SISFA

SUBMISSION TO THE RETIREMENT INCOME REVIEW

in response to the
CONSULTATION PAPER

1. Introduction

This submission argues that Australia's retirement incomes system is not as effective and adequate as it should be.

The main shortcomings are:

- Low caps on superannuation contributions and no flexibility to increase contributions in later working life mean Australians are not saving enough. Low caps on super contributions only lead to more reliance on the Age Pension and higher cost to Government in the future.
- Compulsory super at low income levels is an ineffective use of tax concessions.
- The retirement income system risks being used as yet another redistributive/social engineering mechanism at the expense of effectiveness and fairness.
- Regulatory risk to superannuation, including SMSFs, reduces its effectiveness and creates concern about further changing rules that adversely affect a mandatory, life-long investment.
- Increased complexity in the retirement system leads to greater inequity and increases the need for, and cost of, retirement related advice.
- Superannuation tax concessions to encourage saving are a good investment by the Government – each $1 spent on tax concessions returns $2-$4 in future Age Pension savings.
- Continuing publication of misleading tax concession calculations has, and could still, influence Government decision-makers to implement policy changes that are to the long-term detriment of a sustainable and effective retirement system.

These issues are explored in detail in section 5, supported by analysis using the Pension Sustainability Model developed by Malcolm B Clyde, co-founder of the SMSF Owners Alliance.

We support the key objective of the Review to establish a fact base of the retirement system and list in section 4 some facts (and dispel some myths) that we believe are not widely recognised or understood.

This submission uses results from the "Pension Sustainability Computer Model" based upon certain assumptions. The contents of this paper and the results from the Pension Sustainability Model should not be construed as the provision of financial advice as we disclaim all liability in this respect. The views expressed in this paper, including the assumptions and computations used in the Pension Sustainability Model, are the personal views of the authors and should not be relied upon by any party.

2. About SISFA

The Self-managed Independent Superannuation Funds Association (SISFA) is Australia's original SMSF advocate. It was established in 1998 to represent the interests of trustees and industry to Government. SISFA's mission includes the encouragement of high professional standards through its professional membership and public education initiatives. In May 2017, SISFA merged with the SMSF Owners' Alliance which was established in 2012 to give the owners (trustees and beneficiaries) of SMSFs a direct voice on Government policies that affect them. SMSF Owners' Alliance primarily focused on advocacy supported by comprehensive financial modelling to illustrate the impact of proposed and possible changes to the system.

As an independent association reliant on volunteer effort this submission is less comprehensive and perhaps less focused on the requirements of the Panel than we could produce if we had more time and resources. However, we hope it makes a useful contribution to the Panel's thinking and we would be pleased to engage in consultation with the Panel with a focus on SMSFs.

As a not-for-profit organization, our directors and advisers provide their time pro-bono. We also have a very limited research and lobbying budget and hope that the Panel takes this into account is considering our ideas vis-à-vis differing or contrary views from the major superannuation industry lobbying groups.

In this context, it is important to point out that retail and industry superannuation funds make a lot of money from their members, as the Productivity Commission has pointed out, and can pay for strong and influential lobbying of Government on superannuation policy.

We believe that the SMSF segment provides a valuable pace setter and benchmark for the superannuation sector and should be encouraged. Indeed, SMSFs are arguably the only segment that are achieving what should be its central objective - to be the mechanism for most Australians to achieve financial self-sufficiency throughout their retirement.

3. A timely stocktake

We welcome the opportunity to provide a response to the Consultation Paper published by Treasury in November 2019 and strongly support the key objective of the Review to establish a fact base of the current retirement system that will improve understanding of its operation and the outcome it is delivering for Australians. We submit that the Panel should be careful, however, not to present the Government with data and "facts" relating to the current performance and position of the retirement sector as this might misdirect their policy formulation to focus on "fixing" perceived anomalies with the current situation to the detriment of the long-term sustainability, fairness and adequacy of the system.

Such a stocktake is timely.

- In 2020 it will be 28 years since superannuation was made compulsory. 20 year olds entering the workforce in 1992 will now be 48 with retirement on the horizon and a sharper focus on the level of retirement income and lifestyle they will be able to afford. They are the first generation who will have had the benefits of compulsory superannuation throughout their working lives, although for many their superannuation savings will not last throughout their retirement.
- The baby boomers (1946-1964) have retired or are close to retiring, many having spent half their working lives without any form of superannuation. Many of this generation are facing the reality that their retirement savings will not last the distance and they will need to fall back on the age pension.
- Now that the millennials (1980-2000) are in the workforce there is the opportunity to ensure the retirement system is set up to be sustainable and predictable so as to provide most of this generation with a superannuation system that is adequate and fair and actually reduces reliance on the Age Pension.
- As people live longer, their retirement savings are stretched and may not cover the final phase of their lives when care and health costs will be high. Superannuation policy settings, especially the concessional contribution limits, need to be set high enough to allow people to save enough to support themselves throughout retirement and old age.
- It is also 32 years since the Government accelerated its tax receipts from the existing superannuation system by commencing taxation of previously exempt contributions and superannuation earnings, thus leading to a less effective and more complex system.
- Our analysis clearly demonstrates that the current $25,000 concessional limit is not adequate. This limit applies across the board at all stages of a person's working life. As people achieve the goals of establishing their career, building a home and educating their children and then start looking ahead to retirement, they should be able to increase their concessional contributions to 'super charge' their retirement savings. This point applies to all lifestyles in our diverse society as much as to traditional families.
- After rising on a rapid trajectory over the past three decades, Australia's retirement income system has reached a point when an assessment can be made of how effective it has proved to be so far and how it should perform in the future.

As the compulsory superannuation system affects virtually all working and retired Australians, it is clearly important that Government policy decisions and supervision of the superannuation sector are based on a comprehensive understanding of its role in people's lives and its function in the economy.

The need for a stocktake and of the retirement incomes system was highlighted in the 2019 report by the Productivity Commission (Superannuation: Assessing Efficiency and Competition) which led to the task given to the Panel.

The Productivity Commission concluded: "The superannuation system needs to adapt to better meet the needs of a modern workforce and a growing pool of retirees. Structural flaws - unintended multiple accounts and entrenched under-performers - are harming millions of members, and regressively so." Going on to note that: "Fixing these twin problems could benefit members to the tune of $3.8 billion each year. Even a 55 year old today could gain $79,000 by retirement. A new job entrant would have $533,000 more when they retire in 2064."

The Commission reported that "Evidence abounds of excessive and unwarranted fees in the super system." and "Compelling cost savings from realised scale have not been systemically passed on to members as lower fees or higher returns".

The Commission concluded: "Architectural change is needed". We agree.

SISFA's submission does not focus overly on the shortcomings in the superannuation system identified by the Productivity Commission. These are matters for Government action. However, we welcome the opportunity to offer the Panel advice on how we think the retirement incomes system could be improved to the material benefit and peace of mind of Australians.

We believe that Government policy changes in the past have focussed too much on short-term impacts on the budget and not enough on the long-term economic and social benefits of an effective retirement incomes system. Some of the Discussion Paper questions appear to be seeking evidence relating to the <u>current</u> state of the retirement system. Again, we urge the Panel to ensure its report to Government relates to the <u>long-term</u> condition of the retirement system when it has reached a "steady state" under current settings. Any modelling prepared for the Panel should do this, as does the simulation model we have used.

In addition, some of the legislative changes in recent years have been aimed at high income earners or members with higher balances. While these measures may impact those persons directly, the additional complexity that such changes bring affects all members. In particular, this may decrease the engagement of members in the superannuation system and increase the need for, and cost of, retirement advice. People in mid-career building their savings for retirement may be disconcerted by changes to the superannuation rules that may not affect them directly now but send a signal to them that the rules might be changed to their disadvantage in the future.

We hope that arising from this review there will be broadly agreed principles on the purpose of superannuation and how changes in policy settings should be managed as the system evolves and matures.

Our submission has three main sections:

Section 4 - A list of our view of major facts that need to be properly recognised;

Section 5 - Our view of the main problems with the current system, with supporting facts and analysis; and

Section 6 - Our response to the questions posed in the Consultation Paper.

In representing SMSFs, our expertise and focus is mainly on the superannuation system, however we have over a number of years and in previous submissions modelled superannuation in the context of the overall retirement system, including the Age Pension system. We have always considered that the three pillars must be analysed together with their interrelationships acknowledged, especially between the Age Pension and superannuation pillars.

In this submission, we have used the Pension Sustainability Model (Model) developed by Malcolm B. Clyde, co-founder of the SMSF Owners' Alliance. The Model calculates tax payments and Age Pension receipts with or without a superannuation system, for an individual over his/her lifetime, compares them and then reports them in today's dollars. This provides a much better estimate of the level of lifetime tax concessions vs tax paid and Age Pension payments and we do this calculation across a range of eight income levels (multiples of AWOTE) so that fairness and adequacy can be specifically illustrated.

