Actuaries Institute

PUBLIC POLICY STATEMENT

Securing Adequate Retirement Incomes for an Ageing Australia

– SUPPORTING STATEMENT

AUGUST 2021

The Actuaries Institute acknowledges the traditional custodians of the lands and waters where we live and work, travel and trade. We pay our respect to the members of those communities, Elders past and present, and recognise and celebrate their continuing custodianship and culture.

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About the Actuaries Institute

As the sole professional body for Members in Australia and overseas, the Actuaries Institute represents the interests of the profession to government, business and the community. Actuaries assess risks through long-term analyses, modelling and scenario planning across a wide range of business problems. This unrivalled expertise enables the profession to comment on a range of business-related issues including enterprise risk management and prudential regulation, retirement income policy, finance and investment, general insurance, life insurance and health financing.

Our public policy principles can be viewed at: https://actuaries.asn.au/public-policy-and-media/public-policy/policyprinciples.

PUBLIC POLICY STATEMENT

Securing Adequate Retirement Incomes for an Ageing Australia – SUPPORTING STATEMENT

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Securing Adequate Retirement Incomes for an Ageing Australia – SUPPORTING STATEMENT

1. Context

Having a robust and effective retirement income system is crucial for the wellbeing of retirees. While the current system is sound and broadly sustainable, it is widely recognised there is scope for reform to improve retiree outcomes[1].

This Supporting Statement provides additional information relevant to the public policy positions outlined in 'Securing Adequate Retirement Incomes for an Ageing Australia: Public Policy Statement' by the Actuaries Institute ('the Institute').

2. Background

2.1 Retirement income system

2.1.1 Australia's retirement incomes system is based on three pillars:

A. A publicly funded, non-contributory, means-tested Age Pension with various supplements. It currently provides retirement income for 71% of those aged 65 and over.

B. Individual accumulation-based superannuation which is compulsory for all employees, who make up 83% of the total work force. Superannuation Guarantee (SG) contributions are mainly paid into default or member chosen accumulation-based superannuation accounts, which puts investment, longevity, inflation and other risks into the individual's hands.

C. Voluntary savings, including into superannuation, assets generated by the businesses of the self-employed and other assets of which homes and investment properties are significant.

2.1.2 The three pillars mean that individuals are required to make complex choices as to how much to save and consume, and how to invest.

2.1.3 How the current operation of the Age Pension, and especially how the current means tests regime interacts with the other two pillars, adds to complexity. It is difficult for individuals to optimise their savings and consumption without appropriate advice. As a result, retirement incomes for many Australians are sub-optimal.

2.1.4 Common concerns include inadequate contributions during working lives, insufficient investment returns, a reluctance to spend in retirement because of uncertainty and people exhausting accumulated superannuation at ages before they are entitled to the Age Pension or exhausting their accumulated superannuation by living longer than expected.

1 For example, the *Final Report of the Retirement Income Review, 2020* (key observation 1, p.17) and *Options for an Improved and Integrated System of Retirement*, Actuaries Institute Green Paper, 2019.

2.2 Retirement Income Review

2.2.1 In 2020, the Government instigated the Retirement Income Review (RIR). The terms of reference emphasise that:

"It is important that the system allows Australians to achieve adequate retirement incomes, is fiscally sustainable and provides appropriate incentives for self provision in retirement."

2.2.2 The review covered the current state of the system and how it will perform in the future as Australians live longer and the population ages. The final report of the RIR was dated 24 July 2020.

2.2.3 A key observation from the RIR was that the Australian retirement income system is effective, sound and broadly sustainable, but it can be improved.

2.2.4 The RIR highlighted the need to consider the various policy 'levers' available and how they relate to each other. Levers include the SG level and its coverage, the Age Pension and associated means tests, various tax concessions and incentives and the guidance and advice that is given to members of superannuation funds in planning for their retirement.

2.3 Life expectancy

2.3.1 Life expectancies in Australia continue to increase. Statistics from the latest Australian Life Tables 2015-17 produced by the Australian Government Actuary, including expected future improvements in mortality, indicate that life expectancy at age 65 for men is now 87.5 years and for women is 89.5 years[2]. On average, these retirees may expect about 23-25 years in retirement, or if they are part of a couple, around 29 years in retirement until the last person passes away.

