Chapter 12

Income Support

Introduction

12.1 Australia has a retirement income system designed to facilitate adequate retirement incomes. As discussed earlier in this report, it consists of three pillars: compulsory employer Superannuation Guarantee (SG) contributions, voluntary superannuation, and social security payments funded from general revenue and targeted at those in need through the income and asset tests.

12.2 This chapter examines the relationship between these three pillars of the retirement income system. It considers a number of issues:

- the age pension;
- the age pension income and asset means tests;
- other income support;
- extended working lives (the so-called fourth pillar);
- double dipping;
- retirement income streams; and
- accessing the wealth in housing.

The age pension

12.3 The age pension was introduced in 1909. It is a means tested safety net payment for older people who are unable to fully provide for themselves in retirement.[1]

12.4 The age pension is funded from general taxation revenue, with no explicit tax or contribution required. It is a flat rate payment. In other words, the same basic rate of pension is the starting point for calculation of an individual's age pension payment, regardless of previous earnings. Neither receipt of, nor rate of payment of the age pension is linked to previous workforce participation. In this way, the age pension is potentially available to the entire Australian community of age pension age (subject to residence qualifications), including those with marginal connections to the workforce, or no previous employment history.[2]

1 *Submission* 79, FACS, Attachment A.

2 *Submission* 79, FACS, Attachment A.

12.5 The age pension is thus the fundamental building block of Australia's retirement income system, in that it provides the foundation that the compulsory and voluntary superannuation pillars, and voluntary earned income, build upon. The age pension provides a critical safety net, assisting those who have not been able to accumulate sufficient superannuation and other savings.[3]

12.6 The age pension is paid to people of age pension age and over (65 for men, and currently 62[4] for women). Generally a person must be an Australian resident, and residing in Australia, to be granted the age pension. However, in certain circumstances, a pension may be granted to a former Australian resident who lives in a country with which Australia has a social security agreement. [5]

12.7 The Department of Veterans' Affairs (DVA) provides a similar payment (service pension) to veterans. It is available to people five years before age pension age. At March 2002 there were 268,989 service pensioners.[6] **Table 12.1** below shows the population aged 65 and over by the type of assistance at December 2001.

Table 12.1: Proportion of the population aged 65 and over by type of assistance (Dec 2001)

Type of Assistance	Number	% of population
Full-rate age pension	1,204,860	45.2
Part rate age pension,	598,022	22.5
DVA pension	353,540	13.3
Other income support payment	25,787	1.0
Commonwealth Senior Health Card	271,554	10.2
No FACS* or DVA assistance	208,539	7.8
Total	**2,662,302**	**100**

Source: *Submission* 79, FACS, p.9.
* Department of Family and Community Services (FACS)

12.8 Notwithstanding the progress made in expanding superannuation coverage, the age pension is the major provider of retirement income for the majority of Australians. At March 2002, around 82 per cent of people aged 65 or over received an age pension, service pension, or an income support supplement. Of those, 66.5 per cent of age pensioners receive the maximum rate of pension. The other 33.5 per cent of age pensioners receive a part rate pension because of their other income or assets. Of age pensioners granted in the last 12 months, 51.8 per cent received a full rate pension and 48.2 per cent received a part rate pension.[7]

3 *Submission* 79, FACS, Attachment A.

4 The age at which women qualify for age pension is gradually increasing. By 1 July 2013 it will be 65 years, the same as for men.

5 *Submission* 79, FACS, Attachment A.

6 *Submission* 79, FACS, Attachment A.

7 *Submission* 79, FACS, Attachment A.

12.9 The rate of the age pension is adjusted every March and September in line with movements in the Consumer Price Index (CPI). Payment rates are also indexed in line with wages growth; the maximum single rate of pension is maintained at (at least) 25 per cent of Male Total Average Weekly Earnings (MTAWE), with flow-ons to the partnered rate. Pensioners are therefore protected against price increases, and also share in improvements in community living standards, as measured by wages.[8]

12.10 **Table 12.2** below compares the pension benefit in Australia with that in other countries, based on its replacement of earnings of average production workers, net of taxes and contributions. The table is based on the OECD publication *Policy Responses to the Challenges of Ageing Populations - A Synthesis*, released in April 2002. An important caveat is that the pension systems in different countries are very different in their coverage and retirement ages. This is identified in the table.

Table 12.2: Pension scheme benefit levels across OECD countries

Country	Scheme	Earliest retire-ment age	Normal retire-ment age	Replace-ment rate at earliest retire-ment age[a]	Replace-ment rate at normal retire-ment age[a]
Australia	State means-tested pension		62/65[b]	23	55
Canada	State basic pension		65	21	53
	State earnings related pension	60	65		
Finland	State basic pension	60	65	55	64
	Mandatory earnings related pension	60	65		
France	State basic pension for private sector employees	60	60	87	87
	State supplementary pension for private sector employees	60	60		
Germany	State pension for private sector emp	63	65	68	77
Italy	State pension for private sector emp		57-65	55	80
Japan	State basic pension for private sector employees		65	15	62
Korea	State pension	55	60	50	74

8 *Submission* 79, FACS, Attachment A.

Netherlands	State basic pension		65	83	92
Norway	State basic pension		67		63
	State supplementary pension	62	67		
Spain	State pension	60	65	71	101
Sweden	State pension (including mandatory contributions to individual funds)	62	65	72	72
Switzerland	State basic pension	63	65	55	68
	Mandatory occupational pension	63	65		
UK	State basic pension		60/65[b]		40
	State earnings related pension				
USA	State pension		65	43	58

[a] Replacement rates at earnings of average production workers net of taxes and contributions
[b] Men/Women
Source: OECD, *Policy Responses to the Challenges of Ageing Populations - A Synthesis, April 2002*, Tables 8,14.

12.11 The Committee notes the overwhelming support for Australia's pension system, and a continuation of a separate age pension and occupational superannuation arrangement. For example, ASFA indicated that:

> … the Australian arrangements have had advantages compared to other countries. In some countries the very strong links between occupational retirement income arrangements and social security provisions have led to substantial integration of the two systems, but at the cost of large and growing social security obligations as the population ages. Clearly, the experience of these countries shows that any benefits of improved integration through having earnings related, publicly provided social security provisions are outweighed by the costs. Social security arrangements are effective and affordable when they target poverty alleviation, and private arrangements are best for providing retirement income above that level. Accordingly the sensible and realistic option for Australia is to continue to have social security and occupational superannuation arrangements that are separate.
>
> The challenge is to have them both separate and better integrated. Better integration will have both efficiency and equity benefits. However, it should be acknowledged that poverty alleviation and, to a lesser extent, equity goals are already delivered to a considerable extent by the provision of Age and Veterans Pensions.
>
> The Australian social security provisions are effective in providing poverty alleviation, essentially through providing a means tested minimum benefit. An annuity with similar characteristics that was purchased privately would have a capital value of over $200,000 for persons of Age Pension age. In effect, the existence of the Age Pension means that persons of Age Pension

> age who do not have private savings receive a significant wealth transfer from the government, albeit one that can be accessed only in income form.[9]

12.12 However, in its written submission, the Council on the Ageing (COTA) was more critical than ASFA of the adequacy of the current age pension arrangements, arguing that the current age pension is not sufficient to support a modest but adequate lifestyle:

> Discussion of the adequacy of future retirement incomes funded through superannuation should not preclude debate on the adequacy of current Age Pension and social safety net arrangements. COTA believes the Government needs to address the issues raised by the recent studies, which indicate a disturbing increase in poverty amongst older people. There is much evidence to suggest that current Age Pension and safety net do not result in the “modest but adequate” lifestyle which they are intended to provide. The Government must find the resources to assist older people on the lowest incomes and with the least assets. Assistance must be afforded to older people on the lowest incomes and priority must be given to older people without their own homes.[10]

The age pension income and asset means tests

12.13 The age pension is integrated with the superannuation system through the provisions of the income and asset means tests:

a) Income. As at 1 July 2002, once an individual’s private income reaches $1,185 per fortnight, he or she is not eligible for the age pension. For the purposes of the means test, income includes earned income such as wages and also income from investments. For some investments, such as most financial investments, the amount of income is deemed by way of set percentages applied to the aggregate amount of the financial investments. For other investments it is usually the actual amount of income derived or received. In the case of some income payments such as pensions or annuities there is an adjustment made to the gross amount received in order to reflect any return of capital.

b) Assets. The pension asset test was introduced in 1985 and operates alongside the income test. The test which produces the lower rate of pension is the one that is applied. Certain assets, principally the recipient’s home and certain long-term income streams which meet strict criteria, currently are excluded. The asset test tends to predominate over the income test once a significant level of assets are held. For a single home owner as at 1 July 2002, no age pension is available once assets exceed $288,000. At a 7 per cent annual return,

9 *Submission* 73, ASFA, p. 36.

10 *Submission* 63, COTA, p. 13.

