Retirement Income Review

Submission from Rice Warner

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This report has been prepared in response to a call for submissions from the Retirement Income Review (Consultation Paper, November 2019).

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This submission was prepared by the Market Insights team at Rice Warner. It has been peer reviewed by the firm's senior consultants and executives.

1. Overview

1.1 About Rice Warner

Rice Warner was established in 1987 to support superannuation funds and businesses operating in the financial services industry. It is an Australian business, owned and controlled by its key executives. Over the last three decades, it has built a strong reputation for insightful commentary. Its independence means clients can be sure the firm always acts in their best interest and provides unbiased advice. Clients include most large superannuation funds as well as many other participants in the industry (service suppliers to funds, regulators, and industry bodies).

Through its actuarial heritage, comprehensive industry research and public policy activities, Rice Warner has built an unrivalled reputation for delivering a unique perspective across the superannuation, wealth management and life insurance industries. We are well regarded for our thought leadership in advocating for policy change that is in the public interest.

Rice Warner participates in all major government inquiries into superannuation and retirement incomes.

1.2 About this report

Some of the material covered by the *Retirement Income Review* (the Review) has been addressed by Rice Warner in the past. Where this material remains relevant, we have provided a reference. We also note that some of the Review's coverage has been raised in the Actuaries Institute Green Paper *Options for an Improved and Integrated System of Retirement* (AI Green Paper)[1] of which Michael Rice of Rice Warner was a joint author. Some of the options for reform raised in the AI Green Paper could address many of the questions raised in the Consultation Paper.

In this overview, we have commented on the key areas where the system could be improved. The rest of the report addresses each of the questions raised in the Consultation Paper.

In the time available for consultation, we have not modelled the impact of any of the suggestions we have made for reform. However, if the Review wanted to explore these, we would be pleased to undertake this later.

1.3 Strengths of our system

The Australian retirement system was not developed under any formal objective but has grown in a haphazard way. Over the last 30 years, there have been several problems, and we have had many changes to address these. Nonetheless, the overall success of the system has been remarkable:

- There is compelling evidence that our system is world-leading from international reports such as the *Melbourne Mercer Global Pension Index*[2], where Australia usually features as one of the best systems. Similarly, Willis Towers Watson's annual *Global Pension Asset Study*[3] usually ranks Australia's superannuation system as the fastest growing of any developed country.

[1] *Options for an Improved and Integrated System of Retirement* (Asher, Knox, Rice August 2019) https://www.ricewarner.com/wp-content/uploads/2019/08/RetirementIncomesGreenPaperFinal.pdf
[2] Mercer: https://info.mercer.com/rs/521-DEV-513/images/MMGPI%202019%20Full%20Report.pdf
[3] Willis Towers Watson: https://www.thinkingaheadinstitute.org/-/media/TAI/Pdf/Research-Ideas/GPAS_2019_final.pdf

- Our social security system is well-structured with Age Pension payments at 2.6% of Gross Domestic Product (GDP) and declining in contrast with most other nations which have higher costs, and which are rising as their populations age.
- The overseas investments held by large superannuation funds mean Australia is now a nett exporter of capital for the first time in its history. This has delivered significant benefits to our balance of payments.
- Australian companies have very low levels of unfunded pension liabilities, due to our shift away from defined benefit funds over the last 30 years. This protects employers from being constrained or even brought down by defined benefit funding issues. This has happened with numerous businesses in the United States and United Kingdom.
- Morningstar figures[4] show the large MySuper funds (previously Balanced funds) had real returns of 5% per annum over the last 25 years – far beyond the achievements of any other country.
- Our system provides universal group life insurance cover, cheaper than can be acquired in retail markets and competitive with premium rates globally.

Given the many strengths of the system, it does not need major reform. However, there are areas where the system could be modified to provide more efficient and effective outcomes. The AI Green Paper listed many of these.

The Australian superannuation system depends on the three Pillars of the Age Pension, Compulsory Superannuation and Voluntary Superannuation. Consequently, the impact of any proposed changes will need to be considered carefully because changes in one area can impact on the others. For example, adjusting the taper rate on the Age Pension will determine how much pension is lost from higher superannuation benefits.

When the Superannuation Guarantee (SG) is raised to 12%, for many members, some of the benefit will be offset by a reduction in Age Pension payments. The impact is complex, and outcomes are not readily quantifiable since retirement outcomes for members vary depending on many other factors including the rate at which the member withdraws their savings during retirement.

Home ownership is important for retirees. Apart from not needing to pay rent, homeowners hold an asset which can be used later in life to supplement income (through home equity release) or to pay for Aged Care services (through equity release, sale or rental). Previous research prepared by Rice Warner for the Actuaries Institute shows that growing superannuation balances at retirement will be partly countered by a reduction in levels of home ownership.[5]

We believe that enhancements need to be made in the following areas:

- Simplification of administration and documentation to reduce costs and increase the level of community understanding and engagement.
- Introduction of Joint Accounts for couples, or at least some form of linking of these accounts, as this would raise levels of engagement and allow funds to prepare appropriate benefit projections and improve retirement planning.

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[4] From ASFA's SuperFunds magazine
https://superfunds.superannuation.asn.au/2019/09/all-time-highs-are-the-norm/

[5] For Richer, For Poorer, Actuaries Institute, August 2015
https://www.actuaries.asn.au/Library/Opinion/2015/ForRicherForPoorerRetirementIncomes2WEB.pdf

- A review of retirement income provision to include the establishment of default products (within an overall strategy set by each fund), and the ability to move pension accounts easily from one fund to another.
- A review of financial advice which is perceived to be expensive by members and cannot be delivered cost-effectively under current legislation.
- A review of the role of life insurance within superannuation (especially disability benefits), recognising that, while this provides great benefits for most Australians, it clogs up the superannuation system and leads to unnecessary confrontation at the time of a claim, partly driven by the involvement of plaintiff lawyers.

