Australian Government

RETIREMENT INCOME REVIEW

Consultation Paper
November 2019

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Contents

Abbreviations

ABS	Australian Bureau of Statistics
AIST	Australian Institute of Superannuation Trustees
APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AWOTE	average weekly ordinary time earnings
Cat. no.	catalogue number
CEPAR	ARC Centre of Excellence in Population Ageing Research
CGT	capital gains tax
CPI	consumer price index
DSS	Department of Social Services
DVA	Department of Veteran Affairs
FSC	Financial Services Council
GDP	gross domestic product
The Government	The Australian Government
LISTO	low income superannuation tax offset
LITO	low income tax offset
LMITO	low and middle income tax offset
MTAWE	male total average weekly earnings
OECD	Organisation for Economic Co-operation and Development
The Panel	The Retirement Income Review Panel
RBA	Reserve Bank of Australia
The Review	The Retirement Income Review
SAPTO	seniors and pensioners tax offset
SG	superannuation guarantee

Consultation process

Request for feedback and comments

Interested parties are invited to comment on the issues and materials raised in this consultation paper by Monday, 3 February 2020.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted. All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment.

Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

Closing date for submissions: 3 February 2020

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Retirement Income Review

On 27 September 2019, the Treasurer, The Hon Josh Frydenberg MP, and the Minister for Superannuation, Financial Services and Financial Technology, Senator the Hon Jane Hume, announced the Government had commissioned an independent review of the retirement income system; herein, 'the Review'. The Review is to report to the Government by June 2020 and has the following terms of reference.

Terms of reference

As recommended by the Productivity Commission in its report *Superannuation: Assessing Efficiency and Competitiveness* the Government is commissioning an independent Retirement Income Review.

Australia's retirement income system is based on three pillars:

- a means tested Age Pension;
- compulsory superannuation; and
- voluntary savings, including home ownership.

It is important that the system allows Australians to achieve adequate retirement incomes, is fiscally sustainable and provides appropriate incentives for self-provision in retirement.

The Review will establish a fact base of the current retirement income system that will improve understanding of its operation and the outcomes it is delivering for Australians. The Retirement Income Review will identify:

- how the retirement income system supports Australians in retirement;
- the role of each pillar in supporting Australians through retirement;
- distributional impacts across the population and over time; and
- the impact of current policy settings on public finances.

The Panel conducting the Review comprises Mr Michael Callaghan AM PSM (Chair), Ms Carolyn Kay, and Dr Deborah Ralston.

Foreword from the Panel

The Panel has been tasked with establishing a fact base to help improve understanding of how the Australian retirement income system is operating and how it will respond to an ageing society.

The retirement income system is fundamentally important to the Australian community. However, the settings for the system and its underlying principles have historically been a source of significant public debate. As part of its work, the Panel will undertake a holistic assessment of how the retirement income system is functioning and the interaction between the various components of the system.

Decisions around retirement income invariably involve a range of trade-offs. Judgement is required in determining the value of those trade-offs. It is ultimately up to the Australian community to make judgements about the merits of the various trade-offs. The contribution this Review seeks to make is to identify relevant issues, provide a better understanding of the nature and consequences of trade-offs, and develop a fact base to help the community make any decisions.

In helping to improve understanding of the retirement income system, the Panel will take note of the large range of research papers and reports that have been published on this topic, focusing on identifying the basis for some of the very different conclusions made in those papers and reports. The Panel will draw on the findings of the Productivity Commission report *Superannuation: Assessing Efficiency and Competitiveness,* which assessed the fees, investment returns, overall efficiency of the superannuation system, and how these factors affect retirement outcomes.

The Panel will undertake new analysis of the operation of the retirement income system, including modelling how the system performs today and how it will perform in the future.

The Panel welcomes contributions and invites submissions from the Australian community on the issues and material it should examine in establishing the fact base that will help improve understanding of the retirement income system. This consultation paper outlines some of the issues the Panel will be considering and is intended as a guide to those making a submission. While the Panel welcomes responses to the questions outlined in this paper, submissions need not be limited to these issues.

The Panel is interested in hearing views on any issues considered relevant to the Review. However, consistent with the focus of this Review on establishing a fact base to improve understanding of how the retirement income system operates, the Panel is seeking that supporting evidence is provided for views expressed in submissions to assist the Panel in its considerations.

The retirement income system

Most developed countries have a retirement income system to support their citizens as they age and retire from the workforce. Systems vary across countries and range from non-contributory public pensions which may be universal or means tested, compulsory public pensions with contributions linked to employment income, and voluntary savings which are often supported by tax concessions.

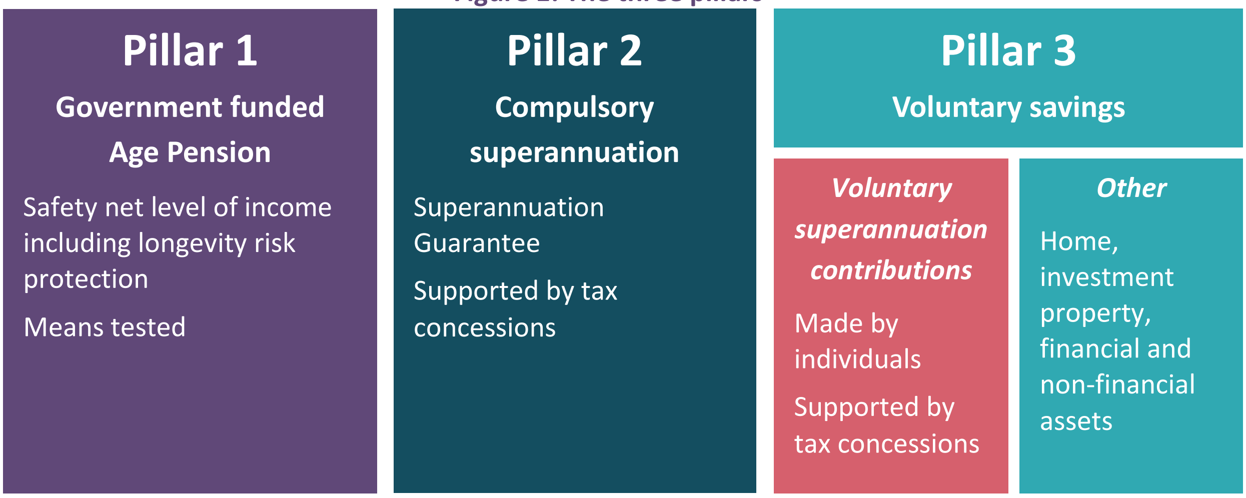
The Australian retirement income system has evolved over the past 110 years from a system which was largely focused on poverty alleviation via the Age Pension. The system now consists of three pillars which ensure all Australians have some income support in old age, and encourage individuals to make provisions during their working lives to support their retirement needs.

The three pillars of Australia's retirement income system

The three pillars of Australia's retirement income system (Figure 1) consist of:

- a publicly funded and means tested safety net in the form of the Age Pension;
- compulsory savings through the superannuation guarantee (SG); and
- voluntary savings through additional superannuation contributions and other financial or non-financial assets.

Figure 1: The three pillars



Age Pension

A national Age Pension was first introduced in 1909. Eligibility for the Age Pension is subject to age, residency, and means testing requirements to target it to those who need it most. Its coverage and settings have been refined over time to reflect changes in community expectations, including through increases in the level of the Age Pension relative to average wages. It is a taxable payment, however the seniors and pensioners tax offset (SAPTO) raises the effective tax-free threshold for eligible older Australians above the rate of the Age Pension.

