Institute of Actuaries of Australia

Submission to the Senate Select Committee on Superannuation

INQUIRY INTO PLANNING FOR RETIREMENT

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Level 7
Challis House
4 Martin Place
SYDNEY NSW 2000

Tel: (02) 9233 3466 Fax: (02) 9239 3446
Email: insact@actuaries.asn.au Web site: www.actuaries.asn.au

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1 BACKGROUND

On 12 December 2002, the Senate referred the following matter to the Senate Select Committee on Superannuation for inquiry and report by the last sitting day in June 2003:

Planning for retirement.

In conducting the inquiry the Committee is to examine in particular:

(a) the effects of ageing on workers' productivity;

(b) the continuing relevance of the concept of a fixed retirement age;

(c) the potential to encourage progressive transitions from work to retirement, including through possible new benefit access and contribution arrangements, and part-time work;

(d) any scope for older workers to access their superannuation to finance retraining to continue work that is more suitable for older people;

(e) ways to assist older workers plan for their retirement;

(f) the short and long term effect on the Budget of any proposals for change; and

(g) any issues for the Federal or State workplace relation systems.

2 SUMMARY OF SUBMISSION

The Institute of Actuaries of Australia (IAAust) is pleased to provide this submission.

A summary of the main details and conclusions of the submission is as follows:

2.1 Coverage

The IAAust has a membership which is engaged largely in the many areas of the financial services industry. Accordingly this submission focuses on the financial aspects of planning for retirement.

2.2 The Continuing Relevance of the Concept of a Fixed Retirement Age

After analysis we have concluded that the concept of a fixed retirement age does not now exist. Any remaining barriers to individuals having a free choice to make their own decisions in this regard should be removed.

There is however, a concept of a fixed age beyond which the community considers there is no obligation to work.

This is the Age Pension age, currently 65 for males and 62 for females (increasing to age 65 in 2014).

Given the improvements in levels of health and fitness of older people, and community attitudes generally, consideration can reasonably be given to increasing this age.

Individuals may retire earlier than Age Pension age. However, this should not be at the expense of the community generally. They must be self-supporting, be restricted from "double dipping" and not receive any special tax or other benefits until they reach Age Pension age.

2.3 The Potential to Encourage Progressive Transitions from Work to Retirement

Our focus in answering this question is to look at the barriers that exist to older people that serve to restrict their capacity or desire to engage in part-time, or less exacting full-time, work.

We noted that modern employment practices favour younger people, and suggest areas where such practices may be reviewed to mutual advantage. This includes employment practices in the state and federal public service.

We also noted the existence of financial disincentives. These include the imposition of up to 60% "tax" on earnings after Age Pension age in the form of income tax and reduction in Age Pension.

One option to ameliorate this position would be to ignore a part of earnings from personal exertion for means test purposes.

We note that the Pension Bonus Scheme is not effective as a strong incentive to work after Age Pension age.

2.4 Access to Superannuation to Finance Retraining

We consider that superannuation benefits exist primarily to provide for retirement needs.

In general, current levels of benefits are inadequate to meet such needs without government support. Allowing access to personal superannuation benefits for other purposes simply creates greater inadequacy in meeting retirement needs.

Loans from superannuation funds to individuals for this purpose may be an option worth considering.

We suggest that retraining of older people is a wider community issue. As the government will benefit from such retraining in the form of taxes from eventual employment and reduced Social Security outlays, it seems reasonable for the government to consider financially supporting retraining.

2.5 Assistance in Planning for Retirement

Financial Planning is a well-established industry. At the same time it suffers because of the complexity of the matters with which it deals.

The complexity of tax rules and regulation for retirees have now reached an all time high. Frequently these dominate financial planner activity and advice, contributing materially to its cost, as well as confusing and disempowering the recipients of that advice. There are no easy fixes to this problem. Nothing short of a full review of the taxation and regulation of superannuation, and of retirees more generally, is required to achieve a simpler and more effective regime.

Extensive financial education is provided by many superannuation funds to prospective retirees. However, the quality will vary. In view of the growing importance of dealing with retiree issues, the government could consider establishing a suitable regime for setting standards of education and monitoring them.