> such a lump sum would generate an income substantially less than the maximum income allowed under the income test.[11]

12.14 The income and asset test arrangements are described more fully in **Appendix 11**.

12.15 The Committee notes that the impact of the income and asset tests on age pension payments is significant. In evidence on 8 October 2002, Mr Dolan from the Department of Family and Community Services (FACS) indicated that the income and assets tests currently save between $6 billion to $7 billion a year on the age pension. As a result, expenditure on the age pension is currently approximately $17 billion a year.[12]

12.16 In its written submission to the inquiry, ASFA argued that the means test system currently works reasonably simply and fairly, but that this is likely to change in the future:

> Currently the means test system works reasonably simply and fairly for the bulk of current retirees. Unfortunately, for the current minority of retirees with significant superannuation derived savings in the order of $140,000 to $280,000 the system is neither simple nor fair. In the future as the proportion of retirees with assets and income in excess of the free areas increases, this problem of lack of appropriate integration will increase. Superannuation and other financial assets of the order of $140,000 to $280,000 is fair and square in the range of outcomes that the Superannuation Guarantee is projected to deliver over 30 to 40 years for a person on average earnings. The means test is already a problem for middle Australia, and will become an even greater problem in the future if it is not reformed.[13]

12.17 Given this concern, ASFA made a number of recommendations for improving integration and fairness in regard to the various parameters of the means test. A number of these suggestions also have the potential to improve the simplicity of the system through adoption of clearer and more uniform rules:

a) The introduction of an income bank for age pensioners for income derived from employment. ASFA argued that the current arrangements discourage intermittent and casual work because the combined effect of withdrawal of the age pension with any income tax liability leads to very high effective marginal tax rates for employment by persons primarily reliant on the age pension. ASFA submitted that this is inconsistent with the thrust of government policies, which aim to increase labour force participation by those

---

11 *Submission* 73, ASFA, pp. 41-42.

12 *Committee Hansard*, 8 October 2002, p. 720.

13 *Submission* 73, ASFA, p. 42.

past normal retirement age and to support flexibility of arrangements past age pension age.

b) The replacement of the current asset and income test by an integrated means test in which a deemed earnings rate is applied to all assets which are included in the test. ASFA argued that there are significant differences at present with regard to how various forms of non-wage income are included in the income test for the age pension. For example, ASFA argued that income from financial investments is treated in a simple and consistent way through the operation of the deeming provisions. In contrast, ASFA suggested that other financial investments such as allocated pensions and annuities and complying pensions and annuities include in the amount subject to the income test the gross amount received by the recipient less an adjustment for any return of capital. This adjustment has to make use of factors relating to life expectancy or the term of the pension or annuity, and identification of an initial capital purchase price.

c) A reduction in the taper rates for income and particularly for assets so as to provide both greater integration and increased incentives for self provision. ASFA noted that the taper rates can still provide considerable disincentives for private provision of retirement income, at least over some income ranges. For example, the most recent significant change to the taper rate for the pension income test was in June 2000 when the taper rate for income above the free area was reduced from 50 per cent to 40 per cent. This change formed part of the ANTS changes, and was estimated to involve additional pension expenses of around $400 million a year. However, ASFA argued that even after this change effective marginal tax rates on additional private income are still quite high, particularly over income ranges where a particular benefit is phased out, or income tax is phased in.[14]

Projected age pension expenditure

12.18 Projected age pension expenditure in Australia over the next four decades will be influenced by two factors: the increase in the number of retirees in Australia, and the maturing of the superannuation system.

12.19 On the first point, the Committee notes the earlier evidence in Chapter 11 relating to the ageing of Australia's population, and the increasing proportion of retirees in the population. In 2002, Australia had 2.2 million people aged 65 – 85, and 0.3 million people aged over 85. By 2042, it is anticipated that these cohorts will have grown to 5.1 million and 1.1 million respectively.[15]

---

14 *Submission* 73, ASFA, pp. 43-47.

15 Commonwealth Treasury, *Intergenerational Report 2002-03*, p. 22.

12.20 On the second point, the proportion of pensioners not receiving the age pension, or receiving a reduced rate of the age pension, is also expected to increase over the next four decades. This is shown in **Table 12.3** below, which shows projected changes in the receipt of the age pension between 2001 and 2050.

Table 12.3: Projected changing patterns of age pension

<table>
<tr><th></th><th>2001</th><th>% of population</th><th>2050</th><th>% of population</th></tr>
<tr><td>DVA pensioners</td><td>341,000</td><td>13% (of age pension age population)</td><td colspan="2" rowspan="2">4.9 million
75% (of age pension age population)</td></tr>
<tr><td>Age pensioners</td><td>1.79 million</td><td>69% (of age pension age population)</td></tr>
<tr><td>Full rate age pensioners</td><td>1.14 million</td><td>67% (of age pensioners)</td><td>1.7 million</td><td>33% (of age pensioners)</td></tr>
<tr><td>Part rate age pensioners</td><td>650,000</td><td>33% (of age pensioners)</td><td>3.2 million</td><td>67% (of age pensioners)</td></tr>
<tr><td>People over age pension age</td><td>2.6 million</td><td>12.3% (of total population)</td><td>6.6 million</td><td>25% (of total population)</td></tr>
</table>

Information based on:

FACS Annual Report 2000-01, pages 204 and 206 (current age pension numbers, full/part rate age pensioners);

ABS Cat. No 3222.0, pages 6 and 11, Series II (population over 65 years in 2050 is projected at 6.6 million); and

The National Strategy for an Ageing Australia*, Independence and Self Provision Discussion Paper,* November 1999, page 13.

Source: *Submission* 79, FACS, p. 7.

12.21 **Table 12.3** shows that in 2001, around 82 per cent of people aged 65 or over received age pension, service pension, or income support supplements. By 2050, this is anticipated to fall to 75 per cent. Similarly, in 2001, 67 per cent of retirees in receipt of the age pension received the full rate of the pension, and only 33 per cent a part rate. By 2050, this is expected to have reversed, with 67 per cent of retirees in receipt of the age pension receiving a part rate of the pension, and only 33 per cent receiving the full rate.[16]

12.22 The decline in the availability of the age pension reflects the maturing of the superannuation system, which will result in higher average superannuation savings and hence (through the operation of the means test) lower age pension payments. The general effect is that people will receive increased retirement incomes, even if they receive lower pensions. However, it is important to note that notwithstanding substantial and increasing superannuation coverage, the majority of older Australians will still rely on the age pension for a significant part of their income.[17]

16 *Submission* 79, FACS, p. 7.

17 *Submission* 79, FACS, p. 7.

12.23 In this regard, the Committee notes the modelling of retirement incomes provided by Treasury in its written submission. Treasury's modelling, using standard assumptions, indicates that a singe male aged 65, retiring in 2032 following 40 years in the workforce at 1.5 times AWOTE, will still draw 82 per cent of the age pension. For a single male in the same situation receiving exactly AWOTE over 40 years in the workforce, Treasury's modelling indicates that he will draw 90 per cent of the age pension.[18]

12.24 **Table 12.4** below shows projected Commonwealth spending on payments to individuals, including age and service pensions, from 2001-02 to 2041-42. The Table shows a large increase in expenditure on the age and service pension which reflects the ageing of the population. This is despite the expected decline in the eligibility for the age and service pension in the future, reflecting the maturing of the superannuation system.[19]

Table 12.4: Projected Commonwealth spending on payments to individuals (per cent of GDP)

	2001-02	2006-07	2011-12	2021-22	2031-32	2041-42
Age and service pension	2.93	2.83	2.90	3.64	4.28	4.59
Disability support pension	0.91	0.72	0.79	0.84	0.85	0.86
Parenting payment (single)	0.59	0.60	0.61	0.61	0.61	0.60
Unemployment allowances	0.85	0.78	0.71	0.59	0.49	0.41
Family tax benefit	1.57	1.34	1.22	1.08	1.01	0.93
Total	**6.85**	**6.26**	**6.23**	**6.76**	**7.24**	**7.38**

Source: Commonwealth Treasury, *Intergenerational Report 2002-03*, p. 44.

12.25 In response to the large increase in expenditure on the age pension over the next four decades, the Committee notes the evidence of Dr Knox on 8 October 2002 that, in his view, the current income support arrangements in Australia are sustainable in the long term. Dr Knox attributed this to the means testing of the age pension and its relatively low rate compared to other Organisation for Economic Cooperation and Development (OECD) countries.[20]

12.26 However, in its written submission, IFSA canvassed a number of options for the Government to finance the shortfall in the growth of age and service pensions (together with other funding shortfalls). They include:

- imposing higher taxes on the contemporary generation of taxpayers;
- cutting benefits to current and future generations of retirees, for example by holding the ratio of spending on the aged to a GDP constant;

18 *Submission* 78, Treasury, pp. 40-41.

19 Commonwealth Treasury, *Intergenerational Report 2002-03*, p. 44.

20 *Committee Hansard*, 8 October 2002, p. 720.

