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Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Online: retirementincomereview@treasury.gov.au

Dear Sir/ Madam

Retirement Income Review

CPA Australia represents the diverse interests of more than 164,000 members working in 150 countries and regions around the world. We make this submission on behalf of our members and in the broader public interest.

The Retirement Income Review provides Australia with a clear opportunity to examine Australia's retirement income system and consider whether it is fit for the purpose for which it has been developed.

While our retirement income system enjoys the validation of a high ranking in international surveys such as the Melbourne Mercer Global Pension Index, where Australia currently ranks third, this survey rates pension systems across a number of uniform criteria. Yet countries included in the index do not have uniform tax rates, economies, demographic profiles, work environments or housing markets, to name a few. Such surveys can therefore only be indicative, and hence we must examine from time to time how our retirement income system serves Australians.

Our submission considers, amongst other things, how this review is able to address the issues of Australia's retirement income, if the consultation paper has not defined 'retirement' and whether, given Australian savings preferences, our focus should be on retirement income, or retirement savings more broadly.

Some of the issues raised by CPA Australia members include:

- Preferences by retirees for security in relation to aged care, healthcare and other large potential expenses in retirement
- Support for lower income earners and women, with actual tangible benefits for these groups in retirement savings
- A need for consumer protection focussing on safety, security, stability, simplicity, sufficiency and fairness
- Appropriate adequacy measures premised upon retirement expenditure
- Suitable tax and social security rewards and hurdles, to reflect the proper regard for tax-advantaged retirement savings environments, and address incentives to tax or social security arbitrage
- The need for financial advice, given low levels of financial literacy and the complex nature of the retirement incomes system in Australia

- Public confidence in superannuation has been significantly shaken since the Productivity Commission's recent review and the Hayne Royal Commission, and there is much to be done to restore that confidence

The scope of the retirement income system described in the consultation paper is broad, and there are many aspects open to discussion. CPA Australia suggests:

1. 'Retirement income' should be defined and considered whether it is fit for purpose as the key area of focus given the preferences of Australians

2. Retirement savings should be encouraged more broadly and not just within the confines of the superannuation system

3. CPA Australia supports choice of retirement income arrangements at retirement.

4. Opt-out should be considered for certain cohorts presently eligible to opt-in, on the basis that compulsory superannuation may disadvantage them, provided that they are not financially disadvantaged

5. Income and expense-based policy should be used in examining adequacy

6. A focus on removing disincentives to keeping money in superannuation should be explored.

Against a background of increasing structural change, this review considers the role that retirement income policy plays in supporting an increasingly large ageing cohort of Australians. We believe that this review will play a vital role in understanding the place of our retirement income system in the Australian way of life. Our responses form an attachment to this letter.

We acknowledge the valuable contribution to this submission by members of CPA Australia's Retirement Savings Centre of Excellence.

If you have any queries do not hesitate to contact Richard Webb, Policy Advisor Financial Planning & Superannuation at CPA Australia on richard.webb@cpaaustralia.com.au or 03 9606 9607.

Yours sincerely

Dr Gary Pflugrath CPA

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Attachment

Consultation questions

The retirement income system

> 1. *Are there aspects of the design of retirement income systems in other countries that are relevant to Australia?*

This submission focuses primarily on two areas where we believe that the review requires further explanation. Above all, we have chosen to focus on how this review is considering the terms 'retirement' and 'retirement income'. This review seeks to understand the retirement income system, yet we know that for many Australians, the age when people choose to retire is not a decision that they get to make.

We consider that to properly understand the key drivers of Australia's retirement income system, we should first place it properly as a retirement savings and income system.

For many Australians, the issue of retirement can be made for them by such life events as illness, injury, retrenchment and even parenthood and carer responsibilities. Health reasons (illness, injury, etc) are cited frequently as the biggest driver of early retirement (Ralston 2013). For older Australians retrenchment can also leave workers out of employment with no realistic chance of re-employment (Davis 2013). Parents who take more than 18 months off work to raise children are less likely to find work than those who take less (Arun, Arun, & Borooah 2004; Beggs & Chapman 1988; Breusch & Gray 2004 as cited in Baxter 2008), with the added issues of commitments around childcare and schooling. Similar issues are likely to exist for older Australians who take carers' leave to look after relatives with chronic health issues.

This makes the very notion that there is a period which we understand as retirement a vexed one. Whilst the consultation paper focuses on the structural notion that there exists support for Australians at various points within their particular phase of retirement, we consider that there are a number of gaps which need to be filled in order to support the universality of the system, where retirees – and those preparing for retirement – are catered for at each part of the cycle.

We also consider the notion of a retirement income system. We note that retirement systems throughout the world consider the question of planning for retirement through the lens of retirement income. However, we also note repeated research showing that preferences in retirement are to allow for lumpy expenditure such as aged care and health care (National Seniors & Challenger 2013, Chambers et al 2019) which predominantly occur at the end of retirement. Retirement benefits, when seen through the lens of an income stream mechanism only, may be a poor fit to cater to these needs.

This raises the question of what it is that is retirement income. Is it an income stream funded by the accumulation of assets through the course of one's life? If so, why has the home been included in pillar three? Is the drawing of income an optional or mandatory part of the system, and how does one do this with large personal assets such as the house? Are large one-off contingent expenses in retirement such as aged care, healthcare or emergency travel totally out of the scope of this review, in the same way as the consultation paper suggests that estate planning might be?

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We consider that another way to comprehensively review this system is to consider the need to save, and for what it is that Australians need to save, as the ultimate end point of the system. We believe that there should be a long-term vision for Australia's retirement savings system which encompasses superannuation, the Age Pension, non-superannuation investments and the family home. This vision must be clearly articulated to provide a clear purpose and how these goals may be achieved.

One of the difficulties that we face in a review such as this one is that circumstances in Australia are different to circumstances elsewhere in the world. Although we enjoy a relatively high ranking in the Melbourne Mercer Global Pension Index (Mercer 2019), the pension systems rated in the survey are rated using uniform criteria. We believe that the Panel should assess whether this is appropriate to Australia, given the unique features of the Australian system. Consequently, our response to this question should be viewed within this context.

Australia presently uses the framework adopted by the Organisation for Economic Co-operation and Development (OECD) (2019:131-142) which differs slightly from the World Bank's framework. The World Bank's classification dates back to 1994 but was revised in 2008 to include a Pillar 0, as well as a fourth pillar (Mercer 2019). The Pillar 0 under the World Bank's new model is a basic public pension which provides a minimal level of assistance. This may be either means-tested or universal.

The World Bank's model has, as its Pillar 1, a public, mandatory, contributory pillar separate from the minimal protection of the Pillar 0. We highlight this, as this is a feature which is not discussed as part of the Australian system.

The Age Pension is presently a means-tested government funded public pension which is designed to be paid to those who need it most. Commentators have pointed out a number of issues in relation to the taper rate, and how beyond a certain level of retirement savings, medium income Australians may in fact be disincentivised to save.

CPA Australia supports the continued use of the three-pillar architecture of Australia's retirement income system. Nevertheless, there is attractiveness in considering the use of the World Bank's Pillar 1 and Pillar 4 in support of Australians who are forced to leave employment sooner, or to address the puzzle that is aged care or healthcare in retirement.

The use of tax concessions is an appropriate policy lever to encourage retirement savings and as compensation for locking money away in the superannuation system. Economists have traditionally upheld the role of incentives towards long term savings as an appropriate policy lever to discourage immediate consumption.

Australia generally recognises this, taxing superannuation at concessional rates at both the entry and earnings points in the accumulation phase of superannuation. However, we note commentary from a variety of pension experts broadly in favour of taxation at the point of payment of benefits (Mercer 2019, OECD 2018, OECD 2019), with the majority of private pension systems globally using this taxation method.

In Australia, arbitrage created by this taxation method has seen the growth in methods implemented to ensure a more equitable levying of tax, including the transfer balance cap, Division 293 tax and greatly reduced concessional and non-concessional contributions caps. The problem becoming increasingly obvious is that the fairness of the system is likely to be undermined by Australians who have managed to accumulate significant wealth in a tax-advantaged environment. At the other end is the issue where lower income Australians are subject to a tax rate of 15 per cent on contributions, which may be higher than their marginal income tax rate on their income.

