2 February 2020

Re: Submission to the Retirement Income Review

Email: Retirementincomereview@treasury.gov.au

Dear Panel Members and Review Secretariat,

Please find below my submission to the Retirement Income Review.

By way of background I was the former CIO of SAS Trustee Corporation (State Super) until 30 November 2016. State Super is responsible for 4 closed defined benefit schemes on behalf of the members and the NSW State Government. I worked for the organization for more than 30 years. Following my retirement from State Super I have become a Trustee Director of Togethr Trustee.

The views expressed in this submission are solely my own. They are in no way linked to State Super or Togethr Trustee.

Please feel free to contact me if you wish to discuss any of the suggestions made in this submission.

Yours sincerely,

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Retirement Income Review 2020

It is important that we continue to evolve the retirement income system in ways that provide protection against poverty and allow older Australians to have as a minimum adequate income in retirement to continue to be consumers and look after their own needs.

It is also critical that we balance the needs of our mature cohorts in a way that is fiscally sustainable and does not disadvantage younger cohorts. Each person in the de-accumulation phase has a retirement income equation consisting of some or all of the following sources of income to fund their individual needs:

Sources of income: Super + age pension + primary residence + other investments =

Expenditures: Life style + health care + aged care + bequest

People retiring over the next 10-15 years will on average fall far short of achieving balance between their level of income and their expenditures over their expected lifetime, especially if they do not own their own residence or have other investments.

Until the retirement income system reaches maturity around 2040, the transition phase has a range of pain points as follows:

- the average super balance upon retirement is too low to finance a modest lifestyle over a 25-year period.

- The average super balance for women upon retirement is substantially lower than the average balance for males. Given the average period in retirement for women is longer than for males, there is a rising number of older women living in poverty.

- Poverty in retirement does not only apply to older women. It equally applies to males on lower than average incomes, who do not own their own home.

- Many retirees are asset rich, but cash poor. An equity release may result in the loss of entitlement to the age pension or other pension related benefits.

- The tax treatment of the sources of income in retirement are not consistent. The tax system encourages individuals to concentrate their assets in the primary residence, which is not an optimal use of resources. Release of equity stored in the primary residence to fund expenditures in retirement either through downsizing or some form of reverse mortgage could be encouraged to the advantage of both the individual and the nation.

- The sole purpose test in the SIS Act governing super funds impacts the funds ability to assist their members in optimising their retirement income equation as health and age care needs/entitlements are outside the remit of the funds.

- It is unlikely that the trustees of any super fund would take on the risks and liability associated with optimising age-related entitlements across pension, health and age care given the current governance framework. That level of liability would likely require professional directors, who were appropriately compensated for taking on that liability.

- Until the superannuation system achieves maturity around 2040 the ultimate liability for inadequate retirement savings rests with the Government. As such this liability needs to be explicitly managed, which is difficult given the system is highly fragmented.

- At the moment the accumulation phase has elements of being a lottery. The retirement balances can be vastly different for two individuals earning the same amount and, paying the same dollar amount into super during their working lives because they are with two different funds.

  The tax concession on the two accounts will be similar during the accumulation phase, but in retirement the fact that one fund under-performed resulting in an inadequate retirement balance creates a public liability as the person in the under-performing fund may need to access the age pension well before the other person.

- Retirees typically do not seek financial advice to help guide them through the opportunities and potential trade-offs they can make as they live through the de-accumulation phase. There is a tendency to become more financially cautious in old age, which is likely to result in an individual's super balance being run down faster than it would have if part of the balance had been less conservatively invested.

The challenge is how we manage the interaction between the sources of income to create sustainable solutions from an individual as well as a national perspective of how fund the expenditure side of the retirement income equation as efficiently as possible. This is especially important until the system reaches maturity in approximately 20 years' time when the average retiree will have experienced a contribution rate of at least 9% for 40 years assuming no broken work pattern.

