSS schemes continue to be indexed by the CPI alone.

The difference between the two methods of indexation does vary from time to time and is mainly dependent on any increases in the average wages paid to the Australian workforce. Recently there has not been a large difference between the two methods but in past years it has been as high as 3% (calendar year 2013) — the average over the past seven years is 0.66% (CPI lower).

In the past 15 – 20 years several other organisations have had their method of indexation changed to equal the method used for the Age Pension: the Reserve Bank; the TPI organisation; the DFRB; and the DFRDB (both ex-military schemes), but the CSS and PSS schemes continue to be ignored.

Several state superannuation schemes are in the same category as the CSS and PSS schemes regarding unfair methods of indexation and each state government has clearly stated that they will not change their procedures until the Commonwealth does so.



Age will also determine different outcomes. Superannuation pension funds pay no tax on investment income. Retirees who make withdrawals from such a fund also pay no tax after the age of 60, but older Australians who retired before the introduction of the compulsory scheme pay tax on their investment income. For example, older Australians who did not benefit from the introduction of compulsory superannuation frequently invested in property as a form of voluntary savings, and income from property is treated differently than income from superannuation in that it is taxed. Should income from savings outside superannuation be taxed differently from superannuation? Of course, superannuation cannot be accessed for decades whereas other forms of savings can be sold at any time.

The current system in Australia is also not geared adequately to deal with those with interrupted working lives (for example, women, who take time out to rear children) or those in the casualised workforce.

Given that the aim is to encourage as many Australians as possible to be self-funded in retirement, policy should aim to support them to reach the \$1.6m cap without prescribing how that is to be achieved. Currently the Age Pension is seen as a fixed cost and tax concessions applicable to superannuation are also seen as a cost to government.

Furthermore, the age at when individuals are more likely to be able to make voluntary contributions to their superannuation is from 50 onwards, when the financial pressures of mortgages and child-rearing start to ease at a point when earnings frequently increase. The amount of money that individuals can voluntarily contribute to superannuation has been decreased over some years — it is now \$25k per annum. This raises questions as to whether it is equitable to reduce the capacity of workers to 'catch up' on their superannuation if they haven't made voluntary contributions throughout their working life.

Q15 Is there evidence the system encourages and supports older Australians who wish to remain in the workforce past retirement age?

Older Australians can still receive a certain amount of income and receive an Age Pension. This income can be derived from investments and property rental or as a salary from employment, as well as several other means.

The Work Bonus is intended to be an incentive for pensioners over the Age Pension age to work by allowing them to keep more of their pension when they have income from working. The Work Bonus operates in addition to the pension income test free area. This means the first \$300 per fortnight of an individual's earnings will not count as income under the income test. This doubles for couples, where both are working – both parties may have the first \$300 per fortnight of their own employment income not counted.

However, under the income test, the Age Pension is reduced when the pensioner's income exceeds certain limits. For a single person the limit is \$174 per fortnight or \$4,524pa (plus \$300 Work Bonus per fortnight or \$7,800 per annum). For a couple the limit is \$308 per fortnight or \$8,008pa. Any income above these limits will reduce the Age Pension by 50 cents for every dollar earned. Although it is unlikely that these pensioners will pay income tax, the rate of pension withdrawal is effectively a marginal tax rate of 50%, when other workers enjoy a tax-free threshold of \$18,200 and do not face a tax rate of 50% until their income reaches \$180,000pa. The income test is a strong disincentive to improving retirement income for those who are willing and able to continue working. The high effective tax rate means the loss of pension makes continued work in retirement uneconomic. That seems very short-sighted when part-time work could do much to improve retirement incomes for a number of retirees.

While those on the Age Pension are subject to restrictions in relation to staying in the workforce, those who are self-funded are empowered to continue working. They can draw down a superannuation pension, tax-free; they can also utilise the SAPTO and pay no tax on additional income up to a tax-free threshold of \$57,948 for a couple and \$32,279 for a single person.



Q16 To what extent does the retirement income system compensate for, or exacerbate, inequities experienced during working life?

As noted earlier, with superannuation tied to employment, those Australians who are out of the workforce, or have interrupted employment status, experience very different outcomes from those in ongoing paid employment. They earn less during their working lives and have less superannuation in retirement. They are also less likely to be able to either voluntarily contribute to superannuation or other savings.

The World Bank has recommended that one of the three key functions of a retirement income system is redistribution – from high income earners to low-income earners. A natural balancing mechanism is built into the retirement income system for those who are disadvantaged during their working lives due to low incomes and low superannuation balances, as this cohort has access to the Age Pension. The current system therefore does compensate for inequities experienced during working life for this cohort.

Those who have earned high incomes during working life and accumulated high superannuation balances benefit from the tax concessions in place.

However, there is a significant cohort ‘in the middle’, whose superannuation balances are not high, but who do not qualify for the Age Pension. This group has saved, but is penalised by the current system, with the taper rate exacerbating the disadvantage experienced by this cohort of older Australians.

Retirees on low incomes enter retirement on the Age Pension as they have always done. People with abundant resources will never be concerned with eligibility for the Age Pension. For the people with enough resources, however, to limit their access to the full pension or those who only just miss out on the pension altogether, the present retirement income system exacerbates inequities as follows:

In order to receive the full Age Pension, a home-owner couple can hold assets of up to \$394,500 which may or may not be in superannuation. The pension is withdrawn at the rate of \$3 per fortnight for every \$1000 above that threshold and is reduced to zero when assets reach \$863,500. That rate of reduction (sometimes called the taper rate) is \$78 per year per \$1000 of assets, or 7.8%. In other words, retirees can increase their pension by more than those assets can earn by reducing the level of those assets. In fact, this couple maximises their total income from the Age Pension and investment income by reducing their assets to \$394,500.

While the taper rate is designed to limit the Age Pension to pensioners with fewer resources, it creates a “sweet spot” of assets around \$400,000 that *maximizes income* from the Age Pension in addition to investment income. However, maximising the Age Pension for recipients is the opposite of what the government should be aiming for. In order to earn the same income as those pensioners in the “sweet spot”, self-funded retirees would need to hold \$1,120,000 in assets, assuming they can only achieve an income return of 5% on their investments.

The current taper rate creates an incentive for part-pensioners to divest themselves of assets in order to become eligible for the full pension. In the pursuit of savings, successive governments have created perverse incentives for retirees to impoverish themselves.

The taper rate that applied between 2007 and 2017 was a pension withdrawal rate of \$1.50 per fortnight for every \$1000 above the threshold. This was equivalent to an earning rate of 3.9%. It was much closer to market rates and created much less of an incentive to reduce assets in order to maximise pension income.

Divesting assets is not as easy as it may seem. Under the gifting rules, any money given away is still counted as an assessable asset for five years, but there is no restriction on spending on personal items such as travel to help



improve Age Pension payments. It is important to note that the family home is a non-assessable asset and its value is ignored in these calculations. Indeed, there is a significant number of Age Pensioners who live in multi-million-dollar homes and still receive the Age Pension. Therefore, renovating or upgrading the family home is always an option for reducing assessable assets in order to increase the pension.

Ironically, downsizing the family home creates its own difficulties. If an Age Pensioner chooses to downsize to a more modest home, the equity thus released increases their assessable assets and therefore reduces their pension. This may be the biggest disincentive for pensioners to downsize, and therefore many choose to remain asset rich but income poor. The new rules around the downsizer contribution into superannuation do not solve this problem; it merely shifts the equity released into an assessable asset inside superannuation.

Selling the family home to enter age care can have the same negative consequences for the Age Pension. It has the added complication that in addition to reduced pension, the resultant increase in assessable assets also increases the personal contribution to the cost of care.

The family home, as an exempt asset, creates a number of distortions in sensible retirement planning. It is perfectly rational behaviour for retirees to seek to protect both their home and what many see as their entitlement to the Age Pension. Many retirees are reluctant to take out a home equity loan to supplement their income because it capitalises the interest and the home may be required to pay the Refundable Accommodation Deposit in an age care facility in the future. For both the pensioner and the taxpayer this behaviour leads to a less than optimal allocation of financial resources. At a time when retirees need regular income to meet ongoing liabilities, the Age Pension rules encourage retirees to arrange their affairs to become asset rich, but income poor.

Q17 What are the implications of a maturing SG system for those who are not covered by compulsory superannuation?

At present, superannuation is tied to employment. It is designed to relieve pressure on the Age Pension. Behavioural finance and economics research shows that individuals struggle to save for retirement for a range of reasons.³⁵ The compulsion aspect of superannuation addresses this. However, current policy settings ignore those outside the compulsory system.

