# Pursuing Adequate Retirement Incomes for All

## Policy Recommendations

CSRI Leadership Forum

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This position paper is one of three closely related papers presenting policy directions supported by the independent Committee for Sustainable Retirement Incomes that would over time improve the effectiveness and sustainability of Australia's retirement income system. The policy proposals have been developed with extensive assistance by Australia's experts, and are presented and explained with a view to building wide support amongst civil society and business leaders at the CSRI's 2016 Leadership Forum. This is intended to begin the process of gaining broader public support and to persuade our political leaders to take appropriate action. Contentious issues are also identified for further informed public debate.

This paper concerns the adequacy of the retirement incomes the system currently delivers and may deliver into the future. It first discusses the concept of adequacy, then identifies possible benchmarks before assessing the performance of our system against those benchmarks. This is followed by a section canvassing the key issues involved in ensuring adequacy before setting out the CSRI's policy conclusions.

# General concept

Adequacy of retirement incomes entails broader considerations beyond direct income levels and costs of living, including security and continued participation in family and community activities.

The concept of 'adequacy' is nonetheless most commonly related to the actual level of income (or the assets needed to generate that income) compared to the costs of living associated with the standard of living expected. In broad terms, the 'adequacy' of the standard of living expected then falls into two components:

A. Poverty protection: the minimum standard that should be guaranteed by society including through the support of a social security safety net, and
B. Income maintenance: the standard people have attained before retirement which they would like to maintain at and through retirement.

At any given standard of living, the actual costs of living vary significantly, particularly with regard to housing. Also important for the aged are health and aged care costs, or the risks that those may prove significant. Costs also vary between single people, couples and those with a dependent (such as a disabled daughter or son). Further, views of adequacy may vary according to whether the focus is on each individual or on the family or household unit.

Adequacy also varies according to individual preferences and expectations, and also as these change over the lengthening period of most people's later years of life: including the stage of transition to retirement, active retirement, the stage of reduced activity and the end of life stage.

Accordingly, it is not possible to set any single definition of an adequate retirement income. Instead, it is important to gain an appreciation of a range of definitions and benchmarks and to use this to make informed judgments for policy.

# More specific definitions and benchmarks

## Poverty protection

The age pension provides older Australians a guaranteed minimum income or safety net. This is intended as sufficient for a modest standard of living relative to community norms, and is provided on an income unit basis subject to tests on the non-pension income and assets of the income unit.

Benchmarks of adequacy include the Henderson Poverty Line (now set regularly by the Melbourne University Centre for Social and Economic Research), which equates roughly to 26% of AWOTE for a single person in their own home), and the more widely used OECD approach which uses half of equivalised median disposable income as the poverty line. The two benchmarks use different methods for identifying equivalent incomes for different income unit sizes. The Henderson line is also adjusted for differing housing tenure. The OECD benchmark is slightly higher than the Henderson line for singles and couples living in their own homes. Both benchmarks are openly based on income relativities and hence are linked to earnings, not the cost of living.

## Income maintenance

Adequacy for most retired people is considerably higher than this. Some benchmarks are based on the concept of superannuation as spreading lifetime earnings to allow the maintenance of living standards in retirement. Typically they apply an income replacement rate benchmark. Taking into account lower average costs of living in retirement (lower housing costs on average, lower if any costs to support dependants, lower transport and clothing costs, more reliance on home produced meals etc.), the net income replacement rate required to maintain living standards is generally well below 100%, and is lower at high incomes and higher at low incomes. The OECD average net replacement rate in practice is 63% at average earnings, 74% at half average earnings and 59% at one and a half average earnings. Accordingly, a net income replacement rate benchmark for most people might be around 70%, accepting a lower figure for those on or above average earnings.

ASFA uses a different approach, setting a ‘comfortable’ income level that many people might aim for, well above its ‘modest’ income benchmark (slightly more than the age pension) but not directly related to past income. This ‘comfortable’ income for a couple is around 80% higher than the pension and assumes the couple owns their own home outright. It is not intended as a benchmark for those on high incomes and may be higher than lower income people might reasonably aim for in retirement.

These are very general benchmarks and do not take into account any extra needs for lump sum expenses in the early years of retirement or for future contingencies such as the risk of future health or aged care costs. Nor do they take into account the likelihood of lower levels of consumption (other than on health and aged care) when retirees reach a less active stage of old age (though ASFA does suggest a lower ‘comfortable’ standard for people aged 80 and over).

