Actuaries Institute Podcast
Title: Spending in retirement and the taper rate

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Introduction

John: Good morning, everyone and welcome to the Actuaries Institute podcast. My name is John McLenaghan and I'm head of the Institute's public policy unit. Recently we launched another thought leadership piece, a dialogue paper, called spending in retirement and the taper rate. This is a really topical issue given the forthcoming release of the government's retirement income review. I'm joined now by the dialogues author, noted superannuation actuarial consultant, Andrew Boal, the CEO of Rice Warner, and a former long-term Convenor at the Institute's Superannuation Practice Committee and its Retirement Strategy Group. Welcome, Andrew.

Andrew: Thanks John. It's good to be here.

John: Well, we're glad to have you. And this is a really interesting paper for superannuation actuaries, but also others who are interested in retirement. The taper rate, for non-retirees, what is the taper rate, what caused it and more importantly, who's likely to fall into it?

Andrew: Wow. That's a lot of ranging questions there. I think that's a good place to start though, what is the taper rate? So I've forgotten when it was exactly introduced, but I think it was around the early 1980s, but the taper rate is essentially a means of reducing access to the age pension for those that don't need it as much. And so, we get a full age pension for people who have a low amount of assets and a low income in retirement and they're therefore in greater need for income support from the government, which is ultimately the taxpayer. But for those that are more well off and need less assistance, then they gradually become less entitled to the age pension, to the point where wealthier individuals aren't entitled to the age pension at all.

I think it's a really good system in that it does keep the cost of the age pension down to a manageable level for Australian taxpayers. It's unusual, not many other countries around the world have a means testing system like Australia, and as a result, you can see a lot of their social welfare pensions for retirement are now approaching 10% of GDP and over the next 20, 30 years, will grow beyond that and in a way, potentially become unaffordable. Whereas the Australian system with our means test system, has been able to keep the cost of the age pension to below 5%. And in fact, it's looking likely over the next 30 or 40 years, subject to no changes to the system, that it will hover between 2.5% and 3% of GDP. So that's a really good outcome that those most in need get help, but those who don't need it, don't.

John: **And was the issue deepened by government changes to superannuation in January 2017, which deepened that tapered track?**

Andrew: Yes, I think before 2017 and the taper rate has changed from time to time, but before 2017, it was set at $1.50 per fortnight or $39 per annum. So that meant that for every $1,000 of assets that a retiree has, above a threshold, they would lose $1.50 per fortnight from the age pension. But in 2017, that was doubled to $3 per fortnight or $78 per annum. And that had, especially in a period now of lower interest rates and lower investment income, you'd basically have to earn 7.8% income on your investments to offset that taper rate. Of course, you shouldn't be aiming to do that with your investment income, but that's one way some advisors have looked at it. But certainly what it has meant is that the less you spend your money at a particular rate in retirement, the taper rate may mean that you're actually worse off, which is why we call it the taper rate trap.

John: **And we know there is some people who are quite wealthy and are very unlikely to ever have recourse to the age pension and on the other hand, at the other end of the scale, there are those people whose sole income in retirement will be the age pension. So roughly where is this group of retirees that will be affected by the taper rate?**

Andrew: Yeah. It's a good question. You have a look at the retirees in 2020, and this is some information that was put out by Treasury and it looked at the proportion of retirees in 2020, or 2019 I think it was, the superannuation balances they had at the point of retirement. And in that year, about 65% of retirees had less than $250,000. In the same time, about 10% of retirees had more than $750,000. Now for me, the taper zone is in between those two, that's people who are retiring roughly between $250,000 and $750,000, I think are roughly in the taper zone. It's hard to get an exact handle on it because it is dependent upon whether a person going into retirement is a homeowner or a non-homeowner, or whether they are single or whether they're part of a couple because the means tests have different thresholds depending on those circumstances.

