Friday, 20 December 2019

Retirement Income Review Secretariat
The Treasury
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Dear Sir / Madam,

Public Consultation: Retirement Income Review

Thank you for the opportunity to comment on Retirement Income through this review and consultation. The following opinions and ideas are mine alone and may be non-conformist but are hoped to be thought-provoking.

Summary

I make the following observations and comments:
- Suggestions are made for definitions of Purpose, Goal, and Objective of superannuation.
- Superannuation should support joint accounts.
- The Government could introduce a HECS-like Retirement Income Supplement Scheme ('RISS') allowing personal election to receive the Age Pension without Means Testing. 'RISS' would be recovered from all assets of the deceased estate including the primary residence.
- Means testing should depend wholly on the Income Test with allowance for deeming and conservative capital extraction.
- Access to Aged Care should follow naturally from the Age Pension in format and cost should be expressed more simply and clearly.
- Taxation could to be amended to create simplified and homogenous landscape for savings. Investment earnings should be taxed at a flat rate.
- The government may be placed to offer or assist in more efficient longevity pooling.
- Superannuation contributions could be made at the same time, and in the same manner, as PAYG tax payments.

Purpose, Goal and Objective

The objective of superannuation is best understood in the context of its purpose and goal. The following are my efforts at defining these -they are far from ideal or final, but I hope they offer an insight as to why the three are important and not just the objective.

The Purpose of superannuation is to be a primary means by which citizens and residents can save to provide for their income needs in retirement.

The Goal of superannuation is to enable citizens and residents to live in retirement free of financial anxiety.

The Objective of superannuation is to facilitate and encourage savings to best achieve financial goals in retirement.

Note that the above are not consistent with the currently drafted objective - to provide income in retirement to substitute or supplement the age pension[1]. This drafted objective does not speak to a retiree's interests and will not induce engagement. Individuals will not save in order to replace income they would otherwise receive without effort. They will only save to improve their income.

Couple Accounts

Superannuation is for Australian citizens, of any gender, individual or couple, and should be suitable and equitable to all. Equitable should mean equal opportunity to engage in and enjoy the advantages of superannuation.

One of the known difficulties of superannuation is gender inequality. Women generally have smaller superannuation balances than men. Much of this issue stems from the linear connection between the individual, his or her income, and superannuation. Income is identified with the individual, not a couple. Super is extracted from individualised[2] income and contributed to an individual account.

Joint superannuation accounts could be allowed. Doing so would:
- Support gender or partner equity in the household regardless of relative or disrupted incomes.
- Allow a single breadwinner to make larger joint contributions[3] to optionally save for a larger retirement household.

Access to Age Pension

The current system has complex rules to access the Age Pension including an income test, an asset test, exempt assets (the primary residence), deeming, and gifting amongst other concepts.

Much of the complexity would disappear if a HECS-like scheme was introduced. The government could introduce a Retirement Income Supplement Scheme ('RISS') where any retiree could elect to access the Age Pension regardless of assets or income but where the amounts are subsequently recovered from their Estate once deceased.

'RISS' could recover costs from the whole of the deceased's Estate including the primary residence. This would overcome the issue of cash-poor asset-rich individuals. It allows access to income to live while fairly recovering the public cost rather than resulting in a bequest[4].

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[1] Superannuation (Objective) Bill 2016

[2] Stay-at-home parenting, or carer responsibilities that disrupt income continuity.

[3] Concessional or non-concessional.

[4] The implications being that a 'RISS' must be repaid before any other Estate disbursement. This should prevent one partner from bequeathing all their assets to leave the survivor with full pension but few assets.

Means Test

If a 'RISS" is not possible, then perhaps the means testing rules could be simplified:

- Remove the Assets test; rely entirely on the income test with deeming.
- Set the deeming rate to a meaningful benchmark such as RBA Rate plus a margin. The margin could be a set proportion of the RBA published AAA spread[5]. e.g. RBA + 50% x AAA Spread.
- Include a conservative proportional drawdown of capital perhaps like the current drawdown rules for pension phase superannuation or alternatively more particularly tuned to a conservative estimate of the pensioner's life expectancy[6].

Aged Care

Means testing and funding of Aged Care is unnecessarily complicated and comes at a time when retirees and their families are most stressed and least equipped to understand the process. It could be simplified to have rules consistent with, or a natural progression from, the Means Testing rules for the Age Pension.

The cost of Aged Care needs to be more simply expressed. The approach whereby costs are explained as Daily Access Payment (DAP) plus additional service fees mixed with an alternative Refundable Accommodation Deposit (RAD) is over-complicated and confusing.

Costs should be explained as a single daily cost of care. Some of this can be recovered or paid by government social security. And some can be paid by RAD instead of DAP. It is the same but in plain English.

