COTA OVER 50s
the voice of older Australians

COTA Over 50s

Response to

Retirement Incomes Consultation paper

CONTENTS

INTRODUCTION

The much-needed restructuring of the retirement income system comes at a time when at least two of its current three pillars – superannuation and private savings - have proven less than rock solid, and the third – the age pension – is under strain, and its inadequacy sorely apparent . The Australian Government must not allow the recent global financial crisis to distract it from securing a robust, viable long term arrangement for retirement incomes. The crisis has delivered an unhappy opportunity to reassess the efficacy of a retirement income system which – at least since the introduction of the Superannuation Guarantee and presumably into the future - relied almost exclusively on the very financial and investment systems that have foundered.

Should we persist with a system whereby citizens make essentially private investment decisions (helped by fund managers and other advisers) to build up a portfolio of assets that will deliver an adequate income stream during their retirement ?

Such a system may well, upon reconsideration, prove still to be the best way to go – or it may prove to be fundamentally flawed. Either outcome will provide little comfort to those at or near retirement who do not have the luxury of several years more employment to try and recoup their recent financial losses.

This submission does not propose any radical alternatives to the structural status quo, but the government would be wise to examine alternative arrangements – such as a national superannuation scheme. The submission in fact assumes the basic architecture of a three pillar system will remain, but offers a critique of elements of the policy to which those pillars give effect.

Getting the perspective right

The economic and social discourse around retirement systems, superannuation, pensions and related mechanisms is influenced by a history of complex tax and income support regimes. As a result, present discussions – which are very needful of new insights, ideas and terminology - are hampered by language and concepts that are embedded in the conversations and popular imaginings informed by past and present arrangements.

For example, we talk blithely about 'retirement' when there is no longer a clear demarcation, as there once was, between people who have 'retired' from work, and people whom remain 'in work'. We often distinguish between 'self-funded retirees' and 'pensioners' and assume, for example, that the former are always and necessarily far better off than the latter. This is not the case. We also often imply that 'self-funded retirees' do not cost the government anything, whereas pensioners do. This, too, is not the case.

It is relevant to observe, when considering public policy and the provision of government support to different categories of senior Australians, that both pensioners and superannuants are the beneficiaries of public funds. Pensions are a cost to the public purse; but so are the substantial tax concessions enjoyed by those who participate in superannuation schemes.

This is not to denigrate superannuants, or 'self-funded' retirees generally, as being unfairly privileged. Superannuants can fairly claim that they have been prudent, self-reliant, taken the government's advice and submitted to its compulsions, and sought to maximise the benefits legitimately available to them. Nor is it to say that governments should not encourage self-reliance, and assist citizens to help themselves. But it is vitally important to retain a proper perspective on the matter, with notions of 'citizenship' at the core of that perspective, and with governments fully appreciating their responsibilities to all citizens, ensuring that fair and equitable practices prevail. The retirement incomes system is an arena where such an approach is absolutely essential.

It is legitimate – indeed important - to ask the question: Have we, as a nation, struck the right balance as to where we apply public dollars to support for the retirement living needs of individual citizens? It is important to recognise that there are significant choices to be made, and that these entail different costs and bestow different benefits to different categories of citizens. This is why equity must remain an abiding principle in policy development.

This submission by COTA Over 50s Ltd addresses the various questions raised by the Henry Review in its *Retirement Income Consultation Paper.* We use these as launching points for comments, suggestions and criticisms that we believe are germane to the Review's role and responsibilities. Whatever might emerge in terms of post-Henry policy changes by the

Australian Government, those changes need to be clearly articulated and explained, with a proper lead-time to implement the new regime so that citizens have sufficient time to plan.

Reforms to Australia's tax system, and to the retirement income system that is integrated with it, are long overdue. Given the long-term significance of these reforms, it is vital that the range and robustness of the reforms is not impeded by anxieties arising from the current global financial crisis. Boldness and vision must characterise the government's planning and actions.

"It's not just the reduction in value of my share portfolio, my financial position has suffered because the dividend income is now so low. I went to Centrelink and have now qualified for a part pension.

I think many people are in the same position but it's not something they want to talk about."

EXECUTIVE SUMMARY

COTA Over 50s supports the notion of Australia pursuing a 'three pillar' retirement income scheme based on age pensions, superannuation and other private savings/income. COTA Over 50s acknowledges the success of the Superannuation Guarantee and other policy initiatives over the last two decades in providing incentives for people to save for their own retirement and reducing the numbers of people reliant solely on the age pension. It remains the case, however, that the vast majority of the current cohort of retirees and 'baby boomers' entering retirement, have had few opportunities for superannuation or other savings during their earlier lives. The age pension remains their sole or principal source of income and there is no evidence of a substantial decline in pensioner numbers for the foreseeable future. As well, the notion of the age pension as one of the 'pillars' of the retirement income system is not compatible with its being construed as a 'safety net'. If it is to be a pillar it must exhibit all the qualities of robust design, public confidence and esteem, sustainability and ongoing maintenance that define what it means to be a 'pillar'.

COTA Over 50s has serious concerns about the fairness of the policy, administrative and taxation arrangements that currently apply to superannuation compared with pensions and savings. These are detailed later in this submission.

COTA Over 50s is generally supportive of the Superannuation Guarantee (SG) reforms, but highlights the substantial and ongoing predicaments of those who have not, and will not yet, benefit from a working life under the SG regime.

It is increasingly inappropriate to draw a hard line separating 'retirement' from other stages of life. Social, economic and cultural circumstances are such that the pension and superannuation systems must be adjusted to reflect the new realities of people's lifestyles and preferences.

The Taxation Review must achieve commensurability and transparency across the pensions, income support, superannuation and tax systems in order to deliver fairness and ensure that the needs of the most disadvantaged seniors are met. Incentives for seniors to save and - if they so wish - to work, are highly desirable, but these must operate in ways that are not detrimental to the capacity of the system to deliver adequacy for those who rely solely on the pension and other government supplements. Any reforms to the tax system should enhance its progressive effect, with income from all sources being taxed more consistently and comprehensively.

The principles of a robust and fair retirement income system

COTA Over 50s considers the following core principles essential to a comprehensive retirement income system for older Australians:

- Adequacy – which includes, among other things, setting pension levels using a credible, reasonable and transparent mechanism that determines the overall income required for a person to live modestly when judged against contemporary Australian standards of living. (The notion of 'adequacy' of retirement incomes is explored further below.)
- Fairness – which means a retirement income system that is adaptable to the circumstances of different groups of seniors, with particular regard for the needs of those who are most disadvantaged and least able to provide for themselves in terms of achieving an adequate standard of living. Poverty traps must be avoided. The system must deliver equity:
    - vertically - those with fewer private resources should receive more assistance than those with more abundant private resources;
    - horizontally - people with similar income-earning capacities should be treated similarly irrespective of the sources of that income, and people with similar needs should receive similar assistance irrespective of the circumstances that prompt those needs; and
    - intergenerationally - no generation should be treated more favourably than other generations.
- Certainty – establishing a clear, comprehensive and far-sighted system that enables people to plan with confidence. This may require a system that addresses two distinct periods – that between now and the maturing of the SG system and the period thereafter. Certainty also requires that the prudential regulation of superannuation funds is robust, and structured so as to minimise the ill effects of the vagaries of economic cycles and the ineffectiveness or perhaps dishonesty of some of those who manage funds
- Sustainability – which means
    - structuring the funding base of the system with regard for its impact on the Australian economy; and
    - ensuring the retirement income support system remains viable and effective while continuing to provide an age pension to Australians who need it.