- targeted policy intervention to reduce future cost, for example by reducing benefits or tightening eligibility and targeting of assistance; and
- transferring the cost to future generations of taxpayers, through increasing government debt.[21]

12.27 Finally, the Committee also notes evidence provided by AMP estimating the increase in expenditure on the age pension under various scenarios, including the provision of a universal age pension without means testing. This is cited in **Table 12.5** below.

Table 12.5: Projected costs of age pension under various scenarios (per cent of GDP)

	Base (25%)	30 %	Universal pension	No SG
1998-99	2.99	2.99	3.68	2.99
1999-2000	2.94	3.45	3.61	2.94
2000-01	2.94	3.45	3.62	2.94
2010-11	3.06	3.61	3.81	3.08
2020-21	3.55	4.22	4.72	3.67
2030-31	4.07	4.86	5.79	4.33
2040-41	4.49	5.33	6.38	4.76
2049-50	4.48	5.32	6.44	4.76

Source: Rothman (1998), cited in *Submission* 64, AMP, p. 27.

12.28 **Table 12.5** shows that increasing the age pension to 30 per cent of male total average weekly earnings (MTAWE), or offering a universal age pension, would significantly increase the cost of the age pension to the Commonwealth under current means test arrangements.

Committee view – the age pension

12.29 The Committee notes that the age and service pension is expected to increase in cost to 4.59 per cent of GDP by 2041-42 from 2.93 per cent in 2001-02. This increase is attributable to the ageing of the population, despite the expected decline in the eligibility for the age and service pension in the future, reflecting the maturing of the superannuation system.

12.30 Treasury's modelling of retirement incomes reinforces the Committee's concern. As noted, Treasury's modelling, using standard assumptions, indicates that a singe male aged 65, retiring in 2032 following 40 years in the workforce at 1.5 times AWOTE, will still draw 82 per cent of the age pension. For a single male in the same situation drawing exactly AWOTE, Treasury's modelling indicates that he will draw 90 per cent of the age pension.[22]

---

21 *Submission* 70, IFSA, p. 6.

22 *Submission* 78, Treasury, pp. 40-41.

12.31 By 2050, with a mature superannuation system, it is expected that the proportion of people aged 65 and over not receiving the pension will rise to around 25 per cent, and of those that do receive the pension, only about one third will receive the full rate. However, in the Committee's view, to reduce pressure on the age pension, through a heightened emphasis on individual self-reliance, the Government should continue to strive for universal and adequate superannuation coverage for all Australians including employees, the self-employed and non-working people, with a focus on assisting low and middle income earners.

Recommendation

12.32 **The Committee recommends that the Government continue to strive for universal and adequate superannuation coverage, with a focus on low and middle income earners.**

12.33 Given the rising cost of the age pension, the Committee also notes the options canvassed by IFSA for financing of the age and service pension in the future, including the possibility of tightening the age pension means tests. The Committee does not support these options at this time, favouring instead an ongoing commitment to broadening superannuation coverage.

12.34 The Committee also understands that there have been some suggestions that the age pension should be made universal, on the basis that such a move would involve significant savings in administration of the means tests.[23] Although the Committee believes that this option is worth investigating, evidence to the Committee indicates that the cost of doing so would be very high (close to 2.0 percentage points of GDP by 2049-50).

12.35 The Committee also notes the findings of a research paper presented at the annual colloquium of superannuation researchers that there appear to be differences in the way younger pensioners (those aged under 70) and older pensioners (those aged 70 and over) hold their assets, which can influence the amount of pension paid. The researchers indicated that this points to the importance of undertaking further analysis of data in this area.[24]

Other income support

12.36 People who receive age or service pensions may, depending on their circumstances, also be eligible for supplementary assistance from a range of additional concessions and allowances:

---

23 *Submission* 79, FACS, p. 16. See also *Submission* 73, ASFA, pp. 27-28.

24 Justin Marshall and Kaye Brown, Senior Research Officers, Research and Analysis Section, Seniors and Means Test Branch, Department of Family and Community Services, *Preliminary Report on the assessable assets of age pensioners,* paper presented to the Tenth Annual Colloquium of Superannuation Researchers, University of New South Wales, July 2002.

- pensioner concession card which provides concessional access to listed Pharmaceutical Benefit Scheme (PBS) items and to concessions provided by State and Territory Governments;
- rent assistance (for those who rent privately);
- subsidised rent (through state and territory governments) for those in public housing;
- a telephone allowance;
- the Commonwealth Seniors Health Card; and
- a remote area allowance.

12.37 These additional concessions and allowances are discussed in more detail in **Appendix 12.**

12.38 Pensioners and self-funded retirees of age pension age also benefit from generous taxation concessions that help to increase their disposable retirement incomes. Under changes announced in the 2001-02 Federal Budget, the Senior Australians Tax Offset (SATO) means that single people in this age group can have income up to $20,000 a year without paying income tax or the Medicare levy. The SATO phases-out over the income range $20,000 to $37,840 (for singles). Similarly, couples can have combined incomes up to $32,612 without paying tax (depending on the income split between the partners). For couples, the SATO phases out between $32,612 and $58,244, if incomes are evenly divided.[25]

The pharmaceutical benefits scheme

12.39 As noted in **Appendix 12**, concession cardholders currently pay only $3.60 for medicines listed on the PBS, excluding any premium for higher cost alternatives. After spending $187.20 (52 scripts) on prescription medicines in a calendar year, cardholders are entitled to free PBS prescription medicines for the rest of that year.

12.40 In its written submission, the Department of Finance and Administration (DOFA) noted that expenditure on the PBS is expected to grow more than five fold as a share of GDP over the next four decades, up from 0.6 per cent of GDP in 2001-02 to 3.4 per cent of GDP in 2041-42.[26]

12.41 The Committee notes that the increase in the cost of the PBS did not receive significant comment during the conduct of the inquiry. However, in its written submission, Catholic Health Australia (CHA) recommended a review of the PBS scheme to address perceived over-utilisation of the scheme.[27]

---

25 *Submission* 79, FACS, pp. 6-9.

26 *Submission* 89, DOFA, p. 9. See also Commonwealth Treasury, *Intergenerational Report 2002-03*, p. 69.

27 *Submission* 45, Catholic Health Australia, p. 14.

The Commonwealth seniors health card (CSHC)

12.42 The Committee notes that the Government substantially increased in the 2001-02 Federal Budget eligibility for the CSHC. Singles with incomes below $50,000 and couples with incomes below $80,000 are now eligible for the card, even where they are not entitled to the age pension. In its written submission, FACS indicated that this change was made for the following reason:

> As well as supporting and rewarding self-provision, availability of the CSHC to self-funded retirees is an important way of smoothing the transition between the reduced rate pensioner group, and the fully self-funded retiree group. Previously, someone who moved from a reduced rate pension to being fully self-funded experienced the complete loss of concessions, (and a corresponding reduction in living standards in retirement).[28]

12.43 The Committee also notes the evidence of DOFA that around 88 per cent of people over the age pension age including veterans, or 2.3 million people, held a health concession card at 30 June 2001. This estimate includes 226,140 self-funded retirees holding a CSHC.[29]

12.44 In its written submission to the inquiry, COTA argued that the CSHC scheme is not sufficiently targeted at those in genuine need of health care financial support:

> There is no justification for additional support for higher income groups amongst the older population. Non-pensioner retiree groups have been the targets of significant public expenditures in recent years through initiatives such as the extension of the Commonwealth Seniors Health Card to people on incomes of $50,000 (singles) and $80,000 (couples) which will eventually afford this group with the full suite of both Commonwealth and State Government concessions. With an ageing population, this measure will prove very expensive over the long term and is not justifiable on either efficiency or equity grounds.[30]

12.45 Catholic Health Australia also argued in its written submission that the Government needs to address the proliferation of health care cards, suggesting that an asset test for qualification for a card may be indicated.[31]

Committee view – other income support

12.46 During the conduct of the inquiry, the Committee did not receive significant comment on other income support arrangements provided by the Commonwealth and the States. However, the Committee does wish to comment on the CSHC scheme.

---

28 *Submission* 79, FACS, p. 8.

29 *Submission* 89, DOFA, p. 9.

30 *Submission* 63, COTA, p. 14.

31 *Submission* 45, Catholic Health Australia, p. 14.

12.47 The Committee notes that the extension in the availability of the CSHC in the 2002-02 Budget is not targeted at those in society in greatest need of Government support. This is evidenced by the fact that around 88 per cent of people over the age pension age held a health concession card at 30 June 2001. In addition, 226,140 self-funded retirees held a CSHC at that time. In the Committee's opinion, the Government should consider reviewing access to the Commonwealth Seniors Health Card scheme to ensure that it is focused on those in greatest need.

