COMMITTEE FOR SUSTAINABLE RETIREMENT INCOMES

A Holistic View of the Retirement Income System - Overview and Summary

Consultation Draft for the CSRI Leadership Forum
12-13 October 2016

October 2016

Contents

Foreword

In 2015, the CSRI led a consultation process with major stakeholder groups culminating in agreement at the National Reform Summit in August 2015 on a set of principles to guide reform of the retirement income system.[1] This built on the agreement reached earlier with key stakeholder groups at the inaugural CSRI Leadership Forum in June 2015.[2]

Since then, and consistent with the agreed principles, the CSRI has progressed a collaborative policy development process with the aim of building consensus on sustainable retirement incomes policies that go beyond the current budget or electoral cycles.

In doing so, the CSRI sought the input, and commissioned research, from a broad range of prominent industry, consumer and academic experts in developing policies to tackle the challenges. This research was presented and debated at a series of Policy Roundtables convened by CSRI in April 2016.[3]

Based on the research and discussions at theses roundtables and subsequent consultations with stakeholder groups, the CSRI subsequently developed three position papers:

- *Pursuing Adequate Retirement Income For All Australians,*
- *Encouraging Sustainability and Self Provision in Retirement*; and
- *Making Income the Goal - Developing the Post Retirement System*.

This fourth document provides an overview of the CSRI's policy conclusions across the three position papers.

The CSRI Leadership Forum on 12-13 October 2016 brought together leaders in public policy, industry and academia to debate how to secure a sustainable retirement incomes system for Australia and to explore alternative policy proposals. The CSRI's policy positions were scrutinized and debated there and the outcomes of the Forum are summarised in a fifth document "*Securing Sustainable Retirement Incomes for All Australians*" October 2016.

I would like to sincerely thank all of our sponsors – **Australian National University, Dimensional, Challenger, PWC, PIMCO, King and Wood Mallesons, First State Super, TAL, Cbus, Link Group, StatePlus, Academy of the Social Sciences and Council of the Aging, -** for being policy development partners in the truest sense of the word.

I would like to thank all the academic and industry experts who contributed research and analysis that provided the evidence base for CSRIs policy positions, including: Siobhen Austen, Curtin University; Hazel Bateman, CEPAR; Bruce Bradbury, UNSW; Nick Callil, Willis Towers Watson; David Cox, Challenger; Suzanne Doyle, StatePlus; Phil Gallagher,

[1] Convened by the Australian Financial Review and the Australian Newspaper, with CSRI, ACTU, ACOSS, ACCI, AiG, BCA, Council of the Aging (COTA), and National Seniors.

[2] Academy of the Social Sciences, Australian Council of Social Service (ACOSS), Council of the Aging, Industry Super Australia and National Seniors Australia.

[3] Hosted by the Academy of the Social Sciences and StatePlus.

Industry Super Australia; David Ingles, ANU Crawford School of Public Policy; Hal Kendig, CEPAR; David Knox, Mercer; Graham Lennon, Dimensional; Zac May, Industry Super Australia; Peter McDOnald, ANU; Catherine Nance, PWC; Rachel Ong, Curtin University; Jim Parker, Dimensional; John Piggott, CEPAR; Murray Radcliffe, ASSA, Martin Stevenson, First State Super; Ruth Stringer, King & Wood Mallesons; Darren Wickham, TAL; Nadine Wilmot; Peter Whiteford, ANU; Catherine Wood, Women in Super; Ian Yates, COTA; and Judith Yates, USyd.

I would welcome any comments and suggestions on these papers and the way forward.

