23 February 2024

Mr Alan Raine,
Committee Secretary
Senate Economics References Committee
PO Box 6100
CANBERRA ACT 2600

By email: economics.sen@aph.gov.au

Dear Mr Raine,

Improving consumer experiences, choice, and outcomes in Australia's retirement system

As the representatives of over 300,000 professional accountants, Chartered Accountants Australia and New Zealand (CA ANZ) and CPA Australia thank you for the opportunity to comment on this inquiry. We make this submission on behalf of our members and in the public interest.

CPA Australia and CA ANZ provide this submission in response to this inquiry to consider ways of improving consumer experiences, choice, and outcomes in Australia's retirement system. We have chosen to respond to two areas considered as part of the Terms of Reference of this review. Additionally, we are responding through the lens of the retirement income system, and only comment incidentally on matters which are not traditionally considered as part of this system.

Retirement income in superannuation

We recently lodged a submission (attached) jointly to Treasury in response to their discussion paper which focuses on retirement income stream products[1]. Our submission aimed to clarify historical factors shaping Australia's retirement income landscape and dispel misconceptions. We noted that Australia's policy allows retirees to access benefits as lump sums, with no indication of policy change. Insurance options in retirement are primarily available through superannuation funds as longevity-focused retirement income streams.

We noted in our submission that the retirement income system is incredibly complicated, primarily because of government policy settings and the lack of interaction between various policies. An added problem is constant changes to those policy settings. Wholesale reform and simplification is essential if Australia is to successfully navigate the challenges of population ageing.

We argued that retirement benefit provision is best handled by APRA-regulated funds, and pointed out that there is little need to subject Self Managed Superannuation Funds (SMSFs) to the retirement income covenant. While we support lifetime annuities and pensions, their uptake may require increased government financial assistance and consideration of lump sum withdrawals for expenses like aged care.

We opposed limiting lump sum withdrawals, considering that unexpected expenses are normal in retirement. We proposed policy enhancements including:

- Retiree representation on trustee boards;
- Simplification of the regulatory environment;
- Potentially adjusting income withdrawal rules; and
- Providing assistance for alternative retirement income products.

[1] Treasury, The (2023) *Superannuation in retirement.* Available at https://treasury.gov.au/consultation/c2023-441613 . (Accessed 22 February 2024)

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We also advocated for more assistance from APRA-regulated funds for retirees, emphasising the necessity of personal financial advice.

Policy options to support greater choice and quality of life in the retirement income system

At a high level, we note that the traditional examination of the retirement income system has considered that the policy approach is defined by the OECD's three pillar retirement income system model. The OECD's three-pillar retirement income model is a framework designed to ensure financial security for individuals during their retirement years. Here's a brief overview of each pillar:

1. **First Pillar - Public Pension Systems:** This pillar consists of publicly managed pension schemes, often operated by governments.
2. **Second Pillar - Occupational or Workplace Pension Plans:** The second pillar encompasses employer-sponsored or occupational pension schemes. These plans are often funded through contributions from both employers and employees, and they aim to supplement the income provided by the first pillar. These schemes may be mandatory or voluntary, depending on the country and specific regulations.
3. **Third Pillar - Private Pension Savings and Individual Retirement Savings**: The third pillar involves individual initiatives to save for retirement. It includes voluntary contributions to superannuation funds but are also intended to consider non-superannuation savings, as well as the family home. These accounts offer individuals flexibility and autonomy in managing their retirement savings and investments. Tax incentives and other government policies often encourage participation in this pillar.

Overall, the three pillars work together to provide a comprehensive retirement income system, combining public support, employer-sponsored plans, and individual savings to ensure financial security in retirement. However, we are aware that matters in retirement such as healthcare and aged care are matters which heavily affect retirement. These are matters which have been traditionally out of scope for all recent Government reviews of the retirement income system.

We consider that these are matters which should be very much part of the development of policy for retirement planning in Australia.

In Australia, there are several policy options available to support greater choice and quality of life in retirement. These options encompass various aspects such as the aged pension, financial advice, home ownership and downsizing, and insurance. We have suggested several considerations below:

- **Age Pension Reform:** Implementing reforms to the Age Pension to ensure sustainability and adequacy of benefits. This may include adjusting eligibility criteria, indexing methods, taper rates and asset and income test thresholds to better reflect changing demographics and economic conditions. Consideration needs to be taken in relation to Australians who are not homeowners as they increase as a proportion of the population, and whether Age Pension eligibility concessions for non-homeowners is as fair as it could be.
- **Financial Advice Accessibility:** Promoting greater accessibility to financial advice for retirees to make informed decisions about their retirement savings and investment strategies. Work is presently underway on this as part of implementation of the Quality of Advice Review, and we are committed to measures to improve the provision of financial advice to retirees. Research released by CA ANZ found that most people would not wish to receive so called "robo advice" and would prefer to receive face-to-face advice from a trusted human[2].
- **Home Ownership and Downsizing Incentives:** Introducing incentives to encourage home ownership among retirees and facilitate downsizing to more suitable accommodations. This could include measures such as tax breaks for downsizers, equity release schemes and support for affordable housing options specifically designed for seniors. It might also include assistance when planning and executing moving home for older retirees.

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[2] Chartered Accountants Australia and New Zealand (CA ANZ) (2020) *Report – Positive future for financial advice, Chartered Accountants Australia and New Zealand.* Available at: http://tinyurl.com/3u7yzh25 (Accessed: 22 February 2024).

