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BY EMAIL

3 February 2020

Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

retirementincomereview@treasury.gov.au

Dear Secretariat

2019-2020 Retirement Income Review

Thank you for the opportunity to provide a submission to the Government's review of the retirement income system.

Challenger is a top-100 ASX listed company and the leading provider of annuities in Australia, delivering on our vision to provide our customers with financial security for retirement. We provide more than 60,000 Australians with a secure and reliable income in their retirement.

We see the review as an opportunity to focus on the core purpose of the retirement income system – providing income in retirement. Our experience as a provider of retirement income streams informs the views we have expressed in our submission.

We have provided responses to most of the consultation questions in Appendix A.

Please do not hesitate to contact me should you wish to discuss our submission further. I can be best reached on 0413 451 435 or choorweg@challenger.com.au.

Yours sincerely

Carla Hoorweg
Head of Government & Industry Relations

Appendix A – Detailed Comments

Executive Summary

Key points:

- Super is deferred wages for spending in retirement
- Management of retirement-specific risks and sustainability of income during retirement should be paramount considerations
- The current taper rate of 7.8% per annum should not be equated with an investment return
- Superannuation members should have more access to lifetime income products

The intent of the superannuation system is to provide an income in retirement – wages are deferred during the working years so that they can be spent during retirement years. We are concerned that this intention is often lost sight of during the superannuation 'debate' resulting in erroneous assumptions, such as equating the loss of age pension benefits due to the taper rate with lost investment returns. Other essential considerations, such as the sustainability of income delivered during retirement, tend to take a back seat to the level of investment returns during accumulation. While the latter is important up to retirement, a different set of risks emerge from retirement onward and these must be managed carefully so that retirement income lasts for life.

In assessing retirement outcomes, we believe a much greater emphasis needs to be placed on management of retirement-specific risks and therefore the sustainability of income. We agree with the principles proposed by the Panel, but note that without a focus on these, or similar goals, it will remain difficult to deliver a properly functioning retirement income system.

Superannuation members should have access to a wider range of lifetime income products that provide sustainable income. We believe the policy foundations are largely in place for this to occur (and we have explained why in our answer to question 21).

Specific consultation questions

We have not answered all of the Panel's questions. Instead, we have answered those questions where we believe we have particular insights or expertise in the issues raised. It should not be inferred by our failure to answer any particular question that we consider it unimportant.

The retirement income system

Q1 Are there aspects of the design of retirement income systems in other countries that are relevant to Australia?

It is always tempting to seek out attractive features from foreign pension systems with a view to adopting them in Australia. The problem with this approach is that pension systems are a complex matrix of social and taxation policy and are strongly influenced by the culture and politics of their origin. Many countries are emerging from a history of defined benefit schemes, which do not translate easily in the Australian context where we have largely made managing retirement risks the responsibility of each individual member. The relevance of global systems to Australia depends on the structure of each system's 'pillars' and the history of how they evolved to their current state.

An example of this is the collective pensions used in the Netherlands. Those schemes can only be understood through the prism of their history; trying to resolve defined benefit schemes that were no longer affordable and the strong cultural attachment to concepts of 'solidarity', industrial agreements and intergenerational risk sharing. In more 'individualistic' societies like Australia, these concepts are not necessarily transferable.

It is difficult to point to any major design feature of a foreign retirement income system in use today that has not already been thoroughly assessed for its applicability to the Australian system.

Purpose of the system and role of the pillars

Q2 Is the objective of the Australian retirement income system well understood within the community? What evidence is there to support this?

Not entirely. There seems to be a relatively limited understanding that superannuation is a consumption smoothing mechanism; deferring wages to be compounded and then consumed in retirement to make a person's standard of living more stable over a lifetime.

The franking credits debates that preceded the May 2019 election provide ample evidence that many retirees do not regard their retirement savings as being for consumption. They regard retirement income as investment income, including franking credits. Many of those concerned about the potential loss of franking credit rebates could have safely spent the equivalent of the lost credits from their capital with very little risk of running out, but they did not regard the consumption of their capital as part of the retirement income equation. This shows that many Australians do not feel comfortable spending down their savings in retirement, despite it being a fundamental element of the system's design.

The objective of the Australian retirement income system is not well understood within the community. The lack of agreement can be seen in the unsuccessful legislative proposal for an objective for the superannuation system. While there is broad agreement about the role of super to fund retirement incomes, there was no consensus on exactly how that should be achieved.

A majority of retirees take the minimum superannuation drawdown and preserve or grow their retirement savings.[1] Surveys of what retirees think about retirement income typically highlight that a

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[1] Examples include: Sneddon, T., Reeson, A., Zhu, Z., Stephenson, A., Hobman, E. V. & Toscas, P. 2016. Superannuation drawdown behaviour. JASSA, 2, 42-53; and Asher, A., Meyricke, R., Thorp, S., & Wu, S. (2017). Age pensioner decumulation: Responses to incentives, uncertainty and family need. *Australian Journal of Management*, 42(4), 583–607. https://doi.org/10.1177/0312896216682577

majority worry about their own situation.[2] Other evidence suggests that people will have enough for retirement, implying that the fears are unfounded.[3] However some of these results are disputed across the industry. On the whole, these data suggest that the objective of the system might not be well understood or that it is not easily given effect to by many retirees.

Q3 In what areas of the retirement income system is there a need to improve understanding of its operation?

There are two aspects to this question. The first goes to improving understanding of the community about the system and the second relates to improving the available fact base around how the system operates.

