

Super Policy Forum

Age Pension & Retirement Incomes

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Age Pension & Retirement Incomes

- Where do we want to be
- Where are we now
- Solutions
 - Policy options
 - Capital market options





Australian population 2050

- Population 28m
 - Median age is 45
 - 50% over age 45
 - 26% over age 65
 - -6% over age 85

- In 1908
 - Median age was 25
 - age 25
 - age 40
 - age 65



Companies in 2050

- Post war ageism has vanished
- For past 50 years

| | 15-24s | Over 45s |
|---------------------|--------|----------|
| Growth in workforce | 10% | 70% |

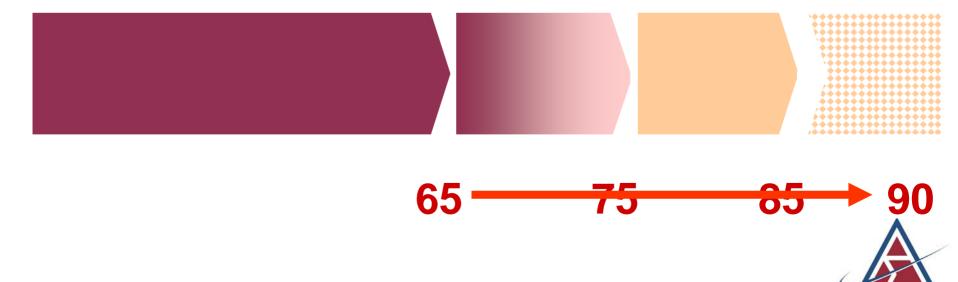
 Company focus is on attracting and retaining over 45s & females



Individual attitudes 2050

• At 65

- We expect to be around 25 years
- Plan to keep working at least another 10 years
- Move onto Age Pension around 75
- Savings + AP = "adequate" retirement income
- House will fund Aged Care entry around 85



Australia's finances in 2050

- Workforce participation
 2007 participation rates
 - 90% for 25-64 year olds
 - 66% for 65-74 year olds 66% for 55-64
- Manageable health costs
- Manageable Age Pension costs

- rates (males)
 - 90% for 25-54



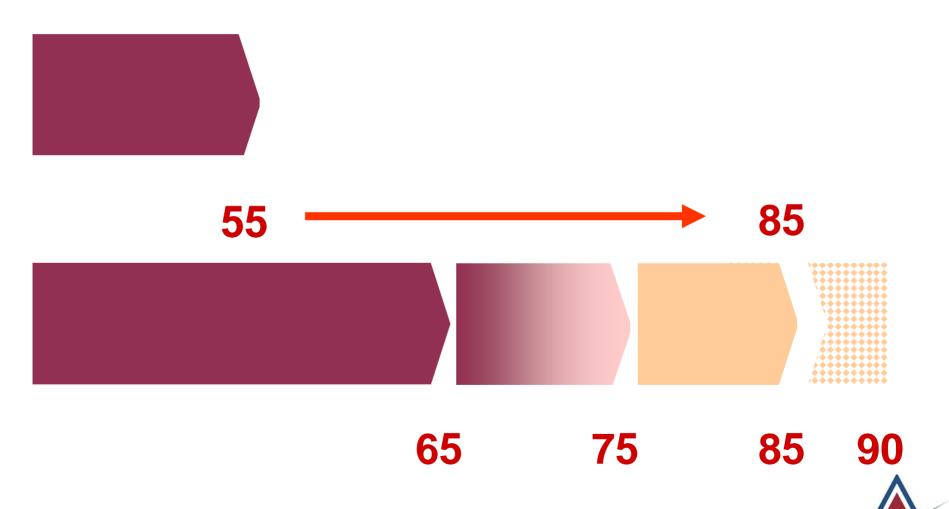
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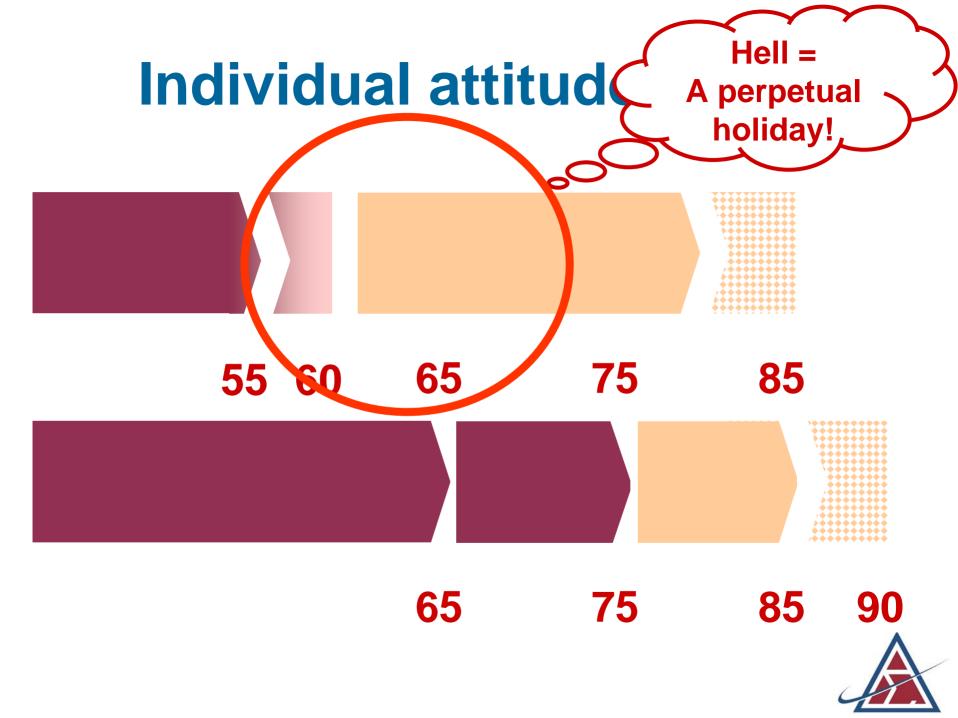




