www.fairerretirement.com.au

2 July 2019

The Hon. Josh Frydenberg MP
Treasurer
Parliament House
Canberra ACT

Cc Senator Jane Hume, Assistant Minister for Superannuation, Financial Services and Financial Technology

Dear Treasurer,

RE: TERMS OF REFERENCE RETIREMENT INCOME REVIEW

The Alliance for a Fairer Retirement System noted your recent announcement that the Government intends to establish a Retirement Income Review as recommended by the Productivity Commission in its recent inquiry. The Alliance supports the proposed Review and would like to suggest items to be considered in the terms of reference for the inquiry plus some background discussion on those items. However, no change should be made that leaves the vast majority of current retirees in a worse position than they are today.

In general, we are supportive of a retirement income system based around three integrated pillars: that is the age pension, the superannuation system, and private savings (including the family home). This inquiry should take account of the interaction between these retirement pillars to investigate the adequacy, sustainability, certainty and fairness of those arrangements. In particular we believe it is important to address:

- How can the retirement system ensure incentives are in place to encourage those who can save for an independent retirement to do so, and avoid disincentives which create conflicts in this regard?
- What is an adequate level of retirement income commensurate with their pre-retirement standard of living that older Australians should be seeking to attain?
- What are the defined objectives of superannuation and the age pension and how should these two pillars work together to ensure intergenerational equity and the sustainability of the retirement income system?
- How can retirement income policy settings ensure the maximum degree of certainty for those planning ahead for retirement over decades?
- Given the outcomes delivered since the adoption of compulsory superannuation and subsequent establishment of the three-pillar retirement system – where are there gaps or issues which indicate a lack of fairness in terms of either horizontal or vertical equity for current or future retirees?

The attachment contains some of the key issues that the Alliance believes should be covered by the Review. Members of the Alliance would be pleased to meet with you, the Assistant Minister and your advisers to discuss our suggestions.

Yours sincerely,

Professor Deborah Ralston
Spokesperson
The Alliance for a Fairer Retirement System

About the Alliance:

The Alliance for a Fairer Retirement System is a group formed to represent millions of senior Australians, shareholders, self-funded retirees and those planning a sustainable retirement, including over one million members of self-managed super funds. The Alliance's mission is to help improve the existing superannuation taxation, Age Pension means testing and broader retirement income systems.

The organisations that form the Alliance include:

Association of Financial Advisers

Association of Independent Retirees

Australian Investors Association

Australian Listed Investment Companies Association

Australian Shareholders' Association

Gold Coast Retirees Inc.

National Seniors Australia

Self-managed Independent Superannuation Funds Association

SMSF Association

Stockbrokers & Financial Advisers Association

WA Self Funded Retirees

Attachment – discussion of elements of the proposed terms of reference

Age Pension

At present, only 30% of the population of over 65s is independent of government support. The remaining 70% is comprised of 42% on the full age pension and 28% on a part age pension. As the superannuation system reaches maturity and balances at retirement increase, reliance on the age pension will reduce. However, changing economic circumstances such as increased costs of housing, lower home ownership rates, higher older worker participation rates, and a lower interest rate environment, have impacted key aspects of the age pension system and warrant review, specifically:

- Support for non-home owners - Despite the broad coverage of the age pension in Australia, expenditure as a % of GDP is very low compared with the OECD average (only 4.3% cf. 8.2%). This low rate of expenditure is partly due to traditionally high home ownership rates amongst older Australians. However, with falling home ownership rates amongst current and future retirees, the means by which the current age pension system accommodates home ownership – either through higher asset limits or by the payment of rental assistance to non-home-owners – have not kept pace with current housing costs.
- Review the age pension asset means test taper rate – from the 1 January 2017 the taper rate has increased from $1.50 per fortnight for every $1,000 over the full age pension asset limit, to $3 per fortnight. This new taper rate equates to a "tax" of 7.8% on assets over the age pension asset limit, well in excess of market rates of return available to part-pensioners on these assets, thereby creating an incentive for those on the part-pension to reallocate their assets to meet full age pension eligibility.
- Review age pension means test deeming rates - there is a need to review the deeming rates used to calculate a person's deemed income from financial assets and to establish a benchmark which adjusts this rate periodically. The deeming rates have not changed since March 2015, since which time the RBA has lowered the cash rate 4 times. Deeming rates no longer reflect the market rates of return received by age pensioners.
- Incentives for work force participation – many older Australians are choosing to continue working after age pension eligibility age, and incentives to encourage them to do so would assist with standards of living in retirement and the sustainability of the retirement system. Incentives such as abolishing the Work Test for retirees between the age of 66 and 74, and allowing workers over the age of 75 to contribute funds to superannuation (in line with contribution caps) would assist in this regard.
- An Age Pension Tribunal - the need for on-going review of the parameters around the age pension system with changing economic circumstances also suggests the need for a single statutory body such as the Age Pension Tribunal to ensure flexibility and responsiveness to changing circumstances.

