FINANCIAL PLANNING ASSOCIATION *of* AUSTRALIA

3 January 2020

Mr Michael Callaghan AM PSM
Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Email: retirementincomereview@treasury.gov.au

Dear Mr Callaghan

Review of Retirement Income System

The Financial Planning Association of Australia[1] (FPA) welcomes the opportunity to contribute to the Review of the Retirement Income System.

It is understood that the purpose of the Review is to gather information and evidence to improve the understanding of the RIS. It is not the Review's role to make policy recommendations to Government. As such, the FPA has not included recommendations in this submission.

We would welcome the opportunity to discuss with the Review any matters raised in our submission. If you have any questions, please contact me on 02 9220 4500.

Yours sincerely

Ben Marshan CFP® LRS®
Head of Policy and Professional Standards
Financial Planning Association of Australia

[1] The Financial Planning Association (FPA) has more than 14,000 members and affiliates of whom 11,000 are practising financial planners and 5,720 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of FOFA.
- We have an independent Conduct Review Commission, chaired by Dale Boucher, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 26 member countries and the more than 175,570 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 18 Australian Universities for degrees in financial planning. Since 1st July 2013 all new members of the FPA have been required to hold, or be working towards, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally.
- We are recognised as a professional body by the Tax Practitioners Board.

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Review of the Retirement Income System

3 January 2020

Submitted to:

The Review Panel

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Introduction

The Financial Planning Association of Australia welcomes the Review of the Retirement Income System Review (the Review) and the integration of the three pillars of retirement – the age pension, the superannuation guarantee system, and voluntary savings – as a crucial support for older Australians now and in the future. Australia's three pillared retirement income system is a good and robust system, which the FPA will continue to support.

It is understood that the purpose of the Review is to gather information and evidence to improve the understanding of the RIS. It is not the Review's role to make policy recommendations to Government. As such, the FPA has not included recommendations in this submission.

The information contained in this submission is based on anecdotal evidence, case studies and member surveys derived from the experience and insights of FPA's practitioner members, from years of helping clients prepare for their retirement and understand the Retirement Income System.

The FPA has not addressed all matters raised in the Consultation Paper, rather this submission focuses on the key areas where financial planners' unique insights can add value to the work of the Review.

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The Retirement Income System and the interaction of the three pillars

The FPA understands the role of the Retirement Income Review (the Review) is to gather evidence so an assessment can be undertaken as to whether the Retirement Income System is delivering retirement outcomes for Australians – to determine if the system, and each of its three pillars, is working the way it should. To undertake such an assessment it is important to ensure the objective of the RIS and the role of the three pillars are accurate and appropriate for the current and future environment; are in line with community, business and government expectations; and adhere to the principles of equity, adequacy, sustainability and cohesion. The FPA supports these principles, as suggested by the Review.

The FPA provides feedback from FPA members about the purpose of the RIS, Age Pension, Compulsory Superannuation and Voluntary Savings pillars, and the interaction of the pillars.

Objective of the Retirement Income System

The three pillars of Australia's retirement income system have evolved in isolation of each other over the past century. There have been many amendments made in an effort to improve system integration and to provide a more targeted delivery to those in need. However, it was not an inherently designed system and it is unclear whether a clear and set objective for the RIS, as a system, has ever been agreed upon.

The Consultation Paper states that: "*Australia's Retirement Income System aims to allow older Australians to achieve adequate income in retirement, in a way that is sustainable for current and future generations".*[2] However, the Review has also suggested that the RIS should be assessed based on the principals of adequacy, equity, sustainability and cohesion. The FPA suggests the intent of the principals of equity or fairness, and cohesion should also be captured in the objective of the RIS. For example:

> *To ensure a level of adequacy is available for all Australian retirees in a manner that is fair, flexible, accessible, and sustainable and encourages a self-funded retirement.*

It is important for a clear objective of the RIS to be set in order to identify a clear role of each of its three pillars and how each pillar contributes to the RIS.

In response to the question - My clients understand the role of the RIS - financial planners gave the following response:

- 49% agreed or strongly agreed that clients understand the role of the RIS
- However, 44% disagreed or strongly disagreed that clients understand the role of the RIS

This demonstrates that many Australians have a lack of understanding about the overarching system and its purpose. This is reinforced by the feedback that 55% of respondents stated that clients do not understand the interaction of the three pillars of the RIS. The FPA suggest that this lack of understanding of the RIS as a system may be a symptom of the isolated evolution of the three pillars that make up the RIS. However, it may also be due to consumer behaviour across different generations – that only those nearing or in retirement think about their retirement savings and the support available to them through the RIS.

[2] Page 8

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Role of the Age Pension

It is vital to the sustainability, equity and adequacy of the RIS to have a clear and widely understood statement of the role of the Age Pension. As explained by Michael Rice, the Age Pension is a material benefit for most Australians.

> *"The value received depends on the extent of the means-testing (and the discount rate applied to future payments). However, for a single person retiring at age 65 and entitled to a full Age Pension for life, the present value of the pension payments exceeds $500,000. The present value of the maximum age pension for a couple who retires at 65 today exceeds $800,000. The value of these benefits is much greater than the median retirement benefit paid from superannuation, which is less than $200,000 due to the relative immaturity of the SG system. It is likely that a lay person would believe their superannuation would be more important than any pension benefit. However, this simple calculation shows the continued high relative importance of the Age Pension."*[3]

When considering the role of the Age Pension it is relevant to examine its history. The establishment of the Age Pension provides an insight into how consumers view the role of the Aged Pension. As summarised in the Parliamentary Library, NSW introduced invalid pensions and Queensland had established age pensions, both in 1908. The Commonwealth Old-Age and Invalid Pensions became available in 1909 and 1910.[4]

> *"The NSW scheme provided statutory entitlements rather than offering payments at the discretion of a government official or charitable body, as had most earlier welfare measures. …. The Australian pensions were modelled in part on the New Zealand scheme and were similar to the NSW scheme. The pensions were non-contributory, non-discretionary and means tested. They were available from the age of 65 years for men and 60 years for women."* [5]

Proponents of introducing a pension argued that a person had a right to live out their old age free from poverty because of their contribution to the community through a lifetime's hard work.[6]

This statement hints at the tension inherent in the Age Pension – between the Age Pension as a safety net from poverty, and an entitlement given to Australians because of the contribution to the community (and through taxes) of an individual's lifetime of hard work.

As explained by the Tax Review, "*the balance between the role of the Age Pension as a safety net and its role as a supplement to retirement savings is a threshold issue for the design of the Age Pension and its integration with the Retirement Income System*".[7]

As indicated in responses to FPA's member survey, the understanding of role of the Age Pension has shifted over time. The majority of respondents (80%) suggest the role of the Age Pension is to help those most in need. Feedback included the following statements (for example):

> *"Provide a basic level of income needs for retirees to keep all above the poverty line."*

> *"The age pension has become more of a safety net since asset thresholds were lowered and this is a good thing. Many more people don't qualify due to excess assets and they are comfortable with this when told it will be there for them if their assets are eroded over time funding their lifestyle. There's some comfort in that and*

[3] The Age Pension in the 21st Century, Michael Rice, 2018, Page 18 cited https://www.actuaries.asn.au/Library/Events/Insights/2018/MichaelRicePaper.pdf
[4] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/1011/SSPayments1#_Toc286050315
[5] https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/1011/SSPayments1#_Toc286050315
[6] National Museum Australia, https://www.nma.gov.au/defining-moments/resources/age-and-invalid-pensions
[7] The Treasury, Australia's Future Tax System: Retirement Income Consultation Paper (2008), 12.

if the age pension is seen this way and not as a right or a repayment of taxes, then it becomes a lot more sustainable. It needs to be, as without it the vast majority would be in poverty post their working life."

"To provide basic means for those with no or limited savings (basically a dole for older people).It's not an entitlement."

"The age pension should provide for those who outlive their life expectancy a basic retirement income as it was intended to do when it was set up."

"To provide a minimum standard of living for all Australians."

"The Age Pension should be the safety net for all Australians (especially one that has worked and contributed to the system over their life). It should be a basic and easy system for everyone to apply and be eligible. Currently as it stand, its complicated, even for a financial specialist. I believe that if it's designed as a safety net, then it should be easily accessed and Australians shouldn t need to jump hoops just to get their head around how it works."

"Over time it should transition to being purely for those who haven't saved much for retirement rather than something which the majority of the population get. As it currently stands people seem to think it should be an entitlement rather than a form of welfare."

However, 20% of respondents suggested there is a dual role of the Age Pension – as a safety net and a payment that supplements income.

"Supplement other income sources in retirement and provide a safety net for lower asset/income people."

"I think that it should be a top-up from super savings so that people can live reasonably in retirement. I think that the current super rules discourage people from saving and that most people have a distrust of super."

"The Age Pension should supplement retirees living costs. I believe that the current system works and is helping people that didn't have the benefit of SG contributions their entire working lives. The Age Pension will phase out over time as super will be sufficient to support people into retirement."

"To supplement [a person's] own financial resources to provide longevity to retirement income needs."

One respondent suggested an evolutionary role of the Age Pension in the RIS in line with the maturation of the superannuation guarantee:

"I believe the current role is different from a future role. At the moment I see it as a top up to superannuation retirement [income] streams and providing a basic living standard to people deprived of superannuation and other financial resources. In the medium future its main role will be a top up, and in the longer term [will] shift more towards safety net only."

This highlights that the RIS and its pillars will continue to evolve and therefore there is a need to periodically review any objectives of the system and roles of the pillars.

It is clear by the feedback received that the effective integration of the Age Pension with the other pillars of the RIS is paramount:

"[The role of the Age Pension is] to work hand in hand with any other savings retirees may have, to give retirees dignity in retirement."

The FPA suggests the Age Pension should seek to deliver a minimum level of income to support those most in need throughout retirement. This may include as supplementary income for individuals who have not had access to the superannuation guarantee throughout their working life, and for addressing issues related to longevity risk, for example. (See section on longevity for detailed discussion.)

Role of compulsory superannuation

Compulsory superannuation was introduced in Australia in 1992. As stated in the Consultation Paper, at the time the Superannuation Guarantee (SG) was introduced the broad objectives were to provide an adequate level of retirement income, relieve pressure on the Age Pension, increase national savings, and improve the future Government budgets facing an ageing population.

In 2016, the Government proposed setting an overarching objective for the superannuation system - "*to provide income in retirement to substitute or supplement the Age Pension*"[8]. A Senate Inquiry into the Bill to legislate the objective found that there was no agreement on how the objective should be defined and the Bill lapsed with the 2016 Election. However, the Senate Report recommended the Bill be passed.[9]

The FPA suggest it is challenging to assess whether the compulsory superannuation pillar is performing as it should in the absence of a clear understanding of its role against which to measure it against. However, measuring whether compulsory superannuation has achieved and continues to achieve its intended function should not be limited to fees, net returns or better quality service by providers. Consumer outcomes also encompass member values, member satisfaction and, importantly, member well-being. (See section on adequacy for further discussion.)

From a consumer perspective superannuation is a compulsory vehicle that was designed to encourage them save for retirement – that is: it is the consumer's superannuation account and the consumer's money that will help them achieve a certain quality of life in the future. This desired quality of life will vary from person to person depending on their beliefs, values, interests, circumstances and aspirations. Hence, a consumer outcome is very subjective.

The FPA suggests the role of compulsory superannuation should reflect the consumers' view of what the SG is supposed to help them with - retirement adequacy - and encompasses the principles of the RIS.

The FPA asked its members what the role of compulsory superannuation in the Retirement Income System should be, and received the following responses:

> *"To build wealth post retirement so that you don't need to rely on the taxation system to support you. To incentivise compulsory saving."*
>
> *"The minimum amount to save for retirement. This should provide retirees with an income stream in addition to any Age Pension, but not provide a comfortable lifestyle. Ideally with an increase in the SG rate, people can become less dependent on Government entitlements. Compulsory super should also include mandated employer contributes like the UniSuper/ESS scheme, matched by the employer or Government."*
>
> *"Compulsory requirement for people to accumulate funds over their working life to provide income and funds in retirement."*
>
> *"To reduce the level of reliance on the Age Pension by providing an income stream during retirement."*

[8] A more sustainable superannuation system, Treasurer Scott Morrison, May 2016
[9] https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1617a/17bd069

"To replace the Aged Pension in retirement for life expectancy, adjusted for improvements in life expectancy."

"Compulsory Superannuation should be part of the overall process. It cannot be the ONLY savings mechanism for people to build for retirement."

"Compulsory superannuation should form the backbone of a person's retirement savings. It should be enough to put food on the table and live a basic life in retirement."

"It should be the foundation in which every Australian's retirement savings are built. The amount saved via compulsory super should be enough to provide a retirement lifestyle which is comparative to that of the individual member's pre-retirement lifestyle."

"To give a basic or ideally better than basic level of income for people to live on once they retire."

"To provide enough capital for a basic retirement cash flow."

"To contribute to a balance to provide a CPI linked income in retirement until death. There should also be a balance (actual or notional) that can be drawn upon for lump sum needs."