- Simplicity – which means better integration of tax and income support arrangements for retirees, and especially a tax system that (a) treats private income similarly regardless of its source, (b) eschews complex regimes of concessions involving fine distinctions of financial means and assets, and (c) functions so that individuals can participate in the system without frequent recourse to accountants and solicitors.

The 'three pillars' approach

A vital pillar of any retirement income system must remain an adequate age pension. It must be a pillar, not a safety net. We have submitted our views on the age pension to the Harmer Review, but reiterate the core message here because of the intimate relationship between the pension and other retirement income issues, and in particular its interaction with the tax system.

It is imperative that the Australian Government, when deliberating upon superannuation, remain keenly aware that the vast majority of existing retirees, and those approaching retirement, have not had a working life supported by the Superannuation Guarantee. Large numbers of citizens have had interrupted work patterns, on limited incomes, that have precluded access to superannuation. Citizens with disabilities, or who have caring responsibilities, also deserve full consideration in a retirement incomes policy context.

Tax concessions on superannuation

The taxation concessions that have operated under the existing Superannuation Guarantee arrangements, while an incentive to build for one's retirement, are regressive. The system has allowed many higher income individuals to enjoy considerable private benefit at a corresponding cost to the public purse. Indeed the estimated cost of superannuation tax concessions in 2006 was around $25 billion and perhaps $29 billion in 2007-08. A recent high-level tax forum was told that $12 billion of concessions went to the top 5% of income earners. This represents a substantial public subsidy to those private citizens who are most likely to be able to afford to invest in their retirement income. An urgent review of the concessions is needed.

The Superannuation Guarantee

There is a prima facie case for a gradual increase in the SG from 9% to 12% provided that there is a severe restructuring of the tax concessions that apply. This would probably be a considerable burden on some low income workers, and may require government to apply incentives and subsidies that are equitable and fair and take into consideration the ability of employees to contribute the extra 3%. Sophisticated modelling would be needed to assess the impact of an SG increase to 12%. A Green Paper on these matters is highly desirable.

Age levels for eligibility for superannuation access and pension

COTA Over 50s acknowledges that there is a serious debate to be had around age eligibility levels in the context of an ageing demographic and a longer living cohort of retirees.

All the different age based rules in the superannuation system for contributions and benefits deliver a very confused message about "retirement age" and need to be amended in order to reflect a clearer message that working beyond age 65 is to be encouraged, whilst the use of retirement savings prior to 65 is discouraged. This must in no way deprive citizens' access to the age pension at age 65 for those who need or choose to leave paid employment.

Increasing longevity is likely to be accompanied by more years of healthy active life. This makes an increasing average retirement age possible and perhaps desirable in order to improve the quality and standard of living in retirement, as well as reducing the fiscal impact of the ageing population. An increasing average retirement age could also help fund the cost of any increase in the age pension. But it is important to take into account many relevant considerations when it comes to policies linked to age of separation from the workforce. For example, the experiences, health, capacities and expectations of people from differing fields of work will bear heavily upon deliberations around what might be fair, as well as what is possible.

<u>Age of eligibility for pension</u>

While health and longevity are improving, raising the pension age would disadvantage people in a financially vulnerable position, and may have only a limited impact on workforce participation. Many people who retire before age 65 have done so not voluntarily but because of redundancy, ill health, or caring responsibilities. Such people are likely to have low private incomes and assets, and they would be particularly disadvantaged by having to wait longer to receive the pension.

The Institute of Actuaries is one of several organisations that have proposed arrangements whereby people can 'defer' the age pension, with appropriate changes to the operation of tax offsets, income and assets tests. The Institute contends that the key advantages would be a voluntary option for increasing both the average retirement age and the level of the age pension, whilst removing the financial penalty for working beyond pension age. A deferred age pension could be integrated with variable work patterns, which is likely to be the case for older workers and cost neutral to the public purse. COTA Over 50s sees some merit in the Institute's proposal. It appears to introduce flexibility and simplicity into the system, and is consistent with the principle of not discouraging participation in the work force into one's senior years.

Age of access to superannuation

There is a sound case for raising the preservation age for superannuation. To the extent that this discourages early retirement it would significantly improve retirement incomes and reduce the cost to government of income support. As ACOSS has pointed out (ACOSS: 2008) those who have little option but to retire early are less likely to be adversely affected by this change because their superannuation assets are typically low.

In many instances, those who voluntarily retire early do so because they are financially well-placed to do so, and many have the resources to carry on active and fulfilled lives, or have the capacity, the interests and the networks to enable them to undertake additional part-time employment should they wish or need to. In short, their position is highly favourable when compared with a low income or less skilled worker, whose choices and opportunities in this respect may be comparatively more limited.

Adequacy

The issue of 'what is adequate' in retirement is a vexed one. For COTA Over 50s, the focus of 'what is adequate' in retirement must be on those who are dependent on public provision of the resources to sustain a dignified life commensurate with contemporary Australian standards. Those individuals for whom 'adequacy in retirement' entails a standard of more advanced comfort should strive to reach that standard using their own resources. Public funds should be applied equitably across citizens, and not in ways that work against the government's capacity to meet a proper level of adequacy for all Australian pensioners.

Once a fully-mature superannuation system is operational, and for those who are the beneficiaries of it, COTA Over 50s considers that an approach to adequacy based on replacement rates involving a comparison of (net) expenditure before and (potential net) expenditure after retirement is likely to operate fairly, and promotes the principle of assets (other than the home) being drawn down for living purposes during retirement rather than for inheritance and estate management purposes. For those who are not well superannuated, and especially for pensioners, adequacy must be considered in absolute terms and linked to a robust and transparent benchmark of what is needed to live a modest, dignified life.

Government action to help citizens prepare for retirement

Governments can assist individuals to prepare for, and deal with the transition to, retirement in many ways. It is important that tax regimes and system rules operate so as to 'make work pay'. The Government should examine the introduction of incentives and supports, and removal of disincentives, to enable people who are nominally retired to further participate in paid work.

Policies and (appropriately capped) incentives that facilitate citizens' access to financial advice – particularly on insurance, retirement income and superannuation – have been shown to deliver clear benefits in terms of reduced debt, higher savings and better long-term decision-making.

Government must establish effective regulatory frameworks that ensure prudence in funds management, and that help individuals nearing retirement and financial organisations to manage longevity risk – including through the development of effective income stream products.

The Australian Government must be courageous and imaginative in developing policies and administrative arrangements that nurture people's capacity to build towards retirement with confidence. Robust prudential regulation of superannuation funds, support for 'nest egg' initiatives such as lifelong savings accounts, offering incentives that steer people in their own welfare-promoting directions while allowing them choice among options, are all important tasks for government.

" My old neighbour has recently had prolonged radiotherapy for prostate cancer and faced a 'gap' bill of about $3,000.