2.3.2 There also continues to be wide variations in the range of actual lifespans i.e., people die at different ages rather than at their life expectancy (idiosyncratic mortality risk). This has implications for policy makers in relation to equity in the retirement income system and the safety nets that may be required.

2.3.3 The RIR identified considerations for policy makers in respect to life expectancies, with three key considerations being:

- Improvements in life expectancy mean people will spend more time in retirement if working lives are not similarly extended, and so retirement incomes need to last longer;

- Longevity risk protection is important as it allows people to confidently draw down assets to fund their retirement. Without longevity protection, retirees may adopt sub-optimal strategies to allay concerns about running out of savings; and

- There are significant differences in life expectancy across different cohorts. Mortality rates of retirees can vary by age, sex, health and lifestyle, income and asset levels, marital status, location etc. Indigenous Australians including Torres Strait Islander people also have a lower life expectancy than the rest of the population.

2 2015-17 ALT with 25-year improvement factors calculated at 1 January 2021 for a person aged 65.

3. Policy Principles

3.1 Overall

3.1.1 Various policy principles or metrics have been put forward at different times, with the RIR grouping its recommendations around adequacy, sustainability, equity and cohesion.

3.1.2 **The Institute proposes that the underlying objective should be that the retirement income system allows Australians to live with dignity in retirement. This requires them to be able to interact with each element of the system with dignity, and for the system as a whole, to provide them with an adequate income.**

3.1.3 The three principles suggested by the Institute to meet the objective are financial security, efficiency and equity, each of which will need to be evaluated on an ongoing basis. Further, the Institute believes that any proposed changes to the retirement income system should be periodically assessed against these principles.

3.2 Financial Security

3.2.1 Financial security requires a standard of living income that is reliable, secure and adequate to live with dignity in retirement, taking into account: basic needs, the overall standard of living of the community and the individual's preferred retirement lifestyle.

3.2.2 It also requires that people should understand the risks that they face and be in a position to address these with some confidence. Confidence implies that the system should be fiscally sustainable in the long-term.

3.3 Efficiency

3.3.1 This requires that the cost to taxpayers is efficiently meeting the core objective of the retirement income system which in turn requires that individuals use their savings efficiently during retirement and there is cohesive interaction between the various elements of the system to eliminate wasted effort and perverse incentives.

3.4 Equity

3.4.1 Horizontal equity requires that there is no unfair discrimination between people in a similar circumstance.

3.4.2 Vertical equity requires that differences in treatment are proportional to differences in circumstances. This includes intergenerational equity and equity between socio-economic or health groups.

4. Policy Positions

Drawing on the principles outlined in section 3, the Institute supports the following policy positions to improve the retirement income system.

4.1 The retirement income system requires a clear objective *(Policy Position 1)*

4.1.1 To further improve our system **the Institute recommends a clear objective be legislated for the retirement income system as a whole, as well as for each pillar and that there be principles for their integration.** This is needed to guide policy, improve understanding and provide a framework for assessing performance of the system.

4.1.2 **We suggest an objective be developed that provides for retirees to have reliable, secure and adequate income to live with dignity in retirement, consistent with the Policy Principles set out in section 3 of this paper.**

4.1.3 It is important to measure how the system is achieving its objective. To do so, the Government will need to set minimum standards for all Australians to live with dignity, and that Age Pension, aged care and health benefits are set at a level that makes this possible.

4.2 Simplify the retirement income system, including the current means testing protocols, so it easier for individuals to understand and engage with *(Policy Position 2)*

4.2.1 The RIR noted that whilst the pillars of the Age Pension, compulsory superannuation and voluntary savings should be better integrated, the current complexity prevents many retirees from optimising their living standards in retirement. Retirees need more guidance and advice to improve their understanding and achieve better financial and lifestyle outcomes. However, the RIR did not suggest how to simplify the system or provide the necessary guidance.

