Super system evolution: Achieving consensus through a shared vision

ASFA White Paper
MAY 2013

The Association of Superannuation Funds of Australia Limited

TABLE OF CONTENTS

INTRODUCTION TO THE PAPER

PART 1

1. Introduction

There has been much debate across the community about the design of Australia's superannuation system. Amidst continued debate regarding potential changes to superannuation, ASFA is calling for a calm and considered debate in order to develop a shared vision for the retirement income system in Australia.

This paper aims to provide a process which supports an informed conversation about whether the system should be evolved or adjusted in light of demographic and economic changes within Australia.

The results of this process will be published and shared with stakeholders including all political parties.

The paper is divided into four parts. Part 1 provides some context, background and describes the consultative process. Part 2 summarises some possible adjustments to the system and outlines the considerations and assumptions that were taken into account in their development. Part 3 provides greater detail about the possible final settings for the system. Part 4 provides a detailed analysis of the background, facts and figures relating to superannuation.

We are not advocating a revolutionary new retirement system – we are proposing that there be consultation on the nature of the evolution of the system given the changing nature of the Australian demographics and the economy. It is worth noting that the current system is regarded by many international commentators as one of the best in the world and its core structure is supported by reports from both the IMF and OECD.

However, the core of the system was designed when the proportion of older people in the Australian community was not very high and the average life expectancy was much lower than it is today. In essence the system was designed to provide a retirement income for people who lived into their 70s not into their 90s. Now is the time to re-look at the system and to modernise it. That said, we are not advocating that we should start again from scratch or invite a debate on whether we should have a superannuation system at all, as those arguments have been had and the core of the system is doing its job.

In Australia, superannuation tax concessions are an important mechanism to address demographic and longevity challenges. Even given the day-to-day challenges for governments in dealing with budgetary pressures, superannuation should remain a priority because it ensures that Australians will be able to have a financially secure retirement without undue reliance on government pensions.

Many Australians plan for their retirement. They want to make sure that they can plan with certainty. This paper is about settling on a design that is bi-partisan, affordable and is supported by sound public policy. That is, a shared vision for the future.

This paper does not attempt to cover the full scope of all retirement policy settings. Many of these areas are covered in other documents referred to in this paper.

In particular, there are a number of ways the system can be improved and simplified. There also needs to be a discussion as to how a person's superannuation balance does and should interact with health care costs and aged care costs as well as access to social security benefits. Future ASFA research and policy analysis will investigate these topics.

The thinking that drives tax policy in relation to a retirement system in Australia must be long term and must be adjusted in-line with the objective of providing a comfortable retirement for the vast majority of Australians who are living longer and whose expectations of lifestyle in their retirement is higher than previous generations.

This paper is about setting out a design that can be agreed by all political parties in order that the Australian community can plan for their retirement with confidence.

It is important that all stakeholders contribute to the debate on the future of the superannuation system because we all have an interest in its success.

2. Key facts about the system

To enable a more informed debate and provide a starting point for the conversation, the following are some key facts.

5:1 THE RATIO OF WORKERS TO RETIREES TODAY

2.7:1 THE RATIO OF WORKERS TO RETIREES IN 2050

THE LIFE EXPECTANCY FOR MEN AND WOMEN

	M	F
2013	86	89
2050	91	93

$1.5 trillion THE SIZE OF THE SUPER POOL TODAY

$9 trillion THE PROJECTED SIZE OF THE SUPER POOL IN 2050

$1.4 trillion
The size of Australia's GDP today

$6 trillion
The projected size of Australia's GDP in 2050

3% THE COST OF THE AGE PENSION AS A % OF GDP (AUSTRALIA)

9-11% THE COST OF THE AGE PENSION AS A % OF GDP (MANY OTHER COUNTRIES)

	Cost of healthcare as % GDP	Cost of age pension as % GDP	Cost of aged care as % GDP
2013	4%	2.7%	0.8%
2050	7.1%	3.9%	1.8%

