SMSF Association

Submission on

Retirement Income Review

We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.

3 February 2020

Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

Email: retirementincomereview@treasury.gov.au

Dear Mr Preston,

SMSF ASSOCIATION SUBMISSION ON RETIREMENT INCOME REVIEW

The SMSF Association (SMSFA) welcomes the opportunity to make a submission to the Retirement Income Review.

The SMSF Association is the peak professional body representing the self managed superannuation fund (SMSF) sector which is comprised of over 1.1 million SMSF members who have $750 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for financial advisers and education standards for trustees. The SMSF Association consists of individual members, principally accountants, financial advisers, auditors, lawyers and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association provides SMSF members with access to independent education materials to assist them in the running of their SMSF.

The SMSF sector comprises over one quarter of the near $3 trillion superannuation assets. There are approximately **1.1 million Australians in 596,000 SMSFs** with an average fund balance of $1.2 million and a median fund balance of $690,000 (the median value is a more useful measure as a minority of very large SMSFs distort the average figure).

SMSFs are typically made up of a couple with an average of 1.9 people in an SMSF and **42% of SMSFs are in some form of retirement phase**. With such a high percentage of SMSFs in the retirement phase, they are a pioneer group for retirement and are responsible for a significant portion of total superannuation retirement income payments. This means they are an extremely integral component of the retirement income system.

We support the Review's aim to identify relevant issues in the retirement income system, provide a better understanding of the nature and consequence of trade-offs and then develop a fact base for policy to be developed to meet evolving community standards and expectations.

We believe that a key focus of the Review should be the integration of the different elements of the retirement income system. Ensuring that all parts of the retirement income system are working together is essential to the system delivering a secure and dignified retirement to as many Australians as possible.

We support the fundamental principle that the retirement income system is built on three pillars being the means-tested Age Pension and associated social security arrangements, compulsory employer superannuation contributions through the Superannuation Guarantee and voluntary private savings including through superannuation. Retention of these three pillars should be a foundation assumption of the Review.

A current criticism of Australia's retirement income system is the significant complexity and lack of cohesion between the three pillars, particularly the Age Pension and compulsory superannuation. This can result in lack of engagement from Australians and a lack of incentives to appropriately save for retirement.

The SMSF Association believes the most important outcome of the Review is to establish a set of facts from which sound, long term policy can be built upon. Too often, superannuation and retirement income debate is repeatedly conducted on the same issues without resolution. This continued debate, for example on the level of the Superannuation Guarantee, has stifled informed policy making.

The Panel, with detailed modelling and assumptions, has the opportunity to establish a fact base that should improve understanding of the operation and outcomes of the retirement income system. Detailing how these facts have interacted with each other through the development of the retirement income system will be essential to identify areas of improvement.

The use of the Model of Australian Retirement Incomes and Assets (MARIA) model will be essential in this process. We agree with calls for this modelling to be used by the Panel and for the model and assumptions to be made public.

Throughout this submission, we aim to provide input into aspects of the retirement income system we believe the Panel should analyse and provide information upon.

This submission touches on the broad aspects of the retirement income system but mainly focuses on the SMSF sector and its role in the retirement income system. Given the SMSF sector is an integral part of the retirement income system and indeed the retirement phase, we will discuss the maturity of the sector and highlight areas of improvement with regards to the principles outlined by the Panel.

At a high level, the SMSF Association believes the Review's fact base should provide guidance on the following questions:

- What overarching objective or set of guiding principles for Australia's retirement income system would foster greater certainty and stability across the retirement income system?
- How are older Australians drawing on their retirement savings and how is any bias towards preservation or utilisation of capital interacting with drawdowns?
- What level of retirement income are individuals retiring with and is this adequate to ensure individuals are able to reasonably maintain their pre-retirement standard of living?
- How the Superannuation Guarantee affects an efficient and effective retirement income system?
- How the current level of incentives to encourage individuals to save for their retirement in the retirement income system is working and what is their impact on public finances?
- What is the role and interaction of each part of the superannuation system in the retirement income system? This should include recognition that SMSFs comprise over a quarter of the entire superannuation system's assets, a significant portion of retirement income payments and are an appropriate and legitimate structure for many Australians.

Yours sincerely,

John L Maroney

John Maroney
CEO
SMSF Association

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The retirement income system

1. Are there aspects of the design of retirement income systems in other countries that are relevant to Australia?

The Australian retirement income system, with its combination of a public pension and compulsory private savings for most employees is one that should be protected and enhanced.

The provision of an Age Pension as a safety net that is available to all regardless of earnings capacity is important in a retirement income system. Australia's Superannuation Guarantee provides a complement to the Age Pension to increase retirement income and replace it for those with adequate means.

Comparatively, the Australian retirement income system is highly regarded. For example, the 2019 Melbourne Mercer Global Pension Index rated Australia's retirement income system as the third best in the world.[1]

However, in comparison to other Organisation for Economic Co-operation and Development (OECD) countries, Australia's compulsory contribution rates are low. In addition, Australia's average earners have an income replacement rate of 43% compared to 63% for the OECD average.

Therefore, it is worth considering the design of other retirement income systems to further improve the Australian system.

One aspect of Australia's system that should not be underestimated is the impact of the SMSF sector in the design of the Australian retirement income system. SMSFs are unique to Australia, particularly due to their size. As stated, there are approximately 1.1 million Australians in 596,000 SMSFs with an average fund balance of $1.2 million or median fund balance of $690,000, making up over a quarter of the system.

No other foreign retirement income system incorporates such a level of choice and control for individuals. For example, in the UK self-invested personal pensions (SIPP) require an external custodian and in America individual retirement accounts (IRA) have restricted choice. Their impact on their local systems is not as significant as the SMSF sector has on the Australian retirement income system. Therefore, including design features of other countries may not effectively be cohesive to the Australian system which has a significant cohort managing their own superannuation.

Australia's mandatory nature of superannuation for most employees also makes our retirement income system unique. Many other retirement income systems offer a system that doesn't involve a mandatory contribution to a private scheme.

We believe these factors may make the ability to import aspects of foreign retirement income systems difficult and unbeneficial.

[1] https://www.mercer.com.au/our-thinking/mmgpi.html

Purpose of the system and role of the pillars

2. Is the objective of the Australian retirement income system well understood within the community? What evidence is there to support this?

The SMSF Association does not believe that the objective of the Australian retirement income system is well understood in industry, let alone within the community.

The fact that Australia's retirement income system does not have a legislated objective of superannuation is partly responsible for the lack of holistic policymaking for the retirement income system and some of the systemic issues uncovered by various commissions and reviews.

Policy momentum to articulate an objective for the superannuation system emerged from a recommendation of the Abbott Government-commissioned Financial System Inquiry (FSI), chaired by David Murray (December 2013 to December 2014). The Inquiry's interim report, released on 15 July 2014, noted that there was 'no legislative or formal statement of the guiding objectives for the retirement income system'.[2]

However, industry and policy makers could not come to consensus over the past six years which led to policy fatigue. The proposed objective for the superannuation system—to provide income in retirement to substitute or supplement the Age Pension—was supported by some groups but was generally seen by others to lack ambition or not be sufficiently specific to provide guidance or assessment about future policy decisions.[3]

Anecdotally, the community understands that Australia's retirement income system does aim to provide for an accumulation of assets to be used in retirement. However, its overall purpose with regards to income in retirement, spending in retirement and the cohesion between age pension, private savings and superannuation is not well understood. For example, a common rhetoric is that Australians believe they are entitled to the Age Pension because of the taxes they paid throughout their working life.

The complexity and constant changes to the retirement income system exacerbate challenges with understanding, engagement and efficiency. The superannuation and age pension pillars are not easy to navigate without financial advice, data and information is opaque and compliance and administration pose significant challenges.

There has been considerable research noting that Australians suffer from low levels of financial literacy.[4] The OECD International Network on Financial Education defines financial literacy as "a combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve financial wellbeing". Financial literacy is therefore an essential component in being able to understand the interaction of the three pillars of the retirement income system.

However, the *Australian Financial Attitudes and Behaviour Tracker, Wave 6, 2018* shows that only 35% of Australians know the value of their super, only 40% understand the concept of diversification and only about a third of investors understand the concept of 'the higher the return, the higher the risk'.[5]

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[2] Financial System Inquiry (FSI), Financial System Inquiry: interim report, Treasury, Canberra, July 2014, p. 2–97.

[3] https://www.aph.gov.au/Parliamentary_Business/Bills_Legislation/bd/bd1617a/17bd069#_ftnref13

[4] The Household, Income and Labour Dynamics in Australia (HILDA) Survey tells the stories of the same group of Australians over the course of their lives. Starting in 2001, the survey now tracks more than 17,500 people in 9,500 households.

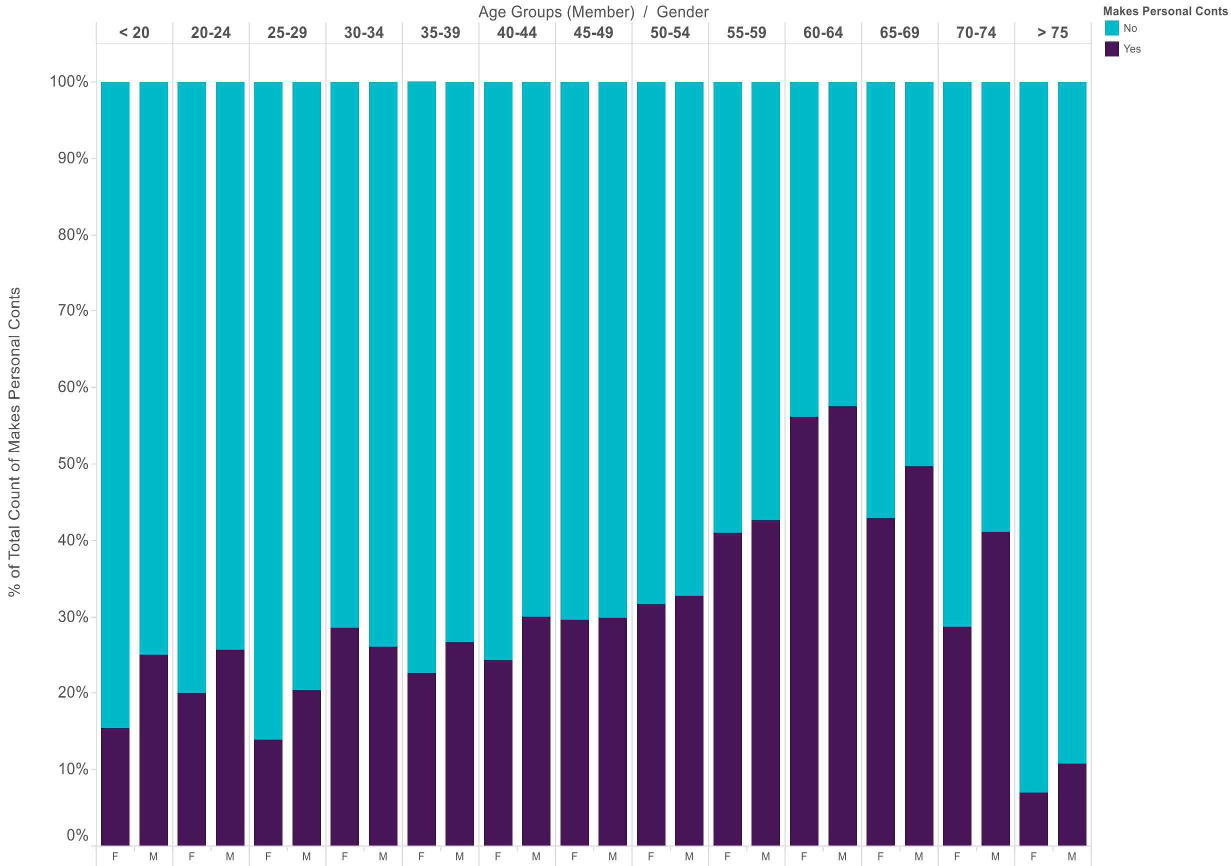
[5] https://financialcapability.gov.au

According to the Productivity Commission, Australians are even less financially literate when it comes to superannuation and retirement planning than other financial matters.[6]

The lack of financial literacy in the population is exacerbated by the fact the employers are responsible for administering superannuation contributions and, as a result, individuals have little engagement with their retirement savings. Evidence for this is the $17.5 billion of unclaimed superannuation.[7]

A further problem is that most Australians do not focus on retirement until they near retirement age. That is, younger members of the population, particularly those under the age of 50, take little interest in their superannuation or follow legislative changes to superannuation and age pension policy to assess the impact of those changes on their retirement savings. They may commence voluntary savings, but those savings could be to fund life choices such as a deposit for a home or travel rather than for retirement.

