SuperEd

Submission to the Retirement Income Review

Focusing on issues in the drawdown phase of the Retirement Income System

03 February 2020

Our Mission: Helping all Australians achieve a better, more sustainable retirement income.

Level 8, 100 Walker St
North Sydney, NSW 2060

03 February, 2020

Retirement Income Review Secretariat

The Treasury

Langton Crescent

PARKES ACT 2600

Dear Sir/Madam,

SuperEd and Retirement Essentials are grateful for the opportunity to make the attached submission to the Retirement Income Review consultation.

We have focused our submission on the "retirement income" or drawdown phase of the Retirement Incomes System because we think that needs great attention. It is quite a challenge for Australians to make a transition from working for their living to finding income to fund a satisfactory lifestyle during retirement - - given the dual uncertainties of unknown longevity and unknown investment conditions.

Please find attached our submission. We would be happy to answer any questions.

Sincerely,

Jeremy Duffield

Chairman

SuperEd Pty Ltd

Introducing SuperEd and Retirement Essentials

Thank you for the opportunity to make a submission to the Retirement Income Review.

SuperEd is a digital advice company established in 2013 to help super funds, financial institutions and consumers directly with retirement-related financial education and advice. In 2018, SuperEd acquired Retirement Essentials, which offers services helping consumers assess their eligibility and apply for the Age Pension through our online (human-assisted) service. The Retirement Essentials service responds to the strong need consumers have for help with the Age Pension.

2. Purpose of the Retirement Income System and role of the pillars

The purpose of the Retirement Income System is to facilitate Australians having an appropriate level of income to meet their needs during retirement.

The system's overall reliance on three pillars is appropriate, with a means-tested Age Pension providing a minimum level of income, a compulsory superannuation system to ensure a substantial level of private savings towards retirement income and voluntary savings to supplement the basics provided by the Age Pension and compulsory superannuation.

The superannuation system would be greatly strengthened if its purpose is laid out in legislation and we broadly agree with the language proposed by the Coalition in Superannuation(Objective) Bill 2016[1]. That is, the purpose should fundamentally be focused on the provision of income in retirement.

Further, we support the government's advocacy of the Retirement Income Covenant to require superannuation trustees to consider the retirement needs and preferences of their members. We strongly believe the focus of the industry on the retirement or "drawdown" phase of superannuation has been inadequate and needs to increase. Despite the massive growth in the superannuation system it continues to focus predominantly on the accumulation phase and too little on the drawdown phase. This belief drives our submission and substantially all our comments will be focused on the drawdown phase.

Why is special consideration of the drawdown phase so important?

Our Retirement Income System places much of the burden of obtaining income in retirement on the individual. Yet,

- Drawing down assets to achieve a level of sustainable retirement income is an exceptionally difficult problem for the consumer, given the multiple uncertainties of investment markets, unknown but expanding longevity, and government policies.
- Consumers are clearly worried about retirement income adequacy and longevity. The National Seniors "Retirement Income Worry" survey had 19.8% of respondents saying they worried frequently about outliving their savings and investments and 31.5% saying they worried "occasionally."[2]

[1] We do think the government's formulation could be improved with some aspirational language asserting the desire to provide for Australians to have a dignified and satisfactory retirement. At the same time, we fully support the idea that Australia, as a whole, has to ensure that the Age Pension is sustainable and not an excessive drain on the public purse. So, it is appropriate to discuss super's role in "substituting for and supplementing the Age Pension."

[2] National Seniors: Retirement Income Worry (January 2020)

What's the evidence of inattention to the drawdown phase?

- As the Financial System Review (Murray 2014) noted the development of income products for retirement has been underdeveloped and there have been few significant developments since then.
- Super funds have done remarkably little to help members in retirement other than offer them a standard account based pension(ABP) which places the longevity and investment risk burden on the member.
- Few super members have access to longevity protection in their pension phase.
- Our experience with retirees applying for the Age Pension indicates that understanding of how to create a sustainable retirement income is low and seriously inappropriate choices are often made. Two examples showing how retirement incomes become suboptimal:
    - we find many Retirement Essentials Age Pension clients (about one third) have taken a lump sum from superannuation and now sit with large balances in unproductive cash.
    - we also find many clients (again about one third) who are eligible for a tax-free account based pension still sit, suboptimally, in an accumulation super fund paying taxes on investment earnings.