# Performance of Australia’s current retirement system in terms of adequacy

## Poverty alleviation adequacy

The Harmer Report in 2009 included a detailed assessment of the adequacy of the age pension, focusing particularly on relativities between single pensioners and pensioner couples. The then Government responded with an increase in both rates of pension, with a significantly larger increase in the single rate to achieve closer equivalence of adequacy between the two rates. Harmer also drew attention to the relative disadvantage suffered by those in private rental accommodation and those living on their own, but these concerns were not addressed directly by the Government (the pensioners concerned did of course share the basic pension increases that followed the Harmer Report).

The single and married couple rates of pension are now higher than the Henderson Poverty Line for those who own their own home but payments for those in private rental accommodation still fall well behind.

Whiteford has analysed Australian pension data against the OECD benchmark, questioning the low ranking of Australia identified by the OECD. Many of those identified as ‘poor’ in the OECD figures have incomes not far below the OECD relative poverty line, and Australia has a higher proportion of its population just below this line than most countries due to the concentration of age pensioners with little or no other income. In addition, complications are introduced by the fact that employer social security contributions in other countries are not included in calculations of income replacement rates: these appear to reduce the rates relative to Australia’s as employer contributions here, apart from the superannuation guarantee, are lower. When adjusting by purchasing power parities the ‘absolute’ living standards of Australian pensioners are higher than many other OECD countries provide even though their ‘replacement rates’ are measured as higher. His conclusion is that the basic rates of our age pension are adequate relative to international practice in providing a safety net, but that those renting privately continue to be disadvantaged significantly.

The proportion of age pensioners renting privately is small (around 10%), but may increase over time if access to public housing remains limited and current downward trends in home ownership continue: these reveal lower ownership rates amongst more recent cohorts for young and middle age groups, though how large the decrease will be at age pension age in the future remains uncertain (ie how much the trend reflects moves away from home ownership or delays in achieving home ownership).

While evidence suggests the basic pension levels are adequate, not all older Australians no longer working have access to the age pension safety net. Those unable to continue working to age pension age rely on other social security payments including the disability support pension (DSP) in particular. The rates of DSP are the same as for the age pension. Those able to work but unable to find jobs may be eligible for Newstart. This is not intended to be an early retirement benefit and is designed to retain incentives to work, but amongst older workers the prospects of employment once becoming unemployed are often limited. The rates of Newstart are well below the age pension (and DSP) even with the higher rate for older recipients, and are also below the Henderson and OECD poverty benchmarks; with indexation based on the CPI rather than earnings, the relative value is continuing to fall, as highlighted by Whiteford. With the age pension age increasing, the numbers on DSP and Newstart are also likely to increase.

## Income maintenance adequacy

Assessing the adequacy of the retirement incomes delivered by superannuation depends not only on the benchmark used but also on individuals' work and contributions history, on their marital status and history, as well as on such parameters as investment returns and assumed rates of drawdowns from accumulated superannuation. Tax and age pension means test arrangements are also critical.

For the purposes of this Position Paper, the focus is on the adequacy into the future when the currently legislated system is mature. It is also based on the latest Government proposals on superannuation tax, and the legislated change to the assets test. The modelling relates to people commencing contributions in 2015, and has the SG rising to 12% from 2025. While every individual's circumstances is different, the assessment is based on some 'standard' cases of workforce participation that correspond closely to reasonably common and apparently desirable norms, eg in the case of males, full-time work from age 22 to age 67 (after part-time from age 18 to 22) and, in the case of females, a more mixed workforce experience including being outside paid work from age 30 to 35, in part-time work from age 18 to22, age 35 to 45 and age 61 to 67, with full-time work from age 22 to 30 and age 45 to 60.

Gallagher has calculated retirement income outcomes for men, women and couples based on these standard cases and different income levels, using different measures. On our advice, his modelling assumes retirees will direct their accumulated savings into income products that fully utilize the savings and provide longevity insurance. As a proxy for this, he uses a 9% drawdown rate whereas the optimal product is likely to involve a Deferred Lifetime Annuity (DLA) costing around 25% of the accumulated savings at retirement and the remainder being drawn down via an Account-Based Pension (ABP) at around 12%. Using conservative investment assumptions, Gallagher finds the following net replacement rates would be achieved (based on lifetime earnings):

**Table 1: Replacement rates (whole of life)**

| Income level | 10 pctl Ft | Median Ft | 1 AWOTE | 1.5 AWOTE | 2.5 AWOTE |
|---|---|---|---|---|---|
| **Female** | 114.2% | 94.8% | 85.8% | 65.6% | 47.6% |
| **Male** | 87.5% | 64.1% | 57.5% | 45.9% | 38.8% |
| **Couple** | 78.3% | 60.0% | 54.0% | 43.1% | 36.5% |