Mercer (2019:15) explains the additional need to ensure that the tax impact on contributions and earnings has a minimal impact on the compounding effect on retirement savings:

> *Are voluntary member contributions by an average-income earner to a funded pension plan treated more favourably by the tax system than similar savings in a bank account? Is the investment income earned by pension plans exempt from tax in the pre-retirement and/or post-retirement periods? The first question assesses whether the government provides any incentives to encourage average-income earners to save for retirement. It is recognised that the taxation treatment of pensions varies greatly around the world so this question assesses whether an incentive exists or not, not the value of the concession. The second question recognises that the level of investment earnings is critical, especially for defined contribution plans. A tax on investment income reduces the compounding effect and will therefore reduce the adequacy of future benefits.*

Modelling a shift in the tax burden from the contributions phase to the benefits phase could provide a clearer picture of the costs and benefits of the policy for retirement incomes.

Purpose of the system and role of the pillars

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

We are not yet aware of a universally accepted objective for Australia's retirement income system, and as such would suggest that this is not at all well understood.

The stated objective of retirement used in the terms of reference is a modified version of the primary objective taken from the *Superannuation (Objective) Bill 2016*. However, the bill lapsed at the last federal election, with no commitment by the Government as to its re-introduction. We welcome the inclusion of the word 'adequate' in the terms of reference, however, we are not aware of a policy basis for the assertion that there is a stated or implied objective of retirement.

The Committee for Sustainable Retirement Incomes (CSRI) (2016) commented about the need to enshrine the objectives of the superannuation system:

> *The CSRI strongly supports the articulation of objectives not only to guide the enhancement of Australia's retirement income system but also to guard against it being diverted towards other purposes and interests such as wealth accumulation and bequests, or the use of superannuation savings for a deposit on a house or to pay off higher education debts. Similarly, it would help to counter any calls that superannuation funds should be directed to invest for purposes other than member retirement benefits such as nation-building.*
>
> *The CSRI considers that the objective(s) should relate to the whole retirement income system rather than just superannuation. For the foreseeable future most retirees will be dependent on income from both superannuation and the age pension, and the two systems need to be seen as complementary. Defining objectives for the whole retirement incomes system will promote this complementarity of superannuation savings and age pensions systems to achieve societal goals at a sustainable total cost to taxpayers, and avoid an inward and likely unhelpful focus on how one instrument such as (superannuation) might reduce pressure on another (such as age pensions).*

CSRI's preferred objectives were an overarching objective with four supporting objectives (CSRI 2016:3) as follows:

> *Overarching Objective:*
>
> *Provides adequate income through all the years of retirement for all Australians*
>
> *Supporting Objectives:*
>
> - *Is fair and equitable*
> - *Helps individuals manage financial risks*
> - *Provides certainty with necessary safeguards*
> - *Contributes to the sustainability of government expenditures*

Notably, a requirement for adequate income was included in their preferred objective. CSRI insisted that income was to cover 'all the years of retirement'. However, despite commentary around this, CSRI craft their preference towards catering to longevity risks with the issue of earlier than expected retirement unaddressed.

CSRI's methodology appears to have been driven by a need to set out reasonable expectations for retirees ahead of retirement. However, in the absence of a formulated policy basis, the needs of retirees themselves are not well understood, least of all by this particular item of research.

A focus of the objective contained in the Superannuation (Objective) Bill was on substituting or supplementing the Age Pension. CPA Australia's submission to the Senate Economics Committee in 2016 noted that as the purpose was written, it could be used to wind back eligibility for the Age Pension:

> *However, we note there is a level of concern in some quarters that, as currently framed, the proposed purpose could be narrowly interpreted by future governments and used as a justification for winding back access to the age pension.*
>
> *The concern hinges on a literal interpretation of the word 'substitute'. Most Australians aspire to and expect to be able to maintain a reasonable standard of living in retirement, above what can be provided by the age pension. Were future policies to be developed within this narrow framework, Australians may be disincentivised to save for their own retirement, in that there may be less incentive to save beyond replacing the age pension.*

In their recent paper, Chambers et al (2019:19 at table 5) surveyed a number of people to ascertain their preferred retirement features. Features were nominated by experts employed in the industry as part of the research, all of whom worked in the superannuation industry, or as service providers to the superannuation industry (Chambers et al 2019:4), in addition to consumers. It is notable that the experts did not nominate a basic degree of consumer protection (such as portability between providers) as a feature that they believed should be rated by consumers as part of the survey.

Consumers themselves were also unclear in parts, with umbrella headings such as 'withdrawal flexibility' used to capture a variety of needs such as portability, liquidity, and income variability. The experts consulted as part of the survey merely acknowledged that flexibility means 'access to capital' (Chambers et al 2019:17). This only underlines the perception that providers are generally happy to cater to only very specific parts of consumers' preferences in this area.

The fact that basic consumer protection was not rated as a preference in retirement by focus groups would suggest that even the risks of retirement income and its various sources are not well understood, let alone the objective in retirement.

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

A key issue that must be determined as part of this review is what it is that retirement is understood to be. We explained in the introduction that the notion of 'retirement' is not properly defined in the discussion paper. This creates immediate issues when considering what it is that retirees prefer in retirement, since there is not universal acceptance of either when retirement occurs, or what it is.

The consultation paper (page 8) suggests that:

> *The retirement income system is not intended to boost private savings* per se*, nor is it intended to be a source of savings for the purchase of large assets during an individual's life (such as housing), or to assist with wealth accumulation in order to provide for inheritances. This is reflected in policy settings such as the restricted access to superannuation before preservation age, minimum drawdown rules for superannuation, and the means testing of the Age Pension.*

The issue with this statement is that the third pillar of Australia's retirement income system, on page 4 of the consultation paper, quite explicitly includes private savings and large assets. Some of these are enjoyed at retirement in the form of retirement income, others such as the home are not.

It may be that other non-superannuation assets which do not readily translate to elements of income in retirement are there because they affect the other two pillars. A difficulty that Australians would have at this point is reconciling why these items are not then located in the other pillars where logic would dictate that they reside. For example, if the only reason that an asset is included in pillar three is because it affects the amount of Age Pension which is pillar one, the question then is why this is the case. CPA Australia supports efforts to encourage non-superannuation retirement savings more broadly. However, at the same time, we question what role these savings are intended to play within the context of Australia's retirement income system.

This inconsistency has led to the current situation where the arbitrage between superannuation and non-superannuation savings environments has been assumed away by policy makers for the purpose of determining what is attractive to Australians. This could be addressed by a tighter definition of 'retirement income system'.

We believe that these questions should form a fundamental cornerstone of the review's findings. As we discuss at various points in this submission, misconceptions are likely to form about what it is that Australian retirees might need in retirement if there are mixed messages about how savings can be used at retirement. This will be the case if this review includes assets that can only be exhausted in specific, narrowly-defined ways at retirement.

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

We agree with the expected roles of these parties as described in the consultation paper.

> 5. *The Panel has been asked to identify the role of each of the pillars in the retirement income system. In considering this question, what should each pillar seek to deliver and for whom?*

One of the difficulties outlined above is that the pillars appear to build more towards a different outcome than exclusively retirement income. A recurring theme in this submission is, what is it that is understood as 'retirement income'? Is the house, or indeed, voluntary savings more broadly there to provide an income in retirement? Are they there to merely be considered in the provision of income in retirement?

The consultation paper (page 5) appears to acknowledge that there is some confusion in the role that voluntary savings plays.

