7 April 2022

Mr Xavier O'Halloran
Director
Super Consumers Australia

Via email: feedback@superconsumers.com.au

Dear Xavier,

Retirement standards consultation

CPA Australia and Chartered Accountants Australian and New Zealand (CA ANZ) represent almost 300,000 professional accountants globally. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

CA ANZ and CPA Australia welcome the opportunity to provide feedback in relation to the Retirement Standards Report (the Report) published by Super Consumers Australia. The Report proposes a new approach to retirement income targets based upon expenditure patterns in Australia by retirees sourced from the Australian Bureau of Statistics (ABS) data and is paired with savings targets designed to assist retirees to better meet their chosen retirement income target.

We generally support the concept of a retirement standard based upon expenditure, as this is likely to provide an evidence-based approach to retirement savings. We believe that the standard proposed by Super Consumers Australia in the Report is both appropriate and useful for a cohort of Australians. Our submission is attached.

The question of how much to save for retirement has had a history of responses, and a number of models suggested. The model chosen by Super Consumers Australia in the Report is a new project which seeks to answer this through examination of expenditure patterns by retirees, with a proposal for a representative user of how to get there.

CPA Australia and CA ANZ welcome the work undertaken on this. We believe that by preparing retirees for likely required retirement savings, this will assist in helping retirees to meet their preferred expenditure level. We believe that this is some of the most comprehensive work to date on solving the retirement problem.

However, we are also mindful that a "one size fits all approach" is potentially capable of focusing on one type of retiree at the expense of other retirees. We believe that with the use of technology, adjustable parameters and a wider range of inputs, the model can be developed further to ensure that as many Australians as possible are able to benefit from this project. Our submission has made the following points:

- Defined benefit superannuation members could potentially be considered as a fourth approach to retirement due to unavoidable occupational capture
- Allowance late in life for the 'retirement smile' (defined below) may assist Australians to allow for larger late life expenses such as aged care and healthcare

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- The model should be revised frequently based on changes in its constituent expenditure, rather than relying solely on indexation
- Consideration should also be given to whether retirees' current expenditure patterns has applied artificial downward pressure on the standard
- The standard should be benchmarked to an objective standard of poverty, such as the Henderson poverty line, and any findings relative to such a benchmark should be justified
- Renters form an increasing number of retirees and should also be able to use the standard. This would require the model to be augmented to recognise rental costs.
- Engagement with users of the standard should be maintained to ensure that, in turn, engagement by users is repeated
- We have a number of questions regarding the methodology, including the assumed effective rate of taxation used
- Expansion of the model to assist users of different genders, investment approaches and geographical locations would assist with inclusivity, and
- To ultimately be certain that users are making use of the standard to assist in meeting their retirement goals and objectives, more behavioural finance research is recommended.

For further information in relation to our submission, please contact Richard Webb, Policy Advisor Financial Planning and Superannuation at CPA Australia at richard.webb@cpaaustralia.com.au or Tony Negline, Superannuation Leader at Chartered Accountants ANZ at Tony.Negline@charteredaccountantsanz.com .

Yours sincerely

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Response to consultation

How do people approach retirement?

Question 1.1

Our research uncovered three distinct approaches to retirement planning. Are you aware of complementary research that affirms or conflicts with this segmentation?

The three approaches to retirement planning outlined in the Report – disengaged, engaged delegators and engaged DIYs – match very closely to the analysis contained in the Cooper Review (Cooper et al 2010), which considered similar approaches as valid audience segments for what they called the MySuper/Choice/Self-Managed Superannuation Fund (SMSF) architecture proposed as part of that review.

We would consider that (as implied in Cooper et al, as well as various legislative and regulatory exemptions since the Cooper Review) there is a fourth group where superannuation can be genuinely outside their control as a result of being an employee – normally in the public sector – where defined benefit superannuation is a feature of their employment. These may be captured as part of the disengaged group, but as there is often very little ability to change arrangements, this group is likely to overlap with the engaged delegators and engaged DIYs cohorts, if only due to necessity.