This suggests that the legislated 12% mandated contribution rate with the age pension will deliver a little under the benchmark 70% net income replacement rate for males on median earnings, but 70% or more IRR for most on earnings below the median; couples on median earnings will achieve 60% IRR; women achieve more than the benchmark (applied to much lower lifetime incomes) unless earning 1.5 AWOTE or more. Accordingly, those men and couples on median earnings or more will need to supplement their mandated savings to achieve adequate retirement incomes against this benchmark (not quite so much if the appropriate benchmark is lower – say, 60% - at higher incomes), whether through additional voluntary contributions or by drawing on other savings including the family home (see further below).

The modelling also reveals that, even at high incomes (2.5 AWOTE), the mandated savings are insufficient to achieve ASFA's 'comfortable' living standard in retirement.

It should be noted that these results all assume people do work to age 67, they do not allow for any extra expenses on retirement or for holding money for possible contingencies later; they also leave out those with broken earnings histories beyond that which was modelled. On the other hand, as canvassed further below, the vast majority of the aged own their own homes and could draw on those assets to supplement their retirement incomes and address future contingencies.

Mercer's World Index ranks Australia's retirement income system as second only to the Dutch scheme, and on the criterion of adequacy it is also amongst the best. Knox advises that this is based on the legislated 12% mandated contribution rate and that the delay in attaining that rate has caused Australia's ranking to fall in the Index.

Pending the system maturing (which will take more than twenty more years), retiring Australians are not able to achieve the results Gallagher has identified without voluntary savings. Gray also notes that ANU surveys reveal over 20% of the non-retired believe they will not have enough savings to retire adequately, and 24% of men and 34% of women are concerned they may become a burden on their families. For these, it will be important to encourage voluntary savings beyond the mandated levels. There is also a case for deferring any substantial tightening of the age pension means test in light of the dependence of many of these on having some age pension entitlement to achieve an adequate level of income maintenance in retirement (this issue is canvassed in the CSRI Position Paper 2 on Sustainability and Self-Provision).

# Key policy issues concerning adequacy

## Social security payments

The case to further increase the base rates of age pension beyond the existing earnings-related indexation is not strong. The disability support pension will be increasingly important as age pension age increases as a forced early retirement safety net; rates should remain tied to the age pension.

Indexation of all social security payments should maintain relativities with community standards. In broad terms that suggests an earnings index, though over time the current pension index (which is linked to Male Total Average Weekly Earnings) may overstate community income increases given demographic trends. As debated in the Parliament in 2014 and 2015, other approaches could be considered including automatic CPI indexation plus regular independent reviews for additional adjustments taking into account various measures of changes in community incomes.

There is a very strong case for increasing rent assistance for those in private rental accommodation, preferably to more closely align the payment to subsidies for those in public housing.

Newstart assists those able to work but unable to find employment. It is not therefore aimed towards those forced to 'retire' early through disability, but it does play an important role amongst older members of the workforce who often face more difficulties in finding work and have a high risk of never finding work. The growing gap between the rate of Newstart and the rate of the age and disability support pensions has been highlighted in many recent inquiry reports, including the Henry Report, and remains a matter of concern. On the one hand, it is important to retain incentives for Newstart recipients to work, but on the other hand distinctions between 'disability' and entrenched unemployment are often less clear amongst older people approaching age pension age. Both groups are unlikely to work again and both are usually entirely reliant on social security. The different payment rates also provide an incentive to accentuate 'disabilities'.

## Superannuation contribution rates

The evidence seems to confirm that a 12% contribution rate is appropriate for most people earning below the median to achieve adequate retirement incomes in terms of maintaining living standards. There is a question however about mandating this given the costs to employers and, by implication, the cost to those for whom the contributions are being made when their more immediate needs may be higher.

It is a matter for judgment whether the currently legislated mandatory 12% contribution rate is appropriate. Some experts (eg Daley) argue the level is excessive given the availability of other assets in retirement, but it is highly uncertain that the current level of other assets (particularly outside the family home) will continue to be available when compulsory superannuation savings increase. Gallagher's analysis suggests 12% is sufficient for a large proportion of those on below-median earnings: forcing them to save more could impose an unreasonable burden particularly while they have dependent children to support. On the other hand, 12% is not sufficient for the majority with median or higher earnings who will still need to draw on other savings.