The cohort outside the current system include the self-employed, those in the gig economy and older, retired Australians — none of these have the benefit of a compulsory superannuation system. ABS statistics show that 8% of the 12.6 million employed in August 2018 were classed as independent contractors and a further 8.8% were classed as other business operators.³⁶ Small business owners frequently rely on selling a business to fund retirement, yet not all business owners can sell their business. Those in the gig economy frequently suffer from fragmented employment, making savings a challenge. As shown, non-compulsory saving can also prove difficult for many.

³⁵ H. K. Baker and V. Ricciardi (Eds.), *Investor Behavior: The Psychology of Financial Planning and Investing*, Wiley, ch. 16: 'The temporal distance of retirement and more immediate tasks lead us to what is known as temporal discounting. This psychological vulnerability refers to our tendency to prefer immediate rewards to rewards more distant in time. Temporal discounting is explained by the fact that individuals attribute more value to a reward obtained immediately than to a greater reward obtained later. An important factor related to retirement decision making concerns the emotional burden involved. We do not like to think about old age, a period of life frequently associated with illness, loneliness, decline in consumption, loss of social status, and the like. Moreover, between the age of 25 and 45, our energy is focused on more immediate tasks or projects, such as finishing studies, work and career, forming a family, buying a property, and the like. It is only after our forties that we begin to think seriously about our retirement. At that point, it may be too late to significantly improve our future retirement income. See Raaij, W. F. van. (2015) : *Understanding Consumer Financial Behavior: Money Management in an Age of Financial Illiteracy*, Palgrave Macmillan, ch. 6 and Howard, J. A. and Yazdipour, R. (2014): "Retirement Planning: Contributions from the Field of Behavioral Finance and Economics"

³⁶ ABS Cat 6333.0, August 2018



Those older retired Australians who did not have the benefit of superannuation have often invested over their lifetime to accumulate savings to fund their retirement (de facto superannuation), yet have not benefited from the tax concessions applicable to superannuation while experiencing the rules and policy settings change to their detriment.

Therefore, changes to superannuation, taxation and Age Pension policy fit only some in this cohort.

Small business owners and those in the gig economy could be obliged to contribute to a superannuation fund of their choice, which would ensure they were covered by the system. And any policy settings relating to retirement income need to consider the impact on those who retired 20 or 30 years ago, having not benefited from superannuation. Currently assumptions are made that all retirees have their savings in superannuation, which ignores the needs of this older group. The proposed policy to abolish cash refunds on franking credits was one such policy that ignored this cohort. Many of these older Australians entered the share market as a means of providing for their retirement and structured their investments to receive dividends and a cash refund for all franking credits. These Australians who retired 20 or 30 years ago diligently saved for and depend on their self-funded retirement income (in effect, a self-funded pension). The proposed policy to abolish cash refunds on franking credits would have penalised investors who have saved for their retirement and invested in Australian companies.

It is vital, therefore, that policy settings take account of the impact on all retirees and not only those who have benefited from superannuation.

Sustainability

Sustainability requires that government expenditure on the retirement income system through the Age Pension and superannuation tax concessions must be affordable over the long term. Changes to retirement income policy must contribute to fiscal sustainability by incentivising self-sufficiency.

Q18 What should the Panel consider when assessing the sustainability of the retirement income system?

Superannuation was designed to relieve the pressure on the Age Pension. While there have been calls, including from the Henry Tax Review 2009³⁷ and the Grattan Institute³⁸, to leave the Superannuation Guarantee at 9.5%, and research showing that there is no one-size-fits-all optimal SG, as it can vary substantially with assumptions³⁹, the Alliance for a Fairer Retirement System is of the view that the modelling shown in the Rice Warner paper is reliable, taking into account a range of factors affecting retirement income.

Our view is therefore that the current Superannuation Guarantee of 9.5% is not sufficient on average weekly earnings to accumulate an adequate retirement income (we refer to the earlier benchmark of the AFSA

³⁷ *The Age Pension in the 21st Century*, Paper prepared by Michael Rice for the Financial Services Forum 2018, p 10

³⁸ Brendan Coates and Owain Emslie, *Money in retirement: will we have enough? An update to the Grattan Retirement Income Projector*, Grattan Institute, 12 April 2019, pp 36—40

³⁹ Gaurav Khemka, Yifu Tang and Geoff Warren, *The 'Right' Level for the Superannuation Guarantee: A Straightforward Issue by No Means*, College of Business and Economics, the Australian National University, 11 January 2020, p 2. The analysis treats the age pension as an income stream that will continue to be available to all, rather than as a safety net that should only be accessed when needed.



Retirement Standard).⁴⁰ Michael Rice has shown in its papers on the Superannuation Guarantee that the impact of leaving it at the current level versus alternative benchmarks.⁴¹ Their paper states that:⁴²

Our modelling demonstrates that without the Age Pension, Australians would need an SG of between 15% to 20% to provide them with an adequate retirement income.

We recognise that the Age Pension will continue to be an integral part of the retirement income system for many Australians, but it could be better targeted. The availability of the Age Pension reduces the required level of SG for adequacy and protects against longevity risks.

Current policy with an SG rising to 12% as legislated would provide most Australians with an adequate retirement income and allow for some reforms to the Age Pension when the system matures. An ideal setting for the SG should be in the range of 10 to 15% if we allow for the Age Pension. It can be shown that a higher level will provide a more comfortable majority for a greater number of retirees. However, higher levels will also require adjustments to tax and contribution thresholds in order to moderate the benefit for those in the top income deciles.

An SG below 10% would result in median income earners relying on the Age Pension for most of their retirement income. While this would provide a comfortable living standard for middle-income Australians under many scenarios, it's not a desirable result if we want people to be self-sufficient in retirement. It does not meet the primary objective of the superannuation system that is about to be legislated. Further, many people living on a full Age Pension (particularly renters) are living in poverty, indicating that the Age Pension by itself is not enough.

The Paper also makes the important point that while many focus on the cost of superannuation concessions to the Federal Budget, seeing them as a cost to the budget of compulsory superannuation when compared to any savings that may arise from the reduction in future Age Pension payments, the savings to government are not realised until the member reaches the Age Pension eligibility age. As the Paper notes: 'Commentators often compare the current cost of variations to the current value of the Age Pension, which is not meaningful. In fact, the current expenditure on the Age Pension (about \$46b a year) simply reflects the past savings behaviour of current retirees.'⁴³ The Rice Warner Paper shows in Graph 3 below how important it is to analyse these items over time and the Alliance notes the similarity of their graph to Chart 3 (also shown below) in the Treasury paper, *The superannuation system in aggregate*⁴⁴, which notes that despite an ageing population, a maturing superannuation system means Age Pension expenditure remains stable.

⁴⁰ <https://www.superannuation.asn.au/resources/retirement-standard>

⁴¹ Michael Rice and Nathan Bonarius, *What is the right level of superannuation guarantee?*, Rice Warner, 3-4 June 2019, p 4