13% THE PERCENTAGE OF AUSTRALIANS AGED OVER 65 TODAY

22% THE PERCENTAGE OF AUSTRALIANS PROJECTED TO BE OVER 65 BY 2050

65% The goal income replacement rate

75% The number of Australians >65 who rely on full or part pension today

ANNUAL EXPENDITURE NEEDED FOR A COMFORTABLE RETIREMENT

Couple — $56,320

Single — $41,170

3. Considerations and some context underpinning the paper

3.1 Starting from a "clean slate" is not practical or sensible.

Moving from the current flat rate taxation of contributions and investment earnings to a system which taxes contributions and investment earnings at marginal personal tax rates would:

- Lead to worse retirement outcomes for Australians
- Reduce tax revenue for many decades to come
- Introduce considerable additional complexity to an already complex system
- Adversely affect consumer confidence in the superannuation system

3.2 However, even though Australia has a truly comprehensive system which is seen as a role model by many other countries, there is scope for improvement.

For example:

- There are tax and other policy settings which may not be sustainable in the longer term
- The superannuation system must been considered together with all retirement policy settings including the Age Pension, aged care and healthcare
- The system is unduly complex with inconsistencies and inequities
- Changes wrought by governments of various political persuasions have compromised the overall aims of retirement income policy
- Work patterns continue to change and contribution and benefit arrangements have not kept up with this
- There are too many leakages of retirement savings both before and after retirement
- There is not sufficient encouragement and support for the taking of income streams in retirement
- There are tax and legal impediments to the development of post-retirement products which address the financial consequences of longevity
- The transition from accumulation phase to draw down in retirement is too costly and complex
- Both investment risk and longevity risks are often borne by individuals who may be ill-equipped to deal with such risks

3.3 Key outcomes for the system on which input and comments are sought include:

- **Better retirement incomes.** The Australian community should have better retirement incomes in the future with at least a 60 per cent replacement rate of pre-retirement earnings.
- **Affordability.** Tax concessions for superannuation together with the Age Pension should result in, say, 80 per cent of all Australians being able to fund a substantial part of their own retirement needs without undue reliance on the Government pension. This will mean that Age Pension payments at the full rate can continue to be made to the minority who need them.
- **Certainty.** Individuals should have certainty in regard to policy settings so they can plan with confidence in terms of savings prior to retirement, and for the retirement income arrangements they put in place when they are no longer working. Bi-partisan support for policy settings can help provide such certainty.
- **Coping with an ageing population.** The system was originally largely designed for people who lived into their 70s and it needs to be redesigned for people living into their 90s.
- **Flexibility.** While certainty in regard to the core design is necessary, the design should be flexible enough so that it can be adjusted as the Australian demography, society and economy changes.

4. The consultative process

The consultation process in regard to the paper commenced in May 2013 with its public launch at ASFA events held around the country.

There is to be a five-month consultation period. During that time ASFA will meet with a number of ASFA members and stakeholders. As well, ASFA will seek submissions from interested parties which can be lodged through a dedicated section of the ASFA website – www.superannuation.asn.au/vision-for-super – or directly with the ASFA secretariat.

The ASFA System Design Policy Council will consider submissions and develop a policy paper that will be ratified by the ASFA Policy Board Committee prior to launch at the ASFA National Conference in November.

Who is to be consulted?

The broader community is now highly engaged in the superannuation debate, which highlights the fact that it is one of the most important public policy issues facing Australians today.

Accordingly, this White Paper is seeking submissions from both the ASFA superannuation community and, importantly, the superannuation system's other major stakeholders. These stakeholders include fund members, consumer organisations, trade unions, employers and employer associations, academics and community groups.