He had no money to pay it so sold off a few possessions and of course valued the Christmas handout. "

RECOMMENDATIONS

1. **That retirement income policy and its associated taxation regime give practical effect to a 'three pillar' model in which the age pension:**

    - **functions as a true pillar of the system not merely a safety net, and**
    - **is set in relation to a benchmark – transparently and robustly arrived at – that declares the minimum level of disposable annual income necessary for the maintenance of a modest standard of active and dignified living in retirement.**

Above relates to Consultation Questions Q1.1; Q6.1

2. **That retirement income policy and its associated taxation regime operate according to the principles of:**

    - **adequacy - consistent with contemporary Australian standards of living**
    - **fairness – delivering equity between various socio-economic cohorts and categories of income-earner, and intergenerationally, and avoiding poverty traps**
    - **certainty – enabling people to plan with confidence, and underpinned by strong prudential regulation of superannuation funds**
    - **sustainability – viable in the long term and providing for continued availability of the age pension for eligible citizens**
    - **simplicity – better integration of taxation and income support systems and navigable by citizens without regular recourse to solicitors / accountants**

Above relates to Consultation Questions Q1.1; Q2.1

3. **That the current regime of tax concessions on superannuation (employer contributions, fund earnings and salary sacrifice contributions) be thoroughly reviewed to:**

    - **eliminate as far as possible regressive elements of the concessions to minimise the use of superannuation as a means of gaining inequitable tax benefits; and**

- **enable taxpayer funds to be applied more equitably to assist all citizens to achieve an adequate standard of living in retirement.**

<u>*Above relates to Consultation Questions Q3.2; Q6.1*</u>

4. **That the Australian Government prepare a Green Paper on the Superannuation Guarantee examining the feasibility and impact of a gradual increase in the SG from 9% to 12%. The Green paper should take especially into account the impact of the increase on low-middle income earners, and should propose strategies for the mitigation of hardship arising from any such increase.**

<u>*Above relates to Consultation Question Q3.1*</u>

5. **That the Australian Government change the existing *Choice of Funds* arrangements for superannuation to provide for the establishment of portable [non-employer-operated] funds, operating under stringent criteria, thereby simplifying matters for workers who 'choose not to choose' their superannuation fund, and reducing the waste and excessive administrative burdens associated with proliferation of superannuation accounts under the current *Choice of Funds* policy.**

<u>*Above relates to Consultation Question Q5.1*</u>

6. **That the Australian Government develop a proposal for a Pension Deferral Scheme which would include features such as:**
   - **A person who defers all or part of their pension receives an increased pension when subsequently commenced. (Initial work suggests 5% to 8% for each year of deferral.) .**[1]
   - **The period of deferral would be totally at the person's choice and there would be no limit on the deferral period.**

<u>*Above relates to Consultation Questions Q4.1; Q6.2*</u>

7. **That the Australian Government examine the viability and effectiveness of the introduction of a lifelong superannuation savings system that involves, for example, co-contributions from government up to a ceiling and in a manner that is progressive in its effect; and in which**

[1] Institute of Actuaries Retirement Incomes Taskforce *Discussion paper on Age Pension and Retirement Incomes Reforms* August 2008

personal contributions are treated in a similar way to voluntary contributions to existing superannuation.

Above relates to Consultation Questions Q1.1; Q2.3

8. **That the Australian Government take a more pro-active regulatory role in securing and facilitating retirement incomes for all citizens by:**
    - **strengthening the framework of prudential regulations applying to superannuation funds, including requiring a certain level of government bonds or investments with similar levels of security in their investment portfolios**
    - **developing regulatory frameworks that promote the development by financial service providers of suitable financial products (lifetime annuities and similar income stream products) so that retirees can better manage longevity risk.**

Above relates to Consultation Questions Q1.1; Q4.2

9. **That the Government examine the introduction of incentives and supports, and removal of disincentives, to enable people who are nominally retired to further participate in paid work. The examination would need to include consideration of modified tax regimes and Workers Compensation legislation and regulations. The examination would need to involve state and territory governments.**

Above relates to Consultation Questions Q2.3

"My rent is $440 per fortnight. This leaves me $195 to pay for food, power and anything else I need. I mix the mince with oats and get two kilos of food from one kilo of meat. I buy a chicken once a fortnight, otherwise its chickpeas and kumera and potatoes that keep me going….

When I need glasses I have to make arrangements to pay them off in instalments. The pension bonus was a godsend as I could pay for my glasses outright for once."

Consultation questions

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

Consistent with the principles outlined in the Executive Summary, the objectives of a retirement income system should enable citizens to:

- Have a clear and meaningful appreciation of the significance of retirement, and of the individual's and the government's respective responsibilities for enabling retirement goals to be met
- Have confidence that their personal efforts in planning and saving for retirement will actually produce rewards commensurate with that effort, and that they will be assisted to manage the associated risks (through good prudential regulation of funds etc.)
- Share a consensus about the fairness of the system, and show allegiance to principles of intergenerational equity
- Manage their interactions with the tax and transfer payments system without recourse to detailed professional advice and support from accountants and solicitors.
- Have confidence that, when they are wholly or partially reliant on the income support or the age pension, that they will be able to live at a modest standard commensurate with contemporary Australian standards.

RECOMMENDATION

That retirement income policy and its associated taxation regime operate according to the principles of:

- **adequacy - consistent with contemporary Australian standards of living**
- **fairness – delivering equity between various socio-economic cohorts and categories of income-earner, and intergenerationally, and avoiding poverty traps**
- **certainty – enabling people to plan with confidence, and underpinned by strong prudential regulation of superannuation funds**
- **sustainability – viable in the long term and providing for continued availability of the age pension for eligible citizens**

- **simplicity – better integration of taxation and income support systems and navigable by citizens without regular recourse to solicitors / accountants**

RECOMMENDATION

That the Australian Government take a more pro-active regulatory role in securing and facilitating retirement incomes for all citizens by:

- **strengthening the framework of prudential regulations applying to superannuation funds, including requiring a certain level of government bonds or investments with similar levels of security in their investment portfolios**
- **developing regulatory frameworks that promote the development by financial service providers of suitable financial products (lifetime annuities and similar income stream products) so that retirees can better manage longevity risk.**

Pensions, superannuation and savings

The current three pillar approach to the retirement income system (albeit with the caveats suggested earlier) provides a reasonably sound basis upon which to proceed.

Age pension

The age pension will clearly need to remain a fundamental pillar of the system, even when the SG system matures. As COTA Over 50s has argued to the Harmer Review, that pension should be set in relation to a benchmark – transparently and robustly arrived at – that declares the minimum level of disposable annual income necessary for the maintenance of a modest standard of living in a contemporary Australian context.

RECOMMENDATION

That retirement income policy and its associated taxation regime give practical effect to a 'three pillar' model in which the age pension:

- **functions as a true pillar of the system not merely a safety net, and**
- **is set in relation to a benchmark – transparently and robustly arrived at – that declares the minimum level of disposable annual income necessary for the maintenance of a modest standard of active and dignified living in retirement.**

Voluntary savings

Public policy related to encouraging voluntary savings seems not to have received anything like the attention given to, say, SG arrangements and associated mechanisms such as salary sacrificing. Greater effort must be applied to creating an environment which is conducive to, and rewarding of, voluntary saving.

