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The Treasury
Retirement Income Review Secretariat
Langton Crescent
PARKES ACT 2600

Attention: Mr Robb Preston

Dear Mr Preston,

Retirement Income Review Consultation

AMP welcomes the opportunity to make a submission to the Retirement Income Review.

AMP has been part of Australia's national life since 1849 and since that time has supported individuals during both their working life and their retirement.

But there have been significant changes over the last 170 years.

When AMP was founded life expectancy was around 30 years of age. Average life expectancy now is 80.76 for males and 84.85 for females and is expected to continue to increase.

Ensuring that all Australians can live their retirement in comfort and dignity has become one of the major challenges for those setting public policy. It has also become a challenge for the Federal Budget.

For these reasons, the Retirement Income Review is timely and important and will set the parameters for changes to retirement incomes policy over the coming years.

AMP was delighted to discuss the retirement incomes challenges with the panel on its recent visit, where many of the consultation questions were discussed.

This submission builds on those topics and provides some additional detail.

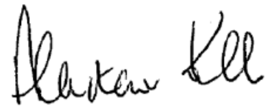
AMP notes that many submissions have been lodged with the Review Panel including those from the FSC and ASFA.

AMP has worked closely with both the FSC and ASFA in the preparation of their submissions. We support the thrust and direction of the recommendations contained in each submission.

AMP supports many of the views contained in the ASFA submission, including the FSC's and ASFA's advocacy for the SG to be moved to 12 percent as currently legislated.

Should you have any queries, or wish to discuss further, please contact me on 02 6295 2966.

Yours sincerely



Alastair Kinloch

Retirement Income Review – AMP Submission

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Key points

- AMP supports the Government's policy to raise the superannuation guarantee (SG) to 12 percent as currently legislated;
- That the system is yet to fully mature and it will be many years before it does;
- That improved financial literacy and financial advice is critical to the accumulation, transition and pension phases of the retirement income system, and more should be done to make financial advice more affordable for Australians.
- Simplification of the complex retirement income system is required, including interactions with the tax and age pension system.
- That the concept of 'retirement' is changing and the system needs to reflect this – fewer people are stopping working at 67 and never working again;
- An objective for the retirement income system needs to be defined.
- There is a need for more education about the retirement income system; financial literacy needs to be improved.
- That retirement incomes adequacy should be defined relative to an individual's income before retirement, but noting that it may need to be subject to a minimum level or safety net.
- Longevity, income and sequencing risks should all be seen as components of adequacy.
- That there needs to be a focus on those disadvantaged by the existing superannuation arrangements, including women, carers and those with interrupted work patterns.
- Consumer confidence and understanding of the retirement income system has been reduced given the many changes to taxation, legislation and regulation governing the system.
- That superannuation needs to be removed from the Fair Work Commission (FWC) regime, along the lines recommended by the Productivity Commission Inquiry.

The Retirement Income System

Consultation Question:

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

AMP response:

Given that the retirement systems of advanced economies have grown independently and reflect the unique expectations and norms of their respective populations, it is difficult to isolate components from one system and transfer them to others.

There are four characteristics that are distinctive to the Australian system:

- The system is unique in its complexity; other comparable systems are far simpler.
- This complexity is brought about by interactions with other policy areas – Centrelink (including means testing) and the tax system. Simplification is necessary for the system to work efficiently. Figure 3 of the consultation paper encapsulates the problem succinctly.
- That in most instances for an individual to achieve optimal retirement outcomes, financial advice is essential.
- That there are too many and too frequent changes to the taxation, legislation and regulations governing the retirement income system. That needs to change as persistent changes to policy settings result in a loss of public confidence in the system.

Despite this, it needs to be recognised that Australia's superannuation system (as opposed to the retirement income system) ranks third among the world's best pension systems.

While recognising that more may need to be done in encouraging individual contributions, Australia was given a B+ grade according to the recent Mercer report. The report also argued that Australia "needs better integration between the age pension and superannuation". AMP agrees with this assessment.

So, while not perfect, there is a recognition that the accumulation phase of the retirement income system is well developed and outperforms comparable systems globally.

