Submission Paper – Legislating the objective of superannuation.

‘The Carrot and the stick.’

My name is James Andersen. I have worked in financial services for the past 15 years. I was the national trainer in changes to the rules of superannuation. I ran numerous seminars, and focussed on the interrelationship between superannuation, social security payments, and the tax treatment of both.

The consultation paper proposes the following:

- *The objective of superannuation is to preserve savings to* deliver income *for a* dignified *retirement, alongside* government support*, in an* equitable and sustainable *way.*

I agree with the concept of defining the objectives of superannuation, but I have issues with inserting the phrase ‘alongside government support’. Past history shows that changes to the assessment of social security payments can contradict proposed changes in superannuation. Superannuation is also used to reduce assessable assets and increase government support. This may not fit with the proposed objective.

On 1 January 2017 the asset test taper rate for pensions was altered to effectively reduce the maximum amount persons can hold in assets to be eligible for a part pension. The intention with the changes was to reduce budget outlays by compelling persons to draw on their retirement savings as a replacement for the pension. The message from the government - you need to save more for your retirement, because you may not be eligible for income support.

However, in July 2017, after the passing of the Fair and Sustainable Super Bill, the government reduced the annual limits on concessional and non-concessional contributions, and imposed lifetime caps on superannuation balances. These changes reduced a persons capacity to save for their retirement, and were at odds with the changes to the asset test. As one customer noted – “If I’m going to miss out on the pension, I’d like to save more, but you’ve slashed my capacity to put money into super. Too many sticks; not enough carrots!”

The taper rate changes also encourage people to draw on their savings. A single person on a part pension, and affected under the asset test, can increase their pension by disposing of assets. For every $10,000 reduction in assets, their pension may rise by $30 pf – a gain of 7.8%. People can adjust their assets in a number of ways: home renovations or additions (no limit), holidays (no limit), gifting (some limits), lifetime annuities and funeral payments.

One of the most popular ways couples can reduce their assessable assets is by transferring their superannuation to their partner. Assume a member of a couple – with one at pension age – has $600,000 on assessable super. This person can withdraw $330,000 from their super and place it in their partner’s super using the bring-forward rules. This will reduce the age-pension-age members’ assessable assets and increase their age pension. If the partner has retired and has met their preservation age for super, that person can also access their super at any time. This strategy may preserve their savings and deliver income or a dignified retirement, but it may not be in the best interests of the government to dish out more in transfer payments than required.

The assessment of superannuation when assessing government support can also change regardless of the rules of super.

In January 2015 the assessment of income changed: deeming was applied to new account-based pensions – replacing the deduction amounts.

In January 2016 the offset for certain portions of defined benefit pensions was limited to 10%.

In July 2019 the Centrelink assessment of lifetime annuities was changed to provide a 40% income and asset test exemption for the means test, and another 30% asset test exemption once a person reached a certain age. Some of these changes supported the preservation of savings; some reduced that capacity, but they illustrate how the rules relating to government support can work **independently** of the rules relating to superannuation.

Proposal 1: that the phrase 'alongside government support' be deleted from the objective of superannuation. This will remove a major level of complexity for the proposed legislation.

The proposed objective could also be re-phrased as, 'to provide a sustained level of income for the life of their retirement'.

One great fear of retirees is the risk they will outlive their savings (the longevity risk). **However, if the objective of super is to preserve savings to deliver retirement income, then major changes are needed to the current rules about access to super.**

In addition to the risk a person may outlive their savings, there is also the risk they will access their super too quickly, or alternately that their savings may outlive them.

Superannuation is a trade-off. You put away funds now, in return for a pot of gold when you wind down your work. The savings are preserved, but generally **there are no rules that say, 'you must turn this into an income stream for your retirement'**. Defined benefits work a bit differently, but most defined benefit schemes are now closed to new members. Once a person reaches their preservation age for super, and retires, or quits a job after turning 60, or reaches 65, they can do whatever they like with their money. They can pull out the lot and go on a 'Women's Weekly World Discovery Tour', then return to OZ and claim a larger pension.

They can also use their super in retirement to pay down their mortgage. Australian Bureau of Statistics figures for 2021 indicate that the number of people with a mortgage aged 65-plus has risen from 3.2% to 9.6% in the last 20 years, and research from REST Super Fund indicates that 21% of their members expect to retire with mortgage debt. One reason for the increase is the greater size of the mortgages - it takes longer to pay off because some amounts are so large.

There is another reason - possible tax benefits. Some people use superannuation to pay off their mortgage once they can access their super. One very common question in financial journals is, 'should I pay off my mortgage or put the funds into super?'