4.2.2 The current means testing protocols are complex, not readily understood and, as a result, create uncertainty for retirees.

4.2.3 One alternative would be to investigate the possibility of a universal pension which would provide protection against longevity risk as well as simplify the retirement income system. However, the funding of a universal pension would require an overhaul of the taxation system and an increase in taxation (assuming the universal pension is at a meaningful level). Another alternative would be to combine the asset and income tests by converting assets into an income stream using life expectancy and reasonable investment returns – as suggested in the RIR. This would focus retirees on the drawdown of their capital and make it easier to plan for a level standard of living in retirement.

4.2.4 The lack of cohesion between the three pillars as well as the aged care system is partly the result of them being separately overseen by different government departments (Social Services, Treasury and Health). Co-ordination could be facilitated by legislation that sets out the objectives of each element of the retirement system and the principles for integration between them. A more flexible approach would be to ensure coordination of policy development by setting up an inter-agency group to make recommendations to Government. It should have a wide remit to address structural issues as well as changes in parameters.

4.2.5 This body should include representation from the departments of Treasury, Social Services, Health and Veterans' Affairs. It should simplify the existing system and oversee changes. A model for this is the streamlined cross agency process for seeking initial 'concept exploration' or 'product review' for innovative income streams from all four relevant agencies (the Australian Taxation Office (ATO), Australian Prudential Regulation Authority (APRA), Australian Securities and Investments Commission (ASIC) and Department of Social Security (DSS)).[3]

4.2.6 In summary, the Actuaries Institute believes that the retirement income system should be made easier for individuals, with a focus on:

- **Simplifying the means testing of the Age Pension** to remove a major source of complexity for many retirees which, in turn, creates uncertainty and conservatism. However, while as noted above, the complete removal of means testing through a universal pension would require significant changes to the taxation system, there is still scope to simplify the means testing structure as well as reduce the frequency at which the assessment occurs. It is noted that while this may reduce equity in the system as well as increase access to at least some portion of the Age Pension, the increase in certainty will, over the long term, allow retirees to utilise their superannuation assets more efficiently; and

- **Improving the interaction between the retirement income and aged care systems.** For example, the introduction of similar means tests for Government support for the Age Pension and the aged care system.

4.3 Promote the efficient use of superannuation savings *(Policy Position 3)*

4.3.1 Superannuation savings are supported by tax concessions for the purpose of retirement income and not purely for wealth accumulation or intergenerational wealth transfer. Yet both the RIR and many other empirical studies find that these savings are not always efficiently used to support retirement income. Most retirees are drawing down their superannuation at the legislated minimum rates, leaving a considerable portion of the overall wealth they had at retirement as an unintended bequest.[4]

4.3.2 The Institute believes there is room to improve the current system so that it more efficiently provides retirement income to Australian retirees for the rest of their and their partner's lives, in order to achieve the objective of providing all Australians with dignity in retirement.

4.3.3 This could be achieved by Government policies that address both the supply side challenges (i.e., product and service providers) and the demand side issues (i.e., retirees' decision making and the guidance and advice they receive).

3 *https://www.ato.gov.au/Super/APRA-regulated-funds/In-detail/APRA-resources/Cross-agency-process-for-innovative-retirement-income-stream-products/*

4 Reeson, A. et al., 2016. Superannuation Drawdown Behaviour: An Analysis of Longitudinal Data. Jassa, Issue 2, pp. 42-53; Asher, A., Meyricke, R., Thorp, S. & Wu, S., 2017. Age Pensioner Decumulation: Responses to Incentives, Uncertainty and Family Need. Australian Journal of Management, 42(4), pp. 583-607; and Daley, J. et al., 2018. Money in retirement: More than enough, s.l.: Grattan Institute.

4.4 Introduce a Retirement Income Covenant *(Policy Position 4)*

4.4.1 **The Institute supports the introduction of a Retirement Income Covenant**[5].

4.4.2 Superannuation funds should be required to have an appropriately designed retirement strategy and make available to their retiring members a variety of retirement solutions appropriate to their circumstances. To meet the diverse needs of retirees, the solutions can be mass-customised and be different for different cohorts/segments of retirees. For some cohorts/segments, the solution should include components that provide longevity protection.