In relation to the first aspect, it is clear that many Australians could have a better understanding of the system. This includes how to interact and engage with their superannuation, greater understanding about the objectives and benefits and options for how best to interact with the system during the different phases: accumulation, pre-retirement, and retirement. Risk management remains an elusive concept, with very little being said by experts and commentators on the specific risks that retirees face. A broader understanding about the need to manage longevity, inflation and sequencing risk, how life expectancy influences retirement planning, and how to manage cognitive decline are some examples of retirement-specific areas for improvement.

On the second point, there are too many aspects of the superannuation system and its outputs that are factual in nature but remain either at large or the subject of ongoing debate. The reason for this is a combination of poor or unavailable data; lack of understanding of the subject; self-interest and ideological perspectives.

A non-exclusive list of the sorts of questions that the system needs answers to is as follows:

Superannuation data

1. How much super do median and average single and couple pre-retirees have? How much other savings?
2. Is there a super gender gap and, if so, how big is it? Does it change with age? Is there an observable trend?
3. What proportions of retirees are on the full or part age pension across various age cohorts? For those under 70 and not on a full age pension, what is the reason: still working, above the means test thresholds or haven't got around to applying?
4. What are the correct life expectancies for 66-year-olds and why? What are life expectancies at 80 and 90 for males and females?
5. Of the $80.1 billion in benefits payments made by super funds in 2018, what proportion of those payments were consumed to meet living expenses and how much of it was merely moved into non-superannuation savings, such as a bank account or other investments?
6. What are the spending patterns of typical retirees at different ages?

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[2] A recent example is National Seniors Australia and Challenger, *Retirement income worry: Who worries and why?* Canberra: National Seniors Australia. January 2020

[3] See Daley, J., Coates, B., Wiltshire, T., Emslie, O., Nolan, J. and Chen, T. (2018). Money in retirement: More than enough. Grattan Institute; and Khemka, G., Y. Tang and G. Warren (2020) "The 'Right' Level for the Superannuation Guarantee: A straightforward Issue is by No Means". Working Paper, Australian National University 11 Jan 2020.

7. What unspent super does the remaining survivor of a typical retiree couple leave on death? The answer to this needs to be sensitive to skews from balances left by those with much shorter lives than normal.
8. What proportion of a typical 66-year old's super balance is made up of tax concessions? The answer could be presented across a range of wealth or income bands.
9. As SG increases beyond 9.5%, which age groups of typical super fund members will be too old to benefit much from the increases; in other words, which age groups will be the beneficiaries of the extra compounding inherent in the increases?

Projections

1. When will the super system go into net outflow (ie more benefit payments than contributions)?
2. What is the point in a typical super member's savings program where investment returns would, on average, have a greater impact each year than SG contributions?
3. In real terms, what should a member expect to withdraw in retirement for each dollar contributed during the accumulation phase?

Cameos

1. What do typical retiree households look like?

Q4 What are the respective roles of the Government, the private sector, and individuals in enabling older Australians to achieve adequate retirement incomes?

As a provider of retirement income products, our comments focus on the role of the private sector in assisting older Australians to achieve financial security for retirement. We see the role of government as one of ensuring a level playing field so the private sector can deliver products in a competitive and open market that are simple enough for the average retiree to understand. To the extent that retirement income products are adversely impacted by taxation or other government policy settings, there should be recognition that changes may be required to ensure equitable outcomes.

The recent means test changes are an example of how policy settings might inadvertently impact products and therefore retirees. In 2017, the Government made changes to expand the range of lifetime income stream products eligible to be offered as part of the concessionally taxed superannuation system. The objective was to encourage more innovative products into the market. For these changes to have their full effect, it was also necessary to review the age pension means testing rules to ensure that treatment was not inconsistent with the Government's intended policy objective. Changes to the means test rules were made following detailed consultation with industry stakeholders. In this case, the Department of Social Services (DSS) undertook a comprehensive examination of associated means test treatment for the new innovative superannuation products to ensure that there was alignment across different aspects of the system; it fulfilled its role of ensuring that policy settings in one part of the system do not create adverse outcomes in another part of the system.

Government should resist suggestions that are made from time to time that it is the only natural issuer of lifetime annuities, principally because of the capital needed to back them. This role should be fulfilled by the private sector. The annuities market in the United Kingdom has long been an example of the willingness of private capital markets to supply the necessary capital to support the issue of (currently) approximately £5 billion in new annuities each year. These suggestions come in the form of proposals for the Government to allow retirees to purchase additional age pension entitlements; to set up some form of longevity pool for older retirees or to issue so-called longevity bonds. They are all examples where activities capable of being undertaken by the private sector would be unnecessarily socialised without properly accounting for the additional risks that would be borne by Government.

The changing Australian landscape

Q7 Demographic, labour market, and home ownership trends affect the operation of the retirement income system now and into the future. What are the main impacts of these trends? To what extent is the system responsive to these trends? Are there additional trends which the Review should consider when assessing how the system is performing and will perform in the future?

The dimensions of the super system change quite dramatically over, say, a 10-year period. Over a decade, it is quite feasible that the following sorts of changes could occur:

- System assets double. Super has actually nearly tripled in size since 2009;
- The age at which people stop work and seek to access their super increases materially for a statistically significant number of members;
- A major financial market disruption occurs and the risk appetite and investor behaviour of a significant cohort of members changes significantly;
- The number of members in the retirement phase increases by 50% or more;
- Home ownership and pre-retiree and retiree debt levels materially changes and impacts their behaviour towards super; and/or
- A significantly higher proportion of younger members are self-employed and do not have an employer obliged to make SG contributions for them.

