24 July 2007

The Secretary
Senate Community Affairs Committee
PO Box 6100
Parliament House
Canberra ACT 2600

email: community.affairs.sen@aph.gov.au

Dear Secretary

Inquiry into the cost of living pressures on older Australians

The National Institute of Accountants (NIA) is one of the three professional accounting bodies in Australia. The NIA has over 14,000 members who work in all areas of the accounting profession. A large number of NIA members work in or provide advice on taxation and superannuation. As such, the NIA has a particular interest in the adequacy of taxation, superannuation and pension arrangements and their impact on the cost of living pressures on older Australians.

The NIA welcomes the role of the Committee in conducting this inquiry and notes, however, that an ongoing effort is required in order to address the issue of adequacy of retirement savings and income for both current and future retirees.

The NIA's submission sets out some of the concerns and possible policy responses which may assist in addressing this issue. In particular, the NIA would like to emphasise the following points:

- Pensions and other government assistance should be rationalised and streamlined.
- Incentives for early retirement should be removed.
- Education on the benefits of retirement savings should be strengthened.
- The regulatory environment should support and encourage increased retirement savings and income.

The attached submission provides the NIA's formal response to the Committee. The NIA is prepared to make additional comment if there are any further issues or questions. Please contact Vicki Stylianou on 02 6260 8619 (or vicki.stylianou@nia.org.au) if you have any queries.

Yours sincerely

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Submission to the Senate Community Affairs Committee on the Inquiry into the Cost of Living Pressures on Older Australians

by

National Institute of Accountants

ABOUT THE NATIONAL INSTITUTE OF ACCOUNTANTS

The National Institute of Accountants (NIA) is one of the three professional accounting bodies in Australia, representing over 14,000 members in Australia and overseas. Members of the NIA work in all fields of accounting including in private practice, government, industry and academia. The NIA is actively involved in setting and enforcing professional standards and in reviewing and commenting on legislation at all levels. Many of our members either work in or advise on taxation and superannuation. The adequacy of the taxation and superannuation systems to meet the expectations of current and future retirees is a popular topic with our members.

As a professional accounting body the NIA's key roles include:

- offering post-graduate study in accounting Professional Education Program (PEP) – a Master of Commerce (Professional Accounting) from the University of New England;
- conducting quality review of members in public practice, instigating investigations and where necessary discipline against members who have breached the NIA's professional and ethical requirements;
- offering Continued Professional Education for all members (and non-members);
- providing members with information about legislative, regulatory and other changes that are affecting or may affect them;
- advocating on behalf of members and the profession as a whole, on issues of national importance;
- liaising with regulatory bodies on issues affecting members, particularly in the areas of taxation, superannuation, financial services, Corporations Law and accounting and auditing standards;
- setting and enforcing professional and ethical standards; and
- promoting issues of importance in the accounting profession.

For more information on the NIA please visit our website: www.nia.org.au

Introductory comments

The National Institute of Accountants (NIA) welcomes the opportunity to make a submission to the Senate Community Affairs Committee ‘Inquiry into the cost of living pressures on older Australians’.

The NIA has particular interest in item (d) of the terms of reference and to an incidental extent item (e), and has restricted this submission to these items. They are**:**

(d) the adequacy of current tax, superannuation, pension and concession arrangements for older Australians to meet these costs; and

(e) review the impact of government policies and assistance introduced across all portfolio areas over the past 10 years which have had an impact on the cost of living for older Australians.

Summary

The NIA believes that the main goal should be a secure and sustainable retirement income which includes supporting and encouraging individual contributions to retirement savings throughout a person’s working life.

Despite numerous public pensions, concessions and allowances, it is unlikely that these will be adequate for future retirees, given the ageing of the population and changing expectations of retirement. However, current evidence indicates that Australians have inadequate retirement savings in superannuation funds and that more needs to be done to increase the level of retirement savings.

The main policy responses to achieving the goal of a secure and sustainable retirement income which are discussed in this submission are:

- Government should consider rationalizing and streamlining the numerous pensions, concessions, allowances and other payments which are made to older Australians with the aim of achieving efficiency gains in order to lower costs for older Australians.