4.4.3 Where relevant, automated information should be made available to members along with an approved set of retirement product building blocks that can provide some level of security and predictability of retirement income.

4.4.4 A 'Heatmap' on retirement products can also be provided by regulators such as APRA.

4.5 Encourage continued innovation in developing retirement income stream products *(Policy Position 5)*

4.5.1 Australia still does not have a well-developed market for products that provide lifetime income streams, despite several recent attempts by product providers to address various reasons for the low demand and steps in the past few years to remove many legislative barriers discouraging uptake of these products.

4.5.2 **The Institute supports measures that encourage uptake of lifetime income streams, as well as continued innovation and development of lifetime retirement income stream products, including lifetime annuities. Adoption of the Design & Distribution Obligations (DDO) will assist and act as a mechanism to ensure the products developed are fit for purpose for their target market.**

4.5.3 The following actions would support this policy position objective:

- Assisting retirement income stream product providers by issuance of longer dated government (and corporate) bonds, including inflation linked bonds;
- Showing retirement income projections on superannuation benefit statements, with clear warnings about investment and longevity risks (see Policy Position 8 below); and
- Developing innovative tools to help retirees plan their retirement funding needs (see Policy Position 7 below).

4.6 Incentivise people who can afford to protect themselves to choose to receive their retirement benefits at least partly as a lifetime income stream *(Policy Position 6)*

4.6.1 On the demand side, **the Government should consider providing greater incentives for retirement benefits to be used to provide a lifetime income stream.**

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5 As noted in Treasury's 19 July 2021 *Position Paper*, "The covenant is a key stage of the Government's retirement income framework. The covenant will codify the requirements and obligations for superannuation trustees to improve retirement outcomes for individuals … Existing covenants in the Superannuation Industry (Supervision) Act 1993 include obligations to formulate, review regularly and give effect to investment, risk management and insurance strategies. The Government intends to introduce a retirement income covenant in the Superannuation Industry (Supervision) Act 1993 outlining a fundamental obligation of trustees to formulate, review regularly and give effect to a retirement income strategy."

4.6.2 In particular, those retirees who can afford to protect themselves against their own longevity should be incentivised to do so. Similarly, disincentives should be considered for people who take part or all of their superannuation as a lump sum.

4.6.3 These policies may include:

- Creation of financial incentives for a proportion of the individual's superannuation assets to be in a product(s) that provides a lifetime income stream (e.g. a form of lifetime annuity, pension or other form of pooled longevity protection). The change to the Age Pension means test rules in July 2019 to support lifetime income streams is a recent example. The Government could make this a requirement for individuals with superannuation assets above a threshold amount based on the rationale that, for a retiree on or above Average Weekly Earnings, a significant proportion of their superannuation balance at retirement would have been generated from tax concessions.

- Introduce disincentives for individuals (again, above a threshold) to take a large proportion of these assets as a lump sum or leave them as a bequest. For example, where an individual takes a lump sum above a threshold amount, part (or all) of the tax concessionary component of that lump sum could be refunded to Government.

4.6.4 Consideration could be given to a phase-in period for any changes of this type. The Hayne Royal Commission pointed out that grandfathering previous concessions is a significant source of system complexity, but it can be unfair to those who have made decisions based on an earlier set of rules.

4.6.5 Equity issues should also be considered in the pricing of lifetime income streams to allow for underwriting factors such as health and socio-economic status that materially influence an individual's life expectancy. The development of Enhanced Lifetime (for those in sub-standard health etc) products should be encouraged, which would provide equity between pensioners with different health and socio-economic status as well as between pensioners and the product manufacturer. (Note – This is part of Policy Position 13.)

4.7 Support policies and innovations that allow retirees and pre-retirees to receive appropriate guidance on retirement matters *(Policy Position 7)*

4.7.1 Financial decisions on retirement matters are critical and can have substantial, sometimes irreversible, and long-term impacts on an individual's lifestyle in retirement. The retirement problem is very complex yet financial literacy among the general population is low, leading to a lack of understanding of the system. For example, the RIR highlighted that a major misunderstanding held by many retirees is that 'retirement income' involves the return from investing superannuation balances rather than drawing down those balances to fund living standards in retirement. Guidance, in one form or another, on these matters should be highly valued.