COTA Over 50s is conscious of the fact that escalating housing costs (greater mortgages), and debts such as tertiary education HECS payments and loans, will continue to have an adverse effect on people's capacity to save during their working lives. Indeed more and more retirees are taking larger mortgages with them into retirement.

COTA Over 50s considers that, along with access to an adequate pension for eligible citizens:

- Citizens should be encouraged and helped to save for their retirement, but on the understanding that for many citizens, the costs of daily living, maintaining a family, or dealing with common contingencies such as illness, marriage and family breakdown and other such events, makes it extremely difficult to save at the levels deemed necessary for retirement.

- During retirement, private savings (assets etc) should be drawn down to meet living expenses, as opposed to being used primarily for estate management purposes and the provision of inheritance

- Citizens who have adequate private resources for retirement should not be favoured inequitably with taxpayer-funded resources, apart from where good public policy might dictate some kind of universal concession or support for seniors generally.

- Taxes on interest earned in savings accounts should be set at levels that are not a disincentive to saving.

Several peak groups have articulated strong cases for the introduction of subsidised savings account schemes. These schemes have been implemented successfully in various forms in other countries. Moreover, in 2002, the Senate Select Committee on Superannuation recommended that, as means of increasing national savings and reducing the temptation for people to accumulate debt which is repaid with superannuation on retirement, the government examine the introduction of a tax preferred medium to long-term savings vehicle which could be accessed prior to retirement for purposes such as health, savings for a home deposit, and education.

COTA Over 50s is supportive of such approaches, and is attracted to the notion of a lifelong superannuation savings system that involves, for example, co-contributions from government up to a ceiling and in a manner that is progressive in its effect. The following schema, drawn from ideas of reputable social justice advocates, is indicative of an approach that might be used:

- At birth (or on attaining citizenship) every Australian is given a lifelong Superannuation Savings Account (SSA) containing a start up deposit.
- During the first eighteen years, government contributions could be phased in annually, and possibly include a co-contribution matching voluntary contributions (by, say, family or friends) up to a modest amount
- Once the person enters the workforce, the SSA could receive superannuation contributions (regardless of changes in employers etc) and operate within a slightly modified superannuation regime, building a stock of mid-life and retirement savings which allowed withdrawals, say up to a certain proportion of the account, prior to retirement.
- Governments could use the SSAs to target financial assistance to eligible citizens

The funds built up in these accounts could be used by the government for investment in major infrastructure or related nation-building activities. They might also be used, for example, to provide concessional loans to low-income families for homes, or to support desirable environmental initiatives such as improved energy efficiency of existing houses and buildings.

RECOMMENDATION

That the Australian Government examine the viability and effectiveness of the introduction of a lifelong superannuation savings system that involves, for example, co-contributions from government up to a ceiling and in a manner that is progressive in its effect; and in which personal contributions are treated in a similar way to voluntary contributions to existing superannuation.

Compulsory superannuation as a savings mechanism

It is assumed that existing compulsion strategies would continue to be effected through the superannuation system along the lines of the existing Superannuation Guarantee's compulsory 9%.

There seems to be no political support for increasing the level of compulsory superannuation payments by employers beyond 9%, even though the relevant government ministers have acknowledged an overall superannuation savings amount of 15% is what is required for a comfortable retirement.

Other issues around superannuation are dealt with below in the context of the relevant Consultation Questions below.

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

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

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

Those who fall outside the system

A comprehensive retirement income system clearly must embrace those who fall outside current SG arrangements. There are various categories of citizen that are not readily accommodated by SG arrangements, and each category differs in people's capacities to make their own private provision for retirement.

Self employed

Self employed – and indeed other - individuals are able to create and manage their own superannuation fund (Self Managed Superannuation Fund SMSF), and the nature of business structure and operations should to a large extent facilitate the setting up and running of an SMSF as a normal business expense.

From July 1, 2007 changes to the superannuation system for self-employed individuals have provided effective arrangements and sound incentives to prepare for their retirement. COTA Over 50s considers these arrangements to be favourable to self-employed citizens.

Carers and others with broken work patterns

COTA Over 50s is especially concerned about the capacity of carers, women and others with broken work patterns, to benefit from existing superannuation arrangements. For those who are largely excluded from workforce participation through being carers, for example, government support should take such special circumstances into account when promoting policies and constructing systems around principles of self-provision.

For the many thousands of Australians on a Disability Support Pension – many of whom have had substantial periods of unemployment – 'retirement' consists of just a transfer from the DSP to and age pension, with no other resources available.

The retirement income system must make explicit provision for all those who fall outside the 'norm' upon which the existing SG system is predicated. In particular, the age pension must always be available as a guaranteed pillar of retirement income that allows for a modest standard of living.

One way to improve the retirement incomes of those with interrupted employment is to help them enter, and stay longer in, the workforce. It not only helps build their superannuation account, but lessens the number of years upon which they have to rely on a retirement income. Unfortunately, in many – probably most - instances, the reasons for interrupted employment are precisely the reasons why longer periods in the workforce in order to build up superannuation are simply not an option.

Elsewhere in this submission, COTA Over 50s has proposed the introduction of government-subsidised 'lifelong savings accounts'. Such a proposal would assist all citizens, including those with interrupted employment.

The question of adequacy

'Adequacy' can be construed in two main ways. One way is to think of 'adequacy' as a base level of resources that are needed to survive and function at an acceptable level commensurate with contemporary Australian standards. This is the view of adequacy that informs the policies of COTA Over 50s.

" I hate having to choose between food, medications and heating. I've moved the TV into the bedroom, turn the lounge heating off and go to bed by 6pm. "

The second way is to think of 'adequacy' in relation to the resources someone needs to conduct their lives in what they they have come to regard as their 'normal' way of living. This will necessarily vary from person to person.

In this second sense of 'adequacy', COTA Over 50s believes that it is largely an individual's responsibility to plan, save for and arrange their affairs in order to meet those personal requirements of adequacy – both before and after retirement. In the first sense of 'adequacy' – a basic level for survival and functioning – the responsibility rests significantly with the state to provide for its citizens in that way.

The adequacy of a retirement income system is complex to determine, in part because there are various ways of measuring it. If adequacy is measured as a percentage of immediate pre-retirement income received after retirement, generally, a replacement income rate of sixty per cent for someone on Average Weekly Earnings is considered an adequate retirement income. Many financial advisers encourage clients to work on achieving 70 per cent income replacement.

What individuals need to do to achieve these levels is difficult to find consensus on. The following is some of the variable advice available:

- *" ... government estimates you need to save 12% of your annual income over a 40 years working life to give yourself an income equal to 40% of your pre-retirement salary."*
- *"Many experts say that about 15% of your salary should be paid over your working life to enjoy a comfortable retirement."*
- *" .. to generate around $40,000 a year you need approximately $800,000 in superannuation savings"*

In fact, the government has not set an explicit benchmark replacement rate but has over recent years introduced policies ostensibly to improve them. Although the Rudd government does not support raising the Superannuation Guarantee to 15%, both the Treasurer and the Superannuation Minister are on the record noting that it would be desirable to see additional incentives leading to a total superannuation contribution rate of 15% of a person's earnings.