Recommendation

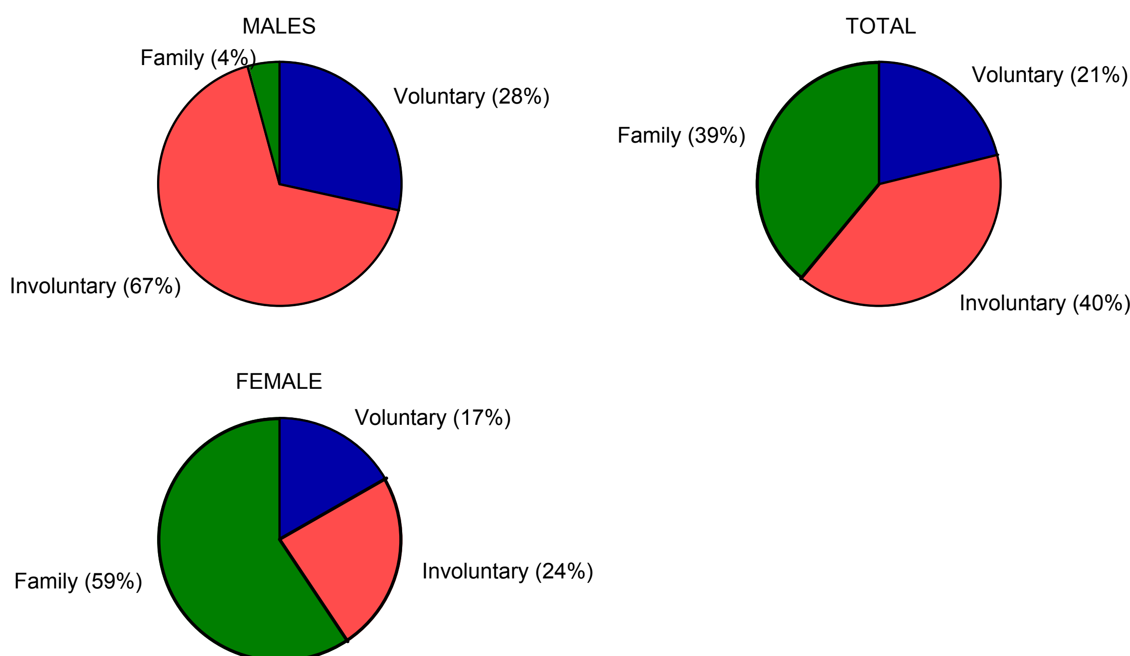
12.48 **The Committee recommends that the Government review the current arrangements for access to the Commonwealth Seniors Health Card scheme to ensure that it focuses on those in greatest need.**

Extended working lives

12.49 During the conduct of the inquiry, various parties raised the fact that many individuals in Australia retire early, before the official age pension age. In this regard, the Committee notes the research of Dr FitzGerald, based on the ABS Retirement and Retirement Intentions[32] that the majority of males in Australia retire involuntarily. This is shown in Chart **12.6** below:

32 ABS Cat No. 6238.0.

Chart 12.6: Reasons for Retirement



Source: Dr FitzGerald, 'Economic Implications of the Greying of the Baby Boomers', Presentation to the Business Symposium on the Economic and Business Implications of the Ageing Baby Boomers', Adelaide, 4 October 2002.

12.50 The early retirement of Australians, be it voluntary, involuntary or for family reasons, results in an early loss of income and contributions to superannuation, coupled with an early drawing down of superannuation savings. Together, they have a significant impact on retirement incomes, especially when coupled with the increasing life expectancy of retirees.

12.51 In this regard, the Committee notes the evidence of Mr Kelly from the National Centre for Social and Economic Modelling at the Canberra roundtable discussion on 8 October 2002 that even an SG rate of 15 per cent would be unable to compensate for the income lost from early retirement:

> I have also looked at increasing the superannuation guarantee to 15 per cent and I have found that it does not make a substantial difference because people are still taking early retirement, which almost negates it. So the priority is to encourage people to stay in employment and to look at ways for them to do so. The superannuation accumulation phase is more important than whether it should be nine or 15 per cent.[33]

12.52 Given the impact of early retirement on retirement incomes, the Committee notes that during the hearing on 19 July 2002, Ms Flanagan from FACS labelled

33 *Committee Hansard*, 8 October 2002, p. 690.

returning to work after formal retirement as a fourth pillar of Australia's retirement income system:

> Something we are very interested in focusing on is the fact that the three pillars can be supplemented by earnings for people who can and wish to work—and we have evidence showing that people after retirement age are interested in continuing to work, perhaps on a part-time or casual basis. We now refer to this as the fourth pillar of retirement income. We believe that it is very important, in a policy design sense, to break away from the concept that people have a full working life and then they retire. The reality today is very different, and we need to have public policy responses to recognise this. For example, the government has already introduced measures to allow superannuation contributions to be made after the age pension age—I think up to 70 years old. We think there are other measures that need to span across the de facto retirement age of 65, perhaps in terms of labour market assistance, encouraging people to continue in education et cetera.[34]

12.53 During the inquiry, various parties suggested means of encouraging more gradual transition arrangements from work to retirement, to encourage a delay in full dependency upon superannuation and the age pension. As stated by the Institute of Actuaries of Australia (IAA) in its written submission:

> One problem of an inflexible retirement age is that it discourages people to wind down and work part-time. In reality, we should encourage people to work part-time until age 70 or later, if they chose to do so. However it is not practical for people to work part-time under the current system as they do not qualify for the Pension Bonus Scheme.[35]

12.54 In its written submission, IFSA noted that many rules in tax and superannuation legislation appear to assume that a person retires once, and once only, on a day they have selected in advance. For example:

a) an income stream (an allocated pension taken out on retirement), once commenced, cannot be suspended if the purchaser returns to work – it must be commuted and re-started;

b) an income stream, once commenced, cannot be topped up by new monies, even by later release from other superannuation accounts – it must be commuted, added to, and a new income stream commenced.

c) The release of benefits rules do not allow someone to continue in the same employment – say on a part-time or project basis – and draw the benefits that they had accumulated up to the change in the nature of their employment.[36]

---

34 *Committee Hansard*, 19 July 2002, p. 527.

35 *Submission* 74, IAA, p. 19.

36 *Submission* 70, IFSA, p. 14.

12.55 Dr FitzGerald also pointed out that:

> There are many rigidities in legislation including superannuation that define retirement as a one-way trapdoor – you are either in work or you are retired – and if you are in one category you cannot touch it, and if you are in the other category, some equally rigid things apply to you.[37]

12.56 Similarly, in its written submission, COTA noted that current superannuation processes do not encourage phased retirement:

> Despite benefits to both employees and employers, current superannuation arrangements do not enable this process [phased retirement]. The requirement that superannuation funds do not accept contributions unless the contributor is working at least 10 hours a week is unwieldy and unhelpful to people who wish to continue limited workforce participation. These barriers should be removed to encourage phased retirement.[38]

12.57 This concern was also raised in hearings. For example, Dr Knox noted at the Canberra roundtable discussion on 8 October 2002 that the superannuation and social security systems need to be flexible enough to enable people to move in and out of part-time or casual employment while they are in their sixties and even their seventies. Dr Knox emphasised that there was a need to 'encourage behaviour to maximise … the human capital.'[39]

12.58 In response to this perceived lack of flexibility in retirement, the Committee notes that COTA recommended in its written submission a number of strategies to assist and help promote mature age employees:

a) Maintaining strong and sustainable economic growth which will generate sufficient jobs for all who want them combined with effective labour force management.

b) Tackling age discrimination so that mature age people are neither targeted for retrenchment nor prevented from gaining jobs for which they are qualified and that there is fair distribution of jobs between groups in the labour market.

c) Promoting opportunities for education, training and life long learning so that all members of the workforce are able to maximise their capacity for maintaining and increasing their skills and mature age people in particular are able to maintain and attain skills.

---

37 *Committee Hansard* , 8 October 2002, p. 668.

38 *Submission* 63, COTA, p. 20.

39 *Committee Hansard*, 8 October 2002, p. 719.

d) Greater flexibility in the workplace and in social security provisions to enable people to change the pattern and intensity of their workforce participation as they age.

e) Ensuring that there are adequate safety net provisions for people who are unable to participate in the labour market.[40]

12.59 The Committee also notes evidence raising a possible increase in the preservation age of superannuation to encourage individuals to stay in employment. For example, Mr Kelly from the Department of Health and Ageing argued that the Government could consider increasing the preservation age of superannuation (currently 55 but gradually being moved to 60) closer to the minimum age for eligibility of the age pension.[41]

12.60 At the same time, however, the Committee also notes the caution of Mr Stanhope from IFSA on 8 October 2002 in relation to changing the preservation age of superannuation funds:

> I will make a comment, in terms of this integration debate, about preservation ages. We need to be very careful. If we move the preservation ages upwards, we will expose even more people to preservation ages after they get to a point where they cannot work or do not want to work, either because of their health status or because they do not have a job. We will need a whole raft of new release of benefit rules if we start to play around too much with the preservation age. Senator Sherry has made much of the fact that we currently have about $350 million a year coming out in early release, and so those rules would have to be changed.[42]

The pension bonus scheme

12.61 On 1 July 1998, the Government introduced the pension bonus scheme to encourage people to work beyond normal retirement age and defer receipt of the age pension. The scheme is targeted at people eligible for the age pension who are in employment. By remaining in the workforce, they attract a bonus payment accumulating at 9.4 per cent of the age pension per year, so that at the end of five years they attract a bonus of 47 per cent of the maximum payable pension. The scheme is thus designed to maintain workforce participation for the full five years.[43]

12.62 In its written submission to the inquiry, ASFA recommended refinement of the pension bonus scheme, so as to make it more attractive to potential users and more fair:

---

40 *Submission* 63, COTA, pp. 21-22.