4.7.2 **The Institute supports policies and innovations that make financial guidance on retirement more accessible and affordable, in one form or another, to the broader population.**

4.7.3 **The Institute believes that superannuation funds are well placed to, and should be required to, provide some form of guidance to all their members approaching retirement.**

4.7.4 The cost of simple guidance, particularly intra-fund advice, can be financed through spreading the cost across all fund members, although more complex advice may need to be charged to members who require it.

4.7.5 Guidance can be in various forms. It can range from the simple default/opt-out arrangement that requires a minimum level of engagement and personal information, to accessing comprehensive financial advice that involves face-to-face discussion on all matters, both financial and non-financial, related to retirement.

4.7.6 Currently, most retirees are defaulted into the account-based pension, with little guidance provided on how much they could afford to spend and how they should invest. Comprehensive personal advice is mostly taken up by those with larger account balances and who are able to afford to pay for such advice (the costs can be a few thousand dollars).

4.7.7 Retirees who are reluctant to pay for comprehensive personal advice may be more in need of guidance. These retirees may choose sub-optimal retirement strategies, such as taking money out of the superannuation system or spending too much or too little of their benefits.

4.7.8 Given the crucial importance and strong need for advice and guidance on retirement matters, **the Institute believes that there is significant need for those forms of guidance that sit in the middle ground. It needs to become more accessible and affordable to every retiree. The middle ground would include smart default, intra-fund advice and scaled/robo-advice that only takes into account limited personal information. Tools or calculators that take account of the Age Pension would support this and would model projected income in retirement into the future.**

4.7.9 Other related reform options include:

- Requiring all APRA regulated superannuation funds to provide their members with an annual retirement income projection. This should be done in a way that the member is encouraged to add further data about their household to improve the accuracy of their estimated Age Pension. Funds might consider including such a calculator on their website, with member data being extracted from the fund's data base; and

- Requiring all retirement income projection calculations to include allowance for the Age Pension and possible variations in longevity and investment outcomes.

- However, current ASIC regulations may present a barrier to innovations in this area. There may also be scope to reduce the cost and effort of collating the necessary information.[6] One example would be for the MyGov website to provide projections based on the ATO's details of all of a household's superannuation balances and other assets. The Australian Government Actuary could provide assumptions to facilitate these ATO projections.

4.8 Develop best practice in providing financial advice and guidance *(Policy Position 8)*

4.8.1 Assessing financial outcomes in retirement is complex. Actuaries are well placed to recommend best practice techniques for developing and assessing retirement strategies. The assessment typically requires trading off different competing retirement objectives such as flexibility, the need for higher return/income and risk management. The relative importance of each of these objectives depends on individual circumstances and can vary with time too.

6 See Anthony Asher and John De Ravin, Submission to the Senate Select Committee on Financial Technology and Regulatory Technology. *https://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Financial_Technology_and_Regulatory_Technology/FinancialRegulatoryTech/Submissions*

4.8.2 Many of the financial projection tools on the market today fail to recognise the impact of risks on retirement outcomes and only show the projected outcomes assuming fixed assumptions around investment returns, inflation and life spans.

4.8.3 **The Institute believes financial advice and guidance should consider the impact of risks including investment risk, inflation risk and longevity risk, as well as eligibility for the Age Pension and likely aged care needs and assistance.**

4.8.4 Fixed assumption forecasts for investment returns, inflation and life expectancy cannot show the impact of future uncertainty on a client's retirement outcomes. An adviser should include the use of risk-based modelling techniques, such as stochastic modelling[7], to compare different retirement strategies. Stochastic modelling allows the user to test a strategy and identify the likelihood of achieving different outcomes to answer questions like:

- 'Will I be ok if markets crash at the start of my retirement?'
- 'Can I achieve a better lifestyle than the Age Pension even if I live a really long time?'
- 'Will I be able to access a lump sum in the future if I need aged care?'