When it comes to the adequacy of living standards in retirement, that assessment can be made either in an absolute framework (seeking to estimate the actual income needed to live at a certain standard) or a relative framework using replacement rates – defined as ratios of a person's income or spending power after retirement to that before retirement. The proposition is that a person's standard of living in retirement should be a reasonable proportion of his or her standard of living during working life.

COTA Over 50s concurs with this proposition, but insists that the government's responsibility to facilitate its realisation by individuals must not impede government's fundamental responsibility to deliver adequacy for those citizens wholly or partly dependent on the age pension .

RECOMMENDATION

That retirement income policy and its associated taxation regime operate according to the principles of:

- **adequacy - consistent with contemporary Australian standards of living**
- **fairness – delivering equity between various socio-economic cohorts and categories of income-earner, and intergenerationally, and avoiding poverty traps**
- **certainty – enabling people to plan with confidence, and underpinned by strong prudential regulation of superannuation funds**
- **sustainability – viable in the long term and providing for continued availability of the age pension for eligible citizens**
- **simplicity – better integration of taxation and income support systems and navigable by citizens without regular recourse to solicitors / accountants**

The 'absolute' approach to adequacy

On the absolute framework front, the Social Policy Research Centre of the University of NSW has reported comprehensively to previous Australian Governments on indicative budget standards for older Australians. According to the Centre, budget standards can be used:

- to inform judgments about the adequacy of income levels
- to benchmark the adequacy of government income support payments and the relativities between recipients in different circumstances

- to contribute to discussions of the adequacy of pension levels, as well as helping to set standards for those who have access to superannuation and other income either as a supplement to ,or replacement of, the age pension .[2]

COTA Over 50s considers the work conducted by the SPRC on a 'modest but adequate' income could be a useful starting point, but would require reworking to take into account contemporary conditions, expectations and standards of living. [3]

The Westpac-ASFA report provides regular assessments of how much money is needed in retirement to fund a *modest lifestyle*, and a *comfortable lifestyle*. The latest Westpac-ASFA report (December Quarter 2008) identifies, for a single older person $19,617 and for a couple $27,454 to sustain a *modest* standard of living that allows for very little other than the basics. A *comfortable* lifestyle is $37,829 for a single; $50,561 for a couple and enables people to fully participate in their community, including social and sporting clubs, learning and volunteering and a number of other personally fulfilling activities.

These figures assume that the retirees own their own home. With many more people entering retirement with mortgages, or already in housing stress in the rental market, or seeking rental accommodation in the future, these figures must be treated with great caution. They certainly reveal enormous gaps between what is adequate and what age pensioners receive.

COTA Over 50s has concluded that the basis for any restructuring of the retirement income support system, and the application of a fair and sustainable allocation of pensions, must take into account a benchmark – transparently and robustly arrived at – that declares the minimum level of annual income (the Cost of Living in Retirement - COLR) necessary for the maintenance of a modest standard of living in a contemporary Australian context.

COTA has already urged the Harmer Pension Review to take the opportunity to explore sophisticated mechanisms of benchmark-setting that take into account not simply what emerges from a costed basket of goods and services or a percentage of an average wage-earner's income. A sophisticated mechanism would also try and factor into the benchmark the level of investment in older Australians' wellbeing required in order to deliver

[2] Saunders, Patulny and Lee *Updating and Extending Indicative Budget Standards for Older Australians* SPRC 2004, p1
[3] Relevant age pension levels might then be set with reference to that benchmark.

advantageous returns across a suite of arenas in subsequent years. Consider the following, for example:

- Wellbeing policies that mitigate expensive health and other interventions are consistent with principles of prevention and early intervention that are informing social policy development across areas as diverse as early childhood, family policy, education, mental health, addressing 'lifestyle' diseases and so on.
- An adequate living income will facilitate older Australians' ongoing engagement with the broader economic sphere both as consumers and as producers, especially when that engagement is considered in 'triple bottom line' terms. Older Australians who have the wherewithal to participate in economically-related social activity - even at the level of local, voluntary and community initiatives - are serving Australia's broader economic, social and environmental interests.
- Perhaps one of the greatest assets held by older Australians is the social capital that they represent. If it is sustained by a living income in retirement that provides for an adequate if modest lifestyle, such social capital has a much greater likelihood of being released into, and realised by, the community. Older Australians who are deprived by dint of circumstance of an outlet for their social capital are like a blocked wellspring unable to help their surroundings flourish.

The task therefore is a combined one of:

- determining the cost of living in retirement at a modest level commensurate with Australian living standards, as well as
- taking into account that an adequate investment in older Australians ability to 'age well' will deliver substantial future benefits and cost-savings to health and support systems, in order
- to arrive at a 'living income' deemed sufficient to provide for Australians to age well.

The 'relative' approach to adequacy

The 'relative approach' to adequacy is of practical use largely in the context of trying to determine the post-retirement living standards of people who have enjoyed the benefits of a superannuation regime throughout their working life. It is a fairly meaningless exercise for those who do not have such a history, and in no way diminishes the requirement for an adequate (in the absolute / budget sense) age pension to remain as a pillar of the retirement income system.

A relative framework concerns itself with ratios of a person's income or spending power after retirement to that before retirement – a replacement rate based either on a comparison of gross incomes before and after retirement, or a replacement rate based on a comparison of (net) expenditure before and (potential net) expenditure after retirement.

COTA Over 50s notes that Treasury, the Institute of Actuaries and others considers a replacement rate measure based on expenditure to be strongly preferable (Rothman: 2007) The argument is that an expenditure replacement rate is an after tax measure which takes account of the drawdown of capital during retirement. Replacement rates based on income alone do not take account of draw-downs of capital. Consequently, such measures understate the contribution of retirement savings to the maintenance of living standards in retirement.

Overall, COTA Over 50s accepts the view that - once the SG system has matured, and for those who have benefitted from it - a replacement rates approach based on comparisons of net expenditure before retirement (actual) and after retirement (projected) is a useful way to proceed.

Government's role in assisting individuals

Governments can assist individuals either directly, or by intervening in and appropriately regulating the markets and financial systems with which those individuals interact as they plan for retirement and attempt to build up their financial resources.

Direct assistance to individuals

Governments can assist individuals by actively providing incentives to save and undertake paid employment, and by avoiding those rules and taxation arrangements that militate against individuals earning supplementary incomes. It is important for government to 'make work pay'. These issues are discussed in more detail elsewhere in this submission.

Policies and (appropriately capped) incentives that facilitate citizens' access to financial advice – particularly in insurance, retirement income and superannuation – have been shown to deliver clear benefits in terms of reduced debt, higher savings, better long-term decision-making and higher rates of return on investment. Financial literacy is an area where government has already proven effective. It should build on that success.