Patricia Pascuzzo
Founder and Executive Director
Committee for Sustainable Retirement Incomes

Overview

Policy Context

Despite the strengths of Australia's retirement income system, there are deep challenges that have the potential to compromise its effectiveness and sustainability. Issues include:

- Many older people will live precariously, especially those without their own homes or who, for health or other reasons, are unable to keep working till age pension age.
- A quarter of a century since the introduction of compulsory super, serious weaknesses remain in translating accumulated funds into secure income streams that last a lifetime.
- Difficulties faced by people with interrupted careers, casual and part-time employees and the gender pay gap means women end their working lives with about half the savings of men on average and facing long years on very low incomes.
- The system shifts significant risk to individuals ill-equipped to manage it. The superannuation framework requires individuals to confront a complex set of financial decisions at and after retirement.
- With rising longevity, increasing years in retirement and low financial literacy, confusion about how much to save and how to manage it is rife.
- The sheer complexity of the system, together with the frequency of policy changes, contributes to high transaction costs and undermines confidence.
- The concept of retirement needs to be rethought in the modern age, which will have implications for the retirement income system.
- Increasing cost of the system to government and taxpayers.

There is an urgent need for a systems-wide perspective in shaping retirement income policies. Policy formulation that ignores broader implications and flow-on effects may result in unintended adverse consequences. Of particular relevance has been the tendency to consider public pension, taxation and superannuation regulatory reforms in separate domains, resulting in poor system integration, excessive complexity and often a failure to achieve their objectives because of countervailing effects in the other domains.

Constant piecemeal change and continued speculation around superannuation rules and age pension eligibility create great uncertainty for Australians in and near retirement. Member disengagement provides the opportunity for the system to be politicised and this in turn undermines community support for the system.

The absence of a clear overarching objective for the retirement income system that can support a consistent set of policies across the different parts of the system has been identified as a significant impediment to the development of good public policy.

In agreeing to legislate an objective for superannuation as providing income in retirement, the federal government has made the vital first step towards building a more sustainable system.

It has also developed a package of super tax measures to better target tax concessions to those who most need them consistent with the objective and lessening the call on the public purse. However, the paring back of inequitable tax concessions should be just the start of reforms that improve the adequacy and sustainability of income for all Australians.

Policy Principles

Further reform is now important and should be pursued through constructive discussion of the inevitable trade-offs involved in designing a reform package if it is to deliver adequate and sustainable retirement incomes for all Australians.

To this end, following the agreement reached at the inaugural CSRI Leadership Forum 2015[4], the CSRI led a consultation process with major stakeholder groups culminating in agreement at the National Reform Summit 2015[5] on a set of principles to guide reform of the system. The agreed principles were as follows:

- Improving the safety net to the aged with unavoidably high housing costs and those below age pension age who are unable to secure paid employment and save for their retirement.
- Better targeting of social security payments in a way that retains incentives to work and save and does not distort the manner in which assets are held or used.
- Supporting the ability of older Australians to remain in the workforce and build adequate retirement savings, while recognizing some are unable to secure paid work while others contribute substantially to society through unpaid work.
- Facilitating transition to retirement while encouraging people to maintain sufficient savings for their retirement incomes.
- Setting the level of mandated contributions so that, together with the tax concessions, any age pension entitlement and any other government contributions, they deliver adequate retirement incomes for Australians while not imposing excessive costs elsewhere.
- Ensuring the design of the super tax concessions are consistent with the objective of the retirement income system in a way that preserves the integrity and progressivity of the personal income tax system.
- Balancing the need for flexibility in the way people use their superannuation savings with sufficient structure to ensure they are used for genuine retirement income purposes and mitigate market and longevity risks to retirement incomes and living standards.

[4] Academy of the Social Sciences, Australian Council of Social Service (ACOSS), Council of the Aging, Industry Super Australia and National Seniors Australia.

[5] Convened by the Australian Financial Review and the Australian Newspaper, with ACTU, ACOSS, ACCI, AiG, BCA, COTA, and National Seniors.

Consultation Process

Since that time, and consistent with the above principles, the CSRI has initiated a collaborative policy development process with the aim of building consensus on sustainable retirement incomes policies that go beyond the current budget or electoral cycles.