5. Items covered in the more detailed supporting document (Part 4)

Part 4 of this White Paper provides background information and more detail on the possible Vision for the super system. It includes sections on:

- The role of government pensions, compulsory superannuation and voluntary savings in the provision of retirement income in Australia.
- Retirement age and the number of Australians who are retired.
- The financial and other risks faced by those approaching retirement.
- The ASFA Retirement Standard, which sets out both comfortable and modest budgets for those in retirement.
- Expenditure patterns in retirement, including the needs of older retirees in terms of aged care and health services.
- Sustainability of tax concessions for superannuation and expenditure on the Age Pension.
- Retirement savings balances and the current take-up of income streams.
- The advantage of taking up income streams.
- Removing current impediments to provision of deferred annuities and other financial products providing protection against the financial consequences of longevity.

6. Other related ASFA documents and references

- *Equity and superannuation – the real issues*, September 2012.
- *The equity of government assistance for retirement income in Australia*, February 2012.
- *Developments in the level and distribution of retirement savings*, September 2011.
- *Enhancing financial stability and economic growth: the contribution of superannuation,* The Allen Consulting Group, Report to ASFA, August 2011.
- *Spotlight on Henry: a comparative analysis of the Henry Recommendations with the proposed increase of the Superannuation Guarantee to 12 per cent*, February 2011.

INTRODUCTION TO THE PROPOSED DESIGN

PART 2

1. What the design covers

The design focuses on the principles and policy settings that should apply to the accumulation of superannuation retirement savings, the transition from paid work to retirement, and the drawing down of income in retirement. These are all core areas of superannuation and are crucial to the system delivering adequate retirement incomes on a sustainable basis.

We acknowledge that the conversation around the superannuation system, and support more generally for those in retirement, is complex and broad. This conversation includes the way in which superannuation policy settings interact with the provision of aged care and health care. Whilst some reference has been made to these areas in this and other documents produced by ASFA, they are not covered in detail as the focus of this document is on superannuation system design policy settings. The broader conversation also includes the role that the superannuation investment pool plays in the economy and financial markets generally. ASFA will be releasing other research and policy documents in the near future dealing with these topics.

The detailed adjustments and policy considerations are contained in Part 3 of this White Paper.

2. Key system design principles and summary – the three phases

There are three phases to the core system: **accumulation, transition, and post-Age Pension age**. By focusing on post-Age Pension age, we acknowledge that retirement may occur at any time in a person's life. The design of the three phases both separately and together has been guided by five key principles:

ADEQUACY	SUSTAINABILITY	EQUITY
The system should be geared to provide, in conjunction with the Age Pension, income which is sufficient for a retiree to live in dignity and which will last for the person's whole retirement.	Superannuation assets should be primarily devoted to providing retirement income, thereby containing future Age Pension costs of the Government, and not as a form of estate planning. This implies that there should be a ceiling on any tax concession.	The amount of tax and Age Pension assistance provided should be broadly comparable over the income scales, with the implication that there should be a cap on the amount of tax assistance for superannuation provided to individuals.

FLEXIBILITY	MEMBER PROTECTION
Individuals will have different needs and hence the system should provide flexibility in terms of contribution patterns as well as access to benefits, including the balance between lump sums and income streams.	Legislative requirements and obligations on trustees should be designed to look after the best interests of members, including the setting of good product defaults and insurance arrangements.

3. Timing of transition

Certainty is something that the community values in regard to superannuation policy settings.

In order to provide stability and certainty it is proposed that income streams currently established retain their current tax and social security means test treatment regardless of any changes that are made going forward.

Given that the arrangements proposed allow choices by individuals, albeit choices driven by both incentives and potential additional tax liabilities, it would be reasonable to apply a period of notice of, say, 12 or 24 months or more prior to the introduction of new measures along the lines proposed by ASFA.

Consideration may also be given as to whether a staged approach, say over a five-year period, might be appropriate in regard to a number of aspects of the proposals. Views are sought on this.

ASFA PROPOSALS FOR THE THREE PHASES OF SUPERANNUATION

PART 3

PHASE 1: Accumulation

ASFA proposes that the accumulation phase should work largely as it does today but with a number of refinements. However, the need for stability in arrangements during the long accumulation phase in order to engender the confidence of fund members in the system is also very important.