"It should be to provide sufficient capital at retirement for a comfortable retirement for a person who enters the workforce at about age 22 and works to age 65. There should be a compulsory contribution by the member as well as the employer in achieving this goal, just like happens in Government defined benefit schemes. If this is the way it works, it will be better understood by the members."

"It should be the foundation upon which retirement income is sourced to take pressure off the public purse - we will see a SIGNIFICANT improvement in the national budget as the baby boomers die off and full benefits of a self-funded retirement are bought to bear on the gen X, Y, Z and Millenials."

"Compulsory super should under pin a 'good' standard of living and no more. You want a luxury lifestyle - that's fine - be prepared to pay a little more tax so that those who don't have money can be adequately supported by our social system."

More than 70 per cent of respondents agreed or strongly agreed that their clients understood the role of compulsory superannuation.

Role of voluntary savings

As discussed in the Consultation Paper, voluntary savings can be accrued inside and outside of the superannuation system and serve a number of purposes, including wealth accumulation, and may not always be intended to provide for retirement.

There is a great deal of research on generational spending and savings habits, including the Gattan Institute's *Generation* Gap report, TranUnion's *Generation Revealed: Decoding Millennial Financial Health,* and the *Suncorp Best Saver Report*, for example. While published research offers a significant and often contradictory range of findings, the research indicates that the reason for saving varies greatly across generations. For example, while Millennials face new financial pressures due to the higher costs of housing and education, individuals in this generation "…are driving the idea of 'peak stuff', with over 75 per cent preferring to spend money on a desirable experience, education or a 'shared' good rather than a material possession. Doing something different and searching for unique, often personalised experiences."[10]

This highlights the significant ‘trade-off’ this pillar presents for different generations - younger generations where many focus on experiencing the here and now, not saving for the future; Generation X and Xenials consider paying down debt, education and child rearing.

While voluntary savings should be encouraged, there is a trade-off for individuals in the decisions they make regarding their short, medium and longer term saving goals. These decisions impact the role of the voluntary savings pillar in the RIS.

FPA members have provided the following comments in relation to the role of voluntary savings in the RIS:

> *“Savings via super (salary sacrifice) and outside super should be strongly encouraged at the appropriate time for all clients. The role should be to encourage clients to save more to achieve their desire to have a comfortable lifestyle and not worry about money. There is not enough emphasis put on the reason to save in-conjunction with the SG, that is, live the life people want.”*
>
> *“To provide an incentive for Australian's to save for a more comfortable retirement and/or to provide a greater degree of certainty that their savings will be sufficient should they outlive their life expectancy.”*
>
> *“Encouraging people to accumulate additional funds over their working life in a tax effective manner to provide income and funds in retirement.”*
>
> *“To reduce the level of reliance on the Age Pension by providing access to capital in during retirement.”*
>
> *“To provide the ability to fund the lifestyle that someone aspires to.”*
>
> *“Voluntary savings should provide the luxuries in life and the 'fun'.”*
>
> *“To provide for early retirement, or extra income in retirement.”*
>
> *“To provide extra for desired retirement cashflow.”*
>
> *“To contribute to a balance to provide an CPI linked income in retirement until death. There should also be a balance (actual or notional) that can be drawn upon for lump sum needs.”*
>
> *“Exactly as it is today - for those who wish to be reliant on their own resources, independent of the Government.”*
>
> *“Building to enable appropriate retirement income in conjunction or in place of Government benefits.”*
>
> *“To allow people to boost their own retirement pot to further enhance the benefits of the [superannuation system] and to allow people to look after their family wealth as well as provide income in retirement.”*
>
> *“Voluntary savings needs to be strongly encouraged, particularly for those who are over 50. These people (more often than not) are becoming more financially free - mortgage under control, children's education costs reduced or gone, second income for the family quite often. Why not increase the concessional contribution cap significantly to actually ENCOURAGE people to build super so as not to be reliant on the Age Pension.*

[10] Macquarie equity strategists, cited AFR June 2017 - https://www.afr.com/markets/how-millennials-will-shift-australias-spending-habits-macquarie-20170619-gwtskf

Why not ENCOURAGE people to get professional financial advice by making advice fees tax deductible - again, strategies to build wealth and rely less on government support in retirement."

Interaction of the three pillars of the Retirement Income System

As stated above, the three pillars of Australia's retirement income system have evolved in isolation of each other over the past century, with many amendments. This has resulted in the development of a system of complexity and has lead to increasing costs of system administration and compliance, reduced competition in service delivery, difficulty for providers to develop innovative products, and a significant reduction in consumer understanding and confidence in the RIS. Given these issues, it is a fair question for the Review to ask – *What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?*[11]

To improve understanding of the RIS it is imperative to consider what consumers believe the purpose of the RIS is, how consumers use the system, and consumer behaviours towards and understanding of financial matters. These can differ at various life stages and across different generational groups. (See section on Cohesion.)

55 per cent of respondents to FPA's member survey stated that clients do not understand the interaction of the three pillars of the RIS.

> *"A large part of my time is educating clients about how the three pillars work together and how it affects them. Most will apply for Age Pension themselves but a lot are not aware of their obligations."*
>
> *"They have some idea that assets and working (earning an income) will have an impact on the Age Pension, but they are not sure what it will actually do. Most believe that when super moves to pension phase, it gets moved into cash, and they just have to live on the drawdown without any growth or income."*

Effective interaction of the three pillars is critical for achieving unified objectives of each pillar. Similarly, consumer understanding of the integration of the three pillars is paramount to cohesion of the system. That is, if users of the RIS do not understand how the pillars work together and impact on each other, and therefore how to use the RIS, a cohesive system will not be achieved. As highlighted in the Consultation Paper, this in turn affects the equity, adequacy and sustainability of the RIS. (See the section on cohesion in this submission for further discussion on consumer understanding, literacy and behaviour.)

Further, effective interaction of the Age Pension and superannuation system cannot be achieved unless all Australians have access to the superannuation guarantee. Access for all Australians is necessary for a sustainable, fair system.

The provision of personal financial advice is a key 'enabler' as it brings together the three pillars of the RIS to help Australians understand the system and plan for and achieve desired retirement outcomes. There is clear evidence of the benefits of financial advice, particularly in relation to financial outcomes in retirement.

Financial advice provides the human interaction necessary to learn and understand the complex issues of financial matters. Financial education is the component of financial advice most valued by consumers[12]. Personal financial advice can help increase Australians financial capability and understanding of the RIS and longevity risk to develop realistic retirement goals and improve retirement savings. Therefore, access to affordable financial advice is a critical element of the Retirement Income System. (See section on Cohesion for further discussion.)

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[11] Retirement Income Review Consultation Paper, November 2019, page 26

[12] *FPA Value of Advice Research*, Rice Warner Actuaries, February 2008.

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Impact of longevity on Australia's Retirement Income System

In determining Government policy for a sustainable RIS that can adequately deliver for retirees now and in the long-term, issues of longevity, differences across generational groups, the expenditure and support needs in the various phases of retirement, and cultural barriers, must be considered.

The predicted impacts from an ageing Australian population create a significant longevity risk within our current RIS, with retirees increasingly at risk of outliving their capital. This impacts the future sustainability of the RIS and the lifestyles of retirees.

Life expectancy rates continue to increase and combined with the rising cost of living, retirement incomes need to sustain people for longer periods and require higher levels of savings. The fundamental difficulty with managing longevity risk is the range of variable factors that create an uncertain environment. For example, it cannot be predicted exactly how long someone will live, what returns their investments will generate or even what income is needed each year, especially when taking into consideration the funding of health and aged care needs as the person ages.

Understanding life expectancy rates

While we cannot predict exactly how long an individual will live, research shows Australians are living longer and staying healthier and Australian retirees are the most active in the world.[13]

The experience from FPA members shows that clients largely underestimate their potential life expectancy and are not adequately prepared when they reach retirement to make their savings last this distance.

The life expectancy tables are also largely misunderstood with many people assuming this is the cumulative age they can expect to live to, rather than understanding they have a 50 per cent chance of living beyond this age and in some cases, significantly beyond this age. For example, a 65 year old male in 1994 had a life expectancy of approximately 14.6 years (to age 80). A, 85 year old male in 2014-2016 had a life expectancy of 6.2 years (to age 91+)[14]. This non-lineal aspect of life expectancies makes it difficult for Australians to anticipate the length of retirement and manage the longevity risk.

It has been estimated (using life expectancy data) that:

- for a couple retiring in 2025 and consisting of a male aged 65 and a female aged 60, it is estimated that the male could expect to live on average for 20.0 years, the female could expect to live for 28.9 years and there is a 64per cent probability that one of them will still be alive at age 90;

- for a couple retiring in 2045 and consisting of a male aged 65 and a female aged 60, it is estimated that the male could expect to live on average for 21.2 years, the female could expect to live for 30.5 years and there is a 71per cent probability that one of them will still be alive at age 90.[15]

The RIS must take into account the future life expectancy rates and the impact they have on the level of savings and Australians' consequential need for Government assistance.

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[13] AXA Retirement Scope 2007, Executive Summary.
[14] Based on Australian Life Expectancy Tables 1985/87 for life expectancy of 65 year old male in 1994; and life expectancy tables 2014-2016 cited https://www.aihw.gov.au/reports/older-people/older-australia-at-a-glance/contents/health-functioning/life-expectancy
[15] Centre for pensions and superannuation, UNSW, *Superannuation Guarantee Adequacy and Retirement: Longevity and economic impacts*, 2007.

To understand the implications of longevity risk on the RIS, including how it may influence human behaviour, a lifetime view of retirement savings should be considered across different generational groups.

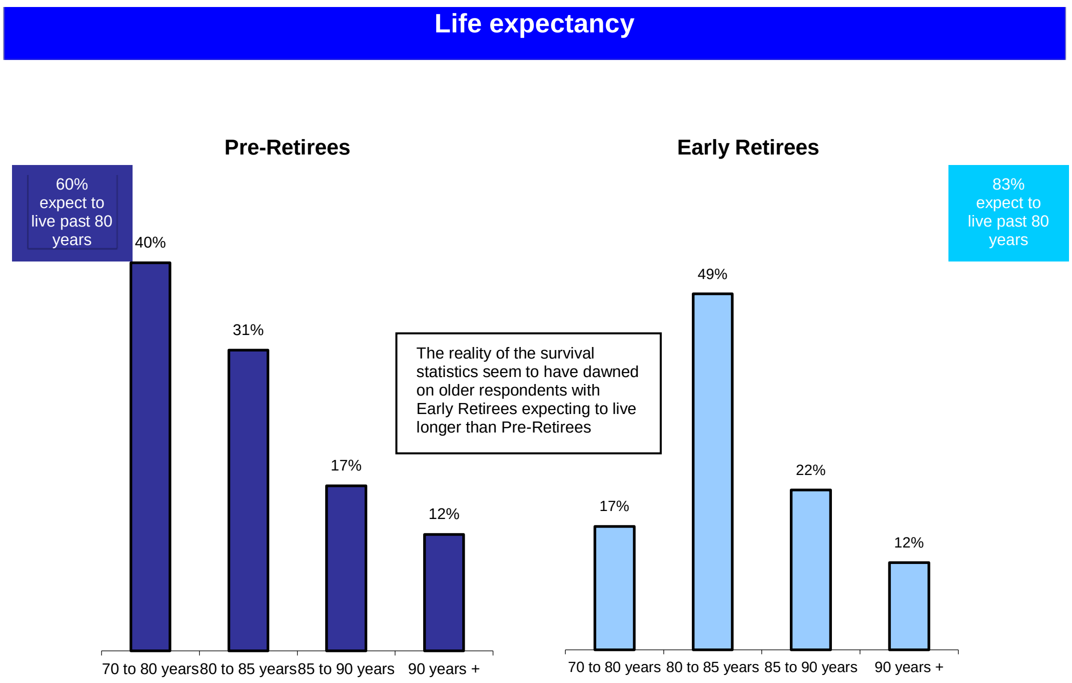
Consumer expectations for life expectancy

Longevity risk is compounded by both the low level of engagement in saving for the future of the younger workforce and the level of understanding of the older workforce about realistic retirement expectations. Financial planner feedback suggests consumers often have unrealistic expectations about the lifestyle, needs and expenditure throughout retirement, and instead focus on the 'honeymoon' phase after leaving the workforce. Consumers also largely underestimate life expectancy. The differences in life expectancy expectations also change as a person ages and the reality becomes more evident. The same trends emerge when consumers estimate their need for income in retirement.

Financial planner respondents to FPA's RIS survey showed that the retirement issue of most concern to their clients was longevity risk / running out of money (72%).

Research conducted by Asteron and Stellar Market Research in 2006 highlights that pre-retires underestimate longevity in retirement compared to what is understood by early retirees as their life expectancy rate. This indicates that consumers preparing to retire may not set in place plans that allow their money to last the difference or realise how much is an adequate level of savings. This highlights the need to create an effective and responsive adequacy benchmark that plans for dealing with longevity issues.