The fact that individuals wait until later in life to make greater financial contributions to superannuation is supported by research undertaken by Rice Warner on behalf of the SMSF Association analysing contribution patterns of SMSF members[8]. The research shows a considerable increase in voluntary contributions by members who are in their-50s and onwards. This accords with the generally accepted idea that people will contribute more to superannuation later in life when they have increased financial resources to do so.



[6] *Superannuation: Assessing Efficiency and Competitiveness, Productivity Commission Inquiry Report*, Productivity Commission

[7] Data released by the ATO for 2017—2018 revealed the total amount of lost and unclaimed super was $17.5 billion.

[8] https://smsfconnect.com/wp-content/uploads/2019/03/Member-Research-SMSFA-Rice-Warner.pdf?trustee_embed=1&hash=Y0lEMTE%3D

Legislating the objectives of superannuation and the retirement income system overall would provide guidance to support more holistic policymaking for retirement incomes across Government. An objective of superannuation would help drive effective policy and the role of all superannuation funds, industry, retail, public sector, corporate and SMSFs.

Legislating an objective for superannuation and the retirement income system should play a role in clarifying and distinguishing the roles of superannuation, the Age Pension and voluntary savings. This would help future cohesive policy development and encourage measures which ensure superannuation continues to provide incentives for retirement savings beyond just the age pension level.

3. In what areas of the retirement income system is there a need to improve understanding of its operation?

As highlighted, Australians typically have poor financial literacy and do not engage with their superannuation or retirement plans until later in life. Therefore, there is an opportunity to improve the understanding of how the retirement income system works for Australians but also to simplify the retirement income system so that it can be more easily understood.

Superannuation

The SMSF Association believes the first step in improving the understanding of superannuation is to introduce an objective which determines its purpose. In addition to enshrining the objective of superannuation in legislation, the SMSFA has advocated for removing superannuation policy from the annual budget policy cycle to promote stability, competition and efficiency for the superannuation system. **(See Question 5)**

Furthermore, superannuation is significantly complex. There is a myriad of rules which require a strong understanding of legislation. This means the majority of Australians do not have a good understanding of the rules which govern their superannuation.

The superannuation changes implemented on 1 July 2017 provided some of the largest and most complex changes to the superannuation system in a decade. Dealing with regulatory change and uncertainty is commonly cited as the number one area of concern for SMSF trustees and advisers.

There are numerous thresholds, caps, indexation methods and limits that require constant monitoring and reporting. This is not only difficult for trustees and members but also their advisers who must be privy to that information. In many cases, advisers are unable to access this data in an accurate and timely fashion.

The following areas of superannuation have potential to cause confusion and could be simplified or amended:

- The trustee structure of superannuation funds
  - The trustee–member rules are one of the most fundamental concepts underlying the operation of SMSF and superannuation which was imported from the law of equity. Trusteeship is a difficult concept to explain regarding superannuation and given legislation requires trustees of SMSFs to be members of SMSFs, there may be potential to simplify this duplication.
- Estate and death benefit rules
  - Death benefit legislation and application is one of the most complex areas of superannuation. Recent changes in superannuation legislation, specifically the

introduction of the transfer balance cap (TBC) and total superannuation balance (TSB), and new ATO interpretations have added further complexity to death benefit planning and payment of such benefits.
    - The SMSF Association believes that in the interest of simplification, there is a clear case for reform to align parts of the SIS Act and Tax Act that govern the payment and taxation of death benefit rules. This could start with bringing into line the different definition of a 'dependant' as well as consulting on further opportunities for simplification.
    - Superannuation does not automatically form part of an individual's estate which not only increases complexity but is not well understood.
- Differing preservation ages and ability to access superannuation.
- Numerous changes to contribution caps
    - The limits relating to contributions have constantly changed over numerous Governments, often changing to align with the current Budget process. Superannuation needs stable and consistent policy settings with adequate incentives for contributions to superannuation.
- Numerous age restrictions on contributions and work tests
    - The work test is no longer relevant to the modern super system, especially as superannuation should be universal and not discriminatory. It is an administratively efficient and opportune time to reconsider removing the work test. This is because the recent introduction of the work test exemption is complex and the announcement to increase the work test to age 67 is yet to be legislated.
    - Under 65s, those 65 to 74 years old, and over 75s have different contribution restrictions.
- Legacy pensions which have not been adapted to current superannuation rules
    - Legacy pensions now exist in an environment where they have little relevance and one where many SMSF trustees and advisers currently do not fully comprehend their operation and the impact the TBC has on them. This is because they have not been able to be established in over a decade. They are difficult to administer, explain and advise on.
- Transfer balance cap, general transfer caps, total superannuation balances
    - The introduction of multiple TSB thresholds and transfer caps is unnecessarily adding to the complexity of the superannuation system. This has made the challenge for an individual to understand the superannuation system and their options increasingly difficult. These should be streamlined as best possible.
- Superannuation residency test
    - The fact that the residency rules unfairly affect superannuation members who 'choose' to save for retirement in an SMSF but do not affect those who save in a large APRA- regulated superannuation is inequitable.
- Components of superannuation
    - Superannuation benefits are typically made up of two components: tax-free and taxable (which may come from a taxed or untaxed source). This provides further complexity which is not well understood.

The SMSF Association believes that for a successful retirement income system the superannuation pillar must:

1. Have an agreed objective introduced.
2. Be simplified.
3. Not be subject to potential significant change every Budget cycle.

SMSF Sector

It is also arguable that the purpose, size and benefits of the SMSF sector in superannuation are not well understood. The SMSF sector is consistently under scrutiny from detractors and policy developments have not always adequately considered impacts on SMSF trustees and advisers.

As noted by the Productivity Commission, the SMSF sector is important as it increases competitive pressure in the superannuation system.[9] SMSFs also provide the opportunity for engaged individuals to take control of their superannuation.

The Productivity Commission's members survey found that the desire to gain greater control over superannuation assets and investments is the leading motivation for the establishment of SMSFs. This has also been reflected in research commissioned by the SMSFA and the Commonwealth Bank of Australia in 2017 in which 53% of individuals indicated that taking more control over their personal finances was one of the main reasons for establishing an SMSF.

Used appropriately, SMSFs can provide better returns and lower operational costs than other sectors of the superannuation sector, especially for larger balances. Their widespread use, effectiveness and uniqueness to the retirement income system should not be underestimated when assessing the retirement income system.

We believe the following ATO 2016-2017 SMSF statistics may be useful for the Panel. Holistically, they highlight the SMSF sector is able to generate adequate retirement balances which a high majority convert into account-based pensions for their retirement. The retirement income system is currently working well for SMSF members because they have a history of consistent contributions, engagement with superannuation and are generally financially literate.

The SMSF sector can be viewed as a pioneer group for retirement, especially when compared to the APRA sector for which the majority of members are still in accumulation phase. 42% of SMSFs are in some form of retirement phase. Therefore, a significant portion of SMSF members have transitioned through accumulation and are now navigating their retirement. Cohort analysis on these SMSF members relating to their balances, spending and behaviour may provide information which will help derive information and improvements for the broader retirement income system and those individuals who have yet to commence retirement.

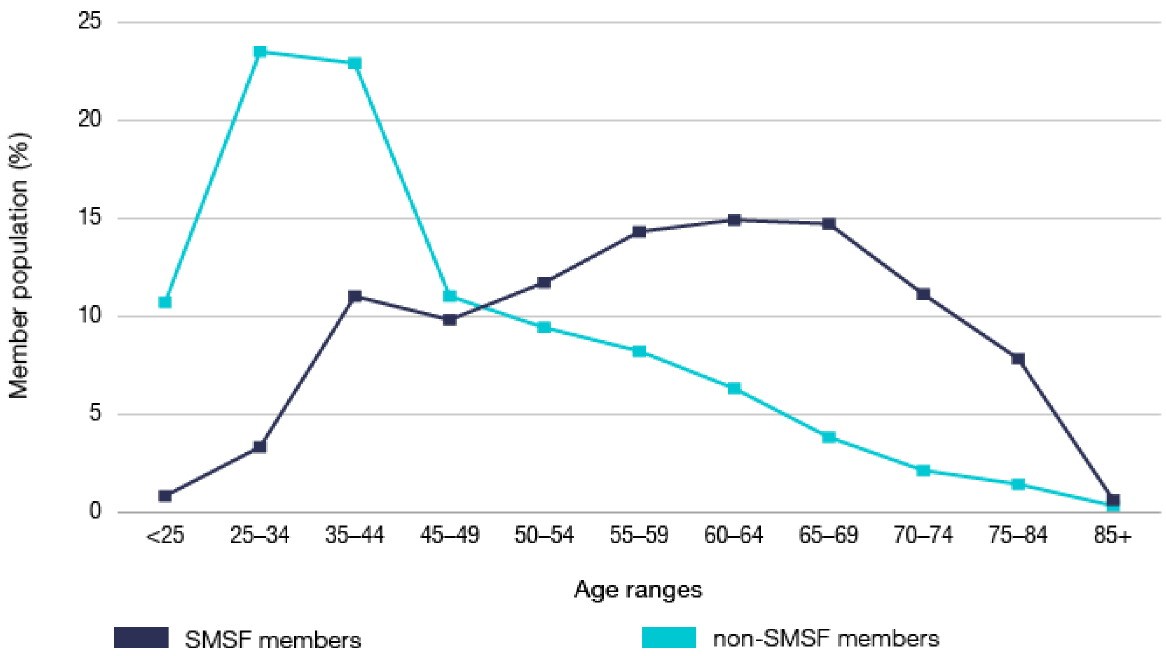
We also believe it is important to note that direct comparisons between SMSF and non-SMSF sectors need to be qualified due to differences in the way the data are collected by the ATO and APRA. In addition, compared to members of other types of superannuation funds, SMSF members are, on average: older; earn a higher income; and have larger superannuation balances.