Savings and Taxation

If the *purpose of superannuation is to be a primary means by which citizens and residents can save to provide for their income needs in retirement*, then it stands to reason that savings in general should be encouraged.

Taxation and Social Security is a material but inconsistent influencer on the savings process:

- Capital gains are discounted while negative gearing is fully deductible.
- General investment income is taxed at marginal rates.
- Salaries are taxed on individual incomes regardless of marital or de-facto status. Total household taxation depends on the mix of incomes within.
- Dividend income is franked and taxed at investor's marginal rate.
- Superannuation contributions are taxed at rates of 0%, 15% and 30%.
- Superannuation earnings are taxed at 15%, or 0% if in Pension phase.
- Superannuation Bequests to non-dependents are taxed at 15% plus Medicare.
- Australia has one of highest dependencies on personal income taxes in the world.

[5] https://www.rba.gov.au/statistics/tables/#interest-rates Schedule F3

[6] e.g. annuity calculation assuming the official deeming rate and term equal to 150% (say) of standardised life expectancy

Some ideas to redress this might include[7]:

- Set the taxation rate on all investment earnings to a flat 15%
    - This should be regardless of the investor's marginal tax rate.
    - Remove the capital gains discount and simply tax at 15%.
    - Interest costs, and thereby negative gearing, assessed against investment earnings at the flat rate of 15%.
    - Eliminate franking and make dividends received tax-free.
    - Tax undistributed income from Discretionary Trusts at the same rate.
- Simplify the tax rates on salary to a three-tier structure of 0%, 15%, and 30% with thresholds based on 50% and 150% of published Average Weekly Earnings.
- Set the tax rate on superannuation contributions and earnings to 15% consistent with the above median rate on salaried earnings, and the above rate on investment earnings.
- Set withholding tax at 15% consistent with the above rates.
- Potentially lower the corporate tax rate to 15% competitive with other world rates and to align with other rates above.
- Recover the revenue shortfall from the above by amending GST to perhaps either:
    - 15% consistent with the above flat rates.
    - 5% but remove the deduction for GST paid. This would probably raise increase taxation revenue[8] while also simplifying BAS returns and alleviating administrative burden.

Longevity Insurance

Treasury's CIPRs covenant commendably promoted longevity pooling and insurance. The Age Pension, however, poses a significant price competitor for longevity products.

Fixed annuities are particularly disadvantaged in the current low and falling interest rate environment. This is evidenced by the limited Australian market for annuities[9] and the overwhelming dominance of the primary participant[10].

Variable annuities offer product differentiation with potential gains on investment but suffer a higher cost of capital protection. Variable annuities are most relevant to those with larger invested savings, but who have lesser concerns for running out of money and may not see the benefit.

Both annuities, however, suffer from one distinct price disadvantage. Longevity is biased to those with larger savings; often white-collar professionals. This same group has materially longer life expectancies and are more expensive to insure or pool.

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[7] These ideas may be non-conformist and are offered to be thought-provoking.
[8] Treasury modelling and verification is obviously needed.
[9] "annuities currently capture less than 5% of the annual transfer from the savings phase of superannuation to the retirement phase", Challenger 2018 Analyst Pack, page 6.
[10] "Challenger is the market leader in retirement incomes with 73% annuity market share.", Challenger 2018 Analyst Pack, page 6.

These are complex issues and difficult yet valuable to overcome. Thought could be given to a few possible ideas.

- The government has the complementary longevity issue. Those on the Age Pension will generally have shorter life expectancies than self-funded retirees. The government may, therefore, be placed to offer or insist in more efficient longevity pooling[11].
- The government might incentivise longevity insurance by perhaps partially sheltering the taxation of earnings on longevity insured products.

Timing of Superannuation Contributions

One issue for many PAYG wage earners is that their small business employers delay or even fail to make the due payments to super funds. Few employees reconcile the contributions made with their payslip records and there is no year-end return to force that reconciliation. Not like PAYG tax.

Further to this, a business makes contributions to multiple funds, and some individuals accumulate a 'litter' of funds after multiple jobs. A single point of entry would be beneficial.

Superannuation contributions could be made at the same time, and in the same manner, as PAYG tax payments. The ATO could then forward contributions on to funds and produce a reconciliation statement on the taxpayer's MyGov account.

Finishing up

I thank and commend the government for undertaking such a broad survey of superannuation and retirement in Australia. I hope the above comments and ideas, and those offered by others, provide food for thought and lead towards a better overall environment supportive of saving for and living in retirement.

Yours faithfully,

Geoff Lewington

[11] Care should be used to ensure that less wealthy retirees do not excessively subsidise the more wealthy.