In essence, the system should be designed with a focus on the needs of the great bulk of Australians, say, 80 per cent or more of the adult population, to save for retirement by way of both compulsory and voluntary contributions which mostly receive tax concessions. While the aim is for an inclusive system it might be necessary to accept that at the very low end of the income scale superannuation may not be very relevant while at the very top of the income scale the provision of substantial tax incentives is not necessary.

1.1 Coverage

Individual needs and capacity to contribute should be the test for coverage of superannuation, not formal employment status or details of employment.

No group should be excluded by design or by opting out provisions.

More specifically, the compulsory system for contributions should be extended to:

- The self-employed;
- Independent contractors (for example, taxi drivers) and domestic carers;
- Employees earning under $450 a month from an employer, who currently do not benefit from compulsory contributions; and
- Individuals who are receiving paid parental leave payments from the Government.

Each of these groups should be brought within the coverage of the compulsory system or receive contributions to superannuation made by the Government. In the case of the self-employed, contractors and the like, this could involve using taxation powers to require such individuals to make contributions following the lodging of their tax returns.

The accompanying ASFA document, *Equity and Superannuation - the real issues*, September 2012, provides further information on current gaps and proposed solutions.

1.2 The retirement income goal for Australians

The overall goal should be to provide dignity and comfort in retirement for all Australians.

The Age Pension is designed to alleviate poverty in retirement, provide protection against the financial consequences of longevity and to provide a base for the overall retirement income of Australians.

For an average wage earner, the goal should be that superannuation savings together with a part Age Pension should be sufficient to fund a lifestyle equivalent to the ASFA Retirement Standard at the comfortable level. This requires expenditure of $41,169 a year for a single person and $56,317 a year for a couple, as at March 2013.

On the other hand, for those on above average incomes a replacement rate in retirement of around 65 per cent is appropriate. This is a common benchmark used in both Australia and other countries.

1.3 What is considered a modest and comfortable retirement lifestyle?

A 'modest' retirement lifestyle is considered better than the Age Pension, but one where only fairly basic activities are affordable.

A 'comfortable' retirement lifestyle enables an older, healthy retiree to be involved in a broad range of leisure and recreational activities and to have a good standard of living through the purchase of such things as: household goods, private health insurance, a reasonable car, good clothes, a range of electronic equipment, and holiday travel. Both budgets assume that the retirees own their own home outright and are relatively healthy.

The difference between the two budgets mainly relates to the extra items included in the comfortable budget. These include items such as: updating the kitchen or bathroom at some stage, eating out from time to time, being able to entertain family or friends at home, private health insurance at the top rate, purchasing magazines and CDs, an economy overseas holiday and being able to afford additional alcohol, purchase tobacco or give gifts.

Sections 3 and 4 of Part 4 provide more details on the ASFA Retirement Standard, and on the various stages of retirement and how the level and pattern of required expenditure in retirement generally will change.

1.4 The rate of compulsory contributions that is required

In terms of the level of employer contributions required to generate retirement incomes of the order of these targets, it is clear that nine per cent of earnings will not be sufficient.

For an average worker on a wage of $60,000 a year, a nine per cent contribution rate over 35 years would generate a superannuation balance at the time of retirement in today's dollars of $270,000. This is well short of what is required for a comfortable standard of living in retirement given that around $450,000 is needed for a single person and around $500,000 for a couple.

For a person who is entering the labour force this year, the phased increase in the rate of compulsory contributions to 12 per cent will boost projected savings to around $334,000. This is still short of what is required for a comfortable lifestyle in retirement. A further increase of three percentage points in the rate of compulsory contributions would boost the retirement savings of the average worker by around $90,000.

For those on above average incomes, contributions well in excess of nine per cent are also needed to generate a replacement rate in retirement approaching 60 per cent.

Accordingly, ASFA supports over the longer term an increase in the rate of compulsory contributions to 15 per cent.