- Government should consider further measures to remove incentives for early retirement and to provide positive incentives for delayed retirement, such as reduced rates of income tax, without penalizing those who choose to retire early or completely from the workforce.

    - We need to ensure that the taxation, superannuation, social security and employment systems provide clear and consistent incentives to encourage workforce participation as a means of securing private savings for retirement income. This also increases productivity and economic growth on which retirement incomes rely.

- Government and industry should strengthen their efforts in educating people throughout their lives on the importance of retirement planning and financial education generally.

    - This includes the benefits of self-sufficiency in retirement through superannuation and other investments or savings to support a comfortable retirement.

- Government and industry should ensure that the regulatory and financial environment is capable of supporting the growth and sustainability of retirement income and assets, including the effective management and protection of superannuation funds and retirement products, by individuals and financial institutions over the longer term.

In undertaking and implementing the above, the NIA is well placed to partner with Government and other stakeholders to ensure a comfortable retirement for all Australians.

The current landscape

Pensions, concessions and allowances

Australia's retirement income system supports older Australians through a range of assistance including public pensions, superannuation and voluntary savings. In terms of public pensions, there is a plethora of different types of pensions, concessions, allowances, offsets and other payments for which older Australians may be eligible.

These include the age pension, which is means tested and is adjusted to keep up with inflation. There are also tax concessions and other assistance, which include the senior Australians tax offset, pensioner tax offset, medical expenses tax offset, the national concession card for seniors, the seniors card (offered by states and territories), and telephone concessions. Other payments include bereavement payment, carer allowance, carer payment, pension bonus scheme, pensioner education supplement, remote area allowance and rent assistance if you receive a pension (or other allowance) from Centrelink. There is also the disability support pension, lump sum advance payment, partner allowance, pension loan scheme (if you are ineligible for a pension), utilities allowance and widow allowance. If working through all this gets too much then Centrelink can appoint someone to look after your affairs.

Within the superannuation system, the superannuation guarantee and the co-contribution are valuable elements. Reforms to superannuation in the 2006 Budget which simplify superannuation and make benefits paid from taxed superannuation tax-free for people aged 60 and over have also been widely welcomed, even though they may not necessarily benefit current retirees.

The need for constant improvement

The retirement income landscape has not escaped the complexity of the Australian taxation system and the constant changes made by Government. However, the NIA recognizes that even though it can be daunting to keep up with constant change, it is also necessary to make improvements. Some of the more recent improvements include the simplification of superannuation, mentioned above, including the ability to make deductible superannuation contributions to be extended up to age 75. One improvement which provides an incentive to save is the halving of the pension assets test taper rate from $3.00 to $1.50 per fortnight from 20 September 2007. This will boost the retirement incomes of asset-tested pensioners and increase the number of people who are eligible for a part pension and the associated concessions. The role played by older Australians has been recognized by the Government with the payment of a $500 bonus to individuals who meet the eligibility criteria, at an estimated cost of $1.3 billion. Likewise, the continuation of the bonus payments to carers is also welcome.

Overall, efforts should continue to build and maintain a flexible, simple and well regulated superannuation regime. The NIA continues to advocate for the removal of punitive upfront taxes on superannuation. In addition, the NIA believes that the nine per cent employer contribution should be increased progressively. Despite welcome changes in the 2006 Budget, the NIA also believes that superannuation policy must be recast to focus on its core responsibility, to this end the NIA recommends a superannuation policy review, focussing on:

- Determining the average income that people will require/expect in retirement and then determine the best policy to ensure the achievement of that goal.
- The review must not be hamstrung by notions of “revenue neutrality”. Some cost to Government today will lead to Government savings in the future, where it will be most needed.
- An immediate focus on taxpayers approaching retirement to help ensure they save sufficiently for retirement. Many of these people will not have sufficient superannuation savings and will therefore be dependent on the pension. Policies need to be made to encourage them to make personal sacrifice now.

Is it enough for retirement

Whilst it is debatable whether the current landscape is adequate (by whatever measure) for some current retirees, it is generally accepted that it won’t be adequate for future retirees. Concerns are continuously voiced, whether in the media or in academic and industry commentary, about the ability of future retirees to meet living costs such as food, transport, utilities, the cost of maintaining housing and especially health and aged care costs.