In doing so, the CSRI sought the input, and commissioned research, from a broad range of prominent industry, consumer and academic experts in developing policies to tackle the above challenges. This research was presented and debated at a series of Policy Roundtables convened by CSRI in April 2016.

The CSRI developed three position papers based on the research and discussions at these roundtables and subsequent consultations with stakeholder groups. Below is summary of the CSRI's conclusions and recommendations resulting from this process.

Summary of Conclusions

System Objective

CSRI considers that an appropriate overarching objective for the retirement income system is:

"*to provide adequate income through all the years of retirement for all Australians in a sustainable way".*

This captures in one succinct statement the necessary elements of the system's objective in terms that may be understood widely.

- it focuses squarely on "*incomes*" in retirement rather than wealth accumulation per se;
- "*all the years of retirement"* emphasizes the importance of effective longevity risk management for financial security;
- *"for all Australians"* acknowledges the importance of equity*;*
- while recognising the need for an efficient retirement income system to contribute to be sustainable.

Adequacy including Aged Care and Housing

Safety net

1. The level of the basic age pension does not need to be further increased beyond earnings-related indexation.

2. Rent assistance does need to be increased for those in private rental accommodation;
3. Disability support pension should be kept in alignment with the age pension, recognizing its role for those unable to work to age pension age.
4. All payments (including Newstart) should be indexed on the same basis to maintain relativities with community incomes.
5. Newstart should be significantly increased and consideration given to its level relative to the disability support and age pension.

Superannuation

6. 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.
7. 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.
8. 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.
9. 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. This would need to be accompanied by efforts to reduce employment barriers and improve employability of seniors.
10. Continued effort should be made to improve efficiencies within superannuation funds. This should also include educating individuals and making it easier to merge and transfer accounts.
11. Consideration should be given to applying mandated contributions to maternity benefits, carer payments, parenting payments and parental leave; to make it easier to split contributions between couples.
12. 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.
13. The translation of superannuation balances into secure retirement incomes needs to be greatly improved (see Post Retirement below).

Housing

14. 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.
15. 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.
16. 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.
17. 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.

18. Within limits, the opportunity should remain for accumulated superannuation to be directed to paying off outstanding mortgages after preservation age, but more general redirection of superannuation into housing should not be allowed.

Health and aged care

19. 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.
20. Public Health Insurance (PHI) reform remains a priority to contain premiums to growth in incomes and to limit out-of-pocket costs.
21. 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.
22. 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).

Sustainability and Self Provision

Principles and Conclusions

23. There is a potential tension between the cost of incentives for the individual to encourage more self-provision and the net cost to the Budget. On the other hand, taxes or means tests which act as a disincentive to self-provision, should not be so high that their net impact on self-provision also comes at a net cost to the Budget. The aim therefore is to strike the right balance between the impact of incentives and disincentives on self-provision and their overall fiscal impact.
24. Given the likely pressure on the Budget for additional retirement income expenditures, it is especially beholden on policy makers to ensure the cost-effectiveness of all retirement income expenditures, including the tax expenditures.
25. Mandated superannuation contributions should remain an integral part of the superannuation system, although the level and timing of any further increase is subject to further consideration on adequacy grounds (see Adequacy above).
26. The Age Pension means test should not leave people worse off for having contributed to superannuation.

Superannuation taxation concessions

27. Voluntary contributions that would attract a concessional tax rate, should be limited. This would best be achieved by taxing contributions at the member's marginal rate less 20%. Alternatively, a broadly similar approach may be to keep the present tax rate scale while applying the following caps as announced by the Government:
    - Impose a limit of $1.6 million that can be transferred into the tax free retirement phase;
    - Reduce the threshold at which high income earners pay an additional 15% contributions tax from $300,000 to $250,000 (this could be lowered even further to $180,000);

- Reduce the annual cap on concessional before-tax superannuation contributions to $25,000 (currently $30,000 under age 50 and $35,000 for ages 50 and over); and
- Lower the annual non-concessional contributions cap to $100,000, and these non-concessional contributions will also only be available to individuals with a superannuation balance of no more than $1.6 million.
- These new revised caps will only affect a very small number of high-income individuals, and will still allow the vast majority of people to maintain a legitimate level of concessional saving consistent with meeting reasonable adequacy targets for their retirement incomes.