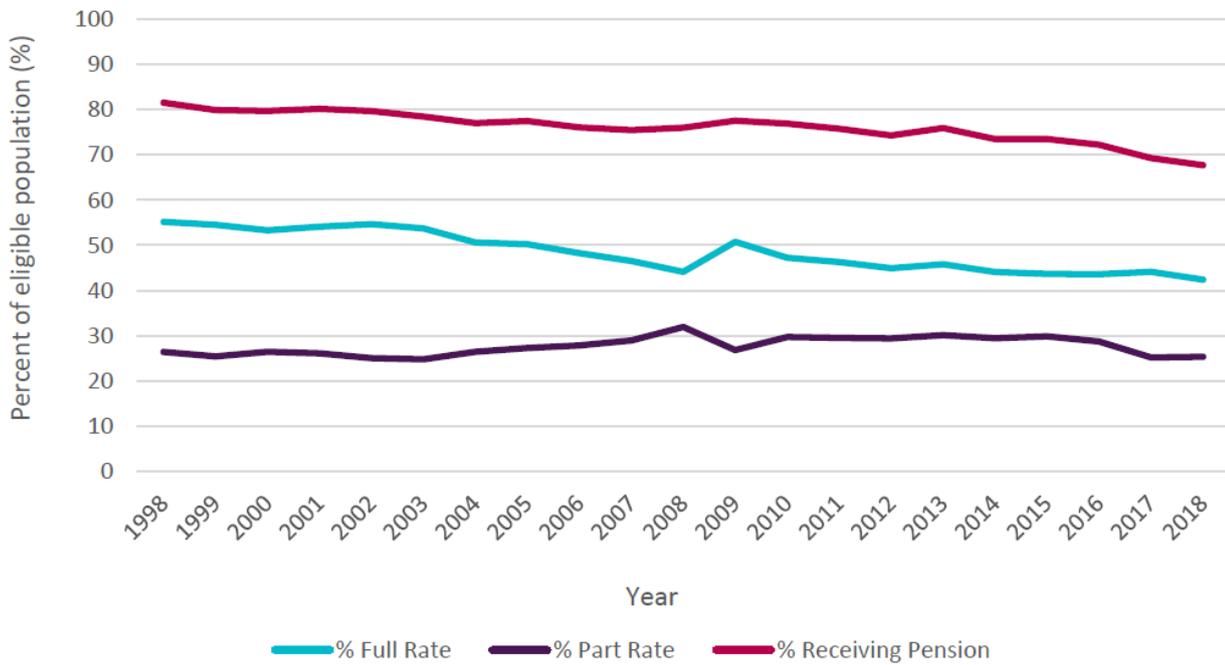
⁴² Ibid, p 6

⁴³ Michael Rice and Nathan Bonarius, *What is the right level of superannuation guarantee?*, Rice Warner, 3-4 June 2019, pp 13—14. 'We note that the level of concessions provided is a policy setting in and of itself and can be separated from the desired level of SG. For example, Savings will not be realised – the abolition of any concessional treatment of superannuation would not deliver budget savings equal to the value of the items in the Tax Benchmarks and Variations Statement because consumers would adjust their behaviour. Without the SG, there would be no \$2.7 trillion retirement savings pool (consumers would have spent much of it), and the Government would have received less in tax on superannuation earnings even at higher tax rates. There would be some revenue gains from the lower levels of concessional contributions, but the long-term cost of the Age Pension would be significant.'

⁴⁴ The views expressed in the paper, which was prepared by Jacob Stone, Mark Bott, Katarina Trinh, Elliot Lavers and Jarek Kowcza in Revenue Group, Treasury, are those of The Treasury and do not necessarily reflect those of the Australian Government.

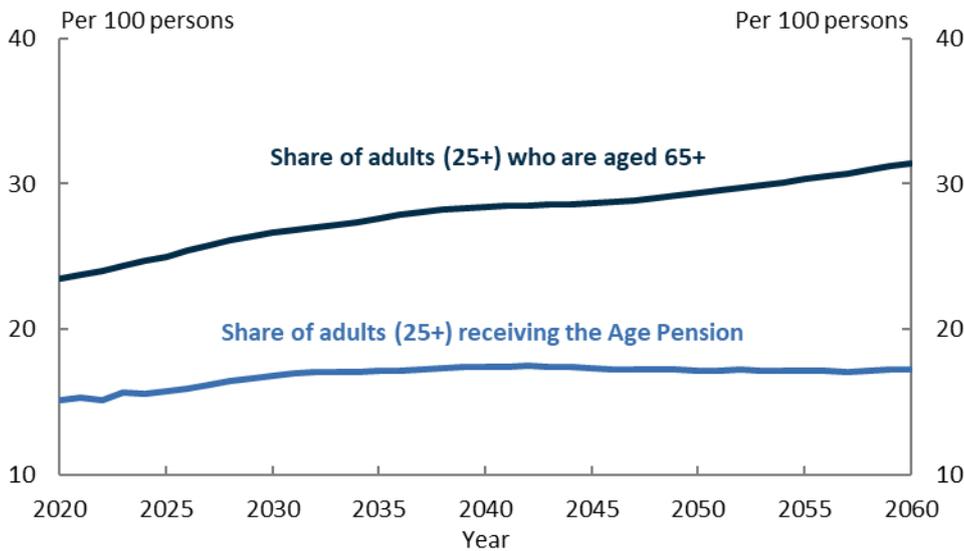


Figure 5: Graph 3 — Projected proportion of the eligible population receiving the Age Pension⁴⁵



Source Rice Warner – based on ABS population and DSS and DVA pension statistics.

Figure 6: Chart 3 — Population ageing and Age Pension recipients



Source: *The superannuation system in aggregate, Treasury*

⁴⁵ Ibid, page 13, reprinted with permission



Importantly, the Rice Warner Paper notes that:

a decision to raise the SG to 12% will have a cost to the budget in the short term but provide longer term savings to the Age Pension. The short-term cost could be managed by adjusting caps on contributions or the structure of concessions provided.

We note also the comment in the paper, *The 'Right' Level for the Superannuation Guarantee: Straightforward Issue by No Means*, that:⁴⁶

The availability of the Age Pension and related supplements looms large in our results given that it provides a substantial head start towards securing any target as well as providing a hedge against investment losses. We find that estimated optimal SGs increase substantially if the Age Pension is excluded, exceeding 12% in the majority of cases. It hence matters whether the Age Pension is viewed as a perennial income source that is openly available to all, versus a safety net such that the implied aim of the SG is to support members in becoming self-funded retirees and hence avoiding relying on the Age Pension.

There has been a great deal of concern expressed that there are some large private superannuation funds attracting most of the tax concessions and cash refunds of franking credits. This is an issue of equity, but it is used as an argument about sustainability.

For example, The Australia Institute issued a paper⁴⁷ that stated that

it demonstrates that the tax concessions flow overwhelmingly towards the well-off, with those earning less than \$34,000 per annum receiving almost no assistance and those earning over \$180,000 per annum receiving the most. Astonishingly, the top five percent of individuals account for 37% of concessional contributions. ... Allowable contributions are such that high-income earners could easily retire with \$5 million in assets, which would then allow them to draw down around \$500,000 a year in retirement, all tax-free. The system has become so skewed that the annual cost of providing superannuation tax concessions to high-income earners is much greater than the cost of simply paying those same individuals the Age Pension. Providing tax concessions for superannuation as a mechanism to help insulate the budget from the cost of providing for an ageing population is not sensible.

The Alliance is of the view that the small number of very large funds distorts the overall system and the picture of how tax concessions operate to provide longer-term savings to the Age Pension, encourage self-sufficiency in retirement and ensure adequacy in retirement income. The policy settings need to address this distortion rather than jettison a system that is proving to systematically work towards providing adequacy and self-sufficiency for a growing number of Australians in retirement. While the Alliance recognises that the consultation is not seeking recommendations, we note that a range of policy settings can be considered in relation to this issue, including mandating minimum drawdowns from all superannuation funds after a specified age such as 67 (that is, the Age Pension eligibility age), or prohibiting accumulation funds in retirement, or putting a cap on contributions to funds when in retirement.

⁴⁶ Gaurav Khemka, Yifu Tang and Geoff Warren, *The 'Right' Level for the Superannuation Guarantee: Straightforward Issue by No Means*, College of Business and Economics, The Australian National University, 11 January 2020, p 3

⁴⁷ David Ingles, *The great superannuation tax concession rort*, Research Paper No. 61, February 2009, pp 2—3



Q19 What factors should be considered in assessing how the current settings of the retirement income system (e.g. tax concessions, superannuation contribution caps, and Age Pension means testing) affect its fiscal sustainability? Which elements of the system have the greatest impact on its long-term sustainability?

We refer again to our comment that that while many focus on the cost of superannuation concessions to the Federal Budget, seeing them as a cost to the budget of compulsory superannuation when compared to any savings that may arise from the reduction in future Age Pension payments, the savings to government are not realised until the member reaches the Age Pension eligibility age.

This means that tax concessions attached to superannuation are consistently seen by governments and Treasury as expenses (liabilities) rather than as investments. Yet, despite an ageing population, a maturing superannuation system means Age Pension expenditure remains stable.

A wealthy country such as Australia should not view the Age Pension as a liability, but as a means of ensuring that the wealth of the nation makes provision for an adequate retirement income for all retired Australians.

It is therefore vital for an adequate, sustainable, equitable and cohesive retirement income system that short-term political expediency not drive policy decisions in relation to ensuring Australians have access to a retirement income system that meets these criteria.

The Alliance concurs with the view expressed in the Rice Warner Paper that:⁴⁸

the purpose of the SG should be defined such that a high number of Australians (perhaps 40 to 50 percent of retirees) are able to provide an adequate retirement income for themselves. When targeting adequacy in this paper, we have explored at what level the SG should be set so that a median income earner with a full career would achieve an adequate retirement income without recourse to the Age Pension. We expect the Age Pension should continue to play an important role in supplementing the retirement income of those below this threshold.

We also refer to our earlier comments on Q5 that incentives built into the system have produced a higher cost of the Age Pension, given it is viewed as an entitlement rather than a safety net. As noted earlier, the Alliance is of the view that the policy focus should be on encouraging Australians to be self-funded in retirement. This in turn supports the sustainability of the system.