Purpose of the system and the roles of the pillars

Consultation questions:

- Is the objective of the Australian retirement income system well understood within the community?
- In what areas of the retirement income system is there a need to improve understanding of its operation?
- What are the respective roles of the Government, the private sector, and individuals in enabling older Australians to achieve adequate retirement incomes?

AMP response:

Our experience is that the objective of the retirement income system in Australia is not well understood, partly because the Government has not defined an objective for the system, and also due to the complexity of the system.

While most Australians are aware that the government provides a means tested aged pension and that SG contributions are paid by employers, a large proportion of the population does not actively engage with its superannuation savings.

In part this is due to the fact that superannuation essentially operates as a default. It happens automatically for most employees through the FWC. This is unfortunate as it leads to a disengagement between members, superannuation providers and members' retirement savings.

It is for this reason that AMP supports changing the retirement savings default arrangements from the present arrangements in the industrial system, as recommended by the Productivity Commission Inquiry, to encourage individuals to engage with the retirement savings and play an active role in their management.

More education about the system and how it works is necessary and critical to improve member engagement.

A further factor that the panel should consider is the need for a clear definition of what the retirement income system is trying to achieve.

In most other areas of public policy, there is a clear objective set by government. In the case of retirement incomes, it is vague.

AMP suggests that setting an objective for the retirement income system is a key priority for the Government.

In 2016, the Government endeavoured to legislate an objective for the superannuation system, which was:

> *'…to provide income in retirement to substitute or supplement the age pension.'*

This definition had been previously developed during the Financial System Inquiry considerations.

AMP considers that this objective should be somewhat different and more aspirational.

AMP believes that the objective of retirement income system should be to lift Australians out of the welfare safety net of the age pension. That is, as many Australians as possible should be able to have a dignified self-funded retirement without having to rely on the Age Pension.

Of course this is an aspirational target so we must continue to ensure that there is an adequate safety net for individuals who cannot save enough to meet this objective (as we are all aware, most Australians will not have adequate retirement savings until the system fully matures).

We understand that 'dignified' or 'adequate' can be difficult to define and that there is much debate on these topics. However, we agree that the superannuation system should not be used as a vehicle for undue wealth creation.

We suggest the objective of the retirement income system should be:

> *'to provide an income to support a dignified retirement for all Australians, including encouraging the self-provision of retirement income, while maintaining a sound safety net aged pension system.'*

By self-provision, we mean that individuals should strive to be self-funded through the whole of their retirement, and not just at the commencement.

Principles for assessing the system

Consultation question:

- Are the principles proposed by the Panel (adequacy, equity, sustainability, and cohesion) appropriate benchmarks for assessing the outcomes the retirement income system is delivering for Australians now and in the future?

AMP response:

The consultation paper sets out four principles that it considers to be the appropriate benchmarks for the system – adequacy, equity, sustainability and cohesion.

These four criteria appear to be the appropriate benchmarks, although prima facie, from a client and provider perspective, retirement incomes adequacy should be the pre-eminent principle since the primary goal of the retirement income system is to provide an adequate income in retirement.

Consultation question:

Adequacy

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

AMP response:

Most practitioners are aware of the longstanding debates surrounding how retirement incomes adequacy is defined.

In broad terms there are two approaches - one that delivers a minimum income level in retirement regardless of prior income; and one that reflects a proportion of the pre-retirement incomes.

AMP supports the latter.

There are two reasons for this.

First, we believe that an aspirational objective for the retirement income system should be set.

The system should be designed to lift people out of the social security safety net of the age pension. That is, the target should be that as many Australians as possible should have a dignified self-funded retirement. As indicated earlier, by self-funding, we mean that they should be self-funded through the whole of their retirement, not just at the commencement.

And to be dignified means that the living standards in retirement must reflect to some extent the way in which they lived prior to retirement. That said, this approach needs to ensure a minimum level or safety net to cater for those with less than adequate support pre-retirement.

Secondly, the superannuation contributions system is designed to be relativist.

Individuals that are well paid before retirement save more through SG (as well as outside of the superannuation system) and invariably have higher account balances when they retire.