1.4 Simplification of the system

It is well known that consumers find superannuation to be too complex. We consider that this leads to uncertainty and disengagement for most Australians. Levels of financial literacy are low and are unlikely to improve enough for consumers to deal with the complexity of the overall retirement funding system. Consequently, we are in favour of strong default structures, so people don't need to make decisions in complex areas (nor be forced by complexity to pay financial advisers to assist them within the mandatory system).

Superannuation documentation is difficult to follow due to the complexity of the legislation and the industry jargon. Australian Securities and Investments Commission (ASIC) should consider providing a standard booklet on many of the sections of Product Disclosure Documents and allow funds to remove this text from their documents.

Finally, it would be worthwhile for the government to work with the industry in a continuous process to improve engagement and simplification. Perhaps a working group could be established for this purpose.

1.5 Joint Accounts

We believe that raising the level of member interest in superannuation will improve efficiency. Higher levels of engagement would lead to higher levels of empowerment. Engaged members will focus on achieving their personal goals and will want competitive products.

One way this engagement could be raised is to allow couples to have a Joint Account within funds regulated by the Australian Prudential Regulation Authority (APRA) for their superannuation. We first suggested this in 2014[6]. The benefits we described remain valid:

- It will be much easier to engage members.
- We could reduce the number of superannuation accounts of *accumulation members* by several million. If half of all couples aged between 20 and 60 exercised the option, there would be a reduction of more than 3 million accounts, which is more than 10% of all accounts.
- Couples who combined accounts are more likely to consolidate all their superannuation and this would remove the costs of holding unnecessary accounts.

[6] https://ricewarner.com/wp-content/uploads/2015/10/Joint-Superannuation-Accounts_April-2014.pdf

- Retirement benefit projections provided by superannuation funds would be more accurate and members would get a better picture of how they are tracking for retirement. For example, the use of the Age Pension in benefit projections or online calculators could then be based on the current marital status, and build in the impact of the means test for the Age Pension.
- In some cases, it might help to reduce the female retirement savings shortfall as couples would plan their retirement finances together.
- Superannuation funds could market to members to bring their spouse into the fund.
- The simplified structure for couples, combined with Member Direct investments now offered by several funds, would provide many of the benefits of a self-managed superannuation fund (SMSF). This might appeal to those members who want the flexibility but not the responsibility of running an SMSF.

We recognise that this structure might be more difficult for members approaching retirement due to the separation of accumulation and pension accounts. This would need to be considered as a separate exercise.

We also note that it might be easier, perhaps as a transition or an alternative, to link the individual accounts rather than combine them. Further, some women's advocacy groups have indicated a fear that Joint Accounts might be abused in some cases. Certainly, it would be necessary for both partners to agree to link accounts and to sign off on any major change (such as investment strategy) as is required in an SMSF.

1.6 Retirement

The Australian system has been developed around accumulating savings. Although close to 30% of the system assets are now in the retirement phase, the administration and structure of retirement products is still at an early stage of development.

As the funds in retirement will grow rapidly in the next 15 years, it is important for the industry to focus on this phase.

Table 1. Retirement projections results (2019 dollars)[7]

Market segment	Today		In five years		In 15 years		CAGR*
	30 June 2019		30 June 2024		30 June 2034		(Over 15 years)
	($m)	(%)	($m)	(%)	($m)	(%)	(%)
Not-for-Profit Funds	157,606	18.6	208,427	23.3	432,034	29.9	7.0
Corporate Funds	10,902	1.3	7,774	0.9	8,031	0.6	-2.0
Commercial Funds	223,523	26.4	247,683	27.8	412,456	28.6	4.2
Self-Managed Super Funds	454,728	53.7	427,937	48.0	589,453	40.9	1.7
Total Retirement Market ($m)	**846,758**		**891,871**		**1,441,975**		**3.6**
Retirement assets as a percentage of all superannuation assets (%)	**31.5**		**27.6%**		**29.8%**		

* Compound Annual Growth Rate

1.6.1 Default retirement products

There are several advantages in having all funds establish a default retirement product which should include a Comprehensive Income Product for Retirement (CIPR). The key ones are:

- A CIPR is intended to more efficiently utilise retirement savings by increasing pension payments for retirees and reducing the payments they will leave as a bequest. We have expressed our concern about the viability of CIPRs if they are not part of a default product[8]. CIPRs rely on covering many members for pooling of longevity risk[9], and global experience with annuities tells us that members will not buy such products if they are voluntary. While each fund will set up a CIPR to reflect the needs of their own members, the system should be structured to allow members to opt out if the product does not suit them.
- At present, anybody entering a retirement product must apply to join it, even if they are already a member of the fund's accumulation division. We consider it desirable to allow members to apply for a pension by advising the fund of a few simple facts:
  - The date they want to retire.
  - The amount they intend to draw as a pension and the frequency of payment. The fund could have a default drawdown rate and payment frequency. We note research from Rice Warner as well as the Actuaries Institute suggests it is optimal to draw more than the legislated minimum drawdown.[10]
  - Acceptance of the default retirement structure, or notification of the member's chosen investment strategies if they do not want the default.

[7] Rice Warner's Superannuation Market Projections, December 2019
[8] https://www.ricewarner.com/wp-content/uploads/2018/06/Ltr-Retirement-Income-Covenant-Position-Paper-The-Treasury-190618375894.8u.pdf
[9] https://www.ricewarner.com/retirement-wont-wait/
[10] https://www.actuaries.digital/2019/07/17/spend-your-decennial-age-a-rule-of-thumb-for-retirement/

This could be set up well before the planned retirement date, which simply and smoothly comes into effect on the nominated date. This date could be changed at any time by the member if they change their mind. The advantage of this simplification is that many members will trust the fund's default and will enter retirement without needing to pay for financial advice.