A positive for the SMSF sector has been the increase in new SMSFs from younger trustees. The last six years has seen a significant increase in establishments of SMSFs from people aged between 35-44. In 2011, 17% of new SMSFs were established by people aged between 35-44, while in 2017 27% of

[9] *Superannuation: Assessing Efficiency and Competitiveness, Productivity Commission Inquiry Report*, Productivity Commission

SMSFs were established by people in this age bracket. This has seen a shift from people using SMSFs as a savings vehicle in preparation for retirement (making large "catch-up" contributions to their SMSF) to one which people view as their chosen vehicle for accumulation and drawdown.

While this new member growth from younger trustees is positive, SMSF members are an aging demographic. As of June 2017, 55.5% of SMSF members were aged between 55 and 75. This will present a number of challenges as the SMSF sector shifts towards having a higher percentage of members in retirement phase drawing down on their assets. New thinking around financial advice in the retirement phase, asset allocations and more sophisticated approaches to managing retirement income risks will be needed.



ATO 2016-2017 Statistics

In 2016–17, 87% of all SMSF benefit payments were in the form of an income stream (including transition to retirement income streams). The remaining 13% of benefit payments were in the form of lump sums.

The existing retirement income policy settings have allowed for a broad range of retirees with varying circumstances and lifestyles to effectively manage retirement incomes through account based pensions via an SMSF. Account based pensions have allowed SMSF trustees to drawdown on their retirement savings over time in a manner that suits them and allows flexibility to withdraw capital to meet lump sum costs as demands dictate, for example, unexpected medical and aged care expenditure.

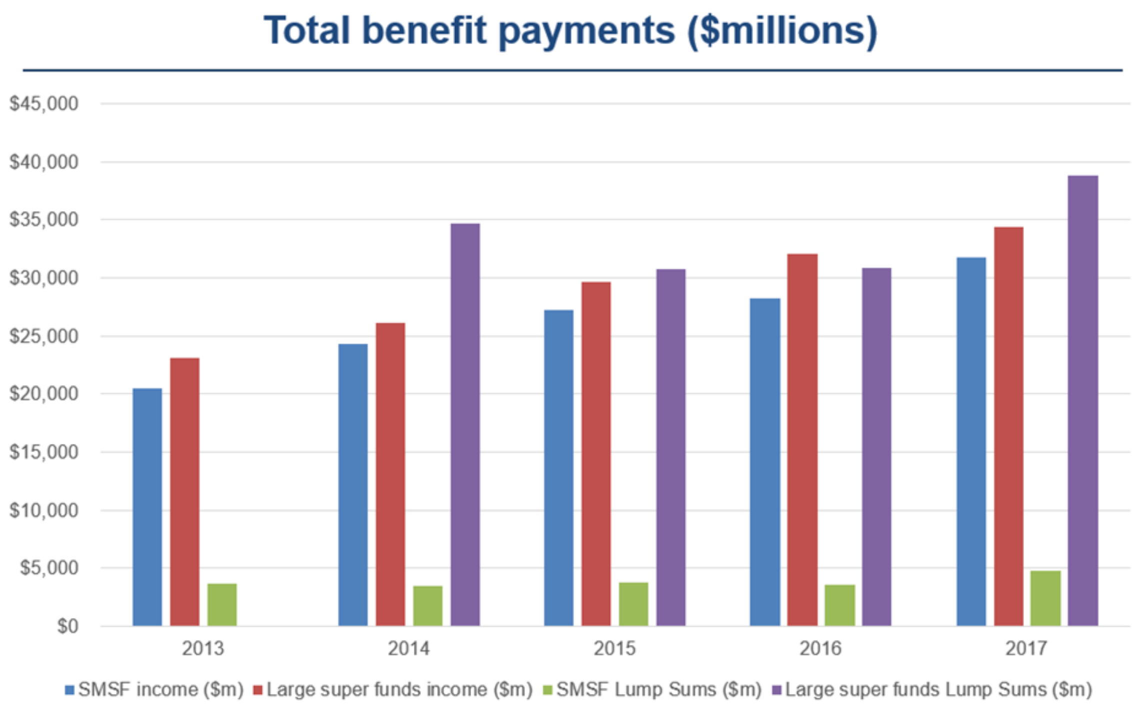
The below table, highlights the number of members and size of benefit payments SMSF members are taking.

	2013	2014	2015	2016	2017
Number of Members receiving benefit payments	350,284	374,462	397,058	410,251	387,714
Average Benefit Payments	$68,940	$74,244	$78,028	$77,651	$94,290
Median Benefit Payments	$32,940	$37,994	$39,610	$39,904	$42,000

ATO Statistics

The median figures indicate that the majority of SMSF members are receiving benefits that is above ASFA's comfortable lifestyle living standard solely from their SMSF.

The graph below highlights that the **SMSF sector is responsible for almost half the income benefit payments in the superannuation system**. Therefore, any policy change must be cognisant that the SMSF sector will be significantly affected.



ATO 2016-2017 Statistics

The table below further breaks down the age profile of SMSF members who receive member benefits. Interestingly, over 25% of SMSF members receive a member benefit before the Age Pension eligibility age. Their balances prior to benefit payment indicate that many of these individuals would not be financially eligible for the Age Pension.

We also note that the average payments are much higher than the median payments due to the distortion by very large SMSFs.

SMSF members receiving benefit payments by age (distribution %), 2016-17

Age range	(%) members receiving benefit payments	average member benefit payment	average member balance prior to benefit payment
< 55	1.9%	$36,566	$652,807
55- 59	6.5%	$52,879	$1,047,858
60-64	22.3%	$92,341	$1,121,328
65-69	28.8%	$97,386	$1,112,654
70-74	23.0%	$93,692	$1,154,928
>74	17.4%	$114,181	$1,176,488
Total	**100%**	$94,290	$1,122,355

ATO Statistics

The SMSF sector receives a significant portion of the voluntary contributions in the retirement income sector as highlighted by the ATO statistics below. Interestingly, the SMSF sector makes up 49% of all the voluntary contributions in the superannuation sector. This indicates that the voluntary savings pillar is integral to the SMSF sector and the retirement income system more broadly. Many small business owners use an SMSF to fund their retirement. Other factors include the financial capability to use contribution caps and engagement within the SMSF sector.

Total SMSF contributions ($m)

	2013	2014	2015	2016	2017
Member	17,886	19,515	24,901	24,480	34,687
Employer	5,426	6,012	6,906	7,160	7,130
All SMSF	23,312	25,527	31,807	31,640	41,817

Contributions to SMSFs as a proportion of total superannuation contributions (% per year)

	2013	2014	2015	2016	2017	Average 2013 to 2017
Member Contributions to SMSFs	43%	49%	50%	53%	52%	**49%**
Employer Contributions to SMSFs	8%	7%	8%	8%	8%	**8%**
Total Contributions to SMSFs	21%	21%	23%	23%	26%	**23%**

ATO 2016-2017 Statistics

Age Pension

The Age Pension pillar is also relatively complex and not well understood by most Australians. The Australian means tests appear to be particularly complex and Australian pensioners on a wider range of incomes and with a wider range of assets are affected by the taper rates under the means tests than pensioner residents of other countries. [10] This is partly because the age pension means test has

[10] The Age Pension means test: contorting Australian retirement, Asher & De Ravin, 2018

two tests which apply separately, an assets test and an income test. The tests also differ depending on whether the individual or couple own a family home.

The income test also introduces 'deeming' of income rather than an assessment of actual income. This is an additional level of complexity that is not well understood by Australians. Determining which test applies is also not intuitively clear.

We are also aware that there is general misunderstanding of when individuals can access the Age Pension. This may partly be because of the different age requirements in the retirement income system.

Our members have indicated that there is also a significant delay between when many individuals apply for the Age Pension and when payment commences. This is an indicator of lack of understanding of the system due to complexity and/or unwillingness to seek advice which could provide a significant and immediate financial benefit.

Retirement focus and SMSF exit strategies

As we highlight in **Question 4**, we believe that the superannuation system has been too accumulation phase focussed and an increased focus on the retirement phase is now needed.

The SMSFA supports the SIS Act being amended to require the inclusion of a retirement income strategy. The SMSFA also believes it is a good opportunity for the Government to consider the SMSFA's proposal to the Australian Legal Reform Commission (ALRC) that SIS Regulation 4.09 be amended to include that trustees of an SMSF should formulate and review regularly the consideration of and planning for the loss of capacity and SMSF exit strategy as part of their investment strategy.

Noting that the consideration of cognitive decline and its effect on member's drawdown of income during retirement is listed as a proposed factor for trustees to consider, the retirement income strategy presents the opportunity to look further at relevant issues. This would include planning for exit strategies relevant to cognitive decline and death, as well as the use of enduring powers of attorney and the potential for elder abuse. In fact, this consideration may fit better under the retirement income strategy requirement than the investment strategy requirement which the ALRC recommended be amended for this purpose.

Recommendation 7-3 from the ALRC's report into Elder Abuse endorsed this proposal[11]. They stated:

'A key part of this proposed operating standard is requiring trustees to consider whether the asset mix of the SMSF is consistent with proposed succession plans. That is, are the assets fungible on a trustee suffering a legal disability or will the assets require long term management by the trustee's enduring attorney. This brings 'front of mind' important questions as to the suitability of the chosen enduring attorney to manage the SMSF.

We believe it is appropriate that trustees should not only consider their asset mix, but also their retirement income needs when considering the loss of capacity and when approaching the end of life.

4. What are the respective roles of the Government, the private sector, and individuals in enabling older Australians to achieve adequate retirement incomes?

Government

[11] https://www.alrc.gov.au/wp-content/uploads/2019/08/elder_abuse_131_final_report_31_may_2017.pdf

We believe the Government should design the retirement income system based on community accepted principles. It is also important that they ensure there is a minimum level of adequacy provided from the Age Pension.

The Government should also endeavour to provide adequate stability to help improve understanding of the retirement income system and encourage willingness from individuals to be engaged and make voluntary contributions to superannuation and their private savings.

The SMSF Association is also supportive of recent policy intent to create a Retirement Income Covenant. We believe the retirement phase of the superannuation system requires more focus, especially as Australia's population ages and the superannuation system develops.

We believe that the superannuation system has been too accumulation phase focussed and the retirement covenant will serve as an important instrument to correct this. Furthermore, a retirement covenant will better align the construction of the superannuation system with the objective of superannuation, which is to provide income in retirement.

Focussing on retirement incomes will also ensure Australians have more choice and flexibility about how they want to structure their retirement income, which includes the take up of Comprehensive Income Products for Retirement (CIPRs) when appropriate. If members are required to consider their retirement income needs and preferences it will help shift behaviours positively to address longevity risk and other financial risks in retirement.

We are supportive of the development of CIPRs as we believe over the medium to longer-term, SMSFs may be able to benefit from a deeper retirement income product market as retail investors.

There is also an opportunity for Government to potentially offer retirement income products (such as the expanded pension loan scheme) as this policy is being developed. Currently, the private sector has not been able to generate much demand via offering new retirement products.