> *Voluntary savings can occur through many investment vehicles, such as business assets, real estate including owner-occupied dwellings, and other financial and non-financial assets. They may be accrued inside or outside of the superannuation system. Voluntary savings serve a number of purposes, including wealth accumulation, and may not only be intended to provide retirement income. The choice of savings vehicles by individuals will depend on their personal circumstances and ambitions. For example, small business owners may choose to build and hold their wealth in their business assets through a trust structure due to the asset protection this structure can provide.*

The paragraph that follows this in the consultation paper, appears to limit the scope of the paper's focus (in relation to voluntary savings) to voluntary superannuation contributions only. However, the paragraph immediately after that then discusses the wealth that can be released from a person's home ownership:

> *Voluntary superannuation contributions can be used to facilitate higher superannuation balances at retirement. However, total superannuation contributions are generally capped at $25,000 of pre-tax income and $100,000 of post-tax income each year. Voluntary superannuation contributions are a particularly important savings option for individuals who are not covered by compulsory superannuation.*
>
> *As demonstrated by Figure 2, most household wealth for individuals aged 65 and over is held outside the superannuation system, with owner-occupied dwellings the largest asset for these cohorts. Outright home ownership supports retirement income by reducing ongoing expenses and acts as a store of wealth that can be accessed in retirement.*

The question about what retirement income is, is thus a difficult one.

More fundamentally, what is income for the purposes of this review? Is it capital from the sale of assets? Is it borrowed proceeds from the Pension Loans Scheme (PLS), reverse mortgages or other equity unlocking products available to retirees?

We propose that this is also a threshold question. Whilst we consider that retirees would prefer the security that a regular, predictable income stream can provide, the very question of other large expenses in retirement loom large in the minds of retirees, if the security of an income stream alone is not able to provide for these purposes.

> 6. *What are the trade-offs between the pillars and how should the appropriate balance between the role of each pillar in the system be determined?*

This question should be considered in the context of the previous question.

The current policy settings in relation to the first two pillars are affected by the degree to which the population is covered by the pillars in question. It is already well documented that the means testing taper rate results in a situation where middle-income earners can very easily find that they are earning less in retirement income than someone fully or partially eligible for the Age Pension.

It is also the case that an Australian who is predominantly self-employed throughout their working life is likely to be supported more by the third pillar than the second, with those who are predominantly employees being in the reverse situation.

This raises the question of which lever to adjust in determining the most appropriate policy settings in relation to retirement incomes policy. However, it doesn't take into account various additional issues if we go outside the definition of 'retirement income'. For example:

- The Age Pension solely represents an income stream. There is no underpinning stock of available capital (with some exceptions) which retirees can access
- On the other hand, an account-based income stream represents a return of both capital and investment earnings at a known percentage, with the added option of accessing capital at a later stage.

A question of utility arises in that there may be an implied value to the flexibility available in an account-based income stream which is not captured in pure comparisons of income amounts. Examining the system purely as an income system will not necessarily capture or measure this feature. It also comes no closer to resolving the roles that the house or voluntary savings plays in this system.

The changing Australian landscape

> 7. *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?*

A number of trends are becoming more pronounced. One of these is declining rates of home ownership (Yates & Bradbury 2010, Chalkley-Rhoden 2017). This has a number of flow-on effects in the retirement income system:

- Measures of adequacy used presently, often assume home ownership
- Eligibility for the Age Pension is set depending on whether the retiree is a home owner or not, and
- Eligibility under normal means testing is also affected by access to equity unlock facilities such as the Pension Loans Scheme (PLS) or reverse mortgages

The concessions available for non-homeowners are disproportionately small, and likely to disadvantage retirees as a whole, as home ownership continues to decline. The Pension Review conducted by Jeff Harmer in 2009 found that the rate of pension paid to renters (outside of public rental housing) was inadequate. Finding 7 of the report states that:

> *The Review finds that there is strong evidence that many pensioners in private rental housing face particularly high costs and have poor outcomes. Rent Assistance and social housing have complementary roles to play in addressing the financial security of these pensioners. The Review notes that the government has proposed an increased investment in social housing and considers that reforms to Rent Assistance would complement this.*

Whilst we note that increased investments in social housing is aimed at improving this, it is still too early to tell if these investments have been successful. However, with rental rates in Australia's two largest cities at all-time highs (Razaghi 2019), it would be difficult to find meaningful statistics suggesting that these have made an impact on how adequate the pension is for non-homeowners in private rental arrangements.

Another trend is the move towards flexible working arrangements, noted by some as 'the gig economy'. AIGroup (2016) note the increased preference of some business for freelance staff, citing the benefits to employers of being able to readily access staff for short-term assignments, wider access to staff and increased productivity. However, these can come at a cost to such staff in the present system, particularly workers who may be below the current $450 threshold. By way of comparison, an employee is only able to access the tax-free threshold at one employer, however, there is theoretically no limit to how many employers may seek to access the exemption on payment of superannuation for a single low paid worker.

We agree that there has been well-documented discussion in relation to the issues around longevity, but we also note a growing number of Australians working longer, past traditional retirement ages, based on statistics from the Australian Bureau of Statistics (ABS) (Myer 2017). We do not agree that it is useful to offset this group against those retiring earlier due to being unable to continue in paid employment, since the lived experience of different cohorts of people is not a system of debits and credits. Australians who are working longer do so for a number of reasons: the most prominent reason cited by Patchell (2016) is not being able to afford retirement.

The system needs to consider the long-term effects that this may have; in particular, the impacts on equity, equality, fairness and universality of the system. We suggest that if Australians are having problems retiring due to a perception that they cannot afford to stop work, this is evidence that the system is either failing this cohort, or they are consciously adjusting for increased longevity. If it is the latter reason, this would appear to reduce the importance of increased life expectancy as a policy issue, since this cohort is also reducing the length of time spent in retirement by continuing in paid employment.

We also note that a number of studies have written about the link between involuntary retirement and poor health outcomes, with König, Lindwall & Johansson (2018) reviewing a number of studies in this area, although the Australian Centre for Financial Studies (ACFS 2014) notes that involuntary retirement is itself driven predominantly by health considerations. This would appear to suggest that the longevity problem is not necessarily the central issue facing Australians who retire earlier.

We additionally note issues associated with an ageing population. The Productivity Commission's (2011) examination of aged care addressed problems including (from Sherry 2010):

- The increase in demand for aged care due to ageing Australia
- Shifts in the type of care – increased independent living arrangements, greater affluence, changing patterns of disease, reduced access to carers, diverse geographic spread, increased need for psycho-geriatric care and skilled palliative care, and
- The need to secure an expansion in workforce given age-induced tightening of labour market and unfavourable differentials.

Ageing populations (Chomik & MacLennan 2014) will increase demand for aged care. This, combined with limited supply, will force up prices further, meaning that costs will increase further. We discuss adequacy issues created by the cost of aged care and health care later in this submission under Adequacy.

Principles for assessing the system

> 8. *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?*

We agree with the principles proposed in the consultation paper. All Australians are potential or actual retirees, and there must be a safety net to ensure that Australians who are unable to access the system can do so. To ensure that those who are not properly able to understand the importance of retirement income and are not required to be part of the system, access should be on an opt-out basis, rather than an opt-in basis, provided that they are not financially disadvantaged by this.

We also believe that the principle of consumer protection is not adequately pursued. Current or recent initiatives such as choice of superannuation fund, open data, removal of entry and exit fees, single touch rollovers and Australian Taxation Office (ATO)-assisted consolidation of inactive low balance accounts are aimed at portability in the interests of consumers and competition. Yet, Australia is presently also seeking to introduce relatively complex products as retirement income product defaults which may be difficult to exit, or even impossible to transfer to another provider in some instances.

Basic consumer protection affects Age Pension recipients as well. Despite this being a payment that Australians are expected to live on, we are not aware of any Centrelink standards regarding time frames for staff to contact clients, in relation to supporting documentation required to process applications. Since the relevant commencement date for the Age Pension is the receipt of all necessary claim documentation, it may appear that Centrelink is incentivised to regard the period between the commencement of the claim and the receipt of all complete claim paperwork as a low priority. Arguably, many Australians would find this unacceptable if this were the case.

We believe that consumer protection will be best served by a six-point approach where the safety, security, stability, simplicity, sufficiency and fairness form the underlying foundation.

9. 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?