Facilitating the development of suitable financial products

One of the most important considerations for ageing Australians, and for governments trying to support an ageing population, is that of longevity, and the risks associated with it when it comes to planning for needs in retirement –which may now extend for two or more decades. The Institute of Actuaries Retirement Incomes Taskforce has produced a discussion paper that COTA Over 50s considers very useful in providing advice and direction about how the government might assist people to navigate their path to retirement. (Institute of Actuaries: 2008)

If retirees want to maintain that income stream for the full lifetime in retirement they need to be able to manage "longevity risk"- but longevity insurance products, in particular lifetime annuities, are currently unattractive. To the extent that market responses to (systemic) longevity risk are slow in evolving or "fail" in the sense that they prove inadequate or incomplete, the government has a role in assisting market developments – for example, as a 'risk manager'.[4]

At the very least, the Government should ensure that the regulatory environment is conducive to sound product development. The Institute of Actuaries contends that the potential scope of government is vast and, were it to think in risk management terms, its thinking should cover both the public and private sectors, and both institutions and individuals. COTA Over 50s commends the Institute's views to the Australian Government.

Facilitating working and earning post-retirement

Australia's retirement income system is under significant strain in each primary pillar. The age pension is not adequate to provide for even a modest standard of living, particularly for single pensioners, and many senior Australians have lost large amounts of capital and income from their investments in superannuation and personal savings, due to the current global financial crisis.

[4] Groome, N et al *Population Ageing, the Structure of Financial Markets and Policy Implications*, Demography and Financial Markets Conference Proceedings, Reserve Bank of Australia, Australian Treasury and G-20 Group of Nations, 23-25 July 2006, p359

One means of improving retirement incomes which would appeal to some senior Australians would be greater recognition and support for income in the form of paid employment by those who are nominally 'retired'.[5] There may be considerable savings to Government expenditure if senior Australians could access their tax-free superannuation pensions without having to leave the workforce, then supplement that with some low-taxed paid work, and still receive the age pension concessions. This would have to be done with close regard for the overall equity of all taxpayers so that people who are already comparatively well off in retirement do not benefit inequitably from arrangements that are meant to enable people with limited retirement incomes to supplement that limited income.

" In returning to part time work, I've taken out insurance just in case it all gets worse ... All the financial assumptions that informed my retirement are no longer valid".

There are several advantages in promoting some level of ongoing employment in our "retirement" years:

- Research on longevity and mental health has demonstrated the importance of maintaining an active, fulfilling lifestyle in our advancing years and workplaces can be of significant help in facilitating this.
- Australia is experiencing a shortage of labour in many fields and there will be increasing employment opportunities for older workers as our workforce declines in coming decades.
- Opportunities for re-training could be stimulating for many older people and help to prolong their active lives.
- Money generated through paid work would supplement incomes from the retirement income pillars, which are under stress.

[5] It must be noted that many older Australians are not able to work for a variety of reasons - indeed, almost 50 percent of those senior Australians reaching pension age are already in receipt of a Commonwealth pension, such as a Disability Support Pension or unemployment benefit. It is essential that these people continue to receive fair and adequate incomes through the other pillars, particularly through the age pension.

The introduction of incentives to continue in work would require some support from the Federal Government, such as:

- Introduction of taxation regimes and pension concessions that encourage older people to work if they wish to.
- Education and information programs to highlight the health benefits of continuing to remain active (at some level) in the workforce.
- Introduction of training programs and mature age career development programs.
- Ensuring Workers Compensation Schemes cover older employees.
- Providing for contributions to superannuation schemes at older ages than current regulations allow.
- Addressing age discrimination in the workplace.
- Working with industry, the public sector and the community sector to identify part-time employment opportunities that will allow older workers to earn some income while at the same time having flexibility to pursue other interests.
- Providing health systems that assist older workers to remain in the workforce if they wish to.

These matters are also addressed in relevant sections elsewhere in this submission.

RECOMMENDATION

That the Government examine the introduction of incentives and supports, and removal of disincentives, to enable people who are nominally retired to further participate in paid work. The examination would need to include consideration of modified tax regimes and Workers Compensation legislation and regulations. The examination would need to involve state and territory governments.

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

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

Level of the SG may be not be enough

Whether the current 9% level of the SG is appropriate to secure an adequate retirement income remains a matter of dispute. What is not in dispute is that the difference between a 9% and 15% superannuation contribution is demonstrably profound over a working life, the 15% rate delivering a superannuation capital at retirement that is around 1.6 times what a 9% contribution delivers.

There is a prima facie case for a gradual increase in the SG from 9% to 12% <u>provided that there is a major restructuring of the tax concessions that apply.</u> Such an increase would probably be a considerable burden on low to middle income workers, and may require government to consider incentives and subsidies for such employees. Sophisticated modelling would be needed to assess the impact of an SG increase to 12%.

COTA Over 50s notes assurances from Treasury's RIMGROUP that under the "Better Superannuation" policy, once SG arrangements are reasonably mature, prospects have been greatly enhanced for future cohorts of retirees and there appears to be no aggregate savings shortfall or savings gap. (Rothman: 2007)

COTA Over 50s is not in a position to make an independent assessment of the appropriateness of the 9% SG level.

Superannuation tax concessions inappropriately targeted

There are several problems with the way current tax concessions operate in the superannuation context. Most importantly, the current taxation concession arrangements greatly favour people on higher incomes. The 15% tax rate for employer contributions applies to both SG and salary sacrifice arrangements. High income earners therefore benefit substantially from placing significant portions of their income into superannuation, thereby avoiding having to pay higher marginal tax rates.

It is not difficult to find financial advisers promoting the taxation benefits of current superannuation arrangements – the tax concessions, the salary sacrificing to swap a high marginal tax rate for a 15% flat tax, the transition to retirement schemes, even salary sacrificing down to the extent that you can put $1000 of your pension back in to collect a $1500 co-contribution payment. (e.g. read Potts: *SMH* April 20, 2008). These strategies feed cynicism among those who cannot participate. There is no doubt that current tax concessions for superannuation have the potential to exacerbate future inequalities of wealth and income between Australians in different employment circumstances.

Lower income employees do not have the wherewithal to salary sacrifice at the level high income earners do. They cannot enjoy the tax advantages that the 15% regime provides for those on higher incomes. Indeed the estimated cost of superannuation tax concessions in 2006 was around $25 billion (ACOSS:2008) and perhaps $29 billion in 2007-08. A recent high-level tax forum was told that $12 billion of concessions went to the top 5% of income earners. By comparison, other superannuation tax concessions and the co-contributions for low/middle income earners are very small. As well, it is difficult to find any evidence that these concessions will eventually reduce age pension costs by a commensurate amount. (Disney:2007)

It is also the case that high income earners are both more likely and more able to save in the absence of incentives than people on lower incomes, so the superannuation tax concessions are less effective than they could be in boosting overall levels of savings. Moreover, generous superannuation tax concessions encourage high income earners to simply switch to superannuation from other investment vehicles rather than increasing their overall savings to any great extent.

In short, current superannuation tax concessions are unfair and regressive. It has been argued that the system would be improved greatly by taxing all superannuation contributions at the beneficiaries' marginal income tax rates, but then reducing their tax liability by a proportion of those contributions up to a certain level. (Disney: 2007) It may also then be possible to provide for limited early withdrawals from superannuation accounts to meet needs during the home-making child-rearing years.

