Public Policy Positions on Retirement Incomes
November 2014

Securing Adequate Retirement Incomes for an Ageing Australia

Background

Australia's retirement incomes system is primarily based on:

- Individual accumulation based superannuation, including compulsory Superannuation Guarantee (SG) contributions and additional voluntary contributions, and also partially publically funded through the provision of tax concessions and incentives; and
- A publicly funded, means tested Age Pension.

Accumulation based superannuation puts *inflation, investment, longevity, expense and other risks* into the individual's hands. However, there is real risk that the Age Pension and an individual's superannuation savings combined may not be sufficient to provide an adequate retirement income (as defined by each individual or couple), due to a combination of factors including inadequate contributions during working lives, insufficient investment returns, a reluctance to spend because of the uncertainty about how long they will live, or because people outlive their accumulated superannuation.

Life expectancies are increasing. Statistics from the latest Australian Life Tables 2005-07 produced by the Australian Government Actuary indicate that life expectancy at birth for men had risen to 79.2 years and for women to 83.7 years (an increase of 24.0 and 24.9 years respectively since 1901–10). If mortality improvements continue at their recent rate, men aged 60 in 2050 are projected to live an average of 5.8 years longer than those aged 60 in 2010, and women an average of 4.8 years longer.

The number of people eligible for the Age Pension (assuming the commencement age remains unchanged at age 67 from 2023 – note, the 2014 Federal Budget announced further increases to age 70 from 2035) is projected to increase by around 150 per cent from 2010 to 2049–50. Over that same period of time, it is expected that the proportion of retirees who are not eligible to receive any Age Pension due to the operation of the means tests will remain stable at about 20 per cent and the balance will rely on the taxpayer, at least to some extent, via a part (or full) Age Pension (Source: Intergenerational Report 2010, based on a Superannuation Guarantee (SG) level of 9% of earnings – of course, the reliance on the Age Pension will reduce as the SG increases to 12%)).

The current Age Pension system, including the operation of the means tests, is very complex and this makes it difficult for individuals to optimise their financial position in retirement without seeking advice. As a result, for many Australians their retirement incomes are less than optimal. Equity issues have also emerged over time in relation to the cost to taxpayers of providing the Age Pension and the tax concessions and incentives provided for superannuation contributions, investment income and end benefits. Questions have been raised regarding the sustainability of the system in its current form, especially when considered in conjunction with the expected increases in health and aged care costs over the next 40 years.

Issues

Specific measures are needed to address longevity issues associated with our ageing population and long-term, uncertain cash flows. The Institute supports the progressive increase in the SG level from 9% to 12% of earnings. Although this policy may have negative

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implications for some low-income Australians, who may prefer an immediate increase in disposable income, on balance such implications are outweighed by the overall public benefit of a progressive increase in the SG. Policy mechanisms, such as the low income rebate, can be used to alleviate negative implications for low income earners.

Policy Principles

In any examination of the Australian retirement income system there needs to be full and careful consideration of the various policy 'levers' available and how they relate to each other, such as the SG level, workforce participation, the Age Pension and associated means tests, and the efficiency of various tax concessions and incentives, acknowledging that living longer may require some to also work longer (including part time employment to supplement their retirement savings). The interaction with other costs of ageing such as health and aged care also need to be considered.

The Institute considers that retirement incomes policy should be guided by the following principles:

- Sustainability, including a long-term regulatory outlook focused on providing retirees with a reliable, secure and adequate income flow during retirement.
- Flexibility within regulation to reflect individuals' different retirement income needs and varying capacity to exercise choice.
- Equity, particularly in relation to the combined cost to the taxpayer of the Age Pension and various tax concessions and incentives, as well as inter-generational equity.
- Efficiency, so that the cost to taxpayers is efficiently meeting the core objective of providing adequate retirement incomes.
- Simplicity, particularly in retirement so that, to the extent possible, retirees can optimise their position without having to obtain expensive advice.
- Regulatory frameworks which support competition and do not unreasonably impede innovation, including an appropriate balance between the social objectives of regulation and the implications for industry including the cost of compliance.

In implementing any changes to the current retirement incomes system, the Institute is concerned about the retrospective impact of various public policy changes. This impact should also be considered when proposing any changes to the current system.

Policy Positions

1. Provide incentives for retirees (i.e. individuals in the draw down phase) to take their retirement benefits predominantly as an income stream

Currently there is no tax payable on lump sums drawn from superannuation funds for members aged 60 and over, although there are tax incentives for assets above a certain level to remain invested in the superannuation system in retirement. There is therefore potential for some people to draw all of their retirement savings at the earliest opportunity, spend these savings, and then fall back on the Age Pension.

Whilst there is little evidence that a material number of retirees do this, there may be a case for the Government to consider providing greater incentives for retirement assets to be used to provide an income stream, which can of course include comparative disincentives for people to take part or all of their superannuation as a lump sum. In particular, those retirees

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that can afford to should be incentivised in some way to protect themselves against their own longevity.

On the other hand, there is evidence that many retirees are reluctant to spend their retirement savings because of the fear of running out of money due to the uncertainty of how long they will live. Further, a significant proportion of superannuation assets end up as bequeaths and is not used for retirement income purposes at all.

The Actuaries Institute believes that there is room to improve the current system so that it more efficiently meets its core objective of providing retirement incomes to Australians.

Further, the Actuaries Institute believes that the draw down phase of superannuation should more closely reflect this core objective. Justification for the existing superannuation tax concessions is much stronger when there is a clear focus on providing an income in retirement.