Adequacy/Equity

We will generally leave to others the question of the adequacy of the superannuation system, and in particular the vexed question of the level of the superannuation guarantee charge. However, we must add our voice to others' in emphasising the gender gap and the challenges female retirees face vs their male counterparts.

It is well documented that Australian women end up with substantially lower superannuation balances than males, as well as lower home ownership rates. They also face the prospect of greater longevity, which makes providing adequate income in retirement that much harder. In the previously cited National Seniors research, women were found to be 47% more likely to be worried about their retirement prospects than men.

The most disadvantaged large segment of the retired population is and will continue to be single, non-homeowning, women. We believe it is necessary for the Retirement Income Review to fully explore this gender inequity and what solutions are available.

Changes in Demographics

Demographic trends demonstrate the increasing importance of the drawdown phase. It's estimated that more than 250,000 Australians retire each year, a number that will rise to 300,000 within the next ten years. There are now approximately 3.9 million people over 65, which continues to be the modal age for retirement, with only 14% of people working full time after 65. Many of course retire much earlier with the median age of retirement at 62.

Challenges in the Retirement or Drawdown phase

"Retirement" is one of the most momentous transitions in life, from a financial perspective, as well as from many other perspectives. Financially, an individual becomes dependent on a mix of government entitlements and their own assets and resources.

Funding one's own retirement is very challenging:

- The Age Pension is not well understood and many consumers are stressed by dealing with Centrelink.
    - The superannuation industry does very little to help members understand the first pillar of their retirement income.
    - There is a high need for help in applying for the Age Pension. National Seniors research survey in 2018 showed 82% of people said they sought help in getting the Age Pension.[3]
- Retired consumers face the daunting joint uncertainty of investment returns and life expectancy.
- The interaction between the Age Pension and one's own investments and super, and other income, creates a complex math problem way beyond most retirees' ability to solve.
- So, retirees struggle to answer the basic questions of retirement:
    - Where's the money going to come from?
    - How much can I spend?
    - How long will it last?

As a result, studies show that consumers tend to underspend during retirement -- relative to their potential and in many cases relative to community expectations of reasonable living standards -- and leave sizable bequests to children.

It's also clear that many older Australians are asset rich -- with a valuable family home at the core-- and yet are income poor. The family home is a major pillar of the Australian Retirement Income System. It should be considered a major element of retirement policy for its multiple uses (residential living, asset of last resort, source of capital). It is not yet effectively tapped as a source of potential income, despite the efforts of the still-inchoate Reverse Mortgage industry's efforts and the government's own innovation with the Pension Loan Scheme. We would expect the government to encourage those developments so the family home can be better utilised to fund retirement living.

The Age Pension -- shortcomings

The Age Pension is the first and most important pillar of retirement income for the majority of Australians over 65. While dependence on the Age Pension will diminish as the Australia super industry matures, it will remain critically important. There are several major shortcomings of the current Age Pension system. We cover four:

1. **Delays in accessing the Age Pension:** Our experience at Retirement Essentials, offering a digital service to help people apply for the age pension, has created a number of learnings, which may be of interest to the RIR. In particular, our applicants on average are getting the Age Pension much later than first eligibility based on age. Our average applicant is 69.4 years old (median 68.2) meaning that the average applicant is 3.4 years older than when first eligible based on age. We believe this represents not so much prior ineligibility but a delay factor caused by poor consumer understanding, procrastination and hesitation about dealing with Centrelink.
    a. Just to give real world examples, we find two of the most common reasons people apply so late are:
        i. A couple with partners of different ages don't understand that the older person may still be able to apply even when the younger person isn't at Age Pension age. They assume they have to wait until both have reached eligibility age.
        ii. People often assume they have to be retired before they can apply, which is not the case.

The costs of application delays for the consumer is poorly understood. A delay results in lost benefits for Age Pension eligible customers since there is no "backpay" for lost opportunity.   So, a prolonged delay in access to the Pension can cost retirees tens of thousands of dollars.