Learning from the shortcomings of existing retirement standards

Question 2.1

Our savings target is constructed using the assumption of constant real terms expenditure in retirement. In your view, is this an appropriate assumption?

The question of whether it is reasonable to assume constant real terms expenditure in retirement – that is, not fluctuating from one year to the next except for notional price increases – is an interesting one. An appropriate measure of adequacy, based primarily on the expenses faced by retirees rather than on a measure of income, would acknowledge the general consensus that expenditure declines in retirement, especially later in life for many retirees reducing their basic living and lifestyle expenditure, but then increases to cater for meeting aged care and healthcare costs. This upturn in expenditure towards the end of one's life is sometimes referred to as the 'retirement smile'.

UniSuper (2016) explain the retirement smile as:

> *The retirement smile is a kind of inverted bell curve which represents the general pattern of people's spending in retirement. The idea is that spending is high at the beginning of retirement, it tapers off in the middle and then spikes again at the end. It's a particularly useful way of illustrating people's expected income needs in retirement.*

We note that most of the existing retirement income standards appear to assume either an unchanging or decreasing expenditure throughout retirement. However, work, such as

Blanchett's (2014) notes an increase towards the end of retirement, primarily due to health costs, which Blanchett sources to healthcare. Chomik et al (2018:24) discussed a similar effect in Australia:

> *The most remarkable change as people age is the increase in public health and public and private aged care expenditure. Consumption of residential aged care starts increasing after age 60 and ramps up significantly after 75. The analysis fosters a broader understanding of resources and consumption over the lifecycle and can be extended to look at aggregate changes.*

We are aware that, given the unpredictable nature of mortality, expectations around late life increases to expenditure could be more difficult to convey in a model such as the one proposed by Super Consumers Australia. We believe that there could be an assumption built into the model to accommodate this effect close to age 90.

Question 2.2

One benefit of budget standards is the ability to provide detailed insights into what can be afforded by someone spending at the level of the budget. Do you see value in providing similar context to people using standards based on actual expenditure and how would this best be achieved? e.g. expenditure on holidays.

There have been a number of limited studies done in the area of expenditure by retirees, and these have tended to conclude that expenditure is limited to a large extent by retirees' own restraint. This suggests that figures obtained through existing budget analysis are likely to be skewed towards austerity.

Reeson et al (2016:4) cite research that shows that if anything, retirees tend to underspend:

> *The empirical evidence to date suggests that retirees are inclined to draw down their wealth relatively slowly. Wu et al. (2014) examined Centrelink data covering a sample of aged pensioners between 1999 and 2007, finding evidence that many retirees engage in precautionary saving, holding or even building a buffer of wealth (in addition to the family home) in the order of $50,000 per person. Rather than drawing down their assets, many were living off the income generated from their investments, along with the age pension, often spending less than the Association of Superannuation Funds of Australia (ASFA) standards for even a modest lifestyle (Wu et al. 2014). It is unclear to what extent this behaviour is motivated by precautionary or bequest motives, or some combination of both.*

We note that the research of Reeson et al (which was cited in the Retirement Income Review) appears to view liquidity as wealth and separates the value of the home from one's retirement savings.

This separation of the family home from retirement savings was a position that the Retirement Income Review (Callaghan, Ralston and Kay 2020) also took. In addition, the role played by equity release options was not widely interrogated beyond acknowledgement, even though these products have been widely available since the late 1990s.

Whilst we understand that these standards must start somewhere, there is a suggestion that as retirement income solutions become better matched with retirees' planned expenditure, any benchmark reflecting actual expenditure will need to move accordingly. We note the Super

Consumers Australia report largely agrees, noting on page 22 that equipping retirees with the confidence to spend is additional value that can be provided.

To reduce the future impact of a circular reference to a present state of expenditure which is generally considered to be less than optimal, we would suggest that movement of standards with indexation, such as with CPI, be the exception rather than the rule. We have provided more discussion of this point in our response to question 4.2

Question 2.3

Are there any further considerations that we ought to take into account in our analysis of the existing retirement standards, that might impact our conclusions regarding their limitations?

CPA Australia and CA ANZ do not intend to answer this question.