Other matters relating to the age pension:

To what extent is the presence of the age pension a disincentive to save for retirement?
The net present value of the age pension is over $800,000 per couple. This is supplied by the taxpayer with no effort required or additional savings on the part of the claimant. If a couple, who own their own home, accumulated $850,000 at retirement, they would find that they are not eligible for the age pension. They may derive great pride from their independence from government welfare, however, with the present taper rate, their income is no higher than a couple with half their assets.

- At the present level, is the age pension a disincentive to be self-reliant in retirement?
- Put another way, are the tax concessions offered in super sufficient incentive to encourage people to save for their own retirement?

Should the family home be included in the assets means test to some degree?

- What are the incentives implied by that arrangement?
- What are the implications for the family home exemption for future contributions to age care?

Should certain non-cash benefits be available to all citizens who reach eligibility age?

- What other non-cash benefits are available for pension recipients?
- What are the incentives to organize one's affairs to ensure eligibility for the age pension?

Superannuation

Although compulsory superannuation for most employees began in 1992, the system will not reach maturity until after 2032, when retirees will have had the benefit of 40 years of contributions to superannuation over their working lives. There were Australians who had the benefit of superannuation prior to 1992, for example people working for government, government agencies and some large corporations. However, of course, many Australians did miss out on superannuation altogether. The full benefit of the tax concessions provided to superannuation and the impact that has on reduced demand for the age pension will then become evident.

Compulsory Super – since its inception the superannuation system has produced a diversity of outcomes. Average super balances at retirement are modest for the majority of Australians, and the self-employed and those earning less than $450 per month with any one employer are excluded from the scheme. Indeed, a 2015 Productivity Commission report estimates that around 40% of Australians over the age of 65 years have no superannuation. This is in part because Superannuation Guarantee (SG) contributions started at only 3% of wages in 1992. SG contributions are now at 9.5% of wages and are scheduled to reach 12% in July 2025. The wide diversity of outcomes and compulsory nature of the SG raise the following issues:

- Remove the $450 per fortnight floor on super contributions – for those with casual positions, and multiple employers as is common in the "gig" economy, this failure to be included in the superannuation system represents an economic disadvantage for casual workers. We believe that this barrier to participation in the retirement savings system should be removed.
- Aligning indexation of government employee pensions - the CSS and PSS pensions (both funds now closed) should be aligned with the indexation method used for the Age pension, as recommended by 2 Senate Select Committee (2001 and 2002).
- Allow a fractional insurance premium for part-time workers – at present those working in a part time capacity pay the full-time worker insurance premium under group policies. For those working part-time on more modest incomes, many of whom are women returning to work after a period of child care, this represent a substantial erosion of their compounding balance. We would support the introduction of a fractional insurance premium for part-time workers.
- No changes to super policy without a full regulatory impact statement – individuals plan for their retirement over several decades. On-going changes to superannuation policy erode trust in the system and can result in unintended consequences for the viability of the system. We would argue that no changes to superannuation policy should be made without a full regulatory impact statement, which would also accommodate potential impacts on the other pillars of the retirement system, and grandfathering where appropriate to allow retirees and potential retirees to adjust their plans.
- Support the retirement covenant and better retirement products eg. deferred annuities, CIPRs – to this point the Australian superannuation system has been largely focused on the accumulation stage. We strongly support the introduction of the retirement covenant to the SIS Act and the development of products and services by super funds to assist members moving into retirement.
- Place an upper limit on the size of member superannuation accounts eligible for tax concessions - Under the changes made by the Government in 2017, the amount that can be held in the tax-free pension phase is now limited to $1.6 million per member. Any excess has to be removed from the tax-free pension phase, and the majority of these excess funds were placed in an accumulation fund where the income is concessionally taxed at 15%. There remains a number of funds with very large balances, in excess of $10 million in both SMSFs and in large superannuation funds. Such large funds are clearly not required for retirement income to supplement or substitute the age pension. The on-going tax concessions for these funds are a current cost to government revenue and indeed tax savings for those on balances over $3.2m exceed the costs of supporting an individual on a full age pension. While such large funds are unlikely to be achieved under current caps, we would support an upper limit on super accounts, in the interests of limiting the use of super tax concessions, and in the interests of intergenerational equity.
- Review the minimum drawdown rates on benefits held in the pension phase – The drawdown rates should reflect both the level of long term interest rates and life expectancy, having regard to abnormal fluctuations which occurred during the Global Financial Crisis and seems to be occurring now during a period of prolonged low official interest rates.

