

SUPPLEMENTARY  
SUBMISSION

# Social Services Legislation Amendment (Fair and Sustainable Pensions) Bill 2015

SENATE STANDING COMMITTEE ON COMMUNITY  
AFFAIRS

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## ABOUT INDUSTRY SUPER AUSTRALIA

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# SOCIAL SERVICES LEGISLATION AMENDMENT (FAIR AND SUSTAINABLE PENSIONS) BILL 2015

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# SOCIAL SERVICES LEGISLATION AMENDMENT (FAIR AND SUSTAINABLE PENSIONS) BILL 2015

The Government has said there would be more than 170,000 pensioners with modest assets who would be better off under the changes proposed under the Social Services Legislation Amendment (Fair and Sustainable Pensions) Bill 2015. However, analysis by Industry Super Australia (ISA) suggests the gains presented are overstated, with a significant proportion obtaining no increase or lower increases than suggested. Moreover, the Government has conceded that a further group of 326,000 would be worse off – many with only moderate assets.

This supplementary submission is necessary to highlight significant additional issues that have emerged after closer scrutiny of the proposed changes to the pension asset test in the Bill and casts significant doubt on the purported benefits and identifies a number of unintended consequences.

Specifically this supplementary submission argues:

- The claim that pensioners with modest levels of assets will be better off is overstated and potentially misleading due to the operation of the dual means test in practice;
- Inappropriate assumptions appear to have been selected to suggest pensioners who are negatively affected are in better financial circumstances than they actually are – including that pensioners could reliably obtain investment returns in excess of 12.7 per cent per annum;
- Life expectancies have been selected to support the sustainability of higher drawdown amounts which are significantly less than those contained in the 2015 Intergenerational Report (IGR);
- The asset test taper will result in inappropriate incentives to divest assets because the pension income gained from doing so will in most instances exceed the investment income forgone;
- If adopted the asset test measures in the bill will result in a harsher means test than applied pre-2007 because there is no comparable 50 per cent asset test discount available for new market linked and term income streams;
- Furthermore, the lack of such an exemption or discount coupled with the effective taper rate in excess of 150 per cent will make such products less attractive than simply spending assets and receiving the pension;
- Due to the retention of the superannuation tax measures also introduced in 2007 the asset test changes in the Bill will result in a less equitable retirement income system than existed prior to 2007.

We understand that the Committee intends to report on the asset test measure contained in the Bill on 22 June without public hearings.

The lack of public hearings for a measure which will materially impact on the incomes of millions of Australians well into the future is not consistent with due process and normal practice for significant income support legislation. The urgency in the consideration of this aspect of the Bill is unclear given its commencement date is not time critical (January 2017).

We respectfully request the committee defer reporting to 10 August 2015 along with other measures in the Bill so that public hearings may occur and evidence can be tested and the complex issues arising from the measure given proper consideration.

## 1. Re-cap - Key facts about the aged pension changes

- Australia's Age Pension is sustainable with its projected long term fiscal cost falling each successive IGR<sup>1</sup> and exhibits the second lowest publicly funded share of total retirement income expenditure in the OECD<sup>2</sup>
- ISA has developed in collaboration with Rice Warner a comprehensive group based long term retirement income model of the Australian population which we have used to assess the impact of the proposed policy changes;
- Such modelling is necessary to understand the long term effects of policy change and the complex interactions between superannuation, private savings and the aged pension.
- The Age Pension is critical to the retirement living standards of nearly all Australians. For Australians retiring in the near term (currently aged 55-59), the Age Pension will be the largest source of retirement income for around 60% of couples and single men, and around 70% of single women. The Age Pension remains critical even with a mature super system placing a floor under super savings which would be inadequate on their own.
- Even without the proposed Age Pension cuts, only about half of Australians will have incomes (from all sources, including super, Age Pension, and private wealth) that support a comfortable living standard in retirement.
- The Government has proposed to (i) increase the asset threshold above which pension payments are reduced and (ii) increase the "asset taper rate" or the rate by which the pension is reduced for each \$1,000 of assessable assets over the asset test threshold from \$1.50 to \$3.00 per fortnight.
- While the increase in the asset test free area ameliorates the impact of the doubling in the taper rate it will not universally deliver increased pension payments for those with modest levels of assets due to the dual means test.
- Pensioners with assessable assets exceeding one million dollars are not the target of this measure – as they only constitute 5 per cent of losers. On the contrary 95 per cent of those affected have assets less than this, including those with assets of as little as \$300,000.
- Subjective judgements about the impact should be avoided. ISA analysis reveals the measure will by 2055 reduce the retirement incomes of:
  - 50 per cent of single females - none of which will obtain a comfortable retirement;
  - 50 per cent of single males - none of which will obtain a comfortable retirement;
  - 10 per cent of couples - none of which will obtain a comfortable retirement.

