SMSF ASSOCIATION

Retirement Income Review

Key areas of interest for the SMSF sector

We are here to improve the quality of advisors, the knowledge of trustees and the credibility and health of a vibrant SMSF community.

Retirement Income Review – Key areas of interest for the SMSF sector

The Government has now released their much-awaited Retirement Income Review Report.

The Report provides a fact base of the current retirement income system in the context of an ageing society. Its objective is to improve understanding of the system's operations and the outcomes it is delivering for Australians.

The Panel found evidence that indicates the Australian retirement income system is **effective, sound and broadly sustainable.**

However, it is clear that the retirement income system is complex and there is a need to improve understanding of the system.

It is important to note the Review did not make any recommendations or propose any changes to policy settings. We expect any policy changes that may be implemented off the back of this review will only occur after appropriate stakeholder consultation and discussion. Therefore, at this time, there is no need for you to be overly concerned about any particular aspect of this review.

Positively, SMSFs as a significant portion of the retirement income system, were not identified as causing any specific issues.

The following is a summary of key areas of interest for the SMSF sector:

1. *Objective*
2. *Complexity*
3. *Bequests/spending*
4. *Taxation (including large funds)*
5. *Taper rates*
6. *Simplified means test*
7. *Advice*
8. *Retirement Income Covenant*
9. *SG design*

1. An objective for the retirement income system

RIR comment:	**SMSF Association submitted:**
A clear objective for the system, agreed by the Australian community through the Government, is needed to guide policy, improve understanding and provide a framework for assessing performance of the system. The RIR suggested objective is: – *'to deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way.'*	The SMSF Association believes the first step in improving the understanding of superannuation is to introduce an objective which determines its purpose. The fact that Australia's retirement income system does not have a legislated objective of superannuation is partly responsible for the lack of holistic policymaking for the retirement income system and some of the systemic issues uncovered by various commissions and reviews.

2. Complexity

RIR comment:	SMSF Association submitted:
The retirement income system is complex. There is a need to improve understanding of the system. Complexity, misconceptions and low financial literacy have resulted in people not adequately planning for their retirement or making the most of their assets when in retirement. Adding to complexity is the interaction with other systems, such as the aged care and the tax systems. People need better information, guidance and good, affordable advice tailored to their needs.	Superannuation is significantly complex. There is a myriad of rules which require a strong understanding of legislation. This means the majority of Australians do not have a good understanding of the rules which govern their superannuation. This is an Association priority.

3. Bequests/spending

RIR comment:	SMSF Association submitted:
Inheritances are significant, representing the transfer of wealth from one generation to another. They are not distributed equally and increase inequity within the generation that receives the bequests. Most people die with the majority of wealth they had when they retired. If this does not change, as the superannuation system matures, superannuation balances will be larger when people die, as will inheritances. Superannuation is intended to fund living standards of retirees, not to accumulate wealth to pass to future generations. Retirees are generally reluctant to draw down their savings in retirement due to complexity, little guidance, reluctance to consume funds that are called 'nest eggs', concerns about possible future health and aged care costs, and concerns about outliving savings. Currently adding to concerns is uncertainty around the impact of the COVID-19 Pandemic.	We believe that capital retention bias and increased estate savings in superannuation is more related to the lack of understanding and lack of products addressing longevity risks rather than a majority of individuals using the tax advantages of the retirement income system for excessive wealth accumulation. There is also a bias towards only spending earnings and not capital and sometimes a desire to leave bequests for children. We believe that a product-neutral approach that encourages retirement income streams through the right policy settings should result in optimal outcomes for retirees.