Question 2.4

In this section we focus on the ASFA standards as they are the only widely cited set of retirement standards in Australia. Are there lessons to be learned from other retirement standard research, in Australia or abroad, that should be incorporated into our approach?

CPA Australia and CA ANZ note the role that the ASFA standards have played historically, as these have arguably contributed to member engagement with their superannuation.

We note that outside Australia, there are other benchmarks used, such as replacement rates of pre-retirement earnings. These may be appropriate where Australians – who through their working lives are used to periodically making saving and spending decisions independently of their expenditure patterns – are looking to replicate the lifestyle to which they have become accustomed throughout their working lives.

However, we note the intention of the project as stated in the Executive Summary of the Report, which is to fit a benchmark level of retirement savings to an expenditure-based standard of living. We believe that this objective is valuable for a core of Australians seeking a realistic retirement savings target. We believe that while this objective has been largely met by the report, there will be Australians who will continue to "shop around" and compare standards. The provision of choice in this area should not be seen as a negative outcome.

Finally, we consider that the standard should itself be subject to a degree of benchmarking to ensure that Australians know what the proposed standard is objectively suggesting. In our response to question 2.2, we considered that there is a very real risk that Australian retirees presently underspend, resulting in any survey of expenditure showing an artificially low result. We would recommend that the retirement income standards themselves also be benchmarked against objective measures, such as the Henderson poverty line, to ensure that Australians are not unwittingly setting themselves up for an uncomfortable retirement.

Rationale for our approach to answering the question "How much do I need to save for retirement?"

Question 3.1

> *Given the prevalence of income poverty and financial stress among retired renters, and their likely inability to achieve aspirational targets, we opted not to produce standards for this cohort. Is it feasible and desirable to provide standards for renters, and if so, how would this best be achieved? e.g. producing standards for younger renters*

We welcome Super Consumers Australia's call on policy makers to make improvements to the system for renters to avoid poverty and financial stress in retirement. That said, we do not understand why an inability to reach aspirational targets should be cited as a reason why the issue, that retired renters are poorly served by the retirement income system, should continue to be obscured. If Australians are failing to meet these targets, this is itself crucial data for public policy purposes.

Standards for renters are not only desirable, but inevitable. The overall declining rate of home ownership, together with the ongoing issue of inadequate assistance provided to renters in private rental circumstances mean that renters cannot continue to be footnoted as trivial compared to homeowners in retirement.

CPA Australia (2020:9) noted in their submission to the Retirement Income Review that:

> *A number of trends are becoming more pronounced. One of these is declining rates of home ownership (Yates & Bradbury 2010, Chalkley-Rhoden 2017). This has a number of flow-on effects in the retirement income system:*
>
> - *Measures of adequacy used presently, often assume home ownership*
> - *Eligibility for the Age Pension is set depending on whether the retiree is a home owner or not, and*
> - *Eligibility under normal means testing is also affected by access to equity unlock facilities such as the Pension Loans Scheme (PLS) or reverse mortgages*

In a finding anticipated by CPA Australia in 2007 (Morrison and Kelly 2007) the Pension Review conducted by Jeff Harmer in 2009 found that the rate of pension paid to renters (outside of public rental housing) was inadequate, and concessions available to renters continues to be disproportionately small, and likely to disadvantage renters as a whole, relative to homeowners. Finding 7 of Harmer's report states that:

> *The Review finds that there is strong evidence that many pensioners in private rental housing face particularly high costs and have poor outcomes. Rent Assistance and social housing have complementary roles to play in addressing the financial security of these pensioners. The Review notes that the government has proposed an increased investment in social housing and considers that reforms to Rent Assistance would complement this.*

Whilst we note that there have been relatively recent measures to increase investments in social housing, it is still too early to tell if these measures have been successful, or even if there has been adoption of tax incentives available.