So for example, if you're a single person that owns your own home, then the lower threshold is $263,000. So if you have less than that, then you get the full age pension from day dot, but if you have more than $263,000 and you own your own home, then you start to lose some of your age pension. Whereas if you didn't own your own home and you have to pay rent, then that threshold is higher at $474,000. So, it's quite variable, but roughly people in that $250,000-$750,000 area in retirement, they're the people who are likely to at least, for material part of their retirement, be affected by the taper rate and the means tests.

John: **Now this may sound counterintuitive, but what that suggests to me is if you do fall within that group, then perhaps you're better off spending some of your retirement savings to get into that lower bracket.**

Andrew: There's always been some discussion about whether retirees do spend their savings more rapidly, especially at the start of retirement so that they become eligible for the full age pension. In practice, I don't think there's much evidence to show that that actually happens. I think the opposite tends to be true, that people tend to spend more conservatively and spend less than they could because they actually have a greater fear and that fear is due to longevity risk and the fear that they will live into their 90s and run out of money.

John: **So, is this problem now becoming exacerbated because of the increasing longevity of the population?**

Andrew: Absolutely. So when the age pension system was first started in 1908, at that stage, the life expectancy from birth was age 57. So less than half the population really was expected to get to retirement age of 65 and if you got there, you're really only expected to live a handful of years. And so the cost of the age pension was quite low, but of course, a lot has changed recent years, in particular, since the early 1970s, from 1908 through to early 1970s, if you reached age 65, you're expected to live around 11 years back in the early period and that had grown into about 12 or 13 years by the early 1970s. But over the last 50 years, from 1970 to now, that's increased from 12 or 13 years, to 20 years for a man and 22 years for a woman. So that's almost double for a woman. So that increased, more people are getting to retirement age and when they get there, they're now living twice as long, so that increased the cost, or potentially increases the cost, enormously.

John: **One of the measures for escaping the trap that you mentioned in your paper, is taking up longevity risk products. That's still a fairly, well apart from annuities, still a fairly immature market, sippers are advocated by the financial system inquiry, but it's been a bit of a slow road to get those products to market.**

Andrew: Yes, the first starting point for that was to have a retirement covenant. And as recently as May this year, Senator Hume announced the deferral again of the introduction of a retirement covenant. And so there's going to be further consultation about that and there is yet to be a new date set for when that will be put in place. That doesn't mean funds can't go ahead and design a sector of their own, but it does mean there could be some regulatory risks that if it doesn't meet the requirements that eventually come in, that they might have to look at it again. But I think the third lifetime annuities I've been talking about them for over a decade and I think they have a great place to play in our retirement income system, especially for people affected by the taper rate and get a part age pension.

The main issue is that people don't have the confidence to spend their money in retirement because of that fear of continuing to live into their 90s and running out of money. A deferred lifetime annuity means that you might be able to set aside 10-15% of your capital, not all of it. So, if you died, a lot of the resistance to annuities over the time has been that if I put all my money into an annuity and then died the next day, it's all gone and my kids, my beneficiaries, don't get it. Whereas here, we're talking about only 10-15%, it's set aside at the start, so if you do have an early death, the family still has full access to the other 85-90% of the money, only loses this proportion and if you do happen to live to age 90, then the income is then payable for the rest of your life, no matter how long you live.

It’s called insurance, and I think people undervalue the insurance component of an annuity. So, if people had an annuity, a deferred lifetime annuity in place, and they were confident that, once I got to age 90, I know I'll be taken care of. Then they can more confidently spend down the rest of their capital between retirement and say age 85 or age 90, whenever that deferred annuity kicks in and through that, they'll then be able to live a better lifestyle during retirement, rather than hoarding their money just in case they live too long. And in particular, they'll be able to spend more of it early in retirement, when they're actually healthy and they can enjoy it.

John: **So, is one of the answers getting better access to low cost advice so that people can understand these issues and if so, do you see trustees becoming much more involved in the provision of low-cost advice to members as they approach retirement?**

Andrew: Yeah. I mean, as you can tell from this conversation, particularly for those affected by the taper rate, it is an enormously complex area. We've gone through the Royal Commission recently and that has shone the light upon some poor practices in the advice industry and it's having a rethink about now what it's going to look like going forward. And I think there is a real appetite from the industry, as well as from the government, to have a look at how we regulate advice. There is a huge need, as you say, for the provision of what I like to call, “information, guidance and advice”. We've had this historical naming system where there was personal advice and general advice, I think that's just confusing. General advice isn't advice, so why confuse people with that? Because if you give someone general advice and they follow it, then I think that if it goes wrong, they can sue you. General advice is actually more like information, I'm providing information to help you.