1.6.2 Simplifying administration of retirement accounts

In addition to setting up default pension products, there are other areas where retirement could be simplified.

Once a member has an account-based pension, it is difficult to change it. For example, it is not possible to roll-over any superannuation benefit into an existing pension account, nor can contributions be paid into a pension account. If a member of retirement age is still working, they can shift their accumulation account into pension phase at any time. However, it is not possible to combine pension accounts without first commuting them.

Further, if a member wanted to change their pension account to a different fund, they would first need to commute their pension back to an accumulation account, then roll-over the benefit to the new superannuation fund's accumulation product, and finally use this benefit to convert into the new pension account. While the new fund will assist with this process, it is inefficient and may impede competition.

We consider it should be possible to combine a member's pension accounts, add any accumulation money to an existing pension account and to move a pension account from one superannuation fund to another seamlessly.

1.6.3 Rebasing the Age Pension

The Age Pension safety net including supplementary benefits provides about 27.7% of average wages to a single person and about 41.8% to a couple. It is based on the Male Total Average Weekly Earnings (MTAWE). It would be reasonable to start setting it against all full-time wages (males and females combined). The initial percentage would be 29.3% for singles and about 44.1% for couples (without changing the quantum of the benefit).

1.7 Financial advice

1.7.1 Intra-fund advice

Australians need financial advice periodically during their working life and retirement.

The introduction of intra-fund advice has enabled superannuation funds to deliver simple, single-issue advice to members. It has delivered advice to many who would not otherwise have received advice while minimising costs. Most funds absorb the cost of delivering this advice within their member fees, but some levy a charge for the service for $300 to $800 (one-off fee). This type of simple advice can even be used to assist members to purchase a pension using the Transition to Retirement facility.

The quality of financial advice varies between superannuation funds. The lack of good data about members, the complexity of issues and the obscurity of current legislation, makes it difficult to deliver this advice as efficiently as it could be. ASIC recently undertook research that showed only 49% of intra-fund cases it reviewed fully complied with the law.[11]

It would be worthwhile reviewing the efficiency of existing legislation and delivery of this advice, as well as single-issue advice delivered outside superannuation.

1.7.2 Paying for advice

Many funds allow members to authorise them to deduct fees for services from a financial planner relating to superannuation. The Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (the Royal Commission) recommended prohibiting such fees being made from MySuper accounts[12]. The logic appears to be that a member in a default structure does not need advice.

However, there are many members in MySuper products who have chosen to join them either directly or based on financial advice. Even those in their employer's default MySuper might still want advice on their total financial affairs including monitoring of their superannuation.

We believe the practice of deducting adviser fees is reasonable provided the service pertains to the member's superannuation.

1.7.3 Advice at retirement

As members approach retirement, it becomes more difficult for superannuation funds to assist members. As there is no default retirement product, each member needs to be placed in an investment strategy which is ideally determined only after provision of a comprehensive financial plan. The cost of delivering such a plan (usually $2,500 to $5,000) is more than most members will pay.

Within the retirement phase, most regular advice is about budgeting and appropriate levels of withdrawals. This *Retirement Counselling* is valuable, and all funds should provide this as part of their account-based pension product. Like the work of Money or Finance Coaches outside superannuation, this activity does not fall under the financial advice regime. Consequently, it should be possible to deliver the service cost-efficiently using technology and retirement counsellors within call centres.

Funds could then offer *Event-based advice* to their account-based pensioners periodically based on the need of each retiree. Such events would include the death or divorce of a partner, the need for a late life annuity or home equity release, and the need for Aged Care services. This advice could be delivered for a flat fee by a financial adviser (not necessarily related to the fund).

We recommend reviewing these services with a view to simplifying the processes (with a goal to reducing costs of delivery and increasing member usage of financial advice leading to and in retirement).

[11]Report 639 Financial Advice by Superannuation Funds (p7)
https://download.asic.gov.au/media/5395538/rep639-published-3-december-2019.pdf
[12]https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf (p29)

1.8 Life insurance

1.8.1 The role of life insurance in superannuation

Life insurance has always been an integral part of the superannuation system. When defined benefit funds were the norm, the death benefit was often linked to the member's salary and paid as a lump sum. Total and Permanent Disablement (TPD) benefits were originally introduced 50 years ago as an advance payment on the death benefit for those who were terminally ill, or who were severely disabled (blindness or paraplegia).

When Award Super was established about 35 years ago, (and formalised with the SG from 1992), all new funds were set up as accumulation funds and they provided lump sum benefits for life cover as well as TPD. There were many advantages of these schemes, including:

- Premium rates set at lower rates than available in the retail insurance market.
- The provision of default insurance without the need for any underwriting, even for those in hazardous occupations.
- No restrictions on pre-existing ailments.
- Continued cover when a member changed jobs, including time off work while looking for a job.

Premium income has grown dramatically in recent years due to higher levels of default cover and the provision of voluntary additional cover subject to underwriting. The latter has been popular as the premium rates for voluntary cover can be the same as those for default cover.

Group insurance benefits are good value in global terms. Some 85% of premiums are returned as claims with the balance paying for expenses, the cost of capital and reserves and the insurers' profits. Further, more than 90% of claims lodged are paid as benefits[13].

Despite the growing importance of life insurance, it was not mentioned in the objectives of the system set out in the Financial System Inquiry (nor the subsequent objectives placed in Parliament). The statutory requirements for insurance are vague in that MySuper funds must provide (undefined) death and TPD benefits whereas the Superannuation Industry (Supervision) (SIS Act) only requires life cover be bought by a premium of at least 50 cents a week. We note that the Royal Commission recommended reviewing minimum and maximum levels of all types of insurance cover[14].

We consider that there should be an overall objective for insurance within superannuation, so that trustees have more certainty over the role of these benefits.