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We consider that the primary issue with respect to renters is at a policy level: the thresholds in relation to Age Pension and Rent Assistance eligibility are designed in a way that reflects the idea that there should be some concessions in exchange for not owning one's own home. We are not aware of any evidence to suggest that these concessions are any more effective now, than they were at the time that Harmer (2009) published the final paper of his review. We note specifically that, where homeowners do not have to pay the cost of living in their accommodation while renters do, Rent Assistance does not cover the full rate of rent, and in fact, is limited to both 75 cents for each dollar, as well as a maximum threshold.

We believe that basic assumptions could be included in a similar way that the standard proposes to consider Age Pension recipients and mortgagors: a market rate of rent could be selected and netted off against the full rate of Rent Assistance to provide an assumed rental expense to be added to the standard for renters.

Question 3.2

We find that a large majority of retirees are financially satisfied, happier than in working life and have low levels of poverty and financial stress. In addition, our standards target homeowners and sit above the age pension. Therefore, we assume using actual expenditure for our targets is appropriate. In your view, is this assumption justified and what evidence motivates your opinion?

We noted that in our response to question 2.2 that there is evidence that Australians are underspending in retirement. Whilst we support the idea that a sort of happiness index is valuable evidence that retirees are comfortable in retirement with their living standards as represented by their spending patterns, we question whether current levels of expenditure have been appropriately interrogated.

As we explained in our response to question 2.4, the standard should be itself subject to benchmarking to ensure that the adequacy of targets is understood in its correct context: money that Australians need to survive on. There is nothing necessarily incorrect about the hypothetical idea that the standard might one day be set at a level less than an objective measure of poverty (such as the Henderson poverty line), provided that such a finding is capable of being justified by researchers. Failure to do so could potentially allow the default inference to be drawn that the standard is condoning poverty.

Our retirement standards – overview, presentation, and methodology

Question 4.1

In order to produce standards that are relevant and interpretable to current pre-retirees, we expressed retirement spending and balance required at retirement in today's dollars in our disclosure. Is this the most appropriate presentation and what caveats if any should accompany this disclosure in our presentation to consumers?

We would agree with the premise that amounts should be expressed in today's dollars. Such presentation ensures that users of the standard are better able to visualise their spending power at today's prices.

One disadvantage of using today's dollars is that Australians may go for a substantial period of time between looking at one instance of savings targets and retirement, and in the interim, inflation affects the targeted amount. For example, what was a $200,000 savings target thirty years before may have become $400,000 in the interim. Such savers may then wonder why they have not as much in retirement as what they originally tried to target.

Thought needs to be given to the way in which engagement in future years is undertaken, in order to ensure that engagement is maintained so that users of the standard are not unintentionally misled.

Question 4.2

We lay out the methodology for construction of the spending levels and savings targets in detail in this section. What, if any, improvements would you suggest to enhance the robustness of our approach?

CPA Australia and CA ANZ generally agree that a high level of confidence is needed to ensure that users of the standard are not inadvertently setting themselves up for what might be a less than comfortable retirement. Whilst we understand the need for simplicity in the provision of 90 per cent confidence, we are aware that 95 per cent confidence could result in significantly higher targeted savings. Publication of the 95 per cent confidence figures could assist more engaged savers to understand how the standard is derived.

We consider the use of the ABS Household Expenditure Survey (HES) to be a useful guide to expenditure patterns but recommend frequent review of future survey data to ensure that changed expenditure patterns are reflected adequately in the standard.

We consider the use of the stochastic model chosen to replicate investment returns to be sound, as this is a method capable of modelling prolonged investment market downturns, such as those likely to show the sequencing risk inherent in the proposed portfolio.

However as past investment experience is never replicated in the future, we believe the modelling would benefit from also using results from a large range of reputably created, randomly-generated, outcomes.

We also believe for both modelling approaches, sensitivity analysis should also be performed.

We were not able to properly ascertain whether the expenditure estimates will differentiate between Australians who are retired homeowners or mortgagors, or whether a figure is used which averages in an expectation of 10 per cent mortgagors to 90 per cent homeowners. To put that another way, we are not certain whether in Appendix A of the Report, the example 66-year-old user is a homeowner or a mortgagor, and whether there would be a different figure provided to her in either circumstance. Clarity regarding this would be useful.

