CENTRESTONE
Wealth Management Pty Ltd

ABN 69 002 722 447

Submission to the Senate Select Committee on Superannuation

Inquiry into planning for retirement

12 February 2003

Table of Contents

1 Introduction

We wish to make a submission to the Senate Select Committee on Superannuation in regards to the "*Inquiry into planning for retirement*".

This submission is offered on behalf of Centrestone Wealth Management Pty Ltd, a licensed securities dealer and insurance broker.

Centrestone was incorporated in 1984 as Investor Security Group Pty Ltd but changed its name to Centrestone in 2002. We have approximately $650 million of clients' funds under advice and a billion dollars of risk insurance policies in place.

Centrestone's clients are committed to achieving financial security through a disciplined process of saving and insurance cover; and generally in retirement the strong majority are purely self funding with a minority in receipt of partial pension benefits. Most recognise that they needed to make many sacrifices to achieve financial success and many express frustration at systems that appear to reward a less responsible approach.

1.1 Objective

This submission aims to describe the current environment that exists for people that are close to retirement age, and to identify strategies that would assist people to adequately plan for retirement. In relation to strategies, it specifically examines:

- promoting part time work in retirement;
- tightening eligibility for Government income support; and
- increasing incentives for investing in superannuation.

2 Executive Summary

The amount of people that are receiving income support by the Government is on the increase as is the level of dependency on these payments. The current environment does not uniformly encourage people to adopt a self responsible approach in regards to planning for their retirement. In particular, there is a genuine need for reform to restrict the number of people receiving income support payments that are of working age, as there is a developing trend for them to remain on income support and merely transfer to receiving age pension.

Such examples of disincentives to planning for retirement are:

- ability to receive income support that is not rigorously activity tested
- accessibility of superannuation for non retirement purposes
- encouragement of the community to receive income support when under age pension age through the exemption of testing superannuation benefits

There is an increasing number of people in receipt of income support, which can be partially attributed to people learning from their peers (see Case Study).

In order to stem these problems the following proposals should be adopted or at least explored:

- promoting people to work on a part time basis rather than retire, through lowering the age of eligibility for the Commonwealth Senior Health Card and through increased awareness of the Pension Bonus Scheme
- encouraging people to retrain to enable them to find more suitable employment by Government funded training benefits
- abolishing mature age allowance and partner allowance
- tightening means testing by assessing superannuation benefits for people aged under pension age, and assessing the value of homes exceeding say $700,000
- introduce superannuation initiatives such as member choice, Government Co-contribution, a reduction in superannuation surcharge levels and abolishing RBLs
- compulsory commencement of income streams for a component of retirement benefits
- implementing financial planning education programmes

3 Current Environment

In the current environment there are many instances that discourage the community to become self responsible and self supporting financially. People do not recognise how to achieve their financial goals but even more significantly how to set financial goals for wealth creation. They also are not aware that prudent expenditure is a vital component in achieving wealth creation.

In our experience there are many people in the workforce who have an unrealistic expectation of the level of cost of living that can be supported from the wealth that they have accumulated. Or more correctly they are not prepared to live a more modest lifestyle in order to save for their retirement years.

Presently, we seem to be rewarding people for failing to adequately save or for using their retirement benefits for non retirement purposes as can be seen from the following examples.

- **The ability to receive Newstart Allowance without having to look for paid work.**

Section 603AA (1) of the Social Security Act 1991 states:

"Subject to subsection (3), a person who has reached 50 years is taken to satisfy the activity test in respect of a period (the relevant period) if the person:

> *(a) is engaged in approved full-time unpaid voluntary work for an approved organisation for at least 32 hours in the period; or*
> *(b) is engaged, for at least 40 hours in the period in a combination of:*
> *(i) approved unpaid voluntary work for an approved organisation; and*
> *(ii) suitable paid work for another person. "*

There appears substantial anecdotal evidence that despite the legislation quoted above, people are effectively advised by certain officers of Centrelink that it is acceptable to breach the activity test. This approach does not encourage people to work or to seek employment, but rather suggests that it is not required.