The maximum rate of the Age Pension is currently around $24,300 a year for singles, and around $36,600 a year for couples combined, with additional rent assistance available to non-home owners.[1] The rate of the Age Pension is indexed twice a year to movement in prices and then benchmarked to

1 As at September 2019.

a proportion of male total average weekly earnings (MTAWE). The eligibility age is 66 years, increasing incrementally to reach 67 years on 1 July 2023.

Compulsory superannuation

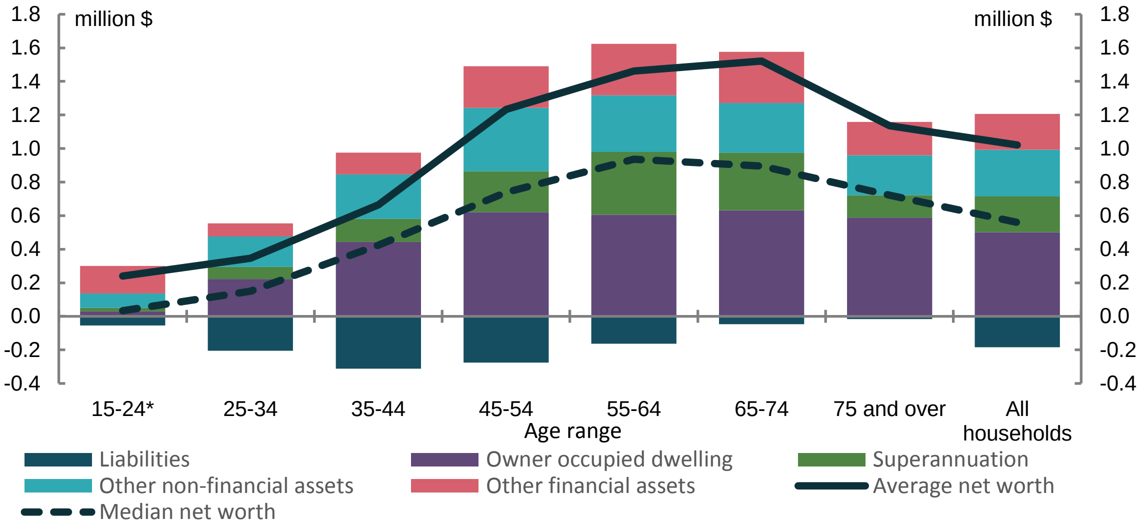
Compulsory superannuation was introduced in 1992 through the SG. Initially set at three per cent of an employee's ordinary time earnings, the SG rate has since increased to 9.5 per cent today and is legislated to reach 12 per cent on 1 July 2025. As at June 2018, 15.6 million people in Australia had a superannuation account (Productivity Commission 2018, p. 89), with median superannuation balances approaching retirement age (60-64 years) being $122,848 for women and $154,453 for men in 2016-17 (ATO 2019).

Tax concessions are provided for compulsory superannuation through a flat rate of 15 per cent tax on contributions and earnings. Low income earners (earnings below $37,000 per annum) are effectively refunded the tax on their contributions through the low income superannuation tax offset (LISTO) ensuring they do not pay more tax on these contributions than they do on their income. Contributions on behalf of high income earners (earnings of $250,000 and over per annum) are taxed at 30 per cent, which reduces the tax concession to these individuals. Earnings and income from superannuation are generally tax-exempt if aged 60 years or older. Savings cannot generally be accessed until an individual reaches their preservation age, which is currently 57 years and is incrementally increasing to reach 60 years from July 2024.

Voluntary savings

Voluntary savings can occur through many investment vehicles, such as business assets, real estate including owner-occupied dwellings, and other financial and non-financial assets. They may be accrued inside or outside of the superannuation system. Voluntary savings serve a number of purposes, including wealth accumulation, and may not only be intended to provide retirement income. The choice of savings vehicles by individuals will depend on their personal circumstances and ambitions. For example, small business owners may choose to build and hold their wealth in their business assets through a trust structure due to the asset protection this structure can provide.

Figure 2: Average net Australian household wealth by age group, 2017-18[2]



Source: ABS 2019a, cat. no. 6523.0.

2 Note: 'Other financial assets' is all financial assets excluding superannuation. 'Other non-financial assets' is all non-financial assets excluding owner-occupied dwelling. *Data for age bracket 15-24 years include standard deviations of up to 50 per cent and should therefore be used with caution.

Voluntary superannuation contributions can be used to facilitate higher superannuation balances at retirement. However, total superannuation contributions are generally capped at $25,000 of pre-tax income and $100,000 of post-tax income each year. Voluntary superannuation contributions are a particularly important savings option for individuals who are not covered by compulsory superannuation.

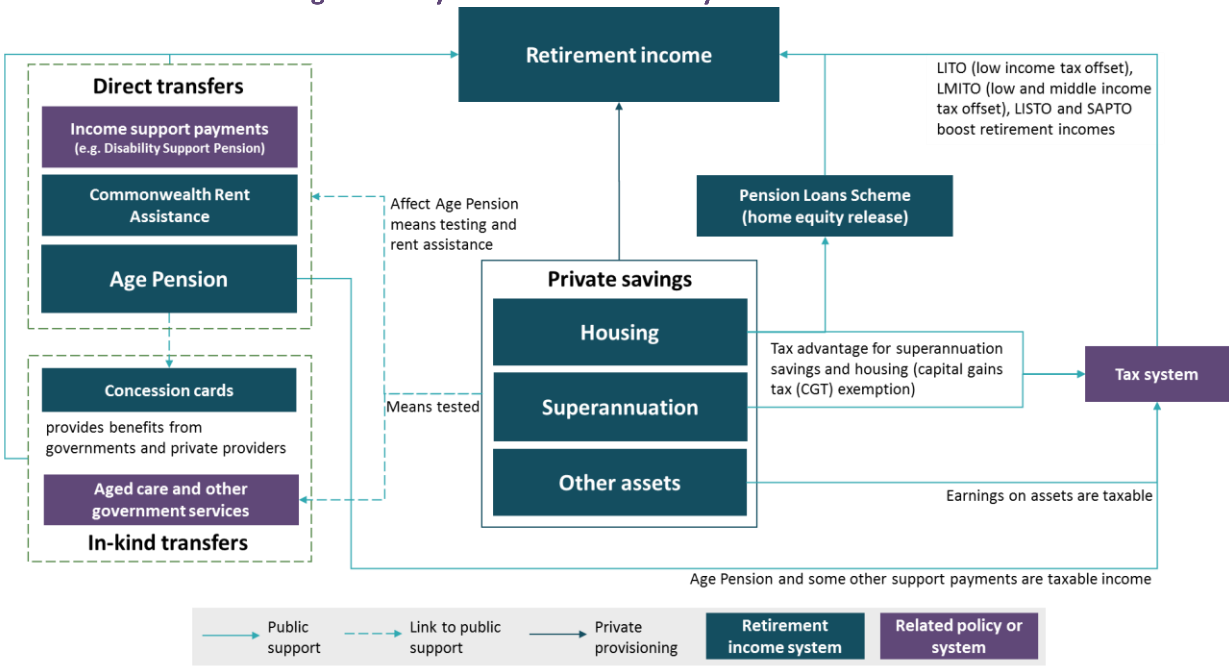
As demonstrated by Figure 2, most household wealth for individuals aged 65 and over is held outside the superannuation system, with owner-occupied dwellings the largest asset for these cohorts. Outright home ownership supports retirement income by reducing ongoing expenses and acts as a store of wealth that can be accessed in retirement.[3]

System interactions

For the retirement income system as a whole to deliver for Australians in their retirement the pillars of the system need to interact effectively and be flexible and responsive to allow individuals in diverse circumstances to achieve adequate retirement incomes.