The panel should note that at this stage there are many Australians that will not have an adequate retirement income until the system fully matures – and that could still take decades. We need to wait until SG reaches 12 percent and then for people joining the workforce at this time to contribute through a full work cycle to retirement. For example, with SG rising to 12% from 1 July 2025, a 20-year-old joining the workforce in 2025 and retiring in 2072 at age 67 (the current Age Pension eligibility age) will be in the first cohort to benefit from a fully mature superannuation system.

Therefore, at this point the retirement trajectory is **different for all Australians**, as it is dependent on factors such as when they first joined the superannuation system, when they first commenced to receive compulsory superannuation, their income and the number of years in which they are in the system.

Some years ago, AMP developed a Retirement Income Adequacy Index based on the above principles. The index modelled expected Retirement Incomes Adequacy over time, based on a range of assumptions and public policy settings.

The aim was to use actual AMP individual superannuation data in the model to monitor the impact on expected final retirement account balances (and adequacy) of changes in the economy, government policy and savings rates over time.

The Index was designed in consultation with Access Economics.

While the analysis is now a little dated, the panel may be interested in the assumptions and methodologies that were used as we consider that these are still valid.

First, the Retirement Incomes Adequacy index was a relativistic measure. The target income in retirement was set at 65% of pre-retirement living standards. Pre-retirement living standards was defined as pre-retirement incomes less tax and savings.

Clearly there is a debate whether 65 percent is an appropriate target; others would advocate for 70 percent.

Second, AMP considered that 'other savings' in addition to superannuation should be included in the model for the assessment of retirement incomes.

This reflected real life experience where 'other savings' are used to fund retirement living expenses. In our analysis, other assets included investment homes, and other financial assets – savings accounts, shares, bonds etc.

Currently, of total household assets some 43 percent is in the family home, 18 percent is superannuation and 17 percent other financial assets. In other words, 'other savings' at around 17 percent of total household assets are now almost the same in size as superannuation savings at 18 percent. It would be misleading to ignore these savings in the retirement incomes analysis.

Thirdly, it was decided that the family home should be excluded from the model.

This was because at the time the model was conceived in 2008, the family home was not generally perceived as being a retirement incomes savings vehicle.

However, we note that in other countries the family home is included, particularly where reverse mortgages are more commonplace.

AMP considers that the above model remains the most rigorous approach to determining Retirement Income Adequacy.

Consultation Question:

Equity

- What should the Panel consider when assessing the equity of the retirement income system?
- What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement?

AMP response:

For many years it has been apparent that people with part time work or broken work patterns are disadvantaged throughout the accumulation phase of superannuation, retiring with account balances well below those with unbroken work patterns and full-time work.

While many people are impacted e.g. carers and those who may have work commitments overseas, it is primarily women that are disadvantaged through lower salaries and broken work patterns over the course of their career.

The statistics are stark:

- 40% of older single retired women live in poverty and experience economic insecurity in retirement
- 44% of women rely on their partners income as the main source of funds for retirement
- 8.5% of women between 65 and 74 still have a mortgage
- The average female salary is $44,000 (including part-time workers)
- 65.3% of the workforce are women
- 43% of women work part-time
- Women working full-time earn 18% less than men

In addition to tracking overall adequacy, AMP's retirement incomes adequacy report demonstrated the disadvantage of women at retirement - women's account balances are often around 30 percent lower than an equivalent male.

While the report is a little dated, it would be reasonable to assume that the situation has not changed markedly.

While there are many reasons that women's superannuation account balances are lower than those of men it is irrefutable that at retirement women are worse off at retirement.

For a nation that prides itself on fairness and equity, such outcomes are unacceptable; AMP considers something needs to be done.

This is an issue that has been raised in many other submissions and we encourage the Panel to explicitly focus on the significant issue of women's retirement incomes adequacy.