- **There is no disincentive to withdrawing superannuation to supplement Newstart Allowance.**

In December 2002, the Family Law Legislation Amendment (Superannuation) (Consequential Provisions) Bill 2002 received Royal Assent. This has served to repeal the sections in the Social Security Act 1991 and the Veterans' Entitlements Act 1986, which now indicate that the growth component of early withdrawals from superannuation is no longer assessed as income.

This effectively means that a person can support a high cost of living while receiving Government income support, by supplementing income support with superannuation withdrawals. This creates a confusing message as Government support is meant to be for people with limited means.

- **Superannuation is not means tested for Centrelink / DVA purposes if a person has not reached age pension age.**

Effective from 1 July 2001, superannuation benefits have been treated as exempt assets and are not income or asset tested for Centrelink / DVA purposes. Previously, superannuation assets commenced to be means tested for people who had been in receipt of income support for at least 39 weeks after reaching age 55.

This change in legislation has provided people aged 55 with a 10 year window of opportunity, in which they can effectively "hide" assets in the accumulation phase of superannuation and receive a benefit (such as Newstart allowance). This can provide a person that would perhaps be regarded by the Government as having achieved financial security to apply for and receive income support.

Hence, the essential needs basis for Government support is breached.

Is it the Government's intention to be more generous in means testing for allowances compared with pensions? Perhaps it is the Government's view that outlays now will avoid outlays later? It is our view that this will merely extend the period where the Government provides income support.

- **The conditions of release, especially reaching preservation age and permanently retiring are quite artificial**.

An individual can state that they are permanently retired, access their superannuation benefits and then work again. Alternatively, they can elect to receive a Centrelink benefit while depleting their savings from drawdowns, and then be eligible for age pension at age pension age.

This does not encourage people to remain working (at least on a part time basis) to save more for retirement and then to utilise those benefits when they are genuinely required.

There is no incentive to retain retirement benefits as it is possible to receive a Government funded benefit for doing nothing, and some people seem to want to spend most of it, to ensure that later they can receive the age pension.

3.1 Case Study

We would like to describe a scenario that we are aware is practiced in the community to a not insignificant extent and explore its potential negative impact on changing community attitudes, resulting in greater pension and allowance outlays for Government.

Part A

John and Margaret, aged 55 and 53 respectively, are a couple who own their own home with an outstanding mortgage of $60,000. John has been working for his employer for many years and as a result of restructuring in the company, is offered a redundancy package of $150,000.

John decides to accept the redundancy offer. He receives approximately $67,500 as a tax free cash payment and uses this to retire the mortgage debt of $60,000 (and the residue is placed in his bank account). He elects to directly receive the remaining taxable portion. He deposits this in his bank account and then makes a $65,000 spouse contribution into a superannuation fund for Margaret as she has only a small amount of superannuation ($8,000). Margaret works as a receptionist in a doctor's surgery and earns $28,000 for the financial year.

In addition, John has a superannuation benefit totalling approximately $500,000, of which $200,000 is preserved. John's superannuation is a mixture of Pre 83 , Post 83 and undeducted components.

John visits the local Centrelink office to determine his entitlement to unemployment benefits. He is advised that as a result of Margaret's income he will not qualify. After some discussion Margaret decides that she will cease working and they will both apply for unemployment benefits. To their surprise they discover that there are no rigorous work test requirements imposed and they decide that they will follow the example of many of their friends, and travel around Australia.

As John and Margaret were accustomed to a very comfortable lifestyle, they continue to spend at their pre-retirement rate where their cost of living was $60,000. This is achieved by drawing down from superannuation to supplement the Newstart that they both receive.

We estimate that John and Margaret will be entitled to the full amount of income support until John reaches age pension age, ten years after the Newstart Allowance first became payable (based on the assumptions in appendix A). When John is age pension age, they will be eligible to receive approximately 90% of maximum pension and allowance payments (based on assumptions in appendix A) as John's superannuation assets (estimated to then only total $185,000 after consumed drawdowns) will now be counted. There is a high probability that John and Margaret will also be entitled to at least a part age pension when Margaret is of age pension age due to their depleted superannuation assets .