The Henry Review (Henry et al 2009) noted in the first finding of its retirement income report that:

> *The retirement income system is facing increasing challenges as the 21st century unfolds. Some are relatively clear to us, including the ageing of the population, longer life expectancies and the fact that many more people will interact with the system. Others are less clear, arising from the diverse range of risks and uncertainties about future economic, social and environmental circumstances faced by all. These challenges will test the sustainability, adequacy, acceptability and coherence of the system, but the three-pillar architecture is well suited for a balanced and flexible response.*

We noted in our response to question 7 that ageing Australia, declining home ownership, flexible work practises and other factors are changing the face of Australia. These will place pressure, in the future, upon the sustainability of Australia's retirement income system. Henry et al (2009:10) acknowledged this, saying that:

> *Governments need to set these parameters on a long term basis to balance the requirements of adequacy and fiscal sustainability. Policy changes to vary any of these parameters will affect the long term work, consumption and saving decisions made by individuals over the course of their lifetime.*

We are concerned that some of the conversations playing out publicly in relation to retirement incomes are not helpful. We have pointed out elsewhere in this submission that there is a cost to a functioning retirement income system. We acknowledge that the system needs to be sustainable. The costs of providing the Age Pension, as well as the retirement income concessions are necessary considerations in the provision of a robust retirement income system to Australians. However, adequacy needs to be considered as to what is best for the cohort that uses the system. If sustainability concerns are what is preventing us from providing adequate retirement outcomes, this balance should be reviewed.

The balance between sustainability and adequacy are challenges that future governments must consider.

Adequacy

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

Adequacy of retirement income is premised upon the normal utilisation of retirement savings in retirement. However, as we explain below, there are a number of things that retirees can reasonably spend their money on in retirement, which may not fall into the subset of 'normal utilisation'.

The Panel should consider the need for money in retirement, whether this be normal expenditure, or large unforeseen one-offs, such as those created by aged care, healthcare and emergency expenses such as travel and other expenses. The Panel should also consider the degree to which flexibility can cater for adequate coverage of seemingly conflicting needs such as longevity, and contingent large expenditure. Research (Shang & Goldman, 2008, Spillman & Lubitz, 2000) confirms that the likelihood of incurring aged care and other healthcare costs increases with longevity, yet the policy response to longevity has been to create products (Comprehensive Income Products for Retirement, or CIPRs) which become, by design, increasingly unable to cater to these expenses as a retiree outlives their life expectancy.

Above all, the measures for adequacy should cater better to all Australians. There are presently policy measures aimed at ensuring that wealthy Australians are unable to benefit beyond set maximums, including means testing for the Age Pension, capped limits on the Superannuation Guarantee combined with contribution limits, and absolute maximums which limit both additional contributions and tax-free post-retirement savings environments.

The pursuit of an objective of adequacy should be the basis on which limits are determined. In this case, upper boundaries as well as lower boundaries. Adequacy should reasonably determine limits where the public interest determines that anything in excess is more than adequate. Adequacy should also determine additional support for low income earners as well. Thresholds provide cut-offs to Age Pension support. However, anomalies continue to exist, such as higher tax rates on contributions to superannuation than what is in place as marginal tax rates for low income earners. Adequacy should consider means to raise to an acceptable level the standards for Australians who are unable to build sufficient retirement savings.

11. *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?*

The currently accepted measures of adequacy tend to be framed in a way which presents income as the primary measure, rather than expenses. Replacement rates tend to be the predominant relative measure of this, reflecting perhaps the influence of Modigliani's lifecycle model (Modigliani & Brumberg 1954). The standard developed by the Association of Superannuation Funds of Australia (ASFA 2019) is perhaps the most commonly used absolute standard.

Methods which are framed in terms of expenses use measures which are generally set in terms such as Average Weekly Ordinary Time Earnings (AWOTE) or poverty measures, and therefore may consider income amounts in excess of what might be considered an acceptable minimum. Henry et al (2008) notes work carried out by the Social Policy Research Centre at the University of New South Wales, which developed 'budget standards' for determining standard of living-based approaches to expense-based measures,

Relative measures such as a replacement rate are generally framed in terms of pre-retirement income. This idea has a number of problems. For a lot of people a pre-retirement income at the end of one's career may be one's peak earning power, as years of education, training, experience and, subsequently, promotions combine to provide a pre-retirement income figure which is not indicative of the average figure that one may have been earning throughout one's working life. This has resulted in, as the consultation paper notes on page 14, a number of different methods in calculating pre-retirement income.

Absolute measures themselves have their issues. We note that the ASFA Modest standard (2019) for singles ($27,913) or couples ($40,194) who are homeowners is currently set at an amount which is only slightly higher than the current maximum rates of the Age Pension ($24,269 and $36,582 for singles and couples respectively including Pension and Energy supplements). One issue with this is that the Age Pension is set at an increment based on a wage inflation measure (Male Weekly Average Time Earnings), whereas the ASFA standards are set to price inflation, being the Consumer Price Index (CPI). Normally, wage inflation measures outpace CPI (Egan Associates 2018) – even though recent experience has not reflected this (Scutt 2019) – which raises the interesting question about what might happen to the ASFA standard in this instance.

Another issue is that the ASFA's Comfortable standard (currently $43,787 for singles or $61,786 for couples) is set close to, or above the median weekly total cash earnings rate ($39,000), which reflects the earnings of full-time employees paid at the adult rate as at May 2018 (ABS 2019). While we agree that this potentially may be regarded as comfortable, we note that this is priced above the experience of most Australians in paid employment. Daley & Coates (2018:35) note that only 20 per cent of singles and 40 per cent of couples spend more when working than this standard.

However, this analysis does not itself form an argument as to why an income of this amount in retirement should be a bad thing. The specific argument that Australians who were badly remunerated during employment deserve poorer retirement outcomes, might be considered by some to be ill-spirited.

We welcome the focus given to adequacy as part of this review. However, we believe that an appropriate measure of adequacy should be based primarily on the expenses faced by retirees, rather than on a measure of income. One of the things that we believe a focus on expenditure could establish is the degree to which the 'retirement smile' should affect retirement incomes. UniSuper (2016) explain the retirement smile as:

> *The retirement smile is a kind of inverted bell curve which represents the general pattern of people's spending in retirement. The idea is that spending is high at the beginning of retirement, it tapers off in the middle and then spikes again at the end. It's a particularly useful way of illustrating people's expected income needs in retirement.*

We note that existing retirement income solutions appear to assume either an unchanging or decreasing expenditure throughout retirement. However, work such as Blanchett's (2014) note an increase towards the end of retirement, primarily due to health costs, which Blanchett sources to healthcare. Chomik et al (2018:24) shows a similar effect in Australia:

> *The most remarkable change as people age is the increase in public health and public and private aged care expenditure. Consumption of residential aged care starts increasing after age 60 and ramps up significantly after 75. The analysis fosters a broader understanding of resources and consumption over the lifecycle and can be extended to look at aggregate changes.*

Adequacy measures based upon pre-retirement income measures, at least in the early stages of retirement when retirees are relatively fit and healthy, are ill-equipped to deal with the pitfalls of expenses which increase near the end of retirement. These expenses can be severe: Ferguson, Toft & Carter (2017, at 37:10) note that the leasehold price of a one-bedroom unit in one retirement complex is $600,000-$700,000. For a retiree nearing the end of retirement, such large amounts of money are likely to mean that this is (disproportionately or not) focused on by retirees to the exclusion of other factors.

Earlier in this submission we discussed the issues around Australia's ageing population. We suggest that if the upward curve of expenditure towards the end of retirement is not addressed by this review, there is unlikely to be another policy review suitably focussed on this issue.

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

As we explained in our response to the previous question, more work needs to be done in examining how expenditure in retirement can be addressed in order to obtain evidence regarding retirement income adequacy.

Equity

13. What should the Panel consider when assessing the equity of the retirement income system?

We consider equity and adequacy to be very closely linked. One issue that we believe should be considered by the Panel is the recurring issue where policy issues are seen as part of the retirement income system, but which in reality are policy issues which naturally reside elsewhere.