While this review is not directed at finding policy solutions, we would ask the panel to consider four policy options that would assist women and others that are disadvantaged in the current system:

- Removing the $450 monthly pay threshold for compulsory superannuation contributions. This would result in an estimated 220,000 women having superannuation contributions while presently they do not;

- Providing women and other low-income earners with an additional $1,000 annual contribution to their super; this will boost their balances and reduce the male/female gap;

- Encourage companies to pay super on both paid and unpaid parental leave. This is the practice at AMP. Women take on average five years out of the workforce to care for children or a family member which can cause their super savings to stagnate and begin to fall behind those of men

- Ensuring no further delays in increasing the superannuation guarantee to 12%. Our analysis show that the current 9.5% Superannuation Guarantee does not enable many women to accrue sufficient savings for a comfortable retirement

The above four measures are low cost, and would not materially impact the budget, yet have a significant impact on women and those on low incomes.

In addition to considering broken work patterns, the Panel should also consider, from an equity perspective, the aspect of relationship breakdowns and the impact on retirement incomes. This too adversely impacts women disproportionately.

Consultation questions:

Cohesion and the need for advice

- What should the Panel consider in assessing whether the retirement income system is cohesive?
- Does the retirement income system effectively incentivise saving decisions by individuals and households across their lifetimes?
- What evidence is available to show how interactions between the pillars of the retirement income system are influencing behaviour?
- What is the evidence that the outcomes the retirement income system delivers and its interactions with other areas (such as aged care) are well understood?
- What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?
- Is there sufficient integration between the Age Pension and the superannuation system?

AMP response:

At the core of many of the above consultation questions is the need for financial advice, not only in the accumulation phase, but during the transition from accumulation to pension and in the pension phase itself.

Advice is critical for Australians more so than in many other advanced nations because:

- The regulatory and legislative framework is very complex. It is difficult to understand, and many Australians do not have the confidence and/or financial literacy to properly deal with this. They can easily make simple errors in managing their financial affairs that will cost them dearly (and in some cases are irreversible), and some examples are given below;
- The means testing arrangements for social security benefits is complex; advisers are required to ensure optimal outcomes for individuals for relatively simple transactions. Examples include the means testing of the aged pension (taper rates, deeming), Centrelink payments and the transition from the accumulation to the pension phase of superannuation;
- The complexity of the taxation of superannuation and its interaction with investment products;
- Topping up of superannuation; superannuation contribution caps and maximum transfer balances;
- Unlike overseas pension systems, the investment risk is carried entirely by Australian retirees, who mainly are invested in account-based pensions. The continued volatility in investment markets is stressful for retirees, with many unsure how much to draw down each year, and whether their investments would survive any global investment shocks. It is therefore not surprising that many will only drawdown the minimum pension from their account-based pensions;
- downsizing of the family home and the potentially adverse financial consequences/outcomes this may have because of its interaction with the Age Pension;

A key question for policy makers relates to the cost of advice. It is now at a point where financial advice is difficult to afford for the many people that most need it.

Attachment 1 provides three simple ‘retirement’ examples of how financial advice can materially benefit individuals. Often the benefits run to many tens of thousands of dollars.

Simple questions like:

- Should I reduce debt or build up super prior to retirement?
- In the lead up to retirement what can I do to enhance my super account balance?

There are also other traps (see Attachment 2) that individuals approaching retirement can fall in to:

- Downsizing the family home and getting it wrong
- Not understanding the age pension exemption for the home
- Traps with ‘gifting’

Most of the examples in both attachments have been drawn from discussions with financial advisers and clients.

As can be seen from the above examples, good advice will enable many to save tens of thousands of dollars compared to making a poor decision. This translates into a much higher quality of life in retirement simply by avoiding relatively simple pitfalls.

Over the last several years the financial advice regulatory burden has increased and so have costs to the point that advice can only be accessed by the wealthy.

The survey conducted by ASIC in 2019, and reported in ASIC report 627 - 'Financial Advice; what customers think' showed that the major barrier to people getting financial advice was cost . Thirty five percent of the population thought advice was too expensive and cost was the leading barrier to customers seeking advice.

There is no silver bullet in relation to reducing the cost of advice, but a range of measures need to be considered.

AMP recommends that the panel consider at least two policy options:

- tax deductibility of the preparation of financial plans, and
- changes to the processes that would enable greater access to scoped/scaled/episodic advice

With regards to the former- tax deductibility of advice - it has been proposed multiple times yet little has been done.

