INDUSTRY SUBMISSION

Retirement Income Review

January 2020

Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

1. Scope and Aim of this Submission

The primary factors that are most relevant to Australia's Retirement Income System have, over an extended period of time, been the subject of numerous research programs and national inquiries[1]. The assumption is made that the outcomes and recommendations determined by this extensive effort will be well known to panel members of the Retirement Income Review and that such information will properly inform the important work to be undertaken by the Panel.

Accordingly, it is not within the scope of this submission to exhaustively re-state the evidence that has already been placed on the public record and DomaCom intends to focus on the so-called "Third Pillar" described in the Terms of Reference as, "Voluntary Savings, including Home Ownership".

Home ownership is an important foundation for the retirement plans of Australians and it is critical that key Centrelink and Australian Taxation Office rules are adjusted so that they apply in an un-biased way to encourage self-funded retirement for those who have the means so as, to enable Government to sustain appropriate levels of welfare funding those who cannot support themselves.

The vast majority of older Australians (70%) store significant personal wealth ($500bn) in the family home; a single, tax-exempt and illiquid asset. However, a growing cohort of non-property-owning seniors face an uncertain future in retirement and the increasing demand placed on the public purse by an ageing population continues to retard Australia's economic progress. Clearly, the family home should now be an intrinsic part of the retirement funding process.

In the past, the equity release market in Australia has failed to meet the needs of older Australians due to poorly designed credit products, a lack of product development, the withdrawal of the vast majority of product providers and the demise of the industry body.[2]

ASIC has found that the leading reverse mortgage providers have "focused primarily on the borrower's short-term objectives, while limited or no attention was paid to their possible future needs"[3]. This situation does little to prevent the mis-selling of reverse mortgages and there is clear evidence for the need to further develop the reverse mortgage regulatory framework given that current regulation was formulated on a range of important industry self-regulatory initiatives which no longer exist[4].

In response to the need for a better solution, DomaCom has developed the first investment-based, fully-advised and regulated equity release product to be made available in Australia. Following a rigorous 6 ½ year regulatory approval process and the development of an ASIC-prescribed accreditation program[5] for licensed financial advisers, the DomaCom Equity Release Product (ERP) was launched in May 2019.

However, little has been done to eliminate persistent asymmetrical regulatory obligation and taxation bias in order to facilitate the growth of an efficient and ethical equity release market in Australia[6]. This submission provides clear evidence of the need to address these important issues through appropriate reform, in order to encourage self-funded retirement.

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[1] "Inquiry into Caring for Older Australians" Productivity Commission, 2011. "Housing Decisions of Older Australians", Productivity Commission -2015 inter alia.

[2] "SEQUAL Ceases Operations", MFAA -2017

[3] ASIC Report 586: "Review of reverse mortgage lending in Australia" August 2018.

[4] https://tinyurl.com/SEQUAL-Self-Regulation

[5] ASIC Instrument [18-0926]

[6] "Government Response to Capital Market Disruption", SEQUAL Submission FOFA -2011

2. Understanding Equity Release Strategies

The key terms that apply in the equity release market are explained in order to establish a proper understanding of the various equity release strategies, as follows:

Equity Release is a means by which property owners seek to retain occupancy of their home, while also accessing the wealth stored in the value of their property through a lump sum payment or income stream.

Equity Release (not Reverse Mortgage) is the correct term to be used when describing the overall market within which the various equity release products are offered.

Reverse Mortgage is an interest-bearing credit product secured by a mortgage over a borrower's home. As repayments are not required whilst the borrower occupies the property, interest compounds over time and is added to the loan balance. Generally, the reverse mortgage must be paid out in full when the borrower permanently vacates the property. Reverse Mortgages are typically sold by lender-accredited mortgage brokers.

Reverse mortgages are regulated by ASIC and offered by a relatively small number of Australian Credit Licence holders. ASIC recently stated that 80% of reverse mortgage transactions were provided by only two credit licensees[7].

The term "Reverse Mortgage" should not be used describe the overall equity release market as it only refers to a particular credit product[8].

The DomaCom Equity Release Product (ERP) represents a new-generation approach to equity release in that it is the only equity release strategy regulated under the Australian Financial Services licencing regime as a financial product.