The Henry Report suggested holding the mandated rate at 9% but in the context of a significant reduction in the earnings tax (from 15% to 7.5%) and the removal of the contributions tax from the superannuation system to the personal income tax system. In the absence of such a tax reduction (which would add directly to public budgetary costs), the case for holding the rate at around the current level (now 9.5%) seems weak.

The CSRI's conclusion is that 12% is an appropriate level for mandated savings. The only concern is that increasing the current rate of 9.5% when employment is weak and incomes are growing only slowly could have adverse effects on the economy and individuals' welfare. Increasing the mandated rate would also increase costs to the budget indirectly via the tax advantages involved, though there would be offsetting savings to age pension outlays in the longer term.

There is a case therefore for graduated increases subject to contributors' net income still growing in real terms and also to total labour costs (including both wages and superannuation contributions) growing no faster in real terms than national productivity increases. Current policy is broadly consistent with this, the SG rising each year between 2021 and 2025 by 0.5% each year (Gallagher's modelling also assumes this will slow the rate of growth in cash wages over this period).

For those on median earnings and above, adequate retirement incomes (delivering 70% IRR, or even 60% at higher incomes) will require some voluntary as well as the mandated contributions. Voluntary contributions of up to 4% (ie total contributions up to 16%) would achieve adequacy for most and seem possible within the Government's proposed caps, at least for those on incomes up to 2.5 AWOTE. At higher incomes, savings from outside the tax-supported superannuation system would be required. This may all be considered reasonable and fair except for those unable to build up their superannuation savings because of interruptions to employment (see further below).

## Preservation and age pension age

Increasing the years of superannuation contributions would improve adequacy for income maintenance purposes. Gallagher's modelling assumes people work to age pension age (67), but they may access their superannuation savings from age 60 (the preservation age). Unless those who do so have made voluntary savings beyond the mandated level, many would be at risk of not achieving the benchmark income replacement rate. There is therefore a case to increase the preservation age.

It is important to appreciate, however, that not all are able to continue to work to age 67, and it may be considered unreasonable to deny them access to their own savings in advance of age 67. One possible compromise is to increase the preservation age in line with any increase in age pension age, keeping the gap at, say, five years i.e. increasing the preservation age now to age 62. This might still be combined with encouragement to work to at least age pension age and to supplement mandated savings with voluntary savings.

As the Government argued in 2014, there is a case for further increasing the age pension age in line with improvements in life expectancy, particularly given continuing improvements in years of healthy living. This could also encourage more years of contributions and better assure adequacy of income maintenance in retirement into the future. On the other hand, there is evidence of widening variability in the capacity to continue working at older ages and some risk that increasing the age pension age could adversely affect the level of poverty protection afforded by the social security.

## More effective and efficient use of savings

The savings accumulated at retirement depend critically upon the net earnings rate individuals obtain after both tax and fees and charges imposed by funds. Taxation arrangements are canvassed in the separate Position Paper on Self=Provision and Sustainability. Lower fees and charges would have a significant impact given the power of compound interest. There is a strong case for continued improvements in lowering fees and achieving greater efficiencies within superannuation funds. The incidence of individuals holding money in multiple funds, some with small balances, is a contributor to excessive fees.

Adequacy of retirement incomes also depends critically on how accumulated savings are drawn down. Post retirement income is the subject of a separate Position Paper which cites evidence of widespread under utilisation of accumulated savings as people drawdown only the minimum required by law. Pooling some or all of the savings would be a much more efficient way to insure against longevity risk and allow people to safely drawdown more money each year. Better education on the management of accumulated savings in retirement could materially improve adequacy.

## Gender and income unit issues

Most analysis of adequacy, including by Gallagher, focuses primarily on the majority of retirees who are in married couples, and assume sharing of incomes and sharing of accumulated savings. Analysis based on individuals provides an alternative picture, revealing sharp gender differences, the superannuation system exacerbating the differences that exist in the labour market. Those differences include both a workforce participation difference and a gender pay gap, reflected these in superannuation contributions and expanded with fund earnings and the impact of compound interest.

The progressive tax system, and the bipartisan proposals to reflect this more clearly in superannuation tax arrangements, as well as the Government's proposal to introduce a contribution cap carry-forward, will go some way to contain these differences but they are likely to remain large. For single women, including widows, the age pension also provides important relief.

The key policy question is whether further variations to the retirement income system are needed to reduce the gender disparity, or whether this issue should be addressed by labour market reform strategies only.