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- **Insurance Options for Retirees:** Coverage for retirees is often restricted due to age. Enhancing insurance options tailored to the needs of retirees, including health insurance, long-term care insurance, and aged care funding arrangements can insure a greater quality of life in retirement. However, this must not come at the expense of programs like Medicare. Enhancements may involve improving affordability, coverage and transparency of insurance products, as well as developing innovative solutions to address the many extant and emerging risks associated with aging populations.
- **Superannuation System Improvements:** Continuously reviewing and refining the superannuation system to enhance retirement savings outcomes for all Australians. This might involve measures such as increasing the mandatory employer contribution rate, consolidating multiple accounts to reduce fees, working with trustees to improve retirement income products and their appropriateness to members and promoting competition and transparency within the superannuation industry.
- **Workforce Participation and Age Discrimination Policies:** Implementing policies to support older workers' participation in the workforce, including measures to address age discrimination, provide training and reskilling opportunities, and facilitate phased retirement arrangements. This can help retirees supplement their income, maintain social connections and contribute to overall economic productivity.
- **Healthcare and Aged Care Support:** Ensuring access to affordable healthcare and aged care services for retirees, including measures to improve the quality, accessibility and affordability of healthcare services, aged care facilities, and support services for seniors with disabilities or chronic health conditions. Increased transparency regarding pricing and funding arrangements to ensure that retirees and their advisers can plan ahead where major expenditure is required.

Overall, a comprehensive approach that addresses various aspects of the retirement income system, including pension provision, financial planning, housing, insurance, and healthcare is essential to support greater choice and quality of life for retirees in Australia. These policy options should be designed to promote financial security, independence and well-being in retirement while also taking into account the diverse needs and preferences of older Australians.

For further information in relation to our submission, please contact Tony Negline, Superannuation and Financial Services Leader at CA ANZ at or Richard Webb, Superannuation Lead at CPA Australia at .

Yours sincerely

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Attachment: Joint submission to Treasury in response to Retirement Phase of Superannuation – Discussion Paper ("Discussion Paper"), lodged 9 February 2024

Introduction / Executive Summary

This submission will look at important historical reasons for Australia's retirement income environment and dispel a series of myths which have accrued over time.

For a variety of reasons, Australia has developed policy settings that allows retirees to take some or all retirement benefits as a lump sum. We are not aware of any intention to change these policy settings.

We are generally of the view that the provision of retirement benefits is a problem for APRA regulated superannuation funds. Self Managed Superannuation Funds appear to provide a service that meets retirees' needs, and we do not believe that there is presently any need for SMSFs to be subject to the retirement income covenant. We will explain how we reached this conclusion and why we think it has come about.

Whilst we think lifetime annuities and pensions are very useful products, we do not think they will have widespread appeal in Australia unless the government offers greater levels of financial assistance. Additionally, we believe that unless product design will consider lump sum withdrawals for large expenses late in retirement such as aged care, as well as consumer protection features such as portability, the uptake of these products will be limited, creating a future scrapheap of legacy products.

We do not support any plans to limit lump sum withdrawals. Large, unexpected, expenses are a normal part of retirement.

Finally, we have suggested a series of policy proposals to improve the retirement phase of superannuation:

- Inclusion of retiree representatives on the boards of equal representation trustee boards
- Wholesale simplification of the retirement income system regulatory environment to ensure inconsistencies and complexities are removed
- Possible adjustment of the minimum income withdrawal rules
- Providing significant additional assistance to retirees if the government would prefer a retirement income product different to account based pensions to be the market preferred default product

While we consider additional guidance, education and communication for retirees and prospective retirees is welcome, we believe these are only partial solutions.

We do think APRA regulated superannuation funds could do much more to assist those nearing retirement and existing retirees. We believe any draw-down offerings different to government selected defaults should only be offered after a person has received personal advice from a financial adviser.

We do not support the idea of government funded free and impartial guidance for retirees in or approaching retirement similar to the United Kingdom's PensionWise service.

Further details regarding our proposals are explained below.

A history of superannuation and retirement income product design

Risk of sub-optimal outcomes: investment risk moved from employers to members

For many generations, retirement benefits for Australian employees were provided by employers. Many of these employers offered defined benefit arrangements ("DB arrangements" – sometimes referred to as "benefit promise" type arrangements). Typically, benefits from these funds were based on a formula involving length of service and average salary on termination.

Employers for these types of arrangements traditionally needed to ensure the retirement fund had sufficient money and other assets to pay benefits as and when they became payable. Effectively, this involved the employer making sufficient contributions to ensure the superannuation fund was always financially solvent. If the investment experience of the superannuation fund was below expectations, then an employer had to make additional contributions to the scheme to ensure benefit promises could be met. In effect, the employer took on the investment risk.

The majority of DB arrangements paid lump sum benefits on retirement, death or permanent disability. A minority also allowed for pension benefits while some offered members a choice – a mixture of pension and/or lump sum – on retirement.

Over the last thirty years most DB arrangements have been closed to new members and slowly but surely those who were in these types of superannuation funds have been leaving. For example, according to APRA's *Annual Superannuation Bulletin*[3], between June 2015 and June 2022, the number of members accounts in DB arrangements fell from 926,000 to 792,000.

Retirement benefits for the vast majority of individuals are now based on contributions, how well the super fund trustees invest and the expenses and taxes that are paid. These are sometimes called accumulation or defined contribution schemes. For these products it is the superannuation fund member who is subject to the investment risk.