Private Sector

We believe the private sector has a significant role in assisting and advising Australians to achieve adequate retirement incomes. It is important that the private sector is guided by legislation that ensures they are acting in the best interests of Australians.

Relevant parties of the private sector include those who create and manage superannuation funds, pension funds and products for the retirement income system plus advisers, researchers and advocates.

The quality of financial advice provided to Australians, particular SMSF members, is crucial to the integrity and performance of the sector. Given that the most significant and complex changes to superannuation for a decade took effect on 1 July 2017, the need for high quality specialised advice is paramount.

Recent research commissioned by the SMSF Association[12] also emphasised the numerous and diverse areas on which SMSFs members seek advice. Compliance is the area members require the most help with, closely followed by tax. If members and trustees do not understand their obligations or allocate the time required to manage an SMSF, this can result in severe penalties and sanctions and a lack of effective engagement and management causing significant financial detriment.

[12] SMSF Association/CBA, The SMSF Report, 2017, and SPAA/Russell Investments, Intimate with Self Managed Superannuation 2014

Tailored taxation and retirement planning can also provide substantial beneficial outcomes to members. This includes control over pension strategies, timing of asset sales, retirement and financial goals and exit strategies, the benefits of which are hard to measure by a simple investment return calculation.

However, the SMSFA recognises that there are impediments in the current regulatory advice model which prevent SMSF trustees and older Australians from obtaining basic SMSF and superannuation advice they require. For example, an unlicensed tax agent cannot recommend that their client dispose of an interest in an SMSF even when it is clearly inappropriate for their circumstances.

The issue to be resolved concerns how basic superannuation services fit into the entire financial sector regulatory framework for both accountants and financial planners. Essentially, the outcome should improve consumer protection, ensure unscrupulous advice is prohibited and ensure consumers are able to receive basic SMSF advice efficiently.

Since 1 July 2016, accountants and other advisers must be licensed or authorised with the Australian Securities and Investment Commission (ASIC) either through a full Australian Financial Service Licence (AFSL) or limited AFSL to provide superannuation services. Operating via an exemption, Tax Practitioner Board (TPB) tax agents (recognised accountants) were typically the main source of advice for SMSF trustees prior to this. However, the take up of the limited licence regime has been relatively underwhelming.

Currently, SMSF trustees who wish to seek simple SMSF advice are either required to seek formal costly financial advice from a licensed adviser or must act without advice. This means there are important unmet SMSF advice needs in the market.

Furthermore, the overarching regulatory framework which regulates professionals who deal with SMSFs is complicated, inefficient, while the law is uncertain and is able to be worked around.

The desired policy outcomes from introducing limited licensing have not been achieved. Individuals have unmet needs, advisers face high regulatory costs and burden and accountants are strangled by regulation.

The increasing ageing population which places demands on health, aged care and the Age Pension, the low levels of financial literacy and the impact of compulsory superannuation will continue to fuel the need for financial advice from the private sector.

We believe a new consumer-centric financial advice framework is needed to address the upcoming risks in the superannuation system.

Individuals

Australians should engage with the retirement income system in a fair and equitable manner. This means they should not look to act against the intention of the system by engaging in schemes or reducing assets against the intention of the retirement income system. If the retirement income system is set up appropriately by Government, individuals should understand the objective of the system and be able to achieve adequate retirement incomes by acting within the principles adopted by Parliament.

5. The Panel has been asked to identify the role of each of the pillars in the retirement income system. In considering this question, what should each pillar seek to deliver and for whom?

Age Pension

The Age Pension should aim to provide a minimum standard for all Australians in retirement. In the absence of compulsory superannuation and voluntary savings, the Age Pension should enable an individual to avoid living in poverty.

With the maturity of the superannuation system, the amount of the population who will need to rely on the Age Pension should fall. The proportion of the eligible population receiving the age pension is projected to continue to fall from around 68% in 2018 to around 57% in 2038 assuming the Superannuation Guarantee increases to 12% as legislated. This fall is comprised of a significant fall in the proportion of the eligible population receiving the full rate of Age Pension (from 42% in 2018 to 29% in 2038) and a relatively smaller increase in the proportion of the population receiving a part-rate Age Pension (from around 25% in 2018 to 28% in 2038)[13]

This supports the ability and sustainability for the Age Pension to be a safety net for those elderly individuals who need to rely on it. A simplified and effective means test is a significant aspect in ensuring this role. In turn, this suggests that it is in the interest of the retirement income system to encourage retirees to become self-reliant.

Superannuation

Compulsory superannuation should enable employees to achieve a higher level of retirement income compared to relying solely on the Age Pension. It should provide a mechanism of forced savings for retirement for working individuals. It should not be used as an excessive wealth generation tool or used to facilitate large estate bequests.

An issue with compulsory superannuation is that it only covers individuals with gainful employment. Many self-employed individuals and others who fall outside the current mandatory coverage of Superannuation Guarantee do not engage with superannuation. The superannuation system should be designed to deliver for as many individuals who join the workforce as possible.

Political instability and ongoing change to the superannuation laws have created a level of distrust and instability in the superannuation system. When superannuation changes occur at the whim of budget policy and when consistent tinkering occurs, these activities affect the public trust in superannuation which can lead to individuals becoming disengaged with the superannuation system. They may withhold from making contributions and managing their superannuation savings in the most appropriate way for them (either in an SMSF or APRA-regulated fund) to maximise their retirement benefits.

The superannuation system needs a period of stability free from significant changes, especially changes to taxation settings, to allow members to have confidence in the system and make long-term savings plans. When superannuation changes do occur they should be fit for purpose and allow time for analysis. Supporting this, the purpose and objective of superannuation should be solidified so that broad policy issues can be evaluated more conclusively against the objective as envisaged by the Government's proposed Superannuation (Objective) Bill 2016. In turn, any sensible changes that

[13] https://www.ricewarner.com/wp-content/uploads/2018/05/The-Age-Pension-in-the-21st-century-220518.pdf

improve the system and efficiency will clearly meet these objectives. The SMSFA supports this approach to superannuation policy making.

The SMSFA has been a vocal supporter of the Financial System Inquiry's (FSI) recommendation to enshrine the objective of superannuation in legislation and believes that the Government should seek industry consensus on the primary objective and proceed with this important step to provide stability for the superannuation system.

We believe that the objective for the superannuation system should be based around the provision of retirement income, as recommended by the FSI, and supported by a set of guiding principles that can be used to give context to the primary objective. It is essential that the objective not only has a focus on providing retirement income but also ensures that retirees are able to build adequate retirement savings through the superannuation system to manage financial risks of aging and retirement.

We believe that the primary objective for superannuation should be:

> *"To provide income in retirement to substitute or supplement the Age Pension, delivering a financially secure and dignified retirement for Australians."*

In support of this primary objective we believe guiding principles are required in order to provide policy makers and superannuation system stakeholders context as to how the primary objective is to be interpreted and applied to retirement incomes policy. The guiding principles should be:

1. *Providing a secure and dignified retirement*
2. *Managing risks in retirement*
3. *Be invested in the best interest of members*
4. *Alleviate fiscal pressures on Government from the retirement income system*
5. *Equity*
6. *Maintain a pool of national savings*
7. *Be simple, efficient and provide safeguards.*

A key point of emphasis we believe is that any intention to legislate objectives in the retirement income system must not be watered down. There is no benefit in an objective that is too high level and without true meaning or intent. For example, an objective to increase retirement balances may be the goal but it is not practical or helpful for policy to be built on.

In addition to enshrining the objective of superannuation in legislation, the SMSFA has advocated for removing superannuation policy from the annual budget policy cycle to promote stability, competition and efficiency for the superannuation system. Superannuation policy can then potentially be undertaken in a review of superannuation settings linked to the Intergenerational Report required under the *Charter of Budget Honesty Act 1998* to be completed every five years and released by the Treasurer at the time.

As the Intergenerational Report projects the long term sustainability of current Government policies over a 40 year time frame, with a focus on demographic change, it is a sensible vehicle on which to base superannuation policy changes. Having the Intergenerational Report released once every five years would allow the Government, industry and consumers to take a 'health check' on the superannuation system to see whether it is attaining its goals and whether any adjustments/changes to policy settings are required. The process should allow Government and key stakeholders to evaluate whether structural changes are needed to ensure the fulfilment of the goals of their superannuation system. In-built with this process should be orderly and timely consultation with appropriate superannuation system stakeholders.

This would allow the superannuation industry and consumers to have confidence that changes to superannuation will only be made with a long-term focus rather than in an uncoordinated manner or with short-term Federal Budget goals as a key motivation.

Voluntary savings

We believe that voluntary savings should supplement retirement income where it is appropriate for individuals. This relies on individuals not losing confidence in the first two pillars.

As the Paper highlights, the family home is an important voluntary saving vehicle for the majority of Australians. However, it is also intrinsically linked to the retirement income system because mortgage payments reduce the ability to contribute to retirement, it is exempt from the Age Pension means test, and homeowners avoid the need to pay rent in retirement.

Voluntary savings also form a significant component of retirement savings for self-employed individuals and small business owners who use their capital component to build their business rather than for retirement savings in a superannuation fund. This pillar must adequately recognise this. One positive example of this recognition is the flexibility provided for the use of business real properties and SMSFs.

The statistics highlight the significant portion of member contributions, which typically indicate voluntary contributions, in the SMSF sector. The SMSF sector makes up around half all the voluntary contributions in the superannuation sector, as detailed above in Question 3.

6. What are the trade-offs between the pillars and how should the appropriate balance between the role of each pillar in the system be determined?

The interplay between the Age Pension as a safety net and private savings through superannuation and voluntary contributions as a supplement is critical. The retirement income system should aim to encourage individuals who have the potential to self-fund their retirement to do so.

The burden on a declining taxpayer base would be significantly eased if more Australians self-fund, resulting in fewer full and part pensioners. This will further help maintain the affordability of the Age Pension in its role as a minimum standard.

However, the encouragement of savings needs to ensure that the system is still sustainable and fair. For example, it is important the settings of the taper rate, tax treatment of income and investments inside superannuation and in voluntary savings encourage people to self-fund without putting the sustainability of the system at risk.

The changing Australian landscape

7. Demographic, labour market, and home ownership trends affect the operation of the retirement income system now and into the future. What are the main impacts of these trends? To what extent is the system responsive to these trends? Are there additional trends which the Review should consider when assessing how the system is performing and will perform in the future?

The changing Australian landscape will no doubt have an impact on the effectiveness of the Australian retirement income system. The modern superannuation system began in 1992 where the Australian economic settings were much different. The increasing maturity of the retirement income system gives the Panel an opportunity to assess the retirement income system's operation over the years and determine if revised settings are required.

Declining rates of home ownership

The Panel should assess how the declining rates of home ownership will affect the retirement income system. There is clear evidence that as house prices have risen significantly, more individuals will be entering retirement age with either a mortgage or as renters.

Not only is the family home exempted from the Age Pension assets test, which means there is a further strong incentive to own a family home, but the significant increase in house prices means many younger Australians have less money to save for their retirement.

It is economically rational for individuals with a modest superannuation account and mortgage at retirement to withdraw their superannuation as a lump sum and eliminate their debt and qualify for the Age Pension. Superannuation savings will allow these individuals to live rent free in their family home. However, this scenario may clash with the objective of the retirement income system.