It must seriously be questioned whether these are needs based benefits and whether they should be paid to support a lifestyle of $60,000 per annum.

We believe that the current method of Income and Asset testing for age pensioners is reasonable and provides a helpful supplement to those who have modest wealth. There is an obvious discrepancy that whereas, people with substantial wealth are disqualified from receiving the age pension, if the individuals are less than age pension age they may be eligible for a full benefit. Surely this creates confusing messages and encourages people to receive income support.

Part B

Next door to John and Margaret are another couple Ted and Maureen who are approximately the same age as John and Margaret. Ted also worked in the same company as John and was offered a redundancy package.

In contrast to John and Margaret, Ted and Maureen wish to continue working. Ted managed to obtain a part time job where he received about half of his former salary and Maureen continued working in her part time job. Between them they were able to achieve a reasonable standard of living on the net salaries they received. Ted's superannuation was able to accumulate to ensure a comfortable retirement in the future. They did not receive any Government support and it is very likely that in their retirement years they will be fully self funding.

After John and Margaret returned from their 18 month holiday around Australia they invited Ted and Maureen for a barbeque. As they sat around talking about their experiences, John and Margaret were very positive about John's redundancy as it had offered them the opportunity to embrace a life of leisure while they were still fit enough to enjoy it. They commented that Ted and Maureen were crazy continuing to work when the Government can in reality, partly pay for people to take a long holiday.

This is the kind of scenario that is being repeated throughout Australia and the attitude of getting something for nothing is possibly replacing values of being self sufficient. Many people express the question "Am I being foolish to not try and get this money for nothing?"

Our modelling shows that John and Margaret would receive income support of almost $200,000 over the ten years until John reaches age pension age. Over that time they pay no income tax (with the exception of lump sum taxes on withdrawals from superannuation). When John reaches age pension age they would be eligible to receive approximately 90% of maximum benefits (based on assumptions in appendix A). This trend will most likely continue when there are both receiving age pension due to their depleted assets.

The most significant focus in policy must be to readdress this trend.

Is it appropriate for a financial planner to argue for a self responsible approach when receiving income support is a more financially advantageous outcome for the client? This creates an ethical dilemma for the financial advice industry. There is much ambiguity about the direction that the Government is taking, and many financial advisers actively adopt and advertise strategies that ensure that people are dependent on income support and do not encourage people to be self responsible.

4 Proposals to plan adequately for retirement

In planning for retirement the Government should develop policies that will encourage the maximum number of people in the community to become self responsible and self supporting financially, as current policies do not uniformly promote these goals.

We applaud the Government's initiative in regards to the Senior Australians Tax Offset and the Commonwealth Seniors Health Card, as they are two endeavours that are greatly appreciated by our clients as an encouragement and reward for their effort in saving adequately for their retirement.

In discussing proposals that would assist the community to adequately plan for retirement the following factors will be addressed:

- the effects of ageing on workers' productivity;
- the continuing relevance of the concept of a fixed retirement age;
- the potential to encourage progressive transitions from work to retirement, including through possible new benefit access and contribution arrangements and part time work;
- any scope for older workers to access their superannuation to finance retraining to continue work that is more suitable for older people; and
- ways to assist older workers plan for their retirement.

4.1 The effects of ageing on workers' productivity

As people age many start to view productivity differently and move from a quantitative perspective to one of quality. Older workers prefer to be evaluated at least partly on experience they can bring to bear, and wish to pass on the valuable information that they have gleaned to others in the business, rather than the company lose those skills when the person leaves. In essence, many skilled older workers see their goal as "putting old heads on younger shoulders".

Financial advisers who have worked in the financial planning industry since the 1980s can be used as such an example. They have seen the development and evolution of the taxation and social security systems and fully understand the mechanisms that are in place today and how they came about. They are in the position to pass on the knowledge that they possess to younger workers who may be less able, alone, to gain that specialist knowledge and historical perspective.

