SUBMISSION TO THE
REVIEW PANEL
IN RESPECT OF FACTS AND SUGGESTIONS FOR THE INDEPENDENT REVIEW OF THE RETIREMENT INCOME SYSTEM ESTABLISHED BY THE FEDERAL GOVERNMENT

1. The SMSF sector is the largest sector within the retirement industry, as disclosed in APRA's "Annual Superannuation Bulletin : June 2018 (re-issued 3 July 2019)" and has out-performed the Government, Industry and Retail sectors of the retirement industry in all material respects. Any proposals which seek to curtail the effectiveness and operations of the SMSF sector in comparison with these other sectors will increase overall costs, and / or reduce returns, and will be sub-optimal. See Attachment 1 for full details.

2. Treasury's arguments that the superannuation system is a cost to revenue are based on a false premise and are highly misleading. My assessment is that the superannuation system is a high-taxing sysytem when viewed over the full life-cycle of the accumulation and pension phases. I urge the Panel to specifically reject Treasury's false premise and the consequent false narrative as to the cost to revenue of the superannuation system. See Attachment 2 for full details.

3. The superannuation system, even when fully mature, fails to provide most retirees with an adequate income to see them through their retirement years. Any proposals to reduce net funding levels can only exacerbate this problem. Further to this – I suggest the Panel advise Government to adopt a funding objective for superannuation along the following lines –

   funds sufficient to provide an indexed net income of 70% of pre-retirement remuneration at age 67 (net of tax and super contributions), for remuneration levels up to $250,000 per annum and which are expected to continue until at least 90 years of age

The superannuation system does not currently meet this objective. In general funds will exhaust after about 15 years of retirement, which means that almost 64% of retirees at age 67 will survive long enough to exhaust their retirement funds.

4. In my view very few participants in the superannuation system have the financial skills to fully appreciate amounts calculated as discounted net present values in an inflationary environment. In my view this observation also applies to most political commentators on the system.

   I find it is instructive to consider what the position would be for a person retiring at age 67 **now** but on the **assumption** that they had participated in the current superannuation and taxation regime for the last 40 years of their working life (ie : since age 27). Attachment 2 adopts this approach.

   The key advantage of this approach is that the numbers referenced for fund balances and retirement incomes are in today's dollars, which are readily understood by most reasonably intelligent persons.

   I recommend the Panel adopt this approach in all of its financial assessments.

5. It was reported in The Australian (28 December 2018) that "*… confidential Treasury modelling … has found that the amount of money spent on welfare for retirees will fall faster than previously expected as bigger superannuation nest eggs push Australians into self-funded retirement …"* The Panel must determine if this is in fact true and, if so, widely publicise this very positive outcome from our retirement incomes system.

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ATTACHMENT 1

SMSF PERFORMANCE VIS-À-VIS OTHER RETIREMENT SECTORS AS REPORTED BY APRA

1. APRA publishes a statistical bulletin each year titled "STATISTICS : Annual Superannuation Bulletin" with the latest publication as at June 2018 which was re-issued 3 July 2019. Of particular interest is the downloadable EXCEL table 4(a) – Financial Performance by Fund Type, covering the period 2004 through 2018. I assume this publication contains data which is complete and accurate. This table provides data over this extensive period separately for each of SMSF funds, Industry funds, Retail funds and Government funds.

2. The key observations and conclusions arising from a detailed and dispassionate review of this data, and which appear to me to be irrefutable, are –

   (a) the SMSF sector remains larger than any other sector;

   (b) the SMSF sector has delivered higher pre-tax investment returns than all of the other "professionally managed" sectors;

   (c) the SMSF sector has delivered lower investment volatility than all of the other "professionally managed" sectors – in part because the SMSF sector significantly out-performed the "professionally managed" sectors during the Global Financial Crisis;