Retirement phase income stream products

Traditionally, these products were defined benefit pensions provided by such schemes or via annuities offered by life insurance companies or friendly societies.

Some defined benefit pensions are still offered to a small number of current employees – typically public sector or other government employees. These pensions remain popular with many employees, due to the generosity of some arrangements. We have more to say about this aspect later in this submission.

In July 1988, the Australian Taxation Office (ATO) prohibited a product called a variable annuity[4] because the ATO concluded that the product did not satisfy the then definition of annuity in the *Income Tax Assessment Act 1936*. The product had the following features (paragraph 13, Taxation Ruling IT 2480):

a. *The purchase price forms part of the vendor's statutory funds and is credited to an investment account maintained by the vendor in the purchaser's name.*

b. *Administration charges and policy fees, the latter subject to periodic review, are to be debited to the account.*

[3] https://www.apra.gov.au/annual-superannuation-bulletin

[4] https://www.ato.gov.au/law/view/document?docid=ITR/IT2480/NAT/ATO/00001

c. *Interest is to be credited each year to the investment account, the rate depending upon the performance of the underlying statutory fund in the preceding year.*

d. *Liability of the vendor is limited to the balance of the funds in the purchaser's account.*

e. *At commencement of the contract the purchaser may nominate the amount to be drawn as the annuity each year.*

f. *The annual payment may be varied from time to time upon notice being given by the purchaser.*

g. *Each annual payment is debited to the purchaser's account.*

h. *Upon death before the expiration of the "annuity" term, the balance in the investment account is payable to the purchaser's estate.*

i. *At the end of the annuity term the balance in the investment account is payable to the purchaser.*

j. *Should debits in the investment account exceed credits, the contract ends and no further "annuity" amounts are payable*

Some variable annuity products allowed investors to take income of only $1 per annum.

From December 1986 a small number of retail superannuation funds began offering what became known as "allocated pensions" or APs. In reality, these were similar products to variable annuities but APs were generally offered via superannuation funds and required an individual to take a minimum pension of an amount often based on life expectancy.

APs were immediately popular primarily because they were relatively straightforward and hence simple to explain. They also allowed investors to take lump sum withdrawals from such products, if that was the member's preference or their personal circumstances required such a withdrawal and provided a death benefit to an investor's spouse and dependants in a variety of forms. They could often be provided quite cost effectively by superannuation funds.

Such products were given official government approval in June 1992 in the *Security in Retirement* statement[5] with allocated pensions and annuities permitted. As a result, from mid 1994, allocated annuities offered by life insurance companies began to be offered in the market.

These pensions effectively allowed superannuation funds and life offices to offer income stream products without the need to hold reserves to allow for adverse investment outcomes.

The Australian retirement product landscape

APRA regulated superannuation funds had 1.7 million pension or annuity accounts in 2020/21 according to APRA 2022/23 *Annual Superannuation Bulletin*[6]. The market value of assets held in those accounts was about $550 billion. Of those member accounts, 1.4 million (81 per cent) were held by those aged 65 years and over, which had $403 billion (73 per cent) of total pension assets.

Total APRA regulated member accounts was 23.2 million and total assets under management was $3.3 trillion.

[5] https://catalogue.nla.gov.au/catalog/1873249

[6] https://www.apra.gov.au/annual-superannuation-bulletin

This means pension member accounts represent 7 per cent of members but have 16 per cent of total superannuation assets in those accounts.

But the breakdown between APRA regulated superannuation fund segments is important:

	Total member accounts '000	Members accounts aged 65+ '000	Members accounts aged 65+ as percentage of total member	Assets under mgt $b	Assets for those aged 65+ $b	Assets for those aged 65+ as percentage of total assets
Corporate	251	31	12%	57	12	21%
Industry	11,360	731	6%	856	159	17%
Public sector	3,545	715	20%	756	219	29%
Retail	6,965	1,106	16%	678	229	34%

From this data we can see that those aged at least 65 have approximately $619 billion in APRA regulated superannuation fund accounts which means 65% of this money ($403 billion as noted above) is in pension accounts.

Unfortunately, APRA does not publish the number of pension accounts by APRA regulated superannuation fund for each sector.

Nevertheless, it is clear that some sectors of the APRA regulated superannuation population have been more actively engaged with older members than other APRA regulated superannuation sectors.

As we have noted above across all APRA regulated superannuation fund sectors those aged at least 65 have fewer accounts but more assets under management in relative terms. We discuss this matter later in this submission.

ATO Self Managed Superannuation Fund (SMSF) statistics estimate that of the 577,700 SMSFs as at June 2021[7], roughly 260,000 of these funds had at least one member who was retired. About $17.5 billion was paid as pension income payments. Roughly $14 billion was paid as lump sum amounts.

Based on the 2023 Class Annual Benchmark Report[8], approximately $410 billion of total SMSF assets was being used to provide pensions alone.

For both SMSFs and APRA regulated superannuation funds there will be a cohort of members who have money in pensions as well as accumulation. The Class Annual Benchmark Report shows that approximately $158 billion of SMSF assets was being used by members in this category however we do not know how much of this money is being used to pay pensions and how much is in accumulation.

ATO statistics show that 41.4 per cent of SMSF members, approximately 445,000 people, are aged at least 65 and likely to be in receipt of at least one pension from their SMSF.