Options for addressing gender disparity through the retirement income system include:

- ✓ Abolishing the means test so that women are not penalized by husband's income and assets (an expensive option that would assist higher income groups whether they shared resources or not);
- ✓ Extending the co-contribution for those on low incomes (would primarily assist women in times of reduced labour market participation, but only if they increase their own savings precisely when their incomes are low and their needs high);
- ✓ Applying the mandated contributions when receiving maternity benefits, carer payments, parenting payments and parental leave (while imposing a cost on employers and government, could provide modest assistance to women);
- ✓ More generous caps on contributions for those (mostly women) who have experienced significant interruptions in employment (noting the existing proposal to allow the contribution cap to be carried forward);
- ✓ Educating young women to encourage them to contribute more before they have children could also help, this having the added advantage of the impact of compound interest on those contributions.

Under Family Law, couples' assets including superannuation are jointly owned. In practice, it is common for a separating wife to gain the family home and the separating husband to retain his superannuation savings, this providing the woman and children greater security but limiting her superannuation savings. This is not to her disadvantage as a rule despite exacerbating the gender gap in superannuation.

It may also be the case that some men increase their own superannuation contributions precisely to compensate for their wives' lesser contributions with the agreed intention to share the assets and the retirement incomes that eventuate. While there is evidence that the individual owners of these accumulated assets (mostly men) exercise most control over their management and use, this does not necessarily mean the assets are not shared or used for the benefit of both parties. Women might benefit more, nonetheless, if there was easier access to splitting contributions, giving women more certainty about their share and more authority about how the savings are used.

High annual concessional contribution caps would benefit large numbers of people on higher incomes whether or not they had suffered employment interruptions, and add significantly to budgetary costs. It may be possible, however, to design a more targeted approach allowing concessional contributions beyond the annual cap for older workers (mostly women) with low levels of accumulated superannuation savings. Options might include allowing up to $35,000 a year for those over 50 with accumulated savings under $500,000, or for those over 50 with less than 25 years of concessional contributions above some low threshold (say, $4,000). Alternatively, consideration could be given to applying a lifetime cap (linked perhaps to the proposed new cap of $1.6 million for tax free savings in the pensions phase).

Possible labour market strategies that would address gender equity are beyond the scope of this paper but might include support that reduces periods outside the paid workforce, or the extent of reduced hours of work, continued education and training opportunities as women re-enter the full-time workforce, and other measures that promote re-engagement and proper recognition of the skills and experience of those with broken paid employment histories. Such strategies would be very likely to lead to improvements in gender equity in superannuation.

## Housing

In many respects, home ownership represents a fourth pillar in Australia's retirement income system. Around 85% of older Australians, including most age pensioners, own their own home and over 80% of these home owners are mortgage-free. As a result, their housing costs are low and the adequacy of whatever retirement income they receive is made more appreciably adequate. Home ownership also provides considerable security, a stable environment for the delivery of home care and is an important source of wealth including for accessing residential age care if required, and hence acts as a source of insurance for older Australians.

At present, however, many age pensioners are relatively asset rich but income poor; they and many other retirees could experience an improvement in their living standards if they gained access to the income stream or liquid assets that their housing equity could provide.

Two approaches could better enable retirees to access their home equity:

- Downsizing with the pensioner drawing down over time on the excess proceeds, representing the difference in price of the former home and the new home; and
- Providing older households with better forms of in situ equity release, with the most common such example being a reverse mortgage.

Apart from social factors which lead most people to prefer to remain in the family home, factors inhibiting people from downsizing include:

- The inclusion in the pension assets test of any equity redirected from the home into another form of asset (unless in the form of a loan – see below);

- A shortage of suitable accommodation in the local communities where the retirees live; a shortage that is often the result of planning regulations; and
- The cost of stamp duty on the transaction which on average amounts to nearly 8 to 10 per cent of the housing equity released via downsizing for older home owners.

The first issue is canvassed in Position Paper 3 on Sustainability and Self-Provision. The other two factors would require action by state and local governments. As part of a broader education and promotion campaign to facilitate better access to home equity, local governments could be encouraged to include in their planning processes potential demand for housing priced and designed for older local residents to downsize. State government reliance on stamp duty has been widely criticized (including in the Henry Report) because of the efficiency costs of such taxes. In the absence of broader action to reduce stamp duty (other than in the ACT), state governments could offer targeted relief for retirees' property transactions involving an equity release.