Duncan Fairweather and Malcolm Clyde were both founding directors of SMSF Owners Alliance and have been invited to co-author this submission. In this regard it is important to note that they have a somewhat jaundiced view of the Government's response to reviews such as this one and the attitude of Treasury to the long-term value of superannuation and SMSFs in particular. This feeling reflects the abandonment by the Government of the earlier "White Paper" process, notwithstanding the constructive and substantial submissions made by SMSF Owners Alliance and other organisations. Indeed, there now appears to be no public record on the Treasury website of the submissions made by many informed and interested groups, including ourselves. We would be happy to provide our two Tax White Paper submissions to the Panel on request (malcolm@clyde.family). They contained far more comprehensive analysis of the system than we have had time to include in this submission. Malcolm Clyde has also indicated that he is prepared to share with the Panel the assumptions and computations used in his Model.

The relevance of this disclosure is our strong urging of the Panel to remain independent, be upfront in its report about any failings of the system and to do what it can to ensure the results of its review are not shelved and that Governments in future will feel obliged to consider them before any significant changes are made to the retirement system.

4. Recognising facts and dispelling myths

We welcome the Panel's focus on establishing facts about the retirement system. Equally important should be a focus on dispelling some myths about superannuation.

We summarise below our view of some of the important facts and myths regarding the retirement system that we believe are not necessarily widely recognised or understood. Some of these are explained and supported in the next section of this submission.

a. Under the current superannuation system few Australians will be able to achieve a reasonable retirement pension. See section 5.

b. The main constraint on this is the annual contribution caps.

c. It is a fact that the Government pays 100% of Age Pensions but a superannuation pension is very substantially funded by taxpayers' contributions (and their earnings). We estimate the tax concession to comprise only about 10% of the cost of a superannuation pension

d. As a result of projected failings with the superannuation system, the Age Pension will be a far higher cost to the Government over time than should be the case if the system were structured so that the Age Pension was just a "safety net" for those on low incomes.

e. The superannuation caps (the annual contribution limit and the Transfer Balance Cap) are indexed to CPI. It is expected that average weekly earnings will grow at a higher rate in a growing economy. The caps will therefore shrink relative to average earnings over time resulting in an even less effective superannuation system. Superannuation is a function of employment and it makes sense for indexation to be linked to AWOTE rather than to the CPI.

f. Contributions into superannuation funds and earnings on them used to be tax exempt from tax from the time the Federal Government first imposed income tax in 1915. The Government then started taxing contributions and earnings in 1988. Our modelling indicates that it is this acceleration of tax payments that is a major cause of the failure of the system to provide a reasonable pension to many Australians.

g. In its annual "Tax Benchmarks and Variations" report (previously known as the "Tax Expenditures Report"), Treasury does not report on the tax concessions integral to our progressive income taxation system because they consider this system to be a "long established" part of the tax system. However, they do not apply the same test to superannuation tax concession which are an <u>equally</u> long established feature of the system. Note: we would not argue for Treasury to cease reporting superannuation tax concessions, but that, in the interests of transparency and full disclosure, tax concessions granted to some tax-payers as a consequence of our progressive income tax system are also reported.

h. The Treasury estimates in the above mentioned report use the wrong benchmark regarding unearned income.

i. In reporting tax expenditure, they make no reference to the savings in Age Pension costs resulting from superannuation. It is of limited value to measure current costs without taking into account future benefits.

j. The Treasury report also takes no account nor makes any mention of additional GST payments as a result of superannuation. Superannuation earnings are subject to GST when they are distributed and then spent on consumer goods and services, adding to tax revenue.

k. Those on low incomes accumulate too little superannuation to have any meaningful impact on their retirement pension vis-à-vis their Age Pension entitlement. Providing such persons with the option of receiving their superannuation guarantee payments as after-tax cash may benefit both tax-payers and the Government.

l. The retirement incomes system is becoming increasingly complex and costly without any apparent improvement in effectiveness. Such complexity inhibits engagement with the superannuation system, increases uncertainty and compliance cost. The Productivity Commission has drawn some critical conclusions about the cost and performance of the managed funds sector. Such complexity also increases the need and cost of advice in relation to the retirement system. But paradoxically, the obligations placed on the advisors over recent years has made it more difficult and expensive for members of the public to access and/or afford such advice

m. Continual changing of the superannuation regulations and rules also adds to regulatory risk for Australians trying to plan ahead for their retirement.

n. Individuals decide to leave managed superannuation funds and start up an SMSF because they desire more control over their investments and fewer parties applying costs to their fund. As the Productivity Commission noted, the managed fund sector still lacks transparency and effective competition. There is no clear simple standardised reporting to members who have no vote in the management of their fund (unlike public companies or mutuals).

o. There is no potential for conflict between trustee and beneficiary in the SMSF sector because they are the same vs the APRA regulated sector where there exists the potential for conflicts between acting in the best interests of the member and maximising profits for the fund manager (or meeting other corporate/union objectives).

p. It has just been reported that the median fund achieved over 13% in 2019. What has not been as widely reported or understood is that the Australian share market returned 23.4% last year. An indexed fund with minimal fees should almost match this.

q. As Warren Buffett once pointed out, a 1% per annum charge on a fund’s net rate of return can halve the value of the assets available for a superannuation pension. As reported by the Productivity Commission, our system is failing to achieve expected returns. Our modelling shows that better returns can dramatically improve the superannuation sector’s ability to pay adequate pensions leading to lower Age Pension costs for the Government without any increased tax concessions.

r. “Evidence abounds of excessive and unwarranted fees in the super system.” and “Compelling cost savings from realised scale have not been systemically passed on to members as lower fees or higher returns” according to the Productivity Commission.

s. It is a myth that SMSFs with balances under $200,000 should not be established. We are aware of funds that started with $100,000 and have earned a compound average of 10% over 5 years, beating APRA funds and justifying their establishment. In 2016-17, the most recent year for which full statistics are available, the return on assets for SMSFs was 10.2% compared with 9.1% for APRA regulated funds. The critical factor in SMSF performance is the commitment and determination of their members to succeed.

t. SMSFs are the only taxpayers charged an annual fee by the Tax Office for doing its job. Again due to compounding, we have previously shown that this fee can have as big an effect on superannuation pensions over a lifetime as a global financial crisis!

u. Apart from the potential impact of fee conflicts, the structure of APRA regulated funds means that they will not hold the optimum mix of investments to maximise long-term returns to members for two reasons:

    i. They need to maintain liquidity because of uncertainty regarding whether any members may wish to withdraw funds. An SMSF has less uncertainty because the trustee knows whether the member plans to make any large withdrawal; and

    ii. They have a relatively short-term focus due to their wish to report performance that could attract new members and minimise members leaving.

   SMSFs have neither of these problems.

v. The purpose of superannuation has not been formally agreed. Legislation introduced in 2016 to define the objective of superannuation lapsed in Parliament. The defined purpose – that the purpose of superannuation is to substitute for and supplement the Age Pension – is inadequate, unambitious and wrong in principle.

5. Some problems with the current system

At the same time that the progressive income tax was introduced 105 years ago a superannuation savings regime was established. This was a much fairer and effective system than our current structure and an approach that is generally recognised internationally as a benchmark for savings taxation – being essentially a tax-deferral system.

However, the taxation of contributions and superannuation earnings that was introduced in 1988 had the effect of accelerating the Government's taxation receipts and it has become more and more difficult to revert back to the earlier system without operating two systems in parallel for a generation.

In the submission by SMSF Owners Alliance (now SISFA) to the Taxation White Paper in 2015, an alternative was proposed and assessed. This was a modified version of the changes first proposed by Dr Ken Henry AC in his 2009 report entitled "Australia's Future Tax System" and built on work by the economist Professor John Freebairn AO of Melbourne University. Analysis indicated that this would be fairer and simpler (and therefore more effective) than the current system with retirement results fairly closely mirroring those from the "benchmark" system we used to have.

The 2015 Taxation White Paper was commissioned by the Government and many submissions were received but the process was abandoned before these submissions were considered and a report prepared by Treasury. The submissions have not been published by Treasury but we would be happy to provide the Panel with the SMSF Owners' Alliance submissions. (malcolm@clyde.family).

However, if there is no political will to fundamentally change to a better alternative, we believe that the current structure can be made to work reasonably well with only a small number of changes. The following is an analysis of the main problems which we believe reduce the effectiveness of the current superannuation within Australia's retirement income system.