The retirement income system has many elements that can interact in complex ways. Key interactions between the elements of the retirement income system and other policies are outlined in Figure 3. The diverse personal circumstances of retirees can contribute to complex interactions, creating the potential for significantly different retirement income outcomes between individuals. These outcomes are also affected by interactions with other policy areas – such as aged care, health and taxation. The Review will explore how these interactions affect outcomes for retirees, but will not consider these policy areas in detail.

Figure 3: Key retirement income system interactions



3 For the purposes of this paper, 'home ownership' refers to 'ownership of one's principal place of residence' (with or without a mortgage) rather than ownership of residential real estate for investment purposes.

How Australia's system compares internationally

Australia has a uniquely structured retirement income system. The 'first pillar', the Age Pension and Service Pension, have high coverage (around 68 per cent of retirees), compared with around 30 per cent across Organisation for Economic Co-Operation and Development (OECD) countries. However, it has a modest entitlement (relative to average earnings) compared to contributory social security schemes where benefits are linked to a proportion of pre-retirement earnings (CEPAR 2018a, pp. 10-12). The publicly-funded Age Pension has a flat maximum rate regardless of an individual's earnings history. This sets it apart from many international systems where benefit entitlements are funded by payroll taxes (such as in the United States, Norway and Switzerland). It is also means tested (unlike New Zealand, for example, which pays a pension to all eligible retirees).

Australia's 'second pillar', a privately-managed superannuation system, is also distinct. It is compulsory for most employees, unlike comparable schemes in Canada and the United States. It is primarily a defined contribution scheme, in contrast to the largely defined benefit structure of many employer-based saving schemes in the OECD. The flexibility that Australia's system provides to individuals to decide how to draw down their retirement savings is also distinct from other countries which generally deliver retirement benefits as income streams. Australia's defined contribution scheme requires the individual, rather than the Government or employers, to bear the risks associated with investment, such as longevity risk and inflation. However, as income drawn from this pillar is backed by assets in retirement, it avoids risks of future governments reducing entitlements to address budgetary pressures that can occur in unfunded or partly funded social insurance schemes.

Australia's 'third pillar' is voluntary savings. For many Australians, the family home is the most significant form of voluntary savings and Australian retirees have historically had a relatively high level of home ownership compared to other countries.

The Melbourne Mercer Global Pension Index (Mercer 2019) ranks the performance of a range of international retirement income systems according to adequacy, sustainability, and integrity sub-indices. In 2019, the index ranked the Australian retirement income system third out of 37 countries' systems, behind those of the Netherlands and Denmark.

Consultation question:

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

Purpose of the system and role of the pillars

Purpose of the retirement income system

Australia's retirement income system aims to allow older Australians to achieve adequate income in retirement, in a way that is sustainable for current and future generations. Although individuals often focus on accumulating assets for a retirement 'nest egg', generating income to support consumption in retirement is the primary purpose of the system.

The retirement income system is not intended to boost private savings per se, nor is it intended to be a source of savings for the purchase of large assets during an individual's life (such as housing), or to assist with wealth accumulation in order to provide for inheritances. This is reflected in policy settings such as the restricted access to superannuation before preservation age, minimum drawdown rules for superannuation, and the means testing of the Age Pension.

Consultation questions:

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

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

Role of the pillars

The Review has been tasked with identifying the role of each of the pillars of the retirement income system. There is no legislated objective for any of the pillars, and community expectations regarding their role have changed over time as the system has developed. Debate on the outcomes each pillar should seek to deliver, and the appropriate balance between the pillars, is ongoing.

The Government, private sector institutions, and individuals have shared responsibility in delivering retirement outcomes. The Government is responsible for designing a system that generates the right incentives, contains appropriate default settings that still allow for choice, and provides a safety net; the private sector (superannuation funds and financial advisers) is responsible for ensuring individuals get the best outcomes from their savings; and individuals are ultimately responsible for managing their financial affairs to deliver their desired outcomes in retirement, including through voluntary saving.

The Age Pension

When it was first introduced, the Age Pension was viewed as a poverty alleviation measure for older Australians. The Age Pension continues to be means tested to serve as a safety net; however, the settings have changed over time to reflect considerations around adequacy, fairness, and sustainability. The Pension Review Report (Harmer 2009, p. 8) considered that the Age Pension, should provide a 'basic acceptable standard of living, accounting for prevailing community standards'. Following this review, the rate of the Age Pension was lifted and its indexation arrangements were altered to better reflect prevailing community expectations.

Compulsory superannuation

One reason for the introduction of compulsory superannuation was to counter concerns that people do not voluntarily save enough for their retirement. Compulsory superannuation enables employees to achieve a higher level of retirement income compared with relying solely on the Age Pension. When first introduced, compulsory superannuation was also seen as an important mechanism for increasing national savings and improving the flexibility of future government budgets in the face of an ageing population (Dawkins 1992).

In 2016, attempts by the Government to legislate that the objective of the superannuation system is 'to provide income in retirement to substitute or supplement the Age Pension' prompted further debate on what level of financial support the superannuation system should aspire to provide to individuals.[4] A range of alternate objectives were put forward, including that superannuation should seek to deliver a 'comfortable' or 'dignified' standard of living or 'adequate' income in retirement (Parliament of Australia 2017).

Voluntary savings

The appropriate role of voluntary savings (inside or outside of the superannuation system) within the broader retirement income system has never been settled.

The family home is an important voluntary savings vehicle for the majority of Australians as it materially reduces expenses in retirement and as a result improves standards of living in retirement. Voluntary savings are also crucial to the retirement incomes of those individuals not covered by compulsory superannuation, such as sole traders and small business owners who may consider their business assets to be an investment for their retirement.

More broadly, voluntary savings allow individuals to choose how much they save for their retirement, and the investment vehicle in which they save, providing an opportunity for Australians to tailor their retirement income plans to suit their goals and preferences.

Consultation questions:

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

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?

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?

4 In 2016 the Government introduced the Superannuation (Objective) Bill 2016. The Bill lapsed in the Parliament of Australia when the 2019 Federal Election was called.

The changing Australian landscape

The retirement income system's ability to support Australians in retirement over time is impacted by broader demographic, economic, and workforce trends. It is important to understand changes in the way Australians work and live to evaluate the system's ability to deliver now and in the future.

Maturity of the superannuation system

It has been nearly 30 years since the introduction of compulsory superannuation. Since then, there has been significant growth in assets held by superannuation funds on behalf of their members. Funds under management have grown from $229 billion in June 1995 to nearly $2.9 trillion in June 2019 (APRA 2005; APRA 2019). This reflects growth in the number of superannuation accounts and the size of superannuation balances, in part due to increases in the SG rate over time. It will not be until 2042 that workers will have experienced a SG rate of at least nine per cent for 40 years of their working lives. Over coming decades, the volume of assets under management is expected to continue to increase as the system approaches maturity.

Home ownership

Over the past 20 years, rates of home ownership have declined across all age groups. For households aged 35-44, the home ownership rate has fallen from around 73 per cent in 1995-96 to 62 per cent in 2017-18. While older households continue to have high levels of home ownership, they are increasingly approaching retirement with mortgage debt – up from 13 per cent of households aged 55-64 in 1995-96 to 40 per cent in 2017-18 (ABS 2019b).[5] If this trend continues, a growing number of households may enter retirement as renters or while still servicing a mortgage on their home.

Life expectancy and demographic trends

Life expectancy has increased significantly since the introduction of the Age Pension over 100 years ago. Compared with the early 20th century, more men and women will reach old age and those that do can expect to spend more time in retirement. On average, both men and women are expected to live into their 80s rather than their 50s, which was the case when the Age Pension was introduced (ABS 2019c; ABS 2019d).

Despite improvements in population life expectancy over the last century, life expectancy at birth for Aboriginal and Torres Strait Islander Australians remains below that of the broader population, at almost 72 years for men and 76 years for women (ABS 2018).