The Panel should also consider how the retirement income system will work for those individuals who do not own their family home. They will most likely have smaller superannuation balances and will need to continue to pay rent in retirement from their superannuation and Age Pension.

Life expectancy

The life expectancy of most Australians continues to increase. The Panel should assess and model if the retirement income system is built adequately for longer lifespans. As we highlight in this submission, many retirees are concerned that they may outlive their retirement savings and hence drawdown minimum or lower than optimal income streams. Increased needs for capital for the cost of aged care and other life contingencies are also valid concerns that older Australians have. It is important that the cohesion between the pillars and appropriate retirement income products are available to address this risk.

In addition, as people live longer there may be an increased reliance on the Age Pension which will require increased funding. Most projections show the cost of the Age Pension is unlikely to increase as a percentage of GDP over the next few decades but those projections are dependent on a range of assumptions.

Aged care

Linked to the increase in life expectancy is an increase in aged care and health expenses. Many individuals will require capital and income to meet increased costs for a longer life.

Aged care can be a significant expense in retirement and understanding of the financial implications are complex. The Panel should assess how the implications of financing aged care can be integrated into the retirement income system.

Changing work patterns

The impact of the gig economy and increased numbers of casual employees were not considered when the retirement income system was developed. Increasing part time work, low paid work and an increase in participation in the workforce for women who take time out of the work force to have children materially affects their level of superannuation contributions.

Many older workers are also increasingly choosing to work longer through a transition to retirement by engaging in part-time work.

The Panel should assess if the retirement income system is adequately designed for the changing work patterns of the modern economy. The retirement income system will lose trust and confidence if low income earners and individuals who do not have full time employment are not able to build adequate retirement incomes through their superannuation and the Age Pension.

For example, a potential issue is the proliferation of superannuation accounts for individuals with many jobs and the reduction in low superannuation balances through multiple account fees. This was highlighted by the Productivity Commission.

Low interest rates

The SMSF Association believes the low interest rate environment will continue to be a long-term trend for the economy.

A low growth environment can affect the retirement balances of those in accumulation phase who are seeking to grow their assets. In addition, retirees who are relying on retirement income may be compelled to seek riskier assets to ensure their retirement balance continues to be adequate.

We believe it is important that the retirement income system is able to offer appropriate retirement income products for a low growth environment. Retirees should also be made aware that accumulated superannuation capital is designed to be utilised and effectively drawn to fund retirement incomes.

Longevity risk, sequencing risk and adequacy are therefore intrinsically tied to the asset allocation of SMSFs and superannuation funds more broadly.

Other Considerations

The following issues should also be given due consideration by the Panel:

- Individuals have higher education debts which result in less ability to save for retirement
- Individuals are having children later in life which results in a later engagement with superannuation than generations of the past. In addition, there will be a loss of compounding of investment returns from contributing later in life.

Principles for assessing the system

8. Are the principles proposed by the Panel (adequacy, equity, sustainability, and cohesion) appropriate benchmarks for assessing the outcomes the retirement income system is delivering for Australians now and in the future? Are there other principles that should be included?

We support the principles proposed by the Panel.

9. How does the system balance each of the principles and the trade-offs between principles (e.g. sustainability and adequacy) under current settings? What is the evidence to support whether the current balance is appropriate?

The SMSF Association believes that adequacy should be the main goal for the retirement income system. It will be fruitless to design a retirement income system that does not allow for Australians to achieve an adequate standard of living in retirement.

However, this does mean that the retirement income system should disregard sustainability. The system must be able to be funded, must have public confidence and be fit for purpose to withstand long term trends. We believe sustainability of the system is best measured by regular long term projections of the financial outlays and liabilities relating to those in retirement and those saving for retirement, such as those included in Treasury's Intergenerational Report and those included in the Department of Social Services Priority Investment Approach reports[14].

[14] https://www.dss.gov.au/review-of-australias-welfare-system-australian-priority-investment-approach-to-welfare/2018-valuation-report

Adequacy

10. What should the Panel consider when assessing the adequacy of the retirement income system?

The Panel should consider the distribution of retirement income for certain cohorts and compare these to other similar cohorts. This would involve including the contribution to retirement incomes from each of the pillars.

Cohorts could include those split by income distribution and other variables such as gender, home ownership, whether single or couple status, geographical location and other relevant variables. No single retirement income target will be appropriate for all cohorts and for those receiving retirement income above the Age Pension level, the major driver will be how much of lifetime earnings has been deferred via a combination of mandatory and voluntary saving to provide higher retirement incomes.

The SMSF sector would be able to provide a significant data set of members who have spent numerous years in the retirement income system with contributions to their retirement income from all three pillars.

Compulsory superannuation is based on earnings. There is evidence that most of those earning higher incomes during their working lives will have sufficient income to fund a comfortable retirement, while many of those on lower incomes during their working lives or who have experienced broken working lives struggle to generate sufficient superannuation to fund a comfortable retirement and will primarily rely on the Age Pension. By its nature, superannuation produces uneven levels of retirement incomes that reflects uneven levels of income during working lives.

We encourage the Panel to refer to research into retirement spending, such as from Milliman. They found that people spend less as they age. However, this finding is not incorporated into the design of the retirement income system nor is this well understood by most Australians.

11. What measures should the Panel use to assess whether the retirement income system allows Australians to achieve an adequate retirement income? Should the system be measured against whether it delivers a minimum income level in retirement; reflects a proportion of pre-retirement income (and if so, what period of pre-retirement income); or matches a certain level of expenses?

A secure and dignified standard of living should be afforded to retirees through adequate retirement savings, encompassing all pillars of the retirement income system. We believe that adequate retirement savings should afford a dignified level of retirement income and flexibility to meet a broad range of needs. However, defining what is adequate is significantly broad and may mean different things to different cohorts which the Panel should recognise.

There is an imperative to ensure that the absolute level of the Age Pension represents an adequate retirement income compared to minimum wage levels. The Age Pension for a couple should be at least equal to the minimum wage[15] and increases should be based on the cost of living, with calculations set by an independent Age Pension Tribunal having regard to other relevant factors including increases in average wage levels. Rental assistance for those who do not own a home and

[15] The current minimum wage in Australia is $740.80 per week, which equates to a minimum hourly rate of $19.49. The minimum wage is the absolute lowest that an employee can be paid. This minimum wage was set on May 30, 2019 and must be adhered to by all businesses operating in Australia. An individual on the Age Pension can receive up to $933.40 a fortnight or $1,407 a fortnight for couples (including supplements). This implies an increase of 5.3% based on increasing the couple age pension to the single minimum wage.

increased provision of social housing are also important aspects of ensuring an adequate retirement income for those on the Age Pension.

12. What evidence is available to assess whether retirees have an adequate level of income?

Efficiently transforming superannuation capital into retirement income is a key issue for many retirees. Currently, most individuals risk outliving their retirement savings. Uncertainty around the length of time in retirement makes it difficult for people to manage their wealth efficiently.

In addition, many superannuation funds seek to maximise a member's lump sum balance at or after retirement, rather than target a specific level of income in retirement.

The SMSF sector encompasses many funds with a greater than average superannuation balance.

Average and median asset sizes

Asset sizes SMSFs	2013	2014	2015	2016	2017
Average assets per member	$507,392	$544,858	$572,509	$587,171	$652,465
Median assets per member	$296,580	$319,301	$336,647	$347,011	$393,141
Average assets per SMSF	$962,562	$1,031,385	$1,081,964	$1,107,726	$1,223,460
Median assets per SMSF	$ 530,407	$570,726	$601,912	$ 618,754	$693,265

ATO Statistics

The majority of SMSFs in retirement use account based pensions to fund their retirement income. There is strong evidence to suggest that most retirees in the SMSF sector have adequate levels of income. This is partly because these SMSF trustees are engaged with superannuation to take control of their affairs and traditionally had the accumulation balance which would translate to adequate levels of retirement income, compared to the ASFA comfortable standard.

Research suggest that most retirees withdraw income close to the legislated minimum withdrawal rate.[16] If this is the case, many individuals may pass away with substantial amounts of their savings unspent. There is reason to believe that superannuation members are inefficiently self-insuring for longevity risk.

A recent National Seniors Survey[17] found that the worry about retirement income is a national issue. This uncertainty indicates an unmet need for financial advice but also encourages conservative spending habits which may undermine adequacy of retirement income.

In addition, when members withdraw money at amounts near the required minimum rate, particularly as they age, the money may be spent or moved into a bank account. Analysis of these trends could provide insight into the appropriateness of these rates and the impact on actual retirement spending.

We urge the Panel to examine the retirement spending patterns of superannuation members as they drawdown over their lifetime. This information can provide a fact base to the degree of concerns

[16] https://publications.csiro.au/rpr/download?pid=csiro:EP163017&dsid=DS2
[17] https://nationalseniors.com.au/research/retirement/retirement-income-worry-who-worries-and-why

regarding adequacy and the tension between adequate retirement balances but inadequate retirement income.

SMSF asset allocation

As the SMSF demographic shifts, greater attention will need to be paid to asset allocation in retirement, including self-insuring against longevity risk by using a "pooled" or "bucket" approach for investing assets to provide security of current income, flexibility to access capital and the ability to manage longevity risk.

SMSF asset allocation has remained steady over time with a significant proportion of SMSF assets invested in listed shares and cash investments. The key drivers for this asset allocation include:

- Tax preferences for domestic equities – fully refundable franking credits increase the after-tax return for domestic equities for SMSFs, especially those in retirement phase.
- A desire for liquidity to pay pensions in retirement – this is especially relevant to the SMSF sector where 42 % of funds are in retirement phase.
- Cognitive biases which drive allocation to assets which trustees are familiar with, especially blue-chip ASX listed shares.

It is also important to realise the limitation of the ATO statistics which underlie these figures, with many international focussed listed investments such as ETFs and LICs being listed as domestic listed shares, potentially understating SMSF's international asset exposure. However, improved diversification of SMSF portfolios is an ongoing challenge for the SMSF sector.

We reiterate that longevity risk, sequencing risk and adequacy are therefore intrinsically tied to the asset allocation of SMSFs and superannuation funds more broadly. Examining the impact of asset allocation decisions should be a worthy consideration for the Panel.

Property investment and borrowing

An aspect of asset allocation that often draws significant attention is SMSF investment in unlisted property, especially residential property funded through limited recourse borrowing arrangements (LRBAs). As of the September 2019 quarter, SMSFs had $43 billion invested in LRBAs, representing 5.8% of total SMSF assets.

Statistics indicate that members using LRBAs are responsible with the strategy and how it relates to their proximity to retirement. SMSFs in the pension phase only have a 1.5% asset allocation to LRBAs compared to 9.4% for SMSFs in accumulation phase. The December 2017 Class Benchmark data[18] also shows that only 1.3% of their SMSFs have an LRBA relating to property in the retirement phase compared to 10.9% in the accumulation phase. This indicates that SMSF trustees are considering their investment needs and are reducing LRBA related risk as they approach retirement.

Property investment, often enabled by LRBAs, is a viable and important component of the investment strategies of some SMSFs. With appropriate specialist professional advice, SMSFs can invest in property assets which have the potential to provide significant long term benefit, subject to careful management of liquidity, diversification and other risk factors.