The DomaCom Senior Equity Release product enables a homeowner to sell a percentage of their home to one or more investors in return for a lump sum or a regular payment. By agreement, they retain the title and have a permanent right of abode until such time as they decide to sell their home. The homeowner can also opt to rent out their home and retain 100% of the rental income.

ASIC has granted exemptions that enable DomaCom to offer the DomaCom ERP subject to some important consumer protection requirements including, the provision of financial product advice by an ERP qualified financial adviser.

Home Reversion Schemes are real-estate transactions subject to State legislation rather than national regulation whereby, a property owner sells part of their property at a discount to the prevailing market value in exchange for a fixed proportion of the future value of that property. There is currently only one home reversion scheme provider in Australia. Home reversion schemes are only available if you live in certain areas of Sydney or Melbourne.

Government Pension Loans Scheme provides a voluntary non-taxable fortnightly loan to supplement retirement income. The amount of loan is limited to 1.5 times the maximum rate of the qualifying pension and cannot be accessed as a lump sum. The loan and all costs and accrued interest must be repaid to the Commonwealth.

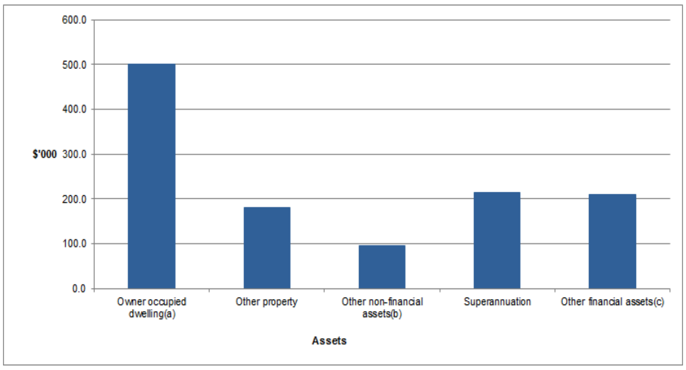
Arguably, all equity release strategies should be advised products.

[7] "Review of Reverse Mortgage lending in Australia", ASIC -2018.
[8] Please note the incorrect use of the term "Reverse Mortgage", at page 18 of the Consultation Paper.

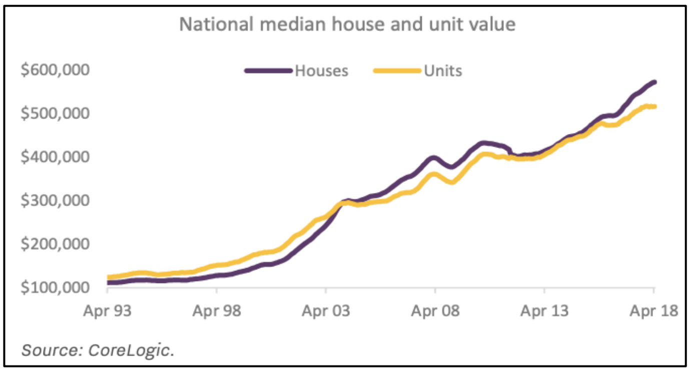
3. Equity Release: Improving Retirement Income System Outcomes

Home ownership has the most profound influence on the welfare of older Australians and for retirees that do not own their home, the amount needed to maintain a comfortable standard of living is significantly higher than home-owning retirees[9].

- The wealth of most of Australians is stored in their family home.
- Around 75 per cent of households where the household head is aged 65 and over, own their home outright.
- Retirees that own their home have accumulated significant personal wealth due to the long-term growth in property value.



Source: ABS Survey of Income and Housing, 2017–18



Senior Australians are determined to "Stay in Place" rather than sell their home and are storing rather than utilising their housing wealth. There has been a significant increase in the value of bequests in Australia primarily due to the sustained increase in property values.

Although Productivity Commission survey[10] results show that 83 per cent of older Australians prefer having the best possible quality of life in retirement compared to leaving as much as possible to their beneficiaries, the vast majority of respondents (88 per cent) intended to leave their home for
their beneficiaries to inherit.