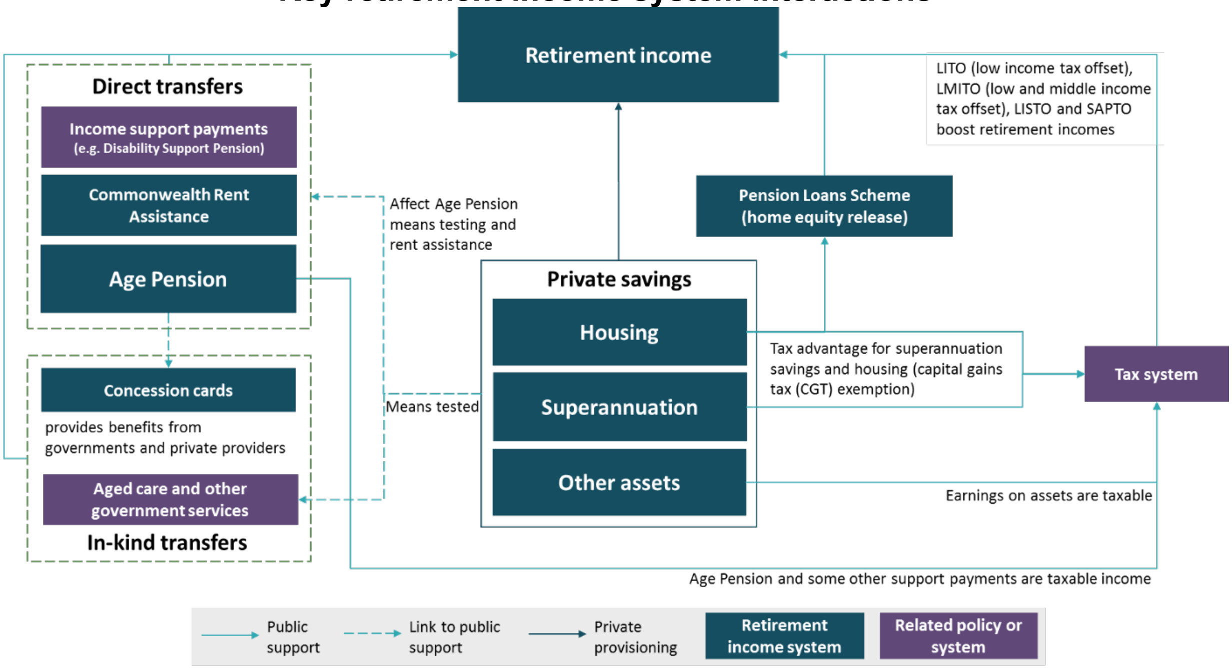
There is a need to have clarity around the parameters within which the super industry can be creative. We need to create a retirement income system where we as an industry provide our retirees with easy to understand products and services that will help them navigate the many challenges in the de-accumulation phase in a customised manner.

During the accumulation phase our objectives are homogenous. The objective is to accumulate as much as possible given the current parameters such as the transfer cap etc. It is different in retirement. In retirement, we become individuals via our retirement income equation, and we need a retirement income system that is sufficiently flexible to accommodate individual needs in a cost-effective manner during the entire de-accumulation phase.

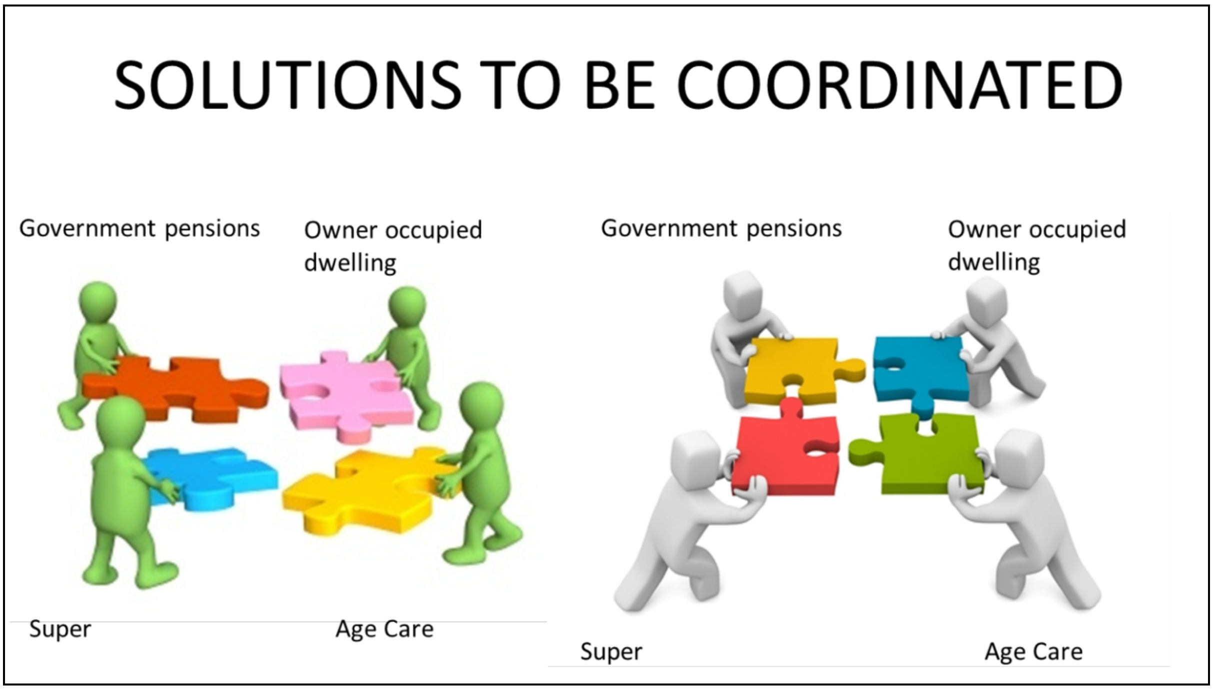
As mentioned in the discussion paper "For the retirement income system as a whole to deliver for Australians in their retirement, the pillars of the system need to interact effectively as well as be flexible and responsive to allow individuals in diverse circumstances to achieve adequate retirement incomes.

The retirement income system has many elements that can interact in complex ways. "The pain points outlined above are manifestations of the complex interactions outlined in the flow chart below (flow chart reproduced from the Discussion Paper). It will not be quick and easy to develop integrated solutions, we therefore need to develop a strategic plan, which can be operationalised into a number of projects that can gradually be delivered and which in turn will allow the current system to evolve in the desired manner, well ahead of the retirement income system reaching maturity around 2040.