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<sup>1</sup> In IGR 2003 Aged related pension expenditures were estimated to reach 4.59%, in IGR 2007 4.4% GDP, in IGR 2010 3.9% GDP, and in IGR 2015 3.6% GDP under the currently legislated scenario.

<sup>2</sup> OECD Pension Markets Focus No. 10 2013

## 2. Detailed impacts

### 2.1 The scope for winners with modest assets is overstated

The proposed changes include an increase in the asset test free area which varies depending on pensioner status. The increase in the free area has been proposed to ameliorate the impact of the harsher asset test taper. It has been argued that the increase in the asset free area will increase the overall fairness of the measure because it will result in pension increases for those with more modest levels of assets. This will be the case for some pensioners but the outcomes will vary significantly. Some pensioners with low levels of assets will not obtain any increase.

There have been claims made that all part pensioners with assets below the new thresholds will be better off<sup>3</sup>. This is incorrect.

ISA's detailed analysis of the application of the Age Pension's dual means test suggests these claims have been overstated with the cameo tables potentially providing a misleading picture as to these effects.

#### 2.1.1 The dual means test and cameo outcomes

The Age Pension is means tested in two ways: against an individual's income and assets. The bill would increase the "free area" for the assets means test, but the application of the income means test will mean many individuals, subject to their particular circumstances, won't gain a benefit.

Under the dual means test the pension entitlement is derived by the test which delivers the lowest pension amount.

At the time of the initial announcement by the Government, tables were issued purporting to show the impact of the measure. Careful interpretation of the tables suggests the outcomes were derived using the asset test only (although this was not stated).

Subsequently the Department of Social Security (DSS) submission to the Committee included the same cameo tables but they included a new footnote which states:

*NOTE: There is an income test and an assets test for the pension. The test that results in the lower pension is the test that applies. The table above applies only where pension entitlements are calculated based on the assets test. Pensioners with assets in the ranges above will not be affected by the assets test change if the income test results in a lower rate of pension<sup>4</sup>.*

This acknowledgement is important because there will be pensioners who will be income tested instead and therefore not gain any benefit from the increase in the asset test free area.

While pensioners may be paid under the income test due to earned income, most will be paid under the income test because of the actual income derived from non-financial assets or from deemed income from financial assets.

The outcomes will vary considerably depending on circumstances and asset mixes. The current historically low deeming rates are not likely to trigger the income test at low levels of financial assets. However as interest rates normalise this will change significantly.

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<sup>3</sup> For example the Minister for Social Services Media Release 7 May 2007 stated: "All couples who own their own home with additional assets of less than \$451,500 will get a higher pension." <http://scottmorrison.dss.gov.au/media-releases/fairer-access-to-a-more-sustainable-pension>

<sup>4</sup> Community Affairs Committee - Department of Social Services (Submission number 5) 11 June, Attachment A pages 18-21

ISA has examined in detail the cameo tables produced, and calculated what the outcome would be if the income test were also included. ISA examined the impact using the current deeming rates (Table 1) as well as the outcomes (Table 2) if deeming rates are at historical norms - which they will revert toward over time.