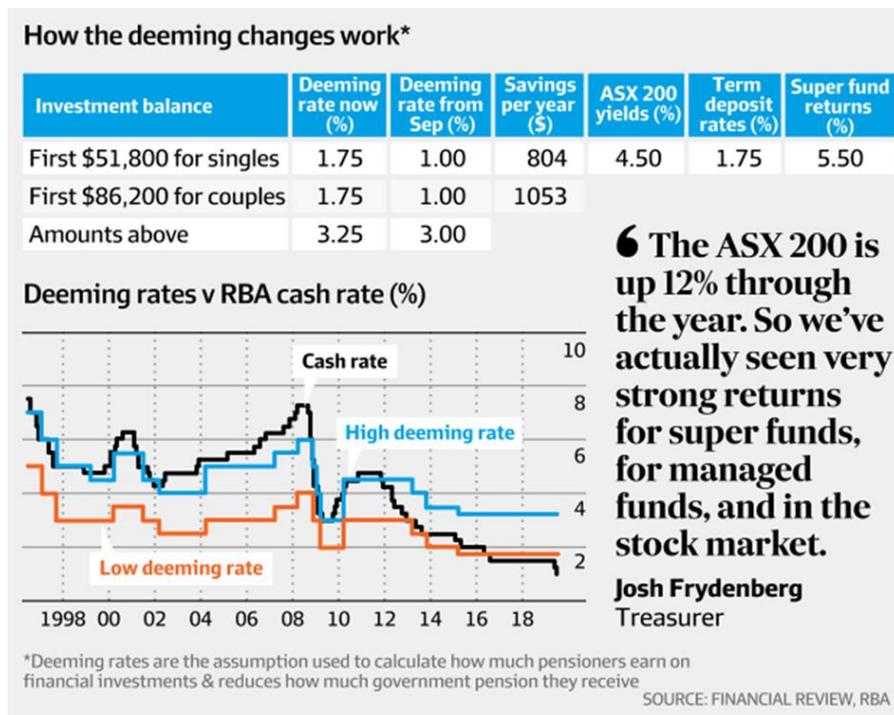
Above all, the Alliance is of the view that a culture or mindset change is required, so that both superannuation concessions and the Age Pension are seen as investments rather than liabilities.

An example of this can be seen with the taper rate applicable to calculating eligibility for the Age Pension. There has been recent publicity given to the interest rates used to 'deem' the income for those retirees seeking to gain access to the Centrelink Age Pension. Deeming rates have been a part of the process for applying for a part Age Pension since 1996. Traditionally, the upper and lower deeming rates have closely followed moves in the Reserve Bank's cash rate and have deliberately been slightly lower than what is available in the financial world in order to eliminate any public backlash from those people affected. Below is a chart that demonstrates these movements since 1996.

⁴⁸ Michael Rice and Nathan Bonarius, *What is the right level of superannuation guarantee?*, Rice Warner, 3-4 June 2019, p 19



Figure 7: How the deeming changes work ⁴⁹



Source: Financial Review, RBA

As can be clearly seen the cash rate (in black) has always been higher than the high deeming rate (in blue), from the commencement in 1996 until 2012. Several moves were made to lower the upper rate until March 2015 when the upper rate remained stationary at 3.25%. It remained at this level until July 2019 when it was brought down to 3%. It remains at 3% despite there having been six reductions in the cash rate since March 2015 — 6 May 2015; 4 May 2016; 3 August 2016; 5 June 2019; 3 July 2019; and 2 October 2019 (each of 0.25%).

It is worth noting that the lower deeming rate is now, for the first time since 1996, higher than the Reserve Bank cash rate.

In addition to Age Pensioners, deeming rates also apply to the Disability Support Pension and Carer Payment, and income support allowances and supplements such as the Parenting Payment and Newstart. None of these cohorts could be considered to be wealthy, nor have they large amounts of funds invested in superannuation or shares or property. Aligning moneys held in term deposits with funds invested in superannuation by the more wealthy segment of our society is a distortion that affects the long-term sustainability of the system.

Q20: How can the overall level of public confidence be assessed? What evidence is available to demonstrate the level of confidence in the system?

There is evidence to demonstrate the success of compulsion attached to the superannuation system, as in 2019 for the first time since the introduction of the scheme, more than 50% of those retiring had some level of self-funding.⁵⁰

⁴⁹ Quote from the Hon Josh Frydenberg MP in the chart from interview with Annabel Crabb, Insiders, ABC, 14 July 2019

⁵⁰ *Challenger Retirement Income Research*, June 2019: ‘Only 45% of 66-year-olds were accessing the Age Pension at December 2018 and only 25% of them were drawing a full Age Pension.’



Measuring confidence is more difficult, but the Alliance is of the view that one measure that can be considered is the level of voluntary contributions to superannuation, as Australians will only make voluntary contributions if they have confidence in the system.

Table 1: Funds with more than four members (APRA funds)

September quarter 2019	\$ millions
Employer DB contributions	4,420
SG contributions	16,490
Salary sacrifice	1,774
Personal contributions	5,421

Source: APRA Statistics – September quarter 2019 and ASFA Superannuation Statistics December 2019

ATO statistics for 2016-17 show that member contributions (\$66.3 billion) represent 42% of total superannuation contributions. However, this is driven by contributions in the self-managed superannuation fund sector, where 83% of total contributions are member contributions (\$34.7 billion). Most member contributions are made voluntarily and are a sign of strong engagement, while most employer contributions are mandatory Superannuation Guarantee contributions.

Research has shown that participation in voluntary contribution requires people to have a certain level of involvement in retirement planning, knowledge of the system, and interaction with their employer, superannuation fund or both.⁵¹ We have noted earlier in this submission that involvement and knowledge are low, apart from in the SMSF sector.

The same research showed that ‘the participation rate in voluntary contributions ... has fallen steadily at a rate of 2.5% per year from half of employees making voluntary contributions in 1993, to a little less than a quarter in 2007’.⁵² This trend is observed for all age groups.

The researchers also note that in the same period, the rules governing voluntary contributions experienced substantial changes. The Alliance notes that the rules have continued to change since 2014, leading to a loss of confidence in the superannuation system overall, not just voluntary contributions. More extensive use of grandfathering arrangements when rule changes are introduced would maintain confidence, given that planning for a retirement income requires a long-term focus. A continuously changing retirement system will discourage long-term investment in superannuation, preferencing current expenditure (as opposed to saving for retirement) and alternative investments. Self-funded retirement needs to be adequate, sustainable, certain and equitable to encourage the behaviour of deferred gratification.

The Productivity Commission Report on superannuation⁵³ noted that:

voluntary contributions — between 11 and 21% of accumulation members (excluding SMSF members) made voluntary contributions in the year prior to survey (figure 5.1) [Members survey and funds survey]. Members more likely to make voluntary contributions are members aged over 50 years, those on higher incomes (noting that this does not take into account the amount contributed), choice members, and members with account balances over \$350 000).

⁵¹ Jun Feng, Monash University, Paul Gerrans, The University of Western Australia, Gordon Clark, Monash University/Oxford University, *Understanding superannuation contribution decisions: Theory and evidence*, 28 February, 2014, Preliminary draft, p 4

⁵² *Ibid*, p 14

⁵³ *Superannuation: Assessing Efficiency and Competitiveness*, Productivity Commission Inquiry Report, Productivity Commission, No. 91, 21 December 2018, p 252



Cohesion

Q21 What should the Panel consider in assessing whether the retirement income system is cohesive?

The Alliance supports the definition of cohesion in the Consultation Paper.

Historically, governments have not been concerned with the cohesion of the retirement income system. The Ministers and government departments and agencies responsible for the pillars of the retirement income system (for example, Treasury, Department of Health, Department of Human Services) have had and continue to have a tendency to operate in a siloed fashion, that is, there is insufficient attention paid to the impact on other pillars when adjustments are made to policy settings. This leads to unintended consequences across the system. It is important that all pillars are considered when setting policy in relation to retirement, to ensure that there are no unintended consequences.

The Alliance is of the view that behavioural changes are a measure of a lack of cohesion in the retirement income system. When the system is cohesive, there is less opportunity for individuals to modify behaviour in order to take advantage of each pillar, particularly in response to the unintended consequences that can arise from a policy modification within another pillar.

When the rules are less complex and easier to understand, there is also less opportunity for loopholes to be exploited. Currently, the rules are very complex and most Australians required professional advice to navigate them so that they can plan their retirement to their advantage, within the rules. Therefore, those who are advised are likely to fare better than those who are not advised. Not being advised in turn hinders understanding of the system. It also causes resentment, as Australians witness some individuals creating successful retirement incomes within the system while others do not, which is the result of one cohort taking advantage of incentives while another cohort does not.

The current focus on complexity means that those without access to professional advice not only cannot navigate the system, but also turn away from trying to understand even the basic elements of the system. They are disenfranchised at multiple levels.

Q22 Does the retirement income system effectively incentivise saving decisions by individuals and households across their lifetimes?