Key retirement income system interactions



The strategic plan needs to include coordinated solutions and seamless interactions between the sources of retirement income and the key expenditure categories.



The issues highlighted as pain points will be discussed as part of the responses to the consultation questions. The key proposals for how to overcome or minimise some of the pain points can be summarised as follows:

1. The retirement income system can be enhanced by developing clarity over the policy parameters within which the superannuation funds can design retirement income products. (Q1)

2. We need to ensure a simple, seamless and efficient interaction between the super funds' retirement income products and government funded benefits and entitlements. (Q1)

3. Given the tax concessions available during the accumulation phase, it is important to ensure that an individual's super balance up to the transfer cap is used for the intended purpose. (Q2)

4. Retirees need investment options that are managed differently to the options they had available during the accumulation phase. In retirement, the products need to specifically manage sequencing risk and balance upside capture with downside protection. (Q3)

5. We can use AI to expand the scope of current calculators to incorporate optimisations of both an individual's and a household's financial positions. (Q3)

6. We can reduce the impact of the reluctance to use a financial planner by providing examples of automated advice. The first step would be to help the individual/household to create a budget, which reflects the lifestyle component

of their retirement income equation. This budget could feed into an investment strategy split into three buckets. Bucket 1 could be invested in liquid low volatility assets to be used to finance living expenses for a 2 - 3 year period. Bucket 2 could be used to invest in assets that can be liquidated over a 3-5 year time horizon with medium volatility. The assets in bucket 3 could be invested in growth assets with a 5 – 10 year time horizon.

The automated advice would provide an estimate of how long the individual's super balance could last and at what level the individual or the household would become entitled to public support (age pension, health or age care related benefit). Through this type of modelling tool, we should be able to ensure much better integration between the different retirement income pillars. (Q3)

7. The fragmentation and size of many of the APRA regulated funds make it difficult to implement coordinated retirement income solutions that seek to optimise the existing super balances for retirees, relative to the Government's retiree related liabilities.

   One solution could be to temporarily establish a Central Pool, where individuals with insufficient balances to be self-funded can invest their super, if their super fund does not provide appropriate retirement income products. This way any income stream can be integrated with other government entitlements. As the Government is already indirectly taking on the investment risk and all of the longevity risk via the age pension and other entitlements, this may enable the Government to manage its liability risk and ensure that the long-term investment return on the super balances invested in the Central Pool is higher than what an individual can currently achieve. As the super system reaches maturity the role of a Central Pool may fade. (Q4-Q6)

8. We need to adjust our tax system to remove the impediments and inconsistencies between the various income streams identified as one of the pain points above. It would be especially advantageous if the tax system could assist asset rich, but cash poor retirees to smoothly turn their illiquid assets into liquid assets in a way that creates flexibility for the individual and at the same time reduce the public liability.

   Individuals who release equity from a property they have lived in for more than 10 years can currently put around $300,000 into their super fund as a lump sum, which is great. It would be better, however, if they could put whatever equity they release into their super up to the value of the transfer cap. This may alleviate some of the current issues such as the release of equity from the primary residence resulting in the individual no longer being entitled to an age pension.

If we can demonstrate to the individual that loss of the entitlement to the age pension is offset by the larger amount of tax free income generated from the individual's super, we may enable individuals to flexibly adapt their housing requirements as they age and also achieving more efficient use of the existing housing stock. (Q4-Q6)

9. Currently super funds are unable to help households understand and solve their retirement income equation unless the super fund has a financial planning entity and the individual member seeks and is prepared to pay for personal financial advice.

   Also, retirement income products can only be designed for the super component of each member of the household rather than allow for an optimisation across the super balances of the household or even better the combined assets of the household. This is a big problem, which we can minimise. It needs clarity around the parameters within which the super industry can operate, which hopefully will come out of this review. (Q4-Q6)

10. We have fixed the problem of small balances being eroded away by fees, now it is necessary to incentivise young people to engage with and build up their super so they can benefit from the power of compound interest. (Q7)

11. Create a model that solves an average retirement income equation, less the need for a bequest (the government is not funding a bequest) and explore how the need for public funding recedes over time.

    Sources of income: Super+ age pension + primary residence + other investments = Expenditures: Life style + health care + aged care

    This will enable us to quantify what would be needed on average to achieve adequacy for retirees during the remainder of the transition phase and balance that with what we can fiscally afford, taking into account that it is beneficial from an economic growth perspective if retirees are able to continue to maintain meaningful consumption levels. (Q9)

12. Expectations and anchoring relative to past consumption patterns will play a big role in what retirees experience as adequate. All we can do is attempt to create realistic expectations based on an average retiree, who may or may not exist and then encourage individuals to improve on that average up to the transfer cap. (Q10)

13. Individuals who have the same lifetime earnings and made the same level of contributions to super should expect to have similar outcomes in retirement. This is unfortunately not the case. The current system is a lottery where individuals in similar circumstances (same contribution levels over the same length can have very different outcomes depending on the fund they are with

The consolidation among super funds that will take place over the next 5-10 years can be expected to help reduce the negative impact of the lottery and move us towards a harmonisation of returns, which would be good from an individual as well as the national perspective. (Q13 -Q14)