Age Pension means test

28. Income testing arrangements for the age pension work reasonably well and should not be substantially changed
29. The new assets test to come into effect from January 2017 effectively has too high a taper that discriminates against annuities, and is likely to encourage behaviour aimed at avoidance. Consideration should be given to introducing a merged means test that would encourage retirees to draw down their assets, and would support the adoption of Comprehensive Income Products in Retirement (CIPRs) and annuities. The improvements in self-provision would also lead to some long-term offsetting savings. The alternative would be to retain a separate assets test but modestly reduce the rate of reduction per fortnight for each extra $1000 of assets.

Housing and the pension means test

30. The value of the home is no different from any other asset, and in principle it should be included in the pension means test. Any proposal to include housing assets in the means test ought to be accompanied by action to enable the pensioner to tap the equity in their home to ensure their cash income is not reduced. (See Adequacy above.)
31. To effectively tap home equity, the exemption limit below which home equity would not be subject to the means test would need to be should be set sufficiently high to:
    - allow the pensioner to raise sufficient revenue from some form of reverse mortgage that they can compensate their future income for the loss of pension income, and
    - still have sufficient unencumbered housing equity to meet the requirements for accessing residential aged care in the future if that became necessary.
32. No existing age pensioner should be affected by a change to include housing in the pension means test, and nor should any person who becomes eligible in the next 7 years be affected. In addition, the exemption cap should be phased in by gradually lowering it after the first year of introduction, reaching its final level in say 10 or 15 years, with a lower exemption level taking longer to phase in.

Assets test treatment of funds released by accessing home equity

33. There is a need to improve the incentives for pensioners to access this equity and improve their cash incomes through the following measures:
    a. Exempt the proceeds of down-sizing from the means test up to some capped amount provided it is invested in an approved retirement income product.
    b. The means test for accessing aged care should be based on the remaining home equity after deducting the amounts that are unencumbered by an equity release product or an aged care Refundable Accommodation Deposit.

Post Retirement

Regulatory Architecture

34. Superannuation trustees should be required to provide information to members about the selection of Comprehensive Income Product in Retirement (CIPR). If members do not participate in the selection process, the trustee would be required to provide information about a CIPR option.
35. CIPRs should be provided on an opt in (rather than a more passive opt out basis) to mitigate the risk of members being assigned a CIPR that is unsuitable for their needs.
36. The regulatory framework would support trustees in guiding their members in choosing a CIPR in two ways. First by specifying minimum design requirements of the CIPR product. Second by outlining the key process requirements for guiding the members' choice of CIPR. If trustees meet the conditions for both of these elements they would be assured of safe harbor protection.
37. CIPR design features - the following design principles for CIPRs are proposed:
    - Longevity risk protection – while CIPRs would not require guaranteed income for life, they would involve a portion of income being sourced from some form of mortality pooling arrangement.
    - Regular and sustainable income streams**.**
    - Ability to take account of cognitive impairment at older ages - involving some form of deferred secure income that requires little intervention from the retiree in their senior years or other approaches that may achieve a similar result.
    - Flexibility, particularly in relation to meeting members' needs over the course of retirement, is best addressed in the range of CIPRs offered and as part of the process for guiding members' choice of CIPRs, rather than as a minimum requirement for each CIPR product.
38. Current requirements in relation to scaled and intra-fund advice ought to be reviewed to determine whether they are adequate for CIPRs or whether modification or further guidance is needed to facilitate the provision of CIPRs.
39. Mandatory restrictions on the use of super balances by retirees are not recommended given the difficulties it would present for meeting the diversity of retiree needs and circumstances.

