9 February 2024

Director of the Retirement Income and Adequacy Unit
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Director

Re: Retirement phase of superannuation: Discussion paper

Thank you for the opportunity to contribute further to the development of retirement policy.

I have convened the Actuaries Institute Retirement Incomes Working Group since its inception in 2012 and for the past 2 years have been working on a project funded by the Orford Foundation that has specifically looked at supply side obstacles to the provision of lifetime annuities. This personal submission focusses on three issues that are raised in the Discussion Paper where I believe that significant policy gains can be made. They are developed in more detail in the working paper that can be found here.

1 Flexibility or a liquidity fetish?

John Maynard Keynes – in 1936 – described investors' desire for liquidity as a "fetish" not least because the liquidity is often not available when needed. It certainly reduces investment returns.

I agree with the Discussion paper's discussion of the issue on page 23 and welcome the suggestion of a Capital reserve. It should however have a maximum rather than a minimum value, or it would eliminate minimum drawdown rates if people made their entire balance a reserve. Introducing the concept of a capital reserve addresses the precautionary motive I discuss in section 4.1.1 and 5.2.2 of the working paper linked above. The suggestion there is that people for aim for no more than two years of expenditure and that the reserve should be available to be drawn down and then replenished in better times. In our analysis of Australian age pensioner data, we found that those with assets less than twice the Age Pension were saving – presumably to replenish their reserves. While an Account Based Pension (ABP) has the flexibility to be drawn down to address expenses, it cannot be replenished without making the system even more complex. Bank savings accounts are a better vehicle, and widely used by retirees.

My proposal therefore is that the objective of flexibility be taken out of the RIC, and that Government should partner with the superannuation and banking industries in developing education material around the need for a reserve account, its size and composition. I have also identified two other issues that need to be addressed to reduce retirees' sense of insecurity about future medical and aged care costs.

- **Unknown and uninsured medical costs.** My attempts to obtain data as to the maximum out-of-pocket costs incurred at older ages have failed to date. Without this information, many retirees are likely to overestimate the amount they need to provide for increased health care. Government could take the lead in collecting this information and making it available. There are huge differences in need between those reliant on Medicate and those with private health insurance (PHI). In our analysis of a sample of retirees' expenditure, we found that those with PHI were paying more for medical costs, and that their expenditure was more variable. PHI needs to be redesigned so that it reduces rather than increases volatility.
- **Unknown aged care costs.** Aged care costs are effectively insured by Government in that, although means tested, they are universally available. This fact needs to be advertised more widely. Retirees need to be confident that they will be able to afford whatever contribution is required. Confidence is undermined by the persistence of the Refundable Accommodation Deposit (RAD) as a potential funding mechanism. There are strong arguments to abolish the RAD, which is a major distraction for those thinking of lifetime annuities.

2 Creating an environment or market rules?

The aim of Government set out in the Discussion paper is to create an "enabling environment". I would like to suggest a shift in paradigm as suggested by Milton Friedman, the great proponent of free markets. He said:

> *The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the "rules of the game" and as an umpire to interpret and enforce the rules decided on.*

Like rules of the game, rules of the market include determining who plays and where, rewards and penalties etc. My presentation to the International Congress of Actuaries covers more of the theory of market design. The main suggestion in section 5.5 of the working paper is that Government and Industry develop a single market in post-retirement options. The idea would be that members could access the same on-line application form and be able to choose the best offer from different providers. This approach is apparently used successfully in Chile. I would envisage setting up a separate body, along the lines of the ASX in its earlier mutual stage, that would determine what information to provide and develop standardisation as necessary and criteria for product comparisons and evaluation. All members would be referred to this single market annually from perhaps the age of 60.

3 Reducing regulatory obstacles and complexity

My research for the working paper clearly identified a number of regulatory obstacles to the development of the annuity market – see sections 4.4 and 5.4. If would urge Treasury officials who have not read it to familiarise themselves with chapter 6 of John Braithwaite's book on "Regulatory capitalism". He describes the "rituals of comfort" that follow infractions of market rules: the royal commissions with hundreds of recommendations and the layers of duplicated regulation that the Australian Law Review Commission (ALRC) describes as "unmanageably and unnecessarily complex." The ALRC has produced excellent reports and is doing useful work in simplifying the structure of the legislation, but I would like to suggest that there is much that needs to be changed or removed.

I list some 20 ways for simplification in the appendix. It makes suggestions as what can be found to be immaterial. Such items appear to have been introduced as a "ritual of comfort" to meet an apparent need, but barely served to make a difference except to the complexity of the system.