   (d) the investment performance of the SMSF sector shows less correlation with the "professionally managed" sectors indicating an independence of thought which has delivered the superior risk/return investment outcomes as evidenced in (b) and (c) – the performances of the "professionally managed" sectors are almost 100% correlated – the suggestion the SMSF sector is somehow "riskier" or "more amateur" than other sectors doesn't stand up to meaningful scrutiny;

(e) some 60% of the funds deposited into SMSF Funds appear to be from non-concessional sources, as opposed to 16% for Industry Funds – what this means, and contrary to popular opinion, is that the SMSF sector has not been a significant recipient of government "largesse" during the Accumulation Phase – the members of SMSF Funds are funding a surprisingly high share of their superannuation savings from after-tax sources;

(f) SMSF Funds have paid out 33% of all income in the fourteen years 2005-2018 by way of Benefit Payments as against 18% for Industry Funds – the suggestions that SMSF Funds are "not running down" their balances and that the SMSF Funds are primarily an inheritance mechanism don't stand up to rigorous scrutiny – in any case there are rules on minimum withdrawals which must increase as a share of fund assets with age and which are designed to ensure adequate draw-down over the retirement years, as well as "top-up" taxation of balances when funds are transferred to non-dependants;

(g) <u>the SMSF Funds sector has lower expense rates than both of the "professionally managed" Industry and Retail sectors</u> – on this point I would urge the Panel to drop the Industry Funds penchant for calculating expense rates against a denominator based on assets held, and adopt the far more sensible and meaningful denominator of TOTAL INCOME, being all net inflows to the fund – adopting assets as the basis for calculating expense rates gives a misleading impression of the expense performance of funds which hold assets over a longer period (ie : the Industry Funds which have a lower payout ratio and are in a growth phase).

On any meaningful metric the SMSF sector has significantly outperformed both Industry and Retail funds – critics need to face facts and let SMSF trustees get on with doing a great job of managing their own money!

Table 1 on the following page provides a summary of the APRA data.

2005 - 2018	CMBD	SMSF	APRA	COMM'L	INDUSTRY	RETAIL	GOVT
Employer Contributions net of Contributions Tax	875,018	88,877	770,648	496,725	277,829	219,157	244,881
Member Contributions	654,263	324,998	343,337	245,646	57,695	187,690	90,060
Net Transfers IN	110,085	127,261	- 16,679	61,081	24,514	36,567	- 23,525
Benefit Payments	- 1,033,839	- 331,902	- 699,697	- 434,844	- 117,923	- 316,921	- 247,264
Investment Income before Investment Expenses	1,423,244	460,806	960,096	662,064	325,839	336,225	247,614
ALL Fund Expenses EXCL TAX	- 188,562	- 57,773	- 130,319	- 106,809	- 40,322	- 66,487	- 18,798
All Other Items	251,647	10,138	242,748	28,532	15,157	13,375	206,334
Increase in Net Assets	2,091,856	622,405	1,470,134	952,395	542,789	409,606	499,302
Closing Total Assets	12.0%	14.3%	11.3%	11.5%	15.9%	8.9%	12.1%
Investment Yield : 2004-2018 (time-weighted)	7.6%	8.7%	7.1%	7.1%	8.3%	6.3%	7.1%
Standard Deviation of Investment Yield	7.7%	7.3%	8.1%	8.1%	8.4%	8.0%	8.1%
COMBINED INCOME FOR PERIOD (excluding All Other Items)	3,062,610	1,001,942	2,057,402	1,465,516	685,877	779,639	559,030
TOTAL ASSETS AT JUNE 2018	2,666,116	749,899	1,914,087	1,253,885	631,383	622,502	604,242
CONTRIBUTION SHARE OF COMBINED INCOME	53.5%	54.0%	53.3%	54.8%	52.5%	56.9%	55.7%
NON-CONCESSIONAL CONTRIBUTIONS TO TOTAL CONTRIBUTION	39.9%	60.1%	31.3%	30.6%	16.0%	42.3%	28.9%
BENEFITS SHARE OF COMBINED INCOME	33.8%	33.1%	34.0%	29.7%	17.2%	40.6%	44.2%
EXPENSES SHARE OF COMBINED INCOME	6.2%	5.8%	6.3%	7.3%	5.9%	8.5%	3.4%
OTHER INCOME SHARE OF COMBINED INCOME	8.2%	1.0%	11.8%	1.9%	2.2%	1.7%	36.9%
INVESTMENT INCOME CORRELATIONS		SMSF	COMML	93.4%			
		INDUSTRY	RETAIL	99.3%			
		INDUSTRY	GOVT	98.7%			

