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Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

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Via: retirementincomereview@treasury.gov.au

Dear Secretariat

Retirement Income Review Consultation Paper

IOOF welcomes the opportunity to provide input into the retirement income review process. This review is an opportunity to build on the strong foundations of Australia's retirement income system with a view to enhancing the retirement lifestyles of all Australians. The current system is complex, and substantial benefits to individuals, the private sector and public sector could be realised in reforms developed through the lenses of adequacy, equity, sustainability, cohesion and simplicity. These changes would target both legacy system complexity and potential future issues with current legislative settings.

We believe IOOF can offer insights into retirement incomes because of the importance we place on the needs of the individual through both our advice services and income stream products. IOOF has a long history of designing and providing unique and innovative retirement incomes to members. AM Corporation which was acquired by IOOF in 2003 released the first account-based (cash-back) pension product, before superannuation law changed to make these products widely available. We have also released hybrid pension products that provided both a guaranteed income for fixed term (life expectancy) coupled with an investment account to provide deferred income to cover longevity risk in the form of our Lifetrack Flexible Pension. We continue to offer a market-linked pension (IOOF Term Allocated Pension) open to rollovers of existing complying pensions.

Our specific feedback can be found on the following pages however the key themes of the submission are:

- **Australia's defined contribution superannuation system is relatively unique**. This creates an **individualisation of retirement savings** as compared to defined benefit systems, which are pooled by nature. Individualisation creates a connection between retirement savings decisions and individual sacrifice, as their retirement balance is directly impacted by reductions in current day salary or foregoing current expenditure. This individualised retirement saving process needs to be reflected through a system focussed on the individual rather than pooling.
- **The retirement income system is complex**. There are many rules, exemptions, concessions and legacy arrangements which impact on the system's adequacy, equity, sustainability and cohesion. In addition to these factors, **an additional factor of simplicity** should be used to assess and develop the retirement income system. There is much scope for simplifying the system which is discussed in detail throughout the paper.
- **Financial advice plays a critical role in helping Australians achieve their retirement objectives**. Given the complexity of the system, many individuals find they need the services of a financial adviser simply to determine how to best access the retirement income system. With a simpler system, financial advisers could focus on helping individuals understand *what* retirement means for them, rather than simply *how* to retire. That is, advisers should focus on what individuals can afford to spend in retirement and what lifestyle they can achieve, rather than simply how to interact with the system to receive an income stream.

Overall IOOF looks forward to helping Australians achieve financial independence and working towards a stronger retirement income system for current and future generations.

Yours sincerely

Renato Mota

Chief Executive Officer

The retirement income system

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

The Australian retirement income system is relatively unique, in that it is one of the first compulsory funded defined contribution systems in the OECD. In the later part of the 1980s and early 1990s when only Australia and Chile were going down the funded defined contribution path for retirement income, other countries were enhancing their unfunded social security pension schemes and shoring up employer-sponsored defined benefit pension arrangements. Many of these countries – UK, Ireland, Poland - are only now moving towards the compulsory defined contribution route through auto enrolment as part of their second tier of retirement income funding.

Australia introduced portability and choice of fund requirements to the superannuation system, which has over time moved to us away from the employer or Governmental paternalism that is still prevalent in defined benefit influenced systems. Australia's system of compulsory superannuation can and does have flaws – members can be disengaged, and inertia has led to inefficiencies such as multiple accounts. However, the paternalistic nature of other countries' retirement incomes systems does not apply here. Australians see superannuation contributions as part of their remuneration, not a benefit provided by their employer. For most workers, their superannuation was provided through pay cuts or reduced wage increases and a significant number make their own contributions and transferred their own savings to superannuation.

As a result, many of the new design developments getting traction in countries such as the UK, such as collective defined contribution schemes, are not suited to Australian conditions. When members have put their own money through both compulsory or voluntary contributions into superannuation, it is unlikely that they will have much appetite for compulsory pooling arrangements where members can lose rights to their capital and where that capital may be lost to the pool on early death. We can see this from the lack of interest clients, superannuation funds and advisers have shown in the comprehensive income product for retirement space, which is effectively a form of collective defined contribution pension.

International comparisons

When looking at international comparisons, our retirement income system is generally ranked well. For example, the Melbourne Mercer Global Pension Index ranks Australia as third, with a 'grade' of B+. This score is generated by analysing global retirement income systems based on a set of standards within three sub-indexes, namely adequacy, sustainability and integrity.

The report suggests improvements to the score – based on the metrics this study uses – could be made by:

- Moderating the assets test on the age pension
- Increasing household savings and reducing household debt
- Introducing a requirement that at least part of a retirement benefit, specifically superannuation, be taken as an income stream
- Increasing the workforce participation rate of older Australians, and
- Increasing age pension age as life expectancies continue to grow

Whilst some of these factors are only directly able to be controlled by individuals, the Government and private sector can indirectly influence individual behaviours.

When we consider the retirement income systems used by various OECD countries, as noted above our structure of a means-tested age pension with a broad-based individualised defined contribution scheme is relatively uncommon. Most countries rely on the pooling of wealth in either the public or private sector – or both – as the funding model for their retirement income systems. Australia however relies on a targeted Government funded pension supported by a strong private defined contribution system. A key feature of a defined contribution system is the shifting of retirement risks from a pooled method where a defined benefit fund takes on the pooled retirement income risks for its members, onto the individual members themselves.

This fundamental shift in the growth phase significantly changes how individuals view their private retirement income. In a defined benefit system, an individual's end benefit is effectively a replication of their salary, provided not by an employer but a super fund, where the fund carries the risks of funding. A defined contribution system individualises the responsibility for providing a retirement benefit onto the member and encourages the individual to make sacrifices during their growth phase to provide a better retirement experience.

As a result, an individual in a defined contribution system is potentially giving up present day salary or contributing substantial amounts of capital accrued through their small business or the sale of their home into a system with the expectation those funds will directly benefit them, or their family unit, in retirement phase. Given this, the retirement phase needs to be similarly structured to ensure individuals are expected to receive the full value of their present-day sacrifices, resulting in a disconnect with pooled retirement income approaches.

Whilst our structure is in the minority, there are features of other retirement income systems which allow for comparison. Chile is arguably the closest system based on OECD categorisation, having moved to a defined contribution system in 1981. The Mercer Global Pension index places Chile 10th, with a grade of B. Chile's position could be improved by increasing the minimum level of support for the poorest individuals, increasing retirement age and requiring pension plans to provide annual reports to help with their integrity score.

Another international comparison is Norway, who in 2011 moved to an employer-based defined contribution system with an earnings-based age pension system to provide a public support option. Ranked 6th with a grade of B, Norway's system could be improved by allocating a specific portion of Government funds for retirement incomes, increasing mandatory contributions into the employer-paid pension system, as well as introducing tax concessions for voluntary contributions into these plans.

Finally, comparisons can be drawn to Mexico. Although Mexico shifted to a defined contribution system in 1997 (2007 for public servants), its retirement income system has not been supported by a broad-based public pension system outside a contributory based system that did not provide a minimum level of benefit. In 2019, Mexico replaced the contributory system with a universal pension payable from age 68, which would be expected to provide a stronger retirement income framework. Mexico's rating on the Mercer scale is 33rd, with a grade of D – however as a system in transition with significant in-roads to make on both adequacy and integrity, this should not be viewed as an admonishment of our approach to retirement incomes.

The above may not provide guidance on features missing in our retirement income system, but goes to confirm what our system achieves well relative to our peers, specifically:

- A **broad-based public pension** to provide a minimum level of income. For example, Mexico and Australia have a similar level of recipients for their public pension (64% v 69%) but provide a substantially different level of benefit (27.8% of average working life earnings v 5.7%).
- A **well-supported compulsory defined contribution** system. The wide coverage of our system is also a strength relative to our peers. For example the Mercer report considers the option for individuals to exclude themselves from New Zealand's KiwiSaver system is a significant detractor.

Simply because we are leading our peers in this space does not mean improvements cannot be made, particularly in the face of changing demographics, however we are starting from a position of relative strength.

A final point considering the international perspective is commentary made by the OECD, which has noted countries have been **removing 'special regimes'** within retirement income systems, such as public sector schemes which have different rules than those which are available to the private sector. These schemes create additional complexity and in some cases provide substantially different outcomes for individuals based on who they work for. This sentiment was also reflected in the final report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, which specifically states that eliminating exceptions and qualifications is the first step towards a simpler and more readily understood body of law.

Special regimes can also be found on a more detailed level. For example, individuals have made the decision to purchase restricted-access income streams such as a term allocated pension or complying income stream, and subsequently the legislative framework has changed to the point where those income streams no longer provide an appropriate solution to their retirement income needs. Providing the ability to unwind these arrangements would help simplify the law and remove legacy regimes.

Purpose of the system and role of the pillars

Is the objective of the Australian retirement income system well understood within the community? What evidence do you have to support this?

We do not have any evidence to suggest that the community is aware of an over-arching objective to the Australian retirement income system. Out of the three pillars, only superannuation has a proposed specific objective of supplementing or replacing the age pension – however there is no such statutory objective for the age pension.

Further, a common retirement objective across individuals is to own their home outright. Whether this is a feasible objective for the retirement income system is uncertain, as home ownership rates for households where the reference person is over 55 shows more people in this demographic in private rentals (6% in 1997-98 to 12% in 2017-18) and increased levels of mortgages (10% of these households were still carrying a mortgage in 1997-98, up to 28% in 2017-18).

Another indirect objective of individuals in retirement is the receipt of an age pension. Whilst only anecdotal, there persists at least to a small degree a view that an individual who has contributed to the public wellbeing through taxes should be supported by the public through their retirement years. Whilst the focus of many individuals is the receipt of a retirement benefit from the Government, they are often unaware of the indirect support they receive through tax offsets such as SAPTO, and services such as Government funded home care and residential aged care.

We believe the clear establishment of, and adherence to, a retirement income system objective would help the community understand the purpose of future legislative change and help raise awareness of the expansive nature of the system.

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

Each individual component of the retirement income system has its own complexities, let alone the interactions between each element of the system. The level of complexity is such that even well-educated, experienced financial advisers can struggle to determine the interactions between tax, superannuation and social security laws to provide a meaningful estimate of retirement income to individuals with even moderate wealth.

Much of this complexity relates to legacy rules or grandfathered arrangements, and these legacy issues create both an administrative burden to operate the system, as well as a mental burden for all parties who interact with the system. These legacy issues create complexity for impacted individuals. For example, Centrelink are still administering ‘transitional rate’ age pensioners due to income test changes in 2006. However, individuals who are seeking information on current age pension income test limits would see references to this transitional rate.

