

6 April 2016

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## **Subject: Objective of Superannuation**

In response to the Discussion Paper released by the Government on 9 March 2016, the Actuaries Institute is pleased to provide this feedback on the issues raised in the paper in relation to the objective of superannuation.

### **Objectives for the whole retirement system**

One of the recommendations of the Financial System Inquiry (FSI) last year was to set a clear objective for the superannuation system to provide income in retirement. However, the Institute would go further than that. We believe that it would be helpful if the Government developed objectives for the whole retirement system, as well as complementary objectives for each pillar or component of the system. This would include objectives for the Age Pension and the compulsory Superannuation Guarantee (SG), as well as for additional savings both inside and outside the superannuation system that are tax advantaged and can be used for retirement (including housing wealth).

### **Superannuation to supplement the Age Pension**

In its final report, the FSI recommended the following primary objective for superannuation:

*To provide income in retirement to substitute or supplement the Age Pension.*

According to the findings of a recent OECD report, Pensions at a Glance 2015, 36% of Australian pensioners are living below the poverty line which the report defined as 50% of median household income. Merely substituting the Age Pension with income from a different source, such as superannuation, will not do much to improve living standards in retirement for many Australians.

Research also shows that, based on the Age Pension means tests that will apply from 1 January 2017, saving a sufficient amount of superannuation to avoid qualifying for any Age Pension payments during the period from age 67 up to life expectancy will be beyond most Australians. Superannuation will therefore act as a supplement to improve their standard of living in retirement.

One of the objectives of superannuation should therefore be:

*To supplement the Age Pension in order to provide a combined level of income that allows Australians to live a dignified retirement.*

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### **Flexibility required due to different retirement needs**

While the focus of tax advantaged retirement savings should be on producing an income in retirement rather than the accumulation of wealth for other purposes, it is understood that the needs of individual retirees will vary significantly and a degree of flexibility will therefore need to be maintained in the retirement system. For example, some savings will be used to pay off debt at retirement, or used for capital improvements or to purchase other items that will be used throughout retirement. Some savings will also be set aside for emergencies such as for large one-off health related costs or to assist family members. Given the variability of individual outcomes in retirement, some savings will also be passed on to future generations on death in some instances.

The Government should consider whether any limits should be placed on how much of a person's superannuation savings can be set aside and used for these purposes. For example, as we suggested in our submission to the Tax White Paper Task Force dated 29 May 2015, consideration should be given to reintroducing maximum withdrawal factors for income streams, which could be set at double the minimum withdrawal factors, to provide a corridor within which payments would be considered to be an income stream. Apart from some limited exceptions (e.g. funding for aged care, financial hardship), any withdrawals in a financial year above the maximum withdrawal amount would be considered to be a lump sum payment and taxed accordingly.

A tax free threshold could be set for the taxable component of lump sum payments, targeted mainly at low income earners, of say \$195,000 (the "low rate cap amount", which is indexed over time). Lump sum payments, above this lifetime threshold (accumulated over time) could be taxed, for example at the rate of 15% plus the Medicare levy.

On death, if there is a Spouse (or other Dependant), they would likely have planned their retirement together and it is therefore reasonable that the partner has the opportunity to rollover (tax free) the death benefit into a super account/income stream in their own name. Payments to non-dependants would be taxed as a lump sum (ie. amounts above \$195,000, except for non-concessional contributions).

Given the retrospective impact of this change to the tax treatment of lump sums, there should be a reasonable transition period provided to allow people to adjust their planning. We also acknowledge that Australians earning much less than the national average may not have the ability to make significant contributions to superannuation without compromising their current basic needs.

### **Fiscal sustainability, adequacy and poverty alleviation**

Another goal should be fiscal sustainability, in other words keeping taxpayer expenditures to a reasonable level. This raises the crucial question of adequacy. What level of retirement income should be targeted?

The Institute's 'For richer, for poorer' White Paper revealed that there is a strong reliance on the Age Pension for half of the population. It comprises 93% of retirement income for those in the bottom 5% income bracket and 44% for 'middle Australia'. Significantly, although those in the top quartile income bracket will achieve a comfortable retirement, many will still qualify for at least a part-Age Pension at some stage during their lifetime. Single women are likely to experience the worst outcomes under the current system.



One suggestion has been to target, say, 65% of a person's after-tax pre-retirement income. However, this would provide very significant levels of retirement income for high income earners and it is questionable whether the cost to the taxpayer of supporting that level of income is warranted.