ATTACHMENT 2

FULL LIFE-CYCLE TAXATION OF SUPERANNUATION FUNDS

1. Treasury and others argue that the marginal tax that would have been charged on contributions to superannuation funds ought to be viewed as a cost to revenue. This is based on a false and misleading premise and I beg to differ. In my view contributions to superannuation funds should not be considered as a deduction from taxable income in the year in which the contributions have been made, but viewed as taxable income when drawn down in retirement. This is the approach adopted in most of the civilised world. Most Western economies treat contributions and investment earnings in the accumulation phase as exempt from tax, with the full amount of drawdowns in the retirement phase taxable as normal income. For most individuals the average rate of tax payable in retirement will be lower than the average top marginal tax rate that would have been payable during the accumulation phase.

   In my view it is simply monstrous to suggest the tax rate that should be applied to income in retirement is the top marginal tax rate that would otherwise apply throughout the accumulation phase. The correct reference point is to set a benchmark based on an assessment of the tax that would be payable on pension income received in retirement at normal tax rates.

2. Consider the position of a person retiring at age 67 <u>now</u> but on the <u>assumption</u> that they had participated in the current superannuation and taxation regime for the last 40 years of their working life, since age 27. I have set out on the next page the assumptions I would make to address these taxation questions.

Age at Retirement :	67 years	
Uninterrupted Accumulation Period	40 years	
Gross Annual Remuneration pre-retirement	$100,000	
Gross Earnings Rate – Accumulation Phase	7.0% pa	
Gross Earnings Rate – Pensions Phase	5.0% pa	
Earnings Rate – Government Funds	7.0% pa	
Salary Indexation	3.5% pa	
Pension Indexation	2.5% pa	
Effective Income Tax Scale Indexation	2.5% pa	
Base Income Tax Scales	2018/19	
Superannuation Tax Rate	15.0%	
Old-Age Pension (singles)	$24,268	
Mortality	ALT (2010-12)	MALES

These assumptions may be summarised as –

(a) investment strategy “balanced” throughout working life and “conservative” after retirement;

(c) investment / economic environment broadly in line with a longer-term outlook from now;

(d) income tax scales maintained at current levels in real terms over the full period;

(e) superannuation taxes as per current rules over the full 40 year period;

(f) contributions 10% of gross remuneration throughout the entire period;

(g) no costs whatsoever other than taxes;

(h) post-retirement mortality in line with Australian Life Tables 2010-2012 (ALT2012), with no future improvement or deterioration;

(i) moderate but not spectacular career progression over the years.

4. For the sake of simplicity I will focus on just five gross annual remuneration levels immediately prior to retirement, being $50,000, $75,000, $100,000, $150,000 and $200,000. Again, for the sake of simplicity, I will adopt superannuation contributions of 10% of gross annual remuneration. Table 2 shows all outputs arising from these assumptions.