There are basically two current types of equity release products (ERPs) that allow retirees to access an income stream based on the value of their home equity:

1. Reverse mortgages, and
2. Home reversion schemes.

Reverse mortgages are loans that allow retirees to borrow money by using the equity in their home as security. No regular repayments are required, and interest is rolled into the total debt. The terms of the loan last until the borrower either sells the home or dies, at which point the loan is repaid in full. The borrower can receive their funds as a lump sum, a regular income stream, a line of credit, or a combination of these. The total amount that can be borrowed is specified as the loan to value ratio (LVR), and the LVR is regulated so that it increases with the borrower's age, starting from roughly 15-20 per cent at age 60 and increasing for each year of age up to around 45 per cent. For example, with a median value home (around $500,000) a pensioner could borrow up to $100,000 at age 65, or $10,000 a year for the next 15 years, accumulating a sizable mortgage. Although the accumulating interest may erode the borrower's remaining equity over time, the conservative LVR means that the borrower would almost certainly maintain a very substantial equity in their home. Furthermore, there is a statutory 'No Negative Equity Guarantee', such that the borrower can never owe more than the value of the home upon sale.

A home reversion scheme is not a loan, but an actual sale of a home's future value. The home owner receives a lump sum payment for a fixed proportion of home equity up to 65 per cent. Relative to the actual present value of this equity, the lump sum is discounted based on the age and life expectancy of the recipient(s), in effect recognizing the 'rent' on the sold share of the property for the resident's remaining life span. Upon sale of the home, the agreed proportion of the proceeds is repaid to the provider.

A key difference between the two types of ERPs concerns who bears the risks of longevity, variable interest rates and property price increases, and declining equity. Broadly, the borrower bears these risks with reverse mortgages, while the risks are shared under a home reversion scheme.

The Productivity Commission has found that the market for ERPs is small and unlikely to grow in the near term given the impediments involved. In 2015 there were only 40,000 outstanding ERPs nationwide comprising just 0.4 per cent of the home equity of older Australians; 88 per cent by value were reverse mortgages. The market is constrained by a complex set of supply and demand factors, including:

- Preferences of older Australians against accessing the wealth they have accumulated in the family home;
- The complexity of the products and lack of information;
- Pension and aged care disincentives; and
- The impact of regulations that require an arguably disproportionate increase in the lender's capital to back the loans.

While the market may remain limited, it could still be enhanced to the benefit of many retirees by reviewing regulatory restraints, allowing new products to emerge and improving education. A principles based approach to regulation could ensure security of tenure, standard and simple disclosures, independent financial advice and consumer safeguards to protect the older home owner including against the risk of financial abuse. This approach could facilitate a range of ERP products to be offered. The Government could also consider options to educate retirees about equity release schemes and to stimulate the private market to compete.

If the home remains exempt from the age pension means test, consideration may need to be given to ensure consistent treatment of different ERP products. Those providing loans via income streams would not be affected if the income streams were regularly consumed. Unless the means test was amended, however, products that redirected home assets into assets assessable under the means test could affect pension entitlements. Consideration could be given to exempt the proceeds of an ERP from the means test (as suggested by the Productivity Commission), or to continue the existing policy which encourages those ERPs offering annuities or other forms of income streams. Exemption of the proceeds of an ERP would need to be carefully targeted to those genuinely drawing down home assets and not allow people to artificially channel non-home savings through the home into other means-test-free assets.

The Government could directly enter this market by expanding the present Pensioner Loan Scheme (PLS) or even become a major supplier by instituting a universal government run equity release scheme. The case for doing so is weak, however, unless the means test is changed to include the home and complementary action is required to ensure those most affected can retain adequate income streams.

The PLS is a limited and little known form of reverse mortgage provided through Centrelink. It is available to those who qualify for the pension but receive a reduced rate of pension because their income or assets (but not both) are over the relevant limits (it is also available to those who would have qualified but for this reason). Payments under the PLS must be received as a regular fortnightly top-up to the pension and the total cannot exceed the maximum age pension amount. The amount of the loan is also limited depending upon the amount of equity in the property used as security, and the age of the borrower when the loan is granted. The rate of compound interest is currently 5.25% (less than for commercial products).

Although the PLS has quite a long history – twenty years in its present form – the take-up remains very low, with only about 800 loans outstanding in 2014. The available evidence suggests the low numbers may be explained by:

- The restrictions on who can access the PLS and the limit that no-one can top-up their (part) pension beyond the full age pension level;
- A desire to access a lump sum rather than income;
- Perceived risks of longevity and losing their homes before they die; and
- The lack of knowledge and familiarity about ERPs in general and the PLS in particular.