Q23 What evidence is available to show how interactions between the pillars of the retirement income system are influencing behaviour?

Age Pension

The Age Pension is paid by the government from general revenue. It is a significant cost to the taxpayer and successive governments have focused on containing those costs in order to ease the burden on the taxpayer.

Increased life expectancies, the number of Australians retiring in the next decades and smaller families have created demographic trends that require shifts in policy settings. According to the Treasurer, the number of people eligible for the Age Pension will rise from 3.7 million to 8.7 million by 2060.⁵⁴ Moreover, according to the Treasurer, in 25 years, there will be 2.7 people of working age for every person aged 65 and over. This compares with 4.5 people in 2014-15 and 7.3 people four decades ago.⁵⁵

⁵⁴ The Hon Josh Frydenberg MP, 'Superannuation review enables us to plan for changing demographics', *The Australian*, 28 September 2019

⁵⁵ *Ibid*



The government response to those cost pressures has been to seek to limit the number of people who are eligible for the Age Pension through means tests and by delaying their access to this benefit by raising the retirement age.

Unlike other countries, which have a universal pension based on residency or employment history, the Australian Age Pension is only paid to those who do not have the personal resources to pay for their own retirement. The Age Pension is progressively withdrawn as retirees hold more personal resources and the pension is withdrawn completely when assets and/or income exceed certain limits.

Clearly, it is in the taxpayer's interest to encourage more retirees to become more self-reliant by saving more for their own retirement. It is self-evident that the key to improved retirement incomes for pensioners and lower costs for the government would be increased savings. The problem is that the means tests themselves actually create disincentives to save. Although it is well known that human behaviour changes in response to incentives and disincentives, it is clear that little attention has been paid to how the pension rules influence behaviour in relation to the Age Pension.

Incentives and disincentives in the Age Pension

Income test

As noted under Q15, the present income test is strong disincentive to improving retirement income for those willing and able to continue working.

As noted in Q16, the current taper rate in the assets test has a strong incentive embedded within it for pensioners to divest assets and maximise their pension.

Superannuation

Superannuation has been available for many years, as a condition of employment, for senior executives, public servants, politicians, military officers and judges. In 1992 the government introduced compulsory superannuation for all workers. Compulsory superannuation is paid by employers on behalf of workers and was originally seen as a trade-off with wage rises. It started at 3% of wages and has now risen to 9.5%. It is scheduled to rise to 12% by 2025.

Saving for retirement through superannuation is a long-term enterprise of about 30 years. Due to the effects of compounding over that time period, the final savings balance is very sensitive to even small variations in investment returns, fees and taxes. Superannuation outcomes could be vastly improved by close attention to these variables, and such a long investment horizon makes it imperative that policy makers understand that any changes to superannuation's regulations will fundamentally disturb many long-term plans.

It is tempting to compare the present cost to the government of these superannuation tax concessions with the present cost of the Age Pension. However, it is an unfair comparison because the superannuation system is not yet mature. According to the Treasurer, the median superannuation balance at retirement is projected to increase from \$188,000 in 2016-17 to \$475,000 by 2050 in real terms.⁵⁶ Although the people presently drawing the Age Pension did not enjoy many years of saving in superannuation, increasing superannuation balances are already having an effect on reducing the claim on the Age Pension. Indeed, December 2018 was the first quarter when fewer than 50% of the recently retired were eligible for the full pension.⁵⁷

For workers, although the superannuation concessions are designed to encourage saving, all saving for future retirement requires that some present consumption be forfeited for future comfort. This saving is in the context

⁵⁶ The Hon Josh Frydenberg MP, 'Superannuation review enables us to plan for changing demographics', *The Australian*, 28 September 2019

⁵⁷ *Challenger Retirement Income Research*, June 2019: 'Only 45% of 66-year-olds were accessing the Age Pension at December 2018 and only 25% of them were drawing a full Age Pension.'



of competing priorities including mortgages, school fees, holidays and other lifestyle choices. Saving for retirement is not always the highest priority, particularly because the Age Pension is always available for those who do not, or cannot, save for their own retirement.

Disincentives to save

It is no accident that in countries without a social safety net of an Age Pension, the saving rate is much higher. Arguably viewing the Age Pension as a safety net is itself a disincentive to save. After a more than a century, the Age Pension is seen by many older Australians as an automatic entitlement that is always available at no cost to the recipient if they meet the age and residency requirements and their own resources are below the means tests thresholds.

Superannuation has become the preferred savings vehicle for retirement. For the government, its principal feature is that no withdrawals are permitted from superannuation until the worker reaches retirement, with severe penalties for early access to these savings. And when these savings do become available in retirement, the superannuation balance is counted against the Age Pension assets test, thereby reducing dependency on the Age Pension.

For the government, tax concessions for superannuation make sense if they help to reduce or eliminate the long-term cost of the Age Pension, because it means that the retirement income is at least partly funded by personal contributions. The individual, however, faces the same equation. Increased savings reduce the call on the Age Pension. For many people the question is: 'If the Age Pension is an automatic entitlement, why bother to save so that you deny yourself something that you could have without any effort?' Clearly if people are going to be incentivised to save for retirement, they must expect an outcome that is superior to the Age Pension, otherwise, why would they bother?

Based on current low interest rates (1% to 2%), the net present value of the Age Pension for a couple can be in excess of \$800,000. By comparison, if the discount rate used was in the range of 5% to 6%, the net present value of the Age Pension for a couple would be \$250,000 to \$300,000 lower. This difference is the extra retirement savings that a fully self-funded retiree couple needs to achieve to an income equal to the Age Pension now compared to when interest rates were in the higher range.

In behavioural terms we should not be surprised if people go to great lengths to get something for nothing and paid for by someone else. Policy makers always look at the Age Pension in terms of costs, never in terms of the incentives or disincentives to change behaviour. It begs the question: How would behaviour change if the Age Pension was not 'free'?

According to an article by Doug Turek in *The Australian*,⁵⁸ the current low interest rates mean that if a couple bought an annuity of \$1 million today, that would purchase an income stream of \$44,250 for life, indexed to inflation. This compares with an annuity purchased in 2011 with the same \$1 million that would then have generated an income stream of \$54,300. This demonstrates that the effect of falling interest rates is to make all assets more expensive and therefore generate a lower income yield.

It also demonstrates something else. The Age Pension is also an annuity paid for life and indexed to inflation. At present it pays a home-owner couple around \$36,000 per year. That suggests the purchase price of such an annuity in the private market is more than \$800,000 and yet it is available to all, without any effort required on the part of the recipient. In addition, this couple can also hold almost \$400,000 in other assets and still qualify for the full Age Pension.

⁵⁸ Doug Turek, The rising cost of retirement, *The Australian*, 11 October 2019; < <https://www.theaustralian.com.au/business/wealth/the-rising-cost-of-retirement/news-story/be0ca79cab0246d5ca543cf93f6a54e1>>

As the Age Pension is risk-free, this couple can take some risk with their other assets. If they invest this \$400,000 in fully-franked Australian shares they can easily earn 6% income, thereby generating another \$24,000. This couple's total income is \$60,000.

Compare that total income with that of the couple in Turek's example. By forfeiting present consumption and saving for their retirement, they have accumulated \$1 million and thereby disqualified themselves from the Age Pension completely. If they purchase a private annuity, which is also a risk-free income stream paid for life and indexed to inflation, they generate \$44,250 pa. Meanwhile the couple with savings of only \$400,000, have \$60,000 pa income, due in large part to the \$800,000 annuity, compliments of the taxpayer

The Age Pension has perverse incentives for retirees to impoverish themselves to qualify for this tax-payer gift of \$800,000 per couple. It is therefore completely rational behaviour for many to arrange their affairs to qualify for this tax-payer funded gift. It also shows that some self-funded retirees who are disqualified from the Age Pension due to their 'abundant' resources have considerable incentive to divest assets to become Age Pensioners. Under the present system, savers pay twice: once during the saving period by forfeiting present consumption and then again by forfeiting what could have been claimed by doing nothing. Someone who chooses to be self-reliant in retirement by diligently saving over many years is merely relieving the taxpayer of the responsibility of providing what many people regard as an entitlement after paying taxes for 40 years. For many that is not rational behaviour.

A self-funded couple can only accumulate \$1 million in personal resources after years of careful saving. Yet these people get no support from the government and still earn a lower income. They often feel they are punished for their prudence. They seldom belong to any organisation that represent their interests and are therefore often very exposed to capricious changes to the rules. By contrast, Age Pensioners have acquired significant political influence. An example of this can be seen in the parliament's decision to maintain the indexation rate for the Age Pension linked to average weekly earnings rather than the lower CPI. This will progressively add to the cost of the Age Pension.