Individual attitudes 2008







What does it take to live in retirement





\$26,000 p.a. couple \$18,000 p.a. single





\$48,000 p.a. couple \$36,000 p.a. single

*Westpac ASFA Retirement Standard research report 2007



The reality in 2008

- Super savings for recent retirees
 - \$136,000 males
 - \$63,000 females
- Percentage with super > \$100,000
 - -8% of males
 - -4% of females
- 80% over 65 rely on the Age Pension
 - 55% rely on full Age Pension

The reality of living post retirement?

Modestly





Age pension



\$24,000 p.a. couple \$14,000 p.a. single

*Westpac ASFA Retirement Standard research report 2007



Reality in 2008

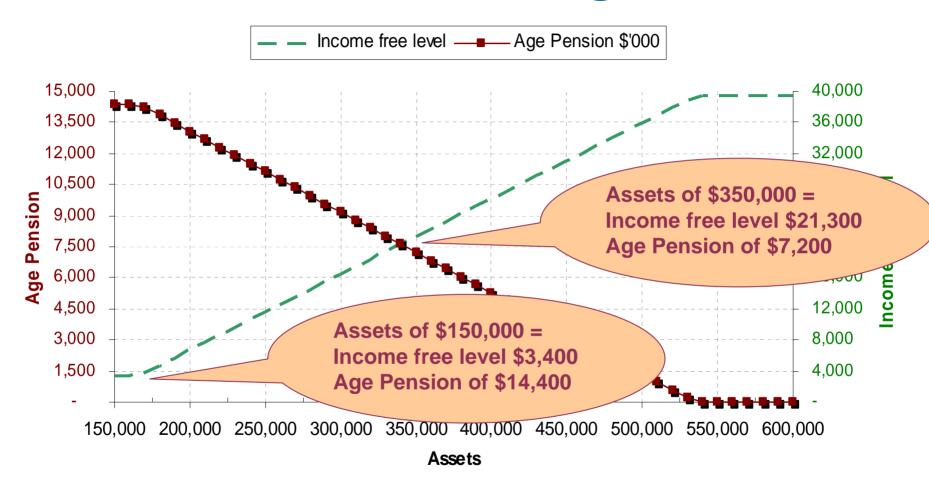


No reason to work beyond age 65

- Age Pension is means tested
 - Asset test and Income test
- Means testing often results in abuse, disincentives and costly administratively
 - Work beyond 65 is not viable
 - Complicated by tax offsets & AP reductions
- Means testing can better target resources
 - Single Age Pension is too low