Equity release enables housing wealth to be unlocked in order to increase economic activity, better align Government funding and improve the lives of retired Australians.

The Productivity Commission has suggested that:

"Most older Australian homeowners on low incomes could achieve a modest retirement living standard over the remainder of their lives by drawing on their home equity and financial equity release products could facilitate withdrawal of home equity to fund retirement needs".

As a large illiquid asset, the family home is an untapped source of retirement income.

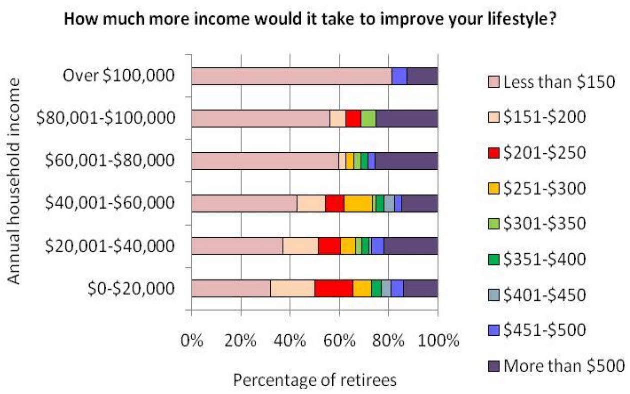
[9] "ASFA Retirement Standard", Association of Superannuation Funds of Australia (ASFA) -2019
[10] Reference: "Housing Decisions of Older Australians", Productivity Commission -2015

Equity Release: Enhancing the "Adequacy, Equity, Sustainability and Cohesion" of the Retirement income System.

In order to operate effectively, the Retirement Income System should encourage self-provision for those (home-owner) retirees that have accumulated significant personal wealth and target payments towards those (non-homeowner) retirees most in need.

Adequacy:

In order to assess whether the Retirement Income System provides an adequate level of income to alleviate poverty, the Panel should consider that half of all Aged Pensioners have less than $20 a week of private income.



The *'It's on the House' SEQUAL-RFI Reverse Mortgage Study*[11] was conducted in October 2007 with phone interviews of 1000 Australians over the age of 60.

This Study found that a modest increase to their income would significantly improve the lives of most retirees, with 50% of those surveyed indicating that as little as $300 a month would be sufficient.

Recent rises in cost of living pressures have led to concerns that people on low incomes, particularly those who are dependent on the maximum rate of pension and have few assets, may be finding it harder to make ends meet.

The Senate Standing Committee on Community Affairs' inquiry into "Cost of living pressures on older Australians"[12] found that people on low incomes are disproportionately affected by rises in the cost of petrol, food, medical care and rental accommodation.

It also found the maximum rate of pension may be insufficient to maintain a basic, decent standard of living, and those most at risk of financial stress are single pensioners receiving the maximum rate of pension and living in private rental accommodation.

The committee acknowledged that certain groups are more likely to be wholly reliant on pensions, including older women, people with severe disability or chronic illnesses, and those whose earning ability has been limited by their caring responsibilities.

Even a modest draw down through equity release can provide the opportunity for senior Australians to significantly improve their standard of living in retirement.

[11] Report available for Download at: http://www.sequal.com.au/images/stories/sequal_rfi_study.pdf
[12] "A Decent Quality of Life: Inquiry into the cost of living pressures on older Australians", Standing Committee on Community Affairs -2008

Equity

The Panel should carefully consider the capacity of home-owning retirees to self-fund their retirement through appropriate use of equity release, in order to enable the allocation of Government funding to those most in need.

Whilst income and assets tests are used to assess the personal resources available to income support recipients in order to calculate how much assistance is payable, in practice income from different sources is treated differently, for example, income from superannuation is assessed differently to income from shares.

There is also a series of exemptions, the most significant being the exemption of the family home from the assets test.

Although higher assets test thresholds apply for pension recipients who do not own a home, most pensioners do not have substantial savings or other assets: over half have assessable assets (excluding the family home) under $30,000 and 30 per cent report having bank balances of less than $1,000.

The family home is a major form of savings for seniors. Most Age Pensioners (61%) are homeowners and among Age Pensioner couples, 83% are homeowners.