4.8.5 The goal is to ensure a retirement strategy has been stress tested for its ability to achieve a client's goals in the face of uncertain future outcomes.

4.8.6 The measure of life expectancy used in advice and adviser tools should reflect relevant, current life tables allowing for future improvements in mortality and, at a minimum, the individual's current age and gender. Advice provided for a couple should consider their joint life expectancy. It should be recognised that this is an estimate of the lifespans of the average Australian, and half of all individuals will live longer, and half will live less than life expectancy.

4.8.7 When providing financial advice and guidance, different options for retirement strategies should be tested against the client's goals.

4.8.8 **The Institute recommends improvement in the capability of advice/guidance tools to recognise the survival uncertainty (with allowance for likely future improvement in mortality) as well as investment and inflation risk.** In providing financial advice and guidance, the testing of strategies should also consider the impact of a member's current health status, past work, pastimes etc. and the impact of this future uncertainty around the length of the lifespans (longevity risk).

4.9 Determine the level of the SG considering overall retirement adequacy *(Policy Position 9)*

4.9.1 The optimal level of superannuation contributions for an individual is based on their personal circumstances and goals for retirement. The provision of appropriate financial guidance and advice for all Australians at an affordable price will improve an individual's chance of achieving a reliable, secure and adequate income to be able to live with dignity in retirement.

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7 Stochastic modelling means developing a mathematical model that uses past variations in investment returns and mortality rates to generate plausible future variations.

4.9.2 A complex and difficult question which needs to be addressed is the level at which compulsory SG contributions should be set. The rate should be set at a sufficient level that provides a reasonable contribution to retirement consumption.

4.9.3 Given that a sizeable proportion of the SG is effectively taken from wages, the level should not be so high that it reduces living standards too much before retirement for many vulnerable people. People generally have the option to make additional contributions on top of the SG. There is also a cost to the Government from the tax concessions given to contributions.

4.9.4 On the other hand, the level of SG should not be so low that most Australians do not accumulate sufficient savings by their retirement, in which case they will be far more likely to be reliant on the Age Pension and to a greater extent. This is against the objective of the SG and a cost to future generations of taxpayers.

4.9.5 Some of the complex interactions that will need to be considered include the Government's overall objective for the compulsory SG system, its interaction with the Age Pension, rental assistance and other forms of welfare that support older Australians, as well as whether other assets, such as the home, could or should be used to provide some income in retirement.

4.9.6 In determining the level of adequacy sought from a compulsory SG system, consideration needs to be given to matters such as the assumptions used in relation to retirement income indexation (e.g. to keep pace with a measure of inflation or wages growth), broken work patterns, involuntary early retirements, homeownership and mortgage and other debt levels at retirement. Further, a higher rate of SG will reduce future Age Pension costs and give more income to retirees throughout the whole of retirement, including to help them deal with improving longevity and potential aged care and health needs.

4.9.7 However, the adequacy of the system is now being undermined by the relative ease for older Australians to obtain a mortgage with a long outstanding term, even though there is little chance of them being able to repay this from wage income alone. The consequence is that some lenders may be relying on superannuation balances to fund the repayments. We do not believe that this is desirable. Superannuation benefits are intended to be used for retirement living rather than to secure mortgages. Instead, lenders should take the borrowers' expected retirement age (remaining years of paid work) into account in determining the term of the loan. This recognises an important reality and should not be confused with unfair discrimination on grounds of age. An exception might be made for non-homeowners, where the purchase of a house may increase retirement security.

4.9.8 **The Institute suggests the Government considers these complex interactions when setting the ultimate SG level and seeks community support for a pathway to the desired level. The most appropriate superannuation contribution rate for most Australians to live in dignity in retirement is likely to be in the range of 10%-12% of salary (based on the current Age Pension levels and means testing rules)**.

4.10 Support preservation of superannuation savings *(Policy Position 10)*

4.10.1 While the Institute supports the use of superannuation to assist members in financial hardship, it should be recognised that the role of superannuation in supporting the retirement income system is undermined by the use of superannuation savings prior to retirement.