1.5 Access to superannuation prior to preservation age

The core purpose of superannuation is to generate income for people in retirement. While it is appropriate that benefits be available prior to preservation age in the case of total and permanent disability or terminal illness, ASFA considers that any other grounds for release should be strictly limited.

The current hardship and compassionate release mechanisms involve a considerable administrative burden for both the government and for funds. They also clearly lead to a diminution of retirement savings and eventual retirement income.

There is some evidence as well, that the provisions are in effect exploited by lenders, who build in access to superannuation through requiring a borrower to make use of the compassionate relief provisions in the case of a loan default. There are also reported cases of compassionate relief payments being used to fund what could be considered to be cosmetic surgery.

ASFA proposes that the current early release provisions be reviewed in order to reduce the scope of cases to those where early release is truly justified on public policy and individual grounds and to streamline administration of the provisions, building on recent reforms in this area. In particular, action should be taken to stop any abuse of the current early release arrangements.

1.6 The taxation of superannuation in the accumulation phase

The mere fact that savings are for retirement does not mean that they should automatically qualify for tax concessions. However, the equity of tax concessions must be considered in the context of overall government assistance for retirement incomes. Too often, superannuation taxation concessions and the Age Pension are considered separately. The community funds retirement income support for both superannuation and the Age Pension recipients, and some will benefit from one or other with most partly from each. The design of tax provisions needs to reflect this.

Theoretically, taxes on super should at least be no more than taxes on alternative investments, such as negatively geared investment housing or shares. Arguably, they should be considerably less because of the restrictions that come with super such as preservation until retirement age and because private super entitlements lead to less Age Pension entitlement.

In order to maintain confidence in the superannuation system it is important to retain the current basic taxation structure in the form of flat rate 15 per cent tax on concessional contributions and investment earnings. To move to a system where contributions and investment earnings were taxed at the marginal rate of the individual would destroy confidence in the system, would have a significant adverse impact on retirement outcomes and would be administratively difficult and costly to implement.

Accordingly, ASFA proposes taxation provisions during the accumulation stage as follows:

- All concessional contributions should be taxed at a uniform rate of 15 per cent, with contribution caps, as described in the following section, being used to limit the amount of concession provided to upper income earners. This has been a core feature of the system and should be maintained.
- A nominal tax rate of 15 per cent should be applied to the investment earnings of an account in the accumulation phase. Again this has been a core feature of the system.
- In order to provide appropriate assistance and tax assistance to lower income individuals there should be a tax rebate, such as the Low Income Superannuation Contribution, which applies to contributions made on behalf of such individuals.

The accompanying document, *Spotlight on Henry: a comparative analysis of the Henry Recommendations with the proposed increase of the Superannuation Guarantee to 12 per cent*, February 2011, provides further detail on why this structure of taxation of superannuation delivers better outcomes for Australians than taxing contributions and investment earnings at personal income tax rates.

1.7 Capping tax concessions related to accumulation

The method

Many countries cap the amount of tax assistance provided to private savings for retirement through caps on tax assisted annual contributions and/or final retirement savings.

Australia has moved from substantial reliance on a cap of tax preferred final retirement savings (the Reasonable Benefit Limits) to caps on both concessional and non-concessional contributions. While this may have delivered additional tax revenue to the Government, the caps on annual contributions do not allow certain individuals with low balances to catch up with their retirement savings when they have the financial capacity to do so nor do they deal with the circumstances of individuals who achieved an account balance of tens of millions of dollars prior to the contribution caps coming into force.

Accordingly, the ASFA proposal is as follows:

- Caps on both concessional and non-concessional contributions should be administered on a lifetime rather than on an annual basis in order to accommodate the fact that individuals will generally have markedly different capacity to make contributions in specific years of their working life.
- If caps are to be applied to concessional and non-concessional contributions on an annual basis, they should be set at levels which allow individuals to accrue a reasonable level of savings for retirement, recognising that individuals generally will make contributions below the caps in most years.
- Provisions should also be in place which allow individuals with low balances to catch up when they have the financial capacity to do so.