For example, the Ripoll report, which was the basis of the FoFA reforms, in its recommendations to government in 2008 stated:

> *Recommendation 5: The committee recommends that the government consider the implications of making the cost of financial advice tax deductible for consumers as part of its response to the Treasury review into the tax system*.

In the event this did not happen.

The extension of tax deductibility of advice would immediately reduce the cost of advice and therefore improve access to advice for individuals approaching and in retirement.

The introduction of scoped and scaled advice as part of FoFA was also seen as a way of reducing the cost of advice to the client, including episodic advice, but for a variety of reasons scoped and scaled advice remains expensive, to the detriment of the consumer.

Appendix 1 - Cameos showing the value of advice in pre-retirement and in retirement

Benefit of advice – reducing debt and building super prior to reaching retirement

Barry is 55, single and earns $90,000 per annum. His goal is to pay off his mortgage of $200,000 by age 65 when he retires, and at the same time build up his super.
His current mortgage is as follows:

Mortgage	$200,000
Interest rate	3.50% pa
Term of home loan remaining	20 years
Monthly repayment (post tax)	$1,160 per month

Barry seeks financial advice and his adviser determines that Barry has surplus net income and his goal is attainable. His adviser suggests 2 separate strategies:

- Barry makes additional repayments to his home mortgage (in post-tax dollars) to repay his mortgage in 10 years; or
- He contributes the pre-tax equivalent of the additional mortgage payments into super as salary sacrifice contributions and then use the super proceeds at retirement to pay off the mortgage.

Assuming the loan interest rate remains the same for the 10-year period, Barry will need to pay an extra $820 per month post tax to clear the mortgage at age 65.

Alternately, Barry can invest the pre-tax equivalent of $820 per month as a salary sacrifice contribution into super. As he earns $90,000 pa, his marginal tax rate is 34.5 per cent (including the two per cent Medicare levy), so the pre-tax equivalent is $1,252 per month. This equals to $15,024 per annum, and after allowing for the 15 per cent contributions tax, he will have 85 per cent of the contribution or $12,770 working for his super in a tax concessional environment.

To work out how much he will have in super in 10 years, we have used the following super assumptions:

- The salary sacrifice contributions, when added to his employer SG contributions, remain within the $25,000 per annum concessional cap.
- His super is invested in 70 per cent growth/30 per cent defensive assets, returning a gross return of 3.07 per cent pa income (50 per cent franked) and 2.37 per cent per annum growth.
- A representative fee of 0.50 per cent per annum of assets has also been used.

Assuming the assumptions remain the same over the 10-year period, the results for Barry are as follows:

Additional amount held in super at age 65	$160,287
Less outstanding mortgage at that time	$117,299
Balance left after paying off mortgage (tax free after age 60)	**+$42,988**

This additional tax-free sum after age 60 of $42,988 could be used to lift Barry's living standards in retirement.

Barry agrees to proceed with the 'additional salary sacrifice contribution option', and his adviser will review this strategy annually to ensure it is on track, and/or can be amended if required should the assumptions change materially.

Benefit of advice - Unlocking cashflow and building super prior to retirement

Ben, age 58, works as a full-time employee on a salary of $95,000 pa.

His employer currently pays 9.5% pa SG (i.e. $9,025 pa). Ben's super balance is $400,000 of which all is taxable component and preserved.

Ben would like to contribute additional money into his super, however he does not have any surplus cash-flow to make any further additional super contributions as his living expenses is fully consumed by his net take-home pay.

He seeks financial advice and his adviser informs him that there is a strategy which can be considered to unlock cash-flow (by use his accumulated super) to increase his salary sacrifice contributions into super.

This strategy involves a person increasing their salary sacrifice or personal deductible contributions into super and supplementing their forgone income with income payments from a 'transition to retirement income stream' (TRIS). A TRIS is a non-commutable income which may only be commenced upon reaching preservation age.

Ben is eligible to commence a TRIS as he has reached preservation age. If he uses his entire $400,000 super balance to commence a TRIS, Ben must draw at least the minimum of $16,000 pa (4%) and not more than the maximum of $40,000 p.a. (10%).