TABLE 2

		Income Level 01	Income Level 02	Income Level 03	Income Level 04	Income Level 05
Salary in Retirement Year		50,000	75,000	100,000	150,000	200,000
Pre-Retirement Income NET OF Super Contributions		45,000	67,500	90,000	135,000	180,000
After Tax Pre-Retirement Income		38,292	53,030	67,767	95,217	122,667
Pre-Retirement Tax		6,708	14,471	22,233	39,783	57,333
Average Tax Rate Pre-Retirement		14.9%	21.4%	24.7%	29.5%	31.9%
Accumulated Gross Contributions		425,756	638,634	851,512	1,277,269	1,703,025
Accumulated Net Contributions		286,442	429,663	572,883	859,325	1,145,767
Accumulation Phase Tax		139,314	208,972	278,629	417,943	557,258
Average Tax Cost in Accumulation Phase		32.7%	32.7%	32.7%	32.7%	32.7%
Accumulated Net Contributions - Full Marginal Tax		180,034	248,054	314,638	433,526	528,363
Age Pension Entitlement at Retirement		22,460	11,293	126	-	-
SuperAnnuation Top-up		4,345	25,828	47,311	66,652	85,867
After Tax Post-Retirement Income Target		26,804	37,121	47,437	66,652	85,867
Post-Retirement Tax		-	-	-	-	-
Age at which Accumulated Fund EXHAUSTS		176.0	89.0	82.0	83.0	84.0
Total Life Expectancy at Retirement		84.6	84.6	84.6	84.6	84.6
Proportion of Retirees EXHAUSTING Funds		0.0%	31.5%	63.8%	59.6%	55.2%
Approx Capital Value Age Pension		314,709	158,238	1,766	-	-
Net Capital Value of Accumulated EET Balance		425,756	548,614	685,074	964,153	1,221,953
Average Tax Cost on EET Balance		0.0%	14.1%	19.5%	24.5%	28.2%

The observations I would make, and the conclusions that I would draw, from the information in table 2 are -

(a) Superannuation balances at retirement in Australia are 32.7% lower than would be the case if contributions and investment earnings were tax exempt in the accumulation phase as is the case in most advanced economies – **the average tax cost on superannuation balances during the accumulation phase of 32.7% is greater than the average tax rate on all income levels up to at least $200,000**;

If full marginal tax rates were applied to superannuation contributions and investment earnings then the tax cost on superannuation balances would be 58% for those with pre-retirement remuneration of $50,000 increasing to 69% for those on $200,000 – this would be a ludicrous level of taxation which Treasury needs to acknowledge;

(b) In all cases the average tax cost that would be applied during the pension phase under a normal taxation regime is less than, and in some cases considerably less than, the average tax cost actually applying under the Australian regime - **Australia's retirement taxes are high** – Treasury's false and misleading narrative on the cost to revenue of Australia's retirement tax "concessions" ought to be clearly called out and rejected;

(c) The combined funds available at retirement under the superannuation system and the age pension system are, for each of the five income levels respectively, $601,000, $588,000, $575,000, $859,000 and $1,146,000. The combined impact of superannuation savings and access to the age pension deliver a broadly equivalent outcome for pre-retirement incomes in the $50,000 to $100,000 region, which may be viewed as "fair" by many commentators;

(d) the capital value of the age pension to a person with a pre-retirement remuneration of $50,000 exceeds the tax cost on superannuation savings – in my view this is a "not unreasonable" outcome;

(e) superannuation funds are expected to exhaust by age about 82 for all retirees with pre-retirement remuneration of $100,000 or more, in which case the superannuation system is failing the 64% of such retirees expected to survive to that age – this should be acknowledged and rectified; reducing tax in the accumulation phase to 10% would add about a further 3 years before funds exhaust;

(f) increasing contributions to 12.5% of gross annual remuneration, **and reducing tax in the accumulation phase to 12.5%**, would lift the age at which funds exhaust to about 90 for those on pre-retirement remuneration of $100,000 or more, and significantly increase the funds available at retirement to those earning less;

5. I have, for simplicity, assumed that the level of age pension at retirement continues unchanged throughout the retirement years other than for normal levels of indexation. In reality of course a retiree may become eligible for a higher level of age pension as their superannuation balance runs down. My preliminary modelling ignores this feature but could be enhanced to more accurately allow for this. I have also, again for simplicity, worked with the single rate of pension although in many cases the couples rate would be applicable.