The maximum amount of superannuation that should receive tax concessions

As noted above, some upper limit on retirement savings attracting ongoing tax concessions is appropriate. If a lifetime limit on the amount attracting tax concessions is introduced ASFA proposes that the limit should be in the order of $2.5 million in today's dollars.

This is more than what is required to fund the comfortable standard living as defined by the ASFA Retirement Standard. While that sets a reasonable base for retirement planning for many individuals, it is also reasonable for a substantial proportion of individuals to seek a higher standard of living than that.

For instance, an income replacement rate in retirement that is commonly used as a measure of adequacy is 60 per cent of gross pre-retirement income. For a person on $200,000 a year, a reasonable upper income limit for the provision of taxation concessions or other government assistance, this implies a drawdown in retirement of $120,000. Using the minimum draw down factor for a person aged 65 to 74, this would require a superannuation balance of $2.4 million.

Other objective indicators of retirement income and asset levels consistent with receiving government assistance are:

- The now abolished Reasonable Benefit Limits (RBL) provided some indication of the amount of benefits regarded as deserving tax concessions. Indexation of the pension RBL would lead to a figure of $1.75 million in 2012-13. The RBL figure does not include non-concessional contributions, which form a significant part of most larger superannuation account balances.
- Superannuation savings of $2.5 million would generate an annual indexed payment of $98,880 from age 60 to age 90 or an annual indexed payment of $113,785 from age 65 to age 90. However, these are central cases. With lower than assumed investment returns of 6.5 per cent nominal in the retirement phase and/or lower investment returns to start with, the amounts would run out prior to age 90 or the annual amount would lower. It is reasonable to provide such levels of retirement income with tax assistance.

The ASFA Pre-Budget submission for the 2013-14 Budget provides further details.

Section 5 of Part 4 provides details on the ongoing sustainability of Age Pension expenditures and tax concessions for superannuation.

PHASE 2: Transition between accumulation and retirement stages

For a variety of reasons individuals may need to cease work prior to Age Pension eligibility age because they:

- work in physically demanding jobs and may be physically unable to continue working in the same jobs after the age of 60;
- are retrenched and are not able to obtain another job;
- need to leave work due to ill health or disability; or
- need to leave work to care for a family member.

Superannuation access and taxation provisions should acknowledge this reality while at the same time providing incentives for individuals to delay taking superannuation benefits until after they reach Age Pension eligibility age.

2.1 Age of access to superannuation

Currently the minimum age at which superannuation can be accessed on retirement grounds is age 55. This gradually increasing to age 60. However, given that there is to be a phased increase in the Age Pension eligibility age to 67 and increases in life expectancy are continuing, ASFA proposes an increase in the preservation age to five years less than the eligibility age for the Age Pension.

Accordingly, ASFA proposes a further phased increase in the preservation age to 62 after the current phased increase to 60 is achieved in 2024.

If the Age Pension eligibility age is increased in the future, there should be an equivalent increase in the preservation age for superannuation.

As is now the case, access to superannuation should be allowed prior to preservation age in cases of total and permanent disability or on specified hardship or compassionate release grounds.

Careful consideration would also need to be given prior to any increase in the preservation age, to the state of the employment market for older workers and the incidence of disabilities which might limit the capacity of older workers to seek employment.

2.2 Access to lump sums and income streams in the transition phase

While access to a lump sum up to a certain level is appropriate to meet various capital expenditure and other immediate needs of a retiree, it is proposed that there should be limits on the amount that can be withdrawn and that the tax treatment should be less favourable than for a benefit taken as an income stream. This would encourage individuals not to substantially run down their retirement savings prior to becoming eligible for the Age Pension. This would have a favourable impact on the ability of individuals to cope with the financial consequences of a long life in retirement and it would also assist in moderating government expenditure on the Age Pension.