We need to have a regulatory environment to help do scaled advice and intra fund advice, so single issue advice. A lot of people we're talking about, have very, very similar circumstances. They have superannuation, they have their home and anything else they own, is not much. They've got their furniture, but they don't typically have hordes of other shares or other investments or assets, if they do, they can go and seek personal advice. But if they're in this roughly generic group, then the issues are much the same and so we have to come up with a system that we can regulate reasonably, to give people information and guidance at an affordable price. And that's the key, I think, to what you were getting at, is personal advice can cost $2,000, $3,000, even $5,000. Whereas we need something where people can get some good guidance and good information for $200 or $300.

John: **I might just move on to the retirement income review because you mentioned that keyword complexity. And of course, our whole system, even though it's relatively efficient and effective, is a complex interaction between different policy leaders, such as rental assistance, pension loan scheme, means tests for the age pension, aged care, just goes on and on. Have you got any high hopes that the retirement income review will be able to join the dots of these particular issues and maybe able to help alleviate the taper trap?**

Andrew: Yeah, I think so. I hope so. When the panel first formed, they identified four principles that are proposed to assess the retirement income system in Australia and they were adequacy, equity, sustainability, which are all, I think, obvious and have been talked about for a long time, but they added a fourth, which was cohesion. And I was really pleased by that because it just goes to the point you just made, that it's how all of these things work together, that's the key issue. And having a cohesive response to the system is really, really important, so I'm hopeful that by adding that word cohesion into their key principles, that they will come up with some good, making recommendations, almost made that mistake, but have come up with good information for the government about how we can make the system more cohesive.

Some of the things you just mentioned there are terrific because retirement is not heterogeneous. I'm sorry, it is heterogeneous, it's not homogeneous like their wealth accumulation system. People, as I said before, some are homeowners some aren't, 70% go into retirement as part of the couple, 30% as singles, some get divorced around retirement. A whole lot of different situations that means their eligibility for certain welfare benefits and others, is very different from each other. And so one thing that has happened over recent years is that the rate of increase in the cost of private rental, has gone up at a far greater rate than was allowed for. And so now, if you're a single private renter in retirement, you were really in struggle street.

The worst hit in the recent years and those that are most likely to have a poor outcome in retirement, are single renters and single female renters slightly more than single male renters, but that's the cohort that we need to look after. So when you're looking at the superannuation guarantee, one approach is, well in order to fix this issue for these people who aren't getting a good retirement outcome, let's just increase the superannuation guarantee, but that's a fairly blunt instrument because that increases it for everybody, including those that don't need an increase. So maybe we should be more looking at the system more cohesively and target the outcome so that if single renters are a problem, let's find another way to boost their incomes in retirement.

John: **Thanks Andrew for that and we'll look forward to it. And for our listeners, the Retirement Strategy Group has just been reformed under Andrew's convenorship to consider the review when it arrives. So, the Institute will be taking an active part in responding to that. I can't let the moment pass without talking about COVID. It is the most important topic at the moment, both economically and socially and health-wise. What have you seen is the immediate impacts of COVID on superannuation and retirement and what do you see is the more longer-term impacts?**

Andrew: Yeah, it's interesting. I think the obvious point is that that markets, share markets fell around 30-35% straight away. There's been a strong recovery in recent months back from that. So, I think the Australian share market, for example, is down 10-11% from the start of this year over the last six months, which has never a great thing to happen. But superannuation funds, particularly the default products, are well diversified and I think for the financial year ending 30 June, that we're going to see some of the better performing funds being around 0%, so being flat lined for the year. And most of those funds, when you're looking at their objectives, they would actually expect to have a negative return about once every four or five years. So these turns of events aren't that unexpected, we typically have strong returns for a number of years and then one or two years of poor returns, so it's sort of how it's built into the system.