The age profile of the population has also changed. Australians aged over 65 currently make up around 16 per cent of the population, compared to around 8 per cent in 1971 (ABS 2019e). This is partly a consequence of changes in life expectancy and a historic decline in fertility rates. These trends have partly been offset by an increase in net overseas migration, as immigrants are generally of working age. Changing age profiles have implications for the size of the population relying on retirement incomes and the length of time retirement savings need to last.

Labour market participation

The composition of Australia's workforce has changed over time. The trend has been towards more working age Australians participating in the labour market. Rates of workforce participation have

5 Household age group refers to the age of household reference person.

grown from an average of 60.7 per cent in 1979 to 66.0 per cent in October 2019 (ABS 2019f; ABS 2019g). Perhaps the biggest change has been the increase in female participation from an average of 43.5 per cent in 1979 to 61.2 per cent in October 2019 (ABS 2019f; ABS 2019g).

The profile of working life has also shifted. The average Australian is now taking longer to commence full time work and is expecting to retire later in life. These trends are reflected in an increase in the participation rate among over 65s and a decline in the proportion of Australians in their early 20s who have commenced full time work (ABS 2019g; ABS 2019h). The changing pattern of work affects individuals' ability to save for retirement, for example, by delaying when they start accumulating savings for retirement. However, the increase in older Australians participating in the workforce also provides a greater opportunity for those workers to boost their retirement incomes. Nevertheless, some older workers report being unable to retain or find employment, despite a willingness to remain in the workforce.

Finally, there is increasing commentary that the way Australians work is changing, including through the emergence of the sharing economy. There is, however, limited data to determine whether this is a long-term trend and its significance to the broader labour market.

Broader economic trends

The Australian economy has experienced 28 consecutive years of annual economic growth. Over this period, average economic growth has been 3.1 per cent per year and the growth in the consumer price index (CPI) has averaged 2.4 per cent per year (ABS 2019i; ABS 2019j).

The unemployment rate was 5.3 per cent in October 2019, which is low by historical standards and below its most recent peak of 6.4 per cent in October 2014 (ABS 2019g). However, wage growth in Australia, as in other advanced economies, has been subdued in recent years. Persistent low wage growth can affect the income achieved during working life as well as individuals' ability to save for retirement.

The Reserve Bank of Australia's (RBA) target cash rate has been falling from its recent peak in October 2011 of 4.75 per cent to a current record low of 0.75 per cent. Consistent with this, returns on fixed interest investments, such as bank deposits and government bonds, have been steadily declining over this period.

However, the Australian equity market and many of its international counterparts have performed strongly over the past decade, albeit with some periods of turbulence in the past few years. Australia's superannuation funds have a relatively high exposure to growth assets by international standards. This has supported solid investment performance, with a 'balanced' investment strategy averaging returns of 6.7 per cent over the past decade (Chant West 2019).

These broader economic trends affect the outcomes delivered by the retirement income system; for example, through the ability of working age Australians to gain employment and make superannuation contributions, and the earnings achieved by savings.

Consultation question:

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?

Principles for assessing how the system is performing

The Panel has been tasked with identifying the facts that will help improve understanding of how the retirement income system operates and the outcomes it is delivering for Australians. The terms of reference for the Review state that 'it is important that the system allows Australians to achieve adequate retirement incomes, is fiscally sustainable and provides appropriate incentives for self-provision in retirement.' In this context, the Panel has identified four principles it proposes to use to assess the performance of Australia's retirement income system. They are:

- Adequacy – whether the system allows for Australians to achieve an adequate standard of living in retirement.
- Equity – whether the system produces fair outcomes for different groups of Australians.
- Sustainability – whether the system is able to continue to meet its objectives into the future and maintain broad community support.
- Cohesion – whether the incentives across the system reinforce or conflict with the system's objectives both before and during retirement.

These principles each provide a different lens on the performance of the retirement income system. They may reinforce or conflict with each other for different aspects of the system, reflecting the trade-offs that exist within the system.

The Review will seek to establish evidence to assess how the system performs against each of the principles, as well as where trade-offs exist between them.

Consultation questions:

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?

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?

Adequacy

What is meant by adequacy

No consensus exists on what is the best metric to measure an adequate retirement income, moreover, it will vary between individuals, based on personal preferences and circumstances, including working life income. Despite this, a measure of adequacy can provide a reference point for Australians to help them understand their needs in retirement and the level of savings required to support those needs. Adequacy measures are also useful for assessing whether outcomes delivered to different groups by the retirement income system are appropriate.

Adequacy considerations

There are a number of questions the Panel proposes to consider when assessing the adequacy of the retirement income system. These include:

- What are the relative strengths and weaknesses of different measures of adequacy?
  - Are there circumstances where one measure of adequacy is superior to another?
  - What are appropriate assumptions to use when determining adequacy?
- What factors affect whether retirement income is adequate?
  - How does the pattern of consumption needs during retirement affect the level of income that is adequate?
  - How do measures of adequacy take into account the different characteristics of retirees and the level of government support they receive?

Consultation question:

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

Measures of adequacy

Measures of retirement income adequacy can be classified as either absolute or relative measures.

Relative measures

Relative adequacy measures estimate retirement income requirements by defining benchmark replacement rates based on an individual's income or expenses prior to retirement.

A benchmark replacement rate in retirement could be set to allow an individual to maintain a similar lifestyle in retirement (i.e. achieve 'consumption smoothing') to that enjoyed pre-retirement. Given replacement rates are usually framed as a percentage of pre-retirement income or expenditure, they may allow individuals to calculate a retirement income goal for their own circumstances.

A key weakness of system-wide measures of replacement rates is they need to be higher for individuals on low incomes to avoid the risk the replacement rate results in incomes associated with poverty. To avoid this outcome, a different replacement rate could be set for those on higher incomes to those on lower incomes. Alternatively, a replacement rate could be combined with an absolute minimum income target to establish a baseline income.

Most benchmark replacement rates deliver a lower level of income in retirement relative to working life income. This is based on an assumption that retirees do not face a number of key working life expenses such as mortgage repayments. While a number of benchmark replacement rates have been proposed by different groups, these generally suggest a replacement rate of between 60 per cent and 70 per cent is appropriate for most people. For example, the OECD (2012, p. 161) suggested a benchmark replacement rate of 70 per cent of pre-retirement income, while the Superannuation Charter Group (2013, p. 21) recommended a replacement rate of 60 per cent to 70 per cent, and Rice and Bonarius (2019, p. 18) have suggested a benchmark of 75 per cent.

An alternative method for calculating a relative adequacy benchmark is to define retirement income requirements against an indicator of community living standards, such as an absolute poverty indicator or average weekly ordinary time earnings (AWOTE). While this kind of method may indicate whether an individual will experience poverty in retirement, it does not consider the person's pre-retirement living standards and therefore may not meet expectations.

Views differ about how to calculate replacement rates. For example, the same replacement rate may generate a different income level depending on the period of retirement and working life which form the basis of the underlying calculation, since neither working life nor retirement income and expenditure is generally constant. This is particularly the case for individuals with broken work patterns. The World Bank (1994, pp. 293-294) identified how the period of pre-retirement earnings used in calculating replacement rates, along with whether the calculation uses pre or post-tax income, can result in a replacement rate yielding significantly different retirement incomes.

The largely defined contribution structure of Australia's superannuation system may also influence the ability of the system to achieve targeted replacement rates for all Australians. Recognising this challenge, the Australia's Future Tax System Review (Henry 2009, p. 1) suggested superannuation guarantee contributions be 'benchmarked by reference to moderate potential replacement rates for retirees with a full history of contribution at median to average earnings.'