1.8.2 Difficulties with life insurance

The government has recognised that life insurance premiums reduce the monies which will be set aside for retirement benefits. This has been partly addressed by removing *default* insurance from those who were considered not to need it. The recent *Putting Members Interest First* legislation removed default life insurance from those accounts with less than $6,000 and all new members under age 25.

This legislation has been a blunt instrument as there will be many members within these parameters who need cover. For example, migrants with families need insurance but will take time to build their superannuation balance to $6,000, and young members will still need disability protection.

[13] Brett Clark, CEO TAL in speech at Conexus Chair Forum on 31 January 2020.
[14] https://www.royalcommission.gov.au/sites/default/files/2019-02/fsrc-volume-1-final-report.pdf (pg 324)

The remaining life insurance can still be a significant cost for other members (albeit good value for money). Some members buy additional voluntary insurance which is a valuable benefit given base cover invariably does not fully protect against the member's full insurance needs.

The growth and complexity of life insurance cover has led to several difficulties for superannuation funds. Some of the issues:

- Superannuation fund administration has lagged in providing an efficient service and the data is not integrated with the fund's insurer. Cleansing and enhancing data are major first steps in any review of insurance arrangements.
- Claims management costs, both in assessing who should receive death benefits and in assessing and monitoring disability benefits, are significant.
- Most superannuation funds do not know enough about members to set the default cover close to their financial needs. Better integration of data, use of technology and engagement with employers and members might help to increase coverage to meet the needs of each member.
- It can take six months or more to settle a death claim. Often, the reason for the delay is the need for the fund to ensure the right dependants receive the benefit. It would be desirable for the funeral costs to be paid out of the fund at an early stage and for standards to be set to simplify the claims management.
- Frequent changes in legislation have added to the difficulties in the insurance market. For example, opt-out cover became a compulsory part of default accumulation products from 1 January 2014, following the Cooper Review. However, it was wound back in the recent Protecting Your Super changes and the Putting Members Interests First legislation which takes effect on 1 April 2020.

We consider that insurance within superannuation is valuable but a review of life insurance against new objectives would be worthwhile. Such a review could look at levels of default cover, standard wording for contracts, claims management processes and the tax-deductibility of insurance within and outside superannuation.

1.8.3 Difficulties with disability benefits

Competition has led to a more complex insurance market, particularly for disability benefits. These benefits now represent 70% of group insurance claims by number and 58.1% by amounts[15].

Some of the matters needing attention include:

- Lump sum payments for TPD. The benefit has evolved to be paid out in a much broader range of circumstances. Nowadays, one-third of claims are for mental health issues and it is very difficult to ascertain whether the claimant will recover or not.
- Disability income benefits are paid as a series of periodic payments after a waiting period. Often, the default benefits within superannuation funds are inadequate – they are not high enough to replace the member's personal exertion income, and they are usually paid for short periods (typically two years in an industry fund).
- Disability income and workers compensation payments are not integrated well.

[15] APRA Life insurance claims and disputes statistics – June 2019
https://www.apra.gov.au/sites/default/files/Life%20Insurance%20Claims%20and%20Disputes%20Statistics%20June%202019_4.xlsx

- An increasing amount of litigation due to the introduction of specialist litigation lawyers operating in this field. Insurers and funds have argued that these lawyers often add unnecessary costs for the member given legitimate claims are paid anyway.

The dilemma facing funds and their insurers is that any default disability insurance whether lump sum or income benefits will be unrelated to a member's financial need. Unlike life cover where it is easier to set the benefit at a level that reasonably reflects needs and affordability, it is not possible to set the default accurately for disability benefits given the variability of income of members.

If we seek to cover members' financial needs, it makes sense to reduce the amount of TPD cover and increase the monthly income benefits. However, this has implications as it will increase the cost of insurance, and consequently reduce the amounts being saved for retirement.

We recommend a review of disability insurance to see if it can be delivered more efficiently. Such a review should look at cover within and outside superannuation, and particularly look at integrating superannuation benefits, State-based compensation schemes and the National Disability Insurance Scheme (NDIS).

1.9 What is the right level of SG?

Two Rice Warner actuaries reviewed this issue in 2019.[16]

The issue is complex as many low-income earners struggle financially and would prefer the SG as cash to pay bills now rather than as a retirement benefit later. We consider it better to have a single rate of SG for simplicity and efficiency - a variable level based on income would create its own problems. Separately, the government should look after low-income people through the tax transfer system and consumer protection measures.

However, there may be grounds for more generous release of superannuation benefits for those with significant debt and little capacity to improve their financial situation. This would be structured to avoid incentivising irresponsible lending by making it easy to use vulnerable members' superannuation.

The current level of SG is 9.5% of salaries from which the cost of life insurance, administration fees and tax on the contributions is deducted. A more efficient system would lead to high levels of contributions allocated to retirement incomes:

Table 2. Table 2 –Allocation of SG Contributions

Item	Current	Projected[17]	Comment
SG Contribution	9.5%	12.0%	Assumes progress to 12% as legislated
Life insurance	1.0%	1.0%	This is upper limit – the cost varies by fund
Fees	1.0%	0.75%	Consolidation and efficiency will drive down future costs
Tax on contributions	1.125%	1.5375%	Tax at 15% of contributions less allowable expenses
Allocated to retirement income	6.375%	8.7125%	

[16] *What is the Right Level of SG?* Bonarius, Rice (2019) presented to Actuaries Institute forum in June 2019
[17] Assumes the legislated path to 12% will continue.

The allocation above would provide a 37% increase in the average dollar allocated to retirement incomes. Such an increase would greatly support retirement adequacy for most Australians. However, as desired, it would have little impact on wealthier Australians who tend to already fund voluntary amounts under salary sacrifice and who are also limited by the annual cap on payment of concessional contributions.

There would be an impact on retirement incomes and the cost of the Age Pension from any adjustment to the treatment of the means-tests on the Age Pension.