3 COVERAGE OF SUBMISSION

The IAAust has a membership which is engaged largely in the many areas of the financial services industry. This includes particularly the financial aspects of planning for retirement. This submission focuses on such aspects.

Our membership does not, however, claim expertise in other aspects of planning for retirement. Accordingly we have not addressed:

(i) "the effects of ageing on workers' productivity";

(ii) "any issues for the Federal or State workplace relations systems"; and

(iii) issues relating to changing lifestyle generally.

In the time available we have not been able to determine the impact on the Government Budget of any proposals.

4 THE CONTINUING REVELANCE OF THE CONCEPT OF A FIXED RETIREMENT AGE

4.1 General Comments

(1) Most state governments have abolished the concept of a compulsory retirement age – i.e. an age at which an employer can force an employee to leave employment regardless of work performance.

(2) Many people have retired well before the Age Pension age of 65 for males and 62 for females.

(3) Many others in the 55-65 age category have effectively retired (some due to redundancy), but for statistical purposes are simply unemployed – many categorised as long term unemployed.

(4) Part time workers over the age of 60 are arguably in semi-retirement.

(5) Access to superannuation is available from age 55 (although planned to increase to 60). This, together with the favourable tax rates applicable to allocated pensions, encourages early retirement.

(6) Redundancy due to corporate restructures and "downsizing" has been widespread and is continuing. Benefits available to those over 55 with long service, assists those who wish to retire early.

4.2 Concept of Retirement

The dictionary definition of "retirement" includes "the withdrawal from office, business or active life".

This probably accords with the general view of those who have not retired; that retirement involves a <u>cessation</u> of work – at least of full time work, or of a particular type of work.

In practice, a change of employment at an older age to less exacting or less strenuous work is common. This can be full time, but is often part time.

The question then arises: When is a person retired?

4.3 Forms of Retirement

From the above, we conclude that "retirement" can include both:

(1) cessation of all work; and

(2) cessation of full time work, but carrying out part time work.

A not uncommon position for older people is: "cessation of full time work, and seeking further work (full or part time)."

Arguably people in this situation are "unemployed". At the same time, if they are only seeking part time work, they could be defined as retired – i.e. consistent with (2) above.

Further, there will be those who have ceased all work and, currently, have no interest in future work. However, at a later date, they change their minds and take up a new job.

4.4 Fixed Retirement Age

Clearly the community has moved to a position where there is no fixed age at which people retire – or must retire.

At the same time, the community does need to consider whether there is an age beyond which there is no obligation to work. At the present time, the existence of a minimum age for eligibility for an Age Pension indicates that such a "cessation of obligation to work" age exists – i.e. currently 65 for males and 62 for females (increasing to 65 over the next 11 years).

This is not however a fixed retirement age.

At the same time, the community appears happy to pay an Age Pension to those eligible from this age. Accordingly, the Age Pension age effectively represents the age beyond which the community considers there is no obligation to work.

4.5 Fixed Age Pension Age

Currently this is age 65 for men and age 62 for women (increasing to age 65 over the next 11 years).

Since the Age Pension is payable from this age, fairness demands that this age should be the same for all individuals reaching it.

At the same time:

(1) consideration could be given to enhancing the Age Pension payable to those who continue to work and become eligible later – having forgone earlier pension payments. (Currently the "pension bonus" system provides a lump sum benefit in such circumstances).

(2) Improvements in levels of health and fitness of older people and increasing longevity generally, may create a desire for the community to increase the Age Pension age – but only for all people reaching that age.[1] While such a change has the potential to be controversial, it need not be so if it is phased in gradually and if the need for the change is explained carefully.

From the point of view of the community generally, a suitable balance must be struck between the proportion of the population working to produce all the goods and services for the whole community, and the proportion of the population who are only consumers and are effectively dependent on the workers. This includes the young, the old and the disabled.

This position applies regardless of whether or not older people have funded their retirement benefits. Investment returns generating those benefits will only arise if the workers produce them. Funding simply provides a more efficient method of distributing wealth to older people. The alternative of having them rely on a government to tax the workers and producers to facilitate diversion of adequate goods and services to such older people, is more subject to the politics of the government of the time, and makes such people "welfare dependent".