In a 2014 report titled The Wealth of Generations, the Grattan Institute found that declining rates of home ownership among younger Australians were driving the growth in inequality.

The report shows that the rise in housing prices generated windfall gains for those who owned property before 1995.

These could be considered unearned gains – the result of policy and economic factors rather than productive activities or as compensation for taking an investment risk.

> “While some retirees likely bristle at the idea of "unearned gains", Roger Wilkins, a professorial research fellow at the University of Melbourne, said such people were showing "wilful ignorance" when it came to acknowledging their run of luck.
>
> "Perhaps what some older Australians don’t sufficiently acknowledge is that plenty of young people work hard but aren’t making the same economic progress as the Baby Boomers did."
>
> Roger Wilkins, a professorial research fellow at the University of Melbourne

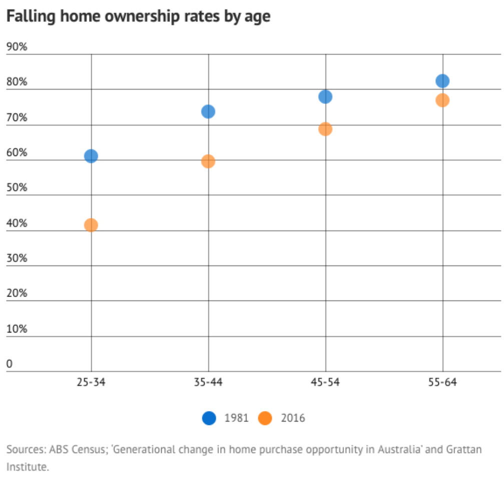
Government policy settings must do more than simply preserve housing wealth.

When retirees are provided with options that enable them to access their home equity, they are maintain economic activity and live well in retirement, without burdening the tax-paying generations that support the welfare system.

Equity Release enables retirees to unlock their housing wealth in order to self-fund the standard of living they desire in retirement and to lessen the burden on future generations.

Sustainability

Australia has an ageing population with 13% of Australians now over 65 years, growing to 25% by 2047 and 77% of Australians over the age of 65 receive income support.

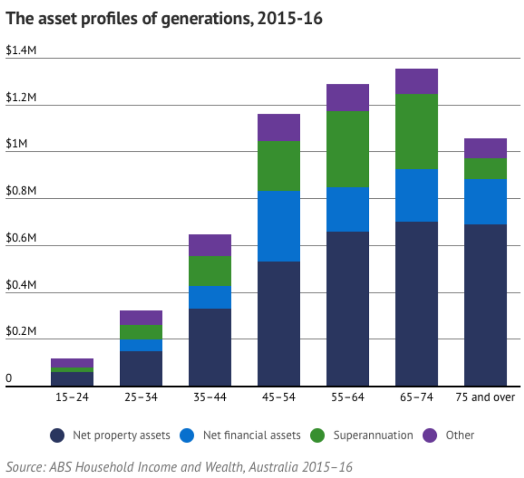


- There is a changing pattern of homeownership and increasingly, those entering retirement will remain in the private rental market.

- This trend is likely to persist across future generations unless home affordability improves.

Furthermore, those retirees who own their home are increasingly likely to enter retirement with residual mortgage debt. This proportion has been increasing over time, from 23% in 2006 to 36% in 2016 for those aged 60-64 years.[13]

In the UK, The Generation of Wealth report in June 2017 found that a typical adult born during 1981-85 had half as much total net wealth at age 30 as a typical adult at the same age just five years earlier.



"We know older Australians don't tend to draw down on their assets too much in retirement, so they will pass on a lot of that wealth.

"Unfortunately, the most likely to get these large inheritances are those who are already well off. People live longer now – which is a good thing – but it also means inheritances come to people in their 50s and 60s rather than their 30s and 40s.

That means people are getting the money at a time when they're less likely to need it."

Danielle Wood, Co-author Grattan's [Wealth of Generations report][14]

When it comes to wealth, the expectation that each generation will do better than last might have been true for some time but that has changed.