A. Caps on super contributions lead to more reliance on the Age Pension and higher cost to Government

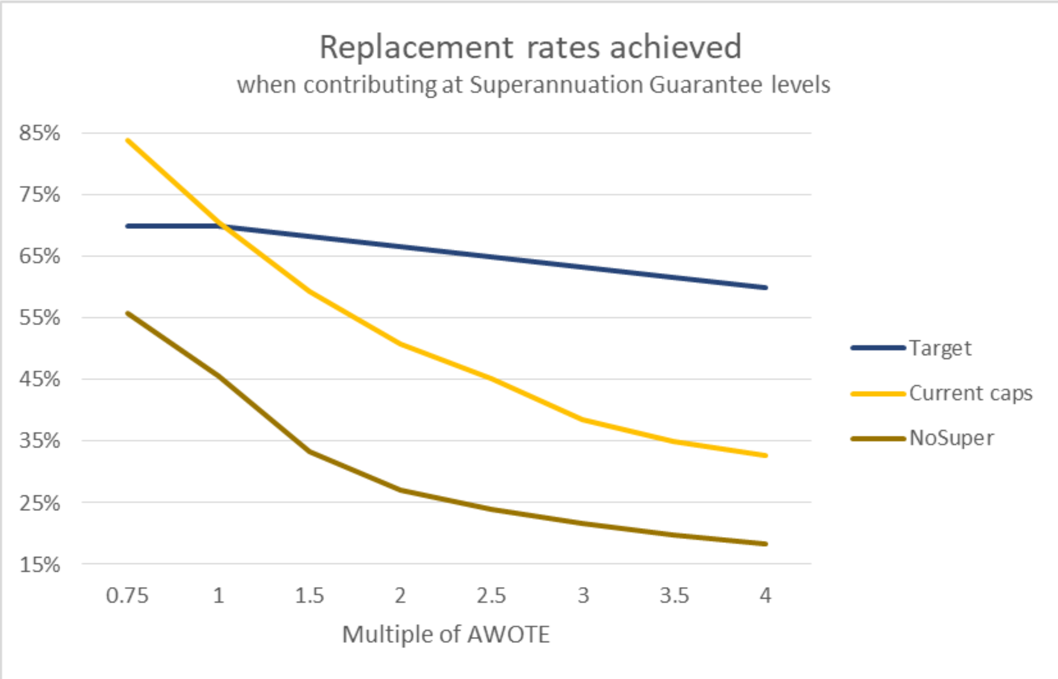
The system fails the 'fair and adequate' test for several reasons. We agree with the universally recognised Replacement Rate as a measure of adequacy – and fairness. We have previously suggested, in our Tax White Paper submissions, an adequate system would provide after-tax pension income (whether Age Pension or super or a combination) equal to 70% of pre-retirement after-tax earned income, all indexed to growth in average weekly overtime earnings (AWOTE). We have further suggested, consistent with OECD guidelines, that the 70% falls to 60% at higher incomes.

However, the current SG level and contribution caps prevent many Australians from achieving adequate savings to retire on such a pension, independent of the Age Pension.

It must be remembered that the Age Pension is funded 100% by Government (that is, by taxpayers) whereas the vast majority of the funds supporting a superannuation pension are provided by individuals foregoing consumption expenditure during their working life. Our analysis indicates that tax concessions comprise about 10% of the cost of superannuation pensions.

Our model projects pensions from both the Age Pension and superannuation accounts if contributions are made at the 12% level planned by 2026 with the contribution and other constraints and the taxes in the current system. It then calculates this as a percentage of the average real after-tax income over the last 10 years of a person's working life ("Replacement Rate"). The following graph illustrates the Replacement Rate achieved for tax-payers on a range of incomes expressed as multiples of Average Weekly Ordinary Time Earnings (AWOTE). It also shows a reasonable "target" Replacement Rate for each person and the Replacement Rate achievable if there were no superannuation system.

For the model to be meaningful as an illustration of the long-term impact of a system, consistent and sustainable long term assumptions must be made. For example, with the Transfer Balance Cap only indexed to CPI, over time this is expected to shrink relative to average earnings which have generally exceeded CPI in a growing economy. Similarly thresholds such as the income tax thresholds, Age Pension tests etc. are also assumed in the Model to be indexed by AWOTE over the long term to maintain meaningful relativities.



The above graph clearly shows that no-one earning above Average Weekly Ordinary Time Earnings (AWOTE) would achieve their target Replacement Rate if contributing at 12% Superannuation Guarantee level. This fails the "Adequacy" test.

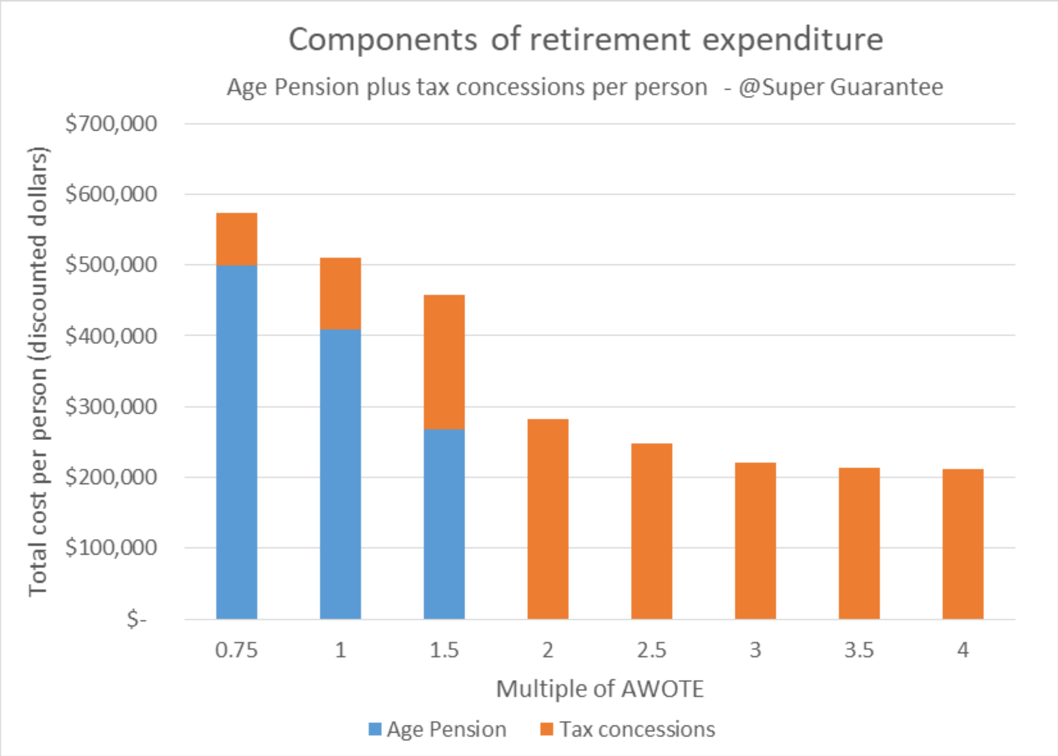
In relation to "Fairness", as already mentioned above, one has to be careful how to define "fairness". For example the total dollar size of so-called "tax concessions" are often quoted without any reference to issues such as:

- How this sum compares with total taxes paid by that person in their lifetime;
- The savings in Age Pension achieved due to the tax concessions; and
- Exactly how to calculate the "concession".

We believe we have addressed these issues. Our model projects both tax payments and Age Pension receipts across a range of income brackets under the current superannuation system. It then compares these – for each income bracket – for projections if there were no superannuation system. (Note: In the latter we have assumed each person still saves some of their after-tax income, notwithstanding the income tax system biases against such decision.)

We then look at the whole of life tax payments. We assess such tax concession as the present value of tax payments made under the superannuation system with those paid if there were no such system.

The following graph show the total cost of Age Pension payments plus tax concessions for a range of income brackets.



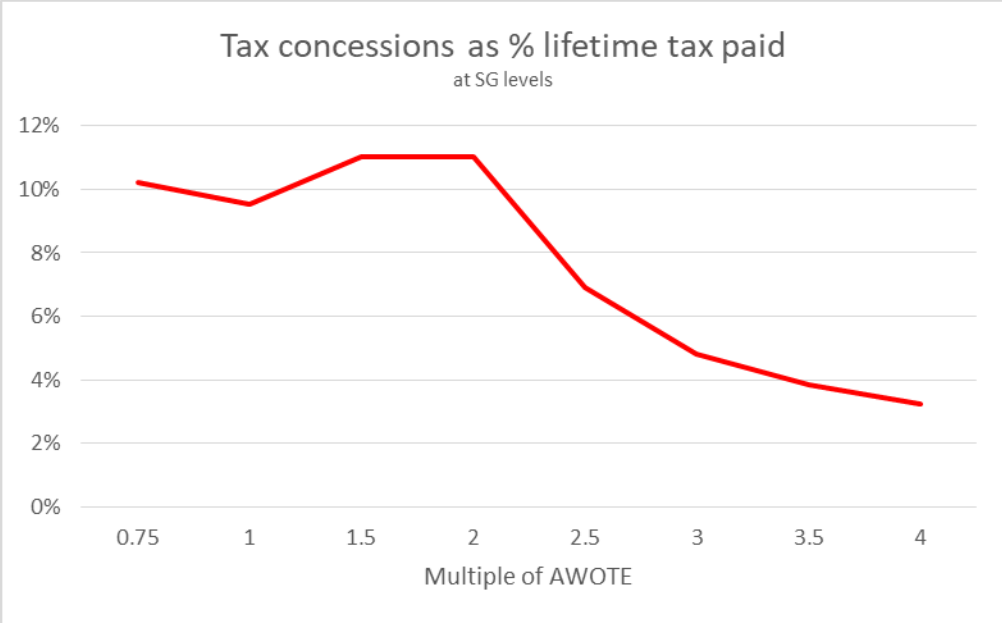
This graphs illustrate two things:

a) How much of the retirement cost for those earnings under 1.5 x AWOTE is projected to comprise Age Pension payments; and

b) How, contrary to "popular" myth, the total cost to government declines with income.

Note: This is even more marked if one takes GST payments into account as GST is effectively paid on superannuation earnings when they are paid out and spent.