Ben's SG contributions are $9,025 pa leaving him with $15,975 p.a. on his FY 2019/20 standard concessional contribution (CCs) cap. He also has $15,975 unused CCs cap space carried forward from FY 2018/19. He can apply this unused CCs cap amount in FY 2019/20 because his TSB on 30 June 2019 was less than $500,000. Therefore, Ben can make up to $40,975 in total CCs for FY 2019/2020 without breaching his CCs cap.

The advice in the first year is as follows:

- Ben salary sacrifices $31,950 (including the $15,975 unused CCs) into his super fund, which will reduce his net employment income.
- He then commences a TRIS with his $400,000 super balance and draws a pension of $25,531, to ensure that he receives the same net income.

As a result of using the income swap strategy in year 1, Ben has added an additional $1,627 into super, as shown in the table below:

	Current Age 58 – No Income Swap	Year 1 Age 58 – With Income Swap
Salary sacrifice contributions	0	31,950
Plus SG contributions	9,025	9,025
Less Contributions tax	1,354	6,146
Net contributions	7,671	34,829
Less TRIS pension payments	0	25,531
Net into super	7,671	9,298
Benefit of TRIS income swap strategy in Year 1		**+1,627**

Over the 8 years to his 65th birthday, the additional amount in super from using the income swap strategy each year is projected to **increase by $26,722**, compared to doing nothing [1]

[1] Assumptions used:

- 50% growth (gross investment return of 5.35% p.a., after-tax investment return of 4.60% p.a.),
- Concessional contributions are made via salary sacrifice,
- Salary and living expenses indexed at 2% p.a.,
- SG rate rises from 9.5% to 12% as legislated,
- Concessional contribution cap is indexed in $2,500 increments based on AWOTE of 2% p.a.,
- Unused concessional contributions of $15,975 from FY 18/19 applied in first year of the strategy, and

Attachment 2 - Case studies/cameos showing how retirees can get it wrong

1. Gifting more than allowable limits and impact on age pension

Alan and Barbara convinced their mother, who was on a part-age pension, to gift them $200,000 so they can repay some debts now rather than wait for an inheritance down the track. They convinced the mother that her age pension would increase as her assets would reduce by $200,000.

Unfortunately, Alan and Barbara were unaware that the 'deprivation rule' applies to gifts over $10,000 in a financial year, so the asset reduction was only $10,000, with the remaining $190,000 counted as an asset, and deemed under the income test for 5 years.

The debts were repaid by the couple, the mother received no increase in age pension and had $200k less in assets to support her in retirement.

2. Downsizing the home and getting it wrong

A single age pensioner, homeowner, with $25,000 lifestyle assets and $150,000 in bank accounts and shares. She also received the full age pension and access to the pensioner health care card.
The house was too large for her, and her children suggested she consider downsizing and buying a smaller (and cheaper) place. Her friends did this recently and so she went about doing this without speaking to Centrelink or getting any financial advice.

She sold her home for $1.5 million and bought a smaller home for $950,000. She had $550,000 left over from the sale and she placed this into her bank account.

Upon reporting this to Centrelink, she was shocked to find out that as she exceeded the assets test, that she would no longer receive any age pension and would also lose access to her pensioner concession card.

She would now have to fund her income and health costs herself for some time, until the assets reduced and she became eligible for the age pension again.

3. Not understanding the age pension exemption for the 'home'

Couple scenario where the husband was an age pensioner, and spouse was under-age pension age. The wife's super was excluded in determining the husband's age pension, and given she was retiring and approaching age pension age in less than 12 months, they were aware that upon turning age pension age her super would start to be counted under the Centrelink means test and that their age pension entitlements would reduce.
They did their own research via the internet, which led them to believing that a 'home' (i.e. a property) was an exempt asset for Centrelink purposes.

As their family home was in the husband's name, upon retirement the wife used her super to purchase an investment property in her name. They then advised DSS of this acquisition, and argued that it was a 'home', even though they already had a principal place of residence.

Centrelink immediately counted the investment property under the means test, and the husband's pension was reduced substantially.