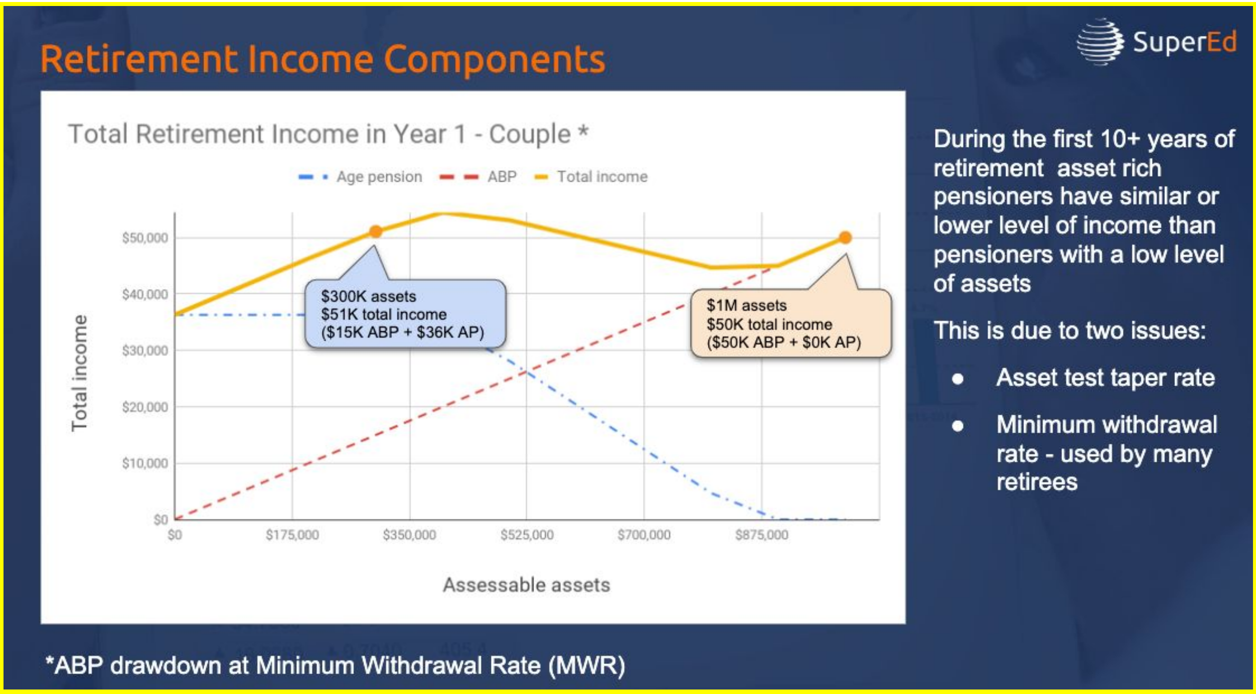
[3] The Centrelink Experience, A Report by National Seniors Australia and Retirement Essentials (May 2018)

We have applied under Freedom of Information Act to get information about the general retiree populations' age when applying for the Age Pension through Centrelink. However, we have not succeeded in getting any useful information. We do think it would be worthwhile for the Retirement Income Review panel to have such information. The panel needs to know when Australians are getting the Age Pension.

2. **The Taper Rate:** The Retirement Income Review should seriously reconsider the means-test based tapering of the Age Pension. Since the budget changes going into effect January 1, 2017, the Age Pension has declined by $78 per annum for every $1000 of extra assets (prior to then the reduction was a much more reasonable $39 per $1000).

   This rapid taper rate creates perverse outcomes where people who save more for retirement may in fact earn a lower level of income, due to a reduced Age Pension, than someone who saved a lower amount.