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[7] https://www.ato.gov.au/individuals-and-families/super-for-individuals-and-families/self-managed-super-funds-smsf/in-detail/statistics/annual-reports/self-managed-super-funds-a-statistical-overview-2020-21/data-tables?anchor=Datatables#Datatables

[8] https://www.class.com.au/educational-resource/annual-benchmark-report-2023/

ATO statistics also show that 11.6 per cent of APRA regulated superannuation fund members are aged at least 65 – this equates to approximately 2.47 million members – details of the number of members in APRA regulated superannuation funds is not published.

We agree with the sentiment expressed in the Discussion Paper that "there has been less consideration of the retirement phase of superannuation" (see p 4) compared to the pre-retirement phase. However we believe the only conclusion that can be made from the above statistics is that it has been the APRA regulated superannuation sector that has given the retirement phase less consideration than the accumulation phase.

It is stated in the Discussion Paper (p.8) that,

> *While SMSF members are encouraged to consider their long-term retirement income requirements, they do not receive the same entitlement to support that members of APRA regulated funds receive under the retirement income covenant.*

It is clear from the above statistics and acknowledged by the Discussion Paper that the APRA regulated fund sector has not focused on their retiring members. In the main, only the SMSF sector was interested in retiring individuals. It appears most retirees operate their SMSF effectively. We know of no statistics to dispute this comment.

As a result, we **do not support** the proposal contained in the Discussion Paper that SMSF trustees be subject to the Retirement Income Covenant.

Retiree representation at trustees

Based on the above APRA regulated super fund data, it can be seen that retired members have significant assets in those funds. But who represents their interests if the trustees are mostly taken from sponsoring employers (or employer associations) and related unions or union organisations?

We consider this to be a major flaw in the prudential framework and prompt legislative corrective action is essential. We recommend that retirees have representation on equal representation trustee boards.

Lump sums conflict with the government's proposed objective of superannuation

ABS data[9] shows that there were 4 million Australian retirees in 2020/21 -

Of these 1.57 million have received at least one lump sum withdrawal from superannuation.

What have those who have received a lump sum from superannuation done with those proceeds? The ABS records the following responses:

Rolled it over, invested it in an approved deposit fund, deferred annuity or other superannuation scheme	10%
Purchased an immediate annuity	0%
Invested the money elsewhere, personal savings or bank	13%
Paid off home, home improvements, bought new home	28%
Bought or paid off car or other vehicle	12%
Cleared other outstanding debts	11%
Paid for a holiday	8%
Assisted family members	4%
Undecided, Did not know	3%
Other	11%

[9] https://www.abs.gov.au/statistics/labour/employment-and-unemployment/retirement-and-retirement-intentions-australia/latest-release

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It would appear that more than one response was permitted in response to this question. This data suggests that just over 50 per cent of lump sum proceeds may have been used to pay down a home loan or personal debts or purchase a new vehicle. Forty per cent of lump sums received in the last four years, were for amounts less than $40,000.

Based on Productivity Commission (PC) research published in 2015[10] many of those who took a lump sum from superannuation only had a modest superannuation balance. The PC research shows that it is difficult to get an accurate picture of the actual amount of lump sums paid from the superannuation system[11].

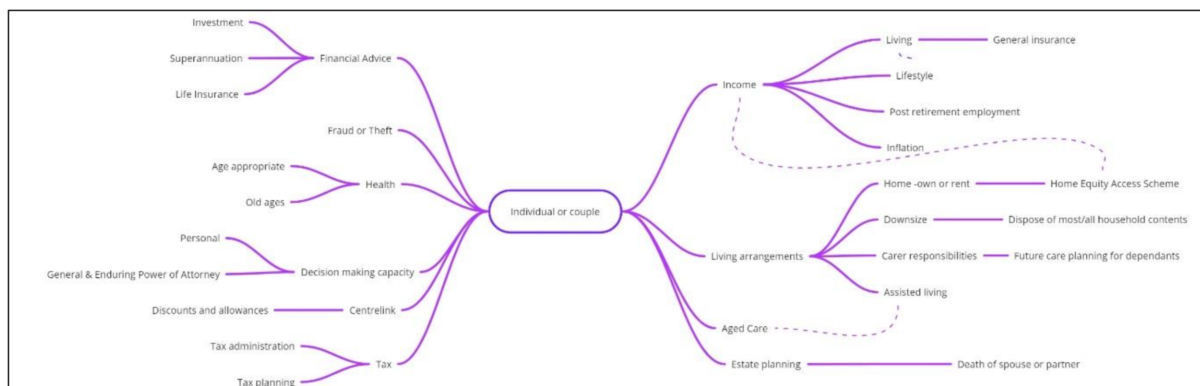
According to the ABS data, just over one million retired people have received some or all their retirement income from a superannuation annuity or pension.

"The Government's proposed objective of superannuation makes it clear that the purpose of superannuation is to deliver Australians with income for a dignified retirement", according to the Discussion Paper (p. 9). We are concerned that this statement implies that as a result access to lump sums withdrawals by superannuation fund members will be restricted, if not banned. We would be against such a policy change.

Interestingly 68 per cent of all those retired from the workforce had contributed to superannuation prior to retirement. Just under 60 per cent of this cohort had been a member of a superannuation fund for at least 15 years.