Graph 1: Life expectancy expectations – pre-retirees versus early retirees



Source: Asteron/Stellar market research on client expectations and longevity, 2006.

Note: For this research pre-retirees are defined as being within five years of planned retirement while early retirees are defined as being within the first five years of retirement.

Longevity risk is one of the major concerns that needs to be addressed and considered throughout the current review of the Retirement Income System. It is at the heart of adequacy as the level of accumulated savings needed at retirement is largely determined by the issue of longevity.

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Lifetime view of the Retirement Income System

The issues of longevity and adequacy need a solution that is sustainable over the long-term and meets the needs of all generations, current and future. The measure for an adequate level of retirement income will apply equally to all Australians but the needs of each generation to achieve this goal will differ - in part due to competing interests at various life stages and in part due to the maturity of the superannuation guarantee system. A lifetime view of the RIS must be used in order to improve the understanding of the system.

The FPA considers that the RIS needs a lifetime view as saving for retirement (either via compulsion with the SG or through voluntary savings) starts at a young age and continues throughout the working life and into retirement. Flexibility needs to be in-built to allow for the needs at various life stages.

To improve understanding of the RIS it is imperative to consider how consumers use the system and consumer behaviours towards and understanding of financial matters. These can differ at various life stages and across different generational groups.

The first step in creating a lifetime view of the RIS is to identify the generational groups and understand the specific issues for each group. This will expose the different attitudes of each generation in achieving an adequate retirement income.

A generational perspective

In the 2007 Intergenerational Report, Treasury reported that the superannuation guarantee system will reach maturity in 2037. By this time the make-up of Australia's population will look considerably different to today, with the proportion of people aged 65 or over reaching 25 per cent and the number of working age people to support those aged 65 and over decreasing from 5 per cent to only 2.4 per cent. In addition, around 75 per cent of retirees will still be in receipt of some amount of the Age Pension.[16]

The 2015 Intergenerational Report stated that since 2011 – when the first of the baby boomer generation turned 65 – the share of the population of retirement age has increased significantly and the share of the population of prime working age has begun to fall. This Report considers the clear fiscal impacts of the changing Australian population on the sustainability of the RIS.

However, delivering an integrated lifetime view of the RIS requires consideration and accommodation of the various life stages and needs that individuals may encounter. Given that parts of the RIS are still relatively immature, this also requires consideration of the needs of different generations currently engaged with the system. By no means can 'one size fit all' in this respect.

Individual's attitudes, beliefs, behaviours and needs are influenced by the experiences they have throughout their lifetime. Based on data from the World Bank, the average life expectancy in Australia is 82.5. Given changes that can occur over such a long period of time, it is understandable that the attitudes, beliefs, behaviours and needs of generational groups differ in all aspects of life, including in relation to the RIS.

[16] Treasury projections, Intergenerational Report 2007.

Table 1: Generation breakdowns

Generation Name	Births Start	Births End	Youngest Age Today*	Oldest Age Today*
The Silent Generation	1925	1945	74	94
Baby Boomer Generation	1946	1964	55	73
Generation X (Baby Bust)	1965	1979	40	54
Xennials	1975	1985	34	44
Millennials Generation Y, Gen Next	1980	1994	25	39
iGen / Gen Z	1995	2012	7	24

Note: Dates are approximate and there is some overlap because there are no standard definitions for when a generation begins and ends.[17]

Current retirees (The Silent Generation)

Anecdotal research from FPA members indicates that the major concern for current retirees is to manage their current savings to provide a flexible, yet steady and tax-effective drawdown of income to meet their current lifestyle needs. Where accumulated capital is insufficient they generally have an expectation that the Age Pension will supplement their private savings and provide adequate support if they outlive savings.

This generation is becoming increasingly concerned that they will outlive their capital and this is emerging as the major concern.

It is important to understand the structure of retirement and the life stage transitions that can occur during retirement. FPA members indicate that, broadly speaking, retirement can be segregated into three phases, each of which has different needs and expenditure requirements:

1. Active phase – retirees are likely to be more active early in retirement and are inclined to continue with their existing lifestyle, including more leisure and travel time, during this active phase.

2. Passive phase – this phase starts to see increased expenditure on health costs, less travel and a change to less active leisure interests.

3. Frail or high dependency phase – later in retirement a retiree’s restricted mobility means expenditure on leisure is increasingly replaced by higher expenditure on health and aged care.

For the generation of ‘current retirees’, increasing health and aged care costs may change the view of retirement income patterns to accept the need for a steady or even increasing income (rather than a decreasing one). Taking a lifetime view of the retirement income system should accommodate the special needs of these different phases.

Baby Boomer Generation

With the end of World War II in 1945 Australia's servicemen and women returned and family life resumed after an interruption of almost six years of wartime conflict. Nine months later saw the start of a population revolution as childbirth rates soared - more than four million Australians were born between 1946-1961. Combined with an increase in European migration to Australia, people born during this period became known as baby boomers[18].

[17] https://www.careerplanner.com/Career-Articles/Generations.cfm
[18] http://www.cultureandrecreation.gov.au/articles/babyboomers/

As baby boomers are generally either approaching retirement or have entered retirement, some of the needs of this group are similar to the needs of current retirees. However, they are likely to still be focusing on maximising their accumulated private savings in preparation for retirement, as they have only partly benefited from the superannuation system during their working lives. This means baby boomers require flexible and generous incentives to build their superannuation savings in a relatively short period of time.

The baby boomers are also likely to be transitioning out of the workplace, perhaps over a substantial period of time.

Longevity risk is particularly prevalent for current retirees and baby boomers.

Generation X and Xennials

The immediate needs of Generation X (1965 – 1979) and Xennials (1975 – 1985) are less aligned to those above. Based on FPA member feedback, Generation X and Xennials are much less likely to view the age pension as an entitlement. Given their age, they are also more likely to benefit from a sustained period of employer supported superannuation contributions through the superannuation guarantee.

Their ability to currently make voluntary contributions, however, is more likely to be constrained by low levels of cash flow. This is usually as a result of considerable education, housing and childcare expenses in the child rearing lifestage. It is critical for these groups to be encouraged to be self-sufficient in retirement.

Millennials, Generation Y, iGen

Based on the above generational definitions, Millennials, Generation Y and iGen include individuals born after 1980.

There is a great deal of research that demonstrates how behavioural finance differs across age groups and demographics. For example, "*The Generation Game: Savings for the New Millennial*", conducted by BNY Mellon and undergraduates at Oxford University, looks at the savings priorities, attitudes to retirement planning and expectations around different types of financial institutions of Millennials across seven key markets including Australia.

The research showed that millennials were susceptible to spending today over saving for tomorrow, finding that saving for retirement is a low priority for this generation. Based on this research, the top four saving priorities were housing, travel, education and a car. However, there are wide and varied research findings in relation to Millennials.

The level of engagement of younger workers in saving, generally and for retirement, is low and this risks people approaching retirement ill-prepared. However, these generational groups will benefit from maturation of the superannuation guarantee system.

Broken work patterns / other circumstances

Irrespective of which generation or life stage an individual may belong to there will always be circumstances which do not fit within the norms. For example, individuals on unpaid parental leave, carers, those who are working but currently excluded from the superannuation system, and those on income protection or workers' compensation insurance benefits and unable to work. The retirement income system should be flexible and strong enough to cater appropriately for these scenarios at whichever life stage this occurs. Life events such as illness, injury, job loss, becoming a carer or parent, for example, can also impact on the adequacy of the RIS for individuals

Small business owners and farmers also face unique circumstances that warrant consideration.

Adequacy

The concept of adequacy of retirement incomes presents complications, as the way the concept is used by Government in setting policy direction and legislation is likely to differ from the way it will be perceived and used by consumers planning their retirement goals. The FPA supports the concept for the development of an "adequate retirement income" but notes that one system is unlikely to suit all Australians and Government should be mindful about the way the concept is used to educate consumers.

The FPA suggests that the issues of longevity and a lifetime view of the retirement system are essential when assessing adequacy. There is also a need for flexibility in a retirement income measure to match the different spending needs and patterns in the different phases of retirement. Measures must recognise that the needs of a retiree are different to the needs of a pre-retiree. Before retirement the focus is on the level of income generated, while in retirement focus shifts to the level of expenditure needed.

Factors that affect the adequacy of the system to fund Australians' retirement include:

- participation in the workforce, including continuing participation beyond "retirement";
- investment returns throughout the funding period and retirement;
- expenses during the funding period;
- level of debt at retirement;
- duration of retirement;
- the cost of living in retirement; and
- access to social security concessions and benefits.

Consumer expectations and adequacy

The experience from FPA members is that clients plan to achieve a dollar level of income in retirement and do not think in concepts of a percentage of pre-retirement income. Clients think in dollar terms and match this to expenditure requirements.

In a utopian sense 'adequacy' can be measured against the capacity of an amount of capital to provide a standard of living commensurate with a retiree's expectations or goals. However, people preparing to retire are somewhat surprised that, what is a comparatively large lump sum of money, results in a decline in their income when compared to their pre-retirement salary/wages.

With this in mind, planning retirement income targets generally use two broad methodologies:

- Project the estimated level of savings at retirement using current balances and savings patterns and determine the level of income that can be sustained from this savings level over an estimated period of time. This sets a benchmark to either adjust the level of savings to achieve a higher savings target or to reduce expectations for expenditure in retirement; or

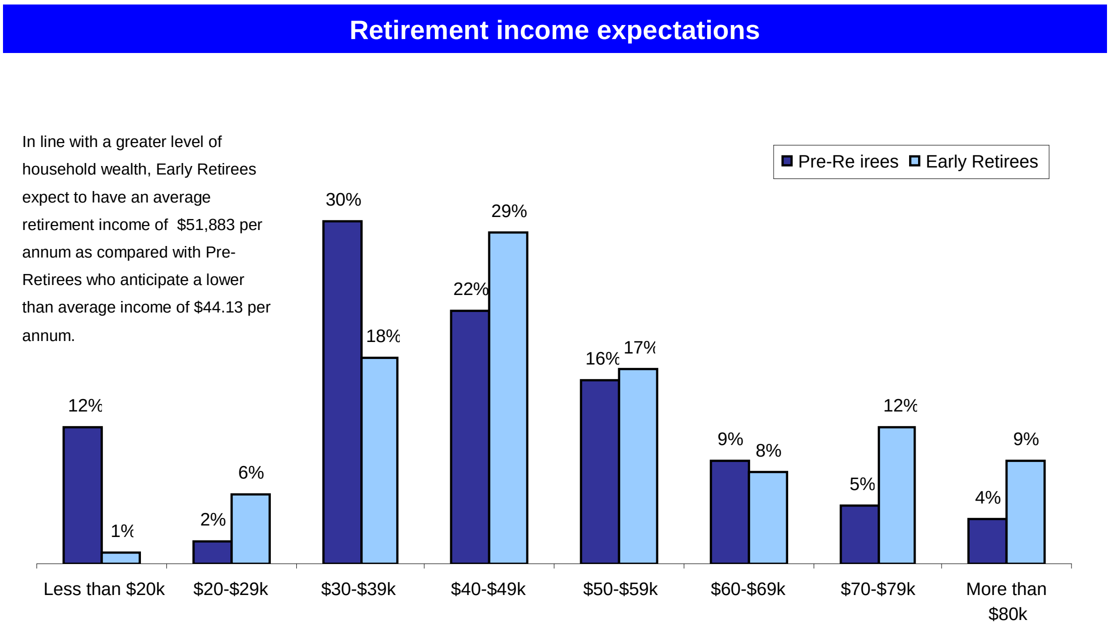
- Project retirement expenditure patterns (using benchmarks such as the Australian Superannuation Fund Association (ASFA) Retirement Standard[19] or the consumer's own detailed budget) to set a savings target to achieve this income.

For most people, these calculations also factor in eligibility for the Age Pension to supplement savings.

Longevity is a major risk in this planning process and can be exacerbated if consumers have unrealistic expectations of expenditure needs or life expectancies.

The reality of consumer experience is that pre-retirees tend to underestimate the cost of retirement. Benchmarks like the ASFA figures tend to play an important role in the education of consumers as they can assist to provide a an insight into potential retirement expenditure to achieve certain lifestyles. Research highlights that income expectations of pre-retirees tend to be underestimated compared to the expectations of those who have retired and face the reality of expenditure needs on a daily basis[20].

Graph 2: Retirement income expectations – pre-retirees versus early retirees



Source: Asteron/Stellar market research on client expectations and longevity, 2006.

Note: For this research pre-retirees are defined as being within five years of planned retirement while early retirees are defined as being within the first five years of retirement.

An interesting point from this research is the strong need for advice and education to embed more realistic income and lifestyle expectations. Individual plans for adequate levels of savings are set in pre-retirement years as clients decide on how much current expenditure to forgo to create retirement income but if they underestimate their retirement needs, the longevity risk is exacerbated. Financial planners have found that often consumers also misunderstand the changing needs they will face as they progress through retirement and the impact this can have on expenditure, particularly with regards to health, aged care, transport and support services.