Currently, other than the government of the day addressing these issues in its day-to-day policy agenda through Treasury, there is no other institutional architecture designed to address these challenges. This might explain the steady stream of ad hoc policy reviews and inquiries affecting superannuation over the last decade (eg Cooper 2010, Charter Group 2013, Murray 2014, Productivity Commission Superannuation Policy for Post-Retirement 2015, Productivity Commission Superannuation: Assessing Efficiency and Competitiveness 2016-2018, Hayne Royal Commission 2019, Retirement Income Review 2019-2020).

Principles for assessing the system

Q8 Are the principles proposed by the Panel (adequacy, equity, sustainability, and cohesion) appropriate benchmarks for assessing the outcomes the retirement income system is delivering for Australians now and in the future? Are there other principles that should be included?

Our view is that the Panel's proposal has outlined appropriate benchmarks. We believe an overarching consideration in assessing outcomes from the retirement income system should be the sustainable income it delivers during the retirement phase. Regardless of the principles chosen, the key outcome must be measured against this consideration, otherwise the system is not functioning as a retirement **income** system.

Q9 How does the system balance each of the principles and the trade-offs between principles (e.g. sustainability and adequacy) under current settings? What is the evidence to support whether the current balance is appropriate?

Under current arrangements, the principles enunciated in the consultation paper are not put forward to become part of the institutional architecture of the superannuation system, but merely to be used by the Panel for this review. If the principles have merit, which they appear to have, could they have a role to play beyond just this review? One option was that recommended by the Charter Group in

2013,[4] which explored principles for the Australian superannuation system that broadly reflect those proposed in the consultation paper: adequacy, sustainability, certainty and fairness, and suggested issues to be considered by a ‘Council of Superannuation Custodians’ in assessing whether future policy changes aligned with those principles. Whether or not the concept of a Council, or other standalone governance structure, still holds weight today is worthy of consideration by the Panel.

Accurate identification of trade-offs and how to make appropriate decisions about them is only part of the puzzle. Without an ongoing, independent entity, decisions about the superannuation and retirement income systems will be subject to change by successive governments, regardless of how robust the concepts used to assess the system are. Another option might be to enact them in legislation resembling the now lapsed *Superannuation (Objective) Bill 2016*.

Adequacy

Q10 What should the Panel consider when assessing the adequacy of the retirement income system?

Consideration of adequacy will vary across the three different pillars of the retirement income system. Adequacy of a safety-net is different from assessing the adequacy of voluntary savings or compulsory super. As such, adequacy might be better measured relative to the objective of each pillar. It would be reasonable to consider the ability of the age pension and compulsory super to adequately sustain someone’s lifestyle through retirement. The adequacy or otherwise of voluntary savings is less relevant but could be considered as those savings are used to improve upon an adequate outcome.

Consumers don’t derive utility from income. It is the consumption of goods and services that are paid for by the income received that matters. The Panel should make careful consideration of income (or retirement capital) that is not consumed when assessing the adequacy of the retirement income system. Residual money from retirement becomes an inter-generational wealth transfer which has the potential to distort any assessment of the adequacy of the retirement income system for current day retirees. For example, if the system supports large transfers as estate balances, then retirement incomes for those leaving such balances will be lower and the actual (as opposed to the potential) adequacy of the retirement income system will be artificially reduced. Alternatively, assuming that every dollar that transitions into retirement will be spent in retirement, with no intergeneration wealth transfer, will overstate the adequacy of the retirement income system. A clear description of the expected intergenerational transfers across the three pillars could be helpful here:

I. As a government-provided safety-net, the expectation should be for no intergenerational transfers
II. To the extent that super is supported by tax and other concessions, expectations of transfers to the next generation should be limited
III. It would be reasonable to consider that voluntary savings might be for the purpose of intergenerational wealth transfer. The concept of the family home (or farm) is central to this idea.

While there are these differences across the three pillars, there are some similarities in the assessment of adequacy. Key to these is the consideration of annual consumption. Adequacy is often measured as a capital balance, but the level of consumption that can be achieved over time can change.[5] For example, if investment returns were 8% p.a., a balance of $500,000 could sustain annual cash flows of nearly $47,000 for 25 years. However, if the return were only 4% p.a., $500,000 would only support cash flows of $32,000 p.a. In the current environment where markets have

[4] 2013 Report by the Charter Group appointed by the then Labor Government to develop and recommend a Charter of Superannuation Adequacy and Sustainability <https://treasury.gov.au/sites/default/files/2019-09/p2013-390349-super_charter_report.pdf>
[5] A related discussion can also be found in Willis Towers Watson, *Viewpoints: Superannuation is for Spending* Melbourne: Willis Towers Watson 2019.

delivered strong historical returns, but yields are near historical lows, making future high returns less likely, assumptions about returns will be critical in any assessment. Assuming that historical high returns will be repeated will create an overly optimistic assessment of the adequacy of current balances.

The Panel should avoid any assessment of adequacy based on capital balances, particularly when they are dependent on arbitrary (and often deterministic) investment assumptions.

Q11 What measures should the Panel use to assess whether the retirement income system allows Australians to achieve an adequate retirement income? Should the system be measured against whether it delivers a minimum income level in retirement; reflects a proportion of pre-retirement income (and if so, what period of pre-retirement income); or matches a certain level of expenses?