As discussed in our response to question 2.2, the idea that CPI alone should determine annual expenditure increments in the standard should be the exception rather than the rule. We would consider that where data in the HES changes in respect of typical expenditure patterns, the revised expenditure pattern should be used wherever possible in order to avoid abrupt periodic shifts in the standard.

There are inevitable questions regarding work such as this in relation to assumptions around working patterns, with some surveys singled out as assuming – especially in the case of women – the idea that people will follow a full working life pattern from entering the workforce through to retirement. As noted, the pre-retirement cohort of the standard should be an opportunity to ensure one's savings are in order. One would expect at age 55 that parental leave from the workforce has passed, however there are still often duties such as carers' duties which may result in a reduced workload.

In addition, many Australians choose to reduce their workloads as they transition to retirement. This can take the form of reduced part-time hours. The reduction in working hours may be unavoidable, as evidence suggests that mature Australians – in particular, women – may be unable to find work again due to age-based discrimination.

Finally, in cases of illness or injury causing people to leave the workforce – in particular, in cases where a person becomes totally and permanently disabled – this will result in a broken work pattern.

In all three cases above there is unlikely to be unbroken wages growth, and in many cases, there will be a reduction in income. We would recommend that this be highlighted in any instructions provided to users.

One final observation in relation to this concerns the assumptions used. While we consider that the expected returns, volatility, and effective tax rate generated by a 60/40 portfolio to be slightly higher than anticipated, we note that this is not too dissimilar to, for example, portfolios built for use with ASIC's MoneySmart retirement calculator. Prior to the current version of the calculator, the MoneySmart calculator suggested that the following rates of return were realistic for investment in the six hypothetical portfolios created for use with the calculator:

Investment option	Amount invested in cash or fixed interest	Amount invested in shares or property	Expected investment return (before tax and fees)	Assumed effective tax rate on investment earnings	Expected years of negative returns in every 20	Expected standard deviation	Recommended minimum time horizon (years)
Cash	100%	0%	2.70%	15.00%	1	1.64%	0 to 1
Conservative	70%	30%	3.80%	10.60%	2	2.97%	2 to 3
Moderate	50%	50%	4.40%	8.30%	3	4.25%	3 to 5
Balanced	30%	70%	4.80%	6.50%	4	5.70%	4 to 5
Growth	15%	85%	5.00%	5.80%	5	7.41%	5 to 7
High Growth	0%	100%	5.30%	4.10%	6	10.11%	7 to 10

(Note that volatility and recommended minimum time horizon information in the last three columns is derived from declared standard risk measures and recommended minima in place for similar portfolios at a number of funds.)

We note that the portfolio used for the standard is a 60/40 weighted portfolio, which falls between ASIC's "Moderate" and "Balanced" portfolios. This raises an interesting question about the appropriateness of the portfolio used for the standard. In our response to question 1.1, we considered that the approach taken in the Report was suitable due to the similarity between the three groups identified in the Report (disengaged, engaged delegators and engaged DIYs) and the Cooper Review's proposed architecture. In this light, the portfolio used in creating this standard resembles very closely a typical MySuper product.

The question this raises is this: Given the likely use of investment options other than MySuper options by up to 62 per cent of the market who may be classified as engaged delegators and engaged DIYs (and disregarding members of defined benefit superannuation), is the portfolio appropriate to anyone other than the disengaged segment, making up 38 per cent of the research group?

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We would consider that a future interactive version of the standard may be structured in such a way that one's chosen investment mix may provide a figure tailored for them. Such a feature could potentially also model investor risk utilising a similar approach to Monte Carlo analysis using the market data utilised in the stochastic modelling.

Effective tax rates

The Report says, "We employed a portfolio tax rate of 10 per cent during the accumulation phase and zero in retirement."

As Super Consumers Australia is no doubt aware, the tax system is not without its complexities. The two biggest concessions often mentioned in relation to super are the Capital Gains Tax (CGT) discount, as well as franking credits on Australian equity dividends. CGT is complicated further by unrealised capital gains which, although included in investment returns, are not themselves taxable.