Superannuation income streams also suffer from complexity inherited from legacy rules. Certain individuals may still be receiving a benefit from a term allocated pension or a complying pension, which have vastly different rules compared to a modern-day account-based pension or annuity. Individuals are also disadvantaged by shortcomings in legislative design, which have been exacerbated by compounding legislative change.

Whilst there is a wide array of information available to individuals provided through various public resources such as MoneySmart, there appears to be very little public awareness of these services. Improving the promotion of these services at relevant times could help raise at least awareness as to the components and operation of the retirement income system. For example, if the ATO are made aware someone over their preservation age has ceased employment, a message could be sent to the individual referring them to various resources around retirement planning.

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

We suggest these parties are responsible for the following elements of the retirement income system

Government

Balance the incentives between the three pillars. One of the Government's key responsibilities is striking the balance between providing a safety net in the form of an age pension, encouraging individuals to provide for their own retirement and the fiscal balance between the three pillars. This includes setting an appropriate level of age pension whilst ensuring fair access based on means testing, providing present day tax incentives to individuals for deferring consumption whilst ensuring funds are at some time used for consumption, and regulating the private sector to ensure the financial products used to provide the second and third pillars are provided in an appropriate manner.

Provide simplicity to the system. Any retirement income system is bound to include complexity, however it is the Government's role to minimise this insofar as possible. Simplicity is required to ensure individuals are able to understand the outcomes provided by the system and have a degree of certainty as to those outcomes. Providing simplicity also allows the private sector to dedicate less resources to legislative changes and more to providing better outcomes to individuals.

Promote financial literacy. There are many studies showing the impact of poor financial literacy on an individual's financial decisions, both before and during retirement. A good summary of this can be found in Xue, R et al *Financial Literacy amongst Elderly Australians*. Individuals with higher levels of financial literacy are more likely to be engaged and plan for their retirement. A higher level of engagement by individuals would be expected to promote stronger retirement outcomes. Providing resources such as MoneySmart helps provide individuals with the information they may need but does not drive an individual to engage with their finances. It would be expected by actively promoting financial literacy that individual outcomes would be improved.

Increase access to basic financial services. Related to improving financial literacy is increasing access to financial services. This could be supported directly, such as through expanding the Financial Information Service to look beyond budgeting and income support payments, and indirectly by providing a tax rebate for individuals who pay for holistic retirement advice.

Carefully consider changes to the retirement income system with a long-term view. Planning for retirement is a long-term consideration, which can only be done with reference to the law at that point in time. Legislative changes are necessary, however over the years we have seen the retirement income system shocked by changes – both proposed and implemented. For example, in 2017 the 'fair and sustainable' superannuation reform introduced a cap on the amount of funds which could be transferred into the tax-free retirement phase, which could be seen as a modification on the pre-2007 reasonable benefit limit threshold which also limited the accessibility of tax concessions. Similarly, in September 2007 the age pension assets taper rate was halved from $3 per $1,000 per fortnight to $1.50, and on 1 January 2017 this rate was reset to $3.

During the interceding ten-year period those individuals had the unique advantage of being able to invest unlimited amounts of capital in a zero tax environment and with a higher level of Government-funded income, whilst those engaging with the system before or after this period were not afforded the same opportunity. Importantly, those who were planning their retirement in say 2009 have potentially had a fundamental shift in how they will interact with the retirement income system with relatively little ability to adjust their existing strategy.

Considering changes to the retirement income system against a retirement-length timeframe would help individuals understand what they can expect from the retirement income system. If changes are required, consideration should be given to deferring the commencement of provisions to allow existing retirees time to understand the impact on their circumstances.

Private sector

Provide high quality holistic financial advice to assist individuals. The role of a financial adviser is important to help individuals understand what lifestyle they are likely to be able to achieve in retirement, as well as helping individuals implement strategies to optimise and protect their lifestyle. With an individualised retirement system, each person's circumstances will differ and no 'one size fits all' approach will cater for each person's circumstances. This is where holistic financial advice can make a difference.

Develop products and services that are fit for use. At present there are two primary products the private sector has available to fund retirement incomes using superannuation capital – account-based pensions and immediate annuities. The comprehensive income products for retirement framework and discussions on a retirement income covenant for superannuation have prompted discussion around the lack of income stream options, however this framework requires a degree of pooling to achieve its outcomes.

Whilst pooling may have a place for some individuals, given the superannuation growth phase has been individualised by moving to a defined contribution accumulation environment, forcing a default approach of pooling risk in retirement is not appropriate. An accumulation balance may not reflect solely employer-mandated contributions, but an individual's sacrificed salary, the proceeds of an individual's business or home, and other financial sacrifices the individual has made to provide for their retirement such as contributing an inheritance to superannuation. A default retirement arrangement which requires these funds to be pooled – and potentially lost in the event of an early passing – is against the principles applied to growth phase.

Additionally, the private sector is responsible for ensuring the underlying investments used by individuals are fit for use. For superannuation income streams, this includes managing investment portfolios to reduce the risk of accrued capital being unable to meet the needs of the individual.

Rebuild and maintain trust with individuals. Over the past five years, the financial services sector has lost the trust of the Australian public. It is now on this sector to rebuild this relationship such that individuals regain their trust in the private sector that is responsible for providing the products used to enhance their retirement beyond the age pension. As such, we as an industry need to reform our practices, ensuring that we place the individual at the heart of everything we do. Without this trust, individuals are unlikely to engage with the retirement income system to its fullest extent, leading to sub-par retirement outcomes.

Individuals

Engage with the retirement income system. A retirement income system should be developed for individuals to receive a benefit. In addition, a system designed to engage with individuals is more likely to provide an outcome that is relevant to the individual. Early engagement in the retirement income system is critical for fostering positive retirement outcomes, as a wider range of possibilities can be achieved with time and planning. Whilst an individual is the one responsible for engaging with the system, the Government and private sector should design their elements of the system to be easy to engage with and promote interactions with individuals.

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

Government funded age pension

The primary role of the age pension is providing a **baseline dignified retirement income** for individuals of modest means or those who have an inability to work. This should be delivered in a simple, honest and efficient manner as individuals who are solely reliant upon this pillar are likely to have a lower level of financial literacy.

The current structure of a broad-based, means tested income stream contains the framework for meeting this need, however consideration needs to be given to current policy settings and payment rates to determine if this objective is being met.

Compulsory superannuation

The primary role of superannuation is **enhancing an individual's retirement income opportunities** beyond the level required for a modest retirement for those who have capacity to work. The current accumulation framework provides a mandated level of contributions for employees as a foundation for this second pillar, as well as tax incentives – both immediate and future – to encourage further savings. Once an individual has retired, superannuation should provide a flexible array of options an individual can access to best enhance their retirement beyond what would be provided solely by an age pension.

Voluntary savings

The primary role of voluntary savings in a retirement incomes context is to provide **additional retirement opportunities** for individuals with excess financial capacity. This does not need to be strictly related to retirement incomes but expands to include broader objectives such as philanthropic giving, providing financial assistance to family members or establishing an intergenerational wealth vehicle such as a business or family trust.

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

The pillars of the retirement income system create the following trade-offs:

- The age pension trades against the superannuation and voluntary savings pillars by providing a Government-backed income stream, which may negatively impact an individual's decision to save for their own retirement or engage with their compulsory superannuation. This is balanced by the pension only providing a modest level of income, which is designed to encourage individuals to save for their retirement.
- The compulsory superannuation system trades against the age pension by providing a mechanism for an enhanced retirement income (potentially resulting in a reduced age pension via means testing) and provides a concessionally taxed environment for accumulation of funds specifically for funding retirement. These funds are however preserved until retirement, unlike voluntary savings outside superannuation providing a trade-off in terms of access. The trade-off is balanced by the superannuation tax concessions, if not sufficiently generous the pillar will not provide any substantial benefit over voluntary savings, and if too generous the equity and sustainability of the retirement income system could be impacted through loss of government revenue.
- Voluntary savings trade further against the age pension through means testing. These savings can generally be accessed before retirement if vehicles such as investment bonds or personal investments are used, providing a trade-off against the preservation of compulsory superannuation, however these vehicles do not bestow the same tax benefits of superannuation.

In terms of establishing a balance between the pillars, the below methodology sets out a basic framework to consider when trading off between the pillars and keeping focus on the principles discussed below.

1. Ensure the full age pension is sufficient to provide a modest retirement. The foundation of our retirement income system should be the provision of an adequate safety net that ensures retirees are not subject to poverty.
2. Determine a compulsory superannuation contribution rate that is likely to provide working individuals a comfortable level of wealth in retirement. The specific contribution rate should consider broken workforce patterns for all individuals, with a view to accumulate a level of wealth to provide a retirement income that allows discretionary spending without sacrificing the sustainability of the tax concessions of superannuation, with only a limited dependence on Government support.
3. Adjust the means testing thresholds for the age pension to reduce pension benefits as an individual's wealth increases, ensuring the thresholds balance the need for a basic level of income in retirement with incentives for individuals to save towards their own retirement income needs and help the sustainability of the retirement income system as a whole.

4. Adjust the tax concessions available to superannuation and voluntary savings vehicles to balance incentives for deferring present-day benefits to save for retirement against the overall transfer incentives available to individuals of more substantial wealth. As noted by the panel, the current transfer settings provide a higher level of support for those with significant wealth compared to those of limited means. This anomaly is against the principles of sustainability and equity as those individuals with greater wealth are receiving a greater benefit (albeit indirectly), which reduces tax revenue available to, amongst other things, provide that baseline age pension benefit.

Whilst the above balancing methodology is relatively simple to list, implementing each step appropriately will prove a difficult task. However, the proposed framework for making these decisions should provide guidance in how to set these levers.

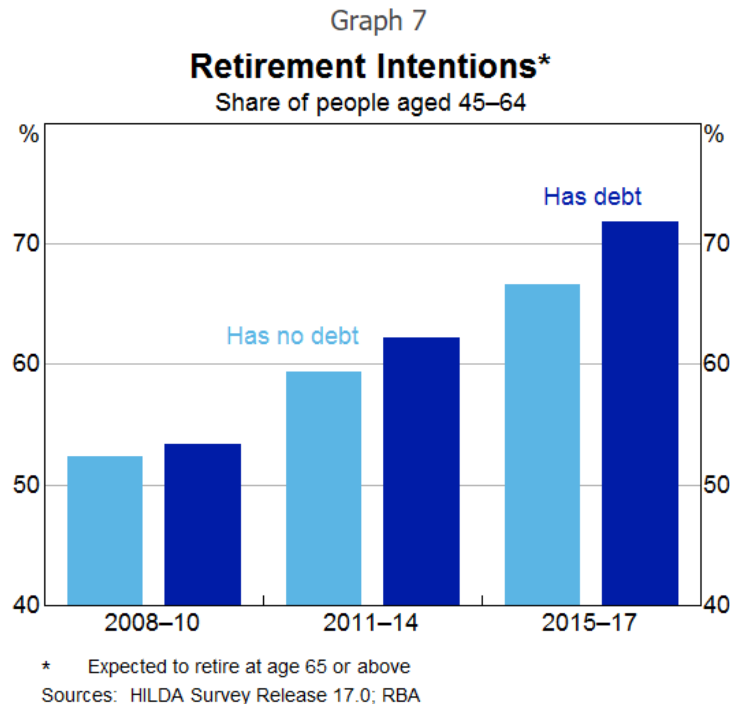
The changing Australian landscape

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

What are the main impacts of those trends?