[18] https://cdn2.hubspot.net/hubfs/2621735/Benchmark%20Report/Benchmark_2017_Dec_FINAL.pdf

Equity

13. What should the Panel consider when assessing the equity of the retirement income system?

We support the Panel analysing if the outcomes for individuals in different circumstances are fair and adequate. Crucially, the retirement income system must be designed to ensure it also treats individuals in the similar circumstances in an equitable manner.

14. What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement? What evidence is available to assess whether the current settings of the retirement income system support fair outcomes in retirement for individuals with different characteristics and/or in different circumstances (e.g. women, renters, etc.)?

Women and broken work patterns

Women currently retire with less superannuation than men. The gender retirement gap is an ongoing problem for the superannuation system. When referencing retirement age (60-64), on average, Australian men enter into retirement with $336,360 while women had just $277,880[19].

Recent MARIA analysis stated that while future superannuation balances at retirement will continue to increase for both genders, women's balances will continue to lag behind men's balances until post 2060.

Not only is this equity discussion worthy in light of balances, we also urge the Panel to conduct analysis specifically with regards to retirement income. This will help provide further insight beyond that of simple accumulation balances.

Due to the recent introduction of the TBC and the lack of opportunity for couples to adjust for its introduction, most couples have balances which are heavily weighted to one member. As highlighted, typically, this is normally the male member who has more likely had uninterrupted working patterns and a higher wage and benefited from higher superannuation guarantee contributions.

In most families, women are still the primary carers of children, which means they spend more time out of the workforce than men, and often return to work part time. There are also larger systemic issues such as the gender pay gap, rise of the gig economy and design of the superannuation system which means it is not as effective for part-time or low-income earners.

Typically, the compounding effect of long-term savings, like superannuation, sees underlying differences between gender pay, participation rates and other factors make the retirement gap larger.

Given compulsory superannuation is based on a percentage of income earned, it is difficult for the majority of women to accumulate similar amounts to men over their full working lifetime.

We believe superannuation should be viewed from a 'couple' perspective where appropriate. Couples make considered mutual decisions in which one partner usually makes sacrifices to support another. This means there should be effective mechanisms to facilitate this approach. A proposal the SMSF Association has outlined recently involves consideration of a spousal rollover for superannuation balances, whereby one partner could choose to transfer part of their balance to their partner when they are nearing retirement.

[19] https://www.superannuation.asn.au/ArticleDocuments/359/1907-Better-Retirement-Outcomes-a-snapshot-of-account-balances-in-Australia.pdf.aspx?Embed=Y

Individuals with extremely large superannuation balances

Individuals with extremely large superannuation balances may be considered to benefit too much from the retirement income system. Curiously, when this policy debate is undertaken it is usually focused on SMSF members, rather than acknowledging that large superannuation balances also exist for members in APRA-regulated funds.

The SMSF Association acknowledges and supports that superannuation is primarily for the purpose of retirement and should not just be an estate planning tool to protect assets in a concessional environment.

Specifically, with regards to SMSFs, 0.7% of SMSFs had assets greater than $10 million at 30 June 2017 which represented 10% of total SMSF assets. For comparison, in 2016, Australian Tax Office figures showed that there were 990 people with SMSFs worth $10 million or more and 944 people in large pooled funds with $10 million or more.[20]

We note that the significant changes introduced on 1 July 2017 implementing a $1.6 million TBC impacted the ability to shelter significant assets in superannuation tax-free. However, there is an argument that these extremely large superannuation balances in both SMSFs and APRA regulated funds are beyond the notion of saving for retirement.

The SMSF Association believes it is worth examining extremely large superannuation balances in the review of the retirement income system. Policy measures to discourage the retention of such balances indefinitely within the superannuation system could be considered.

These may include:

- An increased tax rate for extremely large superannuation balances
- Forced withdrawal of capital for extremely large superannuation balances over life expectancy or a defined period

However, it is also important to recognise that extremely large superannuation balances are a legacy issue. In addition, the TBC means that trustees are no longer able to keep entire balances in the retirement phase (where minimum drawdown rates apply) and this may extend the period in which extremely large superannuation balances stay in the system.

Public support being appropriately targeted

The SMSF Association also notes that the assessment of taxation concessions depends upon the chosen methodology and assumptions. We believe it is important the retirement income debate understands this point, particularly noting the impact this type of analysis can have on a policy debate.

For example, Figure 4 in the consultation paper is highly dependent on the methodology and assumptions such as the discount rate used. The scale of the figure is also inconsistent and potentially misleading.

The SMSF Association also believes that extremely large superannuation balances can skew policy analysis and statistics. We would encourage the Panel to also conduct analysis that removes these legacy outliers. This would provide an additional picture which may be more representative of the current retirement income system.

[20] https://www.afr.com/policy/tax-and-super/nearly-2000-people-have-10m-or-more-in-their-super-20160311-gngl7n

With further regard to Figure 4, tax concessions seem to benefit individuals above the 90th percentile due to the 15% tax rate on earnings. In contrast division 293 taxation has sufficiently curtailed the benefit to high income earners with regards to contribution caps. The Panel should model if there are different tax settings for superannuation earnings that could be applied to those extremely large superannuation balances with significant superannuation earnings.

Most recently, the $1.6 million TBC has limited the amount of superannuation earnings that were not taxed. As highlighted earlier, potential policy solutions include introducing a higher superannuation earnings tax rate for funds or a forced withdrawal of superannuation benefits for extremely large superannuation balances. The introduction of a TBC in 2017 means that many administration platforms will be more easily able to track a potential large superannuation balance cap.

Means testing

The Panel should also review inequities with the means test. One area of concern is inequities borne from the exemption of the family home. We query if it is equitable for very wealthy individuals with exempt family home assets to be provided Age Pension benefits when individuals who have less exempted assets are not. For example, a couple with a $400,000 family home and $1.6 million in superannuation will receive no Age Pension but a couple with $400,000 in superannuation and $1.6 million in the family home may be able to access almost a full Age Pension.

Consequently, the principal residence is a valuable investment, far beyond what was originally envisaged for social security purposes.

15. Is there evidence the system encourages and supports older Australians who wish to remain in the workforce past retirement age?

If Australians wish to remain in the workforce past retirement age, it is important the retirement income system is able to support that decision. Currently, Australians are able to receive a certain amount of income and the Age Pension.

There are certain restrictions on individuals once they reach retirement age. Individuals over the age of 65 must meet a work test if they wish to continue contributing to their superannuation. At age 75 individuals are no longer able to contribute to superannuation.

Another common scenario for SMSF members, of whom approximately 60 per cent are aged over 55, is working in part time jobs which can often fall under a restricted enterprise agreement while transitioning to retirement. These people are restricted from having their Superannuation Guarantee contributions made into their SMSF and are instead required to have contributions made to the relevant default fund under the agreement.

There does not seem to be clear evidence to suggest that the system encourages older Australians to keep working past the retirement age.

16. To what extent does the retirement income system compensate for, or exacerbate, inequities experienced during working life?

If an individual works consistently for at least 40 years, then the retirement income system is generally well designed, disregarding the fact the design of the means tests could be improved to remove disincentives that discourage voluntary saving. For those who don't work consistently, certain failings occur.

The Panel should review in detail how the retirement income system has been designed and accommodates both the accumulation and retirement phases of individuals with varying work patterns.

Individuals who have interrupted employment status earn less during their working lives and therefore have less superannuation in retirement. In addition, they are also less likely to voluntarily contribute to superannuation or have significant private savings. Therefore, the current retirement income system can exacerbate certain inequalities.

17. What are the implications of a maturing SG system for those who are not covered by compulsory superannuation?

A maturing Superannuation Guarantee system has large risks for those not covered by compulsory superannuation. We believe those are not covered will be left behind and the system will further exacerbate inequities highlighted in this submission.

The system should be modernised to provide better coverage of all working individuals including women, gig economy workers, low income earners and the self-employed.

Sustainability

18. What should the Panel consider when assessing the sustainability of the retirement income system?

The SMFSA believes that the superannuation system should be fiscally sustainable over the long-term. This should be assessed by:

- Cost of the system to public and private finances.
- Public confidence in the system.

Sustainability should also be viewed through a long-term lens that matches the long-term policy intent of superannuation and the treatment of the system as whole. This should remove emphasis from short-term tax incentives and Budget costs and focus more on the long-term savings that superannuation creates by decreasing the reliance on the Age Pension.

19. What factors should be considered in assessing how the current settings of the retirement income system (e.g. tax concessions, superannuation contribution caps, and Age Pension means testing) affect its fiscal sustainability? Which elements of the system have the greatest impact on its long-term sustainability?

We believe there should be a decreasing reliance on the Age Pension. This should be measured against the cost of tax concessions using both income tax and expenditure tax benchmarks.

As we highlighted earlier, large legacy funds also materially impact the policy debate and analysis of sustainability and this should be factored in.

Tax concession analysis

The SMSF Association has been a critic of the Tax Benchmarks and Variations Statement (TBVS) (Previously the Tax Expenditures Statement) measurement of the superannuation tax concessions due to the distortionary effect it has on the public debate regarding superannuation policy. We understand that the annual TBVS is an important exercise in the ongoing evaluation of the Australian tax system. However, due to the shortcomings of the TBVS measurements, we believe that the TBVS estimates of the superannuation tax concessions inappropriately influence the view of superannuation tax concessions in policy debates.

We believe that a significant improvement to the TBVS can be made through the following:

- Estimating alternative benchmark measurements regularly for large tax expenditures and ones that generate significant public debate.
- Reducing the focus and effort to estimate smaller tax expenditures to place greater effort on more accurate measurement of large tax expenditures.
- Improving the visibility and wording of caveats regarding the accuracy and use of the TBVS.

It is tempting to compare the present cost to the government of these super tax concessions with the present cost of the Age Pension. However, it is an unfair comparison because the super system is not yet mature. Increasing super balances are already having an effect on reducing the claim on the Age Pension as more people accumulate more savings and thus become less dependent on the Age Pension.

Proposal – superannuation concessions should be assessed as part of the retirement income system rather than the tax system

Besides measuring the fiscal cost of superannuation tax concessions with an alternative tax benchmark, the SMSFA also suggests that the concessions should not be assessed as part of Australia's tax system as a pure tax expenditure but should be evaluated within the context of Australia's three pillar retirement income system.

This would see the fiscal cost of the superannuation tax concessions evaluated with the costs of providing the Age Pension and superannuation guarantee. This would be a more holistic approach to assessing the cost of the retirement income system, rather than just measuring the tax cost of the concessions. This type of analysis has been undertaken by Mercer[21], which shows that accumulated superannuation benefits reduce future Age Pension payments and associated Government spending.

We believe this approach to assessing the superannuation tax concessions would result in a more robust approach to superannuation tax concessions and foster better policy outcomes for Australians saving for their retirement.

Superannuation tax concessions

Generally, we recognise the need to ensure that the taxation settings for superannuation are equitable, sustainable and effective in delivering improved retirement incomes for Australians. However, we note that it is critical that these objectives are balanced with providing an incentive for people to save for retirement. Considerations of having a simple and an efficient tax treatment of superannuation must be considered too.