This analysis reveals the gains for pensioners with lower levels of assets are either considerably overestimated or non-existent depending on the prevailing deeming rate. For pensioners who have income producing non-financial assets, the outcomes are more likely to be similar to those found in Table 2 if their returns (for example rental yields) are 4 to 5 per cent.

Table 1 – Total impact taking account both the income and assets test

Assessable Assets	DSS estimate of pension under current asset test	Estimate of pension using current income and asset test	DSS estimate of rebalanced pension	Estimate using current income test and rebalanced asset test	DSS estimate of change in pension (1)	ISA Estimate of change in pension (2)	Difference (Loss) (2) – (1)
\$100,000	\$34,923	\$34,923	\$34,923	\$34,923	\$0	\$0	\$0
\$200,000	\$34,923	\$34,923	\$34,923	\$34,923	\$0	\$0	\$0
\$300,000	\$34,865	\$34,551	\$34,923	\$34,551	\$59	\$0	<b>\$59</b>
\$375,000	\$31,940	\$31,940	\$34,923	\$33,333	\$2,984	\$1,393	<b>\$1,590</b>
\$400,000	\$30,965	\$30,965	\$32,973	\$32,926	\$2,009	\$1,962	<b>\$47</b>
\$451,500	\$28,956	\$28,956	\$28,956	\$28,956	\$0	\$0	\$0
\$500,000	\$27,065	\$27,065	\$25,173	\$25,173	-\$1,892	-\$1,892	\$0
\$600,000	\$23,165	\$23,165	\$17,373	\$17,373	-\$5,792	-\$5,792	\$0
\$700,000	\$19,265	\$19,265	\$9,573	\$9,573	-\$9,692	-\$9,692	\$0
\$800,000	\$15,365	\$15,365	\$1,773	\$1,773	-\$13,592	-\$13,592	\$0
\$823,000	\$14,468	\$14,468	\$0	\$0	-\$14,468	-\$14,468	\$0
\$900,000	\$11,465	\$11,465	\$0	\$0	-\$11,465	-\$11,465	\$0
\$1,000,000	\$7,565	\$7,565	\$0	\$0	-\$7,565	-\$7,565	\$0
\$1,100,000	\$3,665	\$3,665	\$0	\$0	-\$3,665	-\$3,665	\$0
\$1,194,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0

Source: ISA

Note: Couple homeowner using projected 2017 rates and thresholds (current deeming rates assumed and apply to assessable assets)

Table 2– Total Impact taking into account both income and asset test (using average deeming rates)

Assessable Assets	DSS estimate of pension under current asset test	Estimate of pension using current income and asset test	DSS estimate of rebalanced pension	Estimate using current income test and rebalanced asset test	DSS estimate of change in pension (1)	ISA Estimate of change in pension (2)	Difference (Loss) (2) – (1)
\$100,000	\$34,923	\$34,923	\$34,923	\$34,923	\$0	\$0	\$0
\$200,000	\$34,923	\$34,820	\$34,923	\$34,820	\$0	\$0	\$0
\$300,000	\$34,865	\$32,475	\$34,923	\$32,475	\$59	\$0	<b>\$59</b>
\$375,000	\$31,940	\$30,716	\$34,923	\$30,716	\$2,984	\$0	<b>\$2,984</b>
\$400,000	\$30,965	\$30,130	\$32,973	\$30,130	\$2,009	\$0	<b>\$2,009</b>
\$451,500	\$28,956	\$28,922	\$28,956	\$28,922	\$0	\$0	\$0
\$500,000	\$27,065	\$27,065	\$25,173	\$25,173	-\$1,892	-\$1,892	\$0
\$600,000	\$23,165	\$23,165	\$17,373	\$17,373	-\$5,792	-\$5,792	\$0
\$700,000	\$19,265	\$19,265	\$9,573	\$9,573	-\$9,692	-\$9,692	\$0
\$800,000	\$15,365	\$15,365	\$1,773	\$1,773	-\$13,592	-\$13,592	\$0
\$823,000	\$14,468	\$14,468	\$0	\$0	-\$14,468	-\$14,468	\$0
\$900,000	\$11,465	\$11,465	\$0	\$0	-\$11,465	-\$11,465	\$0
\$1,000,000	\$7,565	\$7,565	\$0	\$0	-\$7,565	-\$7,565	\$0
\$1,100,000	\$3,665	\$3,665	\$0	\$0	-\$3,665	-\$3,665	\$0
\$1,194,000	\$0	\$0	\$0	\$0	\$0	\$0	\$0