Absolute measures

Absolute measures of adequacy attempt to place a dollar value on the income or expenditure required to support a particular lifestyle in retirement, with no reference to the individual's pre-retirement lifestyle. These measures can define the income or expenditure required to achieve a minimum adequate standard of living. Alternatively, they can define the income or expenditure required to achieve a higher standard of living by including discretionary spending. Measures that are more aspirational will incorporate more discretionary spending and target higher incomes.

Absolute measures may be useful for individuals who want to achieve a particular lifestyle in retirement. They are also easy to understand, especially when they define the level of savings required at retirement to achieve a particular income, which can assist with retirement planning.

A key weakness of absolute measures is that they do not consider an individual's pre-retirement living standards (i.e. they do not attempt to facilitate 'consumption smoothing'). As a result, they do not take into account the trade-off between working life and retirement living standards.

An example of an absolute measure is the Association of Superannuation Funds of Australia's (ASFA 2018) Retirement Standards. These define the annual expenditure and superannuation balance needed for singles and couples to fund either a 'comfortable' or 'modest' standard of living in retirement.[6]

6 ASFA considers a 'modest' retirement lifestyle is better than the Age Pension, but only allows for the basic consumption needs. A 'comfortable' retirement lifestyle enables a healthy retiree to be involved in a broad range of leisure and recreational activities and to have a good standard of living through the purchase of things such as household goods, private health insurance, a 'reasonable' car, good clothes, a range of electronic equipment, and domestic and occasionally international holiday travel. Both standards assume outright home ownership.

Additional issues affecting both types of measures

The following factors can affect both the replacement rate required to maintain living standards and the income and consumption required to achieve a particular lifestyle.

- Indexation of income or expenses. There are differing views about the appropriate indexation of pre-retirement and retirement income and expenses. Proponents of wage-based indexation argue retirees should benefit from productivity improvements in the broader economy, despite no longer being in the workforce. Proponents of inflation-based indexation argue wage-based indexation overstates the financial requirements of retirees, as individuals generally spend less as they grow older, but are nonetheless affected by changes in overall prices.
- Pattern of consumption needs during retirement. There is debate about expenditure patterns during retirement. Some analysis of core consumption needs (AIST 2016, p. 22) suggests they remain constant during retirement because some expenses increase while others decrease.[7] Other analysis (CEPAR 2018a, p. 22) suggests expenditure declines for older households after age 60, largely due to lower spending on transport, food, and clothing.
- Characteristics of the individual and government support. Variation in the characteristics of individuals (e.g. home ownership status, relationship status and workforce participation) and government support can affect the level of income or consumption required to achieve a particular lifestyle or maintain living standards in retirement. Such variation may mean there is no one-size-fits-all replacement rate or income benchmark.

Assessing the adequacy of the system

As discussed above, what constitutes an 'adequate standard of living' will vary between individuals, based on their personal preferences and circumstances, as well as their expenditure needs in retirement. As a result, the Panel proposes to assess the extent to which the system delivers fair and adequate outcomes for different individuals and groups. Factors which may have a particular bearing on the adequacy of retirement incomes include gender, marital status, longevity, health and aged care costs, and, for non-home owners, accommodation costs.

Analysis of adequacy in this context will be supplemented with consideration of measures of financial hardship for individuals and groups with different characteristics. This will help identify whether or not the system delivers adequate retirement incomes for such groups.

Consultation questions:

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?

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

7 This analysis found households do not show a decline in expenditure through the course of retirement, although expenditure on food decreased slightly and expenditure on utilities increased slightly after age 75.

Equity

What is meant by equity

The outcomes the retirement income system delivers vary depending on an individual's circumstances and life experience. Equity considers the systemic issues that affect whether those outcomes are fair and adequate in the circumstances, including whether individuals in similar circumstances achieve similar outcomes in retirement, and whether public support is appropriately targeted to those who need it most.

Equity considerations

There are a number of questions the Panel proposes to consider when assessing the equity of the retirement income system. These include:

- Whether outcomes for individuals in different circumstances are fair and adequate.
  - Does the system provide equitable outcomes for women, given they are more likely to take career breaks, work part-time and have lower lifetime earnings and longer life expectancy?
  - Are individuals' needs for income before and after retirement appropriately balanced?
  - Do similar individuals in different generations bear greater costs or receive greater benefits from the system?
  - What outcomes does the system deliver for individuals who experience circumstances such as disability, lower life expectancy, financial hardship, involuntary retirement, career breaks, and relationship breakdowns?
- Whether individuals in similar circumstances achieve similar outcomes.
  - Does the system deliver similar outcomes for individuals who have the same lifetime income, regardless of how they are employed?
  - Does the system deliver similar outcomes for individuals with similar levels of total wealth, regardless of how their assets are held?
- Whether public support is appropriately targeted.
  - Does the system provide most support to those with the least capacity to save for and support themselves in retirement?
  - Is support for non-home owners equitable?

Consultation question:

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

Assessing whether the system is equitable

Fair and adequate outcomes

The retirement income system should deliver outcomes both before and in retirement, for all generations and for individuals in particular circumstances, that are fair and adequate given the circumstances and the degree of control individuals have over those circumstances.

- Women are more likely than men to have broken work patterns due to family responsibilities. Time out of the workforce and part-time work affect women's lifetime income levels and their ability to save for retirement. In addition, during career breaks women tend to forgo compulsory superannuation. The wages gap between men and women further affects women's ability to save for retirement. These factors, among others, have led to women retiring with lower average superannuation balances than men (CEPAR 2018b, pp. 15-17).

- There is generally a trade-off between consumption before and during retirement. While the degree to which compulsory superannuation is paid for by employees in the form of reduced take-home wages is debated, the policy of preservation means these resources are generally not available for needs arising during working life. Voluntary retirement savings, however, result in a direct reduction in pre-retirement consumption. Ideally, the retirement income system should support individuals to save enough to allow consumption smoothing over their lifetime without deferring too much consumption to their retirement at the expense of living standards during working life.
- Where one generation is required to fund their own retirement as well as the retirement of a previous or future generation they may view this as inequitable. Age Pension expenditure is funded from government revenue, affecting the tax impost on working Australians. Australia's ageing population means there will be a declining number of workers for every retiree. It is therefore important the retirement income system does not place an undue fiscal burden on future generations.
- Retirement outcomes for individuals and groups will be affected by a range of life events and circumstances. Where those events reflect an individual's choices (e.g. voluntary early retirement) there does not appear to be a strong rationale for the system to compensate for any forgone retirement income. However, in circumstances that are beyond the control of the individual such as disability, involuntary retirement, financial hardship, and lower than average life expectancy (e.g. Aboriginal and Torres Strait Islander people) there may be benefit in ensuring that individuals are not unreasonably disadvantaged in retirement.

Individuals in similar circumstances achieve similar outcomes

Individuals who have the same lifetime earnings and the same levels of total wealth at retirement should expect to have similar outcomes in retirement. However, this does not necessarily occur.