14. We need to build a retirement income system that encourages us all to become self-funded retirees and supports the retirees who have inadequate balances at or below average. For the people in the latter category we need to ensure that the income sources available to these individuals can be used to extract as much income as possible in a risk-controlled manner. At the moment, management of this risk sits with the individual, who on average may be ill-equipped to manage such risk. Also, the ultimate risk arising from any shortfall in assets sits with all of us and that risk is unmanaged. (Q20)

Consultation question- Q1:

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

My family resides in Denmark, which gives me an opportunity to visit the country on a regular basis. My understanding of the current retirement system is that it rests on the same three pillars as the Australian system; age pension, super and other assets (primary residence and other investments). In addition to each pillar health and age care services are integrated in the assessment of each person’s needs and entitlements.

In Denmark the age pension used to be an entitlement for having worked, paid taxes and otherwise contributed to society. Due to demographic pressures where around 20% of the current population receives age pension plus other retirement related benefits and entitlements, the value of these benefits has been eroded and the age pension by itself is no longer sufficient to pay for a comfortable lifestyle. However, government funded health and age care services are available when the need arises.

Although the retirement income systems in other countries can offer inspiration, it is important that any solution is tailored specifically to align with Australia’s culture and specific circumstances.

It is important to acknowledge that our superannuation system is very good, but it can be enhanced by developing clarity over the parameters within which the super funds can provide retirement income products to members and the interplay between such products and government funded benefits and entitlements. We need to ensure that the integration is simple, smooth and as efficient as possible.

I have been looking for evidence to suggest that the investment and consumption behaviour of retirees' change depending on the perceived strength of the public safety net in place but has not found any convincing evidence.

Instead it would appear that the level of interest rates hence the income that can be generated from a low risk portfolio consisting of cash and fixed income securities have an impact on consumption in retirement. The lower the level of income which can be generated from the relevant sources of income, the less the retired person will spend. It is unclear if we can change this behavioural bias by re-enforcing the strength and confidence in the public safety net. It should be possible to model if the impact of a guaranteed age pension, combined with guaranteed health and age care when needed will increase consumption among retirees and generate sufficient economic activity to enable the Government to finance a strong public safety net.

Consultation questions Q2 & Q3:

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

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

Q2:

I believe the superannuation system is broadly understood but I don't believe that the objectives of the three pillars and how they interact with other policy elements are well understood.

According to the AMP only around 16% of all super is taken in lump-sum payments, with the majority of that money used to pay off home loans, renovate, buy a new property, invest or clear other debts.

Lump sums are often taken by people with relatively small super balances. Over 90% of people with up to $10,000 and around 30% of people with between $100,000 and $200,000 in super take their money as a lump sum.
(https://www.amp.com.au/superannuation/accessing-super/accessing-super-lump-sum)

Assuming this assessment by AMP is correct then super is mainly being used for the purpose of generating an income in retirement, which is good news.

It can be argued that the confidence in the super industry is not as high as it should be given around 25% of assets in super are in SMSFs. I could not find any statistics that clearly showed that the funds managed in SMSFs are used for retirement income purposes. Given the tax concessions available during the accumulation phase, it is important to ensure that super balances up to the value of the transfer cap are used for the intended purpose, by making lumpsum withdrawals difficult except where account balances are small or in case of hardship.

Curtailing access to lump sums may be politically difficult to introduce, so it is important to carefully think through the trade-off that could form part of such initiative to make it acceptable.

Q3:

During the accumulation phase there is a perception that superannuation is complex. The perception of complexity increases as members move into the de-accumulation phase. Part of the problem is that as an industry the super funds have focused on providing products and services applicable for the accumulation phase and the de-accumulation phase has been largely neglected. Going forward it will be increasingly important to provide products and services tailored to the needs of retirees, which reflect that retirees need investment options that provide a balance between upside capture and downside protection to reflect a reduced tolerance for sequencing risk relative to the accumulation phase.

Super funds will aim to optimise retirement income outcome for an average member. The outcome of this optimisation may be quite different from what would constitute an optimised outcome for the individual based not only on the super component of their assets, but total household assets.

A number of super funds offer financial advice services to their members and their families, but generally, people are reluctant to pay for financial advice. As a result, we have a system where we have not optimised the chances of the super balances of a household being used as efficiently as possible. We need to make it as simple, easy and as seamless as possible for retirees to optimise their financial position. We also need to make it as simple, easy and seamless for the super system to interact with government entitlements, health care and age care.

Indications are that a large number of super fund members do not optimise their individual retirement income outcomes either because they do not trust the financial planning industry, or they are unwilling or unable to afford the annual or even a one off cost of a Statement of Advice.

As an industry we should be able to minimise the impact of the lack of optimisation by developing more comprehensive calculators that enable households to explore what their combined household position could look like and highlight the options available to enhance retirement outcomes. The calculators should also include a functionality to enable scenario testing and comparison of different scenarios.

Such calculators would not constitute advice, they would be tools that help individuals get an overview over their financial situation. We could further assist them by using AI algorithms to generate questions that may help them to better understand their options and the trade-offs available to them.

