A comprehensive retirement income system

Earlier I submitted a proposal requiring a seniors income levy (SIL) exclusive of superannuation.
In this document I focus on the superannuation system as it stands and should become. The questions posed have been italicized.

The retirement income system

Q1.1 In considering the future of Australia's retirement income system, which objectives are relevant in setting retirement income policy? Does the current system of the Age Pension and compulsory and voluntary savings meet these objectives? If not, how should the system be changed to meet these objectives?
The government has given substantial concessions to encourage people to invest more for their retirement which is what they should be doing anyway. The basis of those concessions should be that funds are deployed also in the national interest in order to warrant the concession.
For that reason future contributions should be directed to those investment categories the government believes will be in the national interest, including the need to provide sufficient retirement income for contributors. That is justifiable by virtue of the public services and infrastructure that government needs to provide to support retirees in any case.
Until such time as superannuation fully covers all retirees over their working life, in about 37 years, it is necessary to have a means tested seniors’ pension. A second reason for maintaining this is that there are many homemakers and carers who are outside the superannuation guarantee system.
Briefly, in the other submission I have proposed a levy rising to 6.5% over six years which is adequate to fund means tested retirement pensions at $18200 per annum without additional government budget outlays in real terms.

A broad and adequate retirement income system

Q2.1 *As the SG system matures, it will become a greater part of an employee's retirement income. What are the implications for individuals partially or fully excluded from the mature SG system (the self-employed, individuals with broken work patterns such as carers, women and migrants), and how can the retirement income system best accommodate these groups?*

Please see my other submission. In addition, SG contributions should normally be split across partners.

Q2.2 Noting that the adequacy of the Age Pension is being considered by the Pension Review, what is an appropriate concept of adequacy for the retirement income system? Should it be to ensure there is a minimum level of income in retirement, to replace a proportion of income earned prior to retirement, or some other alternative?

The proposed Seniors Income Levy should have its means test reduced gradually, then dropped. This should cover most cases in conjunction with splitting of contributions, with other cases being catered for by government additional special allowances, such as for long time carers without a partner.

Q2.3 What should the role of the government be in assisting individuals to meet their retirement income expectations in relation to the support provided by the Age Pension, the level of compulsory savings and incentives to make additional savings? Should the role of government change as an individual's income increases over their working life?

The combination of maintaining the present real outlay for pensions, the SIL, the SG and special case pension top-ups should be adequate.

An acceptable retirement income system

Q3.1 Do the settings of the retirement income system, such as the level of SG and access to concessions, adequately consider the needs and preferences of individuals both before and after retirement?

It is too easy to double-dip. The before age 65 salary and superannuation pension retirement provisions are a tax rort and should be dropped.

Q3.2 Is the current level of superannuation income tax concessions appropriate and sustainable into the future? Are the current concessions properly targeted, and if not, how should they be reformed?

Contributions in excess of 9% should not be allowed at a concessional rate. Pension payments from superannuation which exceed AWOTE, or some weighting of AWOTE should be considered as ordinary income.

A robust retirement income system

Q4.1 At what age should an individual be able to access their superannuation and at what age should they become eligible for the Age Pension?

60, 65 with allowance for those with no or little work history in the previous 12 months to access pension earlier, but for the pension to be reduced or suspended if work is resumed.

Q4.2 What is the role of individuals in dealing with investment and longevity risk in accumulating and drawing down their retirement income? Do financial markets provide the means to deal with these risks? If not, is there a role for government to address these shortcomings?

Please see Q5.1 answer first. It is quite clear that the hubris of financial market gurus has not been matched with performance. The failure to cater for high impact low probability risk has been made evident in recent times. The ability to make wise decisions about sophisticated options and futures trading provides an avenue to reduce risk, but the world wide fiasco with securitization and credit default swaps shows that even sophisticated investors can get things wrong in a big way. What’s worse is that many institutions have bundled up these instruments and sold them on to retail buyers or smaller fund managers. Particular funds that have done poorly are “parked”, and a new fund is created and advertised to have all the “what’s happening now” desirable features. The superannuation industry spends a good deal of its time catering for recent history.

The point of SG is to provide income for retirement with a high probability of a reasonable outcome. The choices that are to be offered need to be reduced to twenty or so of each of Australian and International, share, hybrids, and deposit options. That’s still a lot. Individuals can choose from among that selection. Who gets what share should be based on an auction of the cost per dollar of funds allocated, and some reward for five year averaged returns. Not all funds should flow to the lowest bid, but more than the proportional bid price is below others.

The government should restrict the forms that SG investments can take to listed shares and property, un-leveraged, where those shares may be in companies which invest in un-leveraged unlisted companies or property. Further contribution to a fund tied to an employer should be disallowed. A related business entity should not in future be allowed as a form of superannuation provision. SMSF trusts may be given some discretion providing that their investments are aligned with the template categories suggested, or are in listed shares, and are un-leveraged.