We believe that a better alternative would be to target a dollar level of retirement income, which is determined after taking into account the after-tax income levels of the majority of working Australians along with any relevant research into retirement living standards. For example, ASFA has suggested that one target could be for the majority of retirees to reach the ASFA Comfortable level (AFSA submission to treasury<sup>6</sup> February 2016). While the merits of the ASFA Comfortable level (or a suitable variation thereof) can be discussed, if we can get at least 50% of Australians up to the ASFA Comfortable level using just their superannuation savings and the Age Pension, then we will certainly be a long way towards achieving a reasonable standard of living retirement for most Australians.

In addition, there should be a target in relation to the proportion of Australian pensioners living below the poverty line (currently 36% according to the OECD). This might mean increasing the Age Pension and/or specifically targeting some pensioner groups (eg. by increasing rental assistance). In our view, it should not be unreasonable for a country like Australia to lead the world in poverty alleviation and a suitable target should be set as part of this process.

For most Australians, the family home is a substantial financial asset, often greater in value than their superannuation savings. In the interest of living a better life in retirement, people should be able to access a certain amount of home equity to top up their superannuation in retirement. Access to home equity could be via a financial instrument (such as a reverse mortgage or equity release scheme) or via a market transaction (such as downsizing to a smaller home). Consideration should be given to maintaining the means test exemption on any home equity released on the sale of (or in respect of) the family home. That amount could go into their superannuation fund in a "protected" account that is not included for the assets test (like the family home was treated). The remaining home equity would still be available for health and aged care.

There should also be a specific target in relation to the fiscal sustainability of the system overall, such as the combined cost to the taxpayer (measured as a percentage of GDP for example) of the Age Pension and superannuation tax concessions.

Whatever the adequacy and other targets, it is important that they are quite specific and measureable, with progress towards the targets assessed on a regular basis, such as in the five-yearly Intergenerational Reports (IGRs). Given the importance of these targets, we encourage the Government and Treasury to undertake further consultation and research before setting them in place, including a suitable level of tax supported superannuation (see section on "equity and fairness").



## **Equity and fairness**

Equity is another core principle that is important for the superannuation system, to ensure that individuals are treated fairly. In our submission to the Tax White Paper Task Force dated 29 May 2015, the Institute made a number of recommendations on how to improve equity in the superannuation system including the retention of the low income superannuation contribution (LISC) and extending the Division 293 tax to individuals with an adjusted taxable income (ATI) of more than the sum of \$180,000 plus an allowance for superannuation contributions, which would provide a tax concession on superannuation contributions of between 15% and 22% for most people.

We also suggested that a lifetime cap be gradually phased in for both concessional and non-concessional contributions. Also, to limit the tax concessions provided on investment earnings on assets supporting a superannuation income stream, we suggested one way would be to limit the amount of any superannuation benefit that can be “crystallised” and then invested in a superannuation income stream that has a 0% tax on investment earnings. For example, a lifetime cap of say \$2.5 million (indexed to wages, such as MTAW) could be applied. Any excess amount could remain in a superannuation account and 15% tax on investment earnings would continue to apply.

## **Sustainability, efficiency and confidence in the system**

The Institute believes that an equitable and sustainable retirement income system that efficiently delivers on its objectives will not need the ongoing tinkering that has been a feature of the superannuation system for decades. Stability in tax and other policy settings will enhance consumer confidence in the system.

The Institute acknowledges that the Productivity Commission released an issues paper on 16 March 2016 to separately develop criteria to assess the efficiency and competitiveness of the superannuation system. We believe that an important role of the superannuation system is to efficiently accumulate sufficient assets to allow each individual retiree to achieve their reasonable retirement goals.

Part of the superannuation system includes the provision of death and disability benefits for members and their beneficiaries. This important role should not be forgotten as many superannuation members “retire” due to disability and many families are afforded financial protection in the event of death. The role (and cost) of such insurance benefits should therefore be considered as part of the objectives for (and efficiency of) the superannuation system.

On 21 July 2014, the Government released a discussion paper as part of a review of retirement income stream regulation. While the results of this review are still not known, it is hoped that the regulatory barriers restricting the availability of relevant and appropriate income stream products in the Australian market (such as deferred lifetime annuities or DLAs) will be removed to provide retirees with the opportunity to better manage their longevity risk and to more efficiently decumulate their retirement savings in a reliable and secure way.



## Conclusion

The Institute acknowledges that flexibility is required in the system to reflect each individual's different retirement income needs and varying capacity to exercise choice. A system that is equitable and sustainable, and allows the majority of Australians to reach an agreed dollar level of retirement income in a reliable and secure way no matter how long they live, could reasonably be judged on track to be a successful retirement income system.

We would be pleased to discuss our submission with you in more detail if required.

Yours sincerely,

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