The retirement puzzle: the challenges for retirees

The retirement puzzle for individuals is incredibly complex. We think many – but not all – of the issues retired individuals have to face are mentioned in this diagram:



Source: CA ANZ

One of our main points is that many of these issues are interlinked. A change in one area can have profound impacts on many other areas. For example, suppose a person had decided to move out of their family home to a smaller more manageable residence. The first issue that needs to be solved is the process of moving and dealing with all the items in their current home. Many retirees find this a significant practical hurdle. Quite a few decide it is too big a problem and resolve to stay in their current home despite it being a less than optimal solution for them personally.

In any event decisions about what should happen to any excess proceeds from the sale of the property become complicated. For example:

[10] https://www.pc.gov.au/research/completed/superannuation-post-retirement

[11] https://www.pc.gov.au/research/completed/superannuation-post-retirement/super-post-retirement-volume1.pdf, see p. 80

- Are the excess proceeds needed to provide living or lifestyle expenses?
- Should the proceeds be contributed to superannuation? If the individual has Transfer Balance Cap space, should the proceeds be used to commence another pension? Do the proceeds cause or may cause the client in the future to face the additional 15 per cent tax from the government's proposed new $3m Better Targeted Superannuation Tax Concessions measure?
- What impact will any additional assets – and the income earned from these assets – have- from a Centrelink and/or aged care assessment perspective?
- Will these proceeds be dealt with differently on death?
- What is the cost of getting tax planning, financial and legal advice for the additional assets to consider all the above?

The Discussion Paper (p. 8) notes that:

> *Retirees are required to decide how they will best draw down their superannuation over the course of their retirement, while managing health and aged care costs, leisure and other living expenses, as well as being prepared for the unexpected.*

As we have shown in the diagram above this assessment is incomplete. We are deeply concerned that Treasury appears to be indicating that it does not understand the enormity and complexity of the decisions that retirees face.

Why is the system so complex? We believe that this is primarily due to government policy settings.

It has remained the case that many government policy settings are developed in silos without adequate consideration of and other impacts or dependencies. This is not a recent problem but has been occurring for many decades.

A good example of this is the potential changes that may be made to the aged care assessment process[12].

It has been claimed that more than 30 per cent of individuals have delayed applying for the Age Pension for at least 12 months after those individuals had become eligible to receive it[13] with other research indicating that, "most seniors (regardless of socio-economic background) opt to seek a helping hand when applying for their Age Pension rather than attempting it independently. The Age Pension application process is felt to be too complicated for most seniors to attempt on their own."[14]

We agree with the sentiment expressed in the Discussion Paper (p. 4):

> *For many Australians, retirement represents a big and complicated life change. It is inherently challenging to navigate the different parts of the retirement income system, combine multiple income sources, consider the needs of your partner and dependents, and manage the numerous risks and changes in circumstances. Retirees will face many of these complexities throughout retirement. Australians need better access to information, advice, and well-rounded retirement income products to help them navigate these challenges.*

However, we are of the view that retirement on its own is challenging but what the above fails to acknowledge is that many of the problems that retirees must solve and work through, sometimes

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[12] https://www.pmc.gov.au/domestic-policy/aged-care-taskforce

[13] https://insights.linkgroup.com/FormBuilder/_Resource/_module/sEWV08wDIE-hXLh5dNDWWQ/article/0839_0722_Link_Advice_Whitepaper_vF.pdf

[14] https://nationalseniors.com.au/research/retirement/the-evolution-of-retirement-income-a-2022-snapshot – refer to p. 4 of the report

constantly re-work, arise because of government policy, constantly changing government policy settings and its lack of consistency across different government policy areas in our diagram above.

If Australia is to successfully navigate the next three decades, then this situation needs urgent rectification. We recommend that wholesale simplification of the retirement income system regulatory environment to ensure inconsistencies and complexities are removed.

The popularity of account-based pension products

The vast majority of SMSF pension money is in account-based pension products (ABPs), and approximately 84 per cent[15] of APRA regulated superannuation fund pensions are in account-based pension products.

As we have noted above, they are popular because they are simple and flexible products and hence easy to understand and they are adaptable. Moreover, initially they were developed in the actual market and not in a "product laboratory".

We are of the view that if the government would like a different retirement product to be used instead of ABPs then two policy changes will be required:

1. The government must provide incentives in the same way public sector employees are enticed into defined benefit pensions provided by their superannuation funds; the level of incentives would likely have to be of equivalent value as that provided to public sector employees, and
2. Appropriate products need to be developed and evolved in the marketplace. To date, closed consumer testing has been an inadequate guide as to what will be popular in the community, and we see no reason why this limitation will not continue.

The discussion paper (p.9) states:

> *The [Retirement Income] Review found some retirees held the view that they should only draw on the income earned on their superannuation assets, not the capital.*