Ideally, the industry should be reorganized so that costs are spread and the role of financial planners is directed more towards a good long term outcome for their clients across investment categories rather than a wealth fund manager’s products. One way to achieve this would be to declare taking fees from fund managers tied to products to be illegal, and to establish two consortiums and invite fund managers to participate in each on the basis of half their client portfolios, and to take on financial planners as equity holding and commissioned investment analysts in return for assignment of half their client portfolio. Thus the link between individual fund or wealth manager’s product offerings and financial planner’s choice horizon would be broken. Over time, and depending on fund manager and individual performance and preferences, the two consortia would go their own way with buying and selling of shares in one or the other, in principle distinct from the share of a client’s portfolio with either consortium.

The two consortia are not proposed to be exclusive of individual fund managers bidding for a share of SG business in the suggested auction process. Financial planners are not obliged to enter the consortia, and may directly manage their clients portfolios subject to the same restrictions set out above for fund managers.

The government should fund the development of expert systems to identify the best asset classes to invest in on a periodic review basis, accessible in one form for financial planners and in a simpler form by individuals. The specification should be developed by a panel of financial planners, on a bid basis by fund managers and others who already have a working system. This will help reduce confusion and complexity.

A simple and approachable retirement income system

Q5.1 In what ways does the retirement income system impose undue complexity and cost on retirees and workers? How could this complexity be reduced?

Choice is valuable when the chooser has the knowledge to make a wise choice, and the information provided or available is adequate for the choice. Accurate information about the future is in short supply. Misleading or misguided information is plentiful.

Restricting choice to fewer but more comprehensible options is a good thing but will probably be a political football. Do it anyway.

The cost of preparing a financial plan partly reflects the complexity of legislation. Financial Planners should not receive fees for product selection. They should however be able to receive fees from fund managers for contributing to investment decisions about what the fund manager will invest in. There are too few financial analysts poring over companies' reports and other investment options, and too much time spent making selections about the mix of those inadequately analysed alternatives. Financial planners need to move into investment analysis.

The reduced mix of permitted investment categories mentioned in answer to Q4.2 will help to reduce complexity for individuals and financial planners alike. Moving the role of financial planners more into investment decisions in large fund should reduce overhead costs and improve underlying investment decisions.

In summary, a key objective for SG should be to reduce complexity by extracting risk at reduced potential but still adequate gain.

A sustainable retirement income system

Q6.1 The Age Pension serves two roles, as a safety-net for individuals who are unable to sufficiently save for their retirement and as an income supplement for many individuals who do save. What should be the role for the Age Pension and means testing in a future retirement income system and what impact does this have on its sustainability into the future?

As set out in the companion SIL submission, a means tested pension based on a levy will enable an increased aged pension to be paid even while meeting the requirements of the "generation gap". The means testing rules are simply understood to be indexed, although the zero rate of tax on SG pensions may require some tightening of the means test in respect of SG pensions. Under the SIL proposal, and as can be seen in the spreadsheet attached to that proposal, the levy is adequate through to year 20 although the amount left to add to funds is falling. Because of the generation gap, the levy residual that can be devoted to increasing funds falls just marginally below zero in years 32 to 38, but then rises. At that time, year 32, the SIL fund will have reached a staggering $1100b dollars and might be better considered to be a sovereign wealth fund. It certainly should be managed as such.

One defect of the current system is that there are diverse fund types, notably state and federal public service funds and defined benefit funds. Actuaries should be employed to determine an equitable basis for bringing these funds to a common base as accumulation schemes. Special cases such as judges can be dealt with by an allowed "signing on" contribution, and a retainer in retirement.

Q6.2 In what ways does retirement income policy affect workforce participation decisions and what, if any, changes might reduce disincentives to work? Does the sustainability and cost of the retirement income system affect the workforce decisions of younger generations of workers?

The point about the SIL proposal is that it will be adequate for all citizens over the long haul. The pressure to keep working requires access before 60 or 65 to require special circumstances. Disincentives to work are more related to effective marginal tax rates between work and welfare between 15 and 65.

Q6.3 What impact could financial intermediation have on the effectiveness of retirement income policy?

If you mean reducing choice in order to ensure a higher probability of an adequate retirement income, it is a good thing. If you mean, should money be directed to say Australian government bonds during difficult times, then if the reason is to keep the economy going, save jobs, maintain government revenue, then it is fine for those not already in retirement or very close to it. For the latter category any reduction in risk would not be a bad thing. The impact is more likely to be political than actually adverse in real dollar outcomes.

Submitted by

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