41 *Committee Hansard*, 8 October 2002, p. 709-710.

42 *Committee Hansard*, 8 October 2002, p. 713.

43 *Submission* 63, COTA, p. 18.

> Currently the labour force participation rate for persons of Age Pension age is very low, and is mostly made up of professionals and the self-employed who are less likely to be eligible for the Age Pension. The bonus payable is also a relatively small proportion of the value of the pension foregone. If this is a tool to encourage higher labour force participation post normal retirement age then it needs to be sharpened somewhat.[44]

12.63 Similarly, COTA argued in its written submission that the pension bonus scheme fails to provide sufficient incentive for people to stay in the workforce:

> COTA believes that there should be greater incentives for people to stay in the workforce for one to four years. Many more people could benefit from the program if there were higher incentives for continuing for these shorter periods. We believe that there would be commensurate savings and tax revenue for the Government as well.
>
> Older people who are part of our organisation say that the pension bonus scheme should offer more to people staying on in employment for shorter periods. Under present arrangements, a single person working for an additional three years gets roughly one third the bonus of the person working five years although the person is saving the Government around $20,000 on the Age Pension and is paying tax.
>
> The program in its present form does not meet the needs of older people or sufficiently take account of their labour market circumstances. We think that some of the underlying formulas for the program are unfair and cause confusion amongst older people.[45]

12.64 Accordingly, COTA recommended in its written submission that the pension bonus scheme be reviewed to provide stronger incentives for people to remain in employment for between one and four years. COTA also recommended that the scheme should allow older people who have already received an age pension to take advantage of the scheme if they have opportunities to return to work.[46]

Committee view – extended working lives

12.65 The Committee accepts the evidence provided during the inquiry that the superannuation system at present is premised on the understanding that individuals retire once on a given day, and do not undertake remunerated work again.

12.66 In the Committee's view, there are a number of areas in the superannuation and social security systems in which the Government could act to encourage individuals to extend their working lives, in line with overseas developments, and make a more gradual transition from work to retirement. These include:

---

44 *Submission* 73, ASFA, pp. 43-47.

45 *Submission* 63, COTA, p. 19.

46 *Submission* 63, COTA, p. 19.

- altering the release of benefits rules for individuals who return to part-time work;
- removing the requirement that superannuation funds do not accept contributions unless the contributor is working at least 10 hours a week;
- changing the provisions of the Pension Bonus Scheme to provide additional incentive for older persons to remain in or return to work.

12.67 Changes to the treatment of lump sum payments and income stream products would also encourage individuals into more gradual transition arrangements from work to retirement. This is discussed in more detail below in the section on double dipping and the sections on income streams.

Recommendation

12.68 **The Committee recommends that the Government examine options to encourage older workers to remain in the workforce beyond the superannuation preservation age, particularly on a part-time basis.**

Double dipping

12.69 During the conduct of the inquiry, various parties raised the issue of double dipping, whereby individuals may retire early from the workforce, and spend their lump sum superannuation payment before they get to pensionable age. Having done so, they may subsequently draw the full age pension.

12.70 In its written submission, Treasury indicated that lump sums account for 79.6 per cent of superannuation benefits paid in 2001, a share that has been relatively stable over the past five years. Treasury noted that from the Commonwealth Budget perspective, double dipping means:

- Commonwealth expenses on age pensions are higher than they otherwise would be if individuals had taken their superannuation benefit as a pension; and
- the Commonwealth's superannuation tax concessions are not necessarily used for the intended purpose, that is, to provide superannuation retirement income.[47]

12.71 However, Treasury continued in its written submission that double dipping is not currently a significant problem:

> Given the high propensity to take superannuation in the form of a lump sum there is the possibility that some superannuation dissipation is being practiced. However, current indications are that such a practice is not wide spread, and that evidence is anecdotal only.
>
> Maximum limits are placed on the amounts of retirement benefits that individuals can receive over their lifetime at concessional tax rates. Reasonable Benefit Limits are set for both lump sums and pensions and

47 *Submission* 89, DOFA, p. 13.

> these are indexed annually to movement in average weekly ordinary time earnings. For the financial year 2002-03, the lump sum RBL is $562,195, while the pension RBL is $1,124,384. If an individual's lump sum benefit is above the RBL, tax is payable at the highest personal income tax rate (currently 47% plus the Medicare levy).
>
> Currently, a lump sum of at least $80,000 is required to purchase an income stream product from a superannuation fund or life office. A couple in receipt of an income stream from a lump sum of up to $100,000 would pass the income test for a full age pension (up to $204 per fortnight is allowed). Research by Treasury's Retirement Income Modelling Unit for this Inquiry suggests that the average superannuation balance per person is currently about $62,000, with a wide variation about this average depending on years of membership and level of contributions. A survey by the ABS in 2000 found that for those aged 55 to 69 years with superannuation, one half held superannuation balances of less than $30,000 (ABS 2001).
>
> When the vast majority of lump sums are below the threshold for an income stream product and still within the means tests for the age pension, dissipation of lump sums is not a significant issue.
>
> However, as superannuation saving increases further, a growing number of retirees will have sufficient savings for a superannuation pension. To the extent that retirees base their investment decisions on the age pension means tests rather than the aim of maximising their private retirement income, they are likely to experience a lower standard of living in retirement.[48]

12.72 The Committee notes, however, that other parties raised greater concern about the potential for double dipping. For example, in its written submission, ASFA recommended that in the future, retirement benefits should be taken in the form of an income stream along the lines of a complying pension or a growth pension. To help implement this, ASFA recommended a cap of, say, $50,000 be placed on the lump sum reasonable benefit limits (RBLs).[49]

12.73 Similarly, the Australian Council of Social Service (ACOSS) argued in its written submission:

> The lump sum RBL should be sharply reduced in order to encourage the purchase of complying pensions. One option would be to reduce the lump sum RBL to the current tax-free threshold for lump sums - $106,000. This is sufficient for the vast majority of retirees to meet immediate expenses on retirement and undertake investments that will improve their retirement living standards (especially paying off their home mortgage). Beyond this, retirees should be either compelled or encouraged (via a penal tax rate) to invest in complying pensions. This is necessary to prevent double dipping:

48 *Submission* 89, DOFA, p. 14.

49 *Submission* 73, ASFA, pp. 47-48.

> the dissipation of retirement savings in order to maximise Age Pension entitlements.[50]

12.74 In addition, the Australian Bankers' Association (ABA) argued in its written submission that a move away from front-end taxes to end benefit taxes would encourage a move towards taking superannuation benefits as income streams, either by

- simply applying ordinary income taxation to all benefits, with at most a limited provision for taking part of a benefit as a lump sum. This would strongly encourage taking income streams (since significant lump sums would be taxed in the top tax bracket); or by
- explicitly requiring payment of benefits (above some lump sum limit) in income stream form.

12.75 The ABA argued that this would considerably improve the mesh between the superannuation and age pension systems. There would be less encouragement to retire early, draw a substantial part of the available benefit as a lump sum, use this to live on in early retirement then qualify for an age pension.[51]

12.76 These arguments were reiterated during hearings. In his evidence to the Committee at the Canberra roundtable discussion on 8 October 2002, Mr Gallagher from Treasury played down the incidence of double dipping:

> One major issue here has been whether there is a major problem with double dipping—people getting their superannuation money and spending it, before accessing the age pension. In looking at the overall equity of the scheme, certainly double dipping presents a theoretical problem. However, we did some research in RIM that looked at ABS data on what people did with their lump sums. We found that people with enough money to affect their pensions—that is, they had a reasonable amount of money, given the three tests: the age pension, income test and asset test—predominantly invested any superannuation amount received. Even if they took it as a lump sum, they still invested it and tried to make use of it rather than spend it on an overseas holiday. So it is not clear that there are major issues with double dipping at the moment. But there certainly is potential there, and it is an issue that probably will be kept under review.[52]

12.77 However, Ms Smith from ASFA suggested at the Canberra roundtable discussion on 8 October 2002 that double dipping might become a greater problem in the future:

> Looking to a mature system, I think there are a couple of things that need to be touched on in terms of the integration. … at the moment I do not think

---

50 *Submission* 65, ACOSS, p. 16.