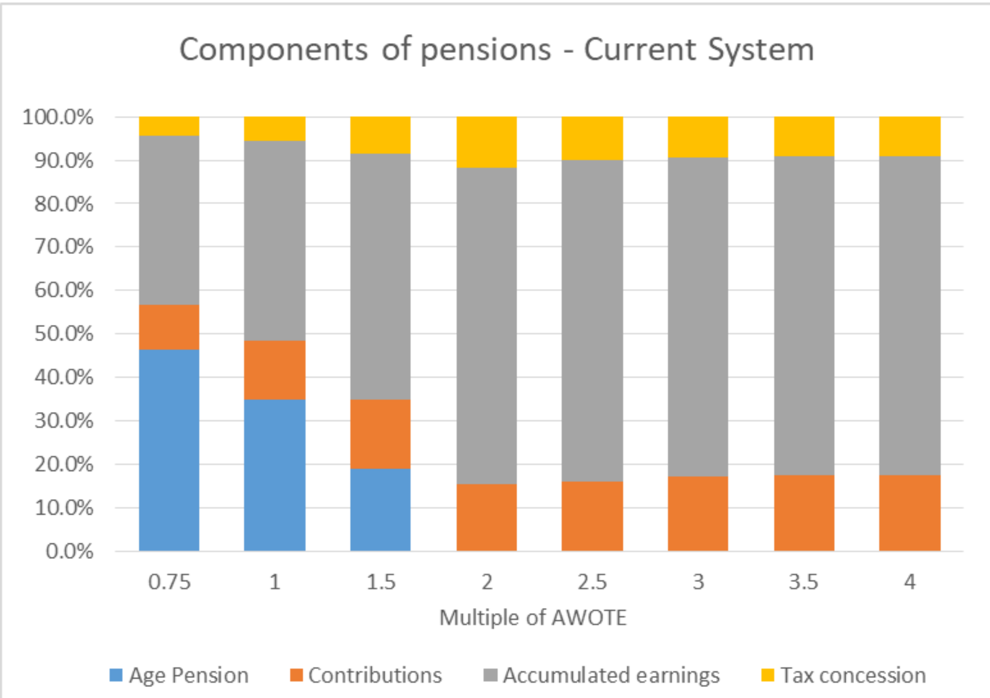
A perhaps more dramatic illustration is showing tax concessions as a percentage of lifetime tax payments (again in present value terms).



At incomes at and below AWOTE, the tax concession appears to be low, but this is not due to the super tax system, this is because the Age Pension system is such that more than half the population are projected to very substantially rely on the Age Pension rather than superannuation savings.

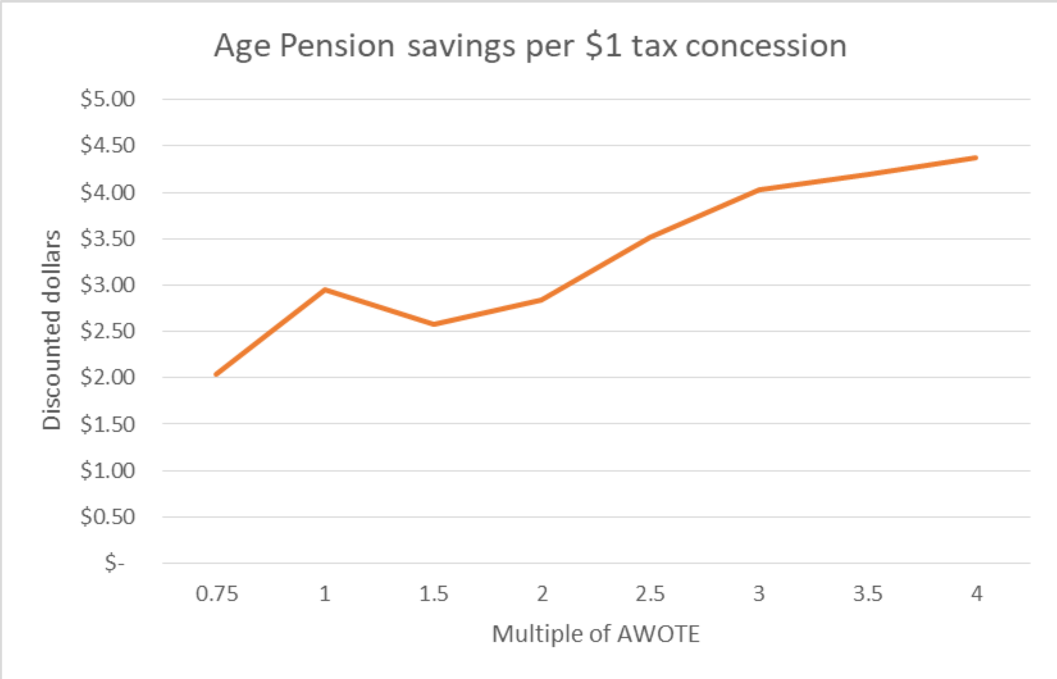
Note that tax concessions as a percentage of lifetime tax payments fall with income.

Another way to illustrate the benefit of super tax incentives vis-à-vis Age Pension payments is to show the components of pensions as in the following graph.



This illustrates how, for those reliant on superannuation for their pension, most of it is funded from their contributions by foregoing consumption during their working life plus earnings thereon. Tax concessions comprise about 10% of super pensions whereas the Government pays 100% of Age Pensions.

Thus every dollar of tax concession has a big impact of savings in Age Pension payments as illustrated by the following graph which, for the purposes of this illustration nets any additional GST payments against projected tax concessions.



The Government saves about $2 to $4 in Age Pension costs for every $1 of tax incentive. Accounting for this value return is missing from Treasury's "Tax Benchmarks & Variations" estimates.

A system that better allows people to save in super is more sustainable for the Federal Budget in the long term than an approach that focusses on reducing so-called tax concessions on superannuation without adequate regard for the impact of long-term Age Pension liability.

We would expect the Panel's modelling to show very similar results.

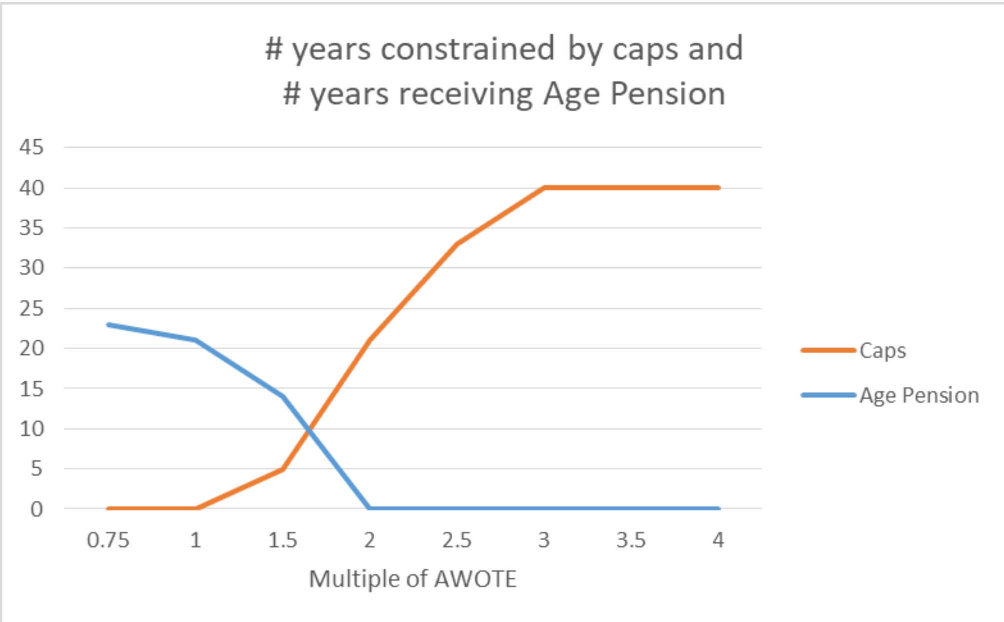
Use of the word 'concession' is perhaps not helpful as it implies a narrow view of superannuation tax concessions as a cost to the budget rather than seeing them as an 'incentive' to save and an 'investment' that will yield future returns in terms of less pressure on the budget and productive investment of superannuation savings in the economy, in turn leading to higher tax revenue.