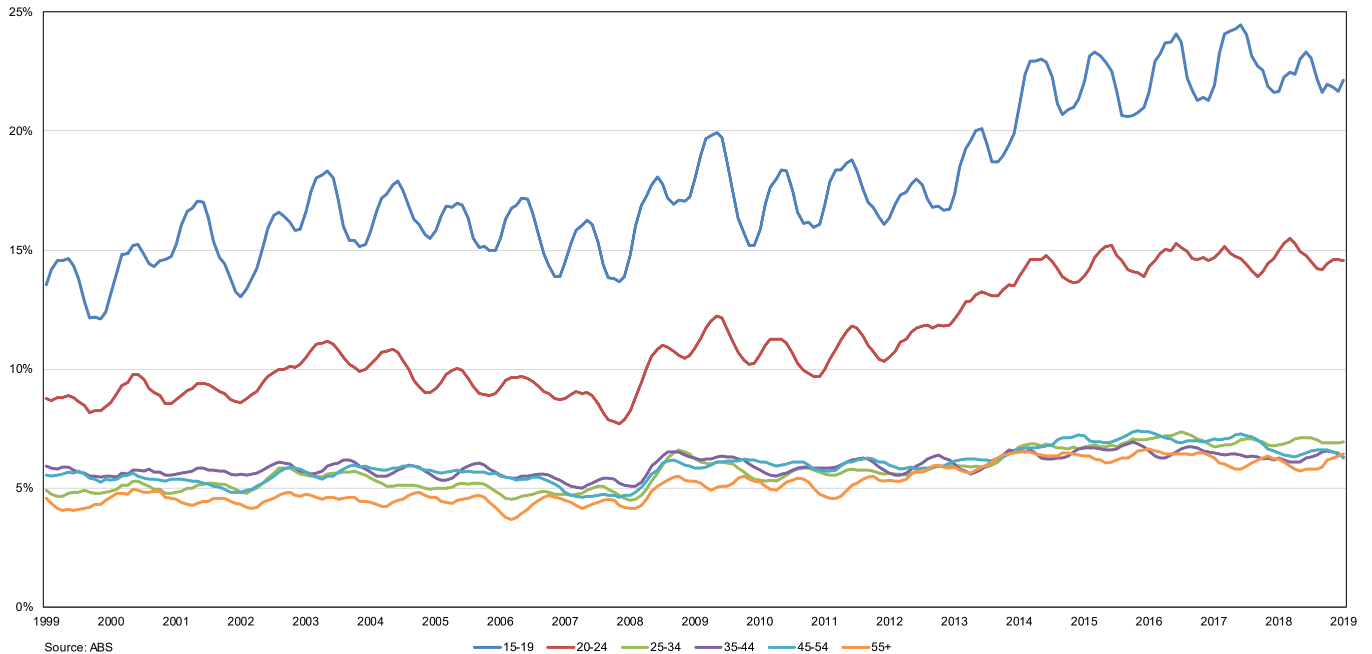
Labour market

We have seen a changing labour market for older workers with both rising labour force participation and debt levels into retirement. This is also coupled with a greater proportion of individuals expecting to retire at age 65 or older as noted by the RBA in the below chart of retirement intentions.



There is a clear need for continued employment to enable the system to function and grow and potentially reconsider income treatment under this backdrop. If more retirees will require normal jobs to supplement income does the existing tax system still enable them to achieve an overall constructive retirement income? We would argue that currently the flexibility is limited. The tax system was not designed with the idea of a sizeable aged worker cohort in mind. We note that tax reform and exemptions can add to the existing complexity of the system. An alternative would be, as discussed elsewhere, ensuring the age pension functions effectively as a minimum standard with any additional income falling under the existing tax regime.

High youth unemployment and underemployment can lead to sustained inequality in superannuation outcomes between those who could find roles and those who could not. This trend also undermines the system in general when older worker balances run off if that process is stronger than new inflows from the younger cohort entering the workforce. Part of this trend will be young workers self-selecting into extended education (and is ultimately productivity enhancing as a result) but even slightly older cohorts (20-24 years old) show poorer employment outcomes that entrench the disadvantage raised here. The chart below highlights the weaker quality of employment growth of this group (15-19 and 20-24 year old persons) in the post-GFC environment with an elevated proportion underemployed compared to historical averages.

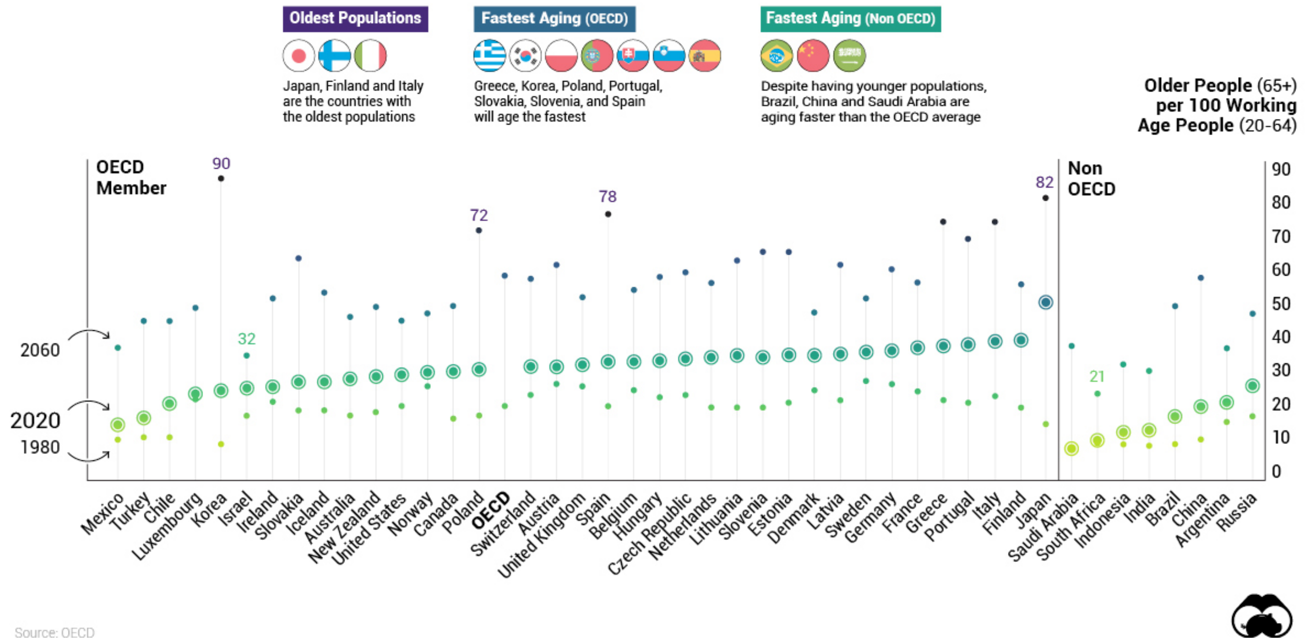


Finally, there is the rise of the "gig economy" affecting the reduced use of superannuation – there is an even greater need for a simple system for people to have portable super. In addition, workers in these situations may fall outside superannuation payments by their employer. This poses a new challenge for system sustainability as this section of the economy grows.

Demographics

Ageing population causes lower interest rates due to reduced inflation (older people spending less) and hence lower economic growth. This has flow-on effects in lower incomes from fixed interest. In the Australian context, high levels of immigration have helped to stave this impact. However, while we are ahead of other developed countries in this regard, as the 2015 Intergenerational Report highlighted this looms as a problem for government finances with the superannuation system as a collective saving vehicle helping to stave off this possibility.

At present however, and as illustrated by the below chart, the Australian dynamic is healthier than most countries in the Developed world both at present and, according to the OECD, expected to be so in 2060 under current projections. The direction, however, remains on an upward trajectory that is an important backdrop to consider in the context of the superannuation system.



In addition, an ageing population means that sequencing risk becomes a more important issue, as more people have large balances and they are needed to be maintained to reduce the burden on society (funding the aged pension) hence downside protection strategies are crucial. Furthermore, people are living longer – hence more growth assets are needed and hence the need for downside protection strategies. These include dynamic management, explicit strategies and products and, the use of annuitisation. We note that annuities as a product are negatively impacted by low annuity rates and bond yields.

Home ownership

Higher prices meaning less people can afford homes hence less people having this as a support to fund their retirement with rent an additional cost instead. The need for zoning laws to accommodate multifamily occupation of normal family homes ("granny flats", dual occupancy) to facilitate children moving in to assist with aged care and the management of home assets.

There is a clear need for equity withdrawal products that are safe and well-regulated to access the large wealth in family homes.

To what extent is the system responsive to these trends?

Historically the system has changed over time to rectify some of these trends. For example, changes to concessional contributions to enable some equalisation for spouses. This helps to offset the negative impact of time taken out of the workforce typically to care for children.

Labour Market

There have been intermittent Government initiatives in this space including the 2014 Restart program under the Abbott government offering employers up to $10,000 to employ workers aged 50 years or over. This was not a notable success with only 500 job seekers joining in its first year of operation (it was meant to benefit 32,000) on Government projections.

Beyond these efforts more is needed to address these trends. The key questions (and potential solutions) are:

- Continued employment into old age – questions on whether this is viable under the current tax system and whether we should embark on additional reform or carve-outs in this space.
- Entrenched youth unemployment – This is a broader question beyond the system itself, but a suggested reform might be to introduce more flexibility for the concessional cap to allow workers to "catch up" with additional contributions if they were unable to do so earlier in their careers.

- The "gig economy" – For workers in this situation we suggest more reform is needed to ensure a base level of superannuation support by employers, particularly as the space grows.

Demographics

The challenges posed by changing demographics, specifically an older population, need to be confronted by a holistic evaluation of how the system interacts with other parts of social security and other government and private sector supports including for example life insurance, the age pension and more.

We believe the questions asked here, and elsewhere in this submission form grounds to articulate a clearer approach on how the system is meant to interact with people entering retirement. This could include articulating a clearer framework of how the system should operate in a retirement setting. An example is requiring part of the account-based pension to be taken out as an income stream as highlighted on page 2.