1.10 Response to specific questions

The balance of this submission answers the specific questions of the Consultation Paper.

2. Purpose of the system and role of the Pillars

2.1 The retirement income system

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

The Australian retirement system is unique and international comparisons are not easy. However, we can observe areas of our system which would appear to be better handled in some overseas countries.

2.1.1 Focus on retirement income

Unlike other countries, we have a focus on the size of a member's and retiree's account balance rather than on the amount of regular income that should be withdrawn each year in retirement. A shift in emphasis to retirement income would be more useful for members.

This can be done by changing communication with members to show their expected annual income in retirement including the Age Pension. We note that these calculations should be based on couples where members have a partner. However, funds do not hold enough information on members to achieve this. ***Perhaps the calculations could be prepared properly by utilising the Australia Tax Office (ATO) data-matching facilities.***

In retirement, the ability for retirees to withdraw any amount tax-free negates the concept of a pension with regular income. There are no guidelines on managing assets in retirement and most retirees with account-based pensions self-insure their longevity risks (other than the protection provided by the Age Pension). This appears to lead to many retirees drawing only the legislated minimum pension amount. They then accrue larger (tax-free) death benefits (bequests) and live more frugally than they need to.

2.1.2 Means-testing of Age Pension

Other countries do not have our complexity and the consequential scope for anomalies. At the least, we should consider a single test (income or assets). This theme is explored in the AI Green Paper (section 5.1).[18]

2.2 Objective of the system

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

Leaving aside the fact that there is no formal objective (see question 5), members and retirees are largely ignorant about the structure and objectives of the retirement system. There have been many surveys conducted by consumer bodies and large funds which highlight the general level of ignorance members have around their super. Examples include:

- In 2010, a survey was conducted by various academic researchers for the *NSW Department of Premier and Cabinet*[19] to assess the impact of the Global Financial Crisis (GFC). It found that 40% of

[18] *Options for an Improved and Integrated System of Retirement* (Asher, Knox, Rice August 2019)
[19] Retirement Planning Survey (p13)
https://www.psc.nsw.gov.au/ArticleDocuments/1479/Retirement%20Planning%20Survey_final%20draft.pdf.aspx

respondents didn't know how much they had in superannuation, with a further 34% of respondents not knowing how their balance had changed over the period from January 2008 to November 2009.

- ASIC's recent *Report 639 – Financial Advice by Superannuation Funds*[20] found that approximately 2% of members across surveyed funds had made advice-related enquiries over the 2017-18 financial year. Few members use the advice services offered by funds, even at advanced ages where the need for advice is significant.
- Rice Warner's 2019 Super Insights shows that 7.4% of members who make an active investment choice have invested 90% or more of their funds in a cash investment option. This trend remains evident even amongst younger members, where 5.0% of members aged under 30 have elected to invest 90% or more of their funds into a cash investment option.

The information vacuum peaks as members prepare to retire. Almost all members need comprehensive financial advice to help them through the decisions they need to make. This advice is expensive to deliver, and surveys conducted by superannuation funds show that most members are not prepared to pay the amount required to provide these services.

Complexities of the system confound the layperson. This includes:

- Industry jargon, which is foreign to them and which changes from time to time.
- Lack of knowledge and understanding of investment strategies, risk and compound interest.
- A lack of understanding about the tax treatment on contributions and benefits.

At retirement, the mix of Age Pension and superannuation rules appears to be little understood. Members need to make several difficult decisions including selecting an appropriate investment strategy and deciding how much to spend each month in retirement.

There is also a lack of knowledge and take-up of longevity products

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

Recent history shows that those members who have been in expensive or poorly performing funds have mostly not moved from them, probably largely through ignorance[21]. Consequently, there is considerable benefit from having strong default products such as MySuper - provided these are well regulated as now appears to be the case. This ensures most members are in suitable products while they save for retirement.

Retirees usually self-insure longevity risks and are exposed to inflation and investment risks. Consequently, retirement accounts and pension withdrawals are not optimised.

There is no default retirement product in Australia. Rice Warner is in favour of setting up a default retirement solution and allowing members to transition smoothly between accumulation and retirement.

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[20] Report 639 Financial Advice by Superannuation Funds (p13)
https://download.asic.gov.au/media/5395538/rep639-published-3-december-2019.pdf

[21] The Royal Commission was a catalyst for many employers to move their default arrangements and for many employees to exercise their option to move under Choice.

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

2.2.1 Government

The government is responsible for:

- Providing a safety net so that retirees do not drift into poverty. This is achieved through the Age Pension, which is indexed to wages, the Medicare system which provides health coverage, and the provision of Aged Care services and facilities.
- Structuring the regulatory architecture so that regulators can enable integrity and proper governance of the system through competent and adequate supervision
- Providing tax concessions to encourage saving for retirement.

2.2.2 Private sector

The private sector is responsible for designing suitable products and services and managing them efficiently. The key outcomes they should seek are to:

- Deliver strong investment returns during a member's working life, followed by delivery of *comfortable* retirement income during retirement.
- Assist with education so that members can make informed decisions around matters such as their investment strategy, timing of retirement and rate of drawdown of benefits.
- Develop a flexible retirement platform to cater for the divergent needs of retirees.
- Provide longevity protection for retirees (through insurance or pooling of retiree members).
- Provide simple administrative services in retirement (such as easy access to money).

2.2.3 Individual

Individuals must take responsibility for:

- Saving pre-retirement.
- Budgeting during retirement.

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?*

The system could be improved further but this needs to be done against the background of some agreed long-term objectives. The Review notes the difficulty we have had in developing an overall objective for the system. We believe the key objective (and the ancillary objectives) need to be revisited.

The Financial System Inquiry's recommended overall objective of the system was to *provide income in retirement to substitute or supplement the Age Pension.* While this is a succinct objective, it does not deal with the objective of the Age Pension itself. At what level should this be set – and what are fair rules for the means-test?