4.10.2 However, it is also recognised that many individuals retire, often involuntarily, before they are eligible for the Age Pension and this access before retirement age is necessary to support them financially.

4.10.3 The Institute supports retention of the existing preservation rules allowing access to superannuation from age 60 for those who permanently retire from the workforce.

4.10.4 While this means some individuals will exhaust their accumulated superannuation prior to eligibility for the Age Pension, this access, combined with other welfare payments, allows some early retirees to live with dignity in their early years of retirement before the Age Pension commences.

4.10.5 Special consideration should also be given to Indigenous Australians including Torres Strait Islander people whose life expectancies at age 60 is about 4-5 years lower than the average Australian[8], to allow them access to at least a proportion of their superannuation savings earlier than age 60. This is consistent with the special consideration given to this group in the Government's aged care policy. While this does not address the issue of lower life expectancy, it reflects the fact that they may need to fund their retirement earlier.

4.11 Support policies that remove disincentives for older Australians to work longer where possible *(Policy Position 11)*

4.11.1 Older Australians who continue to work up to and beyond the current Age Pension eligibility age of 67 continue to accumulate superannuation savings as well as reduce the cost of the Government supporting them through a Government funded pension.

4.11.2 However, the current means testing results in some Australians who continue to work after the Age Pension eligibility age being no better off financially than if they did not. Furthermore, some Australians may be financially better off in the long term by retiring and accessing their superannuation before age 67 and then relying on the Age Pension in later years. While we support retention of the existing preservation rules allowing access to superannuation from age 60, for those who choose to permanently retire from the workforce we also support holistic consideration of superannuation, welfare payments and other policy settings in the years prior to the Age Pension eligibility age, to remove barriers for Australians wishing to work longer.

4.11.3 The Institute supports Age Pension reform to remove these disincentives for older Australians to work beyond the Age Pension eligibility age.

4.11.4 One option is to reintroduce the Pension Bonus Scheme or a similar type of scheme. The Pension Bonus Scheme existed from 1998 to 2014 as a means to provide flexibility to older Australians who wanted to work longer and defer taking the full Age Pension. Such a scheme could operate so that if a person who is eligible for the Age Pension keeps working for a limited (or unlimited) deferral period after the Age Pension eligibility age, their Age Pension entitlement increases or they are financially rewarded in some other appropriate and equitable way.

4.12 Create greater flexibility for the role of the family home in retirement income provision *(Policy Position 12)*

4.12.1 There is a declining rate of outright home ownership at retirement as well as a corresponding increase in retirees retiring with a mortgage: "In 2003–04, 79% older people owned their homes without a mortgage; this had declined to 76% in 2015–16".[9]

8 Retirement Income Review, p.338.

9 Australian Institute of Health and Welfare (2018). Older Australia at a glance, Employment & economic participation.

4.12.2 The Institute acknowledges that the home provides significant financial and emotional benefits to retirees. It also often provides a significant bequest – which should reduce the desire to leave superannuation as a bequest.

4.12.3 The Institute supports measures which allow retirees to keep their home but access the equity to boost retirement incomes effectively.[10]

4.12.4 There are a range of ways to access equity in the home in retirement: Downsizing is relatively safe, but stamp duty is an impediment that can erode the capital released, and the means tests may well reduce the value of the Age Pension. A standard reverse mortgage will include a no negative equity guarantee which means that the owner cannot be forced to sell their home, but the interest rates are consequently higher, and may erode equity in the property when the owners need to downsize to move into aged care. Various equity sharing schemes can cap the loss of equity but have had even less commercial success than standard reverse mortgages.