Other matters relating to the compulsory nature of superannuation:

- Should the SG be increased to 12%
    - Compulsory superannuation means that current wages are withheld for future retirement benefits. As lower-income workers are likely to be mainly dependent on the age pension in the future, is this level of forced savings justified?
    - An effective tax rate on wages, compulsorily withdrawn, of 15% inside the fund is higher than some workers pay on their take-home pay. Should some or all SG contributions be voluntary for workers below a certain tax level and/or below a certain age?
    - Under the present level of compulsory SG contributions, will the projected retirement benefits be adequate for a comfortable retirement (expressed as 60% to 70% of net pre-retirement income over future life expectancy of retirees)?

- Governance and transparency of superannuation funds
    - How can fund governance and transparency of these funds be improved so that members (workers/retirees) of the fund are better informed on, and better engaged in, the money invested on their behalf? How can transparency be improved around:
        - Fund performance in the context of unlisted assets
        - Distribution of franking credits between member accounts
        - The use of fund assets in relation to the Sole Purpose Test
    - What are the effects of management fees, taxes and low returns on retirement benefits?
    - Should superannuation funds be required to publish financial accounts like companies and should Boards of superannuation funds have the same duties and responsibilities as company directors?

- A limit on lump sum withdrawals - In order to maximise the length of time the fund can pay pensions in retirement, should lump sum withdrawals from a superannuation fund be limited to 10% per annum as applies at present to transition-to-retirement income streams?

Voluntary Contributions - people can make voluntary contributions to superannuation to either catch up on contributions missed or to increase the size of their nest-egg. Voluntary contributions may be pre-tax, such salary sacrifice, or post-tax, usually from personal savings and the sale of other investments. While it is only a relatively small proportion of the population who make voluntary contributions, for those with less certain incomes than PAYE workers such as small business owners, contractors and those who have periods out of the work force, the opportunity to make such contributions is an important part of participating in the system. Historically, the limits on after tax contributions were higher for older people in recognition of the higher disposable incomes after family commitments cease, or for women returning to work and catching up for time out of the workforce. We support the need for flexibility in the system via:

- Allowing higher contribution caps for from the age of 50 to allow “catch up” contributions – data on voluntary contributions shows that it is more likely to occur in the age groups 55 to 65 years, and that women are slightly more likely to contribute at that stage than men. We support the implementation of higher voluntary contribution caps for those over 50 years.

- Allow a spousal “roll over” – for a couple where one partner has a much higher balance than the other, for example where one has been out of the workforce or working part-time to accommodate child care, a couple may choose to divide their superannuation savings between the two accounts. We would support a voluntary rollover of superannuation in this manner.

Private savings

In addition to superannuation, the age pension and their own labour, older Australians draw retirement income from a range of sources including bank deposits, investment in shares, ETFs, and property etc. In addition, around half of wealth for Australians over 65 years rests in the family home. Few retirees draw on the family home as a source of income through equity release or reverse mortgage products, and increasingly this is seen as a store of value for an aged care deposit, should the need arise. For those without superannuation, the Seniors and Pensioners Tax Offset (SAPTO) provides a higher tax threshold for those of age pension age.

Drawing on equity on the family home – we strongly support the recent expansion of the Pension Loans Scheme to those who are not in receipt of an age pension as a means by which retirees can draw on the value of the family home.

Review access to Seniors and Pensioners Tax Offset (SAPTO) – at present a couple with $3.2m in super between them can also have approximately $160k in tax free super income and, in addition thanks to SAPTO, have another $55k in tax free income. In the interests of inter-generational equity, we would support the application of a restriction on access to SAPTO for those who already access tax-free super income, for example by amending access to SAPTO to be based on deemed income, not taxable income.

Further action on withdrawal of franking credit refunds – we request that the actual cost of franking credit refunds be reassessed after 2017-18 ATO figures are available on the impact of the $1.6m cap on tax free superannuation balances. Further, we believe that the recommendation made concerning caps on high superannuation balances would also restrict any concerns about this system. Any future policy changes to dividend imputation should impact on all recipients equally. One way to limit the revenue cost of franking credits is to limit the amount of superannuation that is eligible for tax free status, not by artificial means such caps or grandfathering, neither of which are aligned with the taxation principles of horizontal or vertical equity, and introduce further distortions into the system. Any changes to superannuation tax arrangements in retirement need to be carefully considered and be uniformly applied with a long lead-in time, without retrospective effect on any existing retirees.