In addition, and especially with the baby boomer generation, the expectations of retirement will also mean having the ability to meet the additional costs of voluntary work, recreation activities, travel and active participation in the community. Given the increased life expectancies with improved health, this means that some people are spending longer in retirement, in some cases, as long as they have been in the workforce. The OECD states that evidence from most countries shows that workers almost consistently underestimate their financial needs in retirement and many underestimate their life expectancy.

A recent report from the Association of Superannuation Funds of Australia (ASFA) has found that less than 20 per cent of retirees have or are likely to have lump sum superannuation benefits that are above the new tax-free threshold of $135,590. ASFA also found that even though superannuation balances and the spread of superannuation were growing, average balances are still relatively low and some groups – especially women – need further assistance and encouragement to save if they are going to achieve even a modest standard of living in retirement. Increasing the co-contribution is certainly a positive step in this direction.

It should be acknowledged that there are other factors affecting the adequacy of retirement incomes. The continued flow of retirement income for both present and future retirees relies on taxation revenues, savings patterns, the earnings and performance of superannuation funds and other investments, and the economic management of future governments as well as acceptance by taxpayers. This requires the Australian and global economies, where a lot of money from managed funds are invested, to continue to grow.

With respect to the performance of superannuation/pension funds, the OECD has also considered the issue of whether regulation and the changes to accounting standards has meant that pension funds are adopting more conservative investment strategies which are defeating the purpose of maximizing returns for pensioners. The OECD has found that this has been the case with risk reduction now being common and that pension funds have to strike a balance between risk and return. The response by pension funds has been to become more efficient at managing their portfolios and diversifying their assets and investments.

The establishment of the Future Fund to address the potential shortfall in the funding of federal public service superannuation, which is also subject to greater pressure due to the ageing of the public service, is a major achievement. It is hoped that the economic management of future governments will not lead to interference with the objectives of the Fund.

Changing demographics and changing expectations

The appropriate targeting of any policy response in taxation, superannuation and retirement income policy requires an understanding of the changing demographics and expectations of future retirees.

A good starting point is the Intergenerational Report Two (IGR2) prepared by Treasury which shows that the population will continue to increase in size but with a higher proportion of old people; and that substantial fiscal pressures will emerge due to projected increases in spending, particularly in health, age pensions and aged care. The good news is that Australia’s population is not ageing as fast as in some countries; and Australia has experienced uninterrupted economic growth for over a decade with real GDP per person having risen more rapidly than the OECD average.

However, demographic changes are projected to detract from economic growth in the future. Treasury projects that the proportion of people aged 65 and over will nearly double to 25 per cent of the population by 2047. The proportion aged 85 and over is projected to triple to 5.6 per cent of the population. Labour force participation rates will fall over the next 40 years as the population ages, affecting the rate of growth in real GDP per person from 2.1 per cent over the past 40 years to 1.6 per cent per year. Treasury goes on to estimate that people relying on the age pension will drop from two-thirds to one-third of all age pensioners by 2050. Australia’s proportion of pension outlays to GDP is one of the lowest in the OECD at a projected 4.6 per cent by 2050 against an average of 10.8 per cent of GDP average for OECD members.

Public pension spending varies across the OECD from less than one per cent to 10 per cent of GDP. The target pension varies between 30 and 100 per cent of individual earnings. Trends seem to be toward tightening pension eligibility; indexation of pensions has become less generous; some pension schemes link benefit levels to changes in life expectancy; and the introduction of defined contribution pensions where the private pension benefit depends on contributions and investment returns.

Other considerations which affect the ability to save for retirement are the increasing trends toward delayed marriage and childbirth; and second and subsequent marriages which means periods of extended financial obligations.

The IGR2 also states that Australian Government spending on aged care is projected to increase as a proportion of GDP from 0.8 per cent in 2006-07 to around 2.0 per cent in 2046-47. The proportion of the population on the age pension is expected to double by 2046-47. This will be partly offset by the increased value of superannuation and other private assets and income.