As the fitness and health of the older people improves and their longevity increases, their numbers increase and their capacity to use goods and services increases. If the number of workers is not increasing as fast, this unbalances the ratio of dependants to workers.

Improvements in productivity can mitigate this position to some extent, and has done so. However, the community generally will wish to ensure fairness. This includes the general concept of those fit and able properly sharing the load of producing goods and services. This implies an obligation on people who remain fit and healthy as they get older to continue to work and produce, provided reasonable opportunities exist for them to do so, and for the age

[1] This would of course require a change in employment practices to ensure that there are attractive opportunities for older people to obtain jobs and continue working, including the option of working part-time.

when such obligation ceases and the community is prepared to support them, to increase as longevity increases.

4.6 Barriers to Work/Retirement Personal Decision Making

Once it is agreed that there is no age at which a person is obliged to retire, it is necessary to consider what barriers there may be to individuals making a free choice as to whether they work or retire.

In general such barriers should be removed.

In this regard it is noted that there are some areas of age discrimination in the superannuation system.

Contributions to a superannuation fund can only be accepted for a member under the following conditions:

- **Over age 75** – award contributions only. SG contributions, member, voluntary employer and spouse contributions cannot be made after age 70.
- **Age 65 to 70 and working under 10 hours per week** – award or SG contributions only. Member, voluntary employer and spouse contributions cannot be made.
- **Age 65 to 70 and working over 10 hours per week** – award, SG, voluntary member, voluntary employer and spouse contributions can be accepted.

This inability to contribute at the older ages and the lack of the compulsory SG contributions after age 70, distinctly disadvantages some people. People with broken service or those who commenced contributions at a later stage, will be unable to accumulate sufficient benefits in the time allowed. Those people with short working hours are even restricted from age 65 onwards.

In addition, the conditions for payment of benefits after age 65 depend on whether the benefit accrued before or after age 65 and, if it accrued after age 65, whether it is a voluntary benefit or an employer financed benefit.

It is appreciated that some of these rules were introduced to restrict abuses of the tax system. However, we believe that they should be reviewed in the light of the change in community attitudes towards more flexible retirement.

In general, the existence of clear reasonable superannuation benefits limits provides the government with opportunities to restrict tax system abuses without regard for age.

4.7 Early Retirement

In a free society, individuals have choice. The community however wishes to ensure broadly that any choices made are not to the detriment of the overall community.

All things being equal, it is likely that many people, if not most, would wish to retire early. There is nothing wrong with people making such choices. However such decisions should not put a strain on the community.

To encourage behaviours that are right for the community, there should be no community support for early retirement – ie retirement prior to Age Pension age. Early retirees should be self supporting. There should be restrictions on "double dipping" – i.e. exhausting the privately funded retirement benefits and then claiming the Age Pension and associated benefits on reaching Age Pension age. Generous tax treatments available to retirees should apply only to those over Age Pension age.

4.8 Conclusion

Our conclusion is that the concept of a fixed retirement age does not now exist. Any remaining barriers to individuals having a free choice to make their own decisions in this regard should be removed.

There is, however, a concept of a fixed age beyond which the community considers there is no obligation to work.

This is the Age Pension age, currently 65 for males and 62 for females (increasing to age 65 in 2014).

Given the improvements in levels of health and fitness of older people and community attitudes generally, consideration can reasonably be given to increasing this age – for all individuals reaching that age.

Individuals may retire earlier than Age Pension age. However, this should not be at the expense of the community generally. They must be self supporting, be restricted from "double dipping", and not receive any special tax or other benefits until they reach Age Pension age.

5 THE POTENTIAL TO ENCOURAGE PROGRESSIVE TRANSITIONS FROM WORK TO RETIREMENT

5.1 Transition from Full Time to Part Time Work

There seem likely to be sufficient examples of older people wishing to make a transition from full-time to part-time work, to make this a major issue.

Such older people include those who either:

(1) do not wish to (or are unable to) work with the same vigour as when they were younger; or

(2) do not wish to (or are unable effectively to) work as long hours as when they were younger.

The potential for those to make the transition depends upon both opportunities available and financial incentives.

5.2 Opportunities for Part Time Work

While there are plenty of part time jobs, many of these are of a piecework or highly intensive nature, where younger and more active and productive people are favoured.