These issues are discussed in a Rice Warner submission to Treasury on the objectives[22] and the AI Green Paper.

An additional complexity is that Pillar I is designed for couples whereas Pillars II and III are based on individuals.

We note the continued absence of any objective relating to life insurance despite the importance these benefits have in the system.

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?

Australia first needs to set targets for the cost of delivering Age Pension payments, rental assistance for the elderly, and Aged Care benefits. This is the base cost of providing a safety net in retirement.

Once the Australian government has committed to this level of support, it can then determine the right level of tax concessions needed to help Australians achieve adequacy in retirement though the private sector funding of benefits.

[22] https://www.ricewarner.com/wp-content/uploads/2016/04/Objective-of-Superannuation-The-Treasury-2016.pdf

3. 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.

7.1 What are the main impacts of these trends?

One key impact is the increasing proportion of retired persons in the population. An important policy which can mitigate the impact of this change is to encourage part-time work for older Australians. This will defer consumption of superannuation benefits, leading to a more comfortable retirement. It will also help overall workplace productivity through higher participation rates.

The critical encouragement required is not exhortation of retirees, rather it is providing access to the labour market for those who want to work. The system should be designed to ensure that retirees receive appropriate benefit from this work. This is not always the case at present – current means testing rules can result in an effective marginal tax rate (in the form of reduction of the Age Pension) for retirees with incomes as low as $12,324 per year.[23] Further, those who continue to work full-time past the Age Pension eligibility age may forego pension benefits, which also leads to a high marginal tax rate.

As labour markets change, there are higher levels of self-employed contractors and casual employees. Many of these people do not benefit from the SG system.

High house prices in capital cities have led to lower rates of home ownership. The Actuaries Institute Paper, *For Richer for Poorer*[24] shows that overall wealth will stay reasonably stable in future but with more overall contribution from superannuation and less from housing.

7.2 To what extent is the system responsive to these trends?

The mandatory contributions are based on wages. There are no contributions made when people are out of work. This impacts on those with career breaks to care for children, those studying tertiary education, those unemployed, and those who are self-employed. The system allows for *catch-up* contributions but these are voluntary so many do not participate and the caps on contributions make it difficult for those in later life to *catch-up*.

The exemption of the family home from the Age Pension means-tests creates a more favourable system for homeowners. Retirees who rent are less well-off than homeowners in several areas – their regular expenditure is higher, and they do not have the equity of the family home as a financial resource.

7.3 Are there additional trends which the Review should consider when assessing how the system is performing and will perform in the future?

We are in an era of globally low interest rates. This has created uncertainty and unusual investment conditions. For example, savers receive low returns and asset owners have received abnormally high values. Retirees have a choice between receiving low interest rates or taking on more risk and chasing yield. This dilemma reinforces the need for a default retirement product.

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[23] This is calculated at the Income Test Threshold of a single pensioner of $174 per fortnight plus the Work Bonus for a single pensioner of $300 per fortnight, multiplied by 26.
https://www.servicesaustralia.gov.au/individuals/topics/income-test-pensions/30406
https://www.servicesaustralia.gov.au/individuals/services/centrelink/work-bonus
[24] https://www.actuaries.asn.au/Library/Opinion/2015/ForRicherForPoorerRetirementIncomes2WEB.pdf

If we enter a period of low wage inflation, that will reduce the contributions made on behalf of members. In turn, that will lead to lower retirement benefits in real terms (noting that superannuation funds target returns well in excess of wage inflation).

In a period of low wage rises and increasing corporate profits. Any increase in the SG could lead to a higher allocation of company earnings to income. In an era of rising global inequality, such increases might lead to reduced levels of inequality in Australia compared to other regions.

Increasing longevity means that the period of retirement keeps expanding. This means that those retiring in future will need higher accumulations as they will need to fund a longer period of consumption for their superannuation benefit.

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?

The Principles are sound.

Equity should include fairness between generations as well as outcomes within a generation.

8.1 Are there other principles that should be included?

We note the AI Green Paper listed principles including *efficiency*. An efficient system should lead to simplicity, better engagement with members and improved value (outcomes).

9. How does the system balance each of the principles and the trade-offs between principles (e.g. sustainability and adequacy) under current settings?

The main drivers in the system are:

- The level of SG contributions.
- The amount of, and eligibility (via means-tests) for, the Age Pension.
- Levels of permissible tax-concessions on contributions.
- Rules on investing and drawing down pension payments in the retirement years.

Any variation in the parameters will impact on levels of retirement income.

While it should be relatively simple to apply changes in factors, the system complexity means outcomes are difficult to predict. One reason is that superannuation is based on the work and savings patterns of individuals whereas the Age Pension rules are based on couples.

Another reason is the flexibility of retirement, where pension payments can be made at any time with no upper limit. This flexibility makes it more difficult to predict future behaviour.

9.1 What is the evidence to support whether the current balance is appropriate?

Since 2016, changes to the Age Pension eligibility and to tax-concessions have made the system more equitable. However, there are still some retirees with exceptionally high tax-advantaged superannuation balances with other retirees living in poverty, so more work still needs to be done to meet the Principles.

4. Adequacy

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

In the same way that working Australians have different living standards, the circumstances of retirees will vary. We understand that many retirees on a full Age Pension still save rather than consume all their income[25]. This suggests that *adequacy* is a concept which will have a different meaning for different people.

The government has set up a retirement structure that allows all Australians to achieve an adequate retirement if they have a lengthy work history and if they make voluntary contributions later in life.

However, many Australians will fail to achieve an adequate retirement due to unfortunate personal circumstances or ignorance of the value of patient long-term saving. The safety net of the Age Pension and supplementary support is available to keep these people out of poverty.