Source: ISA Modelling

Note: Couple homeowner using projected 2017 rates and thresholds (average historical deeming rates assumed and apply to assessable assets)



In ISA's view, simply projecting the outcomes using current deeming rates is not a reasonable assumption given interest rates are at historic lows. To the extent there are some benefits, they are likely to be temporary.

The outcomes will also vary depending on the income test assessment of superannuation income streams. The new asset test will disadvantage recent retirees or existing retirees with new income streams which commence after 1 January 2015 due to extended deeming.

ISA recommends that the Committee ask the Department to remodel the cameo tables using both the income and asset test with different deeming rate assumptions and mixes of financial and non-financial assets.

The Committee should also seek from the Department information on the numbers of existing pensioners, ranged by assessable asset level that are paid under the income or asset test. This will reveal whether or not they are likely to benefit from the increase in the asset test free area.

Subject to this further analysis, ISA's view is that the equity of the measure is considerably overstated.

### 2.1.2 Benefits for working age income support recipients

The increase in the asset test free area will have flow on impacts for the working age income support recipients. Whilst on face value this may seem beneficial, it is doubtful the benefits will be widespread.

For those of working age, superannuation (the main asset for most Australians apart from their home) is excluded from the pension and allowance asset test. Accordingly, any beneficiaries of the increase in the asset free area will have such high levels of non-super assets that they are unlikely to be claiming benefits or would otherwise be subject to significant liquid asset waiting periods.

## 2.2 Drawdown assumptions and income available for consumption are potentially misleading

A key argument advanced in support of the measure is that those affected can sustain a higher level of drawdown of their assets to offset pension losses. ISA does not believe the argument has been soundly constructed or based on reasonable assumptions.

ISA understands the DSS has furnished to some members of the Committee detailed analysis of so-called 'consumption income' available to pensioners affected (the analysis does not appear to be included in their submission).

ISA has sighted this analysis and has the following concerns:

- It relies in part on an assumed investment returns on managed investments of 12.7 per cent per annum<sup>5</sup> even though such returns could not reliably be obtained by pensioners over the long term.
- It appears to assume pensioners in the specified asset ranges have a mix of income that is the average of those with income in individual asset classes – for any single pensioner this is arithmetically impossible.
- It assumes implied overall rates of return (for example, 7.8 per cent for a couple with \$450,000 of assessable assets) that significantly exceed assumptions which ASIC use for their retirement income projections for consumers<sup>6</sup>.

<sup>5</sup> Cited as the 1 year return for the ASX200

<sup>6</sup> ASIC MoneySmart Retirement Planner calculator assumes retirement returns of 5.5 percent for a conservative portfolio, and 6.4 percent for a moderate portfolio. <https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/retirement-planner>

The DSS submission also includes analysis of increased draw down amounts. The DSS submission (page 11) argues for higher drawdowns - over 7 per cent. Whilst it might be sustainable for the example cited (a couple with assets of \$825,000), couples that are negatively impacted by the measure in the Bill have assets as low as \$450,000 to \$500,000, and singles with assets as low as \$300,000.

Longevity, the volatility of returns and the need to preserve capital for health, housing and financial contingencies, mean the higher drawdowns proposed may not be an individually optimal strategy for a person with \$500,000 in assets or less.