As Julian Disney has nicely put it:

> The superannuation system should not be a magic pudding for the wealthy, a straitjacket for middle-income people and an unreasonable burden for the rest.

RECOMMENDATION

That the current regime of tax concessions on superannuation (employer contributions, fund earnings and salary sacrifice contributions) be thoroughly reviewed to:

- **eliminate as far as possible regressive elements of the concessions to minimise the use of superannuation as a means of gaining inequitable tax benefits; and**
- **enable taxpayer funds to be applied more equitably to assist all citizens to achieve an adequate standard of living in retirement.**

RECOMMENDATION

That the Australian Government prepare a Green Paper on the Superannuation Guarantee examining the feasibility and impact of a gradual increase in the SG from 9% to 12%. The Green paper should take especially into account the impact of the increase on low-middle income earners, and should propose strategies for the mitigation of hardship arising from any such increase.

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

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

Age levels for retirement and pension

COTA Over 50s acknowledges that there is a serious debate to be had around age eligibility levels in the context of an ageing demographic and a longer living cohort of retirees. Increasing longevity has both advantages and difficulties associated with it. Increasing longevity will have a significant impact on the economy but increasing longevity is likely to be accompanied by more years of healthy active life.

This makes an increasing average retirement age possible and perhaps desirable in order to improve the quality and standard of living in retirement, as well as reducing the fiscal impact of the ageing population. An increasing average retirement age could also help fund the cost of any increase in the age pension .

There seems to be some prima facie inconsistencies between the ages at which superannuation can be accessed (55 gradually moving to 60) and being eligible for the age pension (65). But it is important to take into account many relevant considerations when it comes to developing policies based on age of separation from the workforce. For example, the experiences, health, capacities and expectations of people from different fields of work will bear heavily upon deliberations around what is fair, as well as what is possible.

All the different age-based rules in the superannuation system for contributions and benefits deliver a very confused message about "retirement age" and need to be amended in order to reflect a clearer message that working beyond age 65 is to be encouraged, whilst the use of retirement savings prior to 65 is discouraged. This must in no way deprive access of citizens to the age pension at age 65 for those who need or choose to leave paid employment.

The OECD paper *Live Longer, Work Longer*, states that "if working longer is to be an attractive and rewarding proposition for older workers, action on both the demand and supply side will need to be taken in co-operation by government, trade unions and civil society". The actions listed by the OECD paper were as follows:

(a) Provide strong financial incentives to carry on working

(b) Eliminate subsidised pathways to early retirement

(c) Provide employers with stronger incentives to hire and retain older workers - through wage-setting and employment practices

(d) Provide older workers with help and encouragement to improve their employability

(e) Change the attitudes of both employers and older workers themselves.

Age of eligibility for pension

While health and longevity are improving, raising the pension age beyond 65 would disadvantage people in a financially vulnerable position, and may have only a limited impact on workforce participation. Many people who retire before age 65 have done so because of redundancy, ill health, or caring responsibilities. Such people are likely to have low private incomes and assets, and they would be particularly disadvantaged by having to wait longer to receive the pension. As a significant number (80%) of people who move onto the full age pension do so from other forms of income support, any reduction in age pension costs as a result of increasing the age pension age will at least be partially be offset by an increase in other social security costs.

Several organisations have proposed the option of a deferred age pension. The Institute of Actuaries proposes a Pension Deferral Scheme along the following lines:

(a) A person's entitlement to all or part of the Age Pension would be determined each year by the means test rules.

(b) A person could elect at any time to defer all or part of their Age Pension entitlement for that year (or part year) until such time as the deferred pension is subsequently claimed.

(c) A person who voluntarily defers commencing all or part of their Age Pension would receive an increased Age Pension when subsequently commenced.

(d) The period of deferral would be totally at the person's choice and there would be no limit on the deferral period.

(e) The rate of increase could be determined on an actuarial and financially neutral basis (i.e. on a 'no loss' basis for the Government and individual).

(f) Initial work suggests that equivalence in value would support a rate of increase of around 5% to 8% for each year of deferral.

(g) The Government would still benefit from mortality (i.e. people not living to deferral age), the taxes paid on income earned during the period of deferral and the potentially increased effect of means testing at a later age.

(h) The scheme would replace the current, but restrictive, lump sum Pension Bonus system. However, a person could continue to access a lump sum up to the maximum of the existing Pension Bonus scheme, for example up to $33,409 after five years for a single, instead of the increased Age Pension.

(i) All other Age Pension entitlements, such as the Pensioner Concessional Card etc, would remain in place during the period of deferral.[6]

In the Institute of Actuaries' view, the key advantages of this approach are that it provides a voluntary option for increasing both the average retirement age and the level of the age pension , whilst removing the financial penalty for working beyond pension age. In addition, the advantages of means testing are retained whilst the disadvantages are minimised (e.g. high administration costs). A deferred age pension can be integrated with variable work patterns, which are likely to be the case for older workers and cost neutral to the Government. COTA Over 50s sees some merit in the Institute's proposal.

Age for accessing superannuation

There is a sound case for raising the preservation age for superannuation. To the extent that this discourages early retirement it would significantly improve retirement incomes and reduce the cost to government of income support. As ACOSS has pointed out (ACOSS:2008) those who have little option but to retire early are less likely to be adversely affected by this change because their superannuation assets are typically low.

> In 2003, 60% of those who retired before 55 years and 50% of those who retired between 55 and 59 years had an average superannuation account balance of less than $10,000. Although this would limit options for people in their late 50s and early 60s to use superannuation to financially support a gradual transition to retirement, it is likely that this transition process will (or should) occur later among future cohorts of mature age people in any event.

In many instances, those who voluntarily retire early do so because they are financially well-placed to do so, and many have the resources to carry on active and fulfilled lives, or have the capacity, the interests and the networks to enable them to undertake additional part-time employment should they wish or need to. In short, their position may be highly favourable when compared with some low income or less skilled workers, whose choices and opportunities in this respect may be comparatively much more limited.

[6] Institute of Actuaries Retirement Incomes Taskforce *Discussion paper on Age Pension and Retirement Incomes Reforms* August 2008

RECOMMENDATION

That the Australian Government develop a proposal for a Pension Deferral Scheme which would include features such as:

- **A person who defers all or part of their pension receives an increased pension when subsequently commenced. (Initial work suggests 5% to 8% for each year of deferral.) .[7]**
- **The period of deferral would be totally at the person's choice and there would be no limit on the deferral period.**

RECOMMENDATION

That the Australian Government take a more pro-active regulatory role in securing and facilitating retirement incomes for all citizens by:

- **strengthening the framework of prudential regulations applying to superannuation funds, including requiring a certain level of government bonds or investments with similar levels of security in their investment portfolios**
- **developing regulatory frameworks that promote the development by financial service providers of suitable financial products (lifetime annuities and similar income stream products) so that retirees can better manage longevity risk.**

[7] Institute of Actuaries Retirement Incomes Taskforce *Discussion paper on Age Pension and Retirement Incomes Reforms* August 2008

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

The responses to the preceding sets of questions have already addressed various complexities, inequities and inefficiencies that plague the present system. The hallmarks of any revised system must be fairness and simplicity.