The CGT discount has the effect of applying the super fund tax rate to two thirds of assessable capital gains in the accumulation phase – that is, an effective tax rate of 10 per cent.

Pension assets are not subject to tax, meaning that assessable capital gains are exempt from income tax. This however does not mean the issue of CGT can be ignored. Depending on how a super fund determines their tax liabilities it may be that realised capital losses on pension assets can be used to reduce the amount of assessable capital gains subject to tax. Typically, superannuation fund trustees can pass most of the effective tax reduction back to their pension members thereby creating a negative tax rate.

Franking credits adjust a corporate tax rate – typically 30 per cent for larger entities – on dividends paid to most domestic taxpayers, including super funds, to the tax rates applying to a domestic taxpayer. Many incorrectly interpret franking credit refunds as a reduction in tax paid by the accumulation phase of super funds. We acknowledge that the timing of tax payments is an issue from a time value of money perspective however this often has a minor impact on net returns.

We would be happy to talk to Super Consumers Australia about these issues.

Question 4.3

We use a factor to represent the lifecycle change in expenditure between pre-retirement and retirement. Our approach is to look at how a single cohort's spending changes using HES data. Are there other approaches that would help isolate the factor of interest - lifecycle decline in spending?

We are unable to recommend a specific methodology to better examine this transition. However, we believe that the HES method used is sound.

Question 4.4

In the work to date we have not incorporated geographic differences in expenditure such as differences in housing expenditure between regional and metropolitan areas. In your view, would this offer value to consumers and if so, how would it best be implemented?

We believe that there would be enormous value in the provision of variable data incorporating geographical differences, with fuel being a prominent example of the variability in costs between locations. However, we recognise that there may be a significant cost involved in the provision of such information and it may not be immediately available.

We believe that the provision of this sort of standard may require an interface where one enters their postcode into a website along with the rest of their relevant personal information, resulting in the provision of savings targets and expenditure figures relevant to them.

Question 4.5

Given the relative popularity of super funds and financial advisors as sources of retirement planning information, how can we best tailor our standards to suit their methods of information delivery? (e.g., website, consultation.)

As we explained in our response to question 4.4, as the level of sophistication increases in relation to the information provided by the standard, the development of tools such as websites may be required. These may contain different information, depending on whether one is a financial adviser, superannuation fund, or fund member.

It is possible that future additions to functionality may see plugins developed for financial planning software.

For the benefit of financial advisers and superannuation funds, there may be additional benefits in assisting them to understand how to use the standard. In the case of funds, this may need to be at a number of levels including strategic, compliance and operational levels, given the new retirement income covenant requirements.

Question 4.6

Our assumptions for the savings targets imply real terms growth in the age pension. This follows from our assumption that wage growth will outpace CPI in the long term and reflects the current framework for how the age pension is set. In your view, is this the most appropriate approach to take and what evidence informs your view?

We agree with the approach taken in this Report. Presently, the Age Pension is set to increase in line with Male Average Weekly Time Earnings (MAWTE) – a measure of wage inflation which has historically outpaced price inflation. We see no immediate evidence to suggest that this is likely to change in the future.

Question 4.7

We decided to limit our standards to three expenditure levels (low, medium and high). There is a trade-off between utility and complexity here – have we struck the right balance or would additional levels add substantially more value?

CPA Australia and CA ANZ have no response to this question other than to agree that a simpler approach may make the standard more accessible to those inquiring about their retirement preparedness for the first time.

What our standards mean for consumers and the retirement income system

Question 5.1

Are you aware of any research that goes to the question of how well people understand confidence levels and their decision process when faced with a choice between different levels of confidence?

CPA Australia and CA ANZ do not intend to answer this question.

Question 5.2

Do our standards do enough to give people confidence to spend their retirement income, or are there enhancements we could make to further this goal?

We believe that these standards will provide some helpful information and will have a positive impact. However, we remain unconvinced that they will lead to most retirees fundamentally changing how they run their financial affairs. To achieve that objective, we believe that significant behavioural finance research, including engaging with those well versed in conveying complex messages to the community, is required over an extended period of time.

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