The issue of the gender gap in superannuation in relation to women, is an example of just such an issue. We note that the major issue stems from the fact that women as a rule retire with smaller superannuation balances than men, for a number of reasons, including wage differentials, time off work as a parent or carer, and longer life expectancy.

Existing solutions to these problems are often complex or inefficient, including superannuation paid on parental leave or carers leave, as well as some employers who pay women additional superannuation contributions. Other solutions have been implemented, including contributions splitting, family law splitting and flagging orders, as well as spouse contributions and accompanying rebates. Additional proposals mooted from time to time, include joint accounts, ability to nominate spouse superannuation accounts for employer contributions and so on.

However, most of the contributing factors are unrelated to the retirement income system. Several examples highlight this point.

Firstly, there are no good reasons why men should be paid more than women for the same work. However, it is outside the scope of the retirement income system to solve it: The obvious solution would be to ensure that the remuneration gap is eliminated.

Secondly, parental leave is an issue related to social norms where a primary carer – generally a female – is expected to take time off work to look after and raise children. Fixing social norms is unlikely to be satisfactorily repaired by an educative process to let secondary carers know that they too can optionally take time off. We note that a solution proposed elsewhere is to legislate that secondary carers – normally the male parent – be required by law to take precisely the same amount of time off work as the active parent during the bringing up of children. How this would be monitored and how this would impact household income where the carers incomes are different needs to be considered.

The same approach could also be considered for broken work patterns brought on by the situation where daughters may be expected to look after ill family members, rather than sons (identified as an issue in Brodaty & Donkin 2009).

This issue is best dealt with outside of the retirement income system. However, the proliferation of policy band-aids which have been used means that the underlying policy issues are still there.

Consider the idea of joint superannuation accounts. Such a solution is proposed by policy commentators from time to time as a solution to the gender gap in retirement savings. However, such a solution would simply camouflage the real issues above, and as a result mean these issues are less likely to be dealt with. Although, such a solution may provide a way to reduce account-keeping fees.

Where the retirement income system is able to assist is with respect to genuine problems within its domain, such as the impact of longer life expectancy for women. This is a genuine issue that the Panel should consider in its response to the equity issues as part of this review.

14. What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement? What evidence is available to assess whether the current settings of the retirement income system support fair outcomes in retirement for individuals with different characteristics and/or in different circumstances (e.g. women, renters, etc.)?

One area which we believe has not had sufficient exposure during this review is the issue of self-employment, relative to employed Australians. The Panel should undertake further work to calculate the size of this group, how they are saving for retirement and how that savings compares with employees. The Panel should consider whether the definition of an employee for superannuation purposes is meeting its intended purpose due to the changing nature of work, including the supposed increasing preponderance of 'gig economy' workers.

Another issue is the question of non-homeowner concessions in relation to Age Pension entitlements. The primary issue is that the thresholds in relation to Age Pension eligibility are designed in a way that reflects the idea that there should be some concessions in exchange for not owning one's own home. We are not aware of any evidence to suggest that these concessions are any more effective than they were at the time that Harmer (2009) published the final paper of his review. We note specifically that, where homeowners do not have to pay the cost of living in their accommodation while renters do, rental assistance does not cover the full rate of rent, and in fact, is limited to both 75 cents for each dollar, as well as a maximum threshold.

Finally, the question of the family home is pertinent to this section. Whilst consideration of the home in this review is unclear (as we explained earlier), we also note that there were several points in the consultation paper which underlined a view that estate planning is not what the Australian retirement income system is set up to do. If this is the case, there becomes a question of why there is no upper limit on the value of homes securing the exemption which they currently enjoy from Age Pension means testing, since they could similarly be used for estate planning vehicles. This needs to be resolved by the Panel in the interests of consistency.

15. Is there evidence the system encourages and supports older Australians who wish to remain in the workforce past retirement age?

We agree with the paper's suggestion that there is generally a trade-off between immediate and deferred consumption to some extent. We are sceptical however that a freeze in the level of the Superannuation Guarantee will automatically become additional wages for employees, noting that Taylor (2019) has failed to find evidence to support this assertion.

On the other hand, where there is the ability to consciously save disposable income after tax, arithmetic suggests that an increase to disposable income is the only possible outcome. The consultation paper suggests as an ideal that consumption should be smoothed to avoid deferring too much consumption to retirement. However, we ask whether there is a risk that Australians will over-compensate for this risk by not putting enough away for retirement: We note Myer's (2017) observation from earlier in this submission that Australians who do not believe that they have enough to live on are forced, or would like, to remain in the workforce past retirement age.

We are neutral about whether this should be encouraged. On one hand this appears to represent failure by policy makers in meeting this cohort of retirees' needs. On the other hand, where Australians legitimately have full agency in working past retirement for other reasons unrelated to their retirement savings (or financial reasons for that matter) such as happiness in their work, this decision should be supported.

Treasury recently consulted on proposals to align the age requirements for genuine redundancy to Age Pension qualification age' in an exposure draft *Treasury Laws Amendment (2019 Measures No. 2) Bill 2019*. We noted in our submission to Treasury that:

> *Simply put, there should not be differential treatment of genuine redundancy payments simply because of age. The Productivity Commission paper, An Ageing Australia: Preparing for the Future, identified the shift for Australians to work to a higher age, self-manage their retirement and reduce reliance on the aged pension, which the proposed provisions arguably undermine. Notions of the 'traditional working age' are outdated and Treasury's own Intergenerational Report shows that by 2024-25 almost 30 per cent of females and more than 40 per cent of males between 65-69, and around 10 per cent of males aged 70 and over will remain in the work force. This change is part of a global trend with the United States Department of Labor estimating that the 65 and older labour force will be the fastest growing in the US in the next five years.*

As we noted in relation to this proposal, a change such as this further limits a person's agency in relation to the desired wish to work past retirement.

This raises a question around 'retirement age'. The consultation paper (page 5) suggests that this is ages 60-64. We have explained at various points throughout this submission that we are not certain with how the term retirement is being examined as part of this review, however, we would also consider that if there is to be a 'retirement age' this age bracket is not appropriate.

Outside of Australia, retirement age can mean many things, including mandatory retirement. We are certain that the Panel does not intend to examine the suitability of such a concept and would at the same time note that we are not aware of any evidence to suggest that a mandatory retirement age is appropriate to Australia.

Yet, there are a number of ages associated with retirement and for most of these the age bracket 60-64 is younger. Some of these include:

- Preservation age, presently 58, determines when conditions of release start to apply for the release of preserved superannuation benefits for the purpose of retirement
- Age 60, when the ability to access preserved superannuation benefits on the event of leaving a paid employment arrangement (as opposed to retirement) is available
- Age 65, when preserved superannuation benefits become unpreserved, regardless of whether a person has retired or left paid employment, and when additional voluntary contributions to superannuation normally require a work test
- Age Pension eligibility age, presently 66, but progressively increasing to 67
- Age 70, when the ability to make spouse contributions ceases
- Age 75, when the ability to make contributions other than mandatory contributions ceases

As can be seen, if a person wished to work past age 75, the ability to make superannuation contributions is curtailed almost completely. It is limited substantially after age 65. Whilst these ages in some cases may appear arbitrary, it should be noted that some of these are in the process of being rationalised, such as the preservation age, progressively moving to 60. However, as CPA Australia noted in its submission to the Treasury review, that these limitations can punish people further at a difficult time in their lives, particularly where they do not have enough to retire on, as Myer (2017) notes.

The Age Pension appears to provide some support for Australians in receipt of the pension who are working. The Pension Work Bonus provides relief for $300 per fortnight, up to $7,800 per year from the income test.

16. To what extent does the retirement income system compensate for, or exacerbate, inequities experienced during working life?

The predominant findings of research such as Daley & Coates (2018) suggest that the majority of benefits from superannuation as a retirement savings vehicle flow to wealthier Australians. This was a basis for the Henry Review's approaches to taxation of superannuation contributions (Henry et al 2009a), which recommended progressivity, rather than the flat rate which presently applies.