More specifically, ASFA is proposing that:

- A lump sum benefit should be available within the five years following Preservation Age not exceeding, an amount equivalent to, say, two or three times average annual earnings. Any such amount withdrawn should generally be taxed at a flat rate of, say, 15 per cent in order to encourage the taking of an income stream as an alternative.
- There would be no absolute prohibition on taking a lump sum over that amount, but any such withdrawals should generally be taxed at a flat rate of, say, 30 per cent in order to discourage the taking of such lump sums and also to recover the bulk of the tax concession that had been provided to such retirement savings.
- The taking of a large lump sum benefit prior to Age Pension eligibility age generally can be regarded as being inconsistent with the aims of retirement income policy. However, in some circumstances, such as the need to access a lump sum in order to enter a residential care facility, there may be a case for allowing access to a lump sum without any adverse tax consequences.
- Any dollar amount thresholds should be indexed to movements in the dollar amount of average earnings in order to remain relevant and contemporary.
- Dollar amount thresholds should also be rounded to the nearest $5,000 in order to be simple to apply and understand.

PHASE 3: After Age Pension age

3.1 Context

The primary purpose of superannuation is to provide financial security in retirement. This purpose is not currently being achieved with any certainty as there are many potential leakages that are a cost to the system's integrity and the taxation concessions provided.

These potential leakages include:

- using superannuation benefits too fast, which manifests in several ways including:
  - having insufficient protection against the financial consequences of living a long time or longer than most other people
  - excessively running down retirement savings when they become available to either fund excessive consumption and/or debts that were built up in the lead up to retirement in the knowledge that a lump sum would be available
- using superannuation benefits too slowly for estate planning or other reasons and leaving these benefits for others.

Age of survival for 65-year-olds

% surviving	Females	Males	Joint-Life*
90	76.1	72.9	85.9
80	81.7	78.1	88.4
70	85.2	81.7	90.2
60	87.9	84.6	92.4

**Joint Life – in the case of a couple, this is the age that one or other of the couple will live to.*

While the evidence available indicates that most retirees make sensible decisions in regard to their investment of their retirement savings, there is scope to strengthen arrangements.

The policy settings proposed by ASFA are designed to support the provision of income streams in retirement and to direct individuals towards taking up income streams. They also take into account that many Australians will want or need to work beyond the Age Pension age in either a full time or part time paid job. The system should not penalise or otherwise discourage such individuals.

Section 6 of Part 4 provides details of current and projected superannuation balances at the time of retirement and current use of income streams.

Section 7 explains why taking income streams is desirable.

Section 8 provides a set of recommendations for the removal of current impediments to the provision of financial products such as deferred annuities, that deal with the financial consequences of longevity.

3.2 Access to lump sums

While tax and other concessions should be consistent with the primary purpose of superannuation, being the provision of an income stream in retirement, there are circumstances in which access to a lump sum would be consistent with retirement income provision. For instance, it might be desirable for a modest capital sum to be available on favourable taxation terms at the time of retirement to cover capital costs of new domestic appliances, a car or paying off the residual balance of a home loan. As well, if the level of retirement savings is very modest it may be impractical or inefficient to use such a sum to purchase an income stream.

The tax treatment should be less onerous compared to the transition phase given that any lump sum taken will be subject to the means test for the Age Pension. Also, concerns about the financial consequences of longevity while still relevant are lessened for a person aged over the eventual eligibility age of 67.

More specifically, ASFA proposes that a lump sum benefit should be able to be taken after Age Pension eligibility age on the following terms:

- Tax free if the total lump sum taken over the course of retirement is less than, say, an amount equivalent to two or three times average annual earnings.
- Subject to tax at a flat rate of, say, 15 per cent on any lump sum amount over the threshold for tax free lump sums.
- Consideration be given to availability of a larger lump sum on favourable taxation terms if needed for entry into a residential age care facility or for similar reasons.
- Any dollar amount thresholds should be indexed to movements in the dollar amount of average earnings in order to remain relevant and contemporary.
- Dollar amount thresholds should also be rounded to the nearest $5,000 in order to be simple to apply and understand.