That of course does create sequencing risk, so that if you're approaching retirement right now, or just retired or just lost your job and are forced into retirement, and this loss of asset values is obviously going to affect those people harder than others, which means we got to come up with, as you talked about earlier, retirement income products to help retirees manage some of the risks, whether that's through some form of annuitization later in life, but also marketing strategies so that people can have enough of their savings in a cash bucket for their next year's spending, so they don't have to draw down money out of shares and other assets to meet their immediate spending needs for the next 12 months or so. And give the market's time to recover some of that value rather than selling down at low market values. I think that's the big thing that's happened right now.

The other talking point obviously is the early release scheme. So, we've seen, I think about 2.3-2.4 million people have accessed the scheme. The first tranche has been about $18 billion and 400,000-500,000 people have actually drawn all of their amounts out of super and closed their accounts down with the early release scheme. So that will have an impact, they have to start again in saving for their retirement and that's going to be an issue for a number of people. But I think at the moment, this is a fairly significant event that people have needed money to live off and I think the superannuation industry should be proud of itself for having been able to at least contribute to the needs of many people to actually just continue to pay the bills and put food on the table during this really, really difficult time for many, many people. 3.1 million people on JobKeeper, for example, they don't need the assistance just yet, but probably that will come in time, that a lot of people will need.

John: **Andrew, thanks for that. As you say, it's a critical issue. And you made a very valid point there about superannuation. Of course, actuaries are all about risk management and our super funds have been very resilient over time, we expect that they'll remain so. Recently there was some data released by APRA that shows a flattening of fees, and this is happening more in superannuation funds as consolidation continues to happen. How do you see the future of the industry? I gather you think it's reasonably bright, but will superannuation fund consolidation drive better member outcomes?**

Andrew: Well, to the first part of that question, how do I see the industry developing? I think we're already seeing enough signs that we'll end up with four or five mega industry superannuation funds. There's been enough mergers announced recently to be at least four, there may well be another mega merger somewhere down the track that makes that five. So I can certainly see a world where in 2025, five mega industry funds, plus five major retail funds and those retail funds are the ones that are currently owned by the three remaining banks, ANZ sold their wealth division across to IWOF, but the three remaining banks with Westpac, NAB and CBA, IWOF itself, and AMP, so between those five major commercial entities and the five mega industry funds, there's certainly a situation where I think in five years' time, they could account for over $2 trillion between them.

If you take into account then, another $800 billion that might still be in SMSFs, in today's dollars, the industry in five years' time, this is numbers done before the recent market drops, but we were expecting it to be about $3.2 trillion. So that really leaves only about $300-$400 billion for all the remaining players outside the top 10. So there'll be a number of niche funds that will survive, but through this trend, you're going to see a lot of pressure, downward pressure on fees. I think to start with, the fees you talked about before with the APRA numbers they released recently, I think most of the reductions there have been actually in investment fees. Over time, I think we'll start to see the operational fees fall as well, but there's a lot of focus done on reducing the investment fees and improving investment outcomes.

So that'll be good for members, but we've also talked earlier today about innovative retirement income products and developing new things to help members and advice. So whilst we might see fees fall from the normal standard operational things that we do today, I think the industry does need to spend a lot more money and time on the future of advice, information, guidance, and advice, and on the future of retirement income products, which might mean that some of those fees might not fall by as much, but it certainly means that those large funds will be in a great position to invest in future products for the betterment of our retirement.

John: **Well Andrew, unfortunately we have run out of time, but once again thank you very much for providing some of the context and detail behind your latest Dialogue. Retirement incomes remains a significant topic, and your work will no doubt help inform this important public policy debate. Listeners, we hope you have enjoyed this discussion. You can find out more about Andrew's dialogue by visiting the thought leadership section or the Actuaries Institute website, and as always, please send in your questions and comments on the show, we'd love to hear from you. I'm John McLenaghan, thank you for joining us.**