B. **Structure risks being yet another redistributive/social engineering mechanism at the expense of effectiveness and fairness**

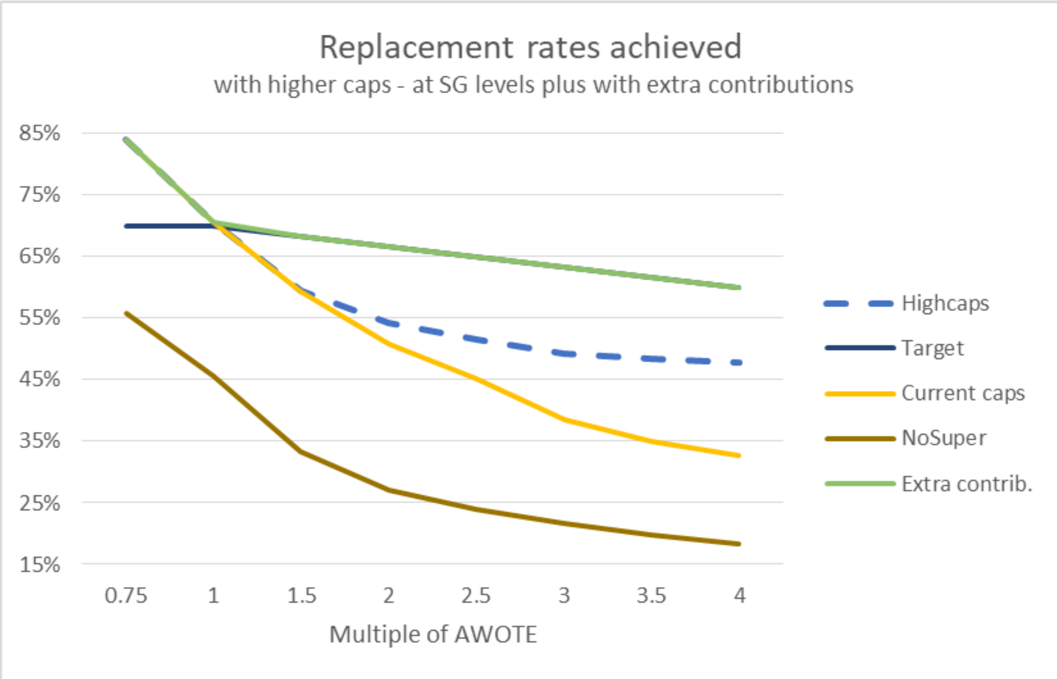
The absolute $ annual cap and a number of other measure set in dollar terms are unfair to those who have contributed most in taxes during their working life. They appear to be providing another redistributive/social engineering mechanism which we do not believe should be a purpose of superannuation. For better transparency, such mechanism is best left to the progressive taxation system.

Of course, we acknowledge that superannuation savings incentives cannot be limitless. However, the current annual cap is projected to be too low to allow anyone to achieve reasonable Replacement Rates even if they contribute above the Superannuation Guarantee level.

Our analysis shows that the current level of contribution caps would impact a very large number of tax-payers. However, for those on low incomes, their eligibility for the Age Pension allows them to achieve pensions in excess of the target Replacement Rate. This following graphs indicates, for each bracket of tax-payer, the number of years their compulsory contributions are constrained by caps but also the number of years in which they are eligible for the Age Pension.



If the current contribution caps were doubled, the following illustrates the Replacement Rates achievable. It shows (dotted line) the Replacement rate achievable if only contributing as compulsory levels and (solid green line) the Replacement Rate achieved if each person made additional voluntary contributions (assumed only during last 15 years of working life).



A system that sets the Replacement Rate as a target and adjusts the cap constraints so this can be achieved would also be fair in providing a higher superannuation pension to those on higher incomes that have contributed more in taxes during their working life.

The transfer balance cap is another limit on the level of funds on pension mode but is only indexed to CPI rather than AWOTE and so over time it will probably shrink as a multiple of AWOTE. For a sustainable system that is also stable and does not require constant government changes, all caps and thresholds should be automatically indexed to AWOTE.

Whether one believes the $1.6m cap on total zero taxed superannuation balance is a good idea or not, it should not have been applied to those already retired who saved legally and in good faith as encouraged by the superannuation system. Our projection indicates that it is the annual caps that is the main constraint on taxpayer's superannuation. Under the current system, not many taxpayers will reach the (indexed) Transfer Balance Cap because of the annual contribution constraints. All the Transfer Balance Cap appears to have done, therefore is to penalise and tax those who have already retired and made larger legitimate contributions into super than now allowed. It has also added to the complexity of the system for everyone.

C. Compulsory super at low income levels is an ineffective use of tax concessions

At present those on relatively low incomes are required to contribute into superannuation, even though the amount they are expected to save will not be adequate, relative to the Age Pension that could be available. The rational behaviour for such persons is to withdraw their superannuation balance in a lump sum at retirement and spend it on a vacation or car or give to their children and then revert to the full Age Pension.

Our projections have illustrated how, with their compulsory superannuation contributions, many people on lower incomes exceed their relevant Replacement Rate because of their eligibility for the Age Pension.

Compulsory super should therefore perhaps start at a higher income or alternatively employees on income below a certain level could be given the right to direct their employer to pay the superannuation guarantee payment obligation directly to them (after income tax) rather than contribute it into a superannuation account.

There should perhaps also be some restrictions on withdrawal of lump sums as we have previously suggested. It would appear inadvisable to allow lump sum withdrawals if the remaining superannuation balance is not adequate to fund a private pension and keep the taxpayer off the Age Pension.

Maybe lumps sum withdrawals above, say twice the minimum % pension level, could only be paid to a banking organisation in repayment of a loan on a taxpayer's residence or if there is an adequate sum remaining to fund a super pension.

D. Regulatory Risk to Superannuation and SMSFs.

Too much fiddling, and threats of fiddling, by successive governments has contributed to a less than optimal result for the superannuation system.

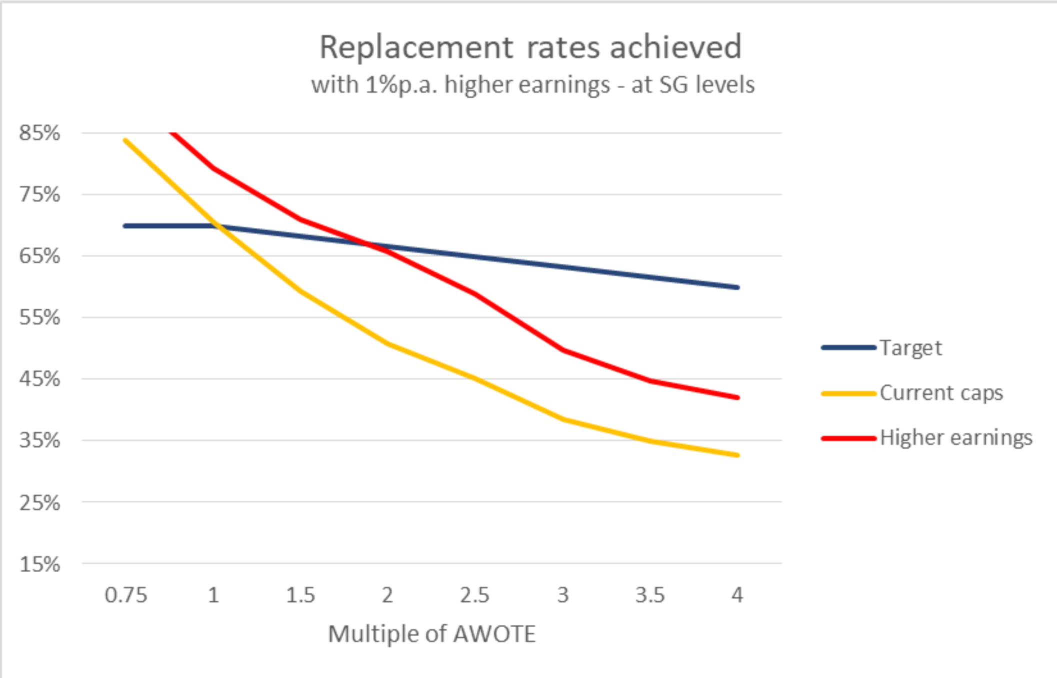
Superannuation is a lifetime investment and unexpected changes to the rules, especially around taxation and usually announced in the budget without warning, are not conducive to confidence in the system and encouraging people to maximise their retirement savings. People make life-changing decisions - when to retire, whether to downsize, when to withdraw super savings - only to find the rules have changed to their detriment. The changes announced in the 2016 budget set a cap on tax free super savings, exposing savings above the cap to an earnings tax that had not previously applied and drew capital gains tax on super fund assets in the accumulation phase back into the tax net.

Tax changes with retrospective effect are unfair whatever the rationale for them. Changes should only have prospective effect and should only be introduced to make superannuation more effective as a retirement savings mechanism.

The Consultation Paper appears to refer to concerns about regulatory risk by suggesting that people may be withdrawing less from their superannuation than they otherwise would because of uncertainty about future imposts.

We also believe such uncertainty impacts the optimal balance of investments and results in lower savings result per dollar of tax concession than would otherwise be the case. This, and the point about regulation risk, may not seem to be important issues but the key result of any modelling is that, whatever other assumptions one might make regarding superannuation guarantee levels and annual contribution caps, the greatest influence on whether you will have enough to retire on a reasonable Replacement Rate pension is the rate of return achieved by the fund.

For example, if the rate of return on our model is increased by 1% per annum – keeping the 12% guarantee contribution and current annual caps, the following graph shows the Replacement Rate pensions that could be achieved.



Target Replacement Rates are achieved for all those earning at or under 2 x AWOTE.

We would welcome Government devising a way to lock in changes to the system for a long period.

A good starting point would be bipartisan support for a meaningful definition of the purpose and goals of superannuation. The 'substitute and supplement the age pension' objective proposed by the Financial System Inquiry (Murray Report) is manifestly inadequate and uninspiring. It positions superannuation as just an adjunct to the Age Pension when the goal should be to make superannuation the main vehicle by which most Australians save for their retirement with the Age Pension serving its purpose as a social safety net for those who will not be able to manage financially on their own in retirement.