We can also reduce the impact of the reluctance to use a financial planner by providing examples of automated advice. The first step would be to help the individual/household to create a budget, which reflects the lifestyle component of their retirement income equation.

This budget would feed into an investment strategy split into three buckets. Bucket 1 would be invested in liquid low volatility assets to be used to finance living expenses for a 2-3 year period, Having earmarked this amount the remainder of the individuals super balance could be split in half between the other two buckets. Bucket 2 could be invested in assets that can be liquidated over a 3-5 year time horizon with medium volatility and the assets in bucket 3 could be invested in growth assets with a 5 – 10 year time horizon

As part of the automated advice it should be possible to test what the impact of different re-balancing regimes would have on how long the individual's super balance could last and at what level and when the individual or the household would become entitled to public support (age pension, health or age care related benefit). Through this type of modelling tool, we should be able to ensure much better integration between the different retirement income pillars.

Consultation questions Q4 – Q6:

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

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?

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?

We know that people retiring over the next 10-20 years are unlikely on average to have accumulated enough super to achieve an adequate income in retirement. We therefore need to find creative solutions to ensure that the interaction between the Government, the super industry and individuals is balanced in a sustainable way, without unduly burdening the next generations of taxpayers, who underwrite adverse outcomes in the superannuation system through the provision of the age pension.

We are moving towards a system where the individual is expected to be able to accumulate enough super to be largely self-funded, assuming contributions at a minimum of 9.5% p.a. over a working life of 40 years full time. Nevertheless, changes in working conditions resulting in broken work patterns and fluctuating participation rates could make it difficult to achieve adequacy. Changes to work practises and business models is likely to occur as a result of increased automation and use of AI algorithms. This is a risk, which needs to be carefully monitored.

The ultimate liability for retirees not having adequate amounts in super or in other assets remain with the Government. This liability is currently not managed.

In a defined benefit fund, we would try to match assets with liabilities provided the scheme was in a fully funded position. Alternatively, if the scheme was under-funded we would aim to work the assets as hard as possible within the constraints of keeping sequencing risk at an acceptable level.

According to the latest ASFA numbers around 50% of the assets in super are spread across around180 APRA regulated funds (Industry, retail and corporate funds), around 25% are held in SMSFs with the remaining around 25% held in public sector funds.

The liabilities relating to public sector funds are already being managed. The balances held in SMSFs are likely to be well above average and I am assuming that the objective of every holder of an SMSF is to be a self-funded retiree. It means the future Government liability relates mainly to the members in the APRA regulated funds due to retire over the next 10-20 years. However, this may not be a valid assumption.

Although consolidation is and will continue to be a major theme among APRA regulated funds it will be very difficult with the current number of funds to efficiently optimise the returns on the assets. The risk appetite and hence the appropriate asset allocation from a national perspective is likely to be higher than the risk appetite of the individual.

Research has shown that in retirement we typically become risk averse and choose conservative or very conservative investment options. Given current levels of interest rates a conservative asset allocation consisting largely of cash and fixed income securities is unlikely to generate more than 1%-2% p.a. above CPI on a forward-looking basis. In contrast, a balanced allocation between fixed income and equities may generate 3%-4% p.a. above CPI. The compounding effect of getting on average an additional 2% p.a. on the super accounts for our retirees over the next 10-20 years will be meaningful and help reduce the public liability.

The fragmentation and size of many of the APRA regulated funds makes it difficult to implement coordinated retirement income solutions that seek to optimise the existing super balances for retirees relative to the Government’s retiree related liabilities. One solution could be to establish a Central Pool backed by the Government, given the Government is already taking on some of the investment risk and all of the longevity risk via the age pension.

Members in APRA regulated funds that do not have the capacity to offer retirement income products could roll their super balance or part of it into the Central Pool. This way every member can have access to a retirement income stream and the income stream could be integrated with government entitlements where appropriate.

The major superannuation funds can offer their respective versions of retirement income products, which will allow competition between those funds and the Central Pool. It would also ensure that every member has the option of using the Central

Pool as a benchmark against which to measure the performance of the fund they belong to.

The idea of centralised pooling runs counter to the way the superannuation industry is currently structured. Centralised pooling may not be required once the super system has matured, but until then it could play an important role of supporting members with average or below average balances during the de-accumulation phase.

Since the requirements in the accumulation phase are different from the de-accumulation phase, there is the opportunity to augment the existing structure to accommodate individual needs in the de-accumulation phase. We could use competitive tension between a Central Pool and the major superannuation funds to develop the best retirement income products and integrate these products with the other health and age -related services, which we will all need at some stage.

The Future Fund could manage the Central Pool. This idea was first promoted in my feed-back to the CIPR discussion paper in May 2017.

We ultimately want to reach a position where the individual is in control and responsible for funding their own retirement. What retirees want may be along the following lines:

- Security in old age – aim to be self-funded retirees combined with the certainty that a base level of income for life is available should it be needed,
- Flexibility to use super and other savings to top up a base level of income to achieve an individualised standard of living in retirement without jeopardizing the base level income,
- Flexibility to finance medical expenses, dwelling maintenance or other lumpy expenses as and when they occur,
- Limited exposure to investment risks. but willingness to take on some investment risk if the safety net is seen as strong and adequate. The Government can provide certainty that the safety net will be in place. It is easier to make decisions if there is a degree of certainty as opposed to no certainty.