4. Taxation (focussing on large funds)

RIR comment:	**SMSF Association submitted:**
While the Age Pension helps offset inequities in retirement outcomes, the design of superannuation tax concessions increases inequality in the system. Tax concessions provide greater benefit to people on higher incomes. At June 2018, there were more than 11,000 people with a balance in excess of $5 million. These people receive very large tax concessions on their earnings. A superannuation balance of $5 million can achieve annual earnings tax concessions of around $70,000. Provision of tax concessions for very large superannuation balances are not required for retirement income purposes, as they are unlikely to encourage additional savings (see 5A. Cohesion). It appears that large balances are held in the superannuation system mainly as a tax minimisation strategy, separate to any retirement income goals. Extending earnings tax to the retirement phase could also simplify the system by enabling people to have a single superannuation account for life and would improve the sustainability of the system.	Individuals with extremely large superannuation balances may be considered to benefit too much from the retirement income system. The SMSF Association believes it is worth examining extremely large superannuation balances in the review of the retirement income system. However, it is also important to recognise that extremely large superannuation balances are a legacy issue. In addition, the TBC means that trustees are no longer able to keep entire balances in the retirement phase (where minimum drawdown rates apply) and this may extend the period in which extremely large superannuation balances stay in the system.

5. Taper rates

RIR comment:	**SMSF Association submitted:**
The current assets test taper rate has several strengths. It creates an incentive for retirees to use the assets they have saved for retirement, and helps ensure Age Pension payments go to those in need. Limiting eligibility contains the fiscal cost of the Age Pension. A number of stakeholders argued the current system could distort incentives to make additional superannuation savings for retirement and, under certain assumptions, lead to lower total income for retirees with higher balances (see 5A. Cohesion). Many stakeholders pointed to high effective marginal tax rates due to the	We believe that the change to the means test taper rate and thresholds may have had significantly adverse consequences. While we support appropriately targeted mean testing to ensure the sustainability of the Age Pension, we are concerned that this measure is not appropriately integrated with the broader retirement income system (i.e. superannuation and taxation settings) and discourages middle income earners from saving for a self-sufficient retirement.

taper rate exceeding the expected return on savings. The review canvassed the impact of reducing the taper rate from $3 per $1,000 to $2.25. Such a change would: • Benefit retirees in the top half of the wealth distribution in the near term • In future, as the superannuation system matures, boost the replacement rates for middle-income earners, although their replacement rates already exceed the 65-75 per cent benchmark • Provide a reward for additional saving, although it would lessen the incentive to draw down savings in retirement • Have a fiscal cost in 2019-20 of $1 billion, which would grow to 0.20 per cent of GDP in the long term	

6. Simplified means test

RIR comment:	**SMSF Association submitted:**
The merged means test would alter the taper rate on assets. The effective marginal taper rate on assets over the free area would be lower than the current effective marginal assets taper rate of 7.8 per cent for men before age 82 and for women before age 84 (Chart 6B-2). This would reduce the effective marginal tax rate and increase the incentive to save for retirement. The merged means test's taper rate may encourage greater asset drawdowns in the later years of retirement by: • Nudging people to recognise the decreasing amount of time they have to consume their remaining savings • Affecting Age Pension payments such that people respond to this incentive A merged means test could simplify some aspects of the current dual means test. But, as the deemed capital consumption varies with age, many retirees would likely continue to find the means test complex. Another issue contributing to the complexity of the system is that there would also continue to be significant differences between this merged means test	The two means tests are confusing and complicated. They also make planning much more difficult for retirees. We believe that a more appropriate and simpler mechanism to integrate superannuation and Age Pension means testing is to shift to a single means test that applies a deeming rate to financial and non-financial assets, removing the assets test.

example and the means test for aged care. Moving to a new merged means test would significantly alter arrangements for some current retirees. The impacts could be very substantial for some retirees (Chart 6B-5). It may be unfair to reduce Age Pension payments for people who did not have the opportunity to plan for such a change. As such, transitional arrangements would likely be required. Transitional arrangements would add complexity and likely come at a fiscal cost.	