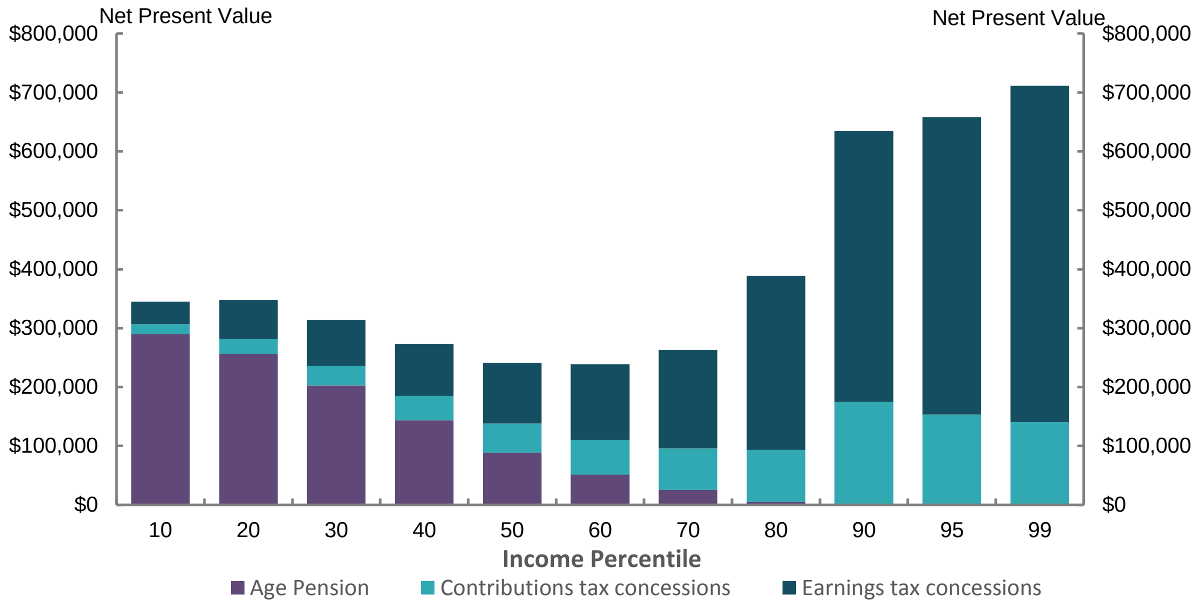
- The self-employed and workers earning less than $450 per month from an individual employer are not required to be paid compulsory superannuation. This can result in these individuals retiring with significantly lower levels of retirement savings than individuals covered by compulsory superannuation, even where their total lifetime earnings are the same.[8] In addition, where individuals have employers who don't meet their SG obligations this can affect superannuation balances at retirement.
- Similar Age Pension payments can be provided to individuals with different levels of total wealth due to the design of the means tests for income and assets. The income test uses proxy or deemed rates of return to determine income from financial assets rather than assessing actual income. This means that an individual's rate of Age Pension depends not only on their level of wealth but also how they hold their wealth and the deemed rates applied. Additionally, non-home owners can have around $210,000 more in assets than a home owner before their pension is affected by the assets means test, in recognition that they do not benefit from the exemption of the family home from the assets test. They may also be eligible for Commonwealth Rent Assistance.

8 Tax concessions are provided to some of these individuals to support voluntary savings. For example, small business owners can access the small business CGT concessions, which can support higher retirement incomes for this group. Workers outside the compulsory superannuation system may also be able to claim a personal income tax deduction for voluntary contributions to superannuation.

Public support is appropriately targeted

The overall level of public support provided by the retirement income system should be targeted to those who need it most. Higher income earners generally have a greater capacity to accumulate savings pre-retirement and make larger superannuation contributions. This can lead to higher tax concessions being provided to this group as a result of the generally flat rates of tax on superannuation contributions and earnings. The application of an additional 15 per cent tax on superannuation contributions for those with total remuneration of $250,000 or more, combined with the LISTO (which effectively refunds contributions tax for low income earners) are designed to reduce the 'gap' in tax concessions between low and high income earners. The Age Pension means test also acts to narrow the gap in retirement outcomes across groups with different levels of household wealth by targeting government support in retirement to lower wealth households. Nevertheless, cameo modelling suggests that over a lifetime, more public support may be provided to those in higher income brackets (Figure 4).

Figure 4: Lifetime government support provided through the retirement income system[9]



Source: Treasury calculations using a hypothetical cameo model

The family home is an important asset for retirement. Pensioners aged over 65 who live in their own home have much lower rates of financial hardship than those renting privately (Daley and Coates 2018). The family home can store equity for use in retirement through downsizing or a reverse mortgage. In addition, home owners with no mortgage are likely to have lower housing costs than those with mortgages and those who rent. The family home is exempt from the Age Pension means test. The financial benefit of owning a home can be well in excess of the support available through Commonwealth Rent Assistance to renters.

9 Calculations assume that individuals commence work in 2018-19 at age 27 and work until age 67, with a predicted life expectancy of 92. Accumulated superannuation benefits are invested in an account based pension and individuals are assumed to draw down their assets at current age based minimum drawdown rates. The level of tax assistance and Age Pension entitlements are discounted by nominal gross domestic product (around 5 per cent per annum) to give a net present value in 2018-19 dollars. Annual incomes are calculated for each percentile based on the distribution of earners at each single year of age. Assumes no non-concessional contributions.

Consultation questions:

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.)?

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

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

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

Sustainability

What is meant by sustainability

Sustainability considers the extent to which the system will be able to continue to deliver adequate retirement incomes in the future and the degree of public confidence in the system.

There is a natural tension between the principles of sustainability and adequacy. Higher levels of retirement income risk being unsustainable over the long term (Mercer 2016, p. 9). The system needs to balance these two principles by providing government support to individuals that delivers a level of retirement income that is adequate and which can be maintained over the long term.

Sustainability considerations

There are a number of questions the Panel proposes to consider when assessing the sustainability of the retirement income system both in the short term and longer term. These include:

- What is the cost of the system to public and private finances?
- To what degree is there public confidence that the system is delivering, and will continue to deliver, on its intended outcomes?
- What is the system's ability to adjust for trends and withstand one-off shocks?
- Is there evidence individuals are saving more than they need to deliver adequate retirement income?

Consultation question:

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

Assessing whether the system is sustainable

Cost to public finances

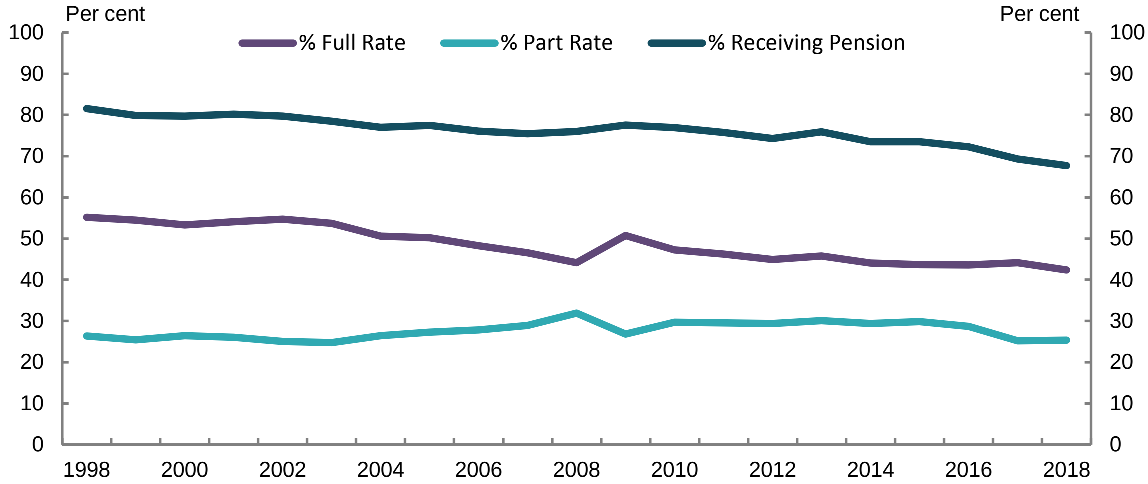
The retirement income system's sustainability is influenced by its cost to taxpayers and how effectively these public resources are used. The Government provides a wide range of tax concessions on compulsory superannuation and voluntary savings. In addition, it provides direct support in the form of the Age Pension and subsidies on health and aged care services. Understanding future trends in these direct and indirect expenditures will help inform the sustainability of the system.