We note the 2016 Superannuation (Objective) Bill lapsed more than three years after it was introduced to justify the changes to superannuation made in the 2016 budget. In itself this failure to legislate was not a bad thing as the ‘substitute and supplement’ objective set in the Bill is so timid and inadequate. The Bill should be withdrawn and replaced by legislation that comprehensively sets out the objective of superannuation and positions it as the prime vehicle for retirement savings. Such objective should be more definitive regarding what is considered “equitable” and “adequate”. See our answer to question 8 in section 6 below.

Taking into account the compulsory, long-term nature of retirement savings and the need for confidence in the system, we believe that changes in the system should only be made according to the following principles:

- Changes should only be made if they result in improvements to the efficiency and effectiveness of the retirement savings system.
- Changes should not have an adverse effect on retirement savings made under the rules that apply up to the point of change (for example, including appropriate grand-fathering rules).
- When changes are made, people should be given time to adjust the disposition of their retirement savings to their benefit and to avoid detriment before the changes take effect.
- Proposed changes to superannuation should be flagged well in advance so retirement savers, associations and other interested parties have an opportunity to comment before policy decisions are made and legislation introduced. Such consultation should be standard good government practice.

E. Increases in complexity in the retirement system leads to greater inequity and increases the need for, and cost of, retirement related advice

Complexity, like regulatory risk, reduces people’s engagement with superannuation and increases the cost thus reducing outcomes.

In particular, the ever increasing complexity of the superannuation and retirement systems makes it difficult to understand for many Australians. This is likely to lead to further disengagement from the system. It also drives up the need for, and cost of, advice. This in turn will mean many Australians will not receive the advice they need or want or will receive inadequate retirement advice.

It would appear that executives in government departments may not have adequate comprehension of the impact of the complexity of their changes on the general public. We would welcome some mechanism whereby Treasury and the ATO have an obligation to consider the impact of complexity on taxpayers and the effectiveness of the systems, audited by an external (non-government) organisation.

F. Continuing publication of incorrect and misleading tax concession calculations has, and could still, influence Government decision-makers to implement policy changes that are to the long-term detriment of a sustainable and effective retirement system

There is continuing publication by Treasury of so-called superannuation tax expenditure figures which are misinterpreted by media and possibly politicians as a measure of the cost of tax incentives, leading to support of changes to the superannuation system that are to its long-term detriment.

Even the Consultation Paper is misleading. The statement that of the three pillars, the "Compulsory superannuation" was introduced in 1992 implies that superannuation tax deductions were introduced at that time. However, superannuation tax concessions were introduced in 1915, at the same time as the progressive income tax system was introduced.

There are more fundamental shortcomings in Treasury's reporting.

Tax expenditures in relation to our progressive income tax system (estimating the cost to the revenue of a stepped income tax system) are not reported in the Treasury tax expenditure estimates with the reason given that it is deemed to be "an established feature of our tax system." However, the superannuation tax system providing incentives to save was originally introduced <u>at the same time</u> as income tax was introduced in 1915 and so is equally well established. We believe tax expenditures in relation to the various progressive income tax brackets should be reported to improve transparency and debate of our tax system.

An analysis of who actually pays tax in Australia would show that many people on middle and low incomes effectively pay no tax when the allowances due to them are taken into account and that, unsurprisingly, those on higher incomes pay the most tax. These higher taxpayers are the same people who are accused of getting an undue benefit from superannuation tax incentives when in fact the value of the superannuation tax benefit they receive is a lower proportion of the income tax they pay in the first place. Note also that high income earners ($250,000 plus) pay 30% tax on their contributions rather than 15%.

It has always been recognised that the income tax system provides a bias against savings (see Ken Henry's report and others) and back in 1915, tax on income could be deferred if it was contributed into a trust (superannuation) fund. This system applied no tax at time of contribution, no tax on earnings but then included any withdrawals in that person's taxable income at progressive rates. (referred to as Exempt; Exempt; Taxed or EET system)

Although the Consultation Paper is correct in stating that such contributions were made compulsory in 1992, it fails to point out that the Government had also decided in 1988 to tax contributions <u>and</u> earnings, leading to a vastly more complicated system that deviates from the EET standard. It is now difficult for any Government to change back to that better system without running two systems in parallel for a generation and foregoing tax income!

Finally, we disagree with the benchmark used to measure tax incentives with regard to superannuation and believe that Treasury do not use the benchmark generally accepted for investment income. The Panel should be aware of this major issue, still unresolved, regarding the incorrect benchmark used for estimating “tax expenditure” for superannuation.

Treasury continues to report “Tax Expenditures” annually in a publication now renamed “Tax Benchmarks and Variations”. This continues to use a benchmark for superannuation that was reported by former Head of Treasury, Dr Henry, in his 2009 report to be “inconsistent with an efficient savings taxation system” and is also now generally accepted internationally to be inappropriate.

Although Treasury carefully state that in estimating tax expenditures, “the tax benchmark should not be interpreted as an indication of the way activities or taxpayers ought to be taxed,” why else produce such figures if not to guide policy-making?

Especially since they state that their latest report: ”reflects the broader objective…to inform the public and contribute to the discussion of the design of the tax system” and that “transparent reporting of variations to the tax benchmarks also helps inform debate on the efficiency and equity of the tax system.”

The fact is that superannuation tax expenditures would be substantially lower if an expenditure tax benchmark were used. Treasury uses the income tax benchmark which exaggerates the extent of the superannuation tax concessions. They reported both measures in 2013 and instead of the aggregate tax expenditures being $32.1m (as subsequently reported widely by the media) they would have been $11.3m under the correct benchmark.

While Treasury has qualified its report in response to criticism by SISFA and examination in 2015 by the Parliamentary Standing Committee on Tax and Revenue, we do not believe the latest version of the tax expenditures report contributes to a better understanding of, or debate on, the tax impact of superannuation measures.

A major omission is also that the Tax Benchmarks and Variations Statement does not refer to the <u>additional</u> cost in Age Pension payments if the concessions on superannuation were reduced or eliminated. We are hopeful that the work of the Panel may lead to a correction of this omission.

6. Responses to Consultation Paper questions

The retirement income system

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

It has been claimed that Australia has the world's best retirement savings system. It is certainly different from most but whether it is the optimal system to enhance national retirement savings in the long-term needs to be tested. A comprehensive comparative analysis of international systems, or even a cross section of countries similar to Australia, is beyond our resources. It is for the Panel to commission an independent and comprehensive analysis of and comparison with other systems. This would provide a useful cross-reference when considering the design and effectiveness of Australia's system.

We noted earlier that because of new superannuation taxes introduced by the Government in 1988, Australia now has a more accelerated savings taxation system (contributions taxed; earnings taxed; distributions exempt, referred to as a TTE system) from the one we had for 73 years since our income system was introduced (EET). The latter is widely considered a superior option in terms of effectiveness (i.e. outcomes per $ of tax concession) but it would be very difficult to switch back to that system now without running two systems in tandem until all of the current crop of superannuation savers pass on.

We have previously suggested a compromise alternative which is also a much simpler and fairer system, based on a proposal by Dr Ken Henry as developed by Professor Freebairn. This was analysed and described in the 2015 submissions by SMSF Owners Alliance in response to the Tax White Paper.

We would be happy to provide the Panel members with a copy of our submission which, with less time constraints, included a more comprehensive analysis of the current system and compared its performance with alternatives.

Purpose of the system and role of the pillars

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

While we could reasonably assume that most people think that they generally understand and support the purpose of superannuation generally and perhaps within the context of the retirement incomes system as a whole we are not aware of any evidence.

We know from feedback from our members that people are very concerned about "tinkering" with superannuation, especially if it has retrospective effect.

What we do hear through our professional members is the difficulties people have with obtaining and providing advice in relation to retirement and superannuation in particular. This is due in part due to:

- The complexity of the retirement and superannuation systems – resulting in the need for advice even for clients with relatively simple affairs;
- The restrictions on accountants providing advice in relation to the superannuation system (and the failure of the limited licensing regime);
- The expense and complexity of advice provided to consumers (including the regulatory burden placed on advisers and how they are required to provide their advice); and
- The issues in this area raised in the Royal Commission.

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

It is likely that many people, while having a broad understanding of the purpose of superannuation, may not be aware of what their own superannuation will actually deliver to them in retirement. Do they know what level of retirement income their superannuation will deliver and how long it will last?

There may be a tendency, particularly in the early years of working life, to see superannuation as something looked after by someone else (their employer and their nominated super fund) and even as a nuisance cost or extra tax when they have other spending priorities, e.g. housing and education. A sense of disengagement with superannuation may be reflected in the high number of default funds.

Owners of self-managed funds will generally have a much clearer focus on the performance of their fund because they have opted to take responsibility for their own financial independence in retirement and chosen their advisers.

As noted in our answer to question 2, a significant issue with people's understanding of the retirement system is the difficulty and expense in obtaining advice.