51 *Submission* 51, ABA, p. 20.

52 *Committee Hansard*, 8 October 2002, p. 718.

> there is any evidence of double dipping occurring in terms of the lump sum—for the most part, people use that money sensibly. On the mature system though, for when those amounts of money become larger, I think it is sensible to put in place now some cap on what that lump sum might be—whether it is $50,000 or something like that for use and then the rest required as an income stream. We think that going with an income stream model makes sense in terms of retirement strategy, although if we do go down that path we need to think of a broader range of products than are there now. Clearly, the set of allocated pensions versus complying pensions does not give much flexibility for people to meet their needs.[53]

12.78 The Committee also notes the evidence of Mr Davidson from ACOSS at the Canberra roundtable discussion on 8 October 2002:

> In relation to the age pension, there is a disconnect between the superannuation system and the age pension system, and in a sense there always will be, because they perform different roles. One is about income replacement and is based on the individual to a large extent; the purpose of the other is poverty alleviation and it is based on the income of the family unit.
>
> I would like to put to rest the notion that ACOSS would like to use the superannuation system to equalise wealth distribution in Australia. We are not that ambitious, to be honest. I would be very happy if the present superannuation system did not contribute to making the distribution of income and wealth worse. If the tax treatment overall, for example, were proportional rather than regressive, that would leave the age pension to do what it does best, alleviate poverty, rather than its having to focus on compensating for a regressive superannuation system. Having said all that, the superannuation and age pension systems would be better connected if lump sums were more restricted. There is a serious disconnect between the two systems that threatens to undermine both. In our view, the best way to achieve that is to place restrictions on the level of lump sum benefits—a simple cap which is either reinforced through the tax system or reinforced by banning lump sums above a certain level. Other countries do that; why can't we? We do not believe the solution lies in making income streams more attractive through further concessional tax or income and asset test treatment, because we do not believe it is necessary or desirable to forgo further public revenue to that end when a simple cap would, to a large extent, do the job.[54]

Committee view – double dipping

12.79 The Committee shares the concerns expressed by some parties during the inquiry that the incidence of double dipping, while not currently a significant problem,

53 *Committee Hansard*, 8 October 2002, p. 722-723.

54 *Committee Hansard*, 8 October 2002, p. 711.

may increase dramatically as the superannuation system matures and lump sum payments become larger.

12.80 To address this issue, the Committee notes a range of possibilities. As discussed earlier in this chapter, this includes the option of moving the superannuation preservation age closer to the age pension eligibility age, and the option of capping lump sum RBLs.

12.81 The Committee considers that its earlier recommendations to limit the indexation applicable to RBLs, together with its proposed changes to the taxation treatment of lump sum benefits, may assist in reducing the incidence of double dipping, in favour of encouraging income streams.

12.82 The following section examines means to encourage retirees to take their superannuation benefits as an income stream rather than as a lump sum.

Retirement income streams

12.83 Income streams are purchased investment products designed to provide payments to a person on a regular basis over either their remaining life or a set term. The payments may comprise both income and a return of the capital used to purchase the product.

12.84 In its written submission to the inquiry, IAA indicated its belief that individuals should be encouraged to take superannuation benefits as income streams rather than lump sum benefits:

> Income streams can be designed to match needs in retirement, and to address issues such as longevity risk (or the risk of outliving your superannuation benefit). Further, one of the reasons for poor integration between the superannuation and social security systems is that superannuation benefits are generally taken as lump sums, while social security benefits are paid as pensions.
>
> There are a range of ways in which the Government could encourage (or require) superannuation benefits to be primarily taken in pension form and hence improve the integration of superannuation and social security. These include:
>
> - enhancing the range of pensions that are regarded as “complying pensions”, to include for example, annuities and pensions invested in equity or growth assets; and
> - requiring superannuation benefits to first be used to purchase a pension that is equivalent to the Age Pension, or only allowing lump sum superannuation benefits to be taken (perhaps above some initial

threshold such as $100,000) once a retirement income that exceeds Age Pension income test eligibility levels has been taken.[55]

12.85 The Committee also notes with interest IFSA's reporting in its written submission of the results of its *Retirement Savings – Desires and Drivers* research project. This project asked retirees and pre-retirees (aged from 45 to five years post retirement) to rank a range of income streams features, both independently and as paired trade-offs, on a zero to ten points scale of importance. The results were as follows:

- Pooling risk: Above all other features, respondents singled out pooled lifetime (longevity) risk as their most disliked feature.

– The most important single attribute of retirement income stream products, was that 'the balance of the fund goes to the estate or to your partner if you die early' (mean importance score 9.2).

– The least important feature among the paired attributes was 'Income is a guaranteed amount, paid for life, but if you die early no further money may be paid to your estate' (mean importance score 2.8)

- Guarantees: Guaranteed income aspects were given very high importance in the single attributes, but fared less well when balanced against trade-offs. Single attribute importance scores were:

– Guaranteed income for life (mean importance score 8.7)

– Income indexed against inflation (mean importance score 8.2)

– Guaranteed level of payment each month (mean importance score 8.1)

- Transparency: 'Transparency' aspects of income streams were rated as having high importance:

– Receive regular account statements, showing balance (mean importance score 7.9); compared to

– No account statements, but you are paid a set amount of income each week or month (mean importance score 5.0)

- Control: 'Control' aspects of income streams were given similar importance:

– Can choose initial investment mix (mean importance score 7.7)

– Can change investment mix (mean importance score 7.7)

– Can switch to another fund manager easily (mean importance score 7.6)

12.86 Taken together, Mr Stanhope from IFSA suggested that two things cropped up as the most liked and disliked components of retirement income streams. The most disliked was losing your money into a risk pool, and the most liked was that, if you

55 *Submission* 74, IAA, p. 22.

died early, any remaining benefit that you had not been able to use in life would pass to an estate.[56]

12.87 The Committee notes, however, that take up of retirement income streams at the current time is low. In her evidence to the Committee at the Canberra roundtable discussion on 8 October 2002, Ms Doyle from AMP indicated that only 30 per cent of retirees are investing their superannuation in income streams. Of that 30 per cent, 90 per cent is being invested in allocated annuities and pensions, and only 10 per cent in complying annuities.[57]

12.88 In response, Mr Maroney from IAA indicated at the Canberra roundtable discussion on 8 October 2002 his opinion that the fact that 30 per cent of retirees invest in income streams is in fact ‘quite good’ and that ten years ago it would have been close to zero:

> Despite the lack of enforcement, we have moved from an almost zero pension system to a 30 per cent pension system by the way that the rules have evolved. Maybe the problem is solving itself, because there is a big attraction under the tax and social security rules for people to take a pension. As education continues and people’s benefits grow et cetera, I am not nearly as pessimistic as I would have been a few years ago.[58]

12.89 Mr Maroney further indicated that within the next five to ten years, depending on the investment in superannuation education by the Government, uptake of income streams may reach 50 per cent. He further argued that individuals’ attitudes to guaranteed income streams will probably be far more positive over the next couple of years, based on recent investment returns.[59]

12.90 The Committee explores below the features and take-up of allocated annuities and pensions, and complying annuities.

Allocated annuities and pensions

12.91 Allocated annuities and pensions are a particular type of income stream, based on an individual account which changes in value with investment returns and income draw downs (calculated according to life expectancy). Upon death, the balance of the account can be used to pay an income to a spouse or can be paid as a lump sum to the beneficiaries of the estate. In its written submission, AMP indicated:

> Allocated annuities and pensions are the most popular type of income stream with retirees, accounting for 90% of sales in 2001. These products give the retiree investment choice and allow them to choose the amount of income they can draw out (within limits). On death, the remaining balance

56 *Committee Hansard*, 8 October 2002, pp. 712-713.

57 *Committee Hansard*, 8 October 2002, p. 676.

58 *Committee Hansard*, 8 October 2002, pp 724-725.

59 *Committee Hansard*, 8 October 2002, p. 725.