Irrespective of whether retirees are self-funded or not they would have a retirement income equation. Retirees would generate income from their super + other investments + their primary residence. Post 2040 the call on the age pension would fade in importance and mainly be used to provide longevity insurance rather than be the major source of income early in the retirement phase, as is currently the case.

To achieve this, we need to remove the impediments and inconsistencies between the various income streams identified as one of the pain points above. It would be especially advantageous if the tax system could assist asset rich, but cash poor retirees to smoothly turn their illiquid assets into liquid assets in a way that creates flexibility for the individual and at the same time reduces the public liability.

Individuals who release equity from a property they have lived in for more than 10 years can currently put around $300,000 into their super fund as a lump sum, which is great. It would be better, however, if they could put whatever equity they release into their super up to the value of the transfer cap. This may alleviate some of the current issues whereby the release of equity from the primary residence can cause the individual to no longer be entitled to an age pension. If we can demonstrate to the individual that loss of the entitlement to the age pension is offset by the larger amount of tax free income generated from the individual's super, we may make it easier for individuals to fadapt their housing requirements as they age and also achieving more efficient use of the existing housing stock.

In addition to creating consistency between the sources of income in retirement, we need to co-ordinate the income with the expenditure side that relates to public services like health and age care. Currently super funds are unable to help households understand and solve their retirement income equation unless the super fund has a financial planning entity and the individual member seeks and is prepared to pay for personal financial advice.

Also, retirement income products can only be designed for the super component of each member of the household rather than allow for an optimisation across the super balances of the household or even better the combined assets of the household.

This is a big problem, which we can minimise. It needs clarity around the parameters within which the super industry can operate, which hopefully will come out of this review.

Consultation question – Q7:

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

There are a number of issues we need to address:

1. Young people are typically not engaging with their super. They find super boring, complex and retirement is a million years away. As a result, they do not use their most valuable asset; TIME. Young people typically do not take advantage of the power of compounding by boosting their super balance early. If they did, they would be more resilient against investment risk, broken work patterns etc. I understand there are many competing priorities to spend money on when you are young, it is therefore important to show young people the power of compounding and to incentivise them to engage with and build up their super in the younger years.

   We have fixed the problem of small balances being eroded away by fees, now let us incentivise young people to engage with and build up their super so they can enjoy the power of compounding.

2. We need to think about incentives that can be cost effectively implemented to help try to close the gap in the average value of balances for men and women. Research shows that a growing proportion of women in retirement are poor. They on average earn less than their male counterparts, they have on average broken work patterns, lower labour market participation rates and they live longer. We need to be creative to find ways of reducing this gap.

   Some super funds are helping women to divert small amounts into their super when they go grocery shopping. Great initiative, but unlikely to be enough to make a difference and close the gender gap.

   We need to close this gap by allowing contributions to be made at any level the individual can afford throughout their productive years whether they are working or not. We need to make it easy to divert savings when going shopping into super, we can help single parents to use crowd-funding to qualify for the co-contribution etc. We can create a broad range of initiatives that make it as easy as possible for people to use time and compounding to their advantage.

   This way we acknowledge that raising future generations or caring for older cohorts despite being unpaid, is still work that benefits society.

3. Home ownership among retirees may change in the future as a result of high property prices in the main cities. High property prices may also cause retirees to have debt going into retirement and super if allowed to be paid out as a lumpsum could be used to extinguish that debt, which leaves the retiree asset rich but cash poor; a problem already discussed.

4. The adequacy of the retirement income system rests on the assumption that individuals work on average 40 years full time and the SG contribution is a minimum of 9% p.a. over that period. If the work pattern changes resulting in significant increases in individuals with broken work pattern, then we need to re-think the level of contribution and how we incentivise people to again maximise the impact of compounding. This would only be a successful strategy if it does not significantly jeopardise shorter-term lifestyle considerations, in which case it is not a viable strategy.

5. We need to eliminate rules that create confusion and inconsistencies of how individuals and households are treated. The system needs to be sufficiently flexible to be able to deal with a single individual, who at some stage becomes part of a household, who may then become single again, then part of a new blended household and then single again.

The simpler we make the rules the more likely that the system will be able to deal with the various permutations of modern living and modern families.

Consultation questions Q8-Q9:

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?

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

To use adequacy, equity, sustainability and cohesion as benchmarks are appropriate for a mature retirement system. We should absolutely aim to deliver on all four benchmarks and ensure that the inter-relationships between the benchmarks are well balanced and understood. At the current level of development, the system is not appropriately balanced.

Given the retirement income system is still transitioning towards maturity we know that the average super balance for the majority of individuals moving into retirement over the next 10-20 years will be too low to achieve adequacy. We also know that the system is currently fragmented, which hampers cohesion.

The low average balances for the majority of members in the APRA regulated funds are largely associated with the big Baby Boomer cohort. Providing age pension as well as health and age care related services to this big cohort will be expensive. Younger tax payers will shoulder the burden unless we can find clever solutions that encourages the Baby Boomer cohort and the cohorts of retirees out to 2042 to pool their resources to obtain higher investment returns than they would achieve as individuals.