Home ownership

There may have been an implicit assumption at design that home ownership would continue along historic levels. To date however the decline in home ownership does not appear likely to be arrested given elevated valuations and subdued wage growth despite a backdrop of RBA stimulus for several years. This has implications in the greater proportion of retirees paying ongoing shelter costs in retirement through rent. In such an environment it may be increasingly unfounded to assume home ownership as a norm with greater income generation required to offset additional costs or, some form of rental assistance by the government.

In addition, the existing government reverse mortgage scheme has limitations on flexibility as well as criticisms for the costs associated with it with the interest rate being charged substantially above long-term government borrowing rates. These criticisms were partially successful with a notable drop in the charged rate from 5.25% in December 2019 to 4.5% in January 2020. We would argue such mechanisms would benefit from more encouragement and competition to enable households to unlock home equity (63.6% of total household net worth at September 2019 according to ABS Catalogue 5232.0) as an alternate retirement income stream.

Are there additional trends which the Review should consider when assessing how the system is performing and will perform in the future?

There is a growing lack of safe assets available to members. Low bond yields both domestically and globally have encouraged risk-seeking by members. Such a move can be ill-advised depending on both their investment time horizon and plans for this capital. Across the industry more generally we have seen a greater reliance on unlisted assets to both add value to member outcomes and, to a lesser extent, cushion the volatility normally associated with investing in growth assets. This is an area that has caused trouble in the past. A notable example was the losses incurred by superannuation fund MTAA Super which had heavily invested into this space heading into the GFC.

In addition, this trend has contributed to weaker annuity rate offerings within the Australian market. Recent reforms from 1 July 2019 have helped this sector notably by reducing the assessed amount for means testing in the Age Pension. However, an alternative approach that might encourage more saving is targeting to an income standard i.e. a certain percentage is exempted from means testing say X% above a target retirement income stream. Under this thinking if the government targeted ASFA Comfortable as the ideal standard (this is offered as an example only) then if a client is fully invested in annuities that reach 70% of this level, the annuity is exempted from means testing to the extent that the remaining 30% is funded by the Age Pension. Such a proposal or variation thereof has its complexities. There are several notable benefits from encouraging greater annuity take-up.

- First it would encourage the pooling of mortality risk across a greater group of citizens promoting stronger diversification and lower sequencing risk for the economy as a whole.
- Second for the government it also lowers the amount of future liabilities being brought onto its balance sheet supporting stronger long-term fiscal sustainability.

In summary,

- There are changing dynamics on the demographic, labour market and home ownership front that pose current and future challenges to the superannuation system.
- Some of our proposed solutions involve building on what is already available, others require a more holistic consideration in terms of where the burden is borne between the public and private sectors.

Principles for assessing how the system is performing

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

These principles, discussed in detail below, are strong indicators as to the health of, and outcomes provided by the retirement income system. We propose a further principle be considered, namely **simplicity**. The effectiveness of an adequate, equitable, sustainable and cohesive retirement income system will be impacted by the ability for individuals of varied backgrounds and understandings to be able to navigate the system.

Whilst the provision of financial advice may help individuals navigate a complex retirement income system, it should not be required to effectively engage with the system. Further, the true value of financial advice should not be seen in understanding how the retirement income system operates but rather in understanding what an individual seeks from retirement, and how to best use the retirement income system to achieve that objective.

How does the system balance each of the principles and the trade-offs between principles under current settings? What is the evidence to support whether the current balance is appropriate?

The retirement income system does not automatically balance the trade-offs between the principles, and as such Government policy-setting is the key lever that can be used to influence the operation of the retirement income system. Further, regardless of the setting, the current retirement income framework will drive different behaviours for different groups of individuals. For example, individuals with a strong savings capacity are heavily incentivised to save within superannuation, as this provides a significant tax benefit over the longer term. However, individuals of more modest means may favour building a small capital pool outside superannuation using voluntary savings, as in retirement their marginal rate will provide an effective nil tax rate savings environment, with additional flexibility around estate planning. These positions may also change over time as an individual's circumstances change.

In terms of balance between the principles, whilst the current settings provide a strong foundation there remain anomalies which could detract from the operation of the system for specific groups. The below addresses specific concerns with current policy settings by principle.

<u>Adequacy</u>

Maximum age pension benefit

The age pension acts as a 'safety net' for individuals of modest means, and as discussed in detail below, the baseline for assessing adequacy should be ensuring those of modest means are able to have their basic needs funded through the age pension.

A widely used benchmark for retirement expenses is the ASFA retirement standard, which provides an estimate as to the average expenditure retirees face. The two categories of retirement, modest and comfortable, are both developed on a set of assumptions about the behaviours of retirees, and whilst the specific details will vary between individuals, the standard provides a useful starting point.

The full age pension for an individual from 1 January 2020 is $24,268 per annum, which is $3,645 per annum less than the modest retirement standard of $27,913, or a shortfall of 15% by the age pension. A similar shortfall is found when considering the couple rate of age pension ($36,582) compared with the ASFA modest couple expense need ($41,613 – a 13.75% pa shortfall). This could be considered a failure of adequacy in this pillar.

An additional issue faced by individuals renting in retirement is the difference between rental increases and indexation of rent assistance. As rental rates in most cities have increased above the rate of inflation, the effective value of a rent assistance benefit has been eroded over time. This impact is pronounced on retirees who do not have capacity to generate additional income to offset the difference and for whom moving to another home may not be an appropriate consideration. Indexing rent assistance purely in line with increases in rental rates would help provide a more adequate benefit to renters, again at the cost of sustainability.

The key trade-off in increasing the pension rate and rent assistance indexation method is the sustainability of the age pension over the longer term, however ensuring individuals can access a modest retirement should be a key objective of a retirement income system.

Age pension assets testing

In January 2017, the Government doubled the taper rate of the age pension assets test such that the pension is reduced by $3 per fortnight for every $1,000 of assets over the relevant assets-test free area. In effect, this requires an individual to achieve a return of 7.8% per annum for each dollar over the assets-test free area. This reduces the sustainability of the retirement income system by requiring either the drawdown of capital - which would result in an increased age pension over time – or an increased level of investment risk taken to achieve a return sufficient to replace the reduction in the age pension.

If this required earnings rate is compared to the maximum assumed earnings applied by deeming – the metric used to estimate income generated by financial assets – of 3% per annum an individual may be required to draw down on their capital at a faster rate than if the taper rate was reduced to a more reasonable level, providing increased adequacy over the longer term. Again, the trade-off for any reduction of taper rate would be the sustainability of the system however an appropriate balance can be struck to provide an adequate outcome for most individuals.

Equity

Age pension homeowner status

Presently the age pension assets test allows for individuals who do not have a long-term right to remain in the dwelling they occupy (non-homeowners) to hold additional assessable assets of $210,500 compared to someone who has that long-term right (homeowners). This ‘extra allowable amount’ is designed to provide equity between homeowners, who benefit from the value of their home interest being exempt from assets testing, by allowing non-homeowners to have a higher level of assessable assets. However, in practice it would be expected that non-homeowners would have a lower level of wealth overall compared to homeowners, so whilst a non-homeowner *could* hold more assets before having their benefit reduced under the assets test, it is unlikely they *do* have this extra wealth.

Further, the extra allowable amount is not linked to property values, and with these having increased across Australia over the past 20 years, the original purpose of balancing the assets test benefit of exempting the family home has been skewed heavily in favour of homeowners, who receive a much greater benefit by the full exclusion of their home.

Superannuation guarantee universality

Equity of a retirement income system is directly impacted by the equity provided during the growth phase of individuals entering the retirement income system. On this front, there are two key areas where concerns have been identified in relation to the second pillar of compulsory superannuation, self-employed individuals and the impact of the gig economy.

Individuals who are self-employed sole traders or partners in a partnership are not covered by the current compulsory superannuation guarantee system. Although there is capacity within the superannuation system for personal concessional contributions to be made, there is no compulsory minimum contribution required. Individuals in this position may consider their business to be their retirement income plan and have specific exemptions from contribution requirements allowing them to ‘top up’ their superannuation on the sale of their business at retirement. Effectively, these individuals have a single non-diversified retirement portfolio, which would unlikely be considered an appropriate retirement investment strategy if undertaken by a superannuation fund.

Another argument in equity is the foregone present benefit of wages an employee is required to undertake, compared to a self-employed person who has the choice as to whether to make contributions. As such, expanding compulsory superannuation to self-employed individuals and partners in a partnership would help balance equity during the growth phase, as well as potentially increase the sustainability of the retirement income system by broadening the application of the second pillar. This would increase the complexity for impacted individuals, however most small business operators already undertake complex income tax and GST reporting and payment obligations and as such it would not be unsurmountable.

Secondly, the gig economy is expanding the number of prospective employers an individual may work for at the same time, and the employment provided by each 'gig' may vary substantially in time and level of remuneration. This creates a circumstance where an individual may be working for multiple employers and earning a living wage, however the individual employers are paying under the $450 per month minimum income level required before superannuation guarantee obligations commence. As such these individuals may be missing some or all their compulsory superannuation contributions compared to someone earning the same gross wage from a single employer.

The $450 per month minimum was introduced to help employers and superannuation funds with administrative workloads that may accompany seasonal or short-term workers. However, with the introduction of SuperStream and Single Touch Payroll, employers and superannuation funds have been required to use technology to solve many of the administrative issues which this limit was introduced to reduce. As such, in the interest of equity the $450 per month limit should be removed. This may create some transitional issues for employers, however the benefit of expanding the coverage of the second pillar of the retirement income system more than outweighs this.

Annual non-concessional contributions cap

Since 2006 a cap has been placed on the amount of after-tax contributions (also known as non-concessional contributions) an individual can make to superannuation, with the aim of limiting superannuation balances to a reasonable level. The fair and sustainable superannuation reforms effective 1 July 2017 introduced a further limit, restricting an individual's non-concessional contributions cap to zero if their total superannuation balance reached or exceeded the general transfer balance cap (currently $1.6m). Generally, an individual's cap is $100,000 in a year, with those under 65 able to bring forward up to 2 future years for a maximum contribution of $300,000 in any one year.

However, with the over-arching $1.6m restriction on accumulating superannuation benefits, the need for annual non-concessional contribution caps is substantially reduced. Replacing the current annual cap arrangement with an annual limit equal to the general transfer balance cap would provide flexibility for individuals who receive a substantial windfall they wish to use to provide for their retirement, such as through the sale of a business that does not qualify for any contribution concessions. The cost of this increased flexibility is potential sustainability issues, as an individual with capacity to make larger contributions earlier will benefit from the low-tax superannuation environment for a longer period.