The Government should therefore put in place policies that ensure that superannuation is used predominantly for retirement income purposes. These policies may include:

- Reintroduce maximum drawdowns and introduce disincentives for individuals with superannuation assets above a threshold amount to take a large proportion of these assets as a lump sum. For example, where an individual does take a lump sum above a threshold amount, part (or all) of the tax concessionary component of that lump sum should be refunded to Government, at least in a broad sense.

- If there is no active choice made by the retiree, there should be an approved set of intelligent default products designed to provide some level of security and predictability of retirement income (refer section 3 below for more details).

- Encouragement for a proportion of the individual's superannuation assets (again, perhaps above a threshold) to be in a product(s) that provides a lifetime income stream (e.g. a form of lifetime annuity or other form of pooled longevity protection).

There would need to be an appropriate phase-in period for any changes of this type.

2. Increase the preservation age

The Government should increase the Preservation Age gradually to (say) five years less than the Age Pension eligibility age. Based on the current phased increase in the Age Pension age, this could see the Preservation Age move to age 62 by 2023.

3. Extend the MySuper regime to include retirement solutions with "intelligent defaults" that provide retirees with secure income streams

The Government should require that all MySuper products develop an intelligent default income stream product for retirees.

In particular, if a person has satisfied defined 'retirement' criteria (e.g. has reached the Age Pension eligibility age and has not contributed to the fund for 6 months) and does not choose a specific retirement product, and they are already in a MySuper product, then they should automatically be placed into an income stream product that allows flexibility and control of capital in the younger retirement years, and then potentially provides a lifetime income in later years to supplement the Age Pension. In designing retirement income stream default products, it needs to be recognised that the retiree will need to engage with the product provider, if only to organise when the income stream will commence and where the income should be paid.

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The Government should seek feedback from the superannuation industry with regard to the most appropriate types of default income stream products. As with the MySuper initiative, the trustees of the various superannuation funds would be required to licence their default income stream products and they would be accountable to their members for the design.

4. Remove the impediments that discourage older Australians who want to work

The Institute supports Age Pension reform, including the following options:

a. Encouraging workforce participation by removing, or modifying the treatment of, 'earned income' in the means test, and simplifying the rules applied to assets for the Age Pension, so those over the Age Pension eligibility age are not penalised for working if and when they can.

b. Introducing a self-financing incentive to defer taking the Age Pension (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).

c. Link changes in the Age Pension eligibility age to improvements in life expectancy (see 6 below, including the ongoing need for a safety net for people who are unable to continue working until the Age Pension eligibility age).

Other related reform options include:

d. Requiring all APRA regulated superannuation funds to provide their members with written annual retirement income forecasts.

e. Retirement income forecasts and projection calculations should be permitted, and ultimately required, to include allowance for the Age Pension.

f. Removing unreasonable restrictions on superannuation contributions for people working after age 65.

5. Remove the legislative barriers preventing innovation in developing-retirement income stream products such as annuities

Annuities are income stream products that can be purchased to provide a pre-determined level of income either for a specified term or for life. Traditional guaranteed lifetime annuities issued by a life company (including deferred lifetime annuities) provide the greatest protection against longevity risk, and can protect against inflation risk if they are indexed. Other annuity products may have a variable level of income with longevity and/or investment risks shared between providers and retirees. Non-guaranteed mortality pooling arrangements can also be used to provide protection against longevity risk outside of a life company.

The Institute supports measures to reduce (or remove) barriers to the development of sound retirement income stream products and voluntary purchase of these products. This policy objective could be implemented by the Government taking the following actions:

a. Amending the SIS Regulations to eliminate unnecessary restrictions on product innovation in retirement income stream products.

b. Changing the tax rules and SIS requirements for deferred lifetime annuities (DLAs) such that, if taken in the drawdown phase, the product would not be subject to the minimum

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drawdown rules but would still be regarded as a pension (rather than a non-pension) and therefore exempt from tax on investment income during the deferral period.

c. Issuing longer dated Government (and corporate) bonds, including inflation linked bonds.

d. Addressing the unfavourable treatment of annuities under aged care and social security rules and making lifetime non-commutable annuities exempt from the Centrelink Assets Test.

e. Removing minimum surrender values for annuity products.

6. Link changes in the Age Pension eligibility age to improvements in life expectancy

In 2009, the Federal Government announced changes to increase the eligibility age for the Age Pension to age 67. This increase is to be phased in over six years, commencing from 1 July 2017 (note, the 2014 Federal Budget announced further increases to age 70 from 2035).

Over the longer term, the Government should consider further increasing the Age Pension eligibility age in line with increases in retiree life expectancy. This would recognise the effect of increasing longevity and improved health, and offset some of the effects of an ageing population on social security costs.

An effective way to do this would be to introduce a process by which increases in the Age Pension eligibility age will automatically be phased-in in response to future increases in retiree life expectancy, as assessed at a specified frequency by the Australian Government Actuary. However, there is an ongoing need for a safety net for people who are unable to continue working until the Age Pension eligibility age.

7. Review the efficiency of the Retirement Income System

There is room to further improve the efficacy of the system to meet its core objective of providing an adequate income to meet the financial needs of retired Australians.

Further, the Actuaries Institute believes that any examination of the Australian retirement income system should take into account not only the cost (and benefits) to the taxpayer of the Age Pension and various superannuation tax concessions and incentives, but also the interaction with other costs of ageing such as health and aged care.

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