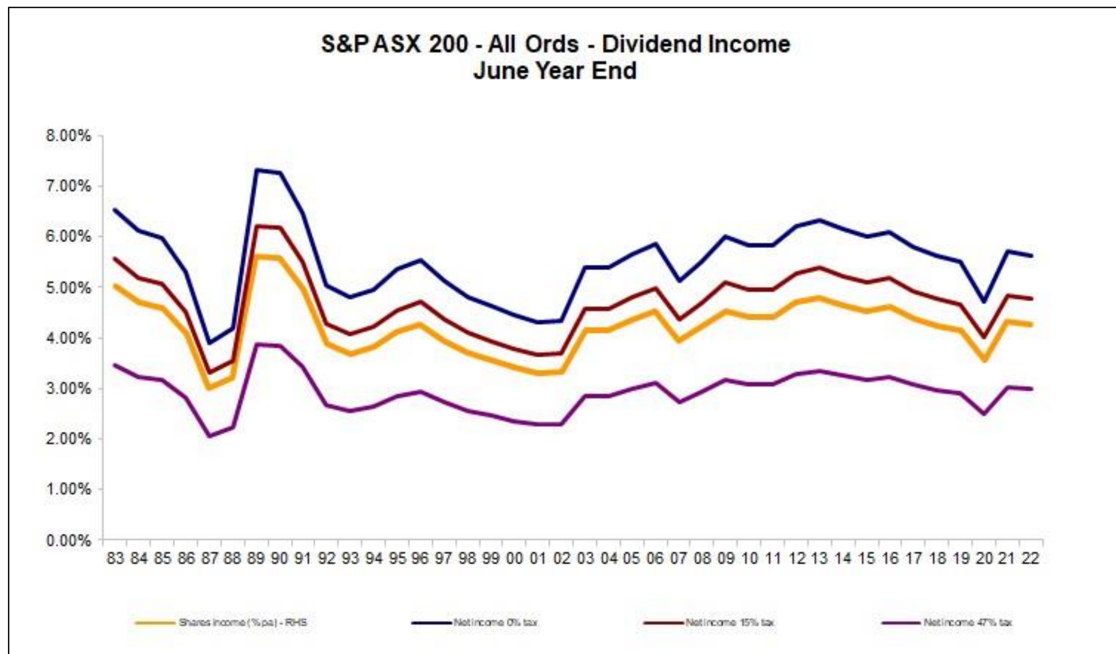
Our analysis shows that this is unlikely to be possible in the medium to longer term.

The minimum pension draw-down rates are as follows:

Age of beneficiary	Minimum pension draw-down rate
Under 65	4%
65 – 74	5%
75 – 79	6%
80 – 84	7%
85 – 89	9%
90 – 94	11%
95 or more	14%

[15] APRA Annual Superannuation Bulletin, https://www.apra.gov.au/annual-superannuation-bulletin

By way of comparison, here are the income percentage returns for the ASX 200 from June 1983 until June 2023. It assumes current tax policies are in place, dividends have not been reinvested and 75 percent of dividends have franking credits attached. It also assumes that there are no investment management fees.



Key statistical items for each line are:

	ASX 200 share income (% p.a.)	0% tax rate	15% tax rate	47% tax rate
Average	4.2%	5.5%	4.7%	2.9%
Median	4.3%	5.6%	4.8%	3.0%
Highest	5.6%	7.3%	6.2%	3.9%
Lowest	3.0%	3.9%	3.3%	2.1%

We have used this data because Australian listed shares typically pay dividend income at a higher rate than many other investments such as Australian residential property.

There are two issues here: one is the minimum income which a superannuation pension must pay, and the other is what a retiree elects to live on.

Based on the above analysis, it is improbable, on an ongoing basis, for pension payments to be made solely from the income earned on an investment especially after the payment of expenses to run a superannuation fund. This is the case from age 65 and highly likely to be the case from age 75 onwards.

Our members have told us that some self-funded retirees withdraw the minimum pension as required by the ABP minimum percentages and then elect to live on less than the income they have had to be paid. Any excess – likely to effectively be the capital that had to be withdrawn from the pension – is then invested in their personal name. Most people in this cohort receive a part age pension or are fully self-funded.

It is commonly accepted amongst financial advice practitioners that a super fund, at all times, should have the next two years of income payments held in an at-call bank account (or a short-term deposit account) in order to ensure that pension income payments can be made on time and at the required level.

The popularity of account-based minimum drawdowns

The Discussion Paper (pp.9-10) says that the account-based income stream minimum drawdown rates:

> *...are generic settings which are not designed for, and do not lead to, an optimal retirement income for all retirees.*
>
> *For many, withdrawing at the minimum leads to a sub-optimal income stream. Their income varies arbitrarily and increases throughout their retirement despite the tendency for retirees' spending to fall as they age, notwithstanding costs such as increased health expenses. Better strategies could see them with a higher income that is smooth across their life or better reflects consumption patterns.*
>
> *Without an appropriate product solution and faced with the uncertainty about one's life expectancy, this approach is a reasonable strategy. Life expectancy at birth in Australia is 83, however this translates to a female retiree at age 65 having a 45 per cent chance of living to 90, and 33 per cent for a male retiree. In effect, the likelihood is even higher as improvements in health and medicine will further increase life expectancy during a person's retirement. As a result of increased life expectancy, more retirees need to rely on retirement incomes that are sustainable into their late 80s and 90s.*
>
> *Evidence suggests varied reasons for low drawdowns. Retirees often do not have access to the right tools to assess what drawdown amount is best for their circumstances. Retirees may default to the minimum amount as a rule of thumb when faced with choice overload, concerns about the cost of aged care and medical expenses, or concerns about the risk of running out of savings. Some retirees may have minimum drawdown rates effectively chosen for them by their fund and are unaware they can even vary the rate of their superannuation pension.*
>
> *Some retirees perceive minimum drawdown rates as the Government's recommendation for superannuation drawdowns. However, minimum drawdown rates are not a recommendation nor guidance tool. Their purpose is to ensure that retirement savings receiving an earnings tax exemption are used appropriately for retirement income purposes.*

We make the following comments to the above:

Firstly, the assertion that "withdrawing the minimum pension leads to a sub-optimal income stream" is presented without a reference. We note that this is subjective and whilst for some it may be sub-optimal, it also may not be. It will depend on many different factors and such blanket assertions are inappropriate.