An absolute measure of adequacy would be suitable to describe the safety-net of the age pension. Beyond that, it makes little sense to use any absolute measure for adequacy. People experience different lifestyles throughout their working lives, and it would be reasonable to expect that to continue. This is a flaw of industry standards, such as the ASFA retirement standard. The ASFA comfortable standard for a single 65-year-old is currently $43,787 p.a. This will not be a relevant measure of adequacy for all people. Some people live on less than this while working, so it will be more than adequate, but $43,787 is likely to be seen as far from adequate for someone who is used to a higher income. It would only be relevant for those people who enjoyed a similar lifestyle while working.

Our concern is that people are not accustomed to converting a lump sum amount into an annual or monthly income amount. The focus should be on income, which is a more relatable concept and gives people a better ability to judge whether the amount is sufficient.

To measure the adequacy of super or voluntary savings, it could be appropriate to use a relative measure. This does not mean that the measure would be fixed across cohorts as replacement rates will vary across different income cohorts. People on low incomes will require higher replacement rates in order to survive. At higher income levels, the necessary replacement rate is much lower as the working life phase involves significant wealth accumulation. The broad measure could be considered as the appropriate for the median or average worker as a proxy for the system.

Q12 What evidence is available to assess whether retirees have an adequate level of income?

The nature of retirement and the continuing maturity of the super system limit the amount of evidence on whether today's retirees have an adequate level of income. Even if income seems adequate at present, in super, the income source can deplete and a retiree doing reasonably well now could face many years of inadequate retirement income in the future. Until the system provides for a large cohort of people living a full retirement supported by super, the direct evidence will be limited, and the answer to this question will have to depend on projections based on assumptions. With an average retirement length of 25 years, this will remain the case until 2035 and possibly later. The difficulty is that an assessment needs to be made now on whether the current system will deliver the right outcomes.

There is some indirect evidence that arises from asking people if they think they have enough for retirement. A recent National Seniors Australia report highlights that a majority of people worry that their income will not last for life.[6] Anecdotally, they overcome this worry by reducing their spending. There is evidence of low drawdowns of super and falling spending through retirement.[7,8] Worry is only partially related to the level of savings. While people with lower balances were more worried, higher balances did not prevent retirees from worrying that they don't have enough to last.

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[6] National Seniors Australia and Challenger (2020) op cit.
[7] Sneddon, T., Reeson, A., Zhu, Z., Stephenson, A., Hobman, E. V. & Toscas, P. 2016. Superannuation drawdown behaviour. JASSA, 2, 42-53.
[8] Daley, J. et al (2018) op cit.

Sustainability

Q18 What should the Panel consider when assessing the sustainability of the retirement income system?

The 2013 Charter Group report contained a number of observations on assessing the sustainability of the retirement income system from a macro perspective.

At a micro, consumer level, there are a number of issues about the sustainability of individual retirement savings. Super is doing the first part of its job; it is allowing people to accumulate assets for retirement. However, there is no structure to the drawdown phase in our defined contribution model – flexibility is prioritised at the expense of risk management and income certainty and sustainability.

Sustainability of individual retirement savings has two elements: the probability of success of the retirement plan (expressed as a percentage of likelihood of reaching a particular age with savings still intact) and the range of potential outcomes based on market returns that deviate from long term averages.

An understanding of life expectancies is critical: to advise on the sustainability of a retirement portfolio and the rate of safe spending from that portfolio, advisers need a strong understanding of life expectancies, including concepts like mortality rates, mortality improvements and, most importantly, the deviation of actual lifespans from the mean.

Diversification does not mitigate all risks: by itself, diversification of asset risks is much less able to deal with retirement income challenges than is widely thought. For example, for most retirees, longevity risk cannot be ameliorated solely by exposure to growth assets. It is not just about having money later, but it is the ability to spend confidently, and not run out.

Retirees say that they want a 'retirement pay cheque'[9] and yet most retirement plans are based on investment returns and capital accretion, rather than regular, stable income.

The availability of lifetime income streams in retirement is critical to ensuring savings accumulated through super can sustainably meet retiree consumption needs. The Government is aware of this and we have explained a lot of the work that has already been done towards increasing the availability of lifetime income streams in our answer to question 21.

Q19 What factors should be considered in assessing how the current settings of the retirement income system (e.g. tax concessions, superannuation contribution caps, and Age Pension means testing) affect its fiscal sustainability? Which elements of the system have the greatest impact on its long-term sustainability?

These questions are analogous to the sorts of questions that are typically addressed in the Intergenerational Report, the next one of which is scheduled to be produced this year.

The fiscal impact of the retirement income system depends on a wide range of factors, including obvious expenditures (both actual and notional) like the age pension and super tax concessions, but also less obvious policies in health, aged care and even immigration.

It also important to use only the latest data in making assessments about sustainability. By way of example, the 2015 Intergenerational Report painted a much less optimistic picture of the sustainability of the retirement income system than a comparable assessment would conclude today. Materially larger super balances and the 2017 changes to the means tests and taper rates have quite dramatically reduced the number of newer retirees who are accessing the full age pension. This, in turn, has affected projections of the sustainability of future age pension expenditures.

[9] National Seniors Australia (2017): Seniors more savvy about retirement income There were over 5,500 respondents who were over 50; 55% were female and the average age was 68.

Another issue that has tended to complicate assessments of sustainability are arguments about the appropriate way to measure notional tax expenditures of the super tax concessions.