Policy responses

Against this background, it is obvious that Government needs to target its policy responses to those who need it the most and to build a sustainable retirement income system which requires increases in private contributions. Part of this is recognizing the interaction between the various drivers including economic growth, the taxation and welfare systems, superannuation and the financial and labour markets more generally. Another part is to remove policy induced distortions. A discussion of suggested policy responses follows.

Scope to rationalize and streamline

The question is not only one of adequacy of pensions, concessions and allowances but also their accessibility and effectiveness. Given the complexity of the system, there would appear to be scope for rationalizing and streamlining at least some of them. One simple example is the pensioner tax offset which must be calculated depending on numerous variables including whether you are single, widowed, separated, if a couple, whether one is in a nursing home, whether you are a veteran, war widow or war widower, whether you've lived apart due to illness, whether your taxable income is more or less than a certain amount, whether you receive all or some or none of the offset, there are lower and upper taxable income thresholds and unused tax offset can be transferred to your spouse.

The process of simplification and streamlining could also incorporate delivery which is undertaken by various government departments, at the federal, state and local levels. There are also numerous private sector and not-for-profit organizations which are involved at all levels and stages of delivery of services to older Australians. It is not unreasonable to assume that at least some of the delivery of these services is occurring on an ad hoc basis. The implication is that any efficiency gains would translate into lower costs for the delivery of these services or pensions which would ease cost pressures on older Australians.

Delaying retirement

An integral part of achieving higher retirement incomes, which is reliant on continued economic growth, is ensuring in turn that the taxation, superannuation and social security systems do not interact to discourage labour force participation or provide other incentives for early retirement. In fact, the importance of labour force participation cannot be underestimated; as IGR2 states, encouraging greater labour force participation continues to be important for improving economic growth and living standards.

The obvious response, and one which the Government has begun to consider, is to delay the retirement of workers, by seeking to influence the timing of retirement. The OECD also promotes the removal of early retirement incentives; and Australia has moved in this direction with anti-age discrimination laws and abolishing compulsory retirement.

The focus may even shift from removing incentives to early retirement to a more positive system of incentives to delay retirement and stay in the workforce. One possible means for achieving this is to introduce lower income tax rates for people aged over 60 (given that taxed superannuation will be tax-free for those aged 60 and over) on the basis that they continue to work at least part time. At the same time, it would be important to ensure that those who choose to retire would not be otherwise penalized. The revenue impact from this measure is likely to be neutral or positive taking into consideration the saving in pensions and the increased taxation revenue from workers who might otherwise be completely retired and paying less tax (see below). There is also the increased productivity to be derived from shifting this segment of people from the pension system or retirement to the workforce.

The OECD recognizes that increasing the effective age of retirement, which has fallen despite increases in life expectancy, would be a great help in dealing with the demographic burden of an ageing population. This would have a double positive effect – reducing benefit expenditure and increasing tax and contribution revenues. The OECD's approach is to stop subsidies for early retirement such as having little or no reduction in benefits on earlier retirement; resource tests encouraging low earners to retire earlier; little or no extra benefit for longer contributions; not being able to combine work and retirement. Australia has gone some way to addressing these obstacles, especially making it easier to phase into retirement by drawing on superannuation whilst working. The OECD points to widespread evidence to show that pension incentives affect retirement decisions (as well as many other factors like health and the state of the economy) with employment rates of older workers increasing with retirement incentives.

Utilising mature age workers

Further policy responses are required to make it easier for older workers to re-enter the workforce, especially for some who may be experiencing barriers to re-entering and may need retraining and encouragement. It is essential to ensure that labour and capital markets respond to the ageing population and to the effects on productivity. Sustained economic growth in the longer term, which will rely on a higher employment participation, will have to address this major demographic change and utilizing mature age workers will have to become a necessity rather than optional.

This will also require mature age and older workers doing enough themselves to ensure that their skills are up to date, especially technology related skills, and that they embrace opportunities to participate.

The NIA and others have a role in promoting the benefits of older workers, including highlighting the benefits of experience and corporate knowledge. Research by the OECD indicates that mature age workers are highly productive; they can mentor junior staff and also are more loyal with a lower churn rate than younger workers. In addition, for business, reflecting the customer base as the population ages will have practical commercial benefits.