A tax concession arises where special conditions – such as exemptions, deductions, or concessional tax rates in the case of superannuation – differ from the standard or 'benchmark' tax arrangements. Measuring tax concessions requires judgments about how individuals would behave in the absence of the concession. Different assumptions will give a different result for the size of a particular tax concession.

Superannuation earnings attract the largest superannuation-related tax concession in dollar terms, closely followed by employer superannuation contributions. The revenue forgone as a result of superannuation tax concessions is expected to continue to grow as the superannuation system matures. Tax concessions are also available on other savings vehicles; for example, the sale of the primary residence is exempt from CGT and most other assets attract a 50 per cent CGT discount if owned for 12 months or more.

In 2018-19, around 2.5 million older Australians received direct support through the Age Pension, at a cost of around $47 billion (2.4 per cent of GDP). Over the past 20 years, the proportion of the eligible population on the Age Pension or a Service Pension has declined from over 80 per cent, to around 68 per cent.[10] This has largely been due to a decrease in the proportion of full rate Age Pensioners, with the proportion of the eligible population on a part rate Age Pension largely unchanged (Figure 5). Older Australians are also increasingly choosing to extend their working lives through part-time work (AIHW 2015, p. 229). At June 2019, around 130,000 individuals over Age Pension age received some other form of income support payment, such as the Disability Support Pension, Carer Payment or Special Benefit. OECD analysis (2017, p. 143) shows that Australia's public expenditure on cash benefits for old-age pensions and survivor benefits as a percentage of GDP is lower than the OECD average.

Figure 5: Proportion of eligible population receiving the Age and Service Pensions over time



Source: Rice Warner, based on ABS population and DSS and DVA pension statistics

The Australian Government also provides discounted health services and medicines, amongst other things, through the Pensioner Concession Card and the Commonwealth Seniors Heath Card. State, territory, and local governments and private enterprises also provide benefits to holders of these cards.

Both the Australian Government and state and territory governments provide substantial assistance to older Australians through aged care and health services. In 2017-18, Australian Government expenditure on aged care was $18.1 billion, making up around 68 per cent of residential care providers' revenue and over 90 per cent of home care providers' revenue (ACFA 2019). While not formally part of the retirement income system, this assistance has implications for its adequacy and sustainability.

Public confidence in the system

The ability of the retirement income system to deliver on its purpose partly depends on Australians having confidence in its settings and long term sustainability. Where individuals do not have confidence in the system, they may reduce voluntary savings or save excessively as a precautionary measure. A perception of a lack of stability in the system may also have implications for community confidence. This is particularly the case for superannuation given the long lead times individuals face when planning for retirement (Financial System Inquiry 2014, p. 2-118).

Saving for retirement requires long term decision making. Over time, successive governments have made changes to the retirement income system. While some of these changes have focused on

10 Service pensions are paid by the Department of Veteran's Affairs to eligible ex-servicemen and women of Service Pension age.

improving consumer outcomes, other changes may have substantially affected retirement planning decisions. Some stakeholders have suggested that any changes to superannuation or Age Pension settings could be considered retrospective for current retirees (Hammond and O'Brien 2017). Others have suggested this undermines confidence in the longevity of the system's features, reducing confidence in retirement planning decisions and promoting disengagement (for example, SMSF Association 2017, p. 3; FSC 2014, p. 33; ASFA 2017).

The degree to which individuals can easily understand the outcomes the system is likely to deliver for them, given their personal circumstances, also affects overall confidence in the system. This issue is discussed further in the chapter on Cohesion.

Effects on overall private savings

Compulsory superannuation has resulted in households on average having more wealth at retirement today than in the past (CEPAR 2018a, pp. 18-20). Superannuation is becoming an increasingly important asset for retirees as the superannuation system matures. Between 2013-14 and 2017-18, average household wealth held in superannuation increased by around 16 per cent to $374,000 for individuals aged 55 to 64 (ABS 2019a). In addition to compulsory superannuation contributions, significant voluntary contributions are made into superannuation, particularly by individuals approaching retirement. Superannuation concessions are likely to encourage this, though the extent to which these savings would otherwise have been made is not clear.

Compulsory superannuation has led to more wealth on average at retirement, however, it may have also led to some households saving less through other means (Connolly 2007).[11] While there are many factors affecting household borrowing, taking on more debt may be associated with growth in retirement assets on household balance sheets. Household debt as a percentage of annualised household disposable income has risen from 71 per cent in June 1992, when compulsory superannuation was introduced, to 191 per cent in June 2019 (RBA 2019). This increase has largely been driven by mortgage debt and has contributed to more households approaching retirement with mortgages.

Nevertheless, growing household wealth at retirement has resulted in a reduction in the proportion of the eligible population receiving the Age Pension over the past two decades.

Changing trends and one-off shocks

The retirement income system needs to be able to accommodate a range of demographic and economic trends without requiring a significant increase in government support. The system also needs to be able to withstand one-off shocks without significantly compromising its ability to deliver on its objective.

- Increasing life expectancy and decreasing home ownership could see higher expenses in retirement and an increase in longevity risk for individuals. These factors could lead to a higher level of savings required to support an adequate retirement income.
- Over the past ten years, returns on low risk investments such as term deposits have fallen. Some individuals nearing or in retirement may invest conservatively to reduce the risk of capital loss through fixed interest assets. Where low interest rates persist, higher total savings or increased investment in riskier assets may be needed to support the same level of income over the same time period. Additionally, the trend in interest rates identified above has, and may continue, to affect the public cost of the retirement income system through changes in the social security deeming rates and the interest rate used by the Pension Loans Scheme.

11 This research estimates that an extra dollar in compulsory superannuation savings leads to a reduction in voluntary savings of 10 to 30 cents.

- Changes in labour market trends could affect the proportion of the population covered by compulsory superannuation.
- Major economic crises, such as a global recession or downturn could place pressure on the retirement income system. A major economic crisis could see low investment returns and a fall in asset prices, potentially resulting in increased dependency on the Age Pension.

Individuals saving beyond their retirement income needs

During their working lives, individuals may choose to save more for retirement than would be required to provide an adequate lifestyle in retirement. This could be because they wish to have a higher standard of living in retirement, or because they lack confidence in the long term structure and settings of the system (as discussed above) and want to ensure they have sufficient savings for retirement.

Research has shown that many households in retirement are net savers (i.e. their income is greater than their expenditure) (CEPAR 2018a, p. 22). In addition, superannuation balances are forming an increasing part of bequests. There are a number of possible explanations for these behaviours, many of which are rational on the part of the individual. However, where individual choices place pressure on public finances, they affect the sustainability of the retirement income system.

Once in retirement, individuals may consume less than their savings would allow because they lack confidence in their ability to manage longevity risk; are concerned about needing to pay for aged care later in life; or wish to leave an inheritance. It is also possible that individuals would like to consume more in retirement but lack financial literacy and would benefit from more information, guidance, and advice to confidently make decisions about their retirement incomes. These reasons may explain why households with superannuation accounts tend to only draw down at or near minimum legislated rates (Balnozan 2018; Reeson et al. 2016). Additionally, home owners may be reluctant to release equity from their homes to supplement their retirement incomes despite public and private initiatives.

Separately, the tax advantaged status of superannuation may encourage some individuals to partly use superannuation for wealth accumulation and estate planning, rather than solely for retirement income purposes.

Understanding which of these drivers is behind the observed saving and consumption behaviour will help inform the assessment of the retirement income system's sustainability.

Consultation questions:

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?

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

Cohesion

What is meant by cohesion

All elements of the retirement income system should work together to support the outcomes the system intends to achieve for individuals. Cohesion considers the drivers, processes, and incentives that exist in the system. It looks at whether they reinforce outcomes in line with the system's objectives, or conflict with one another. It also considers how the retirement income system interacts with other systems. In particular, cohesion is concerned with whether these factors support individuals to achieve outcomes that are right for them.