Henry et al (2008:243) notes that there needs to be some incentives for deferring immediate consumption during a person's life:

> *The decisions made by individuals and households in apportioning income between consumption and saving affect their wellbeing now and in the future. The tax–transfer system impacts on these consumption/saving decisions in three ways:*
>
> - *through marginal tax rates and access to transfers (including the means testing of savings);*
> - *by providing tax concessions to some savings vehicles; and*
> - *through compulsory savings for retirement (the SG).*

The recommendations made by Henry include the continued concessional taxation of superannuation. However, Henry also recognised that there needed to be better distribution of the different positions which exist between high- and low-income individuals. A recommendation from the Henry Review's retirement income report (Henry et al 2009) states:

> *The tax advantages provided for superannuation serve the dual purpose of providing incentives for contributions and delivering more neutral overall tax treatment of deferred consumption relative to current consumption. Current arrangements serve the second purpose effectively but some features do not provide fair or adequate incentives to all. Superannuation should continue to receive tax assistance, but there is a case for distributing assistance more equitably between high and low income individuals, including by limiting generous salary-sacrifice concessions. Similarly, everyone should have equitable access to the assistance. The Panel is undertaking a comprehensive review of the taxation treatment of saving and investment for its final report. Accordingly, it proposes to consider further the taxation treatment of superannuation saving as part of that wider assessment.*

The Henry Review's comprehensive final report (Henry et al 2009a, at Recommendation 18) recommends that a combination of taxation at a taxpayer's marginal rate of tax, together with a refundable tax offset should apply, ensuring that most Australians only pay tax on their superannuation at a rate of 15 per cent. The combination of mechanisms for taxation would result in a situation where income earners who pay no tax, but have superannuation contributions, would be receiving an immediate financial reward for retirement savings.

This would appear to be a far more equitable approach than the current system which potentially taxes superannuation contributions for low income earners at a higher rate than their present marginal rate of income tax.

In the meantime, we note that the Government has implemented a taxation measure on higher income earners, with contributions subject to a higher rate of tax. This is aimed at reducing the tax concession available to higher income earners. However, the measure does not affect all higher income earners equally, with the threshold being set separately to the taxable income thresholds applying to the top rate of taxation. The adjusted taxable income threshold could be reviewed to better align between income tax and superannuation.

Separate to this has been the implementation of the Low Income Super Tax Offset (LISTO), a payment designed to ensure that the tax paid on minimum Superannuation Guarantee contributions for low income earners is returned to their accounts. One problem with this is that the amount returned is in fact set at the old SG rate of 9.0 per cent, leaving low income earners still out of pocket to some degree. In addition, once one's adjusted taxable income is higher than the threshold of $37,000, the LISTO cuts out entirely, leaving taxpayers out of pocket once more. By comparison, the average rate of income tax for a taxpayer on a taxable income of $37,000 is 9.65 per cent, prior to Medicare levy and allowable offsets.

We note as an aside that women are disproportionately represented in low paid work such as the retail and hospitality industries. As noted earlier, the majority of factors contributing to the gender retirement savings gap are outside the retirement income policy area. Therefore, we underline that this is a factor which this review should consider, that is, balancing the additional costs on employers with the benefits to employees.

Aside from taxation, we note that there exists little in the way of mechanisms to better assist low paid workers to better provide for retirement. The co-contribution exists as a way to incentivise lower income earners to make voluntary contributions towards superannuation. However, given the reality that lower income earners are less likely than higher income earners to have additional funds to contribute towards superannuation, it is arguable that this scheme predominantly benefits Australians who are dependants of higher income earners. This raises questions about how well targeted it is.

We are aware that the Age Pension exists as a safety net for those who have been low income earners throughout their working life and have little in the way of assets at retirement. The means test requirements – which, as we noted earlier in this submission, can result in lower retirement income for some retirees due to the taper rate calculation – are designed to ensure that it is received by those who need it. However, we note that those who have concentrated on putting their savings into their home rather than assessable assets may benefit due to the exemption which exists.

On the taxation side, there appears to be very little supporting the use of superannuation vehicles in retirement by a large slice of retirees Even in the pension phase, where the tax rate is zero per cent, the competing non-superannuation tax-free threshold of $18,200 (not including Medicare levy or eligible tax rebates/offsets) means that a significant amount of assets need to be held outside of superannuation before tax even begins to be paid. For example, an investment earning an equivalent rate to the Reserve Bank's current cash rate (0.75 per cent per annum) would need to about $2.43 million in size.

Even a higher assumption, such as a return of 5 per cent per annum, still requires an investment of $364,000 or greater outside of superannuation in order to pay tax. As can be seen from page 5 of the consultation paper, this is still well in excess of the median superannuation balance approaching retirement age, raising questions about what more can be done to support low income retirees in retirement.

With respect to the issue of means testing, financial assets are now deemed the same way, with superannuation treated the same way as financial assets outside of superannuation for the purposes of the income test, with lifetime income streams being one notable exception. To take advantage of this exception, some flexibility will need to be foregone. Whether this is enough for retirees is likely to be the subject of considerable consumer scrutiny as the rules around innovative income streams with a lifetime income component are finalised.

This raises questions about the policy basis for new innovative income streams (including CIPRs) presently under development, which promise more income in return for less flexibility. If superannuation funds are required to offer these as default retirement income products, this may result in Australians moving their money out of the superannuation environment if these default products ever become mandated.

CPA Australia supports choice of superannuation arrangements at retirement. However, we do not consider it to be a defensible position that the best outcome for lower income Australians is to opt out of the superannuation system entirely at retirement, when there may not be an equivalent non-superannuation solution, with the checks and balances that the combination of trust law and prudential regulation provides in the way of consumer protection. A focus on removing disincentives to keeping money in superannuation should be explored for the benefit of all.

17. What are the implications of a maturing SG system for those who are not covered by compulsory superannuation?

We have previously discussed the situation which prevents low income Australians from achieving a comfortable level of retirement savings. In our response to this question, we consider self-employed Australians.

The system has benefited from the control variable of self-employed (or predominantly self-employed Australians, who have had no compulsory superannuation in place. Where Australians in employment relationships have had compulsory coverage, Australians who are self-employed do not.

Superannuation has had benefits in place for self-employed Australians for a number of years. However, they operate on a voluntary basis, meaning that self-employed Australians need to be motivated to take advantage of these. Historically, contributions made by self-employed Australians were eligible for partial tax deductibility up to certain limits prior to July 2007 and fully tax deductible (but subject to contribution caps) after June 2007 provided that the taxpayer satisfied the test to be substantially self-employed.

The self-employment test was abolished from July 2017, making deductible contributions available to all Australians from that date.

Even with the added incentive of tax-deductibility, however, we are uncertain of the success of contributions by those who are self-employed. A large number of self-employed Australians are unable to pay themselves a regular income, and instead rely on profits which can vary from year to year.

Eligible small businesses are also able to take advantage of the retirement or 15-year exemptions from capital gains tax (CGT) if the proceeds of the sale of business assets are paid into a complying superannuation fund or retirement savings account. Limits exist for amounts contributed in one year, as well as a lifetime limit.

The two CGT exemptions rely on an event which may, depending on the assets involved, take some time to realise, from the moment that a taxpayer takes the decision to retire. Some small business assets are not able to be sold into liquid markets, and some may be highly specialised. Valuations may be difficult.

This system effectively encourages small businesses to invest back into their business (with the hope that such investment generates a return on investment), rather than provisioning for retirement along the way via contributions. There is, of course, a risk, that when selling the business, there will not be enough of a return from the sale to make this a viable strategy. It is additionally possible that there may not be any capital gains from which to enjoy the CGT relief. The public policy question of how small businesses are best able to be supported in retirement by the system should ideally be addressed by the Panel. The Panel should reference the Board of Taxation's 2019 *Review of Small Business Tax Concessions*, especially Chapter 5.

Sustainability

> *18. What should the Panel consider when assessing the sustainability of the retirement income system?*

We have already discussed a number of matters relating to sustainability throughout the previous sections of this submission. We consider that where the context of adequacy and equity exist, the notion of sustainability must seek to underpin these, not the other way around.

It is generally accepted that a retirement income system should come at some cost to the public. The Age Pension is a cost and must be met somehow from consolidated revenue.