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[19] https://www.superannuation.asn.au/resources/retirement-standard The ASFA Retirement Standard presents expenditure of 65-85 year old; and over 85 years. This includes expenditure on health services. However, the Standard does not include aged care services which could be incurred in either age bracket depending on the needs of the individual.

[20] Asteron/Stellar market research on client expectations and longevity, 2006

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Assessing adequacy

Adequacy benchmarks should focus on the concepts of retirement expenditure, with consideration to increasing health costs, aged care needs, access to transport and support services, and longevity. Assumptions for the benchmark must include flexibility for the diverse financial positions of retirees (for example, entering retirement with debt and varying lifestyles) and the different expenditure requirements in the three phases of retirement. A one-size-fits-all approach risks delivering insufficient outcomes for Australians.

The Review's Consultation Paper considers various measures of retirement income adequacy, namely relative measures and absolute measures. A significant part of the debate surrounding longevity arises from the differing approaches to adequacy benchmarks as well as the level of income required.

There is a significant body of research devoted to the worldwide use of replacement rates. Replacement rates are defined as ratios of a person's income or spending power after retirement, to that before retirement. The proposition underlying the replacement rate concept is that a person's standard of living in retirement should be a reasonable proportion of his or her standard of living during working life.[21]

The replacement rate is a relative measure based on previous earnings. The use of this type of measure carries significant risks, particularly for low income earners whose pre-retirement income may have been very low relative to average earnings or in some cases not far above the poverty line. This measure also does not take into account actual retirement costs or an increase in health and aged care costs as a person ages.

In contrast, the budget standard is an absolute measure and lacks the flexibility to cater for the different needs of generational groups and the changing expenditure patterns in the active, passive and high dependency phases of retirement. It also does not sufficiently address different lifestyle expectations.

Retirees generally fall into the following broad categories:

- Those who want to live on a defined income (for example, the income generated from their superannuation/investment capital) to allow a transfer of wealth to subsequent generations;

- Those who have no desire to leave capital to their children. This group is – generally speaking - happy to utilise capital for lifestyle;

- Those entering retirement with a mortgage or sizeable debt and need to use superannuation to repay debt, and those with low superannuation balances, and therefore require access to the Age Pension; and

- Those with minimal savings, including superannuation, and need to rely on the Age Pension from the commencement of retirement. The FPA notes this group will become smaller as the superannuation guarantee system reaches maturity.

The Consultation Paper notes the shortcomings of both measures. The FPA agree it may be insufficient to use either the replacement rate or the budget standard as a stand-alone measure for retirement adequacy. Potentially a combination of an absolute and a relative measure could be more appropriate. Integrating these measures would allow the budget standard to set a minimum level of adequacy for all Australians which is then overlaid with a replacement rate methodology (up to a potential cap) to assist Australians on medium and higher incomes to maintain a comfortable level of retirement.

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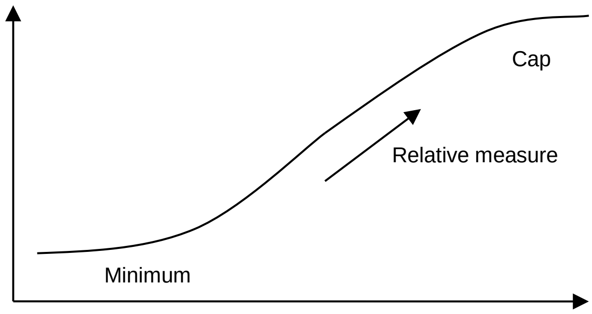
[21] George Rothman, *The Adequacy of Australian Retirement Incomes*, 2007



The FPA also suggests more information and research on expenditure patterns in retirement, based on consumer experience at different phases of retirement and by different generational groups, is required to identify an effective adequacy benchmark.

Assessing adequacy using well-being metrics

As stated in the Consultation Paper, the purpose of the RIS is to allow older Australians to achieve an adequate income in retirement. Considering consumers' needs and well-being in relation to the RIS could offer additional insights in relation to adequacy.

The concept of measuring well-being is not new. It has informed policy development in Australian and globally for well over a decade.

The Australian Bureau of Statistics believes well-being can be measured using people's subjective evaluation of themselves, based on their feelings, or by collating any number of observable attributes that reflect on their well-being; and that well-being might best be assessed subjectively, as it is strongly associated with notions of happiness and life satisfaction.[22]

"*While such measures can be difficult to interpret, subjective measures, as with other statistics, can be aggregated and monitored over time, and, in theory, provide a picture of the nation's view*"[23] which would be an invaluable aspect of measuring the adequacy of Australia's RIS.

The Organisation for Economic Co-operation and Development (OECD) believes that for well-being measures to start making a real difference to people's lives, they have to be explicitly brought into the policy-making process:

> *"Subjective well-being data can provide an important complement to other indicators already used for monitoring and benchmarking performance, for guiding people's choices, and for designing and delivering policies."*[24]

The OECD suggests that being able to measure people's quality of life is fundamental when assessing the progress of societies, and has produced Guidelines which outline why measures of subjective well-being are relevant for monitoring and policy making. [25]

From a consumers' perspective, the RIS is a long term 'nest egg' which each Australian hopes will help them to fulfil a desired quality of life in retirement. According to the Australian Centre on Quality of Life, quality of life includes

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[22] Measuring Wellbeing: Frameworks for Australian Social Statistics, 2001 (updated 2006), Australian Bureau of Statistics
[23] Measuring Wellbeing: Frameworks for Australian Social Statistics, 2001 (updated 2006), Australian Bureau of Statistics
[24] http://www.oecd.org/statistics/oecd-releases-first-comprehensive-guidelines-on-measuring-subjective-well-being.htm
[25] http://www.oecd.org/statistics/oecd-releases-first-comprehensive-guidelines-on-measuring-subjective-well-being.htm

subjective perceptions of well-being, which can be measured though questions of satisfaction directed to people's feelings.[26]

The Commission on the Measurement of Economic Performance and Social Progress recommends quantitatively measuring subjective aspects of individuals' well-being via evaluations of one's life, happiness, satisfaction, positive emotions of pride and joy, and negative emotions of pain and worry.[27]

Findings in the numerous relevant well-being studies already undertaken demonstrate the benefits of overcoming any perceived challenges of using such metrics at a system level. Existing well-being studies in relation to superannuation, for example, include (to name a few):

- BT's Australian Financial Health Index
- WSSA Financial Well-being Index
- Mercer Superannuation Sentiment Index Study
- Australian Unity
- PriceWaterhouseCoopers Employees financial wellness survey
- ING Direct Financial Well-being Index

The Review's stated principles for assessing how the system is performing are equity, adequacy, sustainability and cohesion. However, to truly understand if a system is fairly and adequately assisting consumers to derive their desired retirement outcomes, consumer assessment of the performance of the system is paramount. Well-being indicators could complement other measures for assessing the adequacy of the RIS.

[26] http://www.acqol.com.au/
[27] Sen, A., Stiglitz, J. E., & Fitoussi, J.-P. (2009). Report by the Commission on the Measurement of Economic Performance and Social Progress. Paris, France: The Commission on the Measurement of Economic Performance and Social Progress.

Cohesion

The Review has clearly acknowledged the issue of the complexity of the RIS. This is well recognised and is a symptom of the evolution of the system with each pillar developing in isolation of each other. As stated above, it was not an inherently designed system.

As discussed in the Consultation Paper, it is important to understand how this complexity affects the cohesion of the RIS and consumers' interaction with the system. As indicated by FPA's financial planner members (below), fundamental to this consideration is the impact of financial literacy, consumer understanding, and Australians' attitudes about saving for retirement and the RIS.

Creating an effective RIS requires consumer confidence in the system. A lack of consumer confidence in Australia's RIS, and in particular superannuation, exacerbates longevity risk and levels of inadequate savings. Financial planner feedback indicates that many Australians lack confidence in the RIS as it is viewed as too complex and the perception of constant change leads to a fear that they will be worse off over time.

Financial literacy and consumer understanding of the Retirement Income System

There is a significant amount of research available on the financial literacy levels of the Australian population. Indeed, there has been a great deal of attention and investment made to improving financial literacy levels by both governments and businesses, over the past 15 years in particular. Our submission will add to this discussion by utilising member feedback about the financial literacy, understanding and behaviour of clients in relation to the RIS and retirement.

One member stressed the need to understand "*how scary the idea of retirement and ageing is*" for clients:

> *"Life becomes totally confusing for people about to retire. The idea of not having a regular wage or salary type income coming into their bank is quite scary for many. On the other hand, running out of money is also scary. So when it comes to products like annuities - swapping a capital amount for an income stream - many push back against the idea."*

In our survey on the RIS we asked FPA members: What are the main areas of the Retirement Income System your clients tend to have difficulty understanding? Surprisingly the stand out issues did not relate to the RIS itself, rather to financial literacy (and longevity/running out of money) as the following survey responses demonstrate:

> *"It is not an issue of clients not understanding the Retirement Income System, it goes back to general financial literacy. It is very low and as an adviser we spend most of the time with clients on education. If a client doesn't have basic financial literacy, how are they going to comprehend the Retirement Income System. Advisers are always going to be the only ones who do understand it. It cannot be made simple enough to overcome lack of basic financial skills so work on the latter first."*

> *"Put simply, they have no clue. They don't go to [the] right sources to get educated, they never received any education generally. Having said that, while super tax laws and other legislation information can be found on relevant websites, what's way more scary is their understanding about [the] bigger picture like - how much money they will need to retire, what's the biggest risk in retirement (erosion of purchasing power) and investment basics like difference between shares and bonds (or what's safe and what's risky in the long run)."*

> *"Clients can understand all these issues when I explain it to them. Many struggle to research and integrate it all themselves."*

> *"The system is complex and complicated. The clients require a lot of education to understand and I don t think the Government is doing enough on the education front. For the clients it's in the too hard basket. Clients often come to advisers for help because they can't understand the system and administration is difficult, e.g. dealing with Centrelink. However, the concern is that with the increasing cost in getting advice, it's the clients that need help the most (e.g. [those] not so wealthy with retirement savings less than $200k and overall wealth less than $500k inclusive of principal home) that are not able to afford advice."*

> *"These issues should be taught at school and courses available for adults."*

> *"They are ill-prepared for retirement. They have little thought for their lifestyle requirements and their costs. Absolutely no understanding of aged care and preparation for this stage of their life."*

Financial literacy concerns that financial planners see include some fundamentals of financial matters and money management, as indicated by the following survey respondent:

> *"[Clients have difficulty understanding] Budgeting before and after retirement, how much they need to have in savings to retire, that Centrelink is not a retirement plan or entitlement but rather a fall back for those in need, risk of investing."*

Interestingly, 49% of FPA member survey respondents agreed or strongly agreed that clients understand the role of the RIS. However, 55% of respondents disagreed or strongly disagreed that clients understand how the three pillars of the RIS interact. As the above survey comments indicate, this is a symptom of the complexity of the system. It also highlights the need for financial literacy and education programs to commence at school age and include all three pillars of the RIS and how they work together, not just superannuation. Consumer attitudes and behaviours (discussed below) highlight the need to encourage a savings culture in Australia.

As stated by the Productivity Commission, consumer engagement should not be examined in isolation from measures of financial literacy and cognitive capacity. Anecdotal evidence from FPA members indicates that financial literacy and consumer understanding of the RIS significantly influence a consumer's willingness to engage with the system. This in turn affects the cohesion of the RIS and its adequacy and sustainability.

Consumer engagement is dependent on understating and trust, key attributes of well-being, and reinforces the need to consider well-being measures for assessing adequacy of the RIS, as discussed above.

Consumer attitudes and behaviour

Consumer attitudes also significantly affect the cohesion of the system, as indicated by the following responses to the question - How would you describe your client's attitudes towards saving for retirement?

> *"Clients don't even consider it until they are at least 55 and then the questions arise. Those over 55 want to know how much they need, what they can live on based on the current value of their nest egg and what they can do now to improve the situation. If the same questions were asked at age 30, most clients on an average income would easily be able to build a nest egg that replaces their current net income but most leave it too late. The superannuation system is very generous to those that want to take advantage of it, but younger people rarely do."*

> *"The younger generation are perhaps more aware of the benefit of early superannuation, but expect it through employer contributions. The older generation are more focused on getting some Centrelink to subsidise their lifestyle."*

> *"A determined attitude develops the closer to retirement they get."*

"Quite healthy attitude. Most of them strive NOT to get an Age Pension."

"There is a wide range of views including those that are happy to save for their own retirement because they want to live a more luxurious life that they are used to. Some are in denial and can't think about retirement that is too far away."

"After age 55, people are focussed. Before this, life gets in the way, Kids, mortgages school fees, health insurance, etc."

"They all differ. Some take the idea of providing for their retirement seriously and make positive moves to enhance their savings, while others will try and access the funds as soon as they can with a very cavalier attitude towards retirement."