Risk in self-funded retirement

The Turek example above clearly shows that the Age Pension does not reflect the market interest-rate conditions that self-funded retirees need to manage. Indeed, there are other incentives that are not immediately obvious to encourage self-funded retirees to arrange their affairs to become eligible for the Age Pension.

Self-funded retirees need to manage a number of risks that Age Pensioners do not. In many countries, workers retire with an indexed pension, paid by their former employer or the taxpayer that is a set proportion of their final salary, paid for life, often with a residual paid to the surviving spouse. They can plan their retirement with certainty.

By contrast Australian self-funded retirees must manage the following risks:

- Longevity risk
 - Unexpected health issues
 - Loss of capacity
- Inflation risk
- Market risk
- Legislative risk

Australia is unusual in that retirees with limited financial literacy enter retirement with a lump sum, which is often the largest amount of money they have ever managed, to support themselves for a retirement of uncertain



duration and complexity. For this daunting task, most retirees need the services of a financial adviser, but that then exposes them to the costs of seeking financial advice.

Policy makers understand retirees as a cohort. As a cohort, it is not difficult to determine the average life expectancy, the median superannuation balance or the average annual expenditure on housing and so on.

For the individual retiree, however, their experience may be anything but average. For example, the life expectancy of a male cohort may be 84 years, but the individual experience may bear no resemblance to that. Life expectancy and other cohort averages are of limited usefulness when planning retirement. Indeed, prudent planning suggests that retirees need to plan for the extreme-case scenario. Given that a couple has a 70% chance that one of them will survive until age 90, cautious retirees need to plan for their savings to last for at least 25 years. A lot can go wrong in that time. Similar uncertainties exist around whether or not they will need to plan for age care or whether the next stock market crash will occur in their lifetime.

The historical model of retirement income is the defined benefit pension. This is an indexed pension set at percentage of pre-retirement salary, paid until death with a lower percentage paid to the surviving spouse until their death. These pensions are paid to retired judges, academics, military personnel, and federal politicians who entered parliament before 2004. Such a pension may not have any residual capital value but all the risks, outlined above, are managed by the provider. The beneficiaries of these pensions can plan their retirement with absolute certainty. The reason these pensions have been and are being phased out is precisely to transfer those risks from the provider to the beneficiary.

Given the risks Australian self-funded retirees need to manage, they are understandably very risk-averse. Calls by policy makers for retirees to start spending their capital early or to invest in growth assets which are riskier than term deposits are likely to fall on deaf ears.

A comprehensive retirement income policy could provide more certainty to Australian retirees by reducing, or mitigating, some of the risks set out above. Policy makers could reduce legislative risk by minimising changes to the rules around retirement planning, by ensuring long lead-in times to allow people to adjust to any changes, and by 'grandfathering' to quarantine existing retirees from proposed changes.

In addition to being an annuity, the Age Pension entitles pensioners to a health card which significantly reduces the cost of medical services as well as providing other subsidies. With age care, the Age Pensioner is also subsidised, in part or completely for the cost of that care. The Age Pension is clearly a retirement income stream with much less risk, and much greater certainty around medical and age care needs than that faced by self-funded retirees. Better still, it requires no effort on the part of the beneficiary.

If one of the aims of this review is to reduce risk in retirement, consideration should be given to the idea of a universal health card provided to everyone after a certain age. After all, medical conditions like cancer or heart disease do not discriminate between rich and poor. Without such financial support, the self-funded retiree is compelled to self-insure against life's upheavals and uncertainties. This in turn, may make the savings target for such a self-funded retirement that much further out of reach and create further incentives to arrange affairs to qualify for the Age Pension.

Rather than encouraging retirees to become self-sufficient, the burden of managing these risks in a self-funded retirement may actually create perverse incentives in the opposite direction.



Incentives and disincentives in superannuation

Voluntary contributions

In addition to compulsory contributions, people can make voluntary contributions to superannuation. Employees can make voluntary concessional contributions in addition to the compulsory Superannuation Guarantee (9.5%) up to the concessional limit of \$25,000 through salary sacrifice. Moreover, people can make voluntary non-concessional (after-tax) contributions up to \$100,000 and that might include an inheritance or the sale of a property.

According to ATO analysis, 50% of SMSFs hold assets less than \$693,000, but there are about 4,000 funds that hold assets in excess of \$10 million each. Unfortunately, these very large superannuation funds add significantly to the cost of tax concessions flowing to superannuation funds in retirement. They distort the analysis of tax concessions for superannuation because many commentators assume that all SMSFs are of this size. There are also hundreds of very large superannuation balances in APRA regulated funds, so the issue is of concern to the whole superannuation system.

We note that the significant changes introduced on 1 July 2017 implementing a \$1.6 million Total Balance Cap impacted the ability to shelter significant assets in superannuation tax-free. However, there is an argument that these extremely large superannuation balances in both SMSFs and APRA regulated funds are beyond the notion of saving for retirement.

The Alliance believes it is worth examining extremely large superannuation balances in the review of the retirement income system. Policy measures to discourage the retention of such balances indefinitely within the superannuation system could be considered.

These may include:

- an increased tax rate for large superannuation balances
- forced withdrawal of capital for large superannuation balances over life expectancy or a defined period.

However, it is also important to recognise that large superannuation balances are a legacy issue. In addition, the Total Balance Cap means that trustees are no longer able to keep entire balances in the retirement phase (where minimum drawdown rates apply) and this may extend the period in which large amounts of superannuation stay in the system.

SMSFs tend to be viewed by commentators as a homogeneously wealthy group. This is not the case. There is a smaller group of the top 100 SMSFs with combined funds of \$7.9 billion that are under scrutiny by the ATO. Outside of this and the group with more than \$10 million in funds, most SMSFs tend to be run by ordinary Australians with considerably smaller balances than in the top groups.

Non-concessional contributions are now limited to \$100,000. Previously this limit was as high as \$180,000. It is difficult to understand why this restriction is necessary as there is already a Total Balance Cap of \$1.6 million. Few people achieve that in any case. As there is now an upper limit, it is difficult to see why it should matter how or when that is achieved.

It appears that the government is more concerned with containing the short-term costs of superannuation tax concessions than the long-term benefits of having more retirees with generous retirement savings live independently of the taxpayer. Governments perceive Age Pension costs as unavoidable because, just like unemployment benefits, they view them as welfare payments. Superannuation tax concessions costs, on the other hand, are discretionary that can be adjusted as budgets allow. Budget costs are recurrent, but the benefits of superannuation are in the future and difficult to predict and quantify.



The message is very clear. The Age Pension is always the reference point and governments are more concerned with limiting the costs of the Age Pension than with encouraging people to save for their retirement. Paradoxically, by also trying to contain superannuation costs, governments have introduced disincentives to save. This only adds to Age Pension costs. See our earlier comments on the cost of the Age Pension in Australia being less than in other OECD countries (Q1).

Perhaps not surprisingly, few people make voluntary contributions to superannuation, even with pre-tax dollars through salary sacrifice (see our earlier comments on voluntary contributions). That may be because the tax benefits of saving in superannuation are not well understood, or because of the prohibition on access to these savings until after retirement. It can also reflect the impact of the recent and frequent changes to the superannuation rules which have eroded confidence in the system. Young people do not trust that the superannuation rules will not be changed capriciously again, which would in turn put their future savings at risk.

It may also show that people believe, or have been led to believe, that the compulsory contributions combined with the Age Pension are all that is required for an adequate retirement income. This demonstrates that people trust the Age Pension will always be available. Further, the level of confidence in the Age Pension is so strong that most people need a level of compulsion if retirement savings in addition to the Age Pension are to be achieved.

By contrast, saving through property investment requires no such compulsion. The combination of discounts on capital gains tax, negative gearing and ready access to this capital, makes this type of investment a national obsession in Australia. Also, residential property offers Australians the security of 'bricks and mortar' compared with the fluctuating values of shares and commodities. This is one of the reasons most banks will lend a very high per cent of the value of a residential property compared with all other investment options. The problem for the government, however, is that there is no guarantee that these savings will be used to enhance retirement incomes and relieve the pressure on the Age Pension. Indeed, this accumulated capital can be used to enhance the family home, for example, which is a non-assessable asset for the Age Pension.

Forming a subset of behavioural economics, behavioural finance focuses on the emotions and cognitive errors of investors. Cognitive psychologists Daniel Kahneman and Amos Tversky, thought of as the 'fathers' of behavioural economics, suggest that investors are influenced by two primary behavioural biases: cognitive and emotional biases. Richard Thaler won the Nobel prize for his work in behavioural economics in 2017.