There is substantial risk that the money will run out. We would note that the DSS uses current ABS life expectancy estimates<sup>7</sup> in mounting the drawdown argument which are up to 11 years less than those contained in the Treasurer's IGR 2015<sup>8</sup>.

Additionally, we would note not all assessable assets are income producing or liquid. For example, the increased drawdown of liquid assets amounts in order to sustain an overall increase in consumption of assessable assets of 2 per cent would be considerably more and erode this income producing capital very quickly.

More detailed modelling with sensitivity analysis is necessary for the Committee to be satisfied that the proposed changes will result in sustainable outcomes for pensioners with more moderate levels of assets.

## 3. Policy problems

### 3.1 The change will impact those with insufficient assets for a comfortable retirement

In considering the targeting of the measure, subjective judgements appear to have been made about who should receive less Age Pension support. Without an empirical basis to make these assessments, poor policy outcomes will result.

The ISA-Rice Warner modelling demonstrates where the impact will be felt for singles and couples ranged by income against a standard benchmark for a comfortable retirement income from today through to 2055.

In assessing the impact of the measure, a reduction of Age Pension support for those who will exceed the benchmark would represent appropriate targeting.

However, where there are impacts which suggest a reduction in support for those who will not achieve the benchmark, then serious concern is warranted.

In ISA's initial submission, we identified that by 2055 the proportion of single females who will not obtain a comfortable retirement will increase from 50 to 80 per cent under the proposed measure.

Table 3 shows the proportion of single females, single males and couple retiring in 2055 who are expected to fall short of the benchmark for a comfortable retirement before the proposed asset test change and post the asset test change. Adverse outcomes are particularly likely for single females and single males:

- 50 per cent of single females retiring in 2055, who won't achieve a comfortable retirement under current policy settings, will rise to 80 per cent under the proposed change to the asset test

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<sup>7</sup> Submission 5 – DSS, page 13

<sup>8</sup> IGR 2015 – page 5 Table 1.1

- 49 per cent of single males retiring in 2055, who won't achieve a comfortable retirement under current policy settings, will rise to 70 per cent under the proposed change to the asset test

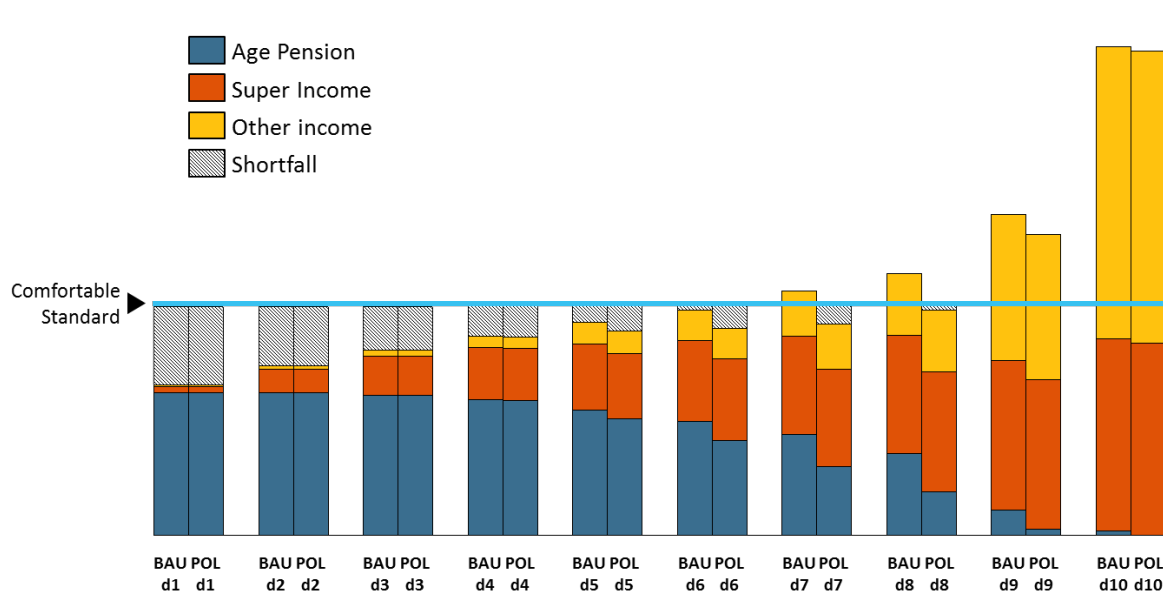
Table 3 - Proportion falling short under current and proposed asset test