The following is a discussion from section 3 of the Henry Review retirement income consultation paper issued in December 2008:

> ‘Box 2.1: Concessionality of the superannuation taxation arrangements(a) Under a comprehensive income tax benchmark the concession to superannuation is the difference between the tax paid if the superannuation contribution and the earnings were taxed as income at the individual's personal tax rate (plus the Medicare levy) and the tax paid in the fund (generally 15 per cent). Under this benchmark the superannuation concessions have an estimated cost to revenue of over $26 billion in 2007-08 (Australian Treasury 2007). An alternative way to calculate the value of the tax concession is to use an expenditure tax benchmark. The two types of expenditure tax benchmarks are: a pre-paid expenditure tax based on direct taxation of labour income with an exemption for saving; and a post-paid expenditure tax based on the taxation of a direct measure of expenditure or of goods and services. Under the pre-paid expenditure tax benchmark, the value of the concession is the difference between the tax paid if the superannuation contribution were taxed as income at the individual's personal tax rate (plus the Medicare levy) and the tax paid in the fund, less the tax paid on earnings in the fund. Benefits are tax exempt under this benchmark, which is consistent with the tax exemption of superannuation benefits in Australia's retirement income system. Under this benchmark, the superannuation tax concessions would have an estimated aggregate cost to revenue of $4.6 billion in 2007-08. Under the post-paid expenditure tax benchmark, both contributions and earnings would be tax-exempt but benefits would be fully taxable when paid. Under this benchmark the tax concession is expected to be less than under the pre-paid expenditure tax benchmark, as individuals will generally have a lower tax rate on their retirement income than their income while working. Under all these benchmarks, superannuation is taxed concessionally. However, the concessions are heavily weighted to individuals on higher personal tax rates.
>
> (a) These estimates are not necessarily indicative of the cost of the superannuation concessions over the long term. The tax concessions help to reduce budgetary expenses in future years, particularly Age Pension payments, through the effect of the means tests.’

Resolving differences of opinion about how to measure the cost of the super tax concessions will be central to getting greater buy-in to the question of their sustainability.

Q20 How can the overall level of public confidence be assessed? What evidence is available to demonstrate the level of confidence in the system?

An assessment of public confidence is something which should be undertaken on the system. Currently, there is no clear measure of satisfaction with the retirement income system, either in accumulation or in the retirement phase.

Cohesion

Q21 What should the Panel consider in assessing whether the retirement income system is cohesive?

The Panel could consider:

- Whether a clearer purpose for the super system could lead to greater cohesion;
- The role the wealth management (and super) industry plays in cohesion. Measures of success, incentives and drivers are all hinged around building wealth. This is not the same thing as maximising retirement income. In some respects, they are in direct conflict. The wealth management (super) industry does not measure success in terms of how much money it hands back to members to spend. For many funds and other intermediaries, this is a sign of failure.

- Whether a higher state of cohesion could ever be achieved in situations where the government is balancing tax expenditures against other outcomes. Trade-offs are inevitable.
- As for the last question listed in the considerations on page 24, it is clear that retirees do not currently have sufficient access to retirement income products that manage the level and longevity of their income. This was the catalyst for recommendation 11 of the 2014 Financial System (Murray) Inquiry and has driven the following initiatives by successive Coalition governments:
    - **July 2014 -** Treasury *Review of retirement income stream regulation* released on the back of 2013 election promises to review ABP minimum drawdown rules and remove regulatory barriers to innovative income streams;
    - **Dec 2014 -** Murray Inquiry recommended the introduction of CIPRs;
    - **May 2016 -** Retirement Income Streams Review final report issued;
    - **Dec 2016 -** First consultation on CIPRs, closed April 2017;
    - **1 Jul 2017 -** Alternate drawdown rules for innovative income streams commenced;
    - **Feb 2018** - Creation of the CIPR Framework Advisory Group by Kelly O'Dwyer to consult with Treasury on governance principles/framework/covenant;
    - **May 2018 -** Consultation on retirement income covenant, closed in June 2018; and
    - **1 Jul 2019 -** New means test rules for pooled lifetime income streams commences.

    The last piece in this stream of work is scheduled to be a further consultation on exposure draft legislation amending the *Superannuation (Supervision) Act 1993* to include new principles-based duties for trustee directors in respect of member retirement income needs, prior to the enactment and commencement of these new duties. In short, this issue, while real, is being addressed by current policy initiatives.

Q22 Does the retirement income system effectively incentivise saving decisions by individuals and households across their lifetimes?

The compulsory nature of superannuation and the generous tax concessions offered create sufficient incentives for those able to participate. Our answer to question 23 below is also relevant to this question.

Q23 What evidence is available to show how interactions between the pillars of the retirement income system are influencing behaviour?

One example of behaviour impacted by the interactions between the super and age pension pillars relates to the taper rate on the assets test for the age pension. Having more super than prescribed monetary thresholds for singles and couples reduces their age pension payments. This occurs at the rate of $3.00 per fortnight for each $1,000 in assets over the relevant threshold (26 x $3 = $78 a year or 7.8% of each additional $1,000). This is called the 'taper rate'. Anecdotally, pensioners talk about spending their super to get more age pension payments, but there are no clear data confirming this practice. There is, however, a widely held view that the assets test and the taper rate create a disincentive for people to have super or other financial assets above the thresholds at which tapering commences.[10]

[10] A recent article in *The Australian* quoted several financial commentators who referred to the impact of the taper rate on retirees with balances of between $350,000 and $600,000 as the 'retirement trap': https://www.theaustralian.com.au/nation/politics/scott-morrisons-tougher-pension-means-test-a-tax-on-average-retiree/news-story/d7de84f211f74c102e728250e74463b6

Asher and De Ravin (2018)[11] explain the taper rate through the lens of effective marginal tax rates (EMTRs) on assets over the thresholds. In doing so, they make a common error, which is to assume that the taper rate equates to a 7.8% p.a. investment return forgone. The partial withdrawal of a Government safety-net payment cannot be equated to an investment return on remaining capital. Proponents of this view then argue that this is punitive because a retiree would be unlikely to be able to consistently achieve such a high return. This view is wrong because it assumes that 'retirement income' is the same as 'investment income' and ignores the consumption of retiree capital as part of retirement cash flows.