These biases are often discussed in the context of shares, but can be considered in terms of other market-based investments, like property. The most common behavioural biases are:

- Cognitive biases — Mental accounting and anchoring
- Emotional biases — Overconfidence; Prospect theory (loss aversion)⁵⁹

Because of its many tax advantages, superannuation is a preferred savings vehicle for retirement, but few people use it to any great extent beyond the compulsory component which is always paid by the employer. Whether it is superannuation's complexity, the lack of access to these savings or the difficulty in passing these assets on to

⁵⁹ Megan Sun, 'The psychology behind investing', 1 Oct 2019. 'Prospect theory, also known as 'loss-aversion theory' models how individuals express a different degree of emotion towards perceived gains compared to perceived losses. In other words, we tend to feel the pain of a loss twice as much as we derive happiness from equal gain. Consequently, people tend to take more risks to avoid the pain of loss than to realise gains, often holding onto losing investments in the hope that the price will bounce back. This relates to 'regret theory' as, similar to the fear of loss, individuals anticipate regret and try to make decisions to avoid this. For example, you've thoroughly researched an investment and go to purchase it. However, anticipating that you'll regret this decision if it later falls in value, you avoid buying to avoid the pang of regret. Instead, you buy something that everyone else is buying. Weirdly enough, people feel less embarrassed about losing on a popular investment than an unknown one. This ties into the behaviour called 'herding', where, like sheep, investors simply follow the crowd without doing proper due diligence. Herding and the associated FOMO is often how market bubbles are formed, as seen in the likes of the Bitcoin boom, dotcom bubble and the housing market of several Australian capital cities in 2017.' < <https://news.brickx.com/investing/the-psychology-behind-investing/>>



beneficiaries, there are insufficient incentives to become self-reliant in retirement and indeed significant penalties for doing so. As a result, both the retiree and the taxpayer are worse off.

As a savings vehicle for retirement, superannuation offers many advantages over property, but most Australians remain unconvinced. This attitude is very pervasive and, because superannuation is so poorly understood, we find that people with large superannuation balances, only accomplished with voluntary contributions by sacrificing current consumption, are vilified as somehow robbing the system rather than being congratulated for achieving financial independence and saving the taxpayer the cost of the Age Pension. For a country facing an ageing population, that is a truly bizarre outcome.

It is well known that expectations shape behaviour. The current retirement system has created an expectation of entitlement that has passed responsibility for the living standards of the majority of retirees to the taxpayer, even as there are fewer taxpayers and many more retirees. All governments respond to this challenge by trying to contain costs.

By focusing solely on costs, however, the government has created a parsimonious culture of grudging dependency. It has also created an army of advisers trying to exploit loopholes, and therefore requiring a strong regulatory regime to police eligibility which in turn creates a climate of suspicion and distrust. We repeat our earlier comments that the mindset of government and Treasury needs to shift from viewing the Age Pension and superannuation tax concessions as liabilities to seeing them as investments.

Australia needs to develop a saving culture, and governments need to create incentives to encourage it. A change in expectations and focus around the retirement conversation from the cost of the Age Pension to the investment needed to generate generous superannuation balances would increase retirement incomes, and there would be less concern about the cost of the Age Pension or the adequacy of retirement incomes. At the same time, it would create a culture of empowerment and independence amongst retirees which, in turn, would generate other psychological benefits.

If the transfer of this accumulated superannuation capital to succeeding generations was encouraged, Australia would become an astonishingly wealthy country, much like Japan is now. Even though its economy has been in the doldrums for decades, the country is doing very well, living on the proceeds of its investments. Increased savings is needed to finance increased investment and that benefits the economy as a whole.

Focusing only on costs is completely logical from an accountancy point of view, but it ignores rational human behaviour which seeks to maximise gains and avoid loss. By ignoring the behavioural responses that flow from the various incentives and disincentives embedded in the present retirement income system, Australia has, in this case, put the cart before the horse.

Q24 What is the evidence that the outcomes the retirement income system delivers and its interactions with other areas (such as aged care) are well understood?

The fact that different rules apply to different pillars in the system makes it extremely difficult for individuals to understand how the retirement income system interacts with aged care. For example, a different calculation is used to means test aged care than is used to test for the Age Pension. One is developed by the Department of Health and one by Treasury, revealing a siloed approach to policy that is to the detriment of delivering outcomes.

The Alliance reiterates that it is important that integrated thinking and policy decision making be brought to bear on the four pillars of the retirement income system.



A key concern of self-funded retirees is not knowing the date of their death and therefore not knowing how long their capital has to last to provide an income stream. There is a reluctance to use capital in retirement in case it is required to access a better quality of aged care. Many Australians would be unaware that it is less expensive for the government to pay for a home care package than institutionalised aged care, which aligns with the preference of most individuals for remaining in the home.

As noted earlier, the numbers of Australians on the full Age Pension is trending down as more become either fully or part self-funded — see Chart 3 in the Treasury paper, *The superannuation system in aggregate*, under Q18. This provides evidence that the outcomes of one pillar — superannuation — are being delivered.

However, given the long lead times between reaching eligibility age and claiming an Age Pension or part pension (6—12 months in many instances), it is suggested that this is evidence that the system overall is not delivering. If the system was better understood, individuals would start the organisation of paperwork much earlier so that payment coincided with eligibility. The Alliance recognises that there are various reasons why people do not apply for the full or part Age Pension, including viewing it as welfare which makes them reluctant to engage, or being above the threshold test at first. Nonetheless, the lag should be considered when determining whether the system delivers.

There is limited modelling to demonstrate the overall outcomes for different cohorts over a lifetime, which take account of the various payments and benefits provided to retirees through the retirement income system. Most retirees want to know the system provides equitable outcomes, yet most people interact with the system through its constituent parts.

For example, when faced with the need to access help through the aged care system, older Australians would likely see this as something separate from the retirement income system and more as part of the health system. However, the application of means testing to determine eligibility firmly grounds access to aged care in the retirement income system. This should not be surprising as access to subsidised health care in the form of bulk billing and subsidised medicines are also tied up with the retirement income system means testing.

This raises a question as to whether it would be simpler to remove the means testing arrangements which restrict access to health care interventions, such as those provided through Medicare and aged care, and recoup these extra costs through the higher taxation of retirement income or through higher contributions to Medicare.

It is also worth noting that when surveyed, more than 90% of older Australians say they want to stay in their own home rather than go into an aged care home. We now see more and more of them paying for in-home care. The Commonwealth Home Care Package waitlist has been described by National Seniors in the Royal Commission as a 'running sore' and an 'abject failure'. Commissioner Tracey said the system is one which can only be described as 'cruel' and neglectful. Sixteen thousand people died in the last year waiting for a home care package to meet their needs and 14,000 went into aged care homes because they couldn't get home care.

After more than \$500m in extra funding and one year after the Royal Commission heard evidence of 128,000 people waiting, the wait list is still 109,000. Two thousand Australians turn 80 every week and that's the time when most begin to need care. As such, more and more older Australians are now saving for and often holding on to funds to pay for and supplement in-home aged care and also putting funds aside to pay for a place in a 'good' aged care home.

The lack of faith in the system is growing and so many are seeing it as a system where the more money you've got in those last years of life, the better care you can get. Often this behaviour is not out of a selfish motive but rather an act of love for their lifelong partners to get the best care money can buy. At the top end of the 'better homes', it can cost more than million dollars to get a place.

The other factor is that people don't know how to predict their longevity or frailty needs. The latest National Seniors Australia report *Retirement Income Worry. Who worries and why?*⁶⁰ is one of the largest comprehensive surveys of older Australians. The study surveyed 3,584 Australians aged over 50 on their behaviour and views across a range of topics including lifestyle, health and wellbeing. The research is a joint partnership between National Seniors Australia, a peak body for older Australians, and Challenger Limited. It showed more than half of older Australians are worried they won't have enough money in retirement. Their worries are not just about day-to-day living but health costs, home care costs and residential aged care costs.

Q25 What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?

The Alliance notes the MoneySmart website attached to the ASIC website, which provides clear and accessible information on many aspects of the retirement income system. Nonetheless, the rules governing superannuation, aged care and the Age Pension are dense and labyrinthine and for the vast majority of Australians too complex to navigate without access to formal financial advice. Low levels of financial literacy compound the problem (see our earlier comments Q2).

In universal public pension schemes and defined benefit plans, individuals do not have to make as many decisions about retirement savings. At the least, investment strategy is the plan sponsor's choice. Participation or enrolment may be automatic for an individual and contribution rates may also be predetermined.

Australia is unusual in having a lump sum provision in its superannuation scheme settings. This means that when an individual moves from work to retirement they are suddenly responsible for making decisions about a large sum of money, decisions which will have impact over decades as they age and for which many are unprepared. In other countries the individual does not take on the risk of managing a large sum of money at this time. The risk remains with the provider and not the recipient.