4.12.5 A number of risks and considerations need careful thought before a retiree uses their home for retirement income.

- Equity release can be in the form of a lump sum payment, or an income that is drawn until the individual reaches an age-based limit (like the Government's Pension Loans Scheme).
- Equity release measures that also protect against longevity risk are preferred e.g., used to buy a lifetime income stream that continues for life rather than a lump sum of income that can run out.
- The Government should reconsider the position where money released from home equity may be adversely treated under means testing when it is the form of a lump sum or is spent on an asset that is assessable by Centrelink. (Under current rules the home is exempt from means testing.)
- Equity release models and advice tools must allow for market risk (home values and interest rates), inflation risk as well as longevity risk.
- Entering into a contract arrangement for older Australians will become problematic given issues in relation to dementia, as well as physical and emotional vulnerability in later life. The rate of dementia in older Australians rises from 19% at age 85 to 29% from age 95.[11] This increases the need to address and plan for access to home equity early by obtaining appropriate advice both before and after retirement age.

4.13 Address equity issues in retirement income *(Policy Position 13)*

4.13.1 While the above reforms will improve equity within the retirement income system, more should be done for specific known areas of concern. Some groups are more adversely affected than others by aspects of the design of the system, such as renters, women, carers and those not covered by the SG. This leads to inequitable retirement outcomes. To improve equity in the provision of retirement income, these gaps need to be addressed.

10 Options for an Improved and Integrated System of Retirement, Actuaries Institute Green Paper, 2019 *https://actuaries.asn.au/Library/Opinion/2019/RETIREMENTINCOMESGREENPAPERFINALWEB.pdf.*

11 Australian Bureau of Statistics (2020). Dementia in Australia. Available at: *https://www.abs.gov.au/articles/dementia-australia.*

4.13.2 The home is the most important component of voluntary savings and is an important factor influencing retirement outcomes and how people feel about retirement. There is a large gap in the retirement outcomes between homeowners and renters. Part of this is attributable to the fact that the system favours homeowners, such as through the exemption of the principal residence from the Age Pension assets test.

4.13.3 However, the Institute is also cognisant of the issues posed by the large variations in home values between regional and urban Australia and also between cities. It is also cognisant of the issues that arise due to home values varying significantly through economic cycles and/or across postcodes or locations in Australia. Limiting access to the Age Pension in these circumstances may result in financial hardship.

4.13.4 **Subject to resolution of the issues posed by the significant variations in home values across Australia, the Institute believes that part of the value of the home above a threshold (which might be indexed) should be included in the Age Pension means test.**

4.13.5 Due to the high housing costs, a significant number of older Australians who are renting in the private market need additional assistance. While the RIR concluded that increasing the rate of Commonwealth Rent Assistance will not be sufficient to significantly reduce income poverty among retiree renters, it only modelled a 40% increase constrained by a fiscal feasibility consideration. If a retiree's principal residence was part of the Age Pension assets test, there may be more headroom for the potential increase in the rate of Commonwealth Rent Assistance.

4.13.6 **The Institute supports significantly increasing the rate of Commonwealth Rent Assistance or any alternative approaches that aim to improve the retirement outcomes of retiree renters.**

4.13.7 The RIR finds that women are currently retiring with over 40% less in their superannuation balance than their male counterparts due to the effect of breaks in employment, the prevalence of part-time and casual work and the effect of the gender pay gap for this cohort. As more women and men take on carer responsibilities for children as well as their aged parents, the lack of SG support will again contribute to inadequate retirement incomes.

4.13.8 The rise of the 'gig' economy means that workers do not automatically participate in the superannuation system through employer SG. While the introduction of Notice of Intent to claim contributions will assist this, it is likely that workers will not reach retirement with adequate retirement savings.

4.13.9 To address these issues, the Institute supports the following changes discussed in the RIR:

- **Include 'gig' workers and other self-employed workers in the SG system for equity reasons and in order to reduce Age Pension costs;**
- **Pay the SG on employer paid parental leave and the Government's Parental Leave Pay;**
- **Ensure that superannuation balances are considered appropriately in property settlements in a divorce;**
- **Extend the SG earnings base to include overtime; and**
- **Ensure people receive the SG they are entitled to, such as by paying the SG at the same time as wages and better enforcing sham contracting laws.**

4.13.10 Equity issues should also be considered in the pricing of lifetime income streams to allow for underwriting factors such as health and socio-economic status that materially influence an individual's life expectancy (as noted in paragraph 4.6.5).

5. Contact

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