Cohesion considerations

There are a number of questions the Panel proposes to consider when assessing the cohesiveness of the retirement income system. These include:

- Whether the incentives in the system are delivering their intended outcomes.
  – Does the system encourage retirees to use their assets and savings to maximise their retirement income?
- How incentives in the system interact to encourage or discourage behaviours, and the outcomes these interactions produce.
  – How do different eligibility ages and rules around access to superannuation and Age Pension drive outcomes?
- How the system interacts with other systems and the impact of this behaviour on outcomes.
  – How do individuals' expectations about lump sum expenses (e.g. aged care and health care) affect how they draw income from their savings?
- Whether individuals understand how to achieve desired outcomes within the system and the extent to which the system is being used to achieve outcomes other than those for which it is designed.
  – Can individuals navigate the system simply or is financial or other advice needed to achieve good outcomes?
  – Do individuals have sufficient access to retirement income products that manage the level and longevity of their income?

Consultation question:

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

Assessing whether the system is cohesive

Incentives in the system

Both the Age Pension and superannuation system have rules designed to encourage retirees to draw on their savings to fund retirement where they have capacity to do so.

- The Age Pension assets test encourages individuals to draw on their own assets to fund their retirement before calling on taxpayer funds for support. The rate of Age Pension paid to an individual decreases as their capacity for self-support increases.

- Minimum drawdown rules for superannuation mandate the withdrawal of a certain percentage of assets from superannuation each year. These rates increase as a retiree ages and are designed to ensure that superannuation is used for its intended purpose of providing income in retirement.
- In addition, the Age Pension income test, including the Work Bonus, incentivises older Australians to continue in part-time paid employment where they have capacity to do so.

However, it can be complex for retirees to determine the extent they should draw on their savings to provide income each year in retirement. Uncertainty regarding future expenditure needs can also affect the income retirees draw from their savings.

Research shows that many retirees ‘default’ their income from superannuation at or near the minimum drawdown rate (Balnozan 2018; Reeson et al. 2016). When combined with Age Pension payments, this can lead to income that grows in real terms during retirement. However, studies (Gebler 2018, p. 22; CEPAR 2018a; AIST 2016, p. 22) suggest that retirees’ expenditure remains constant or decreases as they age. This may result in retirees having higher overall retirement income at a time when they are less likely to have significant expenses, and lower income when retirees are more active and may wish to have higher expenditure.

Interactions between the pillars

There are a number of areas where the interactions between superannuation, the Age Pension and voluntary savings may drive behaviour. These include:

- The difference in the age at which superannuation and the Age Pension can be accessed. This may affect decision making around when to retire, and how heavily new retirees draw on superannuation to fund retirement ahead of meeting the age requirements for the Age Pension.
- The way assets are treated under the Age Pension means test. Some stakeholders suggest that the current assets test taper rate creates high effective marginal tax rates on savings (Asher and De Ravin 2018).[12] It has been claimed that this may discourage working age Australians from making superannuation contributions and encourage retirees to dissipate their assets in retirement.
- The way the family home is treated under the Age Pension means test. There has been debate about whether the exclusion of the value of an owned primary residence from the Age Pension means test may result in Australians overinvesting in their family home (Senate Standing Committee on Economics 2015, p. 198).[13]

Interactions with other systems

The retirement income system interacts with other systems in ways that can be difficult for individuals to navigate or drive unintended behaviour.

The potential need to contribute to aged care costs is a major point of interaction for the retirement income system. Uncertainty about the possible need for a lump sum to access residential aged care can lead to retirees not drawing on savings at the rate that they might otherwise do so. In addition, the means test for the Age Pension is structured differently to the means test for aged care and the interaction can be complex to understand.

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12 The Age Pension assets test reduces an individual’s Age Pension by $3 for every additional $1,000 in assessable assets above the relevant free area. This is a taper rate of 7.8 per cent per annum, which may be higher than the earnings potential of associated assets. This can result in more income being lost through the Age Pension than could be generated by the underlying assets, provided they are not drawn down upon for self-support.

13 There is an implicit value of an owned primary residence of around $210,000 incorporated in the lower assets test thresholds of home owners compared to non-home owners.

Interactions between the retirement income system and the tax system can affect the savings vehicle Australians use to store assets and the level of tax paid in retirement. These interactions can make it difficult for individuals to optimally plan for retirement. This may also lead to unequal tax treatment for the same level of income.

How individuals engage with the system

Research shows that most Australians do not actively engage with their superannuation or in long term retirement planning (Productivity Commission 2018, p. 248). Once Australians reach retirement, the complexity of how the pillars interact – including how different assets, income, and personal circumstances are treated by the system – can make it difficult for individuals to determine how to efficiently maximise their retirement income. Interactions between the superannuation, social security, aged care, and health systems add to the complexity and the difficulties individuals face in determining how to best use their savings in retirement. Financial literacy may also affect how effectively Australians can navigate the system and engage in long term retirement planning.

Financial advice may assist retirees in navigating the retirement income system. A range of financial advice options are available to help individuals understand their entitlements and their potential retirement income. These range from comprehensive personal advice from a financial adviser, through to general information through resources such as the Australian Securities and Investments Commission's (ASIC) MoneySmart website. These arrangements provide everyone with access to a level of financial information or advice, regardless of their means or the complexity of their financial affairs. Superannuation funds are also an important source of information and advice for many Australians, particularly as they approach retirement. It is however not clear the system is sufficiently simple to navigate without resorting to some form of financial advice, or that there is sufficient support provided to ensure individuals feel confident making financial decisions about their retirement.

Given the complexity of the retirement income system, it is important individuals are able to achieve good outcomes even where they have not engaged in retirement planning. Default settings have the potential to improve outcomes by guiding individuals' behaviour in saving for, and consuming, their retirement incomes, whilst still providing support for individual choice and decision making.

The degree to which individuals can understand how the system affects them, the impact of their decisions on their income during their working life and in retirement, and whether the system supports them to engage without difficulty will affect its overall adequacy and sustainability.

Consultation questions:

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

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

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?

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

Is there sufficient integration between the Age Pension and the superannuation system?

Consultation questions

The retirement income system

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

Purpose of the system and role of the pillars

2. Is the objective of the Australian retirement income system well understood within the community? What evidence is there to support this?
3. In what areas of the retirement income system is there a need to improve understanding of its operation?
4. What are the respective roles of the Government, the private sector, and individuals in enabling older Australians to achieve adequate retirement incomes?
5. 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?
6. 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 changing Australian landscape

7. 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?

Principles for assessing the system

8. 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?
9. 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?

Adequacy

10. What should the Panel consider when assessing the adequacy of the retirement income system?
11. 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?

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

Equity

13. What should the Panel consider when assessing the equity of the retirement income system?
14. 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.)?
15. Is there evidence the system encourages and supports older Australians who wish to remain in the workforce past retirement age?
16. To what extent does the retirement income system compensate for, or exacerbate, inequities experienced during working life?
17. What are the implications of a maturing SG system for those who are not covered by compulsory superannuation?

Sustainability

18. What should the Panel consider when assessing the sustainability of the retirement income system?
19. 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?
20. How can the overall level of public confidence be assessed? What evidence is available to demonstrate the level of confidence in the system?

Cohesion

21. What should the Panel consider in assessing whether the retirement income system is cohesive?
22. Does the retirement income system effectively incentivise saving decisions by individuals and households across their lifetimes?
23. What evidence is available to show how interactions between the pillars of the retirement income system are influencing behaviour?
24. 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?
25. What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?
26. Is there sufficient integration between the Age Pension and the superannuation system?

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