Legacy / grandfathered arrangements

As the retirement income system has grown and developed over time, there have been many changes made in how components of the retirement system have operated. When the Governments of the day have made changes to the system, there is generally a consideration as to the immediate impact of the change, and an allowance made to those who may be negatively impacted by said change. For example, the below is includes many of the common grandfathering arrangements which have been established as a result of various changes:

- The 'transitional' rate of age pension for individuals impacted by the income test changes in 2006
- The transitional $1m undeducted / non-concessional contribution cap in 2006
- The increased concessional contributions cap for older workers based on the previous maximum deductible contribution from 2007 to 2013
- The change to income streams which could be commenced from 2007, effectively creating a two-tiered superannuation income stream system of current and legacy products
- The grandfathering of the treatment of account-based pensions for age pension purposes from 2015
- The (separate) grandfathering of account-based pension income testing for Commonwealth Seniors Health Card purposes from 2015
- The provision of special Pensioner Concession Cards for individuals who lost their pension due to the asset test changes in 2017
- The extended rules relating to 'capped defined benefit income streams' for transfer balance cap and total superannuation balance purposes from 1 July 2017

Individuals who have entered the retirement income system at various points have made decisions based on the best knowledge available at the time, and the intent behind grandfathering appears to be to minimise the impact of changes on those receiving current day benefits. However, individuals who enter the system at different points will be subject to different rules, resulting in inequal outcomes over time. These arrangements can also have unintended consequences, resulting in individuals having to sacrifice their grandfathered status or remain in a financial product that may no longer be appropriate for them, or in some cases simply be denied the ability to simplify their affairs due to shortcomings in these legacy systems.

As an income stream provider with members impacted by these legacy issues, we have been seeking a solution that is fair and equitable and allows individuals ‘trapped’ in these arrangements to find a more appropriate alternative. Appendix A include a number of anonymised case studies specifically related to legacy income streams.

These legacy arrangements should be reviewed with the aim of both simplifying the retirement income system and providing equitable outcomes for all individuals. This is not to say grandfathering or legacy arrangements should not be considered, however there also needs to be a consideration as to the equity across individuals entering retirement over time, with the aim of providing broadly similar outcomes for individuals of similar circumstances.

Family retirement planning

As noted previously, the second pillar of the retirement income system is founded on a defined contribution accumulation environment, which creates a direct attachment between an individual and their accumulated capital. The current system also distinguishes between single individuals, and those who are in a couple. The age pension provides different rates of payments for singles compared to most couples, as a recognition that most couples pool their resources and plan their retirement years as a family unit. Superannuation is considered as an asset of the matrimonial pool on relationship breakdown, and there are provisions for allowing superannuation to be split from one spouse to another on the breakdown of a relationship.

However, missing from the retirement income system is the ability for couples to pool their superannuation into a single benefit. Even for individuals utilising a self-managed superannuation fund (SMSF), the benefits are maintained separately. Allowing couples to elect to pool their superannuation capital into joint accumulation accounts and joint income streams would provide additional efficiencies in the retirement income system and assist with retirement planning for these individuals, without creating any additional issues on the breakdown of a relationship. This extension to superannuation would bring legal equity to couples by allowing them to fully pool their funds, which is a baseline assumption for the payment of a lower age pension rate for couples compared to singles.

Sustainability

Superannuation tax concessions

One of the most attractive aspects of superannuation is the combination of present-day tax benefits, concessional earning rates during accumulation and the ability to transition accumulated capital to a tax-free earnings environment with the individual also receiving a tax-free income stream. As a result, most funds introduced into the superannuation system are taxed at a maximum rate of 15% - including funds contributed by way of salary sacrifice and superannuation guarantee. For many individuals this compares favourably with their marginal tax rate, even through retirement. Alternative savings vehicles such as investment bonds generally tax earnings at a rate of 30%, and do not provide a capital gains tax discount on sale of assets.

The 2018 tax benchmarks and variations statements estimate foregone revenue simply on the concessional tax treatment of superannuation investments as $19.5 billion for the 2018-19 financial year, with the concessional tax treatment of employer superannuation contributions resulting in an estimated foregone revenue of $17.75 billion.

Whilst these concessions have undoubtedly resulted in the popularity of superannuation as a savings vehicle over the years, questions remain as to whether this generously low rate of tax is sustainable over the longer term. Even the introduction of a modest rate of tax on benefits paid from superannuation could be used to help sustain the retirement income system without significantly detracting from both the attractiveness of the concessional nature of superannuation and the adequacy of the retirement income system.

Further, based on APRA’s September 2019 superannuation performance statistics, over 90% of employer contribution paid to defined contribution plans were classified as superannuation guarantee contributions. As such a mild increase in the concessional contributions tax rate is unlikely to have a significant impact on the overall level of concessional superannuation contributions.

Superannuation cashing requirements

Since 2007, superannuation is only required to be cashed in event of death of a member, or payments made to temporary residents under the Departing Australia Superannuation Payment rules. From 2007 to 2017, there was no limit on the amount of capital which could be invested in the tax-free pension phase – however pensions are subject to a minimum payment based on the balance of the income stream each year.

With the introduction of the ‘fair and sustainable’ superannuation reforms from 1 July 2017, most individuals are limited to transferring $1.6m of their superannuation money into the tax-free retirement phase under the transfer balance cap requirements. Any amounts above this can however be kept in accumulation phase, where no cashing or minimum drawdown requirements exist. Further, individuals are now restricted from making most after-tax contributions to superannuation if their total superannuation balance exceeds the transfer balance cap.

As a result, individuals with higher accumulated wealth have been able to maintain their funds in an environment which is still providing a substantial tax concession, whilst reducing the amount of their funds which is required to be paid out as a minimum pension. However, most individuals still accruing superannuation will be restricted from achieving a balance of similar size. This equity issue is based on legacy, however a historical tool may also provide a solution which could reduce the inequity of this situation.

Requiring individuals who have a total super balance greater than the transfer balance cap to cash a portion of any funds maintained in accumulation phase after a certain age, say 75, would help relieve this equity issue by requiring the funds to be paid out of the superannuation environment. This may result in additional funds accruing outside superannuation, which creates a more level field for those who would be required to consider non-superannuation savings vehicles due to the total superannuation balance contribution limit. Alternatively, the funds may be spent or gifted to family members, where the money may be used within the economy, rather than simply investing within accumulation phase.

<u>Cohesion</u>

Interactions between social security and superannuation

Within a strongly cohesive system, individuals should be able to logically follow the interactions between age pension means testing and superannuation. However, a number of factors such as different types of income streams, historical grandfathering and inconsistent terminology erode at this understanding. Cohesion between social security and superannuation could be increased by simplifying the terminology used, as well as the means testing of superannuation benefits. As this is a specific question raised by the panel under cohesion, our detailed analysis can be found below.

Adequacy

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

As noted by the panel, there is no single best metric to measure adequacy in retirement. However, we believe a starting point for measuring adequacy would ensure those of modest means are able to access a lifestyle where they do not want for the necessities, whilst promoting an increased level of spending for those who have financial capacity. An estimate of financial capacity in this context could be pre-retirement household income.

On this basis, an adequate retirement income system is one that provides a baseline level of income ensuring individuals are above the poverty line, whilst aiming to replicate a percentage of net household income above that threshold.

It is also important to recognise an adequate retirement income system may also be required to provide access to capital, particularly as individuals age and require access to residential aged care. A retirement income system which provides a limited set of outcomes oversimplifies the needs of Australians and could lead to adequate outcomes for some, but not all.

A further challenge in assessing adequacy is the shift between a defined contribution growth system, which measures values in terms of capital, to a predominately income-focussed retirement phase that focuses on regular cash flow. Care needs to be undertaken in the metrics used to assess whether an amount of capital is adequate to be converted into an income stream to sustain life in retirement. There is substantial uncertainty around this assessment given rising life expectancies with the prospect for further advances in medical technology in the years ahead.

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

In terms of assessing a baseline level of adequacy, it should be considered that the full age pension should support a modest retirement. We would argue the ASFA Retirement Standard definition of a modest retirement is a strong starting point as to what individuals should expect to be able to afford in retirement. This definition allows for income to cover basic home repairs, supports basic leisure activities without providing such a high level of guaranteed income that providing additional savings would be discouraged.

Beyond this baseline, the perceived adequacy of the retirement income system is likely to be substantially influenced by pre-retirement living standards and decisions. A replacement rate provides a generalised measure of pre-retirement standards and would provide a useful benchmark. However, an individual's decisions such as sacrificing salary to increase superannuation savings, becoming actively engaged with their investible capital or developing other savings are likely to influence an individual's view as to whether the income they receive in retirement.is seen as adequate.

For example, if two individuals have the same pre-retirement income, however Individual A maximises their concessional contributions through sacrificing their present-day salary, Individual A would expect a higher level of income in retirement. If both individuals received the same level of post-retirement income based on their pre-retirement earnings, Individual A may not believe this is adequate as they have undertaken additional savings to provide for a potentially higher level of spending in retirement.

Another limit of using a pre-retirement income replacement rate is specific to higher-income households, where incomes in the years just before retirement may have increased substantially, with the increased earnings used not to fund present-day expenditure but to save for retirement. Using a fixed ratio of their pre-retirement income may provide an excessively high adequacy benchmark and provide a 'false reading' of inadequacy compared to their expectations.

An additional tool which could be used in measuring adequacy would be a survey of retirees, which both directly and indirectly assesses their perceived adequacy of their retirement incomes. A survey would provide the opportunity to identify specific issues with the retirement income system, including the level of understanding and perceived adequacy of the system.

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

IOOF clients in retirement phase make up a significant component of our client base, through our advice services; public offer superannuation; small APRA funds; and SMSF platform services. We undertook analysis of one of our main databases covering a significant proportion of account-based pension members within the IOOF Portfolio Services Super Fund.

Key findings are:

1. 31.7% of pension accounts had nominated a reversionary pensioner (this will almost always be a spouse). At first glance, this proportion appeared to be low, given our experience both directly and through financial advisers as spouses ordinarily arrange their retirement incomes together. However, when we looked further, we found 91.8% of pension accounts had a linked dependant client. This indicates the pensioner has a spouse with a super or pension account in the IOOF super fund, and they have 'linked' their accounts together.

   This finding brings into focus what we noted above as a weakness of the Australian superannuation system. The superannuation system has historically focussed on the individual and mostly on the accumulation phase. The accumulation phase is structured around employment and the individual taxpayer: super guarantee contributions are based on the individual's workplace income; contribution caps are at the taxpayer level etc.