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

The Government's role should be

a. to set out clearly the purpose of superannuation within the retirement income system;
b. to provide tax incentives to save for retirement;
c. to provide an Age Pension as a safety net;
d. to encourage efficiency through competition in the managed fund sector;
e. to supervise, via regulators, the fair and efficient operation of the superannuation system and managed funds and transparency regarding fees and members' returns.

The role of the private sector is to provide advice and services to superannuants on a competitive basis.

The system should be structured so that as many individuals as possible are adequately encouraged to take on the role and responsibility for their retirement and not rely on the Age Pension. Active steps should be taken by the Government to simplify the superannuation system and enforce more transparency by APRA regulated funds. A standardised reporting requirement showing income and all outlays in dollars could be a good first step. We have previously made a submission on this subject and would be happy to share this with the Panel.

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

Questions 5 & 6 are the most significant questions in the Discussion Paper. The starting point for policy decisions on the objective and structure of the retirement income system (accepting that we are not starting with a blank page) is what economic and social outcomes do we want the system to deliver over time and what are the respective roles of the key components of the system?

It seems clear that the desired economic outcome is where superannuation savings, assisted by tax incentives, are maximised so the greatest number of working people can build their retirement savings to be financially self-sufficient in retirement and in advanced age without needing to rely on the taxpayer-funded Age Pension. Conversely, the fewest number of people should be reliant on the Age Pension at full taxpayer's expense.

These economic goals link to social outcomes. A society where most people can fund a comfortable retirement while others can rely on an adequate pension will be a fairer and happier one.

As mentioned below the current 2:1 ratio between dependence on the Age Pension and independence via adequate superannuation should be reversed so the <u>majority</u> of people rely on superannuation and the <u>minority</u> on the Age Pension. The latter should be just a 'safety net' for those on low incomes for whom their superannuation savings are inadequate.

A policy objective along these lines should include a broad performance benchmark for the retirement savings system. Working within such a policy objective, governments can then make better judgements about the performance levers of superannuation – the level of compulsory savings (SG), tax advantaged contribution limits, minimum drawdowns, age-limited access to savings and so on.

In setting these parameters, governments should adopt the Replacement Rate benchmark adopted by many comparable countries and favoured by Dr Henry.

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

The first pillar, the age pension, supports people who can't save enough during their working lives to maintain financial independence throughout their lengthening retirement years and old age. Many people are in this group not necessarily because of lack of commitment to save for the future but simply because they don't have the capacity to save if they are on lower incomes with other pressing financial priorities - housing, health, education etc. The policy objective, over time, should be to keep the pension pillar as small as possible.

For the second pillar, superannuation, the policy objective should be to make this pillar as large as possible through making it easier for people to save via tax incentives. A performance target should be set. The 2015 Inter-generational Report forecast that by the middle of this century, two thirds of Australians would still be reliant on the age pension, either fully or in part. A good policy objective would be to reverse that ratio so that by mid-century at least two thirds of people do <u>not</u> need the age pension as they will have saved enough in their working years to support themselves throughout their retirement and old age.

The system as currently structured is projected to fail to meet such an objective. Improvements must be made whilst dramatically simplifying the system and somehow locking it in so that the risk of subsequent changes (inter alia, to meet one year's budgetary targets) is minimised. Uncertainty and complexity reduce the attractiveness of a superannuation system which therefore leads to a lower savings result for a given level of tax incentives than if the system were stable and simple (as it used to be for 80 years!).

The third pillar is built on private savings. Its value and size depend on the commitment and capacity of individuals to save. The Government does not have much direct influence over these factors. Unlike superannuation, there are no incentives for private savings, the returns from which are taxed as ordinary income with the notable exception being the exemption for CGT on the family home. Measurement of private savings is difficult. While the Government knows the value of the return on private savings via individual tax returns, it does not know the value of the assets that generate them. So while the existence of private savings can be acknowledged and described as one of the pillars of the retirement income system, they are difficult to quantify and should not be given the same policy weighting as the other pillars.

The "appropriate balance" between pillars one and two is not one of equal roles or significance. They are complementary and inter-related but have different roles.

The broad policy goal should be to contain the size and cost to the economy of the age pension pillar while promoting growth of the superannuation pillar so that, in time, it will become the strong central pillar of the retirement income system.

The changing Australian landscape

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

Apart from observing that these trends will obviously affect the retirement income system, as part of the economy generally, we don’t have the research capacity to provide an informed analysis of these factors.

We have modelled the impact of a delay in Age Pension eligibility and access to superannuation and this does, as expected, have a significant impact of expected pensions achieved. (though not as great an impact as any small increase in net rates of return achieved)

Principles for assessing the system

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

Yes but they need to be more clearly agreed and defined.

It may appear useful to state that a system should be “adequate, equitable and sustainable” but such a statement is relatively useless without defining these terms.

In particular, there is little evidence of consensus on such a definition. If a “purpose of super” is to be enshrined or agreed, a clearer definition of these terms is required.

The Financial System Inquiry recommended the primary objective should be: “To provide income in retirement to substitute or supplement the Age Pension.”

We believe this definition is too limited and should be expanded to: “The purpose of superannuation is to encourage every Australian to be self-reliant and able to maintain a standard of living in retirement that bears a reasonable relationship to that before retirement by way of fair, equitable and efficient tax incentives that recognise the inherent bias against savings in the income tax system.”

By ‘fair’ we mean the tax structure is appropriate and not overly generous or inadequate overall.

By ‘equitable’ we mean fair as between different members, in particular members on different incomes having regard to the tax contributions made by an individual and his/her access to Age Pension and other welfare.

By ‘efficient’ we mean that the tax structure should maximise the outcome for members per dollar of tax concession or, conversely, maximise the tax income for Government to achieve the same desired outcome. Efficiency in a tax design context means that the tax design should, as much as possible, not drive economic behaviour.

That is, people are making decisions on the basis of economic outcome not tax outcome.

One argument for SMSFs is that they are arguably more efficient because investment choices in an SMSF can closely match investment decisions outside of the super system due to member control, they do not need to hold as much cash to meet unforeseen members cash withdrawals and they have no focus on short-term performance (in order to attract new members).

By ‘reasonable relationship’ we mean a measure known as a ‘reasonable replacement rate’ which is generally agreed to be 60 – 70% of pre-retirement, post-tax income.

The Age Pension is intended to be a ‘safety net’ for Australians who, for whatever reason, have been unable to achieve self-reliance in retirement. Therefore it would be sensible for the Government to set a target for the proportion of Australians who would need the Age Pension and expect everyone else to fund their own retirement with the help of tax incentives (see our answers to Q5&6).

When the superannuation system is mature and stable, most Australians should not need access to the Age Pension. This will clearly take time to achieve and targets should be set to ensure progress towards this goal. Governments should in some way be discouraged or prevented from making changes to the system to ‘fix’ some perceived short-term issue but instead be obliged to always consider, and model, the long-term impacts in order to maximise the sustainability of the system.

An additional principle should be simplicity. As noted above, SISFA believes more work is needed to help the community better understand the retirement and superannuation Systems. This could include:

- Reducing complexity in the superannuation and retirement systems;
- Achieving stability and promoting confidence in the system, in particular by reducing the number of changes to the system and the rules;
- Increasing the availability and quality of advice.

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

We believe that with current settings, the system is neither sustainable nor adequate. Because of the limits on contributions, the system will not provide enough funding of a reasonable retirement for many Australians.

This will mean continuing or even increasing reliance on Age Pension.

It must be remembered that the Age Pension is funded 100% by Government, whereas the vast majority of the funds supporting a superannuation pension are provided by the individual foregoing consumption expenditure during their working life. Our analysis indicates that tax concessions comprise only about 10% of the cost of superannuation pensions.

The funding of an Age Pension system that goes beyond a safety net is likely to be unsustainable.

Adequacy

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

The key test under this heading is whether the retirement income system allows Australians to live in reasonable comfort for the duration of their retirement, including in their advanced age when care costs are likely to be high.

The means tested Age Pension provides a modest but adequate income for people who have not been able to use the superannuation system enough to provide an adequate private pension.

Superannuation savings ideally need to be sufficient for retired Australians to be able to live comfortably and financially independently throughout their retirement and old age. We agree with the OECD definition "that in retirement people should enjoy a certain standard of living comparable to the one they had during their working lives". (known as Replacement Rate)

The Panel should model the pension achievable under the current retirement system for people now beginning to contribute and compare with the Replacement Rate benchmark.

Our modelling shows that the currently planned Superannuation Guarantee level of 12% and the $25,000 annual cap prevents too many Australians from achieving adequate savings to retire on such a pension, independent of the Age Pension.

Private savings are taken into account when assessing eligibility for the age pension. They are not, and should not, be considered in assessing the adequacy of the superannuation system.

We accept that the Government needs to be concerned about limiting the cost to the budget of superannuation tax concessions. The current Government did so in the 2016 budget by placing a cap on the amount of superannuation savings that can be held in a tax-free pension account. Governments have also steadily reduced the annual concessional contribution over the last 12 years to only a quarter of its previous allowance, reducing concessional contributions from $100,000 annually to $25,000.