The age pension regime is particularly complex. For example, the impact of a confusing system of age pension reductions, personal tax rates and tax offsets means that it is extremely complicated for a person of age pension age who is in receipt of the age pension to even know the "cost" of earning additional income. Secondly, the high marginal tax rates on earned income are likely to block any desire to work beyond age pension age.

In the superannuation arena, one obvious site of complexity and inefficiency concerns the operation of the Choice of Fund policy, which has resulted in waste, duplication and inefficiency. The report by The Australia Institute, *Choosing not to choose: Making superannuation work by default* offers a persuasive critique of the shortcomings of the Choice of Fund policy and makes a cogent case for a policy based around default funds for workers who 'choose not to choose'. Stringent criteria would apply in order to become an eligible default fund. COTA Over 50s commends the report and its proposals to the Australian Government.

RECOMMENDATION

That the Australian Government change the existing *Choice of Funds* arrangements for superannuation to provide for the establishment of portable [non-employer-operated] funds, operating under stringent criteria, thereby simplifying matters for workers who 'choose not to choose' their superannuation fund, and reducing the waste and excessive administrative burdens associated with proliferation of superannuation accounts under the current *Choice of Funds* policy.

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

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

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

Role for the age pension

COTA Over 50s has consistently regarded the age pension as an integral part of the retirement income system, a pillar not a 'safety net', providing the basis for enabling every Australian to at least live a modest but active and dignified life during their mature years. COTA Over 50s believes that the provision of an adequate level of age pension is a necessary requirement of justice for all Australians as citizens and taxpayers. Moreover, the longer term benefits of a meaningful pension provision that enables people to age well are very substantial. Governments can reasonably expect solid future budget savings to flow from a well-designed income support system that serves to preserve the health, tap the social capital, facilitate the productivity and enhance the self-reliance of Australians as they age. An adequate pension is essential to those aspirations.

Role of means testing of pension and impact on decisions to work

While means testing is intended to ensure proper targeting of the age pension to those who truly need it, the current rules are complex and expensive to administer. Apparently high levels of error and welfare fraud have been reported over the years.

Of particular concern is that the Income test was never designed to cope with earned income. A parliamentary Research Brief prepared in November 2005 commented as follows:

> The method of assessing a person's pension entitlements under the income test, based on their annual rate of income, allows Centrelink to assess their current need for income support. But it was also introduced, when most age pensioners did not work, and when it was not the Government's intention to increase older workers' participation in the workforce.

Despite recent relaxation, the pension means test continues as a significant deterrent to phased retirement and to efficient investment of retirement savings, especially for middle–income people. The Income test penalises work beyond age pension age, which is completely counter to the mindset we need to encourage. According to the Institute of Actuaries, age pensioners with income in excess of the "income free" level, pay

- significantly higher marginal tax rates (40% to 68% versus 0% to 34%)for incomes of $3,432 to $39,351 per annum
- higher marginal tax rates (46.5% versus 34%) for incomes of $39,351to $43,707 per annum
- higher marginal tax rates (35% versus 30%) for incomes of $53,000 to $63,000 pa.

Marginal tax rates of 40% would usually only apply to incomes over $75,000 per annum and marginal tax rates of 68% exceed the highest personal tax rate of 45%, which applies to incomes over $150,000 per annum. By contrast, age pensioners would be paying these marginal tax rates on incomes of just $3,400 to $44,000. These are particularly sensitive income levels as they are well under the average income (currently $58,000) and therefore highly representative of the income likely to be earned in older years, especially for part time work.

COTA Over 50s agrees with the Institute of Actuaries that the impact of this confusing system of age pension reductions, personal tax rates and tax offsets means that it is extremely complicated for a person of age pension age who is in receipt of the age pension to even know the "cost" of earning additional income. Secondly, the high marginal tax rates on earned income are likely to block any desire to work beyond age pension age.

Given that older people are not necessarily richer or poorer than other members of the tax paying community, there should be greater consistency in marginal tax rates. There would be significant administrative and efficiency advantages in the operation of the means testing regime and improvements in the behavioural and financial incentives to keep working, if the Income test could be removed whilst retaining the Asset test.

A simpler, more efficient and fairer approach might be to abolish the means test, include the age pension in calculating taxable income and radically change superannuation concessions to create an overall pattern of subsidies which is fairer and more efficient.

RECOMMENDATION

That retirement income policy and its associated taxation regime give practical effect to a 'three pillar' model in which the age pension:

- **functions as a true pillar of the system not merely a safety net, and**
- **is set in relation to a benchmark – transparently and robustly arrived at – that declares the minimum level of disposable annual income necessary for the maintenance of a modest standard of active and dignified living in retirement.**

RECOMMENDATION

That the current regime of tax concessions on superannuation (employer contributions, fund earnings and salary sacrifice contributions) be thoroughly reviewed to:

- **eliminate as far as possible regressive elements of the concessions to minimise the use of superannuation as a means of gaining inequitable tax benefits; and**
- **enable taxpayer funds to be applied more equitably to assist all citizens to achieve an adequate standard of living in retirement.**

RECOMMENDATION

That the Australian Government develop a proposal for a Pension Deferral Scheme which would include features such as:

- **A person who defers all or part of their pension receives an increased pension when subsequently commenced. (Initial work suggests 5% to 8% for each year of deferral.) .[8]**
- **The period of deferral would be totally at the person's choice and there would be no limit on the deferral period.**

---

[8] Institute of Actuaries Retirement Incomes Taskforce *Discussion paper on Age Pension and Retirement Incomes Reforms* August 2008

References

Australian Council of Social Service *Strong foundations: Reforming the tax and social security systems.* Submission to the Tax Review Panel, October 2008

Australian Government *Response to Senate Report "A Decent Quality of Life"* September 2008

Alliance Strategic Research *Superannuation as a social policy – Retirement adequacy* 2008

AMP (Access Economics) *The AMP Superannuation Adequacy Report January-June 2008* Dec 2008

Bowerman, Robin *Retirement Options* ASX Investor Update newsletter December 2008

Brotherhood of St Laurence *Towards a progressive tax system: Submission to the Review of Australia's future tax system* October 2008

Catholic Social Services Australia *An Australian Entitlements Commission: A proposal for an independent commission to inform decisions about the adequacy of pensions and other income support payments* ,September 2008

Coleman, Marie (National Foundation for Australian Women) *Retirement incomes and pensions* Reference Paper No.2 January 2009

Disney, Julian *Superannuation and lifelong saving* UNSW Faculty of Law Research Series 28, 2007

Fear J & Pace G *Choosing not to choose: making superannuation work by default* Australia Institute & Industry Super Network , November 2008

Institute of Actuaries Retirement Incomes Taskforce *Discussion paper on age pension and retirement incomes reform* August 2008

Knox, David *The relationship between the age pension and superannuation benefits particularly for women* University of Melbourne Centre for Actuarial Studies Research Paper 12, June 1994

Parliamentary Library *Superannuation contributions – the soft option* Research paper No.22 2007-08 , 13 March 2008

Rothman, Georg P *The adequacy of Australian retirement incomes – new estimates* RIM Unit, The Treasury, July 2007

The Treasury *A more flexible and adaptable retirement income system* http://demographics.treasury.gov.au/content/