In some industries it is a question of sheer necessity. For example, there is concern in the tax agents industry that the age profile of tax agents is increasing with not enough people entering the industry. It is projected by the ATO that 24 per cent of tax agents will leave the industry over the next three years. The NIA offers professional accreditation for its members with a specific training programme tailored to their needs and continues its efforts to raise awareness of the valuable contribution of mature age and older workers.

Changing attitudes

Obviously there will be tension between expecting to retire by a certain age and continuing to work (or feeling coerced to work) until a comfortable retirement can be secured. This may require a change in societal attitudes. However, the point here is that if older workers want to remain or re-enter the workforce to ensure a (more) financially secure and comfortable retirement then they should have the opportunity to do so. In order to provide this opportunity, Government, business and industry may need to constantly reinforce the message of active and continued participation in the workforce in order to enjoy a more comfortable retirement. Another part of the message is that the age pension should be regarded as a safety net, simply because future governments will have less capacity to pay it due to decreased tax revenues.

Changing the mindset – education

The value of saving throughout life for a comfortable retirement is something which must be encouraged over the longer term. Government policies such as *Understanding Money* and the work of the Financial Literacy Foundation have been very useful in this regard.

Across all age groups and throughout each stage of life, the benefits of lifelong learning, lifelong savings and financial planning should be encouraged. Promoting informed and positive community attitudes is vital. Organizations such as the NIA, which represent accountants, financial and tax advisors, have a role to play by seeking to influence our members and their clients.

OECD research highlights that surveys from around the world consistently show alarmingly low levels of financial literacy in general and the need to save for retirement in particular. The OECD states that financial education is crucial and studies in Germany, the USA and Chile have shown that it can have an impact in improving retirement savings and planning for retirement. The OECD mentions the national campaigns launched in Australia (referred to above), New Zealand and the Netherlands, amongst others.

The key message is that planning and commitment are required in order to generate financial gains for use throughout life and for a comfortable retirement. This starts with tackling the young, from a school age so that retirement savings are not just something people think about in later life and to overcome the attitude that the government will provide.

Regulatory environment

Another key policy response is to ensure that the regulatory environment for retirement products and services, including superannuation, is supportive of sound management and the growth of retirement savings and income. One of the key risk areas here, which has been acknowledged by the ATO, is that some members of superannuation funds may wish to participate in the management of their retirement funds which has led to growth in the number of self-managed superannuation funds (SMSF). These will need ongoing special protection and monitoring by Government to ensure that people using this vehicle do not lose or diminish their retirement income and savings.

Consumer protection

In order to protect retirement incomes, including ensuring the performance and safety of the superannuation system, the regulatory and prudential agencies, ASIC, APRA, ACCC and the ATO, will have to be adequately resourced to deal with the changing retirement income landscape. One aspect is consumer protection. The reported collapse of more financial institutions, which had targeted 'mum and dad' retired investors, has placed greater focus on the importance of this issue.

Consumer protection will include responding appropriately to the emergence of new products and services. Whilst there has been some criticism of the lack of diversified retirement products available in Australia, there has been a surge in the take up of some retirement products. One obvious example is reverse mortgages which have become very popular in a relatively short period of time.

Reverse mortgages

Reverse mortgages are becoming increasingly popular as they allow retirees to tap into the equity built up in their house whilst continuing to live in the family home. Usually, regular payments are not required until the owner leaves the home to enter into aged care, sells the home (though some allow portability) or dies. Fees and interest are added to the loan balance. Whilst reverse mortgages can allow some older people to enjoy a greater lifestyle, they can also have negative consequences of which people must be made well aware.

One of the downsides is the compounding effect because interest and fees are added to the loan balance which can quickly build up the amount owing. In some cases this can lead to negative equity where the amount owing exceeds the value of the home. However, after considerable criticism, most providers now include a 'no negative equity guarantee' to prevent this situation.