The question of the actual cost to the budget of superannuation tax concessions is complicated. As mentioned earlier, Treasury's annual Tax Expenditure Statement (now called the Tax Benchmarks and Variations Statement) attempts to measure the value of tax concessions on a range of items, including superannuation. In other words, the value of tax that is not collected.

The misunderstanding and even misuse of the tax expenditure numbers was raised with Treasury by SISFA some years ago and we are pleased to see that the annual publication of these numbers is now more qualified.

However, they still use the wrong benchmark and do not take into account the value of pension payments over time that do not have to be made because people are living on their own superannuation savings. See our commentary in section 5F.

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

We agree with the universally recognised Replacement Rate as a measure of adequacy – and fairness. We have previously suggested an adequate system would provide-after tax pension income (whether Age Pension or super or combination) equal to 70% of pre-retirement after-tax earned income, all indexed to growth in average weekly overtime earnings (AWOTE). We have further suggested, consistent with OECD guidelines, that the 70% falls to 60% at higher incomes.

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

Refer to our answer to question 10.

Equity

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

We take 'equity' to mean fairness of outcome.

For superannuation, we believe fairness means everyone has access to the retirement income system on the same terms. What they are able to take out of the system will depend on what they put in.

It has been claimed that people on higher incomes get a disproportionate share of superannuation tax benefits. This claim is apparently supported by Treasury charts showing tax and other benefits received across the income range (see Figure 4 on p18 of the Consultation Paper and Chart 6 on p138 of the Final Report of the Financial System Inquiry).

These charts are misleading in that they appear to show the lion's share of superannuation tax concessions goes to the top 10-20% of income earners. However, they do NOT show how the amount of the concessions relates to the amount of income tax paid by that group.

People on higher incomes pay more tax and so get a correspondingly higher benefit in $ terms from any tax concessions. Fairly presented charts would show that the $ value of the concessions is proportionate to the $ value of income tax paid across all of the income deciles. Our modelling shows that tax concessions as a percentage of lifetime tax payments actually fall with rising income.

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

We refer you to our answer to Q16.

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

We believe there should be no age limit on superannuation contributions. People should be able to make contributions for as long as they are working. It is questionable as to what some of the age-based rules and constraints in the superannuation system achieve and they detract from people's understanding of and engagement with the system.

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

Beyond providing an adequate Age Pension for Australians whose retirement savings will not carry them through all of their retirement and old age, it should not be the role of the retirement income system to compensate for "inequities experienced during working life". Such inequities are addressed during working life by progressive income tax, social welfare programs and the wage system.

However, the superannuation system should have more flexibility to allow those with broken work patterns, including women who may be out of the workforce for some time caring for children, to still accumulate adequate superannuation to fund a reasonable self-funded pension. This may include the option to increase concessional and non-concessional contributions to make up for time lost and to supercharge retirement savings.

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

Those not covered by compulsory superannuation include the self-employed (many being small business owners, contractors, farmers etc.), people engaged in the 'gig economy', the unemployed/under employed and people not in the workforce for various reasons which may include disability and people who are carers looking after their family or others. Some of these people may have low or no regular income in which case welfare payments are provided by the Government to help them.

For these people, and for people on low incomes, a central savings fund could be established as an alternative to the My Super products offered by managed superannuation funds. The Productivity Commission identified the high cost and lack of competition in the superannuation sector, particularly for default funds. This could be overcome by a central 'retirement savings bank' owned by the Government which would issue investment mandates to providers on a cost competitive basis. The Future Fund is a good example of how a central savings fund can be run economically for the public benefit.

In the case of the self-employed, an SMSF is a way for them to build financial assets to draw on in retirement. Many may borrow via their SMSF to finance assets that support their business. While the Financial System Inquiry recommended that LRBAs be banned, we note that the Government rejected that advice and LRBAs remain available to SMSFs within tight rules. The SMSF statistics published by the ATO show that borrowing by SMSFs, while growing, remains a manageable risk with borrowing amounting to only 3% of total SMSF assets.

Sustainability

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

SISFA believes that a more important consideration is the public's confidence and understanding of the retirement system. In that light, we believe that future changes to the superannuation system should be limited and that more work should be done in relation to increasing the public's knowledge in relation to the superannuation system and the availably of advice.

Based upon our modelling, the factors that we believe have the greatest impact on the long-term sustainability include:

a. Competitiveness in the APRA regulated sector and greater meaningful reporting and transparency in order to improve net rates of returns;

b. Greatly simplified system so that there is more engagement by members in order to take advantage of competition;

c. Reduced uncertainty regarding Government changes to superannuation, especially those perceived to be done for short-term budgetary of political reasons;

d. Raising of contribution caps so that more Australians can retire on a reasonable pension without access to the Age Pension.

Also please refer to our answer to question 8.

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

In our view, the factors listed in our answer to Q18 will reduce the cost of Age Pensions by far more than any increases in tax incentives, thus improving the fiscal sustainability of the system.

Some factors, such as steps taken to improve simplicity, reduce regulation risk and improve net returns should lead to lower Age Pension costs without any consequential increases in tax incentives.

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

We are not aware of any research that assesses confidence in the system. From our own knowledge of the superannuation market, we know that confidence rests on belief that the rules under which people invest in superannuation will remain constant. Confidence is shaken when the rules are changed suddenly, particularly if they have retrospective effect, change the tax treatment of savings already made and reduce the benefits of superannuation, as was the case with the 2016 budget.

There will be need to 'trim the sails' of the retirement income system from time to time as it evolves. Such necessary adjustments should be made on the principle that changes should be made only if they improve the effectiveness and efficiency of the system and do not result in adverse retrospective outcomes.

Confidence could also be achieved through better knowledge and availability of advice in relation to the superannuation and retirement systems.

Cohesion

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

Cohesion is clearly a necessary element in an effective retirement income system, especially for the Age Pension and superannuation pillars. These must work in a complementary way as outlined in our answer to Q6.

The critical nexus between these two pillars is when superannuation savings are depleted to the point where they intersect with Age Pension entitlements. Our modelling highlights the effect of some clashes between the two systems and there needs to be work done to ensure better cohesion between the rules, thresholds and constraints in the two systems.

We believe the minimum drawdown rule and the age-related withdrawal rates are about right, based on life expectancy tables.

The Consultation Paper notes that some people in retirement are not taking out and spending as much of their super savings as they could because of uncertainty about longevity and concern about likely high care costs in advanced age. Some are even managing to increase the value of their super savings during retirement rather than running them down.

This phenomenon is not surprising. People who have accumulated a significant amount in retirement savings are likely to be assiduous savers and prudent spenders.

However, they are penalised for such thrift by being taxed 15% (+Medicare) on their assets when they die. We believe this tax – the only 'death duty' still being imposed in Australia – is inappropriate, ineffective and should be removed.

Those who have not had the foresight to predict the time of their death and withdraw their superannuation savings beforehand are exposed to this death duty.

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

As noted above, SISFA believes that the restrictions on contributing to super have gone too far. The current levels of the contributions caps should be reviewed. In particular, in light of the fact that most people's ability to contribute to superannuation comes late in life (once expenses relating to schooling and raising of children and in relation to mortgages have eased or ended). Therefore, contribution caps need to better accommodate for the fact that many people will be looking to make larger contributions into super later in life and will need to do so in order to retire on a reasonable self-funded pension.

The current settings for the work test also should be reviewed in light of the fact that Australian's are living and working longer.

We do strongly suggest that someone in Government, or perhaps independent of Treasury, investigate the alternative system we proposed in our White Paper submission referred to earlier.

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

The main circumstance that may affect behaviour is the transition from reliance on superannuation savings to reliance, partly or fully, on the Age Pension. If the retirement income generated from savings during working life is sufficient to allow a superannuation-based pension that is appreciably higher than the Age Pension and able to be maintained for most if not all of the retirement period, then clearly this will be the option preferred by many. However, if superannuation savings deliver an income only marginally above the Age Pension and likely to last for only a limited time, then clearly there is an incentive to reduce superannuation savings, through either consumer spending or lump sum withdrawals to the point where the Age Pension or part of it becomes available. This is a rational response. However, we believe it would be most people's preference to support themselves adequately on their own retirement savings rather than to rely on the Age Pension.

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

Please see our answers to Questions 2 & 3.

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

We are not aware of any evidence though know of many people with SMSFs who manage their superannuation fund effectively with no or very selective and competitive advice. Simplifying superannuation and dramatically improving transparency with simple, consistent and comparable reporting by APRA regulated funds should increase that number.

SISFA's professional members have raised concerns in relation to the ability of the public to obtain advice. See our answers to questions 2 and 8.

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

We are unclear as to how this question differs from number 21.

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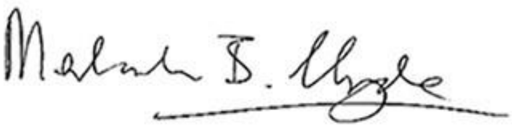
Signed by:

Principal authors



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Malcolm Clyde

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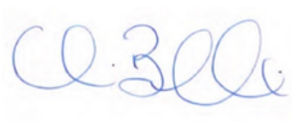
Duncan Fairweather

SISFA Board



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Chris Balalovski (SISFA Chair)

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Phil Broderick (Chair – SISFA Technical and Policy Committee)

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3 February 2020