Sometimes the jobs demand unsocial hours which may be difficult for older people to accommodate.

Even so, it is possible to envisage more opportunities emerging for older people.

Federal and State Governments could seriously revisit their own public service employment practices with a view to (i) improving services; (ii) introducing more part-time work; and (iii) encouraging older applicants to apply for positions.

Larger service industry institutions could probably do the same while still maintaining their "bottom line" – on the basis that happier customers dealt with more efficiently are likely to do more business.

In this regard, it is worth noting that many service industries focus on employment of younger people and offer the prospect of career advancement. Such younger people will therefore be keen to quickly move out of basic or routine roles. Even if they are quicker at such jobs than older people, the high turnover rate impairs overall efficiency. Sometimes also “quickness” increases the error rate or otherwise fails to satisfy customer needs. Older people in such jobs, particularly those with experience in the industry, could make for higher overall efficiency.

5.3 Pension Bonus Scheme

The Pension Bonus Scheme was introduced in 2001 as an incentive for those who wished to work after Age Pension age. In return for deferring the taking of the Age Pension, a bonus is payable. However, the scheme is complex administratively, and requires deferment for five years to achieve reasonable compensation for the deferment. For example a single man who is eligible for the full age pension but defers commencing his age pension until age 67 will only receive approximately $4,200 as a bonus, in return for having foregone more than $22,000 of age pension payments (less than 20% compensation). If he defers for five years, the percentage compensation increases to 46% ($26,200, compared to $55,000 foregone).

5.4 Eliminating Financial Disincentives

These exist in the form of an effective heavy “tax” on earnings for those receiving a part pension.

The combination of tax on the earnings and reduction in the part pension result in earnings in retirement being reduced by some 60% for many people.

Those who lose their part pension, also lose the discounts and other “fringe benefits” which would apply if they were able to continue to hold a Commonwealth Health card.

The impact of such disincentives could be reduced by, for example:

(a) ignoring earnings from personal exertion for means test purposes up to say $300 per fortnight. and

(b) not withdrawing the Commonwealth Health card when a part pension is eliminated as a result of such earnings.

While costing would be needed, it is possible that such an initiative might not be expensive as the number of current workers in this age group drawing an Age Pension is small, and additional tax revenue will be collected from any new workers responding to the incentive.

6 ACCESS TO SUPERANNUATION TO FINANCE RETRAINING

6.1 Superannuation Benefits for Retirement Needs

Primarily, superannuation benefits exist to provide for retirement needs. Tax concessions (largely in the form of deferment of tax) are given, since people who provide for themselves need less government support in retirement.

6.2 Access to Superannuation

For most people retiring in the next 10 years, their superannuation benefits will be inadequate to meet retirement needs – that is, those needs after Age Pension age – 65 for males and 62 for females (increasing to 65 over the next 5 years).

For such people, accessing their superannuation to finance any retraining will potentially cause their benefits available at retirement to be even less adequate.

6.3 Superannuation Fund Loans

It is possible to consider that a superannuation fund could lend money to a member for retraining. This could be considered part of a superannuation fund's wider responsibility to its members.

Significant constraints would, however, need to be considered:

(1) member's likely capacity to repay the loan prior to Age Pension age;

(2) proportion of super fund investments to be utilised for this purpose; and

(3) range and types of work for which retraining loans could be provided.

It is possible that the problems with administrative issues would be considered as outweighing the benefits of such an initiative.

Some government support or financial incentive could possibly assist if this approach was thought worthwhile.

6.4 Retraining – Wider Community Issue

Arguably, ensuring fit and able-bodied people are able to work up to Age Pension age should not depend upon the size of a person's accumulated superannuation benefits, or the availability of loans from the person's superannuation fund.

Education and training have always been considered primarily a community issue. Retraining of older people to continue to participate in the workplace is possibly best developed from this standpoint.

As the government will benefit from such retraining in the form of taxes from eventual employment and reduced Social Security outlays, it seems reasonable for the government to consider financially supporting retraining.

The Government should of course seek views of employers and industry leaders as to where development would be most productive in terms of providing suitable jobs for older people.