	Current Asset Test	New Asset Test
<b>Single Females</b>	50%	80%
<b>Single Males</b>	49%	70%
<b>Couples</b>	30%	30%

Source: ISA- Rice Warner Modelling

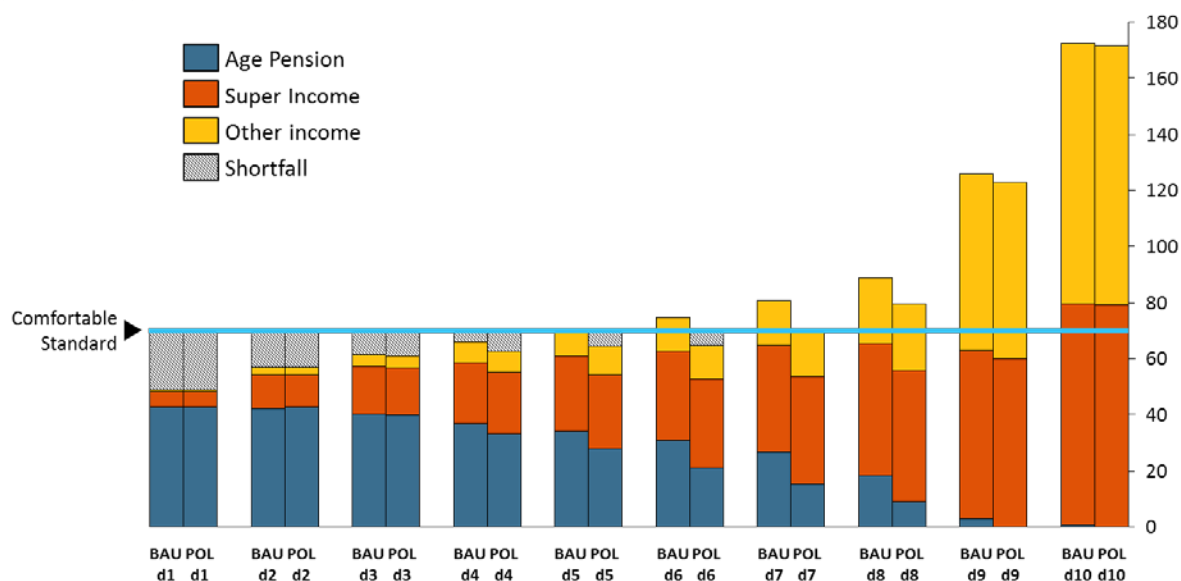
The impact by decile for single females and single males are shown in Figures 1 and 2.

Figure 1 – Effect of asset test change proposal, single females, retiring 2055, 2015 prices, by income decile, 5% and 1%, \$000s



Source: ISA-Rice Warner modelling

Figure 2 – Effect of asset test change proposal, single males, retiring 2055, 2015 prices, by income decile, 5% and 1%, \$000s



Source: ISA-Rice Warner Modelling

### 3.2 Those most affected are on low to middle income without the discretionary income to make up the shortfall

The proposed asset test change will impact significantly on those who are unlikely to have significant additional discretionary income, during their remaining working life, to make up for the loss of Age Pension.