The SMSF Association views the superannuation tax concessions as essential to the policy design of the Australian superannuation system which encourages Australians to save a reasonable amount for a sustainable retirement. The superannuation tax concessions provide an incentive for people to forgo current spending in favour of saving for retirement. It is widely accepted that most people are myopic in their consumption decisions and tend to under-save, preferring current consumption over savings (future consumption). Providing incentives, such as the concessional treatment of contributions and earnings, compensates taxpayers for deferring the use of income to save for their retirement. The tax concessions also compensate people for locking away their income for an extended period. Income can be inaccessible in superannuation for timeframes in excess of 40 years for many savers.

Balancing the need to provide an incentive for people to save for retirement with other considerations, such as more equitable targeting of the superannuation tax concessions is vital to ensuring a robust and effective retirement income system.

Bequests / Estate planning

Some criticism of the superannuation sector relates to individuals who may intend to leave large bequests to beneficiaries. This may conflict with the intention of the retirement income system and may affect the sustainability of the system. However, research conducted by Accurium and the SMSF Association highlights this is not a main motivation. [22]

The findings suggests that most SMSF trustees don't have an explicit target to leave a bequest. Only 7% of SMSF households have included a specific target to leave an inheritance. The vast majority are

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21 Mercer, Tax & Superannuation: Securing Retirement Incomes the Shortcomings of the Superannuation Taxation Expenditures, 2013

22 https://www.accurium.com.au/-/media/Accurium/Technical-Hub/Retirement-Insights/Accurium-SMSF-Retirement-Insights-Volume-6-SMSFs-treading-water.pdf

looking to use their superannuation to fund spending in retirement. This result has also been found in other surveys of older Australians.

We would not expect that only 7% of SMSF retirees will leave an inheritance. Some SMSF retirees won't live to life expectancy, leaving money unspent. Even those who live past life expectancy might not run through their money as the margin of safety (from a high confidence level) might not be needed when market conditions are favourable.

For the SMSF trustees that have explicitly set a bequest, there has been a wide range of different levels. The average bequest was $780,000 (which may encompass superannuation and other assets) and in most cases, the bequest was less than the balance of the SMSF, implying at least some spend down of capital in retirement.

Policy options for retirement drawdown

Policy options to encourage better management of retirement savings that address retirement income and longevity challenges should be considered holistically.

Policy options that could align with this type of coherent policy principle framework could take the form of:

- Reintroduction of maximum annual drawdown levels in addition to minimum drawdown levels.
- A more comprehensive approach of introducing maximum drawdown ceilings beyond which tax or social security disincentives could apply if withdrawals above those maximums are made. Large or regular lump sums would be caught and discouraged by such a policy.
- Re-design of minimum drawdown requirements
- Clawback of some tax-preferences on death of unused capital amounts which could be used to encourage drawdowns and discourage superannuation being used as part of estate planning strategies.
- Reasonable grandfathering and transition arrangements

We believe that a product-neutral approach that encourages retirement income streams through the right policy settings should result in optimal outcomes for retirees. Products (including SMSFs) that meet set drawdown parameters with the aim of achieving the retirement income system's goals for managing longevity risk would encourage retirees to drawdown on their retirement savings appropriately. Such products could qualify for relevant social security and tax incentives to encourage broad usage.

20. How can the overall level of public confidence be assessed? What evidence is available to demonstrate the level of confidence in the system?

Without public confidence, the retirement income system will be unsustainable. Public confidence requires individuals to be engaged with their savings otherwise many superannuation fund members will lack sufficient understanding to support the system.

We believe public confidence can be assessed by engagement in the retirement income system, particularly superannuation. Superannuation is typically an unengaged pillar given the long lead times individuals face when planning for retirement.

Therefore, superannuation requires long term decision making and investment decisions. Public confidence in this pillar can be undermined whenever governments make significant changes or propose significant changes to the system.

Individuals also demonstrate lack of confidence in their own retirement savings being enough. This is exacerbated by a lack of confidence in the retirement income system being able to support their needs in retirement. It also may be the reason individuals do not spend more in retirement and only draw the minimum pension. This can affect the sustainability of the system as older Australians continue to access tax concessions of large retirement balances rather than spend.

We believe that capital retention bias and increased estate savings in superannuation is more related to the lack of understanding and lack of products addressing longevity risks rather than a majority of individuals using the tax advantages of the retirement income system for excessive wealth accumulation. There is also a bias towards only spending earnings and not capital and sometimes a desire to leave bequests for children.

SMSF member experiences with superannuation

The SMSF Association has consulted with its SMSF trustee member base in a survey undertaken in August 2017 to form a broad opinion on how the superannuation system has met their needs. We also have undertaken significant research in the past on SMSF members experiences with the superannuation system

Our survey showed that with regards to SMSF members' overall impressions of superannuation, there has been a decline in both satisfaction with how the system has performed for them and the trust they have in the system to deliver the best outcomes in retirement. We believe that these relate to constant regulatory change, most notably in regards to the 2016 Budget announcements that have been the cause of much frustration.

Over a number of years SMSFA research has shown that legislative change and speculation has resulted in many Australians losing confidence in the superannuation system and reducing their contributions to superannuation.[23] The 2015 SMSF Association Intimate with Self-Managed Superannuation Report showed that advisers most commonly cite regulatory/legislative change as the greatest challenges they face in advising SMSF clients.[24] Similarly, a Vanguard/Rice Warner survey of SMSF trustees noted that 88% of respondents were concerned that they will be significantly impacted by changes to superannuation or taxation law.[25]

Furthermore, it was a common theme amongst our members that high institutional superannuation fund fees were a large issue. This was one of the main motivating reasons for our members establishing an SMSF and not retaining an institutional fund. They believed that large superannuation funds were over-regulated and wanted greater control over their investments and how their funds are invested.

[23] SPAA/Russell Investments, Intimate with Self-Managed Superannuation, 2012, 2013, 2014
[24] SMSF Association/nabtrade, Intimate with Self-Managed Superannuation, 2015
[25] Vanguard/Rice Warner, Survey of Financial Needs and Concerns, 2014

This echoed finding in the '2017 SMSF Report'[26] authored by the SMSFA and Commonwealth Bank which showed that the key motivating factors for establishing an SMSF were as follows:

Unsurprisingly, SMSF members are extremely engaged in their superannuation and SMSFs. All respondents showed a very strong response to the fact they closely follow the performance of their SMSF, which is inherent in the nature of a self-managed fund. Notably, the majority of respondents named the internet as the most common information source used to make decisions about their superannuation. This is more significant given the SMSF trustee age demographic is older than the average APRA regulated fund member.

[26] SMSF Association/CBA, The SMSF Report, 2017, https://www.commbank.com.au/content/dam/commbank/personal/superannuation/smsf/smsf-thought-leadership-report.pdf

Cohesion

21. What should the Panel consider in assessing whether the retirement income system is cohesive?

Cohesion of the retirement income system is extremely important in facilitating public confidence. If all pillars of the system work efficiently that ensures people will be able to invest knowing the system should provide positive retirement outcomes. The panel should consider the following factors in assessing if the system is cohesive:

- Engagement
    - If the system facilitates engagement that indicates that there is cohesion between the pillars.
- Understanding
    - If individuals understand how the retirement income system works this will indicate cohesion.
- Incentives/Motivation
    - If individuals are appropriately incentivised and motivated to save beyond the first pillar of the Age Pension and the second pillar of the Superannuation Guarantee this will demonstrate cohesion.
- Outcomes for different cohorts
    - If the retirement income system provides adequate member outcomes for the vast majority of individuals it means that the three pillars are working cohesively.

22. Does the retirement income system effectively incentivise saving decisions by individuals and households across their lifetimes?

The retirement income system is so extremely complex that it can discourage individuals from making appropriate savings decisions.

The way assets are treated under the Age Pension means test is an example of discouraging working age Australians from making voluntary contributions. The current assets test taper rate creates a high effective marginal tax rate on savings which may encourage retired individuals to spend their assets in retirement to rely on the Age Pension[27].

We believe that coherent retirement income settings should provide behavioural incentives to "nudge" retirees into drawing down on their retirement savings in a way that accords with the goals of the retirement income system. This would encourage the gradual drawdown of retirement savings from retirement onwards by making sure that the social security system and tax system do not encourage retirees to benefit from social security and tax preferences where their actions do not align with the goals of the retirement income system. This would encourage retirees to manage their retirement income so they do not need to rely unnecessarily on the Age Pension. Similarly, social security means testing should be carefully constructed in order to not be too penal on middle income earners and discourage people from saving to achieve self-sufficiency in retirement.

Encouraging all retirees to become more self-reliant by saving more for their own retirement should be an objective of the retirement income system. The burden on a declining taxpayer base would be significantly eased if all retirees could be encouraged to save more prior to retirement.

For the individual, the interaction between super and the Age Pension is a dilemma. By definition, saving requires forfeiting present consumption for a more comfortable retirement. It also means that

[27] Asher and De Ravin 2018.

the more individuals save for their retirement, the less Age Pension they will receive. In that sense, savers pay twice: once during the saving period and then again by forfeiting what they could have claimed by doing nothing. Ignoring those that would never qualify for the Age Pension, someone who chooses to be self-reliant in retirement by diligent saving over many years is merely relieving the taxpayer of providing what many would regard as an entitlement after paying taxes for 50 years. For many that is not rational behaviour and may explain the low level of voluntary contributions by most superannuation fund members. Arguably the presence of the Age Pension as a safety net is itself a disincentive to save.

Allowing higher contribution caps from the age of 50 to allow "catch up" contributions

As we highlighted earlier, data on voluntary contributions shows that it is more likely to occur in the age groups 55 to 65 years, and that women are slightly more likely to contribute at that stage than men. We would support the implementation of higher voluntary contribution caps for those over 50 years in order to facilitate better cohesion between the pillars.

The lead up to retirement (beginning around age 50) is a critical time period for individuals to plan and grow their retirement savings. These are the final years of full-time work and provide the greatest opportunity with an intersection of financial capability and proximity to retirement.

The significant impact that personal contributions can have on superannuation balances at retirement should not be underestimated. The restriction of concessional contributions to $25,000 not only lowers retirement savings, it encourages individuals to consider other forms of tax effective retirement planning such as investment bonds or negatively geared property investment.

We believe superannuation policy should incentivise and encourage Australians to take ownership of their retirement planning and contribute to their superannuation accordingly. For those individuals over 50 the policy settings should be improved.

23. What evidence is available to show how interactions between the pillars of the retirement income system are influencing behaviour?

Anecdotally, we are aware of the rhetoric around individuals who restructure their assets to rely on a part Age Pension. Individuals will almost always be incentivised to save beyond the fringe of the Age Pension means test amount. However, it is incumbent on the design of the system to ensure this fringe is not too large.

Even if the actual instances of behaviour are not of a high frequency, potential damage to confidence in the retirement income system can occur if it is believed that there are disincentives to save voluntarily in superannuation.

The Panel should consider if spending behaviour for people on the fringe of Age Pension eligibility is consistent with the view that individuals restructure to rely on a part Age Pension.

24. What is the evidence that the outcomes the retirement income system delivers and its interactions with other areas (such as aged care) are well understood?