However, as we have commented previously in this submission, there must be immediate tax incentives to ensure that participants in saving for retirement are compensated for the loss in available immediate consumption. Whilst there is some tax collected from superannuation through taxation on contributions and investment earnings, there are also concessions which are a cost to public revenue. Hawkins, Anderson & Gilfillan (2019) note that the concessional tax treatment of superannuation was costed at $37 billion in foregone revenue in 2017-18, with Klapdor (2018) citing a cost of $45.1 billion for the Age Pension in 2017-18.

One of the problems which we outlined earlier is that in a number of cases, the idea of a tax concession can be illusory, and in the case of low-income Australians contributing to superannuation, erroneous. Calculating the cost of the tax concessions is not as straightforward as saying that a dollar paid into superannuation will cost 15 cents in tax concessions, or that a dollar earned in the retirement phase will cost 30 cents, when the lived experience of many is that it will cost them more to contribute than what their tax rate outside of superannuation costs them. Whilst we understand that there are some Australians with quite a lot in superannuation, we recommend that the Panel examine ways to improve modelling of the sustainability of the retirement income system. Modelling needs to be more accurate to get a better picture of the winners and losers. Testing the settings requires nuances in the modelling to ensure that it is the best system. Such improvements in modelling should be embedded in Treasury's annual *Tax Benchmarks and Variations Statement*.

It is appropriate that we raise, once again, the question of what the retirement income system is considered to be. In their model, the World Bank (2008:3) includes a fourth pillar which includes:

> *access to informal support (such as family support), other formal social programs (such as health care and/or housing), and other individual financial and non-financial assets (such as home ownership and reverse mortgages where available).*

We note that the consultation paper has indicated that it is framing this review through the lens of the OECD's three pillar model, and we do not see any reason why this is not appropriate. However, we note the commentary on page 21 of the consultation paper which places the consideration of tax concessions paid to retirees in relation to aged care and healthcare out of scope. Use of the World Bank's model would change the scope of this review substantially.

As we have indicated throughout this submission, the consultation paper's vision of what retirement is and when it is deemed to have commenced is not clear. This makes such determinations of what is or isn't out of scope problematic.

We are uncertain why the criterion of public confidence has been included in this section. The section of the consultation paper titled Cohesion would appear to be a better fit for this concept. We agree that public confidence in the system needs to be considered as part of this review.

19. 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?

We are concerned that a great deal of the commentary around adequacy and sustainability appears to focus on extremes. There does not appear to be discussion of what it is that is the acceptable range of outcomes.

Page 23 of the consultation paper is concerned with the subject of Australians either having access to too much retirement monies or exploiting it. We agree with the consultation paper that knowledge of the key drivers is integral to understanding the retirement income system's sustainability. However, we note that a considerable amount of work has already been done in relation to this issue, which we consider to be relevant.

It appears that self-insurance is a key consideration. Wu et al (2014) notes that Australians will naturally engage in precautionary savings, with liquid cash buffers of $50,000 maintained. Rawlinson & Cater (2008) confirms that longevity risk is front of mind when considering to only draw down minimum amounts. Longevity risk is itself a basket of other risks, the main ones being the risks of outliving one's savings, of incurring large expenses in retirement or drawing down savings too quickly.

National Seniors Australia & Challenger (2013:1) undertook a survey, which found the following top four factors were considered the most important to retirees when determining their consumption patterns:

- Health, including access to aged care and healthcare (73.3 per cent)
- Longevity, where money lasts a lifetime (69.9 per cent)
- Peace of mind, where income is both regular and covers the 'bare essentials' (65.1 per cent); and
- Inflation, where income adjusts for inflation (63.9 per cent)

However, where Reeson et al (2016) and Balnozan (2018) speculate that estate planning is important enough to be considered as a reason why Australian retirees do not draw large amounts in retirement, National Seniors Australia & Challenger (2013:1) note that this factor rated less than 50 per cent.

Chambers et al (2019) found similar responses in their survey, with the added message that some retirees were not wanting to miss out on investment returns in retirement.

Numerous studies appear to have attempted to downplay the reasons why retirees save more and draw small amounts, with aged care and healthcare receiving considerable focus. We note the tendency for a number of researchers to consider that increased expenditure on aged care and healthcare costs can be funded by a retiree's effects, including access to equity in a retiree's home. Cooper, Minney & Sainsbury (2013) is an example of where this strategy is recommended. However, with rising housing unaffordability meaning that Australians are buying property later in life, if they are buying at all (Yates & Bradbury 2010), this strategy is increasingly unsustainable.

We welcome a dialogue over whether too much is being saved by retirees. The relatively recent policy limits on getting money into superannuation via contribution caps and overall limits such as the transfer balance cap and total superannuation balance limits ensure that the superannuation tax environment cannot be exploited by large amounts. Discussion in the media of the handful of superannuation accounts with balances over $100 million (Mather 2019) ignores the reality that due to the imposition of the transfer balance cap, only a maximum of $1.6 million can remain in the pension phase of superannuation. It also disregards the reality that current high balances are an aberration which will wash out of the system as the limit to contributions via the total superannuation balance limit increasingly has an effect.

> *20. How can the overall level of public confidence be assessed? What evidence is available to demonstrate the level of confidence in the system?*

We agree that public confidence in the system needs to be considered as part of this review. We would consider that the criterion of public confidence must consider what messages financial advisers are sending to their clients – typically, financial advisers recommend that any funds to be used in retirement should be contributed to superannuation (see Ellerfield 2020).

CPA members have raised the issue with us that the public confidence in superannuation specifically has been severely rocked by matters identified in the recent Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (Hayne 2018), as well as the findings of the Productivity Commission (2018). The Government must act urgently to restore this confidence.

One issue that we are concerned about is the issue of disclosure and reporting. Protracted issues around how superannuation fund trustees report what most would expect is the simple matter of fee and cost disclosure has resulted in ASIC's work on a new version of Regulatory Guide 97 (RG 97, ASIC 2019), which has taken a considerable period to develop and resulted in guidance which is unable to apply to all superannuation products.

From the reporting perspective, the move towards considering superannuation as an income stream rather than a lump sum still suffers from the disadvantage of superannuation funds building annual statements around account balances as a central figure. We are not aware of any work underway to change expectations of superannuation fund members in relation to how their retirement benefit will look. We are also unaware of how retirees would react if they were informed that the superannuation which had appeared in statements during their working lives as an account balance was restated as an income amount.

We point out as a comparison that changes in the short term to insurance arrangements which exist in funds, most notably with relation to total and permanent disability or income protection, anecdotally results in members of funds finding out at a time when they made a claim that what they thought they were paying for, is not what they got.

Any suggestion of changes to expectations could take a generation to be properly implemented, in order to avoid the risk of breaking the social compact. We consider that any meaningful measure of public confidence in the system must establish what it is that participants expect to get once they retire, and whether current retirees are getting what they expected.

Cohesion

> *21. What should the Panel consider in assessing whether the retirement income system is cohesive?*

We agree that the parts of the retirement income system should work together to support the outcomes that the system intends to achieve for individuals. We have already commented at length about how the retirement income system is not a closed system.

One of the issues that we have raised is that there needs to be an appropriate system of rewards and hurdles, and that the current system generally tends to penalise certain cohorts with hurdles which may not be targeted appropriately. The tax rate on contributions being such an example.

The Panel should consider assessment of arbitrage between tax treatments. We have noted in this submission that efforts to drive behaviour in the retirement income system will have impacts elsewhere. Holding money outside of superannuation could be one outcome of any efforts to restrict access to capital in the superannuation system at the pension phase. An increase in inter vivos gifting would be a likely outcome of efforts to restrict bequests. Inter vivos gifting itself may start to occur prior to retirement, if the deprivation of assets provisions in means testing were to be tightened.

The Panel should also consider whether things like the different retirement ages provided earlier in this submission reflect current attitudes.

The Panel should ensure that fairness is considered in an assessment of cohesiveness. Whilst we are aware that Government assistance, for example, towards the costs of medicine for senior Australians is out of the scope of this review, such assistance should not be used as a reason to direct attention toward other expenses in retirement and avoid discussion of this topic.