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[13] Chomik, Graham, Yan, Bateman & Piggot -2018

[14] "Wealth of Generations" Report, John Daley and Danielle Wood, Grattan Institute -2014

Cohesion

DomaCom wishes to address to following key issues regarding the cohesion of the system:

1. 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?
   - Response: No. An estimated 4.5 million retirees have equity in their home that is, on average, over four times higher than their superannuation savings.
     Equity release should be encouraged in order to enable the top up of inadequate retirement savings and to avoid "Asset Rich but Cash Poor" outcomes.

2. 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?
   - Response: Many people for whom equity release would be suitable currently have little motivation to do so, because the value of their home is largely exempt from the assets test for the Aged pension and aged care co-contributions.
     Those who convert home equity into means-tested assets (e.g. Cash at Bank), may have their entitlements reduced. These policy settings encourage older people to store wealth in the value of their homes rather than release equity in order to support themselves.

3. 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?
   - Response: Retirees often leave large bequests based on significant wealth held in the form of their home equity and undrawn superannuation balances.
     The tax system advantages those who accumulate wealth in this manner and encourages the practice of utilising these asset classes for estate planning rather than retirement income purposes.

4. 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 outcome?
   - Response: No. Retiree risk averse behaviour is driven by a lack of financial literacy about equity release strategies and a reluctance to view the home as an "active asset". This results in excessive "precautionary savings" which, could be avoided if appropriate financial advice were mandated.

   - Do individuals have sufficient access to retirement income products that manage the level and longevity of their income?
   - Response: No. A fragmented regulatory framework, inconsistent application of ATO and Centrelink rules and a lack of institutional funding has constrained growth in the Australian equity release market and as a consequence, consumer choice is limited.

4. What needs to be done?

The family home is a key component of the third pillar of the retirement income system (voluntary private savings). However, the system should better recognise the extent to which owner-occupied housing contributes to household wealth and retirement liveability.

People who do not own homes are exposed to the high-cost rental market and risk poverty in retirement. Worryingly, home ownership continues to decline among young Australians. More retirees are expected to retire with either residual mortgage debt or not owning a home.

The government needs to adjust superannuation policy settings so as to recognise the role of housing in contributing to the objectives of providing for a decent retirement and poverty alleviation. Action needs to be taken in the accumulation phase well before retirement.

The family home can and should be a source of financial support for those facing the challenge of ensuring that their retirement savings will meet their needs and expectations.

In order to achieve improved outcomes for all Australians, the following key issues now need to be resolved:

Enable Equity Release "Downsizer" Superannuation Contributions

The key motivation for Government in introducing the "Downsizer Contribution" was to unlock wealth stored in the family home and transfer that wealth into superannuation balances, so that those approaching retirement would be better placed to fund their retirement.

In 2016, the Government introduced a $1.6 million limit on superannuation pension transfers which, the former Treasurer, Peter Costello considered to be; "less generous than it appeared" and he predicted that:

> **"Historically low return rates would push more retirees onto welfare"**

In 2018, the Government introduced a "Downsizer Contribution" aimed at encouraging older Australians to "Top Up" their superannuation balance by making a contribution of up to $300,000 from the proceeds of selling their home, and the ATO issued a Fact Sheet that did not provide an example based on a partial sale of the home and contained the opening comment that; "More and more older Australians are seeing the benefits of selling the family home…"

This claim is startling in that it ignores clear evidence measured over decades , by numerous agencies (including Government Departments)[15], that rather than selling their home;
Older Australians overwhelmingly want to remain in their homes and "Age in Place"[16]

Equity Release reconciles the desire of older Australians to stay in place with the Government's effort to unlock housing wealth so as to increase the capacity of Australians to self-fund their retirement needs.

Action Required:

We would ask that the proceeds of a "partial sale" of the family home (e.g. DomaCom ERP), be available to be used as part of the "downsizer contribution". This will also enable super funds to assist their members by enabling them to acquire a portion of the property.

[15] "Housing decisions of older Australians", Productivity Commission -2016
[16] "The desire to age in place among older Australians", Australian Government -2013

Eliminate any bias in the Centrelink treatment of Equity Release strategies

Centrelink rules should be applied consistently to the proceeds from equity release transactions, regardless of the particular equity release product selected by the home owner.