We don't believe the interaction with other areas is well understood. For example, aged care is complex and is a pressing need as the population ages. How retirees pay for this out of the retirement income system is not well understood. The differing means test for the Age Pension and aged care is a contributor to this.

Another example, the interaction between the retirement income system and taxation. The seniors and pensioners tax offset can potentially give wealthy retirees a large amount of tax-free income. The retirement income system needs to consider other areas of integration.

25. What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?

As indicated earlier, research shows that many retirees 'default' their income from superannuation at or near the minimum drawdown rate.[28] When combined with Age Pension payments, this can lead to income that grows in real terms during retirement. This suggests that Australians are guided by the minimum superannuation drawdown rate as a retirement income guide. The Panel should determine if the minimum superannuation drawdown is acting as a de facto form of financial advice and if unadvised individuals are achieving desired retirement income outcomes through this process.

We are aware approximately half the SMSF sector is receiving formal financial advice. We believe the majority of the SMSF sector is retiring with adequate balances which means financial advice is not always necessary pre-retirement but is mostly beneficial and valuable especially for retirement planning and dealing with more complex issues. Analysis of the retirement stage may provide different results as we have found the desire and need for retirement advice relatively high.

Support the retirement covenant and better retirement products

To this point the Australian superannuation system has been largely focused on the accumulation stage. We strongly support the introduction of the retirement covenant to the SIS Act and the development of products and services by super funds to assist members moving into retirement.

However, Vanguard and SMSFA research highlighted that[29]:

- Most respondents to their survey do not have life annuities or other guaranteed income products and most people have no plans to buy a life annuity product
- 47% indicated that they would not choose an annuity product regardless of price, while only 40% would accept an annuity products that is twice fair value
- The responses were similar if the annuity product were publicly funded
- 79% do not believe that compulsory annuities will help them to achieve their retirement plan.

Desire for retirement advice

SMSF balances may indicate that some Australians are able to achieve their desired income outcomes without seeking advice. However, the SMSF sector is highly advised with approximately half receiving financial advice.

CBA and SMSFA research asked SMSF investors to describe their retirement plan[30]. 42% said they had no specific plan, including 41% of advised investors. Among those with a plan, most said they simply plan to retire when they reach their target age, regardless of their level of savings. Only around one in three believe they are fully on track to achieve their retirement plan, although most believe they are moving in the right direction. Interestingly, once retired, the vast majority of advised SMSF investors said their plans were fully or partially achieved. Only 2% said they did not reach their target at least partially, compared to 9% of non-advised investors. This suggests that getting advice makes a measurable difference to the likelihood investors will achieve their retirement goals.

Given this uncertainty, it's no surprise that SMSF investors become increasingly likely to seek advice as they approach retirement. Asked whether they believed their need for super advice would increase

[28] Balnozan 2018; Reeson et al. 2016

[29] https://www.smsfassociation.com/wp-content/uploads/2016/08/121127_spaa-vanguard_research_report.pdf

[30] https://www.commbank.com.au/content/dam/commbank/personal/superannuation/smsf/smsf-thought-leadership-report.pdf

or decrease in the next two years, 53% of SMSF investors said their needs would increase when they were 4–10 years from retirement – many more than in the three years prior to retirement or the period after retirement. For advisers, this heightened propensity to seek advice is a valuable opportunity to fill the retirement advice gap by providing extra, targeted support.

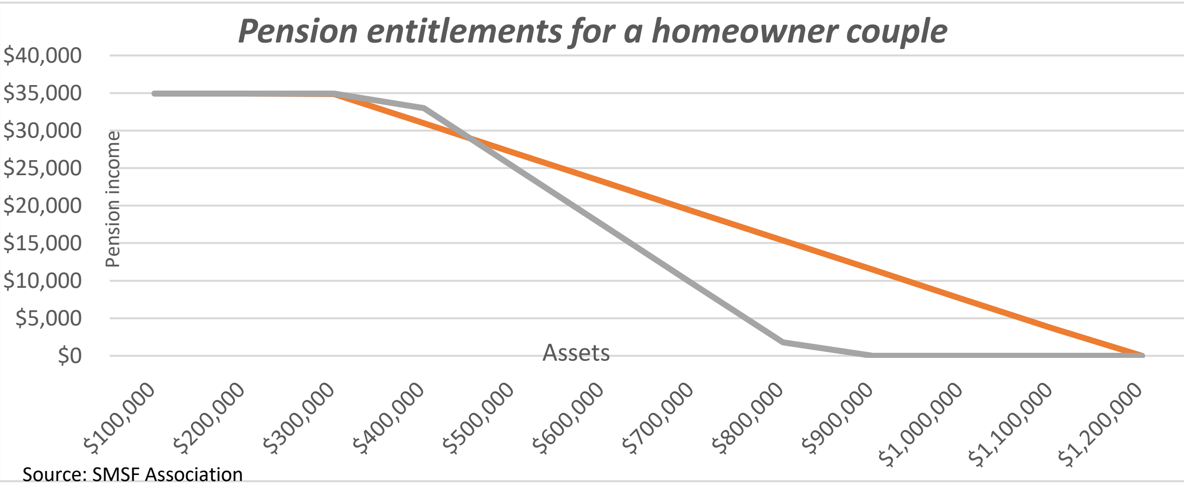
It is therefore important, from a conceptual perspective, to separate the need to further develop retirement income advice and retirement income products. Focusing on the need to further develop or mandate the use of retirement income products alone fails to recognise the strengths of the current retirement income policy settings and the role that quality financial advice should play in best utilising the current system. Similarly, not looking at how current advice practices operate, having regard to how consumer financial literacy and understanding of retirement risks affect the retirement phase of superannuation, could place an overemphasis on the mandating of products to fill this gap.

26. Is there sufficient integration between the Age Pension and the superannuation system?

One policy setting of concern to our Association which highlights the issue of integration is changes to the assets test rules for the Age Pension which took effect from 1 January 2017 reducing the entitlement to the Age Pension as a person's/couple's assets increase. We believe that the change to the means test taper rate and thresholds may have had significantly adverse consequences. While we support appropriately targeted mean testing to ensure the sustainability of the Age Pension, we are concerned that this measure is not appropriately integrated with the broader retirement income system (i.e. superannuation and taxation settings) and discourages middle income earners from saving for a self-sufficient retirement.

The SMSF Association notes that bias for capital preservation and poor advice can exacerbate the lack of integration. The below analysis does not assume that the individual is drawing down on capital when comparing retirement incomes, which in an efficient retirement income system should be the case. The SMSF Association plays a role in educating the sector with regards to retirement income, drawdown and capital utilisation but the impact of perceived disincentives and poor advice makes a significant negative impact on public confidence in the retirement income system.

The changes to the taper rate for the Age Pension assets means test have a significant impact on middle income earners who have accumulated an above average sized superannuation balance and benefit from a part-Age Pension payment which supplements their superannuation income. For home-owning couples that have a superannuation balance between $500,000 and $800,000, the increased taper rate creates a "black hole" where their assets above the asset test free amount cause them to be worse off in terms of income. This is caused by the taper rate equivalent to a 7.8 per cent per annum reduction of their pension entitlement for assets held above the threshold.



Source: SMSF Association

This reduction could be in excess of the income that many retirees earn from their superannuation balance above that threshold. This is especially an issue in a low interest rate and low investment return environment.

This creates a high effective marginal tax rate (additional income lost on Age Pension benefits and additional income tax payable on superannuation assets) on superannuation assets that are in excess of the asset test free threshold. Despite the fact that $800,000 of capital is always more valuable than $500,000, a $78 reduction in income for each $1000 of assets is significant for many retires, especially those who are unable to efficiently manage longevity risk.

This may actively discourage middle income earners from saving for retirement. They may be encouraged to consume now and it may have other detrimental behavioural effects, such as providing an incentive to shift investments from assets that are included in the means test (e.g. superannuation) to those that are excluded (e.g. the family home). This is an example of how retirement income policy changes can have detrimental effects when they have not been appropriately evaluated or integrated with other policy settings.

The financial reality in today's low interest rate regime is that a part or full Age Pension is an increasingly valuable asset providing a fortnightly government-guaranteed income stream for most retirees.

Further, the use of both the assets test and an income test for means testing the pension, exacerbates distortions in decision making on how to hold retirement savings. The interactions of the two means tests with the tax system create complex outcomes for retirees who rely on a part Age Pension to supplement their superannuation income.

The difference between the preservation age for superannuation and the aged pension further exposes this 'black hole'. The lack of alignment may create an incentive for individuals to drawdown on superannuation assets before relying on the Age Pension or 'double dipping'.

Simplified means test

The two means tests are confusing and complicated. They also make planning much more difficult for retirees.

We believe that a more appropriate and simpler mechanism to integrate superannuation and Age Pension means testing is to shift to a single means test that applies a deeming rate to financial and non-financial assets, removing the assets test. This would require a broader range of assets to be included in means testing and adjusting exemption thresholds and/or reducing exemptions from means testing to ensure fiscal sustainability. The Australia Future Tax System Review recommended that a single comprehensive means test should be pursued to ensure that assets are fairly accounted for, to remove distortions based on the form of savings and to ensure that appropriate incentives to save and use savings effectively remain.

A deeming rate can be adjusted to accommodate current economic conditions (e.g. the current low yield conditions confronting retirees) and can provide a far more suitable phase out rate than the assets test taper. In implementing a single deeming test, income test free levels and the treatment of certain exempt assets would need to be revisited.

Furthermore, the means tests for Age Pension and aged care are currently structured differently and the interaction is complex. We would support streamlining these means tests for simplicity and consistency.

Health card

The Panel should consider if individuals are choosing to rely on the Age Pension to receive the Pensioner Concession Card. The Pensioner Concession Card may create perverse incentives to move away from a fully self-funded retirement because the benefits which are not entirely monetary are beneficial to older Australians. Consideration should be given to a universal health card for older Australians.

Minimum rates

Before 2007, minimum pension factors were determined by the retiree's remaining life expectancy. For simplicity and ease of calculation they were placed in the bands below:

These pension factors have not been updated since 2007 although they were eased significantly during the GFC in response to the poor investment returns available at the time.

Age	Minimum % of account balance to be withdrawn
Under 65	4%
65 to 74	5%
75 to 79	6%
80 to 84	7%
85 to 89	9%
90 to 94	11%
95+	14%

Of course, it is not compulsory to spend this money, but after the money is removed from the fund, it is then exposed to normal tax rates. The purpose and effect of these mandated pensions is to remove money from the retirement phase, even if it is not required for current expenditure, so that that the pension fund does not leave a large inheritance of tax concessional money to be collected by beneficiaries at death.

Inevitably there comes a time when the investment earnings are insufficient to pay this minimum pension, and therefore assets need to be progressively liquidated to satisfy the requirement of mandated withdrawals. Minimum pension rates do encourage spending rather than preserving capital and hence may help reduce the overall cost of super tax concessions.

Evidence suggests that retirees draw assets at the minimum and therefore we believe these rates have become a de facto drawdown rate for many retirees. The Panel should consider whether the minimum withdrawal rates should be updated to create better cohesion with the retirement income system and address longevity risk. For example, a potential amendment to the tables could provide drawdowns that address the adequacy and longevity risks outlined in this paper in a revised retirement income system.