While the first two of these concerns could be addressed by expanding the scheme (eg allowing PLS loans that provide income streams up to the maximum fortnightly pension in addition to any pension entitlement, or allowing lump sums to be withdrawn, say up to one year of payments taken in advance), the case for increased government involvement is not clear as against measures to facilitate a greater role for the private ERP market, including through education.

In the event action was taken to include the home in the assets test, the case for expanding the PLS would be much stronger, at least as a transitional measure with a view in the longer term to selling the loan portfolio involved as ERPs became more commonplace in the market. The transitional arrangement would likely need to involve allowing payments at least up to the amount by which including the home affected the pension entitlement, assuming this would not involve exceeding the LVR requirement.

As mentioned, trends reveal a steady fall in home ownership in recent years amongst successive cohorts, but it is not yet fully clear how this will affect future generations of retirees. Some of the fall may reflect delays in home ownership and some may reflect the increasing real value of homes in some markets, neither of which would have any serious adverse impact on the adequacy of people's retirement incomes. Some reduction is also likely to have been the result of changing savings behaviour, offsetting the increased saving in superannuation. This adds to the case for greater consistency in the treatment of different forms of accumulated savings whether for the purposes of assessing retirement income adequacy or for applying tax and means tests.

That said, as mentioned, Australians have long preferred not to access the wealth they have accumulated in the family home and it is a widely held view that, unlike the wealth stored in superannuation accounts, the asset should be passed on to beneficiaries through an estate rather than used for consumption during retirement (except in respect of residential aged care – see further below).

There is a policy question, particularly if home ownership does continue to fall (and therefore impact the extent and/or the net value of such assets amongst the aged), as to whether some form of policy intervention is needed either to stop or reverse the falling home ownership or to ameliorate the situation for non-home owners in retirement. The latter would include improving rent assistance for pensioners in private rental accommodation or extending public housing.

The former is more controversial and could include allowing the transfer of some superannuation assets into housing. This is already possible on reaching preservation age, and evidence shows some people do use a lump sum withdrawal to pay off mortgages on their homes. Earlier access to superannuation savings for home ownership purposes may, however, undermine the primary purpose of superannuation and also promote more wealth accumulation for transfer to the next generation.

## Health and Aged Care

COTA Australia and other organisations representing older Australians have highlighted the importance of ready access to medical and aged care services, this explaining the rational decision to hold some accumulated savings for possible future expenses as well as underlining the need for policies which can respond to the rising demand for affordable care via Medicare and aged care services.

There is increasing concern that Medicare's out-of-pocket costs are increasing, even for pensioners (particularly for specialist services) and that waiting times for elective surgery, a common requirement amongst older people, are often longer than the maximum assessed as medically appropriate. While private health insurance (PHI) premiums for older people are held down by community rating, they are currently increasing faster than incomes, and the cover most often still involves significant out-of-pocket costs; nonetheless, PHI is valued by many retirees for its access to elective surgery in particular.

Following a Productivity Commission report on aged care in 2011, successive governments have taken steps towards the recommended approach of a consumer driven, market based, sustainable system. Key elements being pursued include:

- Independent assessment of care needs and assessment of capacity to contribute to costs;
- Separating accommodation from care, and applying more market-based approaches to accommodation, with means-tested support available;
- Care provided wherever the person lives, with prices set in the market, and with means-tested support based on government-determined, market-informed prices;
- Maximum care costs for consumers (based on government-determined prices and not including discretionary purchase of additional care), so that the system offers a form of social insurance;

- Home care to be consumer directed, with a view to extending that to residential care;
- Means testing includes the value of the family home.

As this new approach is implemented, it is expected that the market will respond with appropriate innovative products. Most people requiring specialist accommodation that allows easy access to required care, will continue to need to pay either a lump sum accommodation fee (fully refundable accommodation deposit), usually financed by their home equity, or a rental fee (daily accommodation payment). New products such as pooled lifetime products may make it easier for the resident or resident's family who wish to pay a refundable lump sum, reducing the upfront payment in exchange for the capital return on death. New insurance products may also become available to complement the social insurance aspects of the new care pricing system.

As a result, retirees may be better able to plan for possible aged care requirements without retaining large amounts of assets for this contingency, allowing them to improve their living standards both before receiving necessary care and while receiving it.

As with ERPs, there may need to be some principles based regulatory reform of financial products aimed to address aged care contingencies, and government involvement in educating retirees about such products and any implications for the means test (see Position Paper 3 on Income Stream Products).