"They want to know they will have enough to retire on. But it's a bit of a lottery. How much do I need? How long will I live? What happens when the money runs out? Can I afford to turn the heating on in winter? RETIREMENT IS SCARY. I have been advising clients on the cusp of retiring for years now about how to work out what kind of income they will need in retirement, whether their savings should be in the super environment or not, what will happen when their savings run out. They would rather work way beyond retirement age in order to keep putting money into super, even when their health is being compromised by continuing to work."

"A mix! 75+ - Generally more defensive, propensity to save rather than consume. Under 70 - More propensity to spend whilst health is good etc."

"[The] young don't see the point because the rules will change anyway. Older clients have been lulled into a sense of someone else has to pay for us. Neither position is sustainable."

"Under 40s - Have an idea, but not sure how to go about it and there are other immediate lifestyle needs than putting money aside. 40-60 - Some interest. 60+ - Some are still working (e.g. farmers) and do not want to think about retirement. Some are stressed because this is where they start thinking about it."

Consumer attitudes have changed. As indicated above, people's attitude toward the Age Pension has shifted across the generational groups from it being an entitlement, to the role of the Age Pension being more widely endorsed as a support for those who need it. Anecdotal feedback also indicates that people now plan to retire later.

Consumers engage with the RIS at different timeframes and frequency, and for different reason. Consumer behaviour and engagement is influenced by consumer need – for example, a 20 year old in their first job would not have an interest in or foresee the economic need to engage with the RIS as often or as deeply as someone approaching retirement age.

Recent research found that 63% of Australians have not mapped out a financial future at all or have loose plans.[28] When asked about their long-term goals, respondents attitudes to retirement planning also differed across generations, with those closer to retirement more likely to have a goal of setting themselves up financially for retirement:

- Gen Y - 29%
- Gen X - 37%
- Baby Boomer – 54%

[28] *Dare to dream:* Research into Australia's financial hopes and fears. FPA, August 2016

Given the time span of a person's working life, from their first pay and superannuation entitlement to retirement, it is also reasonable to expect a consumer's recollection of information about their superannuation and the workings of the RIS may wain, particularly outside of key decision making times. Therefore, measures used for assessing consumer understanding of the RIS should take into account the reason each generation may have to interact with the system and the resulting differences in consumer behaviours by the various generational groups.

Financial planners see engagement intensify when decisions are necessary, such as moving from the accumulation to retirement phase. Consumer engagement can vary throughout different life stages.

There is a concern that the complexity of the RIS and a lack of consumer understanding of the system, how to access the RIS and make it work for each person, could lead to an increased risk of homelessness in retirement. Greater research may be required to understand this risk and identify measures to address it.

Improving cohesion in the Retirement Income System

Information, general advice, intra-fund advice and personal financial advice all offer benefits in relation to consumer understanding and engagement with the RIS. However, there are also limitations and restrictions to each.

In 2015, more than half of the Australian population - 53%, or 12.5 million people - were aged between 25 and 64[29]; and more than 4 million people were aged 65 and over. However only 4,834,720 adult Australians sought personal financial advice[30]. This means approximately 71% of those 25 or older relied on information or other forms of support to help them understand the RIS and make financial decisions. While these statistics are based on 2015 data, they serve to illustrate the potential proportion of the population who do and do not seek professional assistance in relation to financial matters.

It is therefore vital to understand if the "*system is sufficiently simple to navigate without resorting to some form of financial advice, or that there is sufficient support provided to ensure individuals feel confident making financial decisions about their retirement*", as stated in the Consultation Paper[31].

The FPA member comments above, would indicate that the cohesion of the system is stymied as individuals do not understand the RIS and the interaction of the three pillars due to its complexity.

Personal financial advice

The Retirement Income System should be underpinned by initiatives to improve consumer financial literacy and capability. Financial planners play a significant role in assisting Australians to prepare for retirement, explaining the various complexities of the tax and pension systems, and the interactions of the three pillars, to their clients from an education perspective.

As mentioned above, there is clear evidence of the consumer and societal benefits of personal financial advice. Along with financial education, other valued consumer benefits include effective cash and debt management and assisting consumers to reduce lifestyle instability[32].

[29] https://www.aihw.gov.au/reports/australias-welfare/australias-welfare-2015-in-brief/contents/working-age
[30] Regulatory Guide 255 - Providing digital financial product advice to retail clients, Australian Securities and Investment Commission, August 2016
[31] p.26
[32] *FPA Value of Advice Research*, by Rice Warner Actuaries, February 2008

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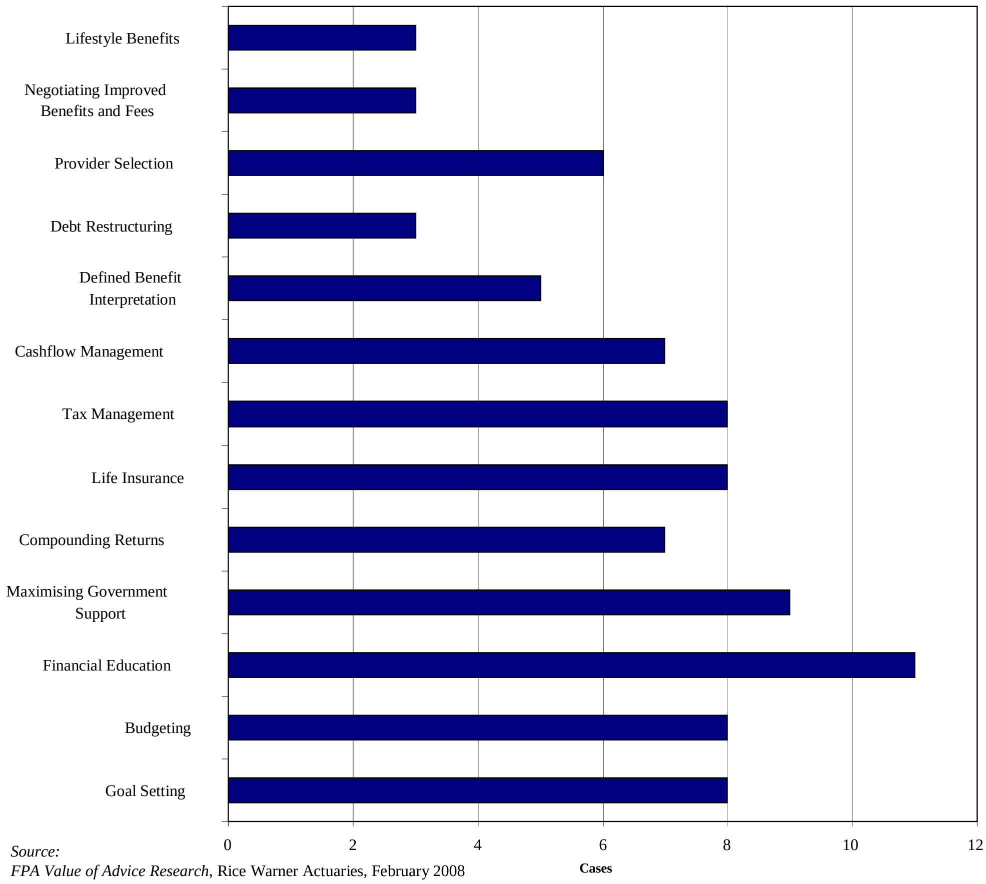
Type of value added – Advice components generating value



Source:
FPA Value of Advice Research, Rice Warner Actuaries, February 2008

This research also identified clear societal benefits of financial advice:

- Reduced debt - increases disposable income for more productive purposes.
- Higher rates of return on investments over long periods - building wealth.
- Insurance protection - prevents people from relying on welfare.
- Higher levels of savings – reduces reliance on government benefits during and after retirement.
- A financially literate and conscientious society that would make better long-term decisions.

Personal financial advice delivers significant benefits including changes in savings behaviour, setting proper budgets, following a plan for paying off debt, and organising finances and building wealth[33], which are essential skills for planning for a financially secure and independent future throughout working life and into retirement.

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[33] *FPA Value of Advice Research*, Rice Warner Actuaries, February 2008.

More recent research confirmed such findings with 77 per cent of respondents stating they believed the personal financial advice they received had helped them feel prepared for retirement; and 72 per cent believed they had a better understanding of what to expect in retirement as a result of seeking financial advice.[34]

Case studies also provide insights into the value of personal financial advice:

> *Case study 1:* *Jim gets a reality check. Jim was 55 and wanted to retire in a few years. After retiring, he planned to buy a new car and travel overseas for at least 6 months. Jim thought he'd need about $50,000 a year in retirement income. Jim went to see a financial adviser about his plans. The adviser explained that Jim didn't yet have enough money to fund the retirement he'd like. To help Jim get closer to achieving his retirement goals, the adviser outlined the pros and cons of different strategies, including working longer, increasing super contributions and downsizing to a smaller property. The adviser also explained how Jim's retirement income would be reduced if he bought a car and went on a big trip. After receiving this advice, Jim decided he needed to rethink the length of his trip, stick to a budget and increase his super contributions. Jim was glad he got financial advice as he now has a realistic plan for his retirement and the steps to achieve it.*[35]

The following case studies have been sourced from Sun Super research: *Value of Advice 2019: The value of advice in preparing for retirement*, which includes detailed case studies with modelling of the financial outcomes clients achieved by acting on the financial advice.

> *Case study 2:* *Adam and Mara's goals for their family of four aren't out of the ordinary. Paying for private education and taking regular holidays are things that many families might prioritise but struggle to achieve when they're paying off a home loan and juggling work and family commitments. Thanks to advice from a financial planner, Adam and Mara have settled personal debt, made appropriate investments to provide extra income for holidays and school fees, and arranged suitable insurances to make sure they're secure in the event of injury or illness. Expected financial benefits from implementing their plan include:*
>
> - *Cover private school fees starting from primary school (instead of high school only)*
> - *32 family holidays before retirement*
> - *An additional $54,720 in assets held at retirement*[36]
>
> *Case study 3:* *Having recently reached retirement, Jocelyn and Lou want to ensure they can continue to meet living and medical expenses and enjoy their senior years without financial stress. Not becoming a burden to their children is important to them and they'd like to retain assets to pass on to the next generation instead of having to sell them to generate more income. With a new financial plan to guide them, Jocelyn and Lou can eliminate debts and reduce the burden of interest and loan repayments on their cash flow. They've also found ways to reduce their annual budget and still save money towards holidays. Expected financial benefits from implementing their plan include:*
>
> - *Savings of $5k pa into a holiday fund for an extra 11 trips post-retirement*
> - *$47,250 of savings in interest on current debts*
> - *An additional $7,237 in assets held at life expectancy that will benefit their children*

[34] 2017 Value of Advice Report, Sun Super
[35] https://www.moneysmart.gov.au/media/460600/financial-advice-and-you.pdf
[36] Value of Advice 2019: The value of advice in preparing for retirement, Sun Super http://www.sunsuper.com.au/valueofadvice

<u>Case study 4:</u> When Lisa sought financial advice she was 58 years old. She worked as a senior, full-time nurse earning $60,000 per year. Lisa's income dropped when she moved to part-time status to transition to retirement and remained at this level to full retirement (although increasing with inflation). She also had $350,000 in mortgage debt and $10,000 in credit card debt. Because of the advice Lisa received, she paid significantly less tax over her lifetime, reduce her spending in retirement, and paid for two holidays each year. Lisa retired at age 65 comfortable that she had enough in savings. By acting on the advice, by age 85 Lisa will have $306,000 additional net earnings on her superannuation balance.

<u>Case study 5:</u> When they sought financial advice, David and Jenny are both 60 and planned to retire aged 65. David was a self-employed tradesperson, and Jenny a part-time teacher. The couple has $350,000 in mortgage debt and $10,000 in a car loan. They had a combined superannuation balance of $350,000, non-super financial assets of $150,000, plus a $700,000 investment property and a small business valued at $700,000. David was suddenly forced to retire early due to an injury. The financial advice they received enable the couple to gain $465,000 in additional net assets and $269,000 additional net earnings on superannuation balances at Jenny's retirement at age 65. By 85 years, their additional net earnings on superannuation balances is projected to grow to $802,000.

The above case studies demonstrate the benefit personal financial advice offers to improving the retirement outcomes for people, and the adequacy and sustainability of the Retirement Income System more broadly. Key element of this advice is bringing together the three pillars of the Retirement Income System with consideration of the client's circumstances, and educating client's to enable them to make informed decisions.

The 2008 Tax Review included a review of the Retirement Income System. In that Review's Consultation Paper, it was a stated objective of the Retirement Income System that it be 'simple and approachable' so that individuals can make decisions which are in their best interests[37]. Significant impediments to the accessibility and cohesion of the RIS are consumer behaviour towards savings and consumer engagement with the system, which are exacerbated by its complexity. These issues need to be addressed through education.

In its review of the how to assess the efficiency and competitiveness of the Australian superannuation system, the Productivity Commission acknowledged that the inherent complexity of the system can limit the availability of information or obscure its understanding, leading to suboptimal outcomes for participants. The Commission suggested that "Regulators, particularly APRA and ASIC, have a role to make information about the superannuation system transparent and easy to understand"[38] in relation to disclosure requirements and reporting standards. However, research shows that disclosure may result in client awareness of issues and processes, but not necessarily understanding.[39] It is understanding that enables an individual to feel confident making financial decisions about their retirement.