'Retirement income' can be realised by spending from the very assets that reduce access to the age pension. In other words, an assets-tested pensioner can realise cash flow by spending their super. Indeed, that is what super is for. Retirees over the thresholds get less assistance from government than they would if they were below them. However, because they have that extra capital, they can access extra spending money (ie retirement income) by consuming some of it.[12] This is the critical difference between them and pensioners with fewer assessable assets; and why the latter need government support. Safely spending capital is also an essential part of a retirement income strategy for a part pensioner. As they progressively spend that capital, the age pension increasingly supports them.

In terms of the taper rate, it is useful to consider annuity prices. The lifetime annuities that Challenger provides to Australian retirees make a broadly analogous payment, which involves both a return of capital and an investment return. While the age pension is indexed to the CPI, the construction of the current means test settings keeps these payments at a fixed $7,800 a year per $100,000. The annuity rate, however, depends on the age and gender of the retiree, as well as prevailing interest rates. As at 28 January 2020, a 66-year-old female purchasing a lifetime annuity for $100,000 would receive $5,581 a year for the rest of her life. A 75-year-old male would receive $8,015 a year for life, due to his shorter life expectancy. Thus, for some people, investment markets can provide a higher payment than the $7,800 taper and others will receive a lower payment.[13]

It is particularly important, in the current low interest rate/low return environment, that retirees understand and are advised that they should be steadily consuming their super to enjoy a higher standard of living in retirement. This is possibly the most significant investor behaviour problem affecting super at the moment.

Q25 What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?

The most recent evidence that we have to hand is a survey conducted by National Seniors Australia in 2019, the results of which were released in a report in January 2020.[14] The survey investigated the extent to which over 50s Australians were worried about running out of (their own) money in retirement. We believe the findings of this survey are a reasonable proxy for the answer to question 25.

Relevant extracts are as follows:

> *'One way of dealing with worry is through accessible financial advice. 74% had sought financial advice and three out of five of those received advice in the last 12 months. People were less likely to worry frequently if they had sought financial advice and when they thought the advice met their needs. There was a wide range of sources of advice specified. Financial advisers had a good record for meeting expectations, but not for all clients. Many other sources of advice were helpful in meeting needs.*

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[11] Asher, A and De Ravin, J 2018, *The Age Pension means tests: contorting Australian retirement,* Actuaries Institute.
[12] A useful discussion on this topic is an article '$1 million is never worth less than $500,000' written by Graham Hand in Firstlinks on 12 April 2018 https://www.firstlinks.com.au/1million-never-less-than-500000-assets
[13] The underlying investments in an annuity are conservative, and most Australian retirees would have an investment portfolio with a higher risk profile and expected return.
[14] National Seniors Australia and Challenger (2020), Retirement income worry: Who worries and why? Canberra: National Seniors Australia.

There is an urgent need to deal with the high levels of worry about retirement income when this may be unnecessary since the Australian system is well regarded around the world. Potential solutions are more accessible and clear advice, as well as improvements in financial literacy. Some financial issues cannot be easily fixed in later life, and need to be attended to along the life journeys. This is a message for people of all ages not just older Australians.'[15]

…

'While it is likely that more money at the start of retirement provides the opportunity to have less decline in savings, this is not always the case. For those who don't manage this, they worry about outliving their savings and investments. Good financial advice is something that could help maintain or increase savings. Respondents were asked if they had ever received advice about retirement and if they had in the prior 12 months. A total of 74% said they had received advice at some stage, and of these, 60% had received advice in the previous 12 months.

There was almost no difference between those who received advice at some stage and those who didn't in terms of worry about running out of money, (54% worried versus 53% who never had advice) but those who did get advice were less likely to worry frequently (18% versus 25%). There was a positive impact when someone had received advice, but not in the past 12 months. Of the 29% of respondents who had received advice, but not in the past 12 months, 35% said that they weren't worried about outliving their savings. This could be an indicator that their previous advice had set them up, or possibly that the advice had just confirmed that they were well placed for retirement.

The outcome for those who had recently received advice depended on whether or not it was acted on. Most (86%) of those getting advice had implemented it and more of this group (15%) reported that they used to, but now no longer worried. Table 5 shows that people who had received advice, but not taken any action, were more likely to worry frequently (25%) and be worried in general (64%). An alternative explanation for this group being more likely to worry is that when they sought advice, it confirmed that they had genuine cause to worry (for example not enough super to meet their needs) and they do not have the financial or other resources to change their circumstances. This suggests that there could be a benefit for people to seek advice about retirement and act to implement the advice, particularly to ensure that they will have a source of income for life.

Table 5: Worry frequency by financial advice received

Was financial advice received in the past 12-months?			
Worry frequency for outliving savings and investments	*Yes: advice used to make changes*	*Yes: but advice not acted on yet*	*Advice not received in previous 12-months*
Frequently worry	*17%*	*25%*	*17%*
Occasionally worry	*37%*	*39%*	*34%*
Used to worry, but not now	*15%*	*10%*	*11%*
Do not worry	*29%*	*24%*	*35%*
Don't know/rather not say	*2%*	*1%*	*2%*

Source of financial advice

People get retirement income advice from a range of different sources, with the most popular sources of advice being financial advisers and superannuation funds, as demonstrated in Figure 12 below.

[15] Ibid pages 4 and 19-21.