Age factors can influence the decision, but assume a person is in their 50's and a homeowner, earning $100k pa. If they salary sacrifice $10,000 of their wage into super, they save 19.5c in the dollar (the $10k concessional contribution into super is taxed at 15%; otherwise, the $10k is taxed outside super at 34.5%). If the interest on the mortgage is 7%, paying down this mortgage provides a tax free return of just 7%. In this scenario, the objective of super is not related to preserving savings for a dignified retirement. It may reduce their ongoing expenses in retirement, but it also reduces their retirement income.

Our rules of superannuation in 2023 are not structured to preserve savings to deliver income in retirement. If we want this objective, one option is to quarantine part of a person's superannuation towards a defined or lifetime income stream. Currently by far the most popular form of income stream is the allocated or account-based pension, which can be easily adjusted or closed, and can run out of funds.

There are moves to develop a range of different retirement income streams to combat the longevity risk. The Challenger lifetime annuity is one example. It's a bit clunky with its 'above-threshold' rates and vague tax rules for non-super products, but it does have a guarantee period for the first few years and can be set up as an indexed pension for life.

Should these products by compulsory? Will the general public accept having their super set up as a lifetime payment?

If you asked me pre-covid, I would have said 'absolutely not!'. However, if the general public can now accept compulsory lockdowns, restrictions on travel, and social distancing, they may be more amenable to having part of their superannuation placed in lifetime schemes with limited access.

The other option may need a 'carrot and stick' approach. **Account based pensions could retain their exemption** from earnings and capital gains taxes whilst in the retirement income phase. **The income could also receive a more favourable Centrelink assessment.** Currently there is no difference to the assessment of income and assets for super if a person is on an age pension – regardless of whether their super is in accumulation or pension phase.

Another incentive would be **a reduction in the 17% death benefits tax for superannuation payouts to non-dependants** if the funds were in pension phase when the person snuffs it.

The 'stick' could apply when lump sums are taken out of super. If we give a person tax concessions to place money into super for their retirement, then we could remove these concessions if the person makes a lump sum withdrawal.

Currently – if over 60 and retired – a person can pull out lump sums tax free. **A tax rate of 15-30% on lump sum withdrawals could discourage individuals from taking funds out of superannuation.** It may also discourage members of couples from moving their funds from an age pension member to a non-age pension partner.

Another stick is compulsory removal of any funds still in accumulation phase in superannuation – in the financial year after a person turns 76. This is a variation of the pre-July 2007 rules when it was compulsory to take out super at 65 if not working. The current rules allow contributions to super till 75.

The other concern with an objective to preserve savings for a dignified income in retirement, is the capacity or desire for people to hold onto their savings.

The Retirement Income Covenant position paper – released in 2021 – claimed that about 90% of their superannuation nest egg is left unspent: partly because they are afraid of running out of money, and partly because they want to leave an inheritance for their children. A survey in 2022 by National Seniors claimed only 1 in 3 people intend to draw down on their capital to generate an income from super in retirement. The 90% figure is disputed by industry figures, but anecdotal evidence suggests many retirees only take out the minimum drawdowns required from their super fund.

They were assisted by temporary reductions in the minimum drawdowns for the past 3 years:

Age	Minimum pension payment 2023-24	Minimum pension payment 2019-20 to 2022-2023	Minimum payments for all years 2013-14 to 2018-19
Under 65	4%	2%	4%
65-74	5%	2.5%	5%
75-79	6%	3.0%	6%
80-84	7%	3.5%	7%
85-89	9%	4.5%	9%
90-94	11%	5.5%	11%
95 or more	14%	7%	14%

At a recent financial seminar, the speaker was asked why a person should not be allowed to leave the superannuation funds to their estate. The speaker replied, **"superannuation is for your retirement. It is not for their retirement."**

If we want people to use their super for a dignified retirement, but not as a means for preserving capital, we could adjust the minimum drawdowns upwards.

2 options:

- We raise the minimum percentage payment for each age group by a percentage point. EG; at 65 it becomes 6%, at 75 7%, ant 80 it's 8%, and so on. The extra income will go to them, not future generations.
- If we want a person to use more of their super in retirement, but they don't want it to run out in their 90's, we could adjust the minimum withdrawals by simplifying the process. A person in their 60's takes a minimum of 6%. A 70's person takes out 7%. 8% for the 80yos, 9% for the 90's, and so on. Half the battle with superannuation is explaining how it works. This will simplify the process, and the lesser amount from 90yo may assist with aged care fees.

Proposal 2: if we plan to use superannuation to deliver income for a dignified retirement, then the rules of super should encourage people to set up an income for life. This could be a lifetime income stream, an account-based income stream, or a combination. It could apply to persons with final super balances above a certain amount – say $100k.

Regards,

James Andersen