Key features of financial planning is the identification of client financial and lifestyle goals assisting clients to plan for the future; and planning for the future implies engagement.[40] The number one topic consumers seek personal financial advice for is retirement planning including superannuation and voluntary savings. Importantly, Elder & Rudolph found that planning for retirement positively correlates with retirement satisfaction (1999).[41]

The role personal financial advice plays in facilitating active and engaged financial decision making, has been recognised by the Australian Government, ASIC, industry and consumer groups who are seeking ways to improve

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[37] Tax Review Panel, *Retirement Income System Review Consultation Paper*, December 2008
[38] https://www.pc.gov.au/inquiries/completed/superannuation/competitiveness-efficiency/report/superannuation-competitiveness-efficiency.pdf, p.286
[39] Value of Financial Planning Advice: Process and Outcome Effects, QUT Business School, 2014
[40] Irving, Kym, The Financial Life Well-Lived: Psychological Benefits of Financial Planning, Australasian Accounting, Business and Finance Journal, 6(4), 2012, 47-59.
[41] Elder, H & Rudolph, P 1999, 'Does retirement planning affect the level of retirement satisfaction?', Financial Services Review, vol.8, pp117–127.

access to financial advice.[42] Personal financial advice plays a key role in improving the cohesion of the system by helping clients overcome the issues created by the complexity of the RIS, making the interaction of the pillars work as appropriate for each client's circumstances, and importantly, educating clients about the system and financial management more broadly.

Further, those individuals who engage in comprehensive financial planning experience an 85% higher financial well-being over those who have engaged in limited planning such as intra-fund advice.[43] Increasing understanding can impact on member engagement and reduce the possibility of poor decision making.

Financial planners also act as a conduit between consumer and providers, both private and Government, providing service providers with an informed source of consumer information and detailed insights into consumer needs and preferences.

It should be noted that the financial planning industry has undergone significant reform over the past decade. For example, the Future of Financial Advice (FoFA) reforms and the establishment of legislated professional and education standards have been implemented.

Government, the private sector, and individuals all face a challenge to encourage a savings culture and integrate the roles of the three pillars to provide an adequate, equitable, sustainable and cohesive Retirement Income System into the future. The role of personal financial advice in helping to change the attitude of consumers in relation to the accumulation, use and management of retirement savings and the cohesion of the RIS is significant.

Making personal financial advice more accessible for all Australians would enhance the operation, sustainability, adequacy and cohesion of the Retirement Income System.

Information

As referenced above, in its review of the superannuation system the Productivity Commission acknowledged that the inherent complexity of the system can limit the availability of information or obscure its understanding, leading to suboptimal outcomes for participants[44], with research showing that disclosure may result in client awareness of issues and processes, but not necessarily understanding.[45]

The availability of information is critical for consumers and service providers. However, consideration must be given to the quality and type of information available.

Superannuation is a competitive industry and therefore a great deal of fund information is produced from a sales perspective. As marketing theory demonstrates, marketing information is developed utilising consumer data and insights to generate customer traffic and drive purchases. Often such information includes value added offers, or select details to enhance the appeal of a particular product, and saturates multiple channels to reach customers, which can cloud any factual information that may be included. It also creates issues for consumers in identifying trusted sources of information.

The Productivity Commission's Research Report refers to this issue:

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[42] Report 224: Access to financial advice in Australia, Australian Securities and Investment Commission, 2010
[43] The value of financial planning, Financial Planning Standards Council (Canada), 2013
[44] How to Assess the Competitiveness and Efficiency of the Superannuation System, Productivity Commission Research Report, November 2016, p.286
[45] Value of Financial Planning Advice: Process and Outcome Effects, QUT Business School, 2014

> *"In particular, the disengagement, lack of financial literacy and behavioural characteristics of many members can encourage marketing and advertising that focuses on the brand or irrelevant or unverifiable outcomes, rather than specific aspects of the service."[46]*

The vast number and complexity of the rules of each pillar of the RIS is also a significant hindrance on the effectiveness of information to facilitate consumer understanding and encourage engagement with the system. A clear example of this is the asset means test for the Age Pension. The information presented on the Department of Human Services website about the asset means test is well presented[47]. As such it clearly demonstrates that the rules can vary significantly depending on the circumstances of the individual and their family members, and the inter-related nature and scope of the rules that exist in the system which can overwhelm consumers.

The role of information is also affected by technology. While technology is a significant contributor to improving the flow of information to consumers, it has also lead to an over-flow of information that anecdotal evidence indicates may overwhelm and confuse some consumers, particularly in the competitive superannuation environment. (See section on technology below.)

Quality, clear, factual information, consistently provided by all stakeholders (Government and industry), is key to improving consumer knowledge and cohesion of the RIS.

General advice

How and by whom the information is provided also affects the role and effectiveness of information. Under the Corporations Act, the provision of information may fall under the current definition of general advice.[48] This raises concerns about how the consumer receives such advice. While the content of general advice may be 'information', evidence shows that it is commonly mis-interpreted by consumers as being personal advice as it is relevant to the individual's circumstances at the time it is provided to them.

ASIC's Report 384 – Regulating Complex Products. In that report, ASIC stated that:

> *"Our research has indicated that marketing information plays a particularly strong role in product distribution and may influence investors' decision making more than other product disclosure. In particular, when investors approach product issuers or other intermediaries responsible for selling products directly, rather than going through advisers, the information contained or implied in product issuers' marketing information is often the first, and may be the only, information that investors use to decide whether or not to invest in that product."[49]*

Commissioner Hayne in his summation of case study evidence presented at the Royal Commission into misconduct in the banking, superannuation and financial services industry stated:

> *"It may readily be accepted that the line between personal advice and general advice may not always be marked clearly or easily. But one important feature of the distinction drawn by the Corporations Act between personal advice and general advice is whether the advice has been prepared without 'taking account of the client's objectives, financial situation or needs'. Personal advice is given where the adviser has considered one or more of the person's objectives, financial situation and needs, or a reasonable person might expect the provider to have considered one or more of those matters. The central purpose of the general advice warning that staff members were supposed to offer was to mark a boundary between what had been said and done and what was about to be said so that personal advice was not given. More precisely it was to convey to*

[46] https://www.pc.gov.au/inquiries/completed/superannuation/competitiveness-efficiency/report/superannuation-competitiveness-efficiency.pdf p. 107
[47] https://www.humanservices.gov.au/individuals/services/centrelink/age-pension/how-much-you-can-get/assets-test/assets#assetstestlimits
[48] Section 766B(4)
[49] ASIC, *'Report 384 – Regulating Complex Products* ' (January 2014), at [46]

the customer that whatever you, the customer, have just told me, the staff member, is entirely irrelevant to me and will wholly be ignored by me when I tell you what I am about to say. But why would the customer believe that? Why would the customer think that, having learned about at least some aspects of the customer's objectives, financial situation or needs, the staff member would go on to tell the customer about a product that was not suitable to whatever objectives, situation or needs had been revealed?"[50]

While the issue of the limitations and consumer issues that can arise from general advice are outside the scope of this Review, it highlights how the current legislative requirements can impact the cohesion of the RIS.

Intra-fund

Intra-fund advice can assist individuals to engage with and understand the rules of the superannuation system, superannuation fund, and the role of superannuation in preparing for and funding retirement. It can also encourage people to utilise the voluntary savings pillar by explaining and assisting with voluntary superannuation contributions.

However, the capacity of intra-fund advice as an enabler of the 'system' and the interaction of the three pillars is limited, as such advice cannot consider the individual's circumstances outside their interest in the fund. This limitation is of most significance when considering transitioning to retirement. Absent from intra-fund advice considerations are the individual's assets held outside of that particular superannuation fund, tax implications, health and aged care needs, spousal and family financial arrangements, and eligibility to social services benefits including the Age Pension, for example. Decisions made in relation to the individual's superannuation can positively or adversely affect the other pillars of the system. Hence, making decisions about superannuation in isolation can hinder cohesion of the system.

The fact that approximately 71 percent of Australians (aged over 25 years) have not received personal financial advice indicates the majority of Australians are making decisions based on information and potentially intra fund advice in relation to the Retirement Income System. Whether these decisions are allowing them to achieve desired retirement outcomes is unclear to the FPA. The case studies presented above in this submission shows that consumers who make decisions and act on personal financial advice achieve enhanced financial retirement outcomes compared to making decisions based on information or intra-fund advice.

It is also unclear whether information and intra-fund advice just improve people's knowledge or go further and increase people's understanding of and engagement with the RIS and help them make decisions to enable them to achieve better retirement outcomes and a sustained level of adequacy.

Given the significant percentage of the population who have not previously received personal advice, it is imperative that quality, trustworthy, clear and accessible information and intra-fund advice is available that allows consumers to make appropriate and informed decisions for their circumstances in relation to the RIS and their retirement.

Impact of technology on the Retirement Income System

Governments and service providers have embraced technology as a significant enabler for the RIS. However, research suggests that the introduction of and continuing changes in the use of technology can present both positive outcomes and challenges for consumers. While research is not specific to the RIS, the FPA suggests the findings highlight the need to consider and examine the impact of technology on consumers engaging with the system and on cohesion of the RIS more broadly.

It is well understood that technology can significantly improve access to information and speed up service delivery.

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[50] Royal Commission into misconduct in the banking, superannuation and financial services industry, Final Report Volume 2, page 95, 4 February 2019

However, the following issues can arise as a result of over-reliance on or poor implementation of technology:

- Not all individuals have access to technology – skills, confidence to use technology, money to buy and run a computer, connection issues, etc

- Too much information to be able to decipher what is relevant, important or a source of truth - information overload can add to the complexity of the RIS and impact engagement and cohesion.

Investment in technology offers many benefits, however human resources are essential to explain the complexity of the RIS to consumers. Technology cannot replace human interaction and service.

Consideration must also be given to the use of technology across generations, particularly in relation to generational groups who did not grow up with the technology of today. For example, Millennials are using technology to help manage their finances closely:

- 30% of millennials use online tools to track their spending and 7% use budgeting applications
- 72% of millennials use technology to compare prices before they shop compared to just 28% of older Australians.[51]

UK company Nominet's Digital Futures Index[52], found that digital savviness decreased with age, highlighting a generational digital skills gap. In 2017 it found that whilst 64% of millennials (born between 1981 and 1996) are digitally savvy, only 46% of Gen X (born between 1965 and 1980) are. This then drops to 34% for Gen Z (born 1997 onwards), 23% of baby boomers (born between 1946 to 1964) and 15% of the pre-war generation (born 1945 and earlier).[53]

Government is increasingly utilising digital platforms for all its services and the laws it administers. However, feedback from financial planners suggests that any limitations in the interaction of systems between government departments or services, affects the usability and accessibility of the pillars for consumers and increases complexity.

For example, a client required assistance to action a Government letter in relation to their superannuation. It took seven steps and considerable time by their son due the parent's lack of skills and experience in using technology:

> Letter received --> Go to ATO --> Go to My gov --> Set up mobile --> Set up email / Confirmation --> connect My gov to ATO Requirements --> 1 Super details --> 1 Payment slip --> both connected to relative's email address as the client does not have email (END)

A streamlined digital identity with simple navigation is necessary.

A report compiled by PwC indicates that financial institutions are increasing the use innovative technologies in customer service[54]:

- Financial institutions are learning to partner and integrate - 82% expect to increase FinTech partnerships in the next three to five years

- Financial institutions are embracing the disruptive nature of FinTech - 77% of Financial Institutions will increase internal efforts to innovate.

[51] https://www.aph.gov.au/DocumentStore.ashx?id=185d5f3a-88fb-455e-b939-36daf31e66a7
[52] https://www.nominet.uk/DigitalFuturesIndex/#!dfi0
[53] https://www.nominet.uk/digital-generation-gap-remains-wide-open-older-generations-fail-embrace-new-technology/
[54] Redrawing the lines: FinTech's growing influence on Financial Services, PwC, 2017

The FPA asked members: What affects has the use of technology by governments and financial services providers had on your clients' interaction with the RIS and why? 50 percent of respondents agreed or strongly agreed that technology had improved their client's engagement with the RIS and provided the following feedback:

> *"Access to details of their super funds balance and investments together with educational information that helps them understand facts about how the RIS works and also access to calculators that help to build a picture around options and impacts."*

> *"Clients have found it easier to consolidate their superannuation through the MyGov portals. Ease of access through online portals to superannuation providers, some clients are a little bit more engaged and knowledgeable about their retirement savings."*

> *"They can see their retirement savings balance more easily. The government's MyGov technology makes it easier to consolidate small balances and understand superannuation held."*

However, 50 percent of respondents disagreed that technology had improved client engagement with the system:

> *"It has severely disadvantage elderly people who cannot use mobile phones / emails / internet. It has become a form of elderly discrimination, almost abuse. It makes them heavily reliant on other people and therefore more likely to suffer from other forms of abuse as a result. It removes their independence and has a big negative effect on their mental health. Particularly when MyGov is such a difficult system to use - it compounds the issue."*

> *"Clients can monitor their investments better. But there is now information overload and confusion when budget announcements come out. By the time [Budget measures] are legislated, confusion reigns as often the legislation is completely different to what is proposed. e.g. work test for those over 65."*

> *"Clients find it more confusing and a lot don't know what's going on as the 'mygov' system gets all the letters, etc and most clients do not understand it or check it. We are getting more enquiries as a result. The same applies to annual statements, etc from providers."*

> *"Most still want to do face to face."*

> *"No interaction what so ever. The take up of technology for the client experience has been almost non-existent…..I can t see any evidence where the government has used technology to engage people with their super savings."*

> *"Older clients feel completely out of their depth when dealing with Centrelink via online systems. They feel there is nowhere to turn for cost effective help. I have encountered several partially self-funded retirees who are not receiving their Age Pension entitlements due to the difficulty in dealing with Centrelink online."*

> *"They are focused on the wrong things at the wrong time and make bad decisions. Fear and greed drive their decisions."*

> *"Zero or negative. Most of my clients have very little interest in their financials, and any interaction with Centrelink's system is infuriating at best."*

There must be a balance between technology and human intervention to ensure technology can be an enabler of the cohesion of the RIS.