The system has enough incentives to allow any Australian to build enough for a comfortable retirement. While the system is not yet mature, average balances at retirement grow each year and retirees overall appear to live well.

11. What measures should the Panel use to assess whether the retirement income system allows Australians to achieve an adequate retirement income?

Consumers are not familiar with terms such as income replacement rates, nor even annualised income. They would be more familiar if retirement income were expressed as prospective weekly income as they can relate that back to their expenditure needs.

Ideally, there should be a benchmark as to how much is needed weekly to provide a comfortable retirement income (recognising that the Age Pension itself should be *adequate*). The benchmark could be done for quinquennial ages from 60 to 90 to give a better guide. Such a benchmark should look at cohorts such as singles or couples and homeowners or renters. It might also look at regional diversity.

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?

Any benchmark should be measured against retiree expenses to make it easier for consumers to understand.

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

There is some evidence to suggest that retirees vary their lifestyle to match their income.

Frugal behaviour makes it difficult to assess how much is needed for a comfortable retirement. For example, those in account-based pension often draw the minimum even though they could freely drawdown more. Similarly, many of those on the full Age Pension save some of their income.

[25] https://au.milliman.com/insight/Surprising-new-research-reveals-the-majority-of-Australian-retirees-spend-less-than-the-Go

5. Equity

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

The government should provide the opportunity for equity in retirement, but it cannot be responsible for the variations in behaviour amongst Australians. Section 2.3 of the AI Green Paper sets out some considerations.

14. What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement?

Some of the metrics which can be measured over time are:

- The level of dependency on the Age Pension – If more people retire with enough assets to be so-called self-fund retirees, and if those on the Age Pension shift gradually from full to part pensioners, then the build-up of superannuation assets is doing its job.
- The median size of benefits at the time of retirement – this shows whether the accumulation phase is working well.
- The level of poverty in retirement – there is evidence that single retirees on the Age Pension renting in private markets are struggling financially. That would be a signal to review rental assistance.
- The number of retirees with accumulated benefits above (say) $3 million at age 65 – arguably, these people have accrued too much and they will be receiving too high a level of tax concessions during retirement.

14.1 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.)?

Our SG system (Pillar II) is based on wages. Therefore, it excludes the self-employed and those earning less than $450 in any month or who are not currently employed (those in gaol, on welfare, caring for family, or too sick to work). As employment conditions change, we might have larger numbers excluded from a key pillar of the system.

Figure 4 in the Consultation Paper appears to show that those on the top 20% of income receive concessions that are too generous and that those in the middle 40% receive the least benefit from the system.

While the graph is indicative, it is worth pointing out a few areas where different assumptions could lead to different conclusions:

- The Age Pension is indexed to wage inflation. As the rate of increase assumed in the graph is less than the assumed nominal GDP growth, it understates the value of the benefit. Rice Warner discounts at a lower rate giving a value closer to $500,000 for an individual (slightly more for a female) and about $800,000 for a couple. As the benefit will always retain purchasing power, it could be argued that it is worth close to the annual benefit times life expectancy.
- The graph is based on individuals. If it were based on couples, it would show the same level of benefit at the bottom deciles, since it is usual for both partners to be on a full Age Pension together. However, the distribution of a partner's income for those in the top 20% will be variable, so the combined concession per partner will be less than that shown.

Four years ago, Rice Warner prepared a comprehensive report for a Senate Economics Reference Committee – *Economic Security for Women in Retirement*.[26] Many of the issues raised remain relevant today.

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

The median retirement age has always been lower than the Age Pension age. In the past, this was a result of several factors:

- Women retiring early to care for their family or retiring at the same time as their (usually older) partner retired.
- Australians retiring early from ill-health.
- Earlier access to the Age Pension (which is rising from age 65 to age 67).

After the GFC, the median age of retirement rose from about 60 to today's level of about 63[27]. The actual median age is difficult to assess accurately as many people now retire and continue working part-time.

There is evidence that self-employed persons retire at older ages, since they can maintain an income through their business. However, some of these people might be working longer as a result of having no superannuation.

The government provides flexibility for those who want to work longer. They can leave their superannuation in an accumulation account so that they don't need to draw income they don't yet need. One disadvantage for many is that continued full-time work at a reasonable income means they forego any Age Pension until they cease work. Further, continued part time work can lead to a marginal reduction in pension of 50 cents per dollar of additional income.

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

As mandatory contributions are based on wages, those on low incomes will build up a lower retirement income than those on higher incomes. Further, those not working will not build up any retirement savings. However, the Age Pension significantly moderates levels of inequality relative to what would apply if the Age Pension were at a very low level and/or calculated on a flat rate basis.

As those on high incomes are more likely to be homeowners, many of those with small retirement balances will be renters in retirement. These people will rely heavily on government support in the areas of the Age Pension, Medicare and Aged Care.

The system acts to increase inequalities in one area. Those retirees with valuable homes and minimal financial assets can receive similar or greater financial support than many other retirees with equal wealth (see AI Green Paper).

[26] https://www.ricewarner.com/economic-security-for-women-in-retirement-submission-to-senate-economics-references-committee/