3.3 The default when a member reaches Age Pension age and stops working

Currently, default arrangements for choice of fund, investment choice and even default rates of contributions have important roles to play. ASFA proposes that while individuals should be able to make choices, with or without the benefit of holistic or limited financial advice, there should be default arrangements relating to superannuation accounts when an individual reaches Age Pension age and stops working, as evidence by the cessation of concessional contributions.

More specifically, it is proposed that:

- In the absence of any other direction from the member, when the member reaches the eligibility age for the Age Pension and employer contributions have ceased, notice should be given to the member that the account balance will convert to an account based income stream.
- The account-based income stream will be required to have both minimum and maximum drawdown amounts, with the default drawdown being set by the standard age based minimum factor.
- Superannuation funds should be required to offer holistic and/or more limited advice related to retirement income streams when an individual has reached age 62 or over and contributions cease, or at Age Pension age in any event.
- The member would be able to purchase a lifetime or a deferred annuity, but would not be required to. Purchase of a deferred annuity could be made over a period of years and/or prior to retirement.
- Current tax and regulatory impediments to the provision of lifetime and deferred annuities should be addressed by the Government.

3.4 Arrangements for those who continue to work part-time

It is important that the retirement income system retains some flexibility for those who wish to maintain a blend of paid work (possibly part-time) and retirement. Indeed the concept of a single or fixed retirement age for society, or indeed for many individuals, is now anachronistic.

Accordingly, tax, social security and superannuation policy settings should support and encourage part-time work by individuals.

If an individual has been defaulted into an income stream account or has chosen to start an account-based income stream or an annuity, they also should be permitted to maintain a separate accumulation account which would receive any concessional or non-concessional contributions. Such accounts would be taxed in the same way as accumulation accounts held by persons younger than Age Pension eligibility age.

When employment ceases and contributions stop, the member should be able to transfer the accumulation amount to the account-based income stream without the need to commute that income stream and to start a new income stream account.

There should be no age limit on Superannuation Guarantee contributions being made on the behalf of an individual.

However, all other concessional and non-concessional contributions should be prohibited once a person is five years older than the Age Pension eligibility age.

3.5 Arrangements for those who work full-time after Age Pension age

If an individual continues to work, the member's account should continue in accumulation mode and be taxed in the same way as accumulation accounts held by those whose age is less than the Age Pension eligibility age.

As with those working part-time, there should be no age limit on Superannuation Guarantee contributions being made on the behalf of an individual.

However, all other concessional and non-concessional contributions should be prohibited once a person is five years older than the Age Pension eligibility age.

This implies that once the member is more than five years older than Age Pension eligibility age **and** all employer contributions have ceased, the account defaults to being an account-based income stream with minimum and maximum drawdown factors and no taxation on investment earnings.

3.6 Integration with the Age Pension and aged care provision

It is critical that the superannuation system and the Age Pension are integrated and that additional superannuation savings and workforce participation are encouraged to provide:

- higher retirement incomes, when all sources of income are considered;
- reduced Age Pension outlays; and
- reduced aged care outlays.

An important design feature of the means test for the Age Pension should be that there are real incentives to save more for retirement, both in regard to the tax incentives for contributions and in regard to the impact on final retirement income. It would be counterproductive if a dollar of additional private income in retirement derived from superannuation led to a dollar decrease in the amount received in the form of the Age Pension.

Past experience also indicates that full or partial exemption of certain longevity products from the asset test for the Age Pension can provide a powerful incentive for individuals to purchase such products.

A concern of many older Australians is in regard to whether they will be able to pay for aged care, particularly any capital sum required for residential aged care. It is important that there be the ability to access capital to pay for such aged care, including possibly by commuting a deferred annuity if one is in place. The lump sum withdrawal necessary to pay a deposit for such aged care (often $200k or more) should not incur a tax penalty.

Superannuation funds should also be able to offer insurance cover for aged care costs, along with more traditional death and disability insurance, should such products begin to be offered in the Australian market.

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