4 Other issues

a) I do not believe that deferred annuities (DA) are normally suitable for retirees. They create the problem of the ABP running out before the DA begins. My calculation is that deferring from 67 to 85 also reduces the benefits of annuitization by about 25%. They have been promoted in environments where the ABP, but not the DA, may be invested in equity type investments, which is not the case in Australia. Some people think that they may be easier to sell (as longevity insurance) but my view is that the consumption frame is more persuasive than an insurance framing.

b) On the section in the Discussion paper headed support for longevity pricing:

- I think the market is probably capable of pricing longevity.
- On longevity and inflation linked bonds, my suggestions, published here, are also for the development of a market – in this case for indexed annuity bonds suitable to back retirement incomes.
- I am in favour of requiring gender neutral pricing (as some are already doing it and those not aware of it can be disadvantaged). I am also strongly in favour of differential pricing for health and socio-economic reasons – as set out in section 3.3.3 of my working paper.

c) One issue that is raised indirectly is the interests of other family members in superannuation benefits. Spouses and dependents have an interest in reversionary benefits and children have an interest in bequests and in the possibility of having to support their parents at some future time. The moral obligations are strong, having force of law in some cases in Australia and even more in some overseas jurisdictions. I believe that there should be some encouragement for advisors and trustees to include family members in the decision process.

Yours sincerely,

Anthony

Anthony Asher

Associate Professor

[redacted]

Appendix

Listed here a few changes that would have minimal impact on individuals or the budget but taken together would significantly reduce complexity. The first section considers how one might determine materiality, which then provides the basis for evaluating the cost and benefit of different welfare and tax elements. The second considers how to simplify the administration of the Age Pension, where Services Australia appears to be irredeemably overburdened by the complexity of what it is tasked with. The third section considers how to simplify taxation, which is largely related to simplifying the need for advice.

1. Determining materiality

Differentiation between different groups of people is justified if the differences can be shown to be material. As a measure of what constitutes materiality, I suggest using the different measures of a fair ratio between the single and couple Age Pension. This ratio is currently 66% of the income of a couple. Bruce Bradbury[1] suggested that the ratio should be somewhere between 66% and 80%. The ABS uses the OECD ratio of 75% for its publications that equivalise household income.[2] The ratio between ASFA's couple and single benchmarks is currently 72% for those on the modest level and 70.5% for those at a "comfortable" level.[3] Choice has found a ratio of 71% for those on the lowest incomes and 72.7% on their highest level.[4]

This difference in ratios gives an indication of the imprecision in the measurement of living standards. Bradbury's range of plus or minus 10% would apply to individuals relative to the average. The ASFA and Choice ratios represent differences in approach and different weightings used in determining averages and so vary less: between 1% and 3%. As a percentage of the single Age Pension, these would amount to $280 and $840 p.a.

These differences can be used to argue that it would normally not be worthwhile to go to administrative inconvenience for amounts of less than (say) $500 p.a. for those on the lowest income, or 3% of annual income. The point is that it is impossible to say that amounts less than this are meaningfully targeted at particular beneficiaries who have a need significantly greater than others.

2. Simplify Age Pension requirements

2.1. Abolish special allowances

It is difficult to see the point of the pension and energy supplements and the "Pensioner Education Supplement"[5]. There are arguments for addressing economic scenarios where pensioners are exposed to different inflation pressures, but this can be addressed by linking the whole payment to an appropriate index. Some pensioners do like receiving a quarterly bonus payment, but this is a trivial reason for additional complexity.

These allowances should be incorporated into the basic amount in a cost neutral manner.

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[1] Bradbury, B. (2014). Pensions for Singles and Couples. *Review of Income and Wealth*, *60*(3), 480-498.
[2] 6553.0 - Survey of Income and Housing, User Guide, Australia, 2017-18
[3] https://www.superannuation.asn.au/resources/retirement-standard
[4] https://www.choice.com.au/money/financial-planning-and-investing/superannuation/articles/our-new-retirement-standards
[5] Up to $60 per fortnight for studying.

2.2. Abolish the lower deeming rate

There are two deeming rates to convert assets into income. The lower deeming rate of interest presumably is intended to compensate those earning lower interest on cash balances. For couples, it has a maximum impact of $936 on their Age Pension. It could be fully compensated by an increase in the income free zone from $336 to $408 per fortnight. For singles, the amount could go from $190 to $230 per fortnight. It would have to be smaller to be entirely cost neutral, but there seems no point in maintaining the complexity.

2.3. Abolish the asset test

Australia is one of only two countries with a separate asset test, and it is a source of unnecessary complexity. Assets need to be translated into a fortnightly amount to determine the clawback amounts.[6] The current deeming rate approach conceptually reinforces the nest egg frame. An alternative would be to convert assets into an income stream using life expectancy and reasonable investment returns – as effectively suggests in the Retirement Income Review. This would focus retirees on the income potential of their capital rather than its current value, and make it easier to plan for a level standard of living in retirement.

2.4. Assess income and assets less frequently

The requirement to notify Services Australia of any changes in assets and income within 14 days[7] is bureaucratic harassment of those on the Age Pension. Little would be lost (or gained) by making assessments every quarter or 6 monthly – or better still – annually.