ASIC has some useful warnings for people considering reverse mortgages and has said that it is monitoring them. As is often the case, it is a question of education and awareness of the implications of financial products and not falling prey to unscrupulous financial operators. In fact, the Senior Australians Equity Release Association of Lenders (SEQUAL) will require members to abide by stricter standards from July 2007, although the details are still being finalised.

There are other aspects to consider such as the interaction with the tax and welfare systems, of which some retirees may not be aware and which could impact on their overall financial position. The Department of Families Community Services and Indigenous Affairs has reviewed the Centrelink treatment of reverse mortgages; and the family home may not attract any tax when it is sold but if equity is released via a reverse mortgage, then tax may be charged on the proceeds. Centrelink treats a reverse mortgage, taken as a lump sum, as an assessable asset (with a temporary exemption). If the money is spent on repairs or medical treatment (which are common uses) it will not be counted as an assessable asset but if the money is spent on a car or furnishings, those items will be assessable. Retirees will also need to be aware of any changes to the taxation treatment of their reverse mortgage and its proceeds.

The most recent figures show that the average reverse mortgage is $30,000 - $40,000. The reverse mortgage market has grown from nothing five years ago to be worth $647 million by 2006 and will reach $3 billion by 2010 according to research group Datamonitors.

Other products include home reversion schemes, which are seen as an alternative to reverse mortgages, and involve the sale of the home to a third party and leasing the property back. Arrangements tend to be more informal, and one attempt to commercialise them led to participants losing their homes.

Lessons from overseas – OECD comparisons

The OECD has undertaken considerable work on the matter of pensions and has produced its *Pensions at a glance – public policies across OECD countries 2007 edition* which compares public pension policies across the 30 OECD member states.

The OECD has also released its *Draft good practices on financial education relating to private pensions: public consultation*. It highlights the specific requirement for financial education relating to pensions, including the role of governments in explaining the interaction between public and private sources of retirement income.

The OECD and the World Bank have also released a joint report in January 2007, *Pensions panorama – retirement income systems in 53 countries* which looks at some of the issues on pension reform debate.

The OECD recognizes that whilst governments can play a leadership and coordination role, it must be undertaken with other social partners, which can provide access to well trained financial intermediaries. It is here that the NIA and like organizations can partner with Government including acting as an interface with accountants, tax agents, financial planners and their clients.

The trend across most OECD countries seems to be that pension promises are being cut with a focus on protecting the lower paid workers. Another trend is the change in pension age with most countries favouring 65. The main focus of the reforms in most countries has been to ensure financial sustainability of the pensions system for current and future retirees.

The OECD notes, however, that more needs to be done. Some countries are phasing in pension reforms too slowly whilst the pension age is still too low in others.

Some aspects of pension schemes in OECD countries which may be worth considering are – to base public pension schemes on lifetime earnings rather than the final salary before retirement, as a matter of equity; and to link the public pension to life expectancy.

OECD economists have been asked which country has the best pension system. The answer essentially is that there is no single model which can be applied in every country, as each country's economy, culture and values will make a difference, though there are aspects of pension schemes which may serve as best practice. It also depends on what criteria are used to make the assessment. The discussion mentions highest replacement rates in Greece and Luxembourg but they would score lower on financial sustainability. The system most targeted towards the poor is Ireland, New Zealand and the UK. Another criterion would be diversification of retirement income sources with Sweden scoring the highest with five sources of income.

One superannuation system which is generally highly regarded is that of Singapore, which relies on a publicly managed, mandatory programme of private saving, known as the Central Provident Fund. It not only takes care of members' retirement, home ownership, healthcare and their children's education, but it also provides financial protection to members and their families through its insurance schemes (including life insurance). The self-employed are also required to contribute to the medisave account. Most of the schemes cover three generations, allowing members to care for themselves, spouses, children, parents and even siblings.

OECD data released in 2007 shows that Australia's gross replacement rates by individual earnings level, mandatory pension programmes, for men, was 70.7 as against an OECD average of 73.0. Other countries were the UK at 53.4, the USA at 55.2, Denmark at 119.6, New Zealand at 79.5, Germany at 39.9 and Japan at 47.8. Net replacement rates have an OECD average of 83.8 with Australia at 83.5.