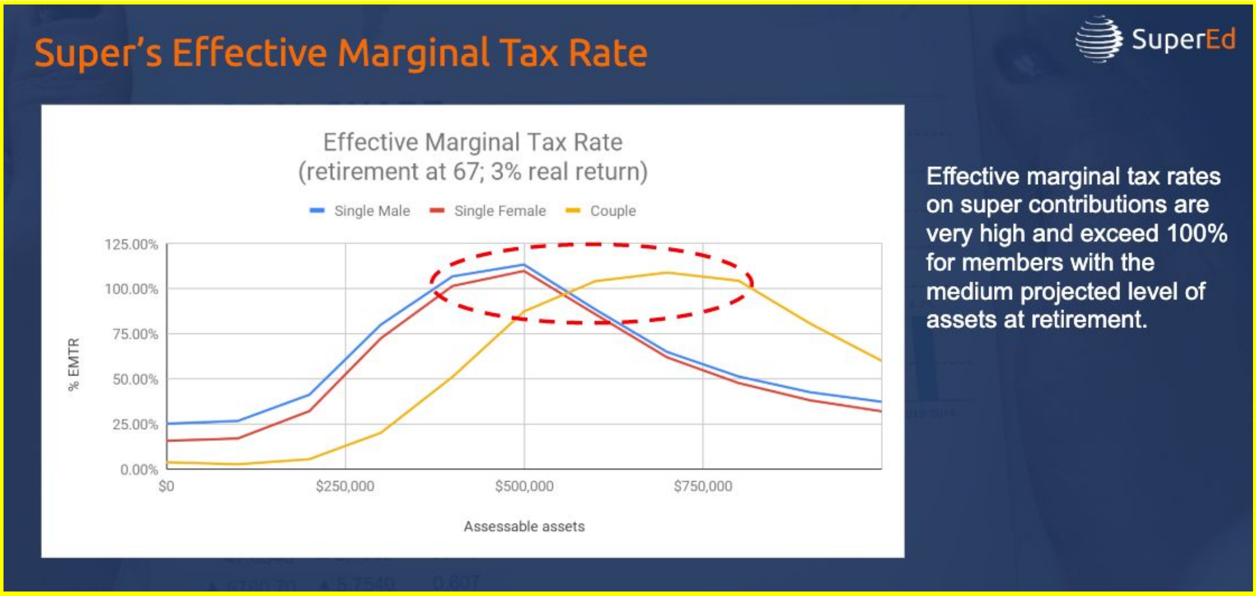
The chart below illustrates this phenomenon. It shows the likely spending rate for couples with different levels of accumulated assessable assets (from zero to $1million). Couples who have accumulated $400,000 in assets are likely to get as much income, or more, than counterparts who have saved more, up to $1 million, due to the generosity of the Age Pension to low asset holders and the effect of the taper rate as the Age Pension is reduced due to the taper rate.



In effect, the tapering of the Age Pension creates negative effective return rates on additional savings. In an excellent paper, Anthony Asher and John De Ravin described this in terms of being equivalent to marginal tax rates of over 100%[4]. That is, a higher investment income earned by larger asset holdings can be more than fully offset by the reduction in the Age Pension

[4] The Age Pension means tests: contorting Australian retirement by Anthony Asher and John D Ravin, 2018

(due to the higher assets) -- that's functionally equivalent to a marginal tax rate of over 100%. The chart below illustrates that concept via SuperEd's own research.



We think it makes no sense to create negative incentives for savings in a Retirement Income System, but our current Age Pension system does exactly that for a large slice of the population who are eligible for partial Age Pension -- those in the "twilight zone."

A particular unintended consequence of this situation is that an adviser cannot unequivocally recommend further savings for a better retirement -- if someone is likely to be in that "twilight zone." In most retirement systems around the world, "save more" would be the number one heuristic for assuring a better retirement outcome.

A second undesirable consequence is the incentive to overinvest in personal residences, since the owner occupied home is exempt from the Age Pension assets test. A consumption service (housing) is incentivised via tax over productive investments.

This discussion of the Age Pension and the taper rate clearly indicates the importance of the "Cohesion" principle raised in the Consultation Paper. The pillars of the retirement systems are clearly not independent but are interrelated. The Panel must confront the interactions and assure that the overall system is Cohesive and Comprehensible, Simple and Sensible. The current taper rate challenges each of these four desirable elements.

3. **The Deeming Rate:** The deeming rate used to assess income from investments for purposes of the Income Test of the Age Pension is not working fairly. Current deeming rates of 3% of capital are well above the interest rates available from bank deposits (more likely 1% at time of writing), which are substantial components of assets for many retirees. As a result, Age Pensioners are assumed to have more income than they can reasonably be assumed to earn and so earn less Age Pension. We think this is a substantial equity issue.
4. **The Homeowner/Renter discrepancy:** The Age Pension appropriately permits renters to have higher balances in assessable assets prior to having the pension rate reduced. This concept is appropriate. However, we believe the current differentials do not sufficiently take into account the cost of rent in Australia and most renters will be significantly worse off during retirement, other things equal.

Account-based Pensions

The predominant form of retirement product offered by superannuation funds is the Account Based Pension. There is room for improvement in the products offered but also in government policy settings.