Throughout this submission we have also examined the need for robust consumer protection. Should retirees have basic consumer rights such as being able to transfer to another income stream provider whether they are 65 or 100? Can consumers be sure about what it is that they're getting, whether this be at retirement, or insurance claims time? Is there a point where consumers can be satisfied there will be no changes to laws, regulations or terms and conditions?

We consider that this is an opportune time for this review. CPA Australia members have suggested that there is a looming problem, with large numbers of baby boomers entering retirement. In addition, it is unlikely that an excellent run of double-digit investment returns will continue, meaning that where Australians have been comfortable with the notion of support from the Superannuation Guarantee, they may need to consider additional investments in their own retirements. Such factors mean that today, more than ever, Australians need professional financial advice.

However, with large numbers of financial advisers leaving the industry (Hastie 2019), this provides the conditions for a perfect storm where Australians cannot get the professional advice which they need. This may act to reduce the cohesiveness of the system.

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

We have provided comments at length throughout this submission noting that lower income earners are in fact penalised by making savings through the retirement income system, noting that they are also a cohort which is not necessarily in a position to save, regardless of the incentives which may be in place.

A focus of policy makers in recent times has been on the manner in which fees affect account balances. This has been a laudable direction of policy, and resulted in the measures introduced as part of the *Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019* which saw for the first time a ban on exit fees, limits on administration and investment fees charged to accounts with low balances, and a removal of the opt-out rules on insurance in superannuation for members with low balances. Another measure introduced by the Act was engaging the ATO to consolidate inactive low balance accounts.

The intention of these measures is to ensure that the balance of Australian's accounts was not impacted inappropriately by fees and insurance premia. From the Explanatory Memorandum to the Bill, paragraph 1.5 states that:

> *Given the importance of superannuation to Australians, the Government is seeking to ensure that people's hard-earned savings are not unnecessarily eroded by fees or inappropriate insurance arrangements.*

The changes to insurance in superannuation has had a number of effects on members. For members under 25 and who have low balances or inactive accounts, this has meant the loss of insured benefits. Much of the media commentary in relation to this measure focused on death cover, noting quite rightly the likelihood that high levels of death cover are not necessarily needed by young Australians. However, what was absent from the debate was the role of another insurance type – Total and Permanent Disability, or TPD, cover.

It is relevant to point out that it is highly unusual for TPD cover to be unbundled from death cover.

We return to our recurring theme about how the consultation paper has not defined retirement. For Australians who are totally and permanently disabled, the reality is that retirement has begun. They have had two doctors, one of whom is a specialist, sign off that they satisfy the terms of the insurance cover and are unable to work again. Whilst we expect that the Panel is likely to see insurance as a cost which prevents retirees from enjoying a higher quality of life, we underline the fact that an Australian making a TPD claim is funding their retirement from the premium which they paid for that policy, in addition to any support from the disability pension and/or National Disability Insurance Scheme (NDIS). Younger members of superannuation funds who are totally and permanently disabled would thus mathematically have a longer period of retirement for which larger amounts of insurance have been justifiable.

Additionally, it should be noted that this is, thanks to the concept of risk pooling which enables insurance, paid for by other Australians as well.

We mention this measure as an example of focussing on a very narrow definition of 'saving' and 'retirement', which has led to increases in insurance premia across the board to everyone else, and a loss of insurance cover for younger members with inactive low balance accounts. Herbon (2019) cites one superannuation fund informing members that their premium will be rising 48.4 per cent for income protection insurance, while Patterson & Fernando (2019), writing for Willis Towers Watson, describe increases for death cover of 5 to 10 per cent, 10 to 20 per cent for TPD cover and even larger increases again for income protection cover.

This policy measure, aimed at ensuring that small balances were not inadvertently eroded by fees, has left a cohort of Australians who need cover without it, while at the same time, increasing insurance premiums for other Australians by substantial amounts. The net result is to provide further disincentives to either saving or insurance, which will in the long term further increase premia as Australians withdraw from further insurance arrangements.

Naturally, it is low income earners who are disproportionately affected by changes such as this.

Finally, we note in this submission that the consultation paper (page 6) classifies certain policy areas to fall out of the scope of this review, such as aged care, health and taxation. We expect that the Panel may consider disability and disability services to form a subset of health.

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

We have discussed at length issues related to the interactions between the pillars throughout this submission. We do not add to what has been discussed.

24. 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?

We are concerned that in light of the evidence of why Australians are drawing down their retirement savings, that aged care and health (including disability services) are seen by the Review as separate systems, and therefore out of the scope of this Review. The sole purpose test, prescribed for all complying superannuation funds, describes benefits needing to benefit superannuation fund members in retirement, and we consider that aged care, in particular, would be such a benefit. The view of superannuation as solely underpinning a very literally interpreted retirement income system, risks failing to cater for Australians who have been recommended by their financial advisers to only hold savings for retirement in superannuation. If financial advisers are not aware that aged care is a separate system which interacts with the retirement income system, and is not a subset, what hope do their clients have?

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

Financial advisers provide quality advice in which consumers can have confidence, and which positively impacts a consumer's financial wellbeing.

Improving levels of consumer financial literacy will enable consumers to make more informed decisions about their finances. A great deal more needs to be done to enable Australians to be able to make decisions regarding their retirement in a way that doesn't involve financial advice. ANZ (2015:6) noted that:

> *When it comes to identifying the best indicator of fund performance the number of people who responded 'can't say' rose to 22 percent from 19 percent in 2011 and 8 percent in 2005 when the question was first asked.*
>
> *One in five people with superannuation could not name any factors they would consider in choosing a superannuation fund.*
>
> *These last two points suggest around one in five people are poorly equipped to make a decision about changing or choosing a superannuation fund.*

Even now, retirement incomes are organised in a way which is complex. The fact that one needs to transfer their superannuation to a new product in order to commence an income stream is fraught with uncertainty and paperwork. The most basic retirement income product, the account-based pension, still requires a formal rollover and application process before it can commence, where retirees would most likely prefer a simple switch to turn it on from their existing account.

The Age Pension means testing process is no simpler. Deeming, lifetime incomes and exemptions conspire to make it almost impossible for retirees to know how their affairs should be set up when they decide that they wish to retire.

We are not aware of any evidence that matters are improving. Sunsuper's (2019) survey found on four measures that people who received financial advice overwhelmingly believed:

- Advice had helped them feel prepared for retirement (77 per cent)
- They had a better understanding of what to expect in retirement (72 per cent)
- Advice had given them more peace of mind (80 per cent), and
- The advice they received was worth more than it cost (75 per cent)

Sunsuper's analysis included actual quantitative benefits that clients receiving financial advice had obtained. These were materially high benefits.

However, we noted above that financial advisers are leaving the market (Hastie 2019), resulting in an advice gap. In our most recent pre-budget submission, we wrote that:

> *Regulatory complexity is placing a significant burden on accountants in public practice, which has flow-on effects for the community. The complex, multi-layered nature of Australia's current regulatory environment, especially the regulation of financial planning advice, is alienating many consumers and small business – the very people it is seeking to serve – while also placing substantial strain on accountants in practice who operate under these regimes.*
>
> *For example, in relation to financial advice, advisers must comply with the Corporations Act, the Tax Agent Services Act, the National Consumer Credit Protection Act, plus there are obligations imposed under the ASIC Act and the Financial Adviser Standards and Ethics Authority (FASEA), amongst others. Often there is no harmonisation between these regulatory frameworks, or even within a single regulatory framework. Depending on how the licensing and registration system is set up, an accountant in practice may need to hold multiple licences and/or registrations to be able to provide one piece of advice.*

At a time when the number of retired Australians is about to increase, this will impose immense structural limitations on advice resources, meaning that Australians who need professional financial advice most may miss out.

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

The ideal system would have the Age Pension commencing for a retiree either at retirement or Age Pension age automatically with the need for very little paperwork. However, it currently requires an application and approval process. We do not agree that the current system displays sufficient integration.

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