For example:

- Single women currently aged 55-59 on annual incomes as low as \$46,000 – or on around 2/3 average earnings – would receive \$41,000 less from the Age Pension over the course of their retirement.
- Single males currently aged 45-49 on annual incomes as low as \$56,000, or around 3/4 of average earnings - would receive \$56,000 less from the Age Pension over the course of their retirement.
- Single males currently aged 55-59 on annual incomes as low as \$52,000 - or around 3/4 of average earnings, would receive \$17,000 less from the Age Pension over the course of their retirement.

These outcomes are compounded by the freeze in the Superannuation Guarantee (SG) rate that has been recently legislated, as they will reduce the capacity for people to be more self reliant in retirement.

### 3.3 Proposed asset test to impose 150 per cent plus tax on savings of low and middle income earners

ISA's initial submission to the committee, as well as others<sup>9</sup>, have identified that the \$3 taper is equivalent to a 156 per cent tax on savings (assuming a 5 per cent return). This is not an irrelevant theoretical construct: In practical terms this means that pensioners will obtain a higher income from consuming assets or diverting them into exempt asset categories.

The reason for this is that the pension increase that can be obtained from consuming assets exceeds the investment income forgone. Only when investment returns on all assessable assets above the asset free

<sup>9</sup> For example see Submission 8 – ANU Tax Transfer Policy Institute

area exceed 7.8 per cent per annum, would pensioners be at least as well off retaining assets. This rate of return exceeds ASIC's long-term, before-tax return for a balanced superannuation fund.<sup>10</sup>

This change in the asset taper rate will expose pensioners to effective marginal tax (taper) rates (EMTTRs) of more than double that applying to any other group in the community, including allowance recipients and women who work part-time who can face EMTTR's of 70 percent.

Such a high EMTTR matters because it could encourage the disorderly run down of assets. It is therefore inconsistent with the intent of the policy for pensioners to sustainably draw down on assets.

The DSS argues that such behaviour was not observed when the asset test was last set at \$3.00, however improvements in financial literacy and availability of cost effective financial advice will dramatically increase awareness of these negative effects. The absence of any asset test discount for income streams in the proposal is a notable omission that will almost certainly lead to different outcomes than previously observed.

In order to ensure pensioners have no inappropriate incentive to dissipate assets the maximum taper would need to be no more than \$2.00 per \$1,000 of assets assuming a long term return of 5.0 to 5.5 per cent.

### 3.4 Asset test change is more aggressive than prevailed prior to 2007 and will penalise the purchase of income stream products

The reversal will result in a more aggressive and inequitable means test than existed prior to 2007.

A key reason for this is because, prior to 2007, there was a 50 per cent asset test discount for market-linked and term-certain income streams.<sup>11</sup> In recognition that such income streams facilitated the orderly drawdown of assets they were given a 50 per cent asset test discount. Indeed without such a discount a pensioner could obtain a higher guaranteed income if they were simply to spend their assets and obtain a higher pension.

Without such a discount, the proposed asset test will discourage Age Pensioners from purchasing income streams that seek to manage market, inflation and longevity risk.

The proposed change also needs to be seen in the context of the 2007 superannuation and pension reforms.

The 2007 changes to the taxation of super were widely considered unsustainable and inequitable.

However the asset test relaxation was the only element which delivered any improvement to the retirement outcomes of those with lower levels of assets, who would not have paid end-benefits tax under the pre-2007 arrangements. As a consequence, reversing the asset test change without any changes to the taxation of super, will result in a less equitable outcome than under pre-2007 settings.

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<sup>10</sup> ASIC MoneySmart superannuation calculator assumes balanced returns of 7.3% before tax  
<https://www.moneysmart.gov.au/tools-and-resources/calculators-and-apps/superannuation-calculator>

<sup>11</sup> Treasury, Simplified Superannuation Final Decisions, 2007  
[http://simplersuper.treasury.gov.au/documents/decision/html/final\\_decision-05.asp](http://simplersuper.treasury.gov.au/documents/decision/html/final_decision-05.asp)