> of the fund is returned to the family. However, the allocated annuity can also leave the retiree with no income if they live past their life expectancy. They also allow leakage of funds into a lump sum, as the pension/annuity can be cashed in at any time.[60]

12.92 Despite the popularity of allocated annuities and pensions, the Committee notes that in its written submission, IFSA expressed concern in relation to the current drawdown factors for allocated income products. IFSA noted that tax and social security regulation of allocated products is based on a single mean life expectancy. While this life expectancy is true on average, it does not address the simple statistical principle that half of retirees will outlive average life expectancy. IFSA continued:

> One simple consequence is that the current drawdown factors for allocated products drop to low numbers after mean life expectancy. This eventually forces retirees to draw a significant proportion of the account, however long the account holder may expect to live. It may not be desirable to reduce the minimum drawdown factors significantly early in retirement – say up to age 75 – to limit tax deferral. However, once a retiree is approaching the mean life expectancy of her or his age 65 cohort, say around age 80, remaining life expectancy can be quite long indeed relative to that mean. It seems a little counter-productive to then require annual drawdowns that will rapidly exhaust the remaining capital.
>
> It would make considerable sense to model the consequences of applying longer life expectancies to the drawdown factors of allocated products. This would allow a sensible trade-off between prolonged income drawdown and the risk of creating inappropriately large estates.[61]

12.93 Given this concern, Treasury noted in its written submission its support for lifetime pensions and annuities which manage longevity risk:

> From the Commonwealth's perspective, if individuals have insufficient retirement savings to partly or fully cover their living expenses over long retirement periods, their dependency on Commonwealth income support will increase in their final years of life when health and aged care needs are greatest. These fiscal implications highlight the importance of encouraging *lifetime* pensions and annuities, which manage longevity risk. The current pension RBL does not apply to *allocated* pensions which carry longevity risk, and provides a substantial incentive for lifetime pensions and annuities for those retirees with substantial superannuation balances.[62]

Complying annuities

12.94 In its 1997-98 Budget, the Federal Government announced a proposal to introduce a new class of 'complying' superannuation pensions and annuities, which

---

60 *Submission* 64, AMP, p. 20.

61 *Submission* 70, IFSA, pp. 17-18.

62 *Submission* 89, DOFA, p. 16.

would receive favourable social security and tax treatment. This was subsequently enacted through the *Social Security and Veterans' Affairs Legislation Amendment (Budget and Other Measures) Act 1998*, which came into effect from 20 September 1998.[63]

12.95 Under this Act, complying income streams qualify for a higher RBL, and may also be exempt from the social security assets test. However, as discussed by the AMP in its written submission, complying annuities are unpopular in Australia:

> Australians have shown little preference for complying annuities, despite their favourable RBL and social security rules. Only 4% of income stream sales in 2001 went into complying annuities.
>
> There are several factors which give rise to their unpopularity. Complying annuities must provide a guaranteed rate of return to investors. The capital backing the annuities are therefore generally invested long-term in conservative assets (bonds and cash). The result is a very low income for the retiree. Times of low interest rates make it unattractive to "lock into" a guaranteed long-term investment.
>
> A further disadvantage of lifetime complying annuities is the loss of capital to the estate on death. The longest that the capital can be guaranteed for is 10 years, which is less than most retirees life expectancy. On the other hand, a complying life expectancy annuity allows the capital to be returned to the estate on death.
>
> Regardless, complying annuities have some attractive features: - they are not commutable, they last for at least life expectancy, and they are designed to drawdown capital.[64]

12.96 This unpopularity of complying annuities was also raised by IFSA in its written submission. IFSA reiterated that the capital backing complying annuities is generally invested long-term in conservative assets (bonds and cash), due to the requirement that complying annuities guarantee returns. However, IFSA suggested that removing this requirement of guaranteed returns would promote the development of 'growth pensions' – complying annuities which included growth assets such as share in their portfolio:

> The current tax and social security treatment of retirement income streams also contributes to inadequate retirement incomes. The current rules for complying income streams – broadly, those that qualify for the higher pension RBL and that are exempt from the social security assets test – heavily favour interest-based investments. This distortion has been canvassed in IFSA's submission to Government supporting the recognition of Growth Pensions – copies were provided to the Senate Committee on

---

63 *Submission* 70, IFSA, p. 70.

64 *Submission* 64, AMP, p. 20.

> 4 May 2001. It arises from the restrictions placed on complying products – chiefly that income paid cannot vary, except for indexation.
>
> If this distortion were removed, and retirement income streams which include growth assets were recognised, IFSA has calculated that a retiree with $100,000 to invest in a 15 year income stream would receive around $30,000 more in real terms than $100,00 invested in a 15-year CPI-indexed guaranteed pension or annuity.
>
> The distortion towards interest-bearing investments affects capital markets, reducing the allocation of retirement savings to economically productive equity (and other) investments. This impact reduces the efficiency of the economy overall, and the impact will become larger as higher future levels of retiree savings are forced into interest-based investments.[65]

12.97 Similar to IFSA, AMP proposed in its written submission that complying annuities would be more attractive if they were able to include a broader range of assets other than interest bearing investments such as cash or bonds:

- First, this would allow the providers to remove the rate of return guarantee from the product and pass the investment risk and rewards through to the retiree, making the annuity cheaper as a result.
- Second, retirees would have investment choice, allowing them to select assets according to their risk preference.
- Third, this would allow retirees to benefit from a long-term investment in growth assets, with the potential for capital growth and therefore improved retirement income. It also avoids retirees having to lock in at low rates of return.[66]

12.98 Ms Doyle from AMP Financial Services also argued at the Canberra roundtable discussion on 8 October 2002 that the incentives for taking out complying annuities need to be increased:

> At the moment, we have the most preferential arrangements given to those income streams which last for a lifetime or a life expectancy. But in the market, we are finding that they are not very popular with consumers. Some of the characteristics of those income streams are that they lock the retiree into a fixed rate of return and, therefore, a fixed income—be that nominal or indexed at a certain rate. Coming out of an environment where you have had asset and portfolio choices and then locking yourself for a long time into those sorts of flows has not been very popular. Likewise, it is only when you hit the really high RBLs that those sorts of income streams make a bit more difference to you as well. So those are features of the products that you might say we really need to address by asking, ‘What do today’s retirees want?’ Those types of products were derived a long time ago, and one

---

65 *Submission* 70, IFSA, p. 16.

66 *Submission* 64, AMP, p. 20.

> would say that they need to be brought into the 21st century for the needs of today.[67]

Committee view – retirement income streams

12.99 The Committee favours effective and equitable steps which will provide incentives to take benefits as an income stream, rather than as a lump sum.

12.100The Committee notes that, by comparison with allocated annuities and pensions, complying annuities are less popular because of the requirement that they must provide a guaranteed rate of return. As a result they tend to provide a low rate of return.

12.101 The Committee notes the arguments made by IFSA and AMP for a revisiting of the *Social Security and Veterans' Affairs Legislation Amendment (Budget and Other Measures) Act 1998* as it relates to the regulation of complying annuities (growth pensions), on the grounds that it may be that the current favouring of interest bearing investments in complying annuities in order to meet guaranteed rates of return is an unintended consequence of the Act that the Government can redress.

12.102 Accordingly the Committee believes that the Government should monitor the uptake of complying annuities, to ensure that the restrictions imposed do not inhibit the attractiveness of complying annuities.

12.103 It may also be possible to simplify the legislation applying to allocated annuities and complying annuities so that there can be a standard set of rules applying to income streams. Importantly, the Committee believes consideration of any legislative reform should accompany any moves to encourage individuals to take income streams in preference to lump sums when accessing their superannuation.

Recommendation

12.104 **The Committee recommends that the Government:**

- **monitor the uptake of complying annuities, to ensure that the restrictions imposed do not inhibit the attractiveness of complying annuities;**
- **consider the appropriateness of the current minimum draw-down limits for allocated annuities; and**
- **develop a standard set of rules applying to income streams.**

Accessing the wealth in housing assets

12.105 During the conduct of the inquiry, various parties raised the issue that retirees in Australia tend to be asset rich, but income poor. That is to say that many older Australians have considerable wealth invested in their family homes, but do not have

---

67 *Committee Hansard*, 8 October 2002, pp. 714-715.

access to that wealth in terms of day-to-day income. Accordingly, they continue to draw the age pension.[68] In its written submission, IAA made the following observation:

> As the family home is exempt from the Assets Test and usually generates no income, there is an incentive for pensioners with valuable homes to remain in them and still receive social security benefits. Many older people are also reluctant to move away from familiar territory. However, the absence of death duties means that the Government pays social security while an asset (such as the family home) is appreciating, for the children to then inherit a valuable tax-free estate.
>
> Australia's high rate of home ownership ensures that most retirees live above poverty levels. Encouraging more people to own a home in retirement continues to be a worthwhile objective. However, for the foreseeable future, it is unrealistic to expect the average Australian to be able to afford to buy their own home and to also fund sufficient income to be self-sufficient in retirement.
>
> Ways should be considered for unlocking the value of the family home in retirement, for example through reverse mortgages or loans from government that are repayable on death.[69]

12.106 COTA supported in its written submission consideration being given to the provision of home equity loans, provided they were developed in conjuncture with strong consumer protection codes:

> … there are dangers and limitations in home equity conversion for some. At worst, there is the prospect of reaching nil equity, and lenders calling for possession of the asset – the family home. There are concerns regarding decision making impairment experienced by some older people and the need to protect these individuals. There is also the fact that these schemes are likely to be available only in metropolitan areas, and to owners of more expensive homes. We believe that safeguards need to be put in place to ensure that Home Equity Conversion schemes are fully understood by older people before they enter into such agreements.[70]

12.107 Home equity or reverse mortgage loans were also raised in hearings. For example, in the hearing on 17 July 2002, Dr Knox noted:

> I think, in concept, it is a great idea to use the family home, or the residence, to borrow money against. There are clearly some issues related to that. For instance, the person lending you the money and, in effect, taking an increasing ownership of the home, would want the home to be maintained and to maintain its value. If you have an elderly couple in the home and they

---

68 *Committee Hansard*, 8 October 2002, p. 709.