Older workers are also more likely to prefer balance in their lives, in terms of leisure and employment. After many years of commitment to their work they now see a need to devote larger amounts of time to family and leisure. Effectively rebalancing their lifestyle to ensure they are not living merely to work.

Enabling older people to work on a part time basis would support those who wish to devote less time to work and would facilitate the transfer of knowledge to younger colleagues. Engaging in part time work would increase the likelihood of people retaining their retirement benefits and would put less strain on the Government budget from reducing the number of people receiving full income support.

4.2 The continuing relevance of the concept of a fixed retirement age

In encouraging people to adequately plan for their retirement, we do not support the idea of a fixed retirement age. Numerous companies share our view as for many of them; a fixed retirement age has become obsolete.

Rather, we promote a shift to working part time indefinitely, with the ability to partially access superannuation benefits to supplement part time income if necessary.

If employment is extended, even on a part time basis, it is likely to keep people feeling younger and healthier in mind as they continue to be active. It would also ease the transition from working to retirement, which is a priority as many people feel anxious and are not equipped to deal with the complete change triggered by retirement.

4.3 The potential to encourage progressive transitions from work to retirement, including through possible new benefit access and contribution arrangements and part time work

The progression from full time to part time work is one area of reform that should be heavily promoted. With this focus in mind, for people who remain employed on at least a part time basis, they could be rewarded by having access to the Commonwealth Seniors Health Card from an earlier age, for example age 55, rather than age pension age. People in this bracket would still be relatively healthy which would be apparent by their continued activity from part time work. This incentive would also assist people to further save for their retirement benefits as potentially they may receive superannuation guarantee from employers. Another factor that would boost retirement benefits is the decreased rate at which superannuation would be drawn down.

This is a better alternative than the scenario described earlier, which is for people to retire, effectively “hide” their money in superannuation and receive Newstart Allowance for little or no effort on their behalf. It helps neither the individual to maintain their fitness nor does it help their retirement savings if they are accessing them to supplement the allowance they receive. It does not encourage a modest lifestyle.

Means testing for allowances should not be more generous than means testing for pensions!!

When promoting people to work longer and build up their retirement benefits there is a contradiction between wanting people to become self responsible and limiting the amount of superannuation that can be received without punitive taxation consequences due to the reasonable benefit limits (RBL) system. The abolition of RBLs would encourage people to contribute more to superannuation, as they would not be penalised for having excessive benefits. It is essential that a consistent message be given that uniformly promotes people becoming self responsible.

A further incentive to promote progressive transitions from work to retirement is the Pension Bonus Scheme available through Centrelink and DVA. Although this is currently an encouragement to remain working at least 20 hours per week for 48 weeks in the year, few people are aware of the scheme. We suggest that more public awareness be generated via education programmes, which could be implemented by Centrelink, DVA and various financial planning bodies that have displayed a high level of skill in educating the public.

4.4 Accessing superannuation to finance retraining to continue work that is more suitable for older people.

We do not support the practice of people accessing their superannuation to finance retraining. This is inconsistent with the sole purpose test, which states that the aim of superannuation is to provide benefits for a person's retirement, not to retrain.

Permitting individuals to access superannuation to meet costs associated with retraining, would result in the addition of another condition of release within the legislation. This would serve to make the legislation more complex, than it is already. The costs for funds could also increase, as this would need to be administered.

We propose that the Government fund an individual's retraining for those that work at least on a part time basis and impose a limit of $3,000 to use per year. This would reduce the Government's expenditure as the cost of retraining would be cheaper than supplying the person with a full allowance. People would be eligible to receive a small part pension at best, due to the level of income they receive from working.

