Savers Hardest Hit by Means Test Rules: Actuaries Institute

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A large portion of Australia's middle-income earners are encouraged to spend their retirement nest egg or lose access to more disposable income from the Age Pension as the current means test rules are adversely applied to their assets.

In a Dialogue paper* prepared for the Actuaries Institute, Andrew Boal states that a 'taper trap' encourages some retirees to spend their savings quickly, and risk living on the Age Pension alone. Mr Boal is a member of the Actuaries Institute's Public Policy Council Committee and was previously Chair of the Institute's Retirement Strategy Group. He is chief executive at actuarial firm Rice Warner.

The taper rate is applied as part of Australia's asset test. However, without suitable retirement income products that provide protection against longevity risk, if retirees do spend their savings quickly, they risk running out of money.

In the Dialogue paper, *Spending in Retirement*, Mr Boal also says all Australians, but especially a 'middle group' of Australians with between $300,000 and $800,000 in retirement savings, need:

- encouragement to acquire longevity protection to give them confidence to spend more in retirement, to live a better life;
- a more equitable taper rate that does not unduly encourage retirees to spend their savings too quickly; and
- low cost access to financial information and advice to help them make better decisions because the retirement landscape is complex, and the average retiree is unable to navigate good outcomes.

The taper rate acts to restrict a retiree's access to Age Pension payments based on the level of their assets through retirement.

Prior to 2017, the taper rate was set at $39. But from 1 January 2017, a retiree's annual pension was cut by $78 for every $1000 of assets held above the relevant thresholds.

The Dialogue paper states that "a higher taper rate does encourage retirees to spend their savings as quickly as possible until they become eligible for the full Age Pension". It says few do, but the retirement system as a whole, including perverse outcomes driven by elements of the asset test, needs review.

"Given the interconnectedness of the system, it is important that all the relevant levers are considered in conjunction with each other, including how it impacts on the efficiency and effectiveness of any other changes, such as increasing the superannuation guarantee to 12%," the paper states. The federal Government is currently conducting a Retirement Income Review, with findings due to be delivered by mid-year.

The *Spending in Retirement* paper states that while Australia has one of the best retirement systems in the world for accumulating retirement savings, "we continue to struggle with how to design an efficient retirement spending system". Part of this is attributable to a lack of clear purpose around what Australia's retirement system is trying to achieve, the paper states.

"While the system needs to be affordable and fair, it also needs to help Australians spend their money in retirement," it says. Retirement income policies should be guided by:

- sustainability, including a long-term regulatory outlook focused on providing retirees with a reliable, secure and adequate income flow during retirement;
- flexibility to allow choice;

- equity, including intergenerational fairness;
- efficiency, so that the cost to taxpayers meets the core objective of providing adequate retirement incomes;
- simplicity so that retirees can optimise their position without expensive financial advice; and
- regulation that allows competition and innovation within a framework that also acknowledges the cost of compliance.

While the current system is relatively immature, over the next 20 years more than 60% of superannuation balances at retirement will reach $250,000 or more, and over the next 40 years around 40% will hit $500,000 in today's dollars.

If a retiree has less than $300,000, they will be entitled to a full Age Pension for most, if not all, of their retirement, which becomes their main source of income. If a retiree has more than $800,000 saved, and also own a home, they are less likely to be eligible for any Age Pension.

But for those caught in the middle, they are likely to be eligible for a part Age Pension for a substantial portion of their retirement and thus be subjected to the means tests. With the taper rates now more than double what they were in 2017, as the super system matures and balances grow, more retirees are expected to lose more of the Age Pension.

Some middle-income retirees will find they are caught in a 'taper rate trap'. "If the retiree draws down and spends the minimum amount each year, the annual taper rate would need to be close to $39 for the retiree to receive total additional retirement payments higher than the accumulated reduction in the person's net take home pay," the paper states.

With the taper rate at $78, the retiree could be as much as $40,000 worse off. In other words, the more they save, the worse off they are.

As balances grow, it becomes even more important for retirees to understand how to maximise their superannuation to improve retirement outcomes, spend appropriate amounts to ensure a good standard of living and safely draw down while being mindful of longevity risks.

The Dialogue also states that there's greater scope for the development of newer deferred lifetime annuity style products. It says middle-income earners would benefit from encouragement to acquire longevity protection so they can spend with confidence, a fairer taper rate, and low-cost access to financial information, guidance and advice.

A copy of the paper is available here. Andrew Boal is available for interview.

For media inquiries please contact:

Michelle Innis P&L Corporate Communications
m +61(0) 414 999 693
p +61(0) 2 9231 5411

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Institute of Actuaries of Australia
Level 2, 50 Carrington Street, SYDNEY NSW 2000
t +61 (0) 2 9239 6100 **f** +61 (0) 2 9339 6170
actuaries@actuaries.asn.au I www.actuaries.asn.au