We also need to encourage the Baby Boomers to use the assets they do have by allowing them to use their primary residence to generate income. Rooms can be rented out, or equity could easily be released without the retirees needing to fear eviction or not having anything to pass on to the kids.

The high level of ownership of a primary residence among Baby Boomers and the wealth transfer that will take place over the next 20-30 years, which is not encumbered by any form of death duties, will go some way to alleviate some of the inter-generational equity issues. The younger tax payers pay for the needs of the older generations, but they will on average get an unencumbered inheritance that will partly compensate for the fiscal support they have funded. I don’t have a model that will allow me to quantify the impact of this.

Consultation questions Q9 – Q12:

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

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?

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

Q9:

Create a model that solves an average retirement income equation less the need for a bequest, as an individual's desire to provide a bequest should not be funded by the public. Solving the equation would assist in quantifying how the need for public funding may recede over time.

Sources of income - Super+ age pension + primary residence + other investments =

Expenditures: Life style + health care + age care

This will enable us to quantify what would be needed on average to achieve adequacy for retirees during the remainder of the transition phase and balance that with what we can fiscally afford, taking into account that it is beneficial from an economic growth perspective if retirees are able to continue to maintain meaningful consumption levels.

Q10:

Calculating a measure of adequacy will by definition be an average and there is likely to be a wide distribution of actual outcomes around that average. We need to understand the distribution and try to pull as many of our retirees as possible out of potential poverty.

We can calculate an average adequacy measure, perhaps in line with the ASFA calculation for a comfortable retirement at September 2019 of $61,786 per annum for a married couple and $43,787 for a single person, these figures assume retirees own their home outright and have good health. However, expectations and anchoring relative to past consumption patterns will play a big role in what retirees' experience as adequate. All we can do is attempt to create realistic expectations based on an average retiree, who may or may not exist.

Q11:

I do not have access to any data that may help answer that question.

Q12:

The average super balances for people aged 55 and over are too low to provide for a retiree to be self-funded for an average of 30 years.

Consultation questions Q13 – Q17:

What should the Panel consider when assessing the equity of the retirement income 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 support fair outcomes in retirement for individuals with different characteristics and/or in different circumstances (e.g. women, renters, etc.)?

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

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

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

Q13 – Q14:

Individuals who have the same lifetime earnings and made the same level of contributions to super should expect to have similar outcomes in retirement. This is unfortunately not the case. The current system is a lottery where individuals in similar circumstances (same contribution levels over the same length of time) may have very different outcomes depending on which fund they are with.

The compounding effect of being with a fund or in an investment option that under-performs over the long-term relative to investment options with a similar risk profile managed by other funds can be very significant. The system should not be a lottery when it comes to the compulsory contributions. It means that all of us tax payers pay the price via the tax required to fund the age pension as well as health and age care related services, because the super balances were lower and therefore the distribution of adequacy was worse than it needed to be.

As a nation we have chosen to play that lottery in the implicit belief that free choice for all will generate a better overall outcome than a system where competition and optimisation takes place between competing investment teams and their efforts are combined into a uniform crediting rate for all SG accounts.

Choice is great when we make the right choices, it is not so great when we make less optimal ones. Trying to get people to switch to a group of preferred super funds as per the suggestion by the Productivity Commission will unfortunately not necessarily solve the optimisation problem, as the measures we rely on to identify the preferred super funds are backwards looking. The proposal would appear to promote yesterday's winners, which may not be the winners over the next 40, 30, 20 or 10 years.

The consolidation among super funds that will take place over the next 5-10 years can be expected to help reduce the negative impact of the lottery and move us towards a harmonisation of returns, which would be good from an individual as well as the national perspective.

People may argue that harmonisation leads to mediocrity. I don't believe this is the case, although it is a possibility. People subscribing to this belief have the freedom to set up their own SMSF. For the majority of individuals with small balances any optimisation process that seeks to reduce the chances of relative under-performance would be a bonus.

As mentioned above as part of the answer to Q7 there are a number of issues that impact adequacy and many of those issues also impact the question of equity. In Q7 we discussed the issue of the big gap between the average super balance for men and women in retirement. It is important to create a range of initiatives to make it as easy as possible for people, who work part-time or not at all to be able to contribute to super whenever they can so they can use time and compounding to their advantage.

Q15 – Q17:

I don't have any answers to those questions.

Consultation questions Q18-Q20:

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

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

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

Q18:

By solving the retirement income equation, we will be able to quantify and aim for a viable balance between on average achieving adequacy for retirees during the remainder of the transition phase and what we can fiscally afford as a nation.

Sources of income - Super+ age pension + primary residence + other investments =

Expenditures: Life style + health care + age care

It is not easy to balance a large number of complex policies, but it may be that by seeking to streamline, simplify and eliminate the inconsistencies that currently exist we can enhance the efficiency of the system, which in turn will assist in easing the fiscal pressure until the retirement income system reaches maturity.

Q19:

This is an optimisation problem, which can be modelled.

Q20:

Within the super industry we often discuss how we can improve the engagement with members. We seek continual improvement and the frequent regulatory changes provide opportunities to engage with members. Some of these changes have added to the complexity of the system and more importantly the perception of complexity.