It is rare for Australians who have access to formal financial advice to take a lump sum payment. While some individuals may do so for personal reasons (for example, to pay off a mortgage), unless directed otherwise by the client, those who have access to a financial adviser will receive advice on putting superannuation into pension mode. The advice will not be to take a lump sum payment and all associated risk. The percentage of Australians taking a lump sum payment is therefore a measure of lack of access to formal financial advice.

Table 2: Funds with more than four members (APRA funds)

September quarter 2019	\$ millions
Lump sum benefits	11,776
Pensions	10,728

Source: APRA Statistics – September quarter 2019 and ASFA Superannuation Statistics December 2019

There is a significant unmet need for access to formal financial advice to assist with managing longevity risk, market risk, inflation risk and estate planning. While it is clear from speeches at the time of the introduction of superannuation that it is not intended to be part of an estate but expended in retirement, the fact that individuals do not know when they are going to die results in a level of risk-aversion, which sees them planning for their funds to last 5–10 years beyond life expectancy. As a result, given that people die at different ages,

⁶⁰ *Retirement income worry: Who worries and why?*, Challenger and National Seniors Australia, January 2020, <https://nationalseniors.com.au/uploads/0120203573PAR-RetirementIncomeWorry-ChallengerRpt-FNREV_1.pdf>



superannuation does become part of estate planning in various instances. Without access to formal financial advice, Australians are at risk not only of not having sufficient capital for any years beyond life expectancy, but of not being able to manage other risks adequately and achieve a desired retirement income.

In 2016/17, around 2.6 million Australians sought financial advice (Investment Trends 2017). Most clients sought financial advice relating to superannuation (including self-managed superannuation funds) and loan and investment advice (IBISWorld 2018). However, Investment Trends estimates that about half of the Australian population (48%) have an unmet advice need...providing a great opportunity for the financial planning profession.⁶¹

Q26 Is there sufficient integration between the Age Pension and the superannuation

The Alliance is of the view that there is insufficient integration between the Age Pension and superannuation.

Leakage from superannuation will increase the costs of the Age Pension. The longer money stays in superannuation, the more Age Pension costs can be reduced. Age Pension rules are overly complicated and if simplified there would be less opportunity to undermine savings behaviour leading to perverse outcomes.

Australians are not homogenous. Those without financial literacy are most exposed if they do not seek financial advice, yet the cost of financial advice can prevent people seeking it. Below we discuss the outcomes that arise that have a strong negative impact on the system, and particularly on those who do not understand the complexities of the Age Pension and the superannuation system.

Minimum superannuation pension withdrawals

Accumulation funds pay 15% tax on investment income. There is no obligation to withdraw any money or start a pension in retirement, and it is possible to maintain an accumulation fund indefinitely and only make tax-free withdrawals (after age 60) from that fund as required. The accumulation fund continues to pay 15% tax on its income.

Superannuation pension funds pay no tax on investment income. Retirees who make withdrawals from such a fund also pay no tax after the age of 60. It is important to note that members of a superannuation pension fund have an obligation to progressively remove some of their money from the fund, in cash, and those mandated withdrawals increase with age as follows:

Table 3: Pension factors

Age	Factor
<65	4%
65-74	5%
75-79	6%
80-84	7%
85-89	9%
90-94	11%
>95	14%

Source: Australian Taxation Office

These pension factors have not been updated since 2007, although they were eased significantly during the GFC in response to the poor investment returns available at the time. There has been no recognition of increased life

⁶¹ Dante De Gori, CEO, Financial Planning Association, <<https://fpa.com.au/news/the-future-of-financial-planning/>>

expectancies since 2007 nor of the poor investment returns presently available to risk-averse retirees. This review should reconsider these mandated withdrawals in that context.

Of course, it is not compulsory for retirees to spend this mandated pension payment, but after it is removed from the fund, it is exposed to normal tax rates. The purpose and effect of these mandated pensions is to progressively remove money from the pension fund, so that that the pension fund does not leave a large inheritance of tax concessional money to be collected by beneficiaries of the estate.

How long a pension fund is able continue paying a pension depends on many factors including investment earnings, the rate of withdrawals and so on. Inevitably there comes a time when the investment earnings are insufficient to pay this minimum pension, and therefore assets need to be progressively liquidated to satisfy the requirement of mandated withdrawals.

A superannuation pension fund is designed to be depleted and when it is, most retirees fall back on the Age Pension as the universal safety-net. As mandated pensions become larger, they accelerate the rate of depletion of the capital in the pension fund. Taking a lump sum withdrawal has the same effect.

The requirement for mandated pension payments may contain the cost of superannuation tax concessions, but it encourages spending rather than capital preservation. The effect is that many people spend their savings before they need to and many retirees exhaust their superannuation savings before death. In today's environment of low investment returns and increased life expectancies it may also actually increase the cost of the Age Pension.

Australians have a history of accessing lump sums from their superannuation in retirement. The purpose of these withdrawals is not always to generate a long-term retirement income stream. This is aggravated by the fact that retirees can access their superannuation many years before they become eligible for the Age Pension.

As we have already noted in Q25, the percentage of Australians taking a lump sum payment is a measure of lack of access to formal financial advice. It is also a measure of low financial literacy because people with lower levels of financial literacy tend not to distinguish between capital and income. For them a large sum of money is like a lottery win and thus available for current expenditure.

Unless a lump sum withdrawal is used to purchase an income product such as an annuity (and that would be unusual), that money is no longer available to augment retirement income. As noted above, lump sum withdrawals compromise the superannuation fund's capacity to pay an income stream. Therefore, under the present rules, unlimited lump sum withdrawals from superannuation are likely to increase the cost of the Age Pension.

The availability of lump sums in retirement has another behavioural effect. It may actually encourage people to take on more debt during their working life. In effect, tax-free lump sum withdrawals allow people to mortgage their superannuation by promising to repay the debt on retirement when lump sums withdrawals from their superannuation become available. This may or may not be a valid use of these tax concessional savings, but it does not enhance retirement incomes and is likely to increase the cost of the Age Pension.

There is considerable evidence that people are accessing their superannuation tax-free after age 60 to pay down debts so that they enter retirement with little or no mortgage⁶², and on a full or part age-pension. In that context, it is worth noting that everyone is entitled to withdraw \$200,000 from superannuation tax-free at retirement, but if they postpone their retirement until age 60, they can withdraw *all* of their superannuation tax-free.

⁶² Alicia Hall, Statistics and Mapping, and Dr Matthew Thomas, Social Policy, *Declining home ownership rates in Australia*, Social Policy, Parliament of Australia, based on BS Census data, 1971 to 2016. 'Between 1987 and 2015, the real mortgage debt of older mortgagors aged 55+ blew out by 600%'



It is easy to see that for people with modest superannuation and a mortgage at age 60, it makes perfect sense to use that superannuation lump sum withdrawal to eliminate the debt and also qualify for the Age Pension. Their tax-concessional superannuation savings may allow them to live rent-free for the rest of their lives and pass the family home on to their children. Given the Age Pension's underlying bias towards home ownership and exemptions afforded the family home, that is perfectly rational behaviour.

The availability of lump sum withdrawals from tax-advantaged superannuation raises some interesting questions:

- Would people take on more debt as they approached retirement if superannuation withdrawals were limited to regular income payments rather than lumps sums?
- Is it valid to use the tax concessional savings of superannuation to eliminate lifestyle debt and still be eligible for the Age Pension? Is this double dipping from taxpayer subsidies?
- Is it government policy that housing in retirement has a higher priority than retirement income and that it is perfectly valid to eliminate housing debt from superannuation, even if that means an increased need for the Age Pension?
- If the family home can be transferred to beneficiaries to the estate tax-free, why can't superannuation have the same conditions if there was an upper limit and it could only be transferred to another superannuation fund where it would go on reducing the cost of the Age Pension for the next generation of retirees?



The Alliance
for a Fairer
Retirement
System

About the Alliance:

The Alliance for a Fairer Retirement System is a group formed to represent millions of senior Australians, shareholders, self-funded retirees and those planning a sustainable retirement, including over one million members of self-managed superannuation funds. The Alliance's mission is to help improve the existing superannuation taxation, Age Pension means testing and broader retirement income systems.

The organisations that form the Alliance include:

- Association of Financial Advisers
- Association of Independent Retirees
- Australian Investors Association
- Australian Shareholders' Association
- Gold Coast Retirees Inc.
- Listed Investment Companies & Trusts Association
- National Seniors Australia
- SISFA
- SMSF Association
- Stockbrokers & Financial Advisers Association
- WA Self Funded Retirees