69 *Submission* 74, IAA, p. 18.

70 *Submission* 63, COTA, p. 33.

> have no financial interest in doing that then you have some conflicts. But you can constrain that with certain limits and so forth by not borrowing the full value of the home but half the value of the home.[71]

12.108 Similarly, Ms Wolthuizen from the Australian Consumers' Association (ACA) raised reverse equity mortgages at the Canberra roundtable discussion on 8 October 2002. She indicated the ACA's broad support for a re-examination of such schemes:

> We think they are worth considering, particularly as long as eligibility for the age pension is measured with respect to a means test but the family home is not subject to that same test. It is worth looking at ways of unlocking equity in the family home, particularly in the kinds of situations we have reported to us by people who have elderly parents or relatives who cannot pay their rates because they are living in a house in an area which has experienced rapid property value rises. In those scenarios they do not necessarily want to see the individual having to move and sell up in order to afford to live. By the same token, there is a sense of a growing demand for that sort of product and it is worth looking into, to see if it can be made viable. I also think some of the demand issues which may have prevented it from being popular when last examined in the Australian context possibly do not exist any more, largely because of the focus on rising property values in certain Australian property markets.[72]

12.109 However, Mr Kelly from the Department of Health and Ageing raised at the Canberra roundtable discussion on 8 October 2002 the failure of reverse equity loans to gain widespread support in Australia. According to Mr Kelly, a similar scheme met with limited success in the USA, although the scheme in the UK has been more successful.[73]

12.110 Similarly, Mr Stanhope from IFSA commented:

> I will make a comment about reverse equity mortgages, because they are always put on the table in this debate. The question is often asked: 'Why aren't they available?' One of the first points to make is that, in the US experience, they were expected to be so popular that the first run was balloted to 50 institutions. There have been a number of supplier exits from the reverse equity mortgage market in the US, because it simply has not worked the way anyone expected it to. The demand that people keep hypothesising just does not eventuate. Perhaps the most compelling fact is that the US government started the securitisation of those mortgages. They intended they would all be securitised into the secondary market through the Fannie Mae Corporation—their federal national mortgage loans association—which is a US government instrumentality. They have not been able to exit that market—they are still the only securitiser of those mortgages—and so, in effect, the risk in that portfolio is still underwritten

71 *Committee Hansard*, 17 July 2002, p. 348.

72 *Committee Hansard*, 8 October 2002, p. 719.

73 *Committee Hansard*, 8 October 2002, pp. 683, 709-710.

> by the US government. So these things have a lot in promise but not a lot in actuality. They are very complex beasts to get into place.
>
> The risks and the costs associated with them mean that they probably could not be provided as a pure market product for the same rate as an ordinary housing mortgage, and I think that that would meet with very great resistance on the demand side. The pilot scheme that was started under the Keating Labor government and not continued by the current government had an interest rate subsidy in it of one per cent. Those kinds of issues are quite critical to acceptance of reverse mortgage schemes. People in Australia keep forgetting that not only are there a whole lot of supply issues in getting the thing to market but also there is a real demand issue—whether people are prepared to pay for the risk in the product and whether a subsidy would be needed to get over that demand hurdle, much less all the other hurdles.[74]

12.111 As noted, however, reverse mortgages have had some success in the UK. In evidence to the Committee on 8 October 2002, Ms Doyle from AMP Financial Services expanded on this:

> In the UK we have what we call an 'equity release' product which is offered through one of the UK subsidiaries. It is usually bought by people who are 70 to 75 who are maybe looking for funding from a proportion of their house equity. It is not very often that you find that they would actually release 100 per cent of the capital in the house—it might only be 20 per cent. It can be as a lump sum or as an income stream for the retiree, but usually it is not a great deal that is coming out. Lump sums are very popular, and if they want to they can pay it back; so they can release the mortgage over the house. Usually you will find that we have done it with a mortgage provider underneath, and so it is not the life company that takes the sole risk of that; it is with a partner as well. That way has been seen to be quite popular in the UK.[75]

12.112 Finally, the Committee notes that as an alternative to home equity loans or reverse mortgages, Third Son Financial Services submitted the following HOMEX model for accessing housing wealth:

> An estimated 31.5% of older Australians are homeowners but are dependent on Government payments and allowances for 90% or more or their income. The ability of these older Australians to purchase aged care services, beyond those provided free by Government and Charitable Organisations, is directly related to their income position, and hence limited by their dependence of Government payments.
>
> The Home Exchange Program (HOMEX) has been specifically designed to address these problems, by providing a new mechanism to generate significant additional income for homeowner older Australians who are

74 *Committee Hansard*, 8 October 2002, pp. 713-714.

75 *Committee Hansard*, 8 October 2002, pp. 715.

currently dependent on Government pensions and allowances for their income, without losing the key benefits commonly associated with owning their home.

HOMEX involves:

- The sale of an older Australian's home to the State Government,
- The older Australian gaining rent-free lifetime tenancy of their own home,
- The older Australian retaining 100% of their existent Age pension and associated entitlements,
- The older Australian receiving an additional monthly "pension payment" for the rest of their life with payments annually incremented by a fixed percentage or CPI (these payments being guaranteed for 10 years even if they pass away within that time period),
- The older Australian having an entitlement to a once-off Health Care Grant from the Government, the value of which will be up to 25%[76] of the prevailing market value of their home, to be used to meet their health care needs should they need to enter a hospice or nursing home accommodation.

HOMEX is an entirely voluntary program providing benefits to older Australians who chose to enter into the program.

The decision to enter the program is entirely the decision of those older Australians, made in consultation with their family and loved ones should they so chose to do so, and supported by the Government.[77]

Committee view – accessing the wealth in housing assets

12.113 The Committee notes that in general terms, many retirees continue to live in their family home, and are not in a position to access the wealth stored in the home to fund their retirement. As a result, they are forced to rely on the social security and health systems for income and other support in retirement.

12.114 The reliance on Government support through the social security system rather than drawing down assets in retirement clearly has equity implications. In general terms, asset rich but income poor retirees often continue to rely on the taxpayer funded age pension, but leave to their children or other beneficiaries assets such as the family home of significant value. This raises the question whether additional avenues

---

76 A Health Care Grant of up to 25% of the prevailing market value of the home is available under a Private Funding scenario for HOMEX, under a Public Funding scenario this percentage is about 12.5%.

77 *Submission* 13, Third Son Financial Services, Attachment 1.

could be explored by which asset rich retirees could contribute to some of the costs of their access to the age pension and health care.

12.115 The Committee considers that the Government could offer loans to retirees, repayable on death. The Committee also believes that there may be some merit in the Government re-examining reverse equity or home equity loans. The Committee notes that similar schemes have met with limited success in the USA, but that the UK has had greater success through introducing a range of flexibilities into their schemes.

Recommendation

12.116 **The Committee recommends that the Government examine options by which those who wish to could draw an income stream from their owner-occupied housing assets for retirement income purposes, including health and aged care expenses.**

Overall conclusions - integration

12.117 The Committee found that Australia's public and private health and aged care system is well regarded, but, in the light of projected expenditure identified in the *Intergenerational Report* and other reports published in the last decade, the system faces significant challenges in the future as Australia's population ages.

12.118 The Committee believes that the Government could consider a number of strategies to address these challenges, including:

- identifying ways to make savings in health care costs, through further examination of options such as voluntary heath insurance through superannuation protocols; and
- monitoring community and residential aged care programs to ensure their effectiveness and sustainability.

12.119 The Committee notes that Australia has a modest universal age pension system which includes targeting through the assets and incomes tests. The Committee also notes that the costs associated with the system are expected to increase in the future, and that strategies need to be identified to deal with this anticipated development.

12.120 To address this, the Committee believes that there are a number of initiatives that the Government could undertake to enhance integration of the three pillars of the retirement income support system in Australia: compulsory employer SG contributions, voluntary superannuation, and social security measures. Specifically, as discussed in this chapter, the Committee believes the Government should:

- continue to strive for universal and adequate superannuation coverage, with a focus on assisting those who face the greatest challenges in achieving an adequate retirement income – the low and middle income earners;
- review current arrangements for access to the Commonwealth Seniors Health Card scheme to ensure that it focuses on those in greatest need of Government support;

- explore options to encourage workers to remain in the workforce beyond the current superannuation preservation age;
- monitor the uptake of complying annuities, to ensure that they offer an attractive investment option for retirees;
- consider the appropriateness of the current minimum draw-down limits for allocated annuities;
- develop a standard set of rules applying to income streams; and
- develop means by which those who wish to could draw an income stream from their owner-occupied housing assets for retirement income purposes, including health and aged care expenses.