- The marginal impact of the usual change in assets is really too small to make retrospective adjustments.
- Those suffering a significant loss of assets could be assisted by the single hardship provision suggested in 2.7 below.
- For those whose income is not directly reported to Services Australia, income earned over the quarter/half year could be counted in the following period. Those earning additional income would still have the option of asking for a reduction in their benefits as soon as they start earning.

2.5. Remove personal assets from regular reporting

The requirement to report on the market value of personal assets[8] is perhaps the most intrusive of the asset test requirements. We understand that a standard deduction is commonly applied, and we think this should be made formal and universal. Exceptions could be made for items with a value over a certain limit – say $30,000.

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[6] It is easy enough to use the translation methodology to penalise assets relative to earned income if that is considered desirable.

[7] https://www.servicesaustralia.gov.au/sites/default/files/transcript-update-your-income-and-assets-online.docx

[8] Questions 36 to 38 in form SA369

2.6. Abolish the means tests for the Senior Health Card

Given the recent increase in the test for the Commonwealth Seniors Health Card, we suggest that it be made universally available to remove one of the spikes in the Effective Marginal Tax Rate (EMTR).

2.7. Abolish all grandfathering provisions and replace with a single hardship provision

A hardship provision could be discretionary and aim to compensate people for any regulatory change or disaster (not their fault) that leads them to have a significantly lower income (perhaps set at 10% less?). It could also be limited (say) to increasing their income back to 150% of the Age Pension.

3. Simplify the tax system

Some obvious and simple ways of simplifying are:

3.1. Abolish minor contribution concessions

The offending items include:

a) The Superannuation (Government Co-Contribution For Low Income Earners) Act 2003 (worth $500 pa or $20,000 over a lifetime, which is less than 3% of the value of the Age Pension). Low-income earners could be compensated by increasing the single Age Pension to 70% of the couple, and increasing rental assistance (but abolish the distinction between singles and couples.)
b) LISTO. The Low-Income Super Tax Offset compensates low-income earners who would not pay tax on at least part of their earnings for the 15% tax on the super contributions made largely by their employer. The maximum annual value is $500, which is immatarial.
c) Abolish the spouse, child and friend contributions. The main beneficiaries are partners where the one is considerably wealthier than the other. The maximum benefit of $540 is again immaterial in the bigger scheme – and only a few thousand people are taking advantage.

3.2. Abolish the SAPTO and the Work Bonus

I have great difficulty supporting special treatment for pensioners that are not available to other welfare beneficiaries. The Work Bonus and the Seniors and Pensioners Tax Offset fall into this category. I am not aware of any evidence to suggest that this addresses the particular needs of older people and not those who are younger.

I do however support policies that reduce excessive EMTRs, which is well over 50% for those subject to the income test and income tax. The Work Bonus is a particularly complex method of attempting to do this. I suggest that the ATO investigate the possibility of giving refunds each year of the income tax that caused EMTRs to exceed 50%. While the calculations would also be complex, the effect would be simple to determine.

3.3. Abolish the bring forward rule.

There is a savings on the tax on the investment earnings of money that would not be able to be contributed to Super immediately: of the order of 1% for people with more than $110,000 to invest.

3.4. Abolish the distinction between taxed and non-taxed superannuation balances

These give rise to complex recontribution strategies[9] to avoid tax on death benefits to non-dependents. While the amounts can be material to individuals, the rule is unfair in that the better-informed avoid the tax.

3.5. Abolish the prohibition of additional transfers from accumulation to drawdown products.

All this does is create administrative overhead as funds are rolled back and forth.

3.6. Abolish the division 293 additional tax charges

The new tax over $3m addresses some of this issue. Increase the top marginal rate by 1% if the generosity to the wealthy is an issue.

3.7. Reduce and index the new tax from $3m to $1.9m (or somewhere between) and abolish the tax cap provisions totally.

These provision are both aimed at the wealthy and can achieve the same purpose.

3.8. Abolish RSAs.

Only four entities are now accepting new accounts, and they could easily be offered in the superannuation framework. APRA could give some concessions if necessary.

3.9. Abolish SIS Regulations 1.05 and 1.06

These define annuities and pensions and abolish any grandfathering. This will require small amendments to Reg 1.06A.

3.10. Abolish all grandfathering provisions

The pre-1983 concessions can now surely be removed, and the impact of removing the pre-2008 concessions could be investigated. People should understand that tax rates can change with economic conditions.

4. Harmonise where possible

a) Increase the age at which members automatically satisfy a condition of release to 67, the Age Pension age.

b) Either abolish the maximum age for contributions or set it to 67, the Age Pension Age.

c) Use the same means tests to determine income for both the Age Pensions claw-back and for aged care charges. For the Age Pension, the rate of clawback can be set to somewhere between 30% and 50%. For all aged care costs, government should pay an amount equal

[9] https://www.mlc.com.au/content/dam/mlcsecure/adviser/technical/pdf/re-contribution-opportunities-fast-fact.pdf

to the cost of fully subsided care, and the clawback can be set to 85% of income. As above, abolish the RAD.