# Main policy conclusions

**For the safety net:**

- ✓ The level of the basic age pension does not need to be further increased beyond earnings-related indexation;
- ✓ Rent assistance does need to be increased for those in private rental accommodation;
- ✓ Disability support pension should be kept in alignment with the age pension, recognizing its role for those unable to work to age pension age;
- ✓ All payments (including Newstart) should be indexed on the same basis to maintain relativities with community incomes;
- ✓ Newstart should be significantly increased and consideration given to its level relative to the disability support and age pension.

**For superannuation:**

- ✓ The legislated increase in the mandated contribution rate should proceed, but only as real incomes increase and subject to total labour costs increasing no faster than national productivity;
- ✓ The system should facilitate those on middle and higher incomes, and those with interrupted employment, to make additional contributions to accumulate sufficient savings for adequate retirement incomes within contribution caps;
- ✓ Those approaching retirement within the next twenty years or so, whose mandated savings will be considerably less than 12% over their working lives, should also be encouraged to make voluntary superannuation savings;
- ✓ Individuals should be encouraged to work and to contribute for longer to help fund adequate retirement incomes, suggesting a case for increasing the superannuation preservation age to move in line with increases in the age pension age;
- ✓ Continued effort should be made to improve efficiencies within superannuation funds including by educating individuals and making it easier to merge and transfer accounts;
- ✓ Consideration should be given to apply mandated contributions to maternity benefits, carer payments, parenting payments and parental leave; to make it easier to split contributions between couples;
- ✓ While the proposed contribution caps are reasonable and fair in most cases, consideration should be given to further relax the caps for older workers with interrupted employment histories;
- ✓ The translation of superannuation balances into secure retirement incomes needs to be greatly improved (see Position Paper 3).

**Regarding housing:**

- ✓ Housing should be regarded as a fourth pillar in the retirement income system, even if it is not expected to be directly drawn down during retirement;
- ✓ Market-based options for people to increase their retirement incomes by accessing their home assets should be made easier and promoted by wider education. Principles based regulation could ensure security of tenure, appropriate disclosure, independent advice and consumer safeguards; government should also look to educate retirees about equity release products;
- ✓ State governments should reduce stamp duty to make downsizing more attractive, and local government should review planning arrangements to facilitate the availability of housing priced and designed for local older residents interested in downsizing;
- ✓ The Pension Loan Scheme should not be widened unless the family home is included in the pension means test; in that case, an extension to protect the income streams of those directly affected should be considered as a transitional measure pending the maturing of market-based equity release products (as discussed in Positions Paper 2);
- ✓ Within limits, the opportunity should remain for accumulated superannuation to be directed to paying off outstanding mortgages etc after preservation age, but more general redirection of superannuation into housing should not be allowed.

**Regarding health and aged care:**

- ✓ Medicare should continue to provide affordable access to health care based on health needs, implying that out-of-pocket costs should be contained and waiting times kept to medically determined standards;
- ✓ PHI reform remains a priority to contain premiums to growth in incomes and to limit out-of-pocket costs;
- ✓ Aged care reform should continue towards a more consumer-oriented and market-based system, facilitating the development of products that make it easier to plan for any accommodation costs involved and to meet out-of-pocket care costs and offering more choice and improved quality with reduced supply side controls;
- ✓ Reform of the aged care means test to remove impediments to the development of non-superannuation products which use pooling of longevity risk to help finance health and aged care (see Position Paper 3).

# References

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Phil Gallagher PSM, Industry Super Australia, 'Modelling Adequacy for the Broad Retiree Population'

Dr Siobhan Austen, Curtin University, 'Gender Aspects of Retirement Income and Savings Policies'

Professor Peter Whiteford, ANU, 'The adequacy of the retirement income system in assisting people unable to provide for themselves'

Professor Peter Whiteford, ANU, 'Assessing the adequacy of the Age Pension'

Professor Judith Yates, Dr Rachel Ong, Dr Bruce Bradbury, Sydney University, 'Housing as the fourth pillar of Australia's retirement income system'

Mr Ian Yates AM, Chief Executive of COTA, 'Retirement Income Policy and Aged Care'

Also, discussant comments at the Roundtable by Dr David Knox (Mercer), Professor Hal Kendig (ANU and CEPAR), Dr Catherine Wood (Superfunds), Professor Andrew Podger (ANU and CSRI), Professor Matthew Gray (ANU), Mr Sean Innes (DSS), Professor Mike Woods (ANU and UTS), Mr Ian Winter (AHURI).

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