7. Advice

RIR comment:	**SMSF Association submitted:**
The evidence suggests that most people do not seek advice about retirement income planning. Barriers against seeking advice include cost, small finances and lack of trust. People need advice and assistance to make better informed decisions. But the advice has to be sound. Assessments by regulators and the Hayne Royal Commission, identified weaknesses and misconduct in financial advice. Reforms are underway to remove conflicts of interest for those giving advice and to improve their education. Superannuation funds are uniquely placed to provide advice and guidance because members have to contact their fund to commence a retirement income product. But funds can have a conflict of interest between the interest of members and maximising funds under management. Funds are also restricted in what they can consider when providing intra-fund advice. Changes would need to be made to the regulatory framework to facilitate funds providing more guidance at retirement.	The quality of financial advice provided to Australians, particular SMSF members, is crucial to the integrity and performance of the sector. The SMSFA recognises that there are impediments in the current regulatory advice model which prevent SMSF trustees and older Australians from obtaining basic SMSF and superannuation advice they require. The issue to be resolved concerns how basic superannuation services fit into the entire financial sector regulatory framework for both accountants and financial planners.

8. Retirement Income Covenant

RIR comment:	SMSF Association submitted:
Using superannuation assets more efficiently and accessing equity in the home can significantly boost retirement incomes without the need for additional contributions. A range of measures could help people have the confidence to use their assets more effectively, including focusing retirement planning on income streams rather than balances, better quality and more accessible advice and guidance, and advancing the concept of the Retirement Income Covenant so funds guide members into effective retirement strategies. The retirement phase is more complex than the pre-retirement phase, but little guidance is available to help people choose their retirement income products. To address this, stakeholders suggested: • Advancing the Comprehensive Income Products for Retirement concept and making available regulated, simple and safe retirement products • Developing the proposed Retirement Income Covenant under which superannuation trustees would be required to develop a retirement income strategy, and provide guidance to help retirees choose a retirement income product.	The SMSF Association is also supportive of recent policy intent to create a Retirement Income Covenant. We are supportive of the development of CIPRs as we believe over the medium to longer-term, SMSFs may be able to benefit from a deeper retirement income product market as retail investors. Focussing on retirement incomes will also ensure Australians have more choice and flexibility about how they want to structure their retirement income. If members are required to consider their retirement income needs and preferences it will help shift behaviours positively to address longevity risk and other financial risks in retirement.

9. SG design

RIR comment:	SMSF Association submitted:
The self-employed are not required to contribute to a superannuation fund on their own behalf. There are approximately 2.2 million self-employed people. Requiring self-employed people to make SG payments on their behalf would boost their superannuation balances and diversify their retirement savings. But it would reduce their ability to invest in their businesses. It would also be difficult to determine the equivalent contribution base for the self-employed.	An issue with compulsory superannuation is that it only covers individuals with gainful employment. Many self-employed individuals and others who fall outside the current mandatory coverage of Superannuation Guarantee do not engage with superannuation.

Self-employed people generally have lower superannuation balances than employees. But many have other assets, such as business assets, which result in them having similar wealth profiles as employees when approaching retirement. Small business owners also benefit from a number of capital gains tax concessions. A rate of compulsory superannuation that would result in people having an increase in their living standards in retirement may involve an unacceptable reduction in living standards prior to retirement, particularly for lower-income earners. This is based on the view, supported by the weight of evidence that increases in the SG rate result in lower wages growth, and would affect living standards in working life.	

Other area of interest: The family home

The home is the most important component of voluntary savings and is an important factor influencing retirement outcomes and how people feel about retirement. Home owners have lower housing costs and an asset that can be drawn on in retirement. If the decline in home ownership among younger people is sustained into retirement, there will be an increasing number of retirees who rent. The system favours home owners, such as through the exemption of the principal residence from the Age Pension assets test.

Additional Resources

Click here to read the Retirement Income Review overview.

Click here to read the full Retirement Income Review Report.

Click here to read the SMSF Association's Retirement Income Review submission.