4.5 Ways to assist older workers

As mentioned previously the main focus to assist older workers plan for retirement is to encourage people to work longer at least on a part time basis. When helping older workers plan for their retirement we support people having the same amount of flexibility, as they have currently, in terms of investment choice for their retirement savings, which promotes self responsibility. When an individual has accumulated a retirement nest egg they need options and flexibility regarding how it is invested. As our clients have been responsible and are saving or have adequately saved for retirement we would not support the introduction of tax concessions that predominantly favour people with low superannuation balances or those receiving lower incomes.

In assisting older workers plan for retirement we support the following initiatives:

- **Abolishing non activity payments**

The Government has signalled its intention to abolish new applications for mature age allowance (MAA) and partner allowance (PA) by 1 July 2003, in the form of the Family and Community Services Legislation Amendment (Australians Working Together and Other 2001 Budget Measures) Bill 2002. If passed, it will result in the complete phase out of MAA by 2008 and PA by 2020.

As numerous instances illustrate, these payments encourage people to terminate working, obtain Government support and to begin accessing their retirement benefits earlier. As acknowledged by the Government Report "Building a simpler system to help jobless families and individuals", most people aged over 50 who receive income support do not stop receiving income support but merely move on to age pension.

If these payments were abolished it would force people to receive Newstart Allowance potentially increasing the opportunities and encouragement for getting employment. It would begin to emphasise the proposition that if you are not disabled, sick or bereaved you should start to look for work, which would help people build up larger retirement benefits. It would also reduce the increasing dependency that people have on income support payments.

- **Reducing the likelihood of receiving pensions by tightening means testing.**

Tightening means testing measures would ensure that the people that genuinely need the support would receive it. A large proportion of the Australian community have a "love affair with bricks and mortar" and the majority of their assets take shape in the form of the family home, which is an exempt asset for social security purposes. This can create a scenario where an individual who possesses a million dollar house subsequently receives the full age pension. We suggest that the proposal of means testing a portion of a person's residence in some situations (eg. when the residence exceeds say $700,000) be explored. The family home is the most widely used means for sheltering assets from the means test.

- **Having equivalent means testing for allowances and pensions**

When the Government introduced the policy that superannuation was an exempt asset for people that had not reached age pension age, it generated a significant inconsistency for means testing of allowances and pensions. It has created a situation that allows asset sheltering for superannuation, which has seen many people qualify for benefits earlier than was previously possible. As many people who are over 50 and in receipt of income support merely move to the age pension, this discrepancy facilitates people to depend on Government support ten years earlier. It does not encourage people to become self responsible by working longer or attempting to save for their retirement.

- **The introduction of member choice for life**

The provision of member choice for the community is an initiative that has been tabled since the mid 1990s and is currently in the form of the Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002.

We support a whole of life approach to superannuation whereby an individual at an early age, begins to contribute to superannuation and has the choice to determine the superannuation fund that they join. This choice should be ongoing into retirement and an individual should be able to change the superannuation fund at any time.

Member choice would raise awareness within the community and people would take more responsibility for their retirement than is the current practice. It would increase the level of public education and practically equip people with the skills necessary to plan for their own retirement. Preparing for retirement would not be as traumatic an experience as it would not be a new process.

- **Introduce the Government co contribution**

The introduction of the Government Co-contribution is a positive initiative that would encourage the community to contribute to superannuation. As recommended by the Senate Select Committee on Superannuation in the report on the adequacy of the tax arrangements for superannuation and related policy, we support an increase in the threshold to encompass average earnings. If adopted and promoted by the Government, more people would inject money into the superannuation system and would ultimately have larger retirement benefits.

- **Reduce the level of surcharge**

Lowering the level of superannuation surcharge has been proposed in the Superannuation Legislation Amendment Bill 2002, which would increase the attraction of investing in superannuation for higher income earners, a group of the community potentially able to save.

- **The implementation of financial planning education programmes**

Such programmes would be of significant value to the community in helping people recognise how to accomplish their financial goals. In addition, people would gain knowledge to set financial goals for wealth creation that will lead them to understand that prudent expenditure is a vital component in achieving financial security. In our experience there are many people in the workforce who have an unrealistic expectation about the level of cost of living that can be supported from the wealth they have accumulated. Or more correctly they are not prepared to have a more modest lifestyle now in order to save for their retirement years.