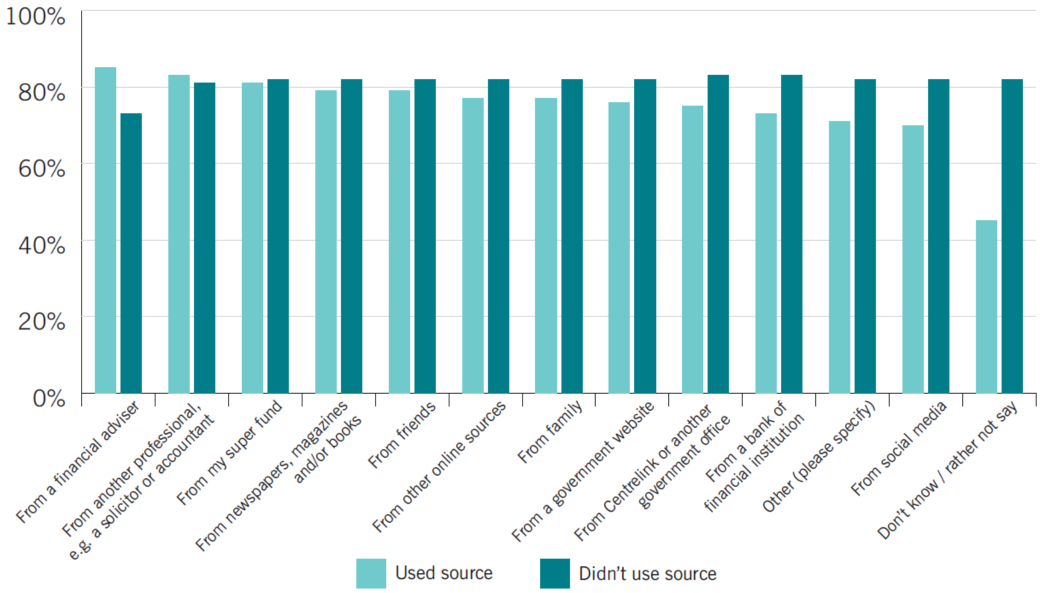
Figure 12: *Sources of retirement income advice*

Most people (83%) reported that they were able to get sufficient financial advice to meet their needs. With advice coming from multiple sources, it is unclear if one source or another provided the advice that met the respondent's needs. Participants who identified as being retired were more likely to say that they had received sufficient advice than those who did not identify as retired (86% v 70%).

Looking closer at the impact of the sources and sufficiency of advice, we can see that respondents thought that financial advisers made a positive impact. The figure below shows the proportion of people who were satisfied with the advice they received, depending on whether or not they used a particular source for that advice. The only two sources where satisfaction was higher when used was a financial adviser (86% v 73%) and other professionals (84% v 82%) but the latter wasn't statistically significant. While it is probable that multiple sources were used, the improved satisfaction for those who saw a financial adviser indicates that advisers can be beneficial in helping people get sufficient retirement income advice.'

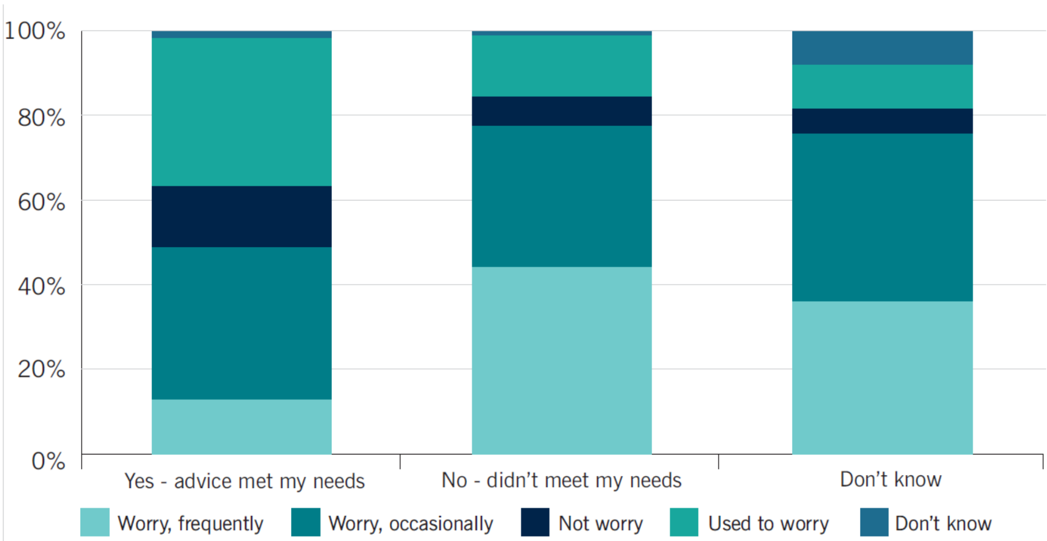
...

Figure 13: *Satisfaction with financial advice according to source of advice used*



Getting the right financial advice had an impact on how much people said they worried about their retirement finances (Figure 14). 35% of people who said their advice met their needs didn't worry and another 15% said that they used to worry, but no longer did. Only 13% said that they worried frequently. Unmet advice needs were associated with an increased level of worry, as can be seen in Figure 14. Of those who were unable to get advice that met their retirement needs, only 22% reported not worrying. The majority were worried, and 44% said that they worried frequently.

Figure 14: *The level of worry reduces when perceived advice needs are met.*



The value of advice and financial literacy indicated in these results require further attention and ways of reducing retirement income worry.'