   Yet when it comes to the retirement and pre-retirement phase for couples, it is the combined couple income in retirement that is paramount. Spouses see their income needs in retirement as combined. Social security benefits in retirement are calculated and assessed on joint income and assets; spouses seek financial planning together and pool their income etc. Consequently, when considering the adequacy of income in retirement, family income should be the focus, not individual income. The adequacy of the retirement income system could be improved by considering couple retirement, with measures such as:

   - Facilitating sharing of superannuation benefits between spouses and/or allowing for joint superannuation accounts. It is ironic that despite the clear superannuation savings gap between men and women, currently the only way to substantially shift benefits between spouses is relationship breakdown or death.
   - Sharing contribution caps before retirement and transfer balance cap thresholds. This recognises that families plan for their retirement together and can allow for additional retirement savings where incomes are not equal between spouses.
   - Recognising that financial advice in retirement and pre-retirement is provided to a couple.

2. Concerns have been expressed that account-based pensioners don't draw down on their retirement savings – but rather take the minimum pension payment in order to accumulate wealth to transfer to adult children as an inheritance.

   In our analysis:

   - The proportion of pensioners between age 65 and 80 taking the minimum pension payment ranges from 55% to 60% for account balances over $100,000. Therefore 40%-45% are taking pensions above the minimum.
   - 69% of pensions with account balances under $100,000 took the minimum pension. This could reflect a desire to protect capital for those who have not accumulated substantial superannuation savings.
   - For all account balances, the proportion of pensioners drawing down the minimum increased for those over age 80 to between 66% and 75, reflecting the increase in the minimum drawdown percentages for older individuals.

- The focus on high balances in pension phase is arguably misplaced. Of the database, 78.8% of pensioners had less than $500,000 in super. Of those with balances over $500,000, less than 5% were over age 80. It should be noted that our clients are generally advised, and whilst a maturing superannuation guarantee system is likely to result in an increase in average superannuation balances over time, the current retirement income system has a small number of individuals with incredible wealth which can reduce the usefulness of system-wide averages.
- The general statement that older pensioners are accumulating large balances to pass on wealth to later generations is not borne out by the data. From the data, pensioners over age 80 are 13.1% of the total number of pensioners but 21% of those with under $200,000. This suggests individuals are drawing down on their capital during retirement years.

3. Do retirees have enough in super for a comfortable retirement? The ASFA standard for the required amount of savings for a comfortable retirement is $640,000 per couple and $545,000 for singles.

   In comparing the data against this standard, we looked at the 12.2% of pensioners who commenced their pensions within the last 12 months (1/1/19 to 1/1/20). Although some may be rolling over from existing pensions with other super funds, a significant proportion - 65% - of these new pensioners are under age 70 and would be expected to be entering retirement.

   - 77% of pensioners who commenced pensions within the last 12 months had less than $600,000 in their pension account. 33% had less than $200,000.
   - Only 27.5% of new pensioners commenced their pension with between $300,000 and $600,000.

Equity

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

When considering equity, key considerations include seeking to achieve similar outcomes for individuals of similar circumstances, and ensuring public support is appropriately targeted where it cannot adequately and sustainably support all individuals.

The retirement income system should also aim to provide equity to individuals who enter retirement at different points. Whilst this is not always going to be possible to achieve, limiting the different treatment between individuals of similar circumstances who happen to commence retirement at slightly different points will help promote equity within the system.

What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement? What evidence is available to assess whether the current settings of the retirement income system supports fair outcomes in retirement for individuals with different characteristics and / or in different circumstances?

A key factor which should be considered when determining whether the system is providing fair and adequate outcomes in retirement is Government support, capturing both direct and indirect transfers to individuals.

As noted by the panel, there is a significant level of indirect support for higher wealth individuals under the current retirement income system provided in the form of tax concessions resulting from a combination of tax-free income provided by retirement phase pensions, tax-free investment earnings on capital backing those pensions and a concessional 15% flat earnings tax on additional capital retained within the accumulation phase of superannuation.

Further, higher income individuals receive additional indirect transfers through the main residence CGT exemption, as individuals in higher wealth households are more likely to own their home. This provides a justification in equity for continuing to support non-homeowners through direct transfers such as rent assistance.

Another factor noted by the panel is superannuation guarantee support. As we have discussed above, we believe the universality of compulsory superannuation will be a key driver to ensuring individuals of similar circumstances achieve similar outcomes, as well as helping the system provide fair and adequate outcomes for individuals in retirement.

In relation to equity and the age pension, some participants in the retirement income system may suggest that means testing the age pension derides the equity of a social security safety net by limiting access to funds and placing bureaucratic hurdles in the way of an individual accessing a benefit. In an ideal circumstance, means testing of the age pension would be abolished and all retired individuals would receive a pension sufficient to provide a modest retirement.

However, under the current retirement income system such a system would not be sustainable without radical change to increase taxes or impact the funding of other services. In the absence of such radical action, it is preferable to have the age pension provide a modest level of income to individuals most in need rather than a lower level of income to all individuals regardless of means. Further, as noted above a review of the specific operation of the means testing is warranted, as the system is complex and this can create inequitable outcomes between individuals.

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

When viewing how the system interacts with older Australians, a key consideration for many individuals who are nearing retirement is the ability to access the tax concessions available should the person be made genuinely redundant. Whilst younger members of the workforce are likely to have more career changes, and this trend may continue into their later working lives, there exists an inequity in that an individual who is made redundant just under their age pension age receives in most cases a substantially higher level of tax concessions compared to an individual who works past their age pension age. For an individual who wishes to work past their retirement age, they could be reducing their retirement benefits significantly, which may only be recouped after years of additional time in the workforce. Revisiting the need for an upper age limit on genuine redundancy payments could provide equity for older Australians who wish to continue working past their retirement age.

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

As noted by the panel, it is well publicised that men tend to reach their retirement age with greater superannuation balances compared to women, and this is primarily driven by a difference in average wages and women tending to take more time out of the workforce than their male counterparts. Further, the ABS publication *Retirement and Retirement Intentions* shows that women are more likely to leave the workforce at a younger age and are more likely to leave the workforce to provide care for another person.

An equitable retirement income system would help ensure that individuals who spend the majority of their working lives in employment should achieve similar outcomes. However, factors such as the timing of breaks from careers, family care needs and broader family circumstances have a substantial impact on the ability for an individual to be covered by the superannuation guarantee at an appropriate rate for their working lives. The key driver for the inequality of retirement capital is superannuation guarantee, as this is based on a percentage of salary and wages. Lower wages also impacts the ability for an individual to save for their retirement using voluntary superannuation contributions or other savings mechanisms as a higher percentage of their present-day income tends to be spend on present-day consumption. One consideration would be to review the superannuation guarantee rate on the basis of assuming a career break for say a two-year period, and gradually increasing the rate to provide a comfortable retirement income. This could result in individuals who do not take these career breaks accumulating additional capital in superannuation, however with the appropriate tax settings, contribution limits and cashing requirements, this could be managed to provide for a more equitable result than present.

The current system provides limited mechanisms to help even out superannuation balances between spouses by allowing for concessional contributions splitting and encouraging voluntary spouse contributions via the provision of a tax offset for low-income spouses – however the amount of contributions a working spouse can make is still limited by their individual cap, and the concessional contributions cap of the spouse effectively goes wasted. In 2016 the concessional contribution carry forward was introduced, which took effect from 1 July 2018. This allows individuals to access up to five years of the historical unused concessional contributions cap if their total superannuation balance is under $500,000. In practice, the design of this catch up mechanism effectively assumes the financial capacity of the individual to make substantial contributions to superannuation after a career break and realising a benefit from claiming a substantial tax deduction in a particular year. Although the measure is only in its first year of operation, it is hard to marry the stated objective with increasing contributions for women returning to work after maternity leave with the financial reality most families experience after having a child.

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

The primary groups of individuals who are not currently covered by a compulsory superannuation contribution regime are those who are self-employed sole traders and those earning less than $450 per month, which were discussed previously. Whilst larger business will tend to structure themselves through a corporate structure, which creates superannuation guarantee obligations for any owners employed by the company, sole traders are completely excluded from the superannuation guarantee framework.

For most small business operators in this space, instead of using the second pillar for the foundation of their retirement savings, the business itself is seen as their retirement plan. Small and medium primary producers also tend to fall into a similar category, where their retirement income is inherently linked with the value of their farming business – and especially the value of their farmland.

Whilst there are contribution concessions which allow individuals who sell their business to make substantial contributions to superannuation as they near retirement, they experience a much higher level of asset concentration compared to an individual who is receiving regular superannuation guarantee support. This creates a retirement income scenario that is centred on the value of a single asset which contains a much higher level of risk compared to a regular savings plan invested in a broad range of assets through superannuation. Further, many individuals do not access the small business capital gains tax exemptions due to the complexities in understanding if the concessions would apply in their circumstances, and which concessions are relevant for each capital gains tax event. As noted above, requiring sole traders to participate in the superannuation guarantee system would help alleviate this risk.

Another group of individuals who do not receive superannuation guarantee support are those who cannot work, either on a permanent basis or temporarily. Those temporarily absent, assuming they can find employment within a reasonable timeframe, are unlikely to have their retirement income significantly compromised. However, an unemployment safety net sufficient to meet minimum living costs would reduce the need for those individuals from having to access their savings, or apply for early release of superannuation under severe financial hardship or compassionate grounds.

Those who are unable to engage in the workforce on a more permanent basis provide a difficult challenge as there is limited ability for those individuals to engage with savings. For those who have suffered a disability after working for a number of years, the current superannuation insurance framework is likely to provide a total and permanent disability benefit which will help fund both present-day costs as well as increase the retirement standard compared to being solely reliant on social security benefits.

There are also tax concessions available to accessing superannuation for those individuals, although the specific implementation of those concessions can create administrative challenges. Based on current tax law, individuals need to continue obtaining new medical evidence to certify they remain totally and permanently disabled to continue to receive an increased tax-free component on superannuation lump sum withdrawals, regardless as to the disability suffered by the member. Revisiting the operation of these tax concessions with a view to simplification of both their operation and application would promote simplicity and equity within the retirement income system.

Individuals who leave the workforce for other reasons, such as caring for a relative, do not have any insured benefits to help increase their retirement savings and will tend to be largely reliant on the age pension in retirement. Whilst additional benefits are paid to carers, the value of these additional benefits is insufficient to allow an individual receiving carer payment to receive a similar level of income in retirement compared to someone who has maintained paid employment for their entire working life. The level of benefits provided to carers should be reviewed to ensure those who are required to leave the workforce to care for a relative do not create significant inequalities in the retirement outcomes experienced by those individuals, in so far as it is possible to control through a sustainable social security system.