Retirement Income Products

40. The Parliament should pass the government's bill to remove regulatory impediments to the development of post retirement products. This would involve the introduction of an additional set of income stream product rules, the key features of which should be:
    - Products such as deferred annuities and pooled products, which are excluded by the current regulatory framework, would be able to qualify for the earnings tax exemption.
    - Products would not have to meet the minimum drawdown requirements to qualify for the earnings tax exemption, but would have to comply with a diminishing capital access schedule.
    - Effective operation of the products under the alternative rules will require a credible pool size and for income payments to be determined at arm's length. Accordingly, it would not be appropriate for products under the new rules to be offered directly by either SMSFs or small APRA funds.

41. The Department of Social Security should clarify the treatment of new income stream products under the social security means test to permit product development and allow competitive neutrality among products.
42. For those who can afford them, non-super products which use the pooling of longevity risk to help fund health and aged care will increase self-sufficiency and by doing so reduce fiscal pressures. These products need to be accommodated in health insurance and aged care legislation. Similarly, they also require clarity on their tax and means test treatment.
43. There should be an ongoing focus on the identification and removal of regulatory barriers when identified as impeding the market.
44. Regulatory authorities should facilitate product innovation by providing a central point of contact for new product development.
45. Aged Care – consideration should be given to facilitating the provision of a single premium aged care lifetime loan product through the following:
    - Government guarantee on return of the bond to the life office should apply in the same way as it applies to a resident;
    - Product to be assets test treated in the same way as a bond paid by the resident;
    - Resident must be legally capable of assigning to the life office any right to return of the bond so that it can be dealt with outside their estate; and
    - Alterations to the Aged Care Assessment Team (ACAT) assessment criteria must be capable of being monitored so that life offices can understand changes in the risks they are underwriting.

Financial Advice

46. Strategies to increase the role of financial advice in relation to retirees managing their superannuation balances include:
    - Ensuring training of advisers in relation to retirement related matters (such as annuities, age pension and aged care funding)
    - Setting standards for financial advisers who are advising on retirement matters to ensure competency across the complexity of retirement issues.
    - Regulatory settings to facilitate the rapid evolution of digital advice in retirement matters.

Empowering Members

47. Requiring funds to inform members of their projected income in retirement in member statements is a significant policy development that will encourage members to focus on retirement incomes.
48. Government, industry and consumer should collaborate in developing disclosure requirements suitable for the decumulation phase where retirement income is the goal. Information architecture is needed to enable product comparisons across a range of features to be understood by members including the trade-offs among different products in relation to the strength of guarantees, as compared to a target, and the cost of guarantees.
49. Government, industry and consumer groups to work together to develop a plan for providing education on the benefits and operation of home equity release schemes.

Acknowledgements

Anchor Partner
Adequacy & Sustainability Roundtable Partner, 2016

ACADEMY OF THE SOCIAL SCIENCES IN AUSTRALIA

Post-Retirement Initiative Partners, 2016-17

Dimensional

challenger

first state super

TAL

KING&WOOD MALLESONS

StatePlus
Formerly State Super Financial Services

Post-Retirement Roundtable Partner, 2016

Post-Retirement Initiative Partners, 2015-16

CSRI Leadership Forum 2016, Partners

Lead Sponsors

Gold Sponsors

Bronze Sponsors

How to become involved

The CSRI seeks to engage with like-minded organisations that share the goal of improving the efficiency and sustainability of the retirement income system.

By partnering with CSRI, you will be contributing to an important public policy initiative and securing your leadership role in the industry.

Express your interest in becoming involved by contacting:

Patricia Pascuzzo
Patricia.pascuzzo@csri.org.au

Patricia Boow
Patricia.boow@gmail.com

CSRI
T: +61 2 9275 7971
https://csri.org.au