In the wake of the Royal Commission the outflows from retail funds into industry funds clearly suggest that there is trust in the super system. Despite this trend, it is a worry that SMSFs account for roughly 25% of the assets in super. This is not a ringing endorsement of the system. It is a clear message that individuals, generally with significant balances, believe they can do better than the industry. Such belief is not a problem as long as the beneficiaries of the SMSFs become self-funded retirees and therefore make no or limited calls on the public purse.

We need to build a retirement income system that encourages us all to become self-funded retirees and supports the retirees who have balances at or below average, which are inadequate. For the people in the latter category we need to ensure that the income sources available to these individuals can be used to extract as much income as possible in a risk-controlled manner. At the moment management of this risk sits with the individual, who on average may be ill-equipped to manage such risk. Also, the ultimate risk arising from any shortfall in assets sits with all of us and that risk is unmanaged.

Consultation questions Q21 – Q26:

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

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

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

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?

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

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

Q21:

The discussion paper highlights the lack of cohesion in the existing system and points to a number of inefficiencies relating to the interactions between the retirement income pillars:

"There are a number of areas where the interactions between superannuation, the Age Pension and voluntary savings may drive behaviour. These include:

- The difference in the age at which superannuation and the Age Pension can be accessed. This may affect decision making around when to retire, and how heavily new retirees draw on superannuation to fund retirement ahead of meeting the age requirements for the Age Pension.
- The way assets are treated under the Age Pension means test. Some stakeholders suggest that the current assets test taper rate creates high effective marginal tax rates on savings (Asher and De Ravin 2018).[1] It has been claimed that this may discourage working age Australians from making superannuation contributions and encourage retirees to dissipate their assets in retirement.
- The way the family home is treated under the Age Pension means test. There has been debate about whether the exclusion of the value of an owned primary residence from the Age Pension means test may result in Australians overinvesting in their family home (Senate Standing Committee on Economics 2015, p. 198).[2]"

1 The Age Pension assets test reduces an individual's Age Pension by $3 for every additional $1,000 in assessable assets above the relevant free area. This is a taper rate of 7.8 per cent per annum, which may be higher than the earnings potential of associated assets. This can result in more income being lost through the Age Pension than could be generated by the underlying assets, provided they are not drawn down upon for self-support.

2 There is an implicit value of an owned primary residence of around $210,000 incorporated in the lower assets test thresholds of home owners compared to non-home owners.

“The retirement income system interacts with other systems in ways that can be difficult for individuals to navigate or drive unintended behaviour.

- The potential need to contribute to aged care costs is a major point of interaction for the retirement income system. Uncertainty about the possible need for a lump sum to access residential aged care can lead to retirees not drawing on savings at the rate that they might otherwise do so. In addition, the means test for the Age Pension is structured differently to the means test for aged care and the interaction can be complex to understand.
- Interactions between the retirement income system and the tax system can affect the savings vehicle Australians use to store assets and the level of tax paid in retirement. These interactions can make it difficult for individuals to optimally plan for retirement. This may also lead to unequal tax treatment for the same level of income.”

Having identified some of the pain points surrounding the parameters within which the retirement income system works, the policy framework needs to be enhanced to provide clarity, consistency and simplicity so the super industry can develop products and services that will help members optimise their retirement income outcomes based on their individual retirement income equation.

In order to do this, we need to model the average retirement income equation and determine the level of adequacy that can be provided in a fiscally sustainable manner at various points during the next 10-20 years, until the retirement income system reaches maturity.

There is another anomaly with the current system. At more modest levels of savings, the more the individual saves the quicker the entitlement to the age pension is phased out. The problem is the pension assets test. For a group of middle income earners, an increase in savings/investment outside of the family home can lead to a reduction in lifetime incomes.

A better designed assets test would ensure that additional savings weren’t penalised in this way.

Q22:

As argued in the response to Q7 we need to do more to incentivise and assist young people and people with broken work patterns to contribute to super and use time to their advantage.

Q23:

I don’t have any information to show how interactions between the pillars of the retirement income system are influencing behaviour. However, it is difficult to make decision under a high level of uncertainty. Therefore, the more certainty we can provide the individual and provide confidence around the strength of the public safety net, the more likely it is that individuals will be prepared to take on more investment risk than they otherwise would.

Q24:

I believe that the interaction between the retirement income system and other areas such as aged care is very poorly understood and there seems to be a perception that the rules are very complex. I have no direct experience with the interaction between the retirement income system and aged care services.

Q25:

Most people do not seek formal financial advice. There have been a number of unfortunate incidents and the Royal Commission highlighted how parts of the financial planning industry did not service their clients well. This has resulted in a degree of distrust of financial planners. In addition, the majority of individuals approaching retirement are unlikely to spend \$3,000 – \$5,000 on a personalised financial plan if their total super balance is \$400,000 or less.

How this problem could potentially be reduced was discussed under Q3.

Q26:

The integration between the age Pension and the super system needs to be improved. As long as the age pension is means tested based on household assets and the super system only has access to the individual's super account with no visibility over the household assets it is difficult for proper integration to occur.