These programmes could be developed and implemented by various financial planning bodies who have demonstrated a high level of skill in educating the public. Education is vital as it would empower the community with the aid of financial advisers, to plan for retirement. This should serve to reduce the amount of Government support that would be required.

- **The compulsory commencement of an income stream for a component of retirement benefits**

The current RBL legislation is inappropriate in encouraging the use of income streams. Only those individuals who are least likely to draw on Government support are encouraged into income streams as only those with a lump sum in excess of approximately half a million dollars exceed the lump sum RBL.

This principle should be changed to require everyone to take a component of their superannuation as an income stream (say half of the first $300,000) and above that people should be free to choose to use superannuation income streams or to invest in non superannuation income producing assets. The amount above the limit should be deemed reasonable.

The actual amount to be directed to the income stream would need to be explored and it would most likely be indexed with AWOTE. The individual would have flexibility to choose the type of income stream to utilise, which is indicative of member choice, although the income stream would ultimately be non commutable (even if an allocated product was chosen).

- **Method of ensuring that Newstart recipients cannot access preserved superannuation benefits**

As outlined by the Australian Taxation Office Technical Liaison Committee in the minutes of their meeting dated 26 August 2002:

> *"The normal conditions of release apply to withdraw benefits from a superannuation fund when a person is in receipt of Newstart allowance. If in receipt of Newstart allowance, the person would not be considered retired.*
>
> *If benefits are withdrawn in contravention of the preservation requirements in Part 6 of the SIS regulations, they will be assessable income in accordance with subsection 26AFB(2) of the ITAA 36. …… The payment will therefore not receive concessional tax treatment."*

The intention of Newstart allowance recipients is to be gainfully employed as they are looking for employment, which suggests they should not be able to access their preserved superannuation benefits. However, it is our understanding that this is not always practised, and there is no vetting procedure in place that actively ensures that Newstart recipients are not accessing their preserved superannuation benefits.

A method could be devised for data cross-checking that effectively stops Newstart recipients from either cashing their preserved benefits and receiving concessional taxation treatment or receiving Newstart allowance.

5 Costings

The proposals offered in this submission promote increasing a person's working life and encourage people to fund their own cost of living in retirement. This would reduce the costs to the community and would result in more people being active and healthier. It should reduce both pre retirement benefit outlays and pension payments.

It is outside the scope of our resources to produce actual expenses and costings for each proposal, as we are not equipped to generate such figures.

6 Appendix A

The Case Study in this submission regarding John and Margaret is based on the following assumptions:

- The cost of living of $60,000 is indexed annually by 2.5% to represent an assumed rate of inflation
- The income support payable is indexed each year by 2.5% to represent an assumed rate of inflation
- The earning rate of the assumed mix of superannuation is 6.08% for the first two years due to the higher proportion of cash to allow for initial anticipated withdrawals. The average earning rate in later years is 6.57% as the cash holding has been withdrawn.
- John and Margaret have a car and caravan, which they owned before the redundancy payout, valued in the first year at $50,000. After ten years the value is estimated to be $10,000
- Financial planning fees are applicable as per our set fee structure and are in addition to the $60,000 cost of living
- Neither John nor Margaret pay income tax on the income support received due to rebates
- The total assessable assets they hold are less than the current asset test threshold and the income counting from all sources is less than the current income test threshold.
- At commencement John had $50,000 of undeducted contributions
- John and Margaret initially had $7,500 cash at bank when they were both receiving allowances and home contents of $10,000 has remained constant
- The income support income and asset test thresholds used are based on current values

7 References

Commonwealth of Australia. 2002, *Building a Simpler System to Help Jobless Families and Individuals,* Commonwealth of Australia, Canberra.

Senate Select Committee on Superannuation. 2002, *Superannuation and Standards of Living in Retirement: Report on the Adequacy of the Tax Arrangements for Superannuation and Related Policy,* Senate Printing Unit, Canberra.