These rules have implications for both the Assets and Income Tests because the very essence of equity release is to transfer value from an exempt asset to another form, one that may end up counting as an assessable asset.

The option to receive regular payments (staggered settlement), rather than a lump sum, improves the opportunity for older Australians to properly manage their ongoing living expenses and although this option is available across all equity release products it is not clear to us whether current Centrelink rules unfairly discriminate between particular products and we have been unable to engage with Department of Social Services to obtain clarity.

In the case of debt-based equity release products such as, reverse mortgages, only the cash payments received by the retiree (not the overall facility amount), are considered in the calculation of benefits entitlement.

For example: If a retiree signs up to a $100,000 reverse mortgage facility but only draws down $5,000, it is the $5,000 drawn down that is considered in the Centrelink calculations, not the $100,000 facility amount.

The same Centrelink treatment should apply to other equity release products such as, the DomaCom ERP.

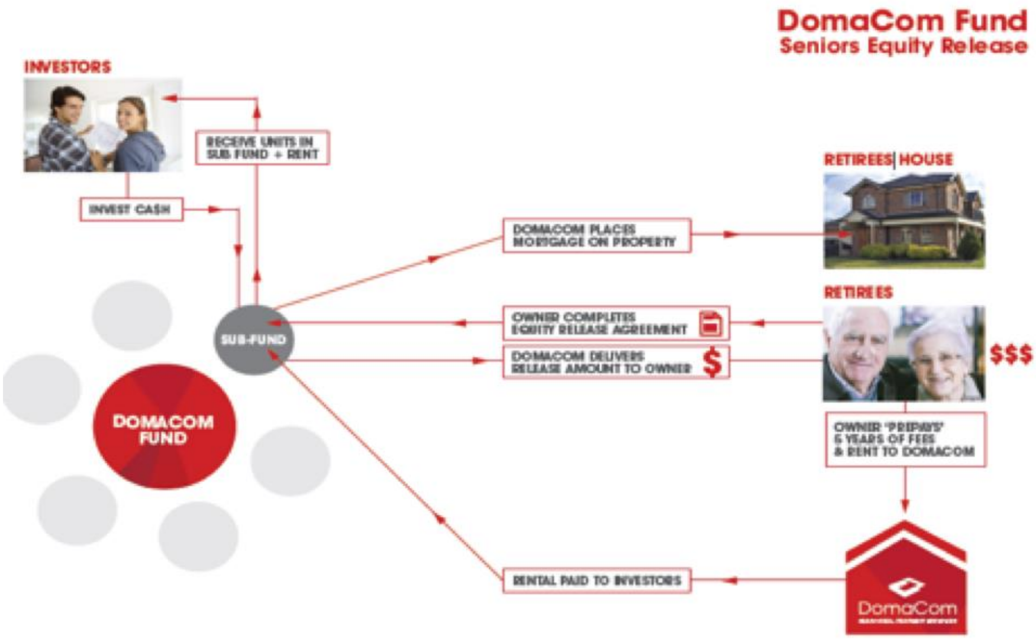
This approach would ensure that no product bias exists and confirm that retirees are able to select the equity release product that best suits their circumstances, without the unintended penalty of impacting their benefits entitlement determinations.

Action Required:

Centrelink to confirm that the proceeds of a staggered settlement using the DomaCom ERP are assessed in the same manner as instalment payments using a reverse mortgage.

Attachment:

The Concept of Fractionalised Property Investment



The concept of Fractionalised Property Investment enables property owners to separate their "Right to Occupy" from their "Economic Interests", such as rent and capital, in their property in order to provide the opportunity for investors to gain access to a fractional interest in their property, rather than selling the whole property to those investors.

The mutual benefit is that the property owner can release cash from an otherwise illiquid and indivisible asset and the investor can both scale their investment to meet their particular asset allocation objectives and diversify their risk through an individually selected property portfolio.

Unlike reverse mortgages which are a credit product where interest is charged and compounded monthly or a home reversion scheme where home owners receive a discounted lump sum payment by selling a portion of their home, the DomaCom Equity Release Product (ERP) provides an advice-based alternative for clients to access the equity in their homes.