Sustainability

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

The sustainability of the retirement income system is largely driven by the effective use of both public and private resources. A sustainable use of public resources should consider the level of tax concessions available on retirement savings, and any means testing associated with the age pension. Ideally, these would be balanced within a retirement age group to broadly balance the tax receipts from individuals in the retirement age group with the direct transfers made to individuals in that same group. However, in reality this fine level of balance may not be possible or practical. For example, current policy settings result in individuals of moderate wealth paying no tax as they receive a tax-free income stream from superannuation as well as a partial age pension benefit. Additionally, their retirement phase capital does not generate any taxable income within superannuation. Considering even a modest tax on retirement phase income or assets could help increase the sustainability of the retirement income system.

The sustainability of public resources is also impacted by the application of means testing for access to public benefits. As noted above, provided the age pension and means testing provisions are structured to provide at least a modest safety net for individuals of lower means, the sustainability of the public system can be enhanced through encouraging the use of private savings.

The sustainability of the retirement income system is also impacted by the incentives to subsequently use their retirement income capital. Superannuation provides a basic minimum pension payment rate for funds transferred into the retirement phase, and we have discussed above potential issues with the retention of wealth within accumulation phase post retirement which could also impact the sustainability of the retirement income system.

A key consideration in the use of private capital for individuals of moderate or greater wealth is the effective use of funds associated with the family home. The family home receives very generous tax and social security concessions, and these concessions are not linked to any features of the property outside its use as the primary residence of the individual. These concessions can lead to cases where the sustainability of the retirement income system is strained as individuals may be retaining the majority of their retirement capital in an asset that provides a home, but no income, as the impact of selling the home to release those funds would result in the reduction or loss of the age pension, and any subsequent investments made with that capital could be subject to tax.

These concessions incentivise individuals to maintain the home, even when the alternative is reduced expenditure as other retirement capital is used to meet their needs. Taken to its extreme, there are individuals who have homes valued in excess of $1 million who have exhausted their other retirement income sources and are fully reliant on the age pension. Yet, despite desiring a smaller home which may be easier to maintain, many individuals choose to maintain their home rather than effectively transfer the longevity risk of their retirement income to themselves by downsizing. Additionally, when the home is sold (potentially after the individual has passed away), any capital gain is unlikely to be taxed under the main residence exemption.

Over time this home ownership trend may change with lower home ownership rates, however these generous concessions could currently be impacting the overall sustainability of the retirement income system. Supporting methods to unlock this equity via reverse mortgages and other structures may be another solution to improve sustainability as flagged in our discussion above.

What factors should be considered in assessing how the current settings of the retirement income system affect its fiscal sustainability? Which elements of the system have the greatest impact on its long-term sustainability?

The key factor in maintaining a sustainable retirement income system under the three pillars is balancing the transfers to individuals from the first pillar, and the tax concessions / receipts from the second and third pillars. For example, providing a present-day tax saving through concessional contributions can boost retirement savings – further boosted by concessional earnings in accumulation phase, resulting in a lower mean-tested pension for the individual at retirement. As noted under equity, the panel has already identified that indirect transfers to higher wealth individuals exceeds direct transfer support provided to those with lower wealth, which also raises a question of sustainability.

The panel notes that individuals may save beyond what would be required to provide an adequate lifestyle in retirement. As noted, there are many reasons why an individual would save beyond their needs, which could be broadly explained as a lack of understanding as to what their level of retirement income their savings is likely able to afford. Holistic financial advice to retirees can help individuals understand their potential level of expenditure that can be realistically achieved – both helping individuals who have saved beyond their needs feel comfortable with their position, and outlining the consequences of an individual over-spending in retirement should their desired retirement consumption exceed what is likely achievable.

Another factor the panel should consider in assessing the sustainability of the retirement income system is the impact of sequencing risk on an individual's retirement capital, and what measures can be put in place to reduce this risk. As individuals move closer to retirement their level of wealth tends to increase and they become more sensitive to negative market returns since they will begin drawing down on benefits rather than saving. In the event of a significant market downturn, those just about to enter retirement may find their retirement income objectives at risk and find themselves more reliant on the age pension. However, as individuals are spending longer in retirement and need to make efficient use of their capital, it is not appropriate in all cases to simply remove any exposure to growth assets for those about to retire. Finding a sustainable investment approach which reduces sequencing risk particularly within superannuation would increase the sustainability of the retirement income system.

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

The public confidence in the retirement income system has no doubt been shaken by the Financial Services Royal Commission. The specific impacts on public confidence would be hard to measure, however indirect measures such as superannuation fund outflows, complaints by retirees made to the Australian Financial Complaints Authority and requests for reviews of Centrelink decisions could provide indirect evidence as to public confidence.

Cohesion

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

A cohesive retirement income system is one which has a unified approach to providing retirement outcomes for individuals. This is aided by having a universal language between the different parties involved in the system and streamlining communications between stakeholders.

A 'universal retirement language' would provide a consistent set of definitions, timeframes and thresholds which are simple for an individual to understand, without compromising the adequacy, equity or sustainability of the system itself. A current example is the differences between 'retirement age' for the purposes of receiving an age pension (between 66.5 and 67), or accessing your superannuation benefits (between 58 and 65), or making additional personal contributions to superannuation (over 65 most individuals will be subject to a work test). The Government has discussed aligning the contribution requirements to age pension age, however access to superannuation is still tied to a maximum of age 65.

By way of example, the 2017 fair and sustainable superannuation reforms introduced a broad limit of $1.6m as it relates to superannuation – however the specific implementation creates substantial complexity, detracting from a cohesive superannuation system. For example:

- The maximum superannuation capital an individual can use to commence a retirement phase income stream is the general transfer balance cap at the time they commence said income stream.
- At this time, the general transfer balance cap becomes the individual's personal transfer balance cap, which indexes based on a 'high water mark' test. Only specific transactions impact an individual's transfer balance account, which is then measured against their personal transfer balance cap.
- However, the ability for the same individual to contribute after-tax funds is determined by measuring their total superannuation balance against the general transfer balance cap each year. The calculation of total superannuation balance is performed each year at 30 June based on current market values of assets, including income streams.
- The removal of the ability for a self-managed superannuation fund to use the segregated method for determining the fund's exempt current pension income (i.e. the investment earnings which are not subject to 15% tax) is determined by measuring each member's total superannuation balance against a fixed rate of $1.6m – which is not linked to indexation in the transfer balance cap.

So for an individual who commenced an income stream with the general transfer balance cap at $1,6m, when this cap indexes the general transfer balance cap will be $1.7m, their personal transfer balance cap will be somewhere between $1.6m and $1.7m and the SMSF threshold will remain at $1.6m. This arrangement could be simplified by removing the personal transfer balance cap indexation and having all thresholds aligned to the general transfer balance cap.

Most individuals who commence a retirement phase income stream will use as much capital as possible to commence a pension on retirement. For those who maximise the use of the cap at commencement, they would not benefit from indexation going forward as the personal transfer balance cap is only indexed on the unused portion of the cap based on a high-water mark test. Individuals who do not reach their transfer balance cap at commencement are unlikely to receive a substantial amount of additional superannuation funds post their retirement. As such indexation of the cap provides a limited benefit outside potentially allowing a greater amount of a death benefit to be retained as an income stream for a surviving spouse. Each individual having their own personal transfer balance cap reduces cohesion within superannuation income streams and increases the chances of an individual misunderstanding what specific limit applies at any time. Instead of indexing the personal transfer balance cap, an individual would simply receive the general transfer balance cap as their lifetime personal cap, at the time they first commence a retirement phase income stream.

Simplifying and aligning the interactions within and between the pillars would reduce the mental load required to navigate the system, as well as improving cohesion of the system.

A further consideration for improving cohesion of the retirement income system is further automation of communication between stakeholders. A great example of this is the automation of social security income stream reviews by having income stream providers directly provide updates to the Department of Human Services rather than requiring individuals to contact their superannuation fund to obtain the information, which is then on-sent to the department. It would be possible to extend this logic by reforming the personal concessional contributions notice process. Currently, an individual is required to submit a notice of intent to claim a tax deduction with their superannuation fund, who then taxes the nominated amount and reports this intention to the ATO. The individual also must ensure the amount is claimed when completing their tax return. This process could be adjusted to allow an individual to lodge their notice of intent to claim through myGov or the individual's tax return, where the ATO can then communicate that intention to the super fund who could then apply the appropriate rate of tax to the relevant personal contributions.

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

The current retirement income system provides incentives for saving at nearly all points through an adult life. However, the benefits of those incentives are generally greater for individuals generating higher levels of incomes who both tend to have the financial capacity to use those incentives and be towards the end of their working life. Conversely, the effectiveness of savings is increased the earlier those savings are made, as saved amounts can be invested for a longer period but most individuals find themselves with other financial objectives.

Whilst the incentives may exist, engagement with retirement savings has been historically difficult to achieve with younger individuals, as the perceived sacrifice of saving for retirement is significantly greater than the desire for present expenditure. As such ensuring younger people are covered by superannuation guarantee – as well as holding employers to account to ensure those obligations are paid appropriately – is critical to the long-term health of the retirement income system.

Additionally, as noted by the Productivity Commission's review of the efficiency of the superannuation system, there are several factors which impact the retirement outcome achieved by individuals due to a lack of engagement with superannuation at a younger age, and the existing default system.

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

We have previously noted how the concessions afforded to the family home are potentially influencing retiree behaviour, particularly in relation to age pension benefits, and noted the significant concessions available by using superannuation are driving its use amongst higher net wealth individuals.

What is the evidence that the outcomes the retirement income system delivers and its interactions with other areas (such as aged care) are well understood?

We have expanded the flow chart provided by the panel in Appendix B to illustrate the complexity of the retirement income system as well as emphasising the impact of current tax policy on various features of the system. As can be seen, tax and means testing play critical roles in the cohesiveness of the system.

An example as to how the complexity of the retirement income system reduces the cohesion with external systems is how the family home is treated for aged care purposes, compared to age pension purposes. If an individual moves into aged care, the family home is generally a significant asset that needs to be managed by family who are already in a heightened emotional state and are already under pressure to make complex decisions on a short timeframe.

For age pension purposes, the asset value of the family home is exempt for two years in the case of an individual moving into residential aged care. After this two year period, the full value of the home is assessed as an asset. The only exemption to this is if there is a spouse to remain in the home, which extends the main residence exemption whilst they continue to reside in that home.

For aged care means testing, the value of the family home is included immediately, although the value is capped at $169,079.20 as at 1 January 2020. By design, the capped value of the family home results in individuals who are unable to exempt their home being liable for the full cost of their residential accommodation costs, as opposed to receiving some Government support towards this specific cost. The home is able to be excluded from aged care means testing if a 'prescribed person' remains living in the home when the individual moves into care. A prescribed person is defined as a:

- Spouse
- Dependant child
- Carer who lived with the individual for two years and was eligible to receive an income support payment
- Close relation who lived with the individual for five years and was eligible to receive an income support payment

The interaction between these definitions can create issues where say a child has moved in to provide care for an elderly parent, but does not qualify as a protected person. The parent will likely be liable to pay their full residential aged care accommodation costs which may necessitate the sale of the home. However this will first require their child to find alternative accommodation, and the sale of the home will result in the loss of the age pension assets test exemption for those funds well before the two year window is reached. If the child is able to meet the definition of a protected person, the parent will still be subject to age pension means testing on the property after two years.