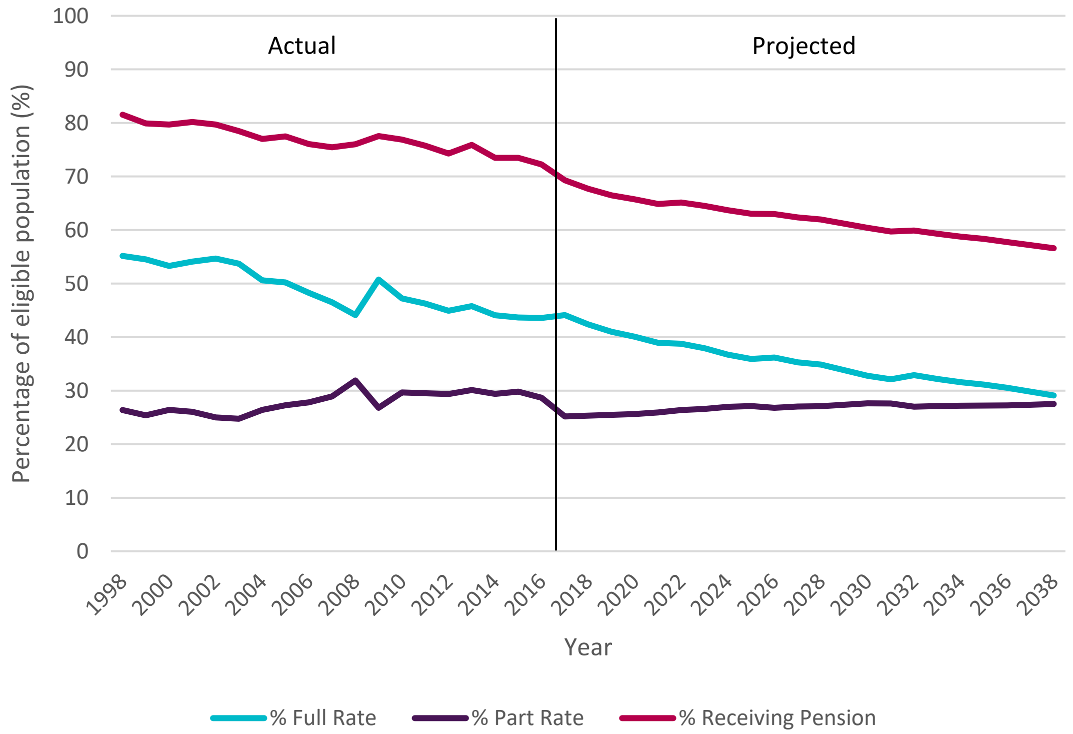
[27] ABS document 6238 Retirement and Retirement Intentions (2008/2009 and 2016/2017)

17. *What are the implications of a maturing SG system for those who are not covered by Compulsory Superannuation?*

Successful self-employed persons will build wealth in savings and in their business. Many will invest in property which will become their de-facto retirement savings. However, not all self-employed persons are successful in building assets and many will have little wealth at retirement.

Many of those outside the SG system will not save voluntarily and they will be dependent on the Age Pension for their retirement income. Trends show that the numbers of Australians eligible for a full Age Pension has been declining and will continue to decline in future. This is positive and indicates that the current system is working but the number of poorer Australians at retirement is still too high.

Graph 1. Proportion of the eligible population receiving the Age Pension



6. Sustainability

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

The key measure is whether taxpayers and members receive good value. Broadly, this appears to be the case. However, in this submission we have pointed out areas for improvement.

For example, the means-testing on the Age Pension is complex, invasive and inequitable:

- The taper rate is punitive for many members making additional contributions particularly those with middle incomes. The impact of this has been worsened by further reductions in market interest rates.
- Retirees do not understand *deeming*.
- We have a dual test on assets and on income.
- The asset test excludes the family home irrespective of its value.
- Higher asset test thresholds for those without homes often do not fully deliver on their headline impact, due to deemed income from financial assets causing the asset test to be over-ridden by the income test.

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?

Age Pension expenditure (funded through taxation), tax concessions and contribution caps all impact on the current year's Budget and forward estimates.

The current year's Age Pension expenditure is a function of past savings patterns and should not be added to tax concessions to show the 'cost of the system'. Rather, concessions today should be considered against the cost of future Age Pension expenditure for the current generation.

Cohort analysis is required in order to compare current concessions against future expenditures

Contribution caps should allow people to accumulate an adequate retirement balance and generate an adequate retirement income but should not support the accumulation of excessive balances.

19.1 Which elements of the system have the greatest impact on its long-term sustainability?

The major elements are:

- The level of the SG.
- The level of the Age Pension.
- Eligibility for the Age Pension.
- The cost of the Age Pension as a % of GDP.
- Tax concessions to encourage savings (and their cost as a % of GDP).

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

Confidence appears to be low due to continual negative media coverage of superannuation.

Confidence has also been sapped by the regular and ongoing tinkering with the system which is often presented as fixing problems rather than improving the overall benefits.

Confidence could be tested by assessing whether people feel that:

- Their money is safe.
- They will get a good, inflation beating, return on their money invested.
- The system is well regulated.
- There are simple systems to remediate any problems that occur.

7. Cohesion

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

The three Pillars of the retirement income system are well integrated, but there are anomalies which can be addressed by:

- Ensuring the Age Pension (and supplementary payments such as rental assistance) is set at a high enough rate to avert poverty amongst retirees.
- The taper rate on the means-test is set at a rate which allows members to make additional savings without losing too much of their added benefit.
- The lack of a default retirement product and the absence of longevity products means many members do not make optimal decisions about investment drawdown strategies.

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

A difficult question to answer given the range of outcomes for individuals in similar financial positions.

The tax concessions do attract contributions in excess of the mandated SG, so many Australians see the value in deferring consumption by saving for retirement.

The annual caps on contributions can disincentivise investments by some older Australians seeking to *catch-up* their superannuation in the lead up to retirement.

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

There has been commentary suggesting (anecdotally) that savings are being directed to the family home rather than financial assets in order to maximum assets whilst minimising the impact of the assets test. Most comprehensive financial plans addressing retirement funding seek to optimise the mix between the social security system (Age Pension and Medical Benefits) and personal savings (superannuation and private wealth).

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?

We are not aware of any such evidence.

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

We are not aware of any such evidence. However, we note the large cohort of people in SMSFs who have built wealth without using formal financial advice.

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

The Age Pension and superannuation system are tightly integrated because of the means tests. The complexity of the means tests causes confusion and the tapering of the Age Pension because of asset and income levels causes anomalies for those with middle incomes.