When the minimum income percentages were first announced[16] (in 2006) it was stated that,

> *A minimum amount would be required to ensure that the capital is generally drawn down over time. This would enable a larger account balance to accumulate in the early years with a drawdown of capital and income in later life if that suits the pensioner's circumstances. If a pensioner finds they have unexpectedly large expenses in a particular year, they could withdraw as much as required to meet that need, including the whole amount.*

[16] https://ministers.treasury.gov.au/ministers/peter-costello-1996/media-releases/plan-simplify-and-streamline-superannuation, p. 21

These minimum income percentages replaced age-based minimum and maximum pension valuation factors (PVFs). The minimums were designed to ensure that a pension would be payable, on an actuarial best estimates basis, until average life expectancy. The maximum PVFs were designed, on actuarial best estimates basis, to ensure the pension was only payable to age 80.

The Retirement Income Streams Review[17] (RIR Review) found that "the current annual minimum drawdown requirements are consistent with the objective of the superannuation system to provide income in retirement and should be maintained". It further stated:

> *The current minimum drawdown factors are based on conservative assumptions about real interest rates, such that if investment earnings average 2 to 3 per cent more than inflation over the course of a person's retirement, then the current rates ensure that retirement income can be broadly maintained in real terms over a fairly long retirement.*
>
> *While investment volatility is likely in the short term, for the purpose of minimum drawdown a long-run view is appropriate. Historical experience suggests that an expectation of 2 to 3 per cent per annum in real earnings is realistic and, if anything, conservative. …*
>
> *The AGA [Australian Government Actuary] advised that, even on somewhat conservative assumptions about investment, the current minimum drawdown factors lead to an expected average balance on death of around 25 per cent of the purchase price in net present value terms.*
>
> *Given that the objective of the drawdown rates is to ensure that superannuation balances are used primarily to provide retirement income and that the amount of money left over on death is not inappropriately high, we have concluded that although life expectancies are increasing, there is not a strong case for reducing the minimum drawdown factors at this time.*

The RIR Review document contains an example and graph which shows the result of a person commencing an account-based pension with $100,000 that earns 6 per cent per annum. The Review states: "an account-based pension drawn down only at the minimum rates can be expected to last beyond average life expectancy, although the [net present value] NPV of the annual income will generally gradually diminish … The net present value of income from the pension declines steadily over time, but 'ratcheting-up' occurs when the regulated percentages increase, resulting in a somewhat variable income stream in nominal terms."

Secondly, there is an additional assertion that:

> *[Retirees'] income varies arbitrarily and increases throughout their retirement despite the tendency for retirees' spending to fall as they age, notwithstanding costs such as increased health expenses.*

The amount of income payable from an account-based pension is based on the net market value (NMV) of assets. By their very nature, the NMV of many asset classes are variable. This method is a deliberate regulatory design feature.

In any event, part-age or service pensioners often find that their Centrelink income fluctuates based on the market enforced variations in private pension income payments.

Alternatives are available and it is open to the government to change this approach. For example, those who retire before 70 could be forced to take at least 5 per cent of their initial account balance as income in the first year and then after that income paid must increase each year by increases in average weekly ordinary time earnings so that a retiree maintains living standards commensurate with those still working. As wages increase typically faster than consumer inflation, we consider average wage increases to be a better factor for increasing income payments. However, our initial analysis suggests that applying this rule sees less income paid over time to an individual compared with the current method. We would welcome the ability to assist in the design of alternatives.

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[17] https://treasury.gov.au/publication/retirement-income-streams-review

Thirdly, the assumptions in the above quote about life expectancies is understated; although it does acknowledge that health, medicines, lifestyles, safer workplaces and other changes that are likely to improve life expectancies. Life expectancy data combines experiences for single people and couples. There is also a considerable body of international research arguing that couples tend to survive longer than single people. There is also international research that shows that variables such as religious beliefs may extend life expectancies.

According to Australian Bureau of Statistics data[18], life expectancies can be influenced by educational attainment, occupation and where a person lives.

We note that from the 2019 HILDA report, at least 65% of individuals aged at least 65 lived with their spouse – in other words they were a couple.

The government should ask the Australian Government Actuary to investigate these matters and publicly report his findings as a significant portion of the population are impacted by variable life expectancy factors which mean it is likely average life expectancies have limited practical application.

Fourthly, we reject the statements that retirees elect to use the statutory minimum income amounts because they do not have suitable tools or as a rule of thumb when faced with choice overload. When a person retires, they effectively use their retirement savings to provide for their ongoing living and lifestyle expenses as well as to self-insure for all future contingencies such as health, aged care expenses, solve the longevity puzzle including possible mortality improvements and allow for ongoing government policy setting changes which may create positive or negative outcomes.

We would argue that, in these circumstances, an initial conservative approach in how much income is paid from an ABP is simply good common sense.

Our members have told us that the Transfer Balance Cap (TBC) has altered retiree behaviour – before the introduction of the TBC retirees would often take an income amount higher than the statutory minimum from their ABP. The TBC has seen them reduce their income amount to the minimum required with any additional income amount being withdrawn as lump sum commutations as this can have a favourable impact on their Transfer Balance Account balance.