Retirement is significantly more complex than the accumulation of savings and there are very few products available that are specifically designed for the retirement phase. The Government's retirement income reforms summarised in our answer to question 21 seek to address this issue, as well as to 'embed' advice in 'mass-customised' products or strategies that would be 'pre-selected' for large cohorts of fund members, based on the characteristics of those members known to the fund.

Today, the majority of retirement income strategies are delivered by funds through an account-based pension (ABP). In many cases, delivery of an ABP through a retiree's existing super fund eliminates the need for personal advice because the product is delivered through the fund using intra-fund advice. By contrast, if a retiree wants to access a product outside their fund, the Corporations Act currently affords them more protections, but with a higher level of compliance; a level that has been rejected by a number of intermediaries as too onerous and uneconomic. This has created an inconsistency in the system, as well as making it more difficult for some intending retirees to get advice.

Further, there appears to be residual uncertainty across the industry regarding the ability of product providers to provide 'scaled' or 'limited' advice to potential customers. It is a widely held view that the distinction between 'general' financial product advice and 'personal' advice is not sufficiently clear. As a result, inconsistent practices have arisen between product providers. Whether the issue is with the way the law is designed, or that more practical guidance is required is unclear. However, resolution of this issue and consistency across the industry will be key factors in the system delivering better retirement outcomes for more Australians.

Q26 Is there sufficient integration between the Age Pension and the superannuation system?

Fundamentally, yes. It is commonly thought that the age pension means test thresholds and taper rate discourage people from building up their superannuation or other voluntary savings. We disagree with this view as we have explained in our answer to question 23.

The degree of integration is evidenced by the commencement of new age pension means test rules for lifetime income streams on 1 July 2019. The DSS undertook extensive consultation on these new rules commencing with its 2017 consultation, which was augmented by its January 2018 Position Paper, updated in February of that year.[16]

On page 3 of the revised Position Paper, the DSS said:

> 'The Government has undertaken to consult regarding the social security means test rules that will apply to lifetime retirement income products, to ensure that they are appropriate for the innovative types of retirement income products that are expected to be developed. The Government is mindful of the need for social security means testing arrangements to be complementary to the facilitation of these products. The ongoing suitability of the current rules has also been considered.'

The point to be made here is that the DSS painstakingly consulted to ensure that new means test rules to accommodate innovative lifetime income streams products (that have features distinct from ABPs) achieved an appropriate integration between the age pension and the super system.

It is not necessary to descend into the detail of the new rules, but rather to point out the extent to which the rules were consistent with positions taken by industry associations, funds and potential providers of such products during the submission process.[17]

[16] https://engage.dss.gov.au/wp-content/uploads/2018/02/updated_position_paper_means_test_rules_for_lifetime_retirement_income_streams_february_2018.pdf

[17] The submissions can be viewed here: https://engage.dss.gov.au/social-security-means-testing-of-lifetime-retirement-income-streams/social-security-means-testing-of-lifetime-retirement-income-streams-public-submissions/

Additional research

Challenger has published various white papers in recent years that provide relevant information for the Retirement Income Review. Copies have been attached to this submission. The list of papers (and year of publication) are:

Papers published in conjunction with National Seniors Australia:

1. Retirement income worry: Who worries and why? (2020) <https://nationalseniors.com.au/research/retirement/retirement-income-worry-who-worries-and-why>
2. Feeling financially comfortable? What retirees say (2019) <https://nationalseniors.com.au/uploads/ChallengerReport-FeelingFinComfortable-Web.pdf>
3. Once bitten twice shy: GFC concerns linger for Australian seniors (2018) <https://nationalseniors.com.au/news/latest/once-bitten-twice-shyquestion-gfc-concerns-linger-for-seniors>
4. Seniors more savvy about retirement income (2017) <https://nationalseniors.com.au/uploads/09172675CRP_ChallengerReport_RetirementIncome_FN_0.pdf>
5. Over 50s: still not confident about their retirement income (2016) <https://nationalseniors.com.au/research/finances/over-50s-still-not-confident-about-their-retirement-income>
6. Outlook for Australian seniors' retirement plans? Mostly sunny, with possible late rain (2015) <https://nationalseniors.com.au/uploads/07151272CRP_Challenger_PlanningForRetirement_FN.pdf>
7. How realistic are senior Australians' retirement plans? (2014) <https://nationalseniors.com.au/uploads/140708_NationalSeniorsResearch_Challenger_RetirementPlans.pdf>
8. Retirees' needs and their (in)tolerance for risk (2013) <https://nationalseniors.com.au/research/finances/retirees-needs-and-their-in-tolerance-for-risk>

Challenger Retirement Income Research Papers:

9. Super is delivering (2019) <https://www.challenger.com.au/about-us/media-centre/retirement-income-research/super-is-delivering-for-people-about-to-retire>
10. Understanding life expectancies (2019) <https://www.challenger.com.au/about-us/media-centre/retirement-income-research/understanding-life-expectancies>
11. Spending patterns in retirement (2018) <https://www.challenger.com.au/about-us/media-centre/retirement-income-research/spending-patterns-in-retirement>
12. Retirement really is different (2018) <https://www.challenger.com.au/-/media/challenger/documents/thought-leadership/Retirement-Really-Is-Different-Position-Paper.pdf>
13. Looking at super wealth at the household level (2016) < https://www.challenger.com.au/about-us/media-centre/retirement-income-research/super-wealth-at-a-household-level>
14. The Yin & Yang of Retirement Income Philosophy (2014) <https://www.challenger.com.au/about-us/media-centre/retirement-income-research/yin-and-yang>