In terms of the products on offer, shortcomings include:

- The lack of a holistic view. Our system should encourage providers to offer complete retirement income solutions. It's not possible to prepare a good retirement income plan without factoring in the Age Pension. And it's not possible to estimate Age Pension payouts without thinking about the household rather than just the individual and the level of nonsuper assets.
    - Thus, to provide good retirement income solutions, superannuation providers need to be able to take a holistic view of the members' retirement situation, including partner situation and nonsuper investments and the Age Pension.
        - The sole purpose test for superannuation should allow super funds to help members with entire retirement income solutions.
- The limited availability of Longevity Solutions. Very few super funds today offer longevity solutions as part of their retirement product offer. As a result, the vast majority of members don't have access to assurances that their income will last throughout their lifetime.
    - We note the government has made substantial efforts to address this weakness through development of default offers incorporating longevity solutions(CIPRs). We support those initiatives but are extremely disappointed by the lack of progress made to date.
    - Consumers rate longevity protection as very important. Recent research showed investment risk and longevity protection as the two top concerns of retirees with respect to retirement income.[5]

In terms of government policy settings, shortcomings include:

- The superannuation minimum withdrawal rate settings are too high in a low return environment. Given people's fair concerns about their savings lasting through their life, the current Minimum Withdrawal Rates(MWRs) are too high to allow people to remain confident their superannuation will last for their lifetime.
    - To simplify, consider a person without access to the Age Pension. A MWR of 5% from age 65 to 74 may lead someone to withdraw more than they should draw down in order to sustain their income during a long lifetime. In today's low interest rate, low investment return expectation environment, 5% is well above a safe withdrawal rate.
    - A person on the Age Pension will also often find 5% is too high to sustain their income level at the desired rate during their later years.

Advice Needs

As sustainable retirement income is such a major challenge for Australians, they need ready and affordable access to high quality information and help to achieve the retirement income they need. Unfortunately, the Australian advice industry is ill equipped to provide most people with the advice/help they need. Certainly, the wealthier segments will always have access to financial help. But ordinary Australians are largely underserved and left pondering the complex questions associated with retirement on their own.

[5] The silver tsunami: an enquiry into the financial needs, preference and behaviours of retirees by Barbara Chambers, Ruth Walker, Jun Feng, Yuanyuan Gu (2019)

Our assertion is we cannot have an adequate retirement income system without an adequate advice system. And the advice system was never up to the size of the task and has been seriously eroded by the consequences of regulatory change. While the Royal Commission was a commission on financial misconduct, it did not recognise “sins of omission” in the industry’s failure to provide advice services to a substantial portion of the population. A substantial Advice Gap around availability and affordability exists and is getting worse.

The Royal Commission seemed largely to dismiss the value of financial advice. However, there is well documented evidence of the value of advice. Morningstar has measured the value of advice as “gamma” and Vanguard as “Adviser Alpha.”

We encourage the Retirement Income Review panel to consider the importance of advice to decision-making in retirement and the outcomes realised by consumers. And to consider the preparedness of the advice industry to help with the silver tsunami of retiring Australians. The Panel should consider:

- The sharp reduction in adviser numbers. An estimated decline of 25%, with some forecasts calling for a decline of up to 40%.
- The sharp rise in financial planning minimum fees -- due to regulatory overheads and risks-- and the impact that has on access for ordinary Australians. It is anecdotally often stated that minimum fees for comprehensive financial planning is now $5,000, putting it well out of the reach of most Australians.
- Why super funds have been so reticent to offer advice to retiring members. Yes, many funds have advice services, but they are extremely limited in most cases. ASIC’s recent report (693) on advice from super funds provides compelling evidence of how little the super fund industry is doing to provide advice to members.[6] Super funds with more than 10 million members were represented in the ASIC survey; they collectively provided advice to only about 2% of members.
- The impact of murky regulatory settings for “general” and “personal” advice on the willingness of institutions to provide advice.
- The regulatory settings on Retirement Income Forecasts, which can be vital to members understanding their prospects in retirement[7].

The Panel should also consider the potential role of Digital or Hybrid (Digital/Human) Advice in helping address the inaccessibility and affordability of advice issues. We note that major progress is being made in this area in the United States with digital advice having been commonly available for over a decade to members of corporate 401(k) plans and many financial institutions offering “robo advice” with new offerings and developments announced regularly. Australia lags well behind in rollout of digital advice to retirees and members of superannuation plans. In the above-cited ASIC report 693, it was revealed that only about 0.1% of members had used digital advice. We simply must do better to make advice and guidance available to members.

[6] Australian Securities and Investments Commission: Report 693: Financial Advice By Superannuation Funds, December 2019

[7] The impact of projections on superannuation contributions, investment choices and engagement, by George Smyrnis, Hazel Bateman, Isabella Dobrescu, Benjamin Newell and Susan Thorp (CEPAR, 2019).