Areas affecting the Retirement Income System

The delivery of an inclusive and effective Retirement Income System is a significant challenge facing Australia. Meeting this challenge requires a fundamental consideration of the hurdles to be overcome and innovative thinking on how retirees needs can be met.

There are key areas that sit outside the three pillars of the Retirement Income System (RIS) that significantly affect the effectiveness and ability of the RIS to deliver Australians' desired retirement outcomes and meet their retirement needs. It is important to consider a lifetime view of the retirement income system and the impact of the following areas on the adequacy, equity and sustainability of the RIS:

- Australians' attitudes to savings – across different generational groups (discussed above)
- Aged care (as referenced in the Consultation Paper)
- household debt, and
- the role of the principal residence (family home).

The FPA notes that health system also affects the ability of the RIS to delivery Australians' desired retirement outcomes however the health system is outside our area of expertise and will not be discussed in this submission.

Aged care and the Retirement Income System

Traditionally many people have taken the view that retirement income needs decrease as a client ages. In many cases, this meant that clients were willing to spend savings in early years of retirement and rely on the Age Pension at older ages. It has been suggested that to adequately fund retirement, a typical couple would need to reduce expenditure by around 40 per cent upon retirement and then further reduce this by 0.5 per cent per year thereafter[55].

This traditional view is being challenged by the current issues facing an ageing population. Increasing health and aged care costs as a person progresses through retirement may lead to an increase in retirement expenditure during the frail phase of retirement and significantly impacts adequacy.

The impact of aged care can be difficult to quantify. Not all retirees will need to move into aged care accommodation, but most will require progressively greater levels of aged care support as they age. The expenses and impact on their retirement income will depend on the level of support from a spouse, family and friends, ongoing suitability of their family home to meet their needs, location and associated property expenses or care availability, personal health and mobility, and level of savings.

In fact, it could be argued that later in life, the need is higher for capital than income to access and pay for health and aged care needs. Yet the decision to spend capital in early years of retirement and rely on income from the Aged Pension later in life runs counter to this need. Adequacy of income or savings is therefore important at older ages when a person commonly needs greater care, to allow choice and dignity in how they are treated. It also allows greater access to the services they need.

There are many anomalies in the funding of aged care services. The FPA acknowledges the consideration of this issue by recent Government inquiries and the current Aged Care Royal Commission.

[55] Centre for pensions and superannuation, UNSW, S*uperannuation Guarantee / Adequacy and Retirement: Longevity and economic impacts*, 2007.

The Aged Care Funding Authority 2019 Annual Report[56] shows both increasing demand for aged care services from 2013-14 to 2017-18, with steadily rising consumer costs.

	2013–14			2014-15			2015-16			2016-17			2017-18		
	Home support	Home care	Residential care	Home support	Home care	Residential care	Home support	Home care	Residential care	Home support	Home care	Residential care	Home support	Home care	Residential care
Number of providers	1,676	504	1,016	1,628	504	972	1,686	496	949	1,621	702	902	1,547	873	886
Numbers of services/ facilities	N/A	2,212	2,688	N/A	2,292	2,681	N/A	2,099	2,669	N/A	2,367	2,672	N/A	2,599	2,695
Number of allocated places	N/A	66,149	189,283	N/A	72,702	192,370	N/A	78,956	195,825	N/A	N/A[57]	200,689	N/A	N/A	207,142
Number of consumers	775,959	83,144	231,515	812,384	83,838	231,255	925,432	88,875	234,931	784,927	97,516	239,379	847,534	116,843	241,723
Commonwealth funding	$1.7b	$1.3b	$9.8b	$1.9b	$1 3b	$10.6b	$2 2b	$1.5b	$11.4b	$2.4b	$1.6b	$11.9b	$2.4b	$2 0b	$12.2b
Consumer contribution	N/A	$87m	$4.0b	N/A	$136m	$4.2b	N/A	$127m	$4.5b	$204m	$128m	$4.5b	$219m	$122m	$4.5b

The ACFA stated that the formal aged care system is funded through a combination of universal taxation and means-tested user contributions (or fees), with most aged care consumers contributing to the cost of their care.

> *"In residential care, consumers contribute 85 per cent of the single age pension towards their living expenses (through the Basic Daily Fee) and, subject to means testing, may be required to contribute towards their accommodation and care costs. In 2017-18, residents contributed $3.3 billion towards their living expenses, $780 million towards accommodation costs by those who chose to pay through a Daily Accommodation Payment (which excludes those choosing to pay through a fully refundable lump sum deposit) and $504 million towards care costs. Overall contributions from residents (excluding lump sum deposits) represent 26.6 per cent of total residential care provider revenue.*
>
> *Consumers of home care packages contributed around $122 million (representing 5.9 per cent of home care provider's revenue) to their care costs in 2017-18, while Commonwealth Home Support Programme consumers contributed $219 million, which represents 9.3 per cent of total expenditure on home support."*

This demonstrates that expenditure in retirement changes and can increase in the frail phase when aged care services may be needed. The high level of consumer contribution shows the need for aged care to be a considered in establishing

[56] https://agedcare.health.gov.au/news-and-resources/enewsletter-for-the-aged-care-industry/aged-care-financing-authority-acfa-letter-to-providers/2019-acfa-annual-report-on-funding-and-financing-of-the-aged-care-sector, Table 2.**Error! Main Document Only.**: Aged care in Australia 2013-14 to 2017-18

[57] Since the changes in February 2017, packages are no longer allocated to providers. Instead packages are assigned to consumers who choose their preferred service provider.

FINANCIAL PLANNING ASSOCIATION of AUSTRALIA

benchmarks for assessing adequacy in retirement, in pre and post retirement planning, and the impact aged care can have on the ability of the RIS to deliver desired and necessary outcomes for Australians.

However, 87% of respondents to FPA's member survey on the RIS disagreed or strongly disagreed that clients understand the interaction and implications of aged care needs on the RIS particularly in relation to adequacy.

Due to the potential impact aged care could have on the sustainability of the RIS, in relation to both Government and consumer funding, it is reasonable to consider whether aged care needs and services should be included as part of the system.

Household debt

As discussed above, a fundamental risk to achieving a sustainable and effective Retirement Income System is longevity. The superannuation and voluntary savings pillars are particularly exposed to longevity risk as more and more Australians are entering retirement with a high level of debt which drains savings. Debt significantly impacts on the adequacy and longevity of retirement income and highlights that improving consumer saving habits generally should be a key element of the retirement income system. There is also commentary regarding the impact of household debt on the equity of the RIS, as those who practiced a proactive attitude to saving and debt management throughout their life potentially compensate for those who enter retirement with significant household debt.

The proportion of households holding debt has remained almost unchanged for more than a decade (73% in 2003-04, compared to 74% in 2015-16); however, average household debt (after adjusting for inflation) has almost doubled, increasing from $94,100 in 2003-04 to $168,600 in 2015-16. This increase was mostly driven by property debt, which has increased steadily over the period, from $78,400 in 2003-04 to $149,600 in 2015-16.[58]

At 30 June 1991, household sector debt represented 69 per cent of annual gross disposable income and by 30 June 2006, that percentage had grown to approximately 170 per cent.[59] Over the 2018 June quarter, Australia's household debt hit a record high of 191% of household disposable income, roughly tripling since the late-1980s:[60]

As indicated by the following graph, a relatively high percentage of people are entering retirement with debt which can impact the adequacy and sustainability of the RIS.[61] This graph also shows there is a significant drop in household debt in the early retirement years between ages 65 and 75. This may be an indication that lump sum superannuation benefits are being used for debt repayments.

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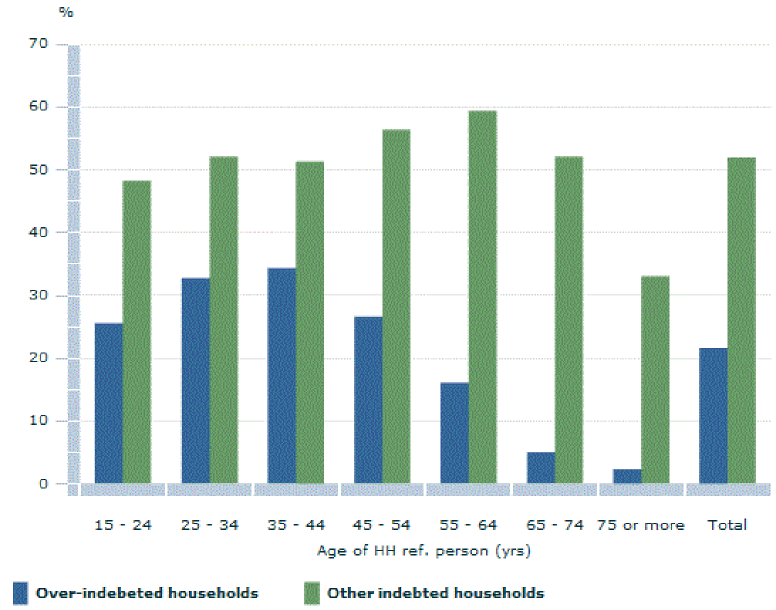
[58] https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/6523.0~2015-16~Feature%20Article~Household%20Debt%20and%20Over-indebtedness%20(Feature%20Article)~101

[59] Australian Bureau of Statistics, Household Sector Balance Sheet – A National Accounts' Perspective, March 2007 https://www.abs.gov.au/ausstats/abs@.nsf/Latestproducts/5204.0.55.011Main%20Features202003-04%20to%202017-18?opendocument&tabname=Summary&prodno=5204.0.55.011&issue=2003-04%20to%202017-18&num=&view=

[60] https://www.macrobusiness.com.au/2019/10/australias-vast-household-debt-a-giant-economic-millstone/

[61] https://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/6523.0~2015-16~Feature%20Article~Household%20Debt%20and%20Over-indebtedness%20(Feature%20Article)~101

Graph 6 Over-indebted & other indebted households, Household characteristics, 2015-16



Select a different graph

Age of household reference person

Save Chart Image

Australian Bureau of Statistics

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The role of the 'principal residence' ('family home') in the Retirement Income System

When considering to the role of the 'family home' in the Retirement Income System, it is important to consider it from a number of different perspectives.

Access to adequate housing has long been viewed as a basic human right and is considered to be an integral factor in the enjoyment of other economic, social and cultural rights[62]. The vast majority of Australian households either own their home (34 per cent) or are paying it off (35 per cent). Renters comprise around 29 per cent of Australian households, with 22 per cent renting privately, 5 per cent in public housing and the remainder in other rental accommodation, such as caravan parks or employer-owned housing[63].

Access to affordable and quality housing is central to community wellbeing. Apart from meeting the basic need for shelter, it provides a foundation for family and social stability, and contributes to improved health and educational outcomes and a productive workforce. Thus it enhances both economic performance and 'social capital'[64].

It is clear that housing remains a priority for people and Australia generally has a high proportion of home ownership. The FPA considers there is a need to recognise that housing is a fundamental factor in retirement planning. The home should primarily be viewed as a mechanism to provide housing in retirement, not as an investment vehicle. While paying for the purchase of a house is a barrier to investing additional funds in superannuation, it should be recognised that housing is an essential requirement that can be a costly expenditure in retirement if renting.

The FPA suggests that the role of the home in the RIS cannot be considered in the absence of the benefits of home ownership. Research has shown that home ownership leads to a greater capacity for financial management and stability over time.[65] Home ownership in retirement also reduces Government spending on rent assistance for retirees.

In its report on housing affordability in Australia, the Senate Committee stated that older households renting privately spent 36 per cent of their gross income on housing, and that renters appear to have lower incomes and lower retirement savings and as a consequence renters have a lot less to spend on other things. [66]

While home ownership has advantages in relation to stability and social benefits, home ownership also entails substantial financial risks. Such issues as fluctuations in market value, expected/ unexpected maintenance expenses, rates and insurance premiums, can comprise significant additional costs over and above renting. Home ownership also minimises people's ability to diversify assets as many homeowners' ability and priority to save is reduced as servicing the mortgage creates a significant burden.