We further note the lack of comparable statistics which would identify retirees who use a combination of minimum pension drawdowns and lump sum withdrawals. Such retirees may prefer this for pragmatic reasons on an *ad hoc* basis, or may have implemented a long-term strategy of retirement income drawdowns utilising such a combination.

If the *Better Targeted Superannuation Tax Concessions* measure is legislated, then we expect this to encourage retirees to withdraw required lump sums from the portion of their retirement assets that face a higher tax rate.

Fifthly, we reject the comment above that the "minimum drawdown rates are not a recommendation nor guidance tool". To repeat the quote from the Retirement Income Streams Review above: "the objective of the drawdown rates is to ensure that superannuation balances are used primarily to provide retirement income and that the amount of money left over on death is not inappropriately high". Based on this, and wanting to ensure retirement savings last for an unknown period of time with unknown future expenditure, why would a sensible retiree not use the minimum drawdown rates as a guide and as an effective method to ensure they keep sufficient "rainy day" or "what if" money available?

The argument that many retirees die with more assets than they had when they fully retired appears to be based on a nominal assessment not a real, or net present value, assessment. Our modelling, available upon request, agrees that most retirees who survive until at least average life expectancy have assets below their initial investment on a real basis.

In any event, a significant cohort of retirees die before reaching average life expectancy and often die with assets greater than what they had at retirement. Why is such an outcome considered bad?

It is our understanding that some APRA regulated super funds require a member that wishes to receive income higher than the permitted minimum income amounts must seek financial advice. This

[18] https://www.abs.gov.au/statistics/people/population/life-expectancy/2020-2022

requirement exists to ensure that taking more than the minimum is in the best interests of the member and that they fully understand that taking more than the minimum may see them run out of retirement savings before they reach their likely life expectancy.

Sequencing Risks

The Discussion Paper states that,

> *Sequencing risk is how investment losses can be magnified if they are poorly timed with your retirement plans.*

This is only partly correct. It arises if assets must be disposed of in order to pay some or all of a pension's income. To prevent the disposal of assets causing sequencing problems many account-based pensioners retain the next two years of pension payments in cash accounts. Such a strategy, often known as a "bucket strategy" is often used in retirement planning to minimise this effect.

This problem can often happen in unitised investment structures. We believe that unitised investments which combine income and capital returns via a prevailing net market value of assets may result in unnecessarily early asset disposal and, subject to a range of factors including being in existing member's best interests, may need to banned for income stream products.

SMSF specific issues

The Discussion Paper states that:

> *SMSFs may face unique challenges in retirement, including a need for exit planning in the event of the member-trustee becoming unable to manage the fund at older ages or due to the death of a member of the fund who undertook management responsibilities.*

This is certainly an issue for SMSFs. But it is not unique to this type of structure. They also arise in other investment structures such as companies and discretionary trusts.

The SMSF sector is well aware of these matters and good practitioners regularly raise them with their clients.

It is difficult to get all superannuation fund members to consider all older age issues and then act on what needs to be done. It has been estimated that 52 per cent of Australians die without a will[19]. A minority of APRA regulated superannuation fund members have competed a Binding Death Benefit Nomination or taken advice on which type of nomination would be most suitable for their circumstances. Failing to address these issues is not unique to SMSF trustees.

It is inaccurate to believe that old age issues such as these do not arise for APRA regulated superannuation fund members. For example, when an APRA regulated superannuation fund member is deemed to have lost capacity then the fund needs to be approached to enquire what documentation is required so that another person can represent the member. Solving this issue can be a difficult, complex, ongoing and repetitive process. It can also arise when one half of a couple, who looked after the finances, dies. It is our professional members experiences that the surviving spouse often finds it difficult to step into the vacant financial management role for themselves and often have insufficient financial literacy as they have left that aspect to their spouse.

Supporting funds to deliver better retirement income strategies

We consider the suggestions offered in this section of the Discussion Paper to be useful but unlikely to be particularly effective.

To repeat what we have said above, a retiree's task is complicated largely because of the regulatory environment. Governments over many decades made this system and must set about untangling it.

Making lifetime income products more accessible

[19] https://www.news.com.au/finance/money/wealth/new-research-reveals-52-per-cent-of-adult-australians-dont-have-a-will

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We agree that lifetime income streams are not popular in the marketplace.

They are quite popular in one segment: the public sector. We have explained the reason for this above, namely that such products come with considerable financial incentive by employers (effectively the Government). This assistance is provided via the contribution cap mechanism concessions, lifetime consumer price indexed income payments, income payments to surviving spouse for their life, Transfer Balance Cap concessions, potential tax offsets and so on.

If the government would like all other retirees to use a different product with similar features to lifetime pensions and annuities, it will need to offer similar incentives. The current incentives offered to non-public sector workers for these products are insufficient to entice many people to swap their life savings for less income payment flexibility, loss of access to capital sums and death benefits.

Additionally, products need to address issues which the evidence shows are the largest uncertainties retirees for late in retirement: aged care, healthcare and emergency expenditure costs.

Finally, the question of defaulting members into retirement income products that prioritise longevity needs to be conducted with extreme care. Current longevity products are very often future legacy products, and locking members into specific providers for decades with no escape, either through withdrawals or rollovers, is controversial.

We do not support the creation of so-called standardised products as mentioned on page 24 of the Discussion Paper without additional government provided incentives that we have mentioned above.