These complex interactions with both immediate and subsequent consequences are unlikely to be fully grasped by individuals who are not exposed to these rules in detail or on a regular basis, or otherwise seek the services of a financial planner.

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

Whilst we do not have any direct evidence to provide the panel, the considerations, complex rules and interactions involved in navigating the retirement income system outlined by this submission are all relevant considerations made by financial advisers in helping individuals understand the retirement income system and how individuals can best use the current system to maximise their retirement benefits. These rules are complex to the point that even experienced financial advisers are supported by legal specialists to help them understand how a specific circumstance may interact with the various components of not only the retirement income system, but also the broader tax and social security system (including aged care) – and this is before considering the underlying investments which would best be suited to each client's circumstances.

The noted considerations are in addition to understanding what an individual is seeking to achieve in retirement, and how those future needs may require changes to their current day behaviour or other sacrifices to be realised. We believe the role of a financial adviser should focus on providing an understanding as to what goals an individual can achieve – something which provides a degree of comfort in respect of retirement planning, rather than navigating the complexities of how the individual's specific circumstances integrate with the retirement income system.

In short, financial advice should not be required to simply understand the operation of the retirement income system. Advisers are currently expending significant efforts to simply determine the application of the system to an individual, when individuals find more value in understanding what they can achieve in retirement. Making the retirement income system simpler and more cohesive could shift the focus of advice onto what individuals value most, and make advice accessible to more individuals.

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

Under the current retirement income system, there is very little integration between the age pension and superannuation. As noted above, superannuation income stream providers now deal directly with the Department of Human Services for income stream reviews, and superannuation capital impacts age pension means testing, however it is unclear as to whether the specific interactions between these pillars is considered in the means testing process.

Further, in 2017 regulations were introduced to promote the development of innovative income streams, also referred to as ‘comprehensive products for retirement’ (CIPRs). These regulations are very broad, allowing the private sector to develop an expanded range of products designed to provide a broadly consistent level of income throughout retirement, at the cost of reducing access to capital over time. From 1 July 2019, age pension means testing provide substantial incentives in the form of discounted assets and income testing for individuals who purchase CIPRs, or CIPR-like income streams provided external to superannuation.

These products by their very nature require the pooling of capital – and as noted above, the defined contribution system in place creates an individual attachment to accumulated superannuation capital. Given this individualised nature of superannuation savings, and the legacy issues faced with products which have required individuals to detach themselves from access to their savings it is unsurprising these products have been largely unsuccessful at finding a place in the retirement income system.

We further note the Government released a discussion paper for the develop of a framework for CIPRs on 15 December 2016. This paper suggested a requirement which would effectively result in superannuation fund trustees ‘suggesting’ as a default, members should access their retirement benefits in the form of a CIPR. As CIPRs both require a degree of pooling and loss of access to capital, such a position is likely to detract from the long-term sustainability, equity and cohesion of the retirement income system as each individual will have relatively unique requirements for income and access to capital throughout their retirement. Whilst a CIPR may be appropriate for part or all of an individual’s private retirement income needs, requiring superannuation funds to push these products as a default is fraught with risk.

Appendix A:

Case Studies in relation to legacy pension issues

Mrs B

Mrs B is age 70 and has a market linked pension (MLP) which her late husband commenced in 2004 as a reversionary pension. Mrs B's account balance as at 1 July 2017 was $17,000 which comprises $4,000 cash and $13,000 of an illiquid asset which cannot be redeemed. Mrs B does not have any assets outside of her MLP that could be used to purchase the illiquid asset from the fund.

The annual pension payment is $4,630 per annum. The ATO supervisory levy is $259, the audit fee is $300 and annual administration fees are $150, totalling $709 per annum. Whilst these audit and administration expenses would generally be considered very inexpensive, the fund expenses represent over 4% of the total account balance – probably more expensive than any current retail fund offering. The supervisory levy alone represents 1.5% of the total account balance.

The rules of the MLP mean that Mrs B cannot commute or otherwise convert the pension to a more flexible pension or withdraw the funds from superannuation altogether, which would negate the need to maintain an inefficient arrangement.

The annual pension payment and expenses will result in the available cash being exhausted within the year. After this time the fund will not be able to meet its pension payments and will therefore be in breach of the pension standards. In addition, the fund will be unable to pay its ATO supervisory levy.

It would be in the best interest of the member if she were able to take a lump sum commutation of the illiquid asset and wind the fund up as soon as possible.

Mrs K

Mrs K is a 76-year-old widow who received a reversionary life expectancy complying pension following the death of her husband. The pension originally commenced with a term of 15 years which is due to expire within three years. Her annual pension payments are $9,000 which Mrs K receives as a monthly payment of $750. The account balance is $20,500 and the actuary is unable to certify the solvency of the pension. As the trustee is unable to take any action to return the fund to a solvent position the trustee must initiate winding-up proceedings.

The pension can be commuted to acquire an annuity or a MLP. As Mrs K is 76, the maximum annual payment in a MLP with an account balance of $20,500 is $1,880 per annum or $156 per month. The monthly payment options from an annuity were even lower. Mrs K relies on the $750 monthly payment to maintain her very modest lifestyle and a $600 per month income reduction causes great hardship.

Mr L

Mr L is 78. He is receiving a complying lifetime pension of $26,550 pa from a balance of $168,000 in his SMSF. The pension has been in place since 1 December 2004 and receives a 50% exemption from the assets test for the purposes of the age pension.

Mr L's daughter and son-in-law are also members of the fund and hold the vast majority of the overall balances.

The last actuarial valuation of the fund showed that it met both the "best estimate" and "high degree of probability" solvency tests.

Mr L is now required to an aged care facility and to do so would like to access some of the assets built up in the fund. He is also quite ill and would prefer to wind up his interests in the SMSF.

Both the *Superannuation Industry (Supervision) Act 1993* and the *Social Security Act 1991* prohibit him from ending his pension to access the capital for his move to an aged care facility. Pensions of this nature can only be commuted to acquire another restrictive pension such as a market linked pension or an annuity.

Superannuation law does permit him to end his membership of the SMSF by transferring the value of his complying lifetime pension to another fund to acquire another restrictive pension such as a market linked pension or an annuity.

However, social security rules only permit him to do this under a limited number of circumstances as an “allowable commutation”. Any commutation that is not an allowable commutation triggers a reassessment of his age pension entitlement for the last 5 years. He will effectively be assessed as having a debt if the age pension payments he has received over that time would be lower if the account balance supporting his complying lifetime pension had been included in the age pension assets test.

Mr L does not meet the “allowable commutation” conditions such as:

- Failing the solvency test (his pension is satisfactorily funded);
- Winding up the fund due to because the administrative responsibilities have become too great. The fund cannot be wound up because it has other members.

He is therefore effectively trapped in his current structure with no ability to access his capital or end his membership of the SMSF.

Mr and Mrs C

Mr & Mrs C are each receiving complying life expectancy pensions from their SMSF. The pensions commenced in July 2003 and are payable for 17 and 22 years respectively (ie, have 2 and 7 years to run respectively). The pension amounts are approximately $25,000 and $9,000 pa.

The fund currently has significantly more assets than required to fund these pensions (approximately $435,000) and hence there will be a substantial surplus remaining if the pensions simply run their course. In the meantime their ability to draw income is limited to the (fixed) amounts of the pension.

Superannuation law would permit them to transfer their life expectancy pensions to another restrictive income stream such as a market linked pension or annuity but the amount transferred for this purposes would be limited to the value of their outstanding payments or a statutory commutation amount, whichever is lower. Either would result in a substantially lower amount being transferred to a new income stream than the capital currently available to finance their income streams.

In addition, as they have also treated these pensions as asset test exempt income streams for social security purposes, they are subject to the commutation limitations under the social security regulations. Since their pensions commenced before 20 September 2004 the restrictions are even more substantial than applied for Mr PL above. There is virtually nothing they can do to end their pensions without incurring a social security debt.

Mr S

Mr S (68) is currently receiving a complying lifetime pension of approximately $90,000 pa from his SMSF. The balance available to support it is approximately $6m compared to its actuarial value of $2m. The pension is reversionary to his spouse Mrs S (65).

There is no mechanism by which Mr S can increase his pension payments other than by indexing them at the agreed rate of 5% pa. The “surplus” of $4m will therefore inevitably grow in the future due to earnings on the very high asset base.

Mr S is also effectively prohibited from converting this account to a market linked pension because the application of the new transfer balance cap rules would see him triggering a significant credit to his transfer balance account which would vastly exceed the debit triggered by commuting his complying lifetime pension. The net result would be an excess arising from a pension that:

- he cannot commute; but
- does not receive the special treatment applicable to “capped defined benefit pensions” as a market linked pension established on or after 1 July 2017 is not defined as a capped defined benefit pension.

He is therefore effectively trapped in his current structure.

Should he and Mrs S both die tomorrow, there would be a $6m reserve in the fund with limited ability to pay the monies out of superannuation. In fact the current rules would achieve precisely the opposite of the Government’s intention to force superannuation balances to be paid out on death and would instead force the family to leave this money in a concessionally taxed environment, where it would need to be allocated to new members of the fund. These allocations are not taxed, but would likely count towards the recipient’s concessional contribution cap.

If this fund were an APRA regulated fund, would the expectation be that the “reserve” was an amount available to the trustee? If so, are the funds available as a distribution to the trustee company’s shareholders, surely an outcome that no-one could consider fair and equitable?

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Appendix B

Resource links

Melbourne Mercer Global Pension Index

The OECD Roadmap for the Good Design of Defined Contribution Pension Plans

OECD Pensions at a Glance 2019

OECD Policy Brief - Future Pensioners

ABS – Across the Generations: 20 years of housing

Financial literacy amongst elderly Australians

Parliamentary Chronology - History of means testing

ASFA retirement standard

Parliamentary Briefing - Housing affordability

Treasury – Comprehensive Income Products in Retirement discussion paper

What's the deal with superannuation and working in the gig economy?

Employment and Wages, Guy Debelle, RBA Deputy Governor (2019):

Treasury Intergenerational Report (2015):

The Problem of an Aging Global Population, Shown by Country, Visual Capitalist (2020):

Key Abbott government employment scheme struggles to meet target, *Sydney Morning Herald*:

Treasury Tax Benchmarks and Variations Statement 2018