7 ASSISTANCE IN PLANNING FOR RETIREMENT

7.1 Financial Planning Industry

The financial planning industry is well established, with a professional association and specialist tertiary education requirements. In addition, government regulation on selling processes provides significant consumer protection through a disciplined advice regime incorporating detailed needs analysis and product features disclosure.

Despite the growth in the industry, the public is largely ignorant of the key issues in planning for retirement – even amongst those who use financial planners.

This is largely due to three factors:

(i) the complexity of investment issues;

(ii) the complexity of Social Security arrangements; and

(iii) the complexity of tax and regulatory issues.

Of these three, the last one - tax and regulation – is the most forbidding, and causes the most confusion and disempowerment amongst consumers. Other than tax, the main element of regulation that affects individuals is the SIS rules regarding how and when benefits may be taken out of the superannuation system or transferred into a pension product (preserved benefits and restricted benefits), and how or when contributions may be made.

7.2 Complexity of Government Regulation

The last factor above - the complexity of tax and regulatory issues - is capable of solution. The taxation of most individuals with superannuation in retirement is significantly different from, and far more complex than, that applying to such individuals prior to retirement. Not only is this complexity unnecessary, but it is introduced to people at a time in their lives when new rules are difficult to absorb.

Social security can also be a problem in that the means testing rules contain anomalies which can lead to some of the disadvantaged missing out on the Age Pension while many of the relatively well-off, through careful financial planning, can collect a full benefit.

Arguably, tax and regulatory issues should not be the major part of financial planning. The focus should be more on analysing expenditure needs in retirement and strategies to provide income to meet them from private sources through saving, investment and superannuation. In addition to confusing and disempowering consumers, the complexity of tax and regulatory issues is also responsible for a large part of the cost of financial planning, whether paid directly through fees or indirectly through commission.

There are no easy fixes to this problem. Nothing short of a full review of the taxation of retirees and of the regulation of their superannuation is required to achieve a simpler and more effective regime. The Social Security system should also be reviewed with the aim of achieving better integration with the superannuation system, thus avoiding the anomalies mentioned above.

7.3 Income Streams

For a range of reasons, prospective retirees focus on their expected lump sum superannuation benefits (other than those in public service and some others whose benefits are automatically paid in the form of pensions).

The lump sums are growing in number and size. In order to provide income in retirement, the lump sums need to be invested, and this calls for an investment strategy. Financial Planners are well equipped to advise on a suitable investment strategy having regard to the retiree’s propensity to accept risk. However, many retirees do not really want to know about investments. The jargon and issues are largely foreign to them. In many cases, retirees choose investment strategies that are quite inappropriate for their needs, leading to adverse outcomes.

For such people, a more ideal strategy would be for them to receive a steady income that increases in line with the cost of living.

In this context, IAAust believes increased encouragement for superannuation benefits to be paid as income streams rather than lump sums would be desirable. 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.

7.4 Financial Education

Currently employees receive a wealth of information from their superannuation funds regarding retirement benefits and options. For those close to retirement many funds run special education sessions. These often include at least some basic financial planning advice.

The levels and quality of such education vary and it is possible that the Government should look closely at the standards achieved and consider establishing a suitable regime for setting standards and monitoring them.

8 CONTACT

The IAAust looks forward to continuing its active contribution to the development of a financially sustainable and equitable retirement incomes system for Australia.

Please contact Andrew Kirk, Manager Policy and Research should you require further information. Tel (02)9233 3466 e-mail andrew.kirk@actuaries.asn.au

APPENDIX – THE INSTITUTE OF ACTUARIES OF AUSTRALIA

The Institute of Actuaries of Australia represents over 1,200 Fellows and 1,400 other members. The profession specialises in applying mathematical, statistical, economic and financial analysis, to longer-term financial contracts, in a wide range of practical business situations particularly those involving risk assessment.

As a profession, actuaries have a capacity and an obligation to contribute to public policy in their areas of practice and expertise. Many actuaries work in superannuation, financial planning, health insurance and related financial services areas.

The IAAust is therefore well positioned to make a valuable contribution in assisting the Government to develop appropriate policies in relation to planning for retirement.

The IAAust looks forward to continuing its active contribution to the development of sustainable and equitable financial systems for Australia.