A key finding of the Senate Committee on Economics inquiry into Affordable Housing in Australia was that seniors whose only source of income is an Age Pension or annuity tied to superannuation have no capacity to generate additional income other than divesting themselves of the family home. This would lead to additional pressure on the private housing rental market and social and public housing, and increase the risk of homelessness.[67]

The family home fulfils many roles for the individual, however from a financial perspective consumers view the family home as a way of saving via a secure growth asset. The financial role of the family home in the RIS should consider the treatment of the proceeds of the sale of the home – will the retiree be disadvantaged or worse off? How will this impact the affordability and fairness of the system for the retiree? And the sustainability of the system?

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[62] Senate Select Committee on Housing Affordability in Australia, *A good house is hard to find: Housing affordability in Australia*, June 2008
[63] Australian Institute of Health and Welfare, 2008
[64] Productivity Commission, 2004
[65] Re-examining the Social Benefits of Homeownership after the Housing Crisis, Joint Centre for Housing Studies, Harvard University, August 2013
[66] Senate Committee on economics report: Out of reach? The Australian housing affordability challenge, May 2015
[67] Senate Committee on economics report: Out of reach? The Australian housing affordability challenge, May 2015

The family home can also be used as equity to access aged care; those without home ownership will most likely need to rely on the Government for their residential aged care needs. However, the Aged Care Funding Authority reports that there has been a consistent focus on rebalancing the formal aged care system towards home care over the last decade because older people have expressed the desire to live in their own homes for as long as possible. There has even been additional expenditure on Home Care Packages reflecting demand pressures.[68] These considerations have flow on implications for the RIS for individuals and Government.

The Productivity Commission addressed the adverse effects the sale of a residential home might have on a retiree's access to the Aged Pension and equity to fund aged care needs in its 2011 report, *Caring for Older Australians*.

There are currently two options for accessing the equity in the home for use in the RIS. Consideration could be given to the implications of adapting these programs to ensure they are more compatible with the Review's principles' for the Retirement Income System.

- Commonwealth's Pensioner Loan Scheme
- Reverse mortgages

However, the Parliamentary Inquiry into Affordable Housing Report released 8 May 2015 found that home ownership rates for older Australians, like home ownership rates overall, are trending lower, from 81 per cent of over-65s today to a projected 55 per cent by the middle of the century.[69] The Inquiry raised concern about the declining trend in home ownership rates for older Australians given Australia's Retirement Income System is to a large degree predicated on the assumption that most retirees will own their own home outright and therefore have relatively low housing costs:

> *"Australia's Retirement Income System is in large measure based on the assumption that people will own their home by the time they retire. As the CFRC explained in its submission, Australia's relatively low pension rates, when considered against rates in other OECD countries, reflect typically lower housing costs resulting from higher levels of outright home ownership. As home ownership levels decline, however, so too will the adequacy of the Aged Pension."*

Changing trends of home ownership in retirement make the role of the principal residence a more critical issue for the equity and adequacy of the Retirement Income System for individuals. If less Australians are able to maximise the benefits home ownership presents in relation to retirement income, it changes the balance of fairness in relation to the role of home in the system.

Role of the 'family home' in the means test for the Age Pension

Another role of the family home in the RIS is as a financial asset.

As requested by the Review, the FPA provides the following implications of including and of not including the family home in the means test for the Age Pension:

[68] https://agedcare.health.gov.au/news-and-resources/enewsletter-for-the-aged-care-industry/aged-care-financing-authority-acfa-letter-to-providers/2019-acfa-annual-report-on-funding-and-financing-of-the-aged-care-sector, p. 58
[69] Out of Reach? The Australian housing affordability challenge, 8 May 2015, https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Affordable_housing_2013/~/media/Committees/economics_ctte/Affordable_housing_2013/report.pdf

Implications of including the home in the means test for the Age Pension

- The family home is not just a financial asset. For most, it is a source security and provides vital 'wellbeing' connections to family, friends and community. This means there are flow-on implications for individuals and Government finances that are broader than access to the Age Pension that must be considered

- Including the family home in the means test for the Age Pension will have a greater impact for those who are reliant on the Age Pension (in whole or in part), and whose only financial asset is the family home

- Consideration should be given to whether the inclusion of the family home in the Age Pension test would create a policy setting that would 'push' retirees to downsize. While this may improve the availability of housing stock for non-retirees, for retirees downsizing also has its pros and cons (as examined in the 2014 Senate Inquiry into Housing Affordability and 2001 Intergenerational Report) :

    - Cost of downsizing such as stamp duty (in some state over 65s are exempt), moving costs, utility costs

    - Potential relocation away from local community

    - Mental Health Implications (2001 Intergenerational Report)

    - The treatment of the proceeds of the sale in relation to the RIS and Age Pension and whether these conditions make it affordable, equitable and sustainable for the individual

    - The sale of the family home could negatively impact a person's access to the Age Pension, which could significantly impact those on a middle and lower pre-retirement income. Over time, and as they age, this could leave them in a worse financial position.

    - If the retiree is unable to find a suitable home to purchase in their locality, particularly in regional areas, pushing retirees to sell their home could increase the level of renter retirees.

    - Lead to an increase in applications for the Rental Assistance Package for Retirees.

    - Renter retirees do not have the home to use as equity for aged care needs.

- Property values vary significantly across metropolitan and regional locations. The challenge of identifying a fair and reasonable test for the family home that can take into account the range in home values across Australia, risks further complicating the means test for the Age Pension.

- Impact of household debt and fees - once any outstanding mortgage and stamp duty are paid, a person who sells their home to unlock the capital to fund retirement may still be eligible for the Age Pension. (See table below for 2019 asset amounts.)

As the following comments from FPA member survey respondents indicate, views on the implications of <u>including</u> the family home in the asset means test for the age pension are wide and varied:

> *"Equity among all Australians would be achieved - there are no other implications. Affected clients would have the option to sell or borrow against their home which is exactly what they do when they run out of their savings anyway. This would be fairer to taxpayers and create genuine equity amongst welfare recipients."*
>
> *"People might be forced to sell and move away from their support networks. If clients wish to stay in their home, draw on the equity but I would like this to be controlled by the government, much like the pension loan scheme."*

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“The principal residence provides shelter for people and cannot provide an income to meet living expenses. This combined with the wide variation in capital values would make this unfair across the country.”

“It would likely reduce clients entitlements for the Age Pension. It would possibly make the system fairer forcing those with an expensive home to use some equity or downsize to a more suitable property.”

“It depends on the level at which the principal place of residence is included. A partial approach could be adopted similar to aged care. Such an approach would need to be phased in otherwise there would be significant backlash in the older population.”

“CARNAGE!!! You will not be able to compare an apple with an apple regarding house prices for starters! Everyone needs a home to live in. If they have worked hard enough to live in a home of greater value then good luck to them. There are still costs associated with living in said home, and so they will need the means to support this.”

“It would knock out a considerable number of people from receiving the age pension.”

“More retirees would be willing to sell their family homes in order to downsize and free up capital for spending during retirement. Some retirees may have to move away from their immediate support network of friends and family in order to unlock the value in their home and in order to maintain sufficient cash flow following the reduction of their Age Pension. Others would see this as an opportunity for a sea-change / tree-change. There would be a greater supply of housing made available in some regions as retirees leave the area in favour of lower cost housing elsewhere. There would be an economic boost to those areas that attract a greater number of retirees.”

“Far greater complexity and probably more gaming of the system.”

“Should only be counted above an 'average' value for that city. Would unlock equity (people may downsize earlier).”

“1. Homeowners may lose their aged pension.2. The assets test limit may need to increase which may increase the benefits to non-homeowners. 3. Sales of lifetime annuities may rise to gain an assets test benefit. 4. More residential properties may be sold and downsizer contributions made to super. 5. Changed treatment of reverse mortgages vs asset test value of home.”

“More people will not qualify for the age pension. Maybe there needs to be a threshold a bit like farming properties have to be less than 2 hectares is exempted. Maybe the house value above $1m or $1.5m needs to be included in the asset test….. Cost of living, fuel electricity etc we have no options to shop around for cheaper prices and to save money etc. If people are asset rich/cashflow poor get the age pension if their home and total assets are above the threshold as almost a reverse mortgage against the property and when home is sold/person dies government is repaid.”

“Many people would have a reduction or lose their Age Pension. However, forcing people to relocate because their family home has increased in value over 30 years, and having to move away from neighbours and local community's would be extremely negative on emotional wellbeing.”

“More appropriate allocation of the [Age Pension] to those truly in need, would force [people] to consider downsizing as an option more frequently.”

“It would likely mean that pensioners would need to sell the family home sooner.”

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> *"If the family home was assessed, it would force a LOT of people out of their homes to be able to survive!"*

> *"You would need to: Define how to value. Do this periodically and in a non-challengeable way. Consider the impact on client's lives who have lived in a home all their life and may be forced to move."*

Implications of NOT including the home in the means test for the Age Pension

- Equity of the system – non-home owners v home owners
  - Home owners may have the option of selling the property to access the capital in the home during retirement. Non-home owners have a cap on the allowable amount of assets and capital to be eligible for the Age Pension. However, depending on the value of the property and any remaining mortgage on the home, the amount of capital held in a property may be disproportionate to the amount of allowable capital for non-home owners under the Age Pension asset test. From 1 July 2019, payments cancel if assets are more than the amounts below[70]:

If you're	Homeowner	Non-homeowner
Single	$263,250	$473,750
A couple, combined	$394,500	$605,000
A couple, 1 partner eligible, combined	$394,500	$605,000

  - However, as discussed above, the family home is more than just a financial asset.
  - While owner-occupied housing is not included in the asset test, the asset threshold above which the full pension is reduced is higher for non-homeowners than for homeowners based on the amounts in the above table.
- Sustainability - Currently home-owners with high value properties can access the Age Pension which impacts public finances.
- People can still access the Age Pension irrespective of the value of their principal residence.

FPA member survey respondents provided the following comments in relation to the implications of not including the family home in the asset means test for the age pension:

> *"The main issue is the very elderly that rely on the age pension and live in a valuable home tend to save the age pension and this then passes to their estate. The balance should be to allow clients to stay in their home for as long as possible, with the help of care, but with house prices so expensive in capital cities, it becomes inequitable. The house should be considered like any other asset that is able to be drawn upon when funds run out. Sell the house, draw a loan against it but use it's wealth to support the lifestyle without relying on government handouts."*

> *"Too many wealthy people are receiving the age pension creating massive inequity between individuals. The taxpayer is subsidising the wealthy who sit in homes worth millions."*

[70] https://www.humanservices.gov.au/individuals/topics/assets/30621

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“Allows some clients to put more money towards their 'family home' as a kind of savings for a rainy day. Clients tend to over invest in their home with the view that it will increase their asset base without impacting on the Age Pension.”

“Unfair distribution of wealth and taxpayers funding that unfair distribution through additional taxes to fund the age pension, and also aged care.”

“An asset from which a client earns no income is not tested for Centrelink. This makes the pension easier to obtain. However, it can be unfair when some people hold a great amount of capital in their homes than others.”

“There is anecdotal evidence that retirees with significant long-term property growth on their homes are not willing to downsize for fear of losing their Age Pension entitlements. This places more strain on the Government to support these people who may otherwise have enough wealth to partially/fully support themselves during retirement. This is more of a capital city issue as lower average house prices in regional centres tends to result in less of this behaviour due to property sales having less impact on Age Pension entitlements.”

“Encouraging people to overcapitalise on their family home, refusal to sell and downsize as they would get less age pension even if they might be better off financially, greater inheritances for some people over others.”

“Skewed benefits to cities/suburbs with high value homes.”

“1. Pensioners who are asset rich with limited income may have a poorer experience in retirement due to them not wanting to sell the home to invest the proceeds for a higher income or commence a reverse mortgage / pension loan to supplement their aged pension. 2. Pensioners are trapped in their home due to the assets test implications of selling. Including the home in the calculations may make moving home a financially neutral decision.3. Non-homeowners are disproportionately disadvantaged as most metropolitan homes/units are worth a lot more than the difference in the assets test values for homeowners vs non-homeowners.”

“More people will qualify for the age pension. Maybe there needs to be a threshold a bit like farming properties have to be less than 2 hectares is exempted. Maybe the house value above $1m or $1.5m needs to be included in the asset test.”

“People who have been unable to save / obtain a home of their own are severely disadvantaged under the current assets tests. As a single person, it is not possible to rent on the Age Pension, unless you live well below the poverty line.”

“We have a number of pensioners who are asset rich and cash poor, clients can live in a mansion and get full benefits.”

“Age pensioners I have contact with understand the benefit of not including family home in the means test. They have an asset which appreciates and therefore can fund them in the future.”

“It means those whose home prices have increased (through no part of their own) are able to receive an income and stay in their home.”

“Encourages home ownership and is a method of forced saving. Ownership provides other practical and non-financial benefits to the community.”