Income free level for Age Pension

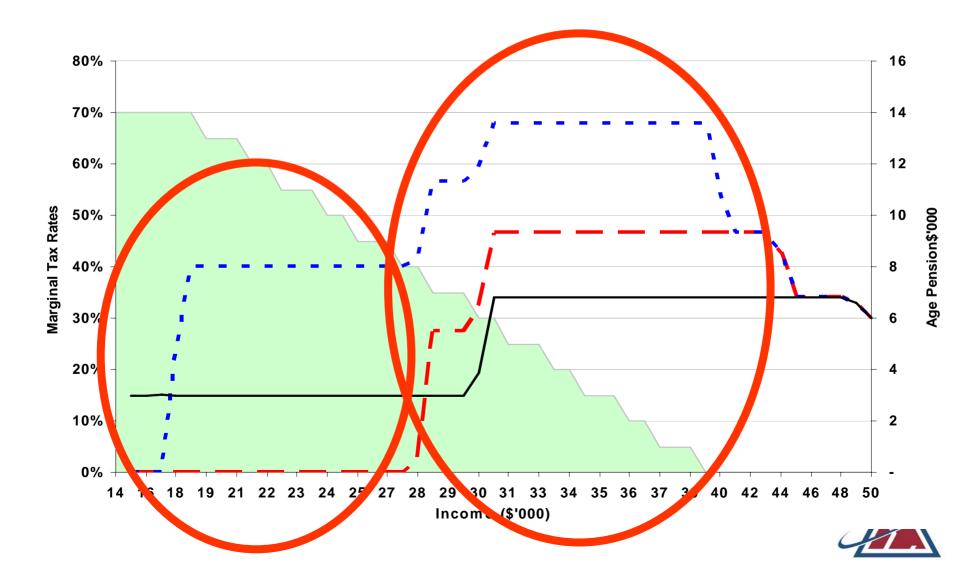


Earned Income over "Income free level" reduces AP by 40c



Marginal tax rates on Earned Income

Person under Pension Age, Self-funded retiree Age Pensioner single (homeowner)



Single Age Pension

| Income p.a. | Modest | Comfortable | Age Pension (inc Pharm) | Age Pension as %age of 'Modest' |
|-------------|--------|-------------|-------------------------|--|
| Single | 18,920 | 36,607 | 14,368 | 76% |
| Couple | 26,531 | 48,962 | 23,904 | 90% |

- Expenditure for single is 70%-75% of couple
- Age pension for single is 60% of couple
- Increase single AP from 25% to 30% MTAWE
 - Represent 72%-75% of couple Age Pension
- Growing pressure on the Single Age Pension

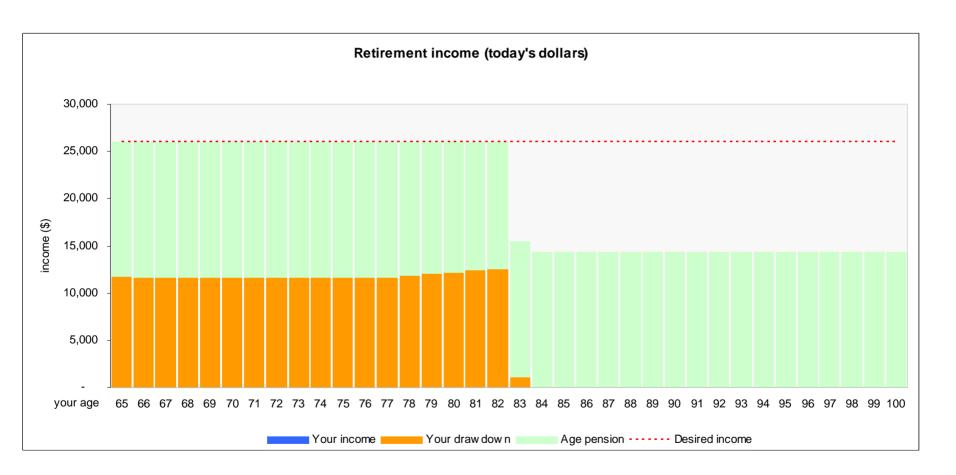


Future looks the same

- Age pension will remain primary pillar for over 65s
 - 75% on all/part Age Pension in 2050
 - Full Age Pension reduces from 55% to 35%
 - 25% self funded retirees
- Median to average income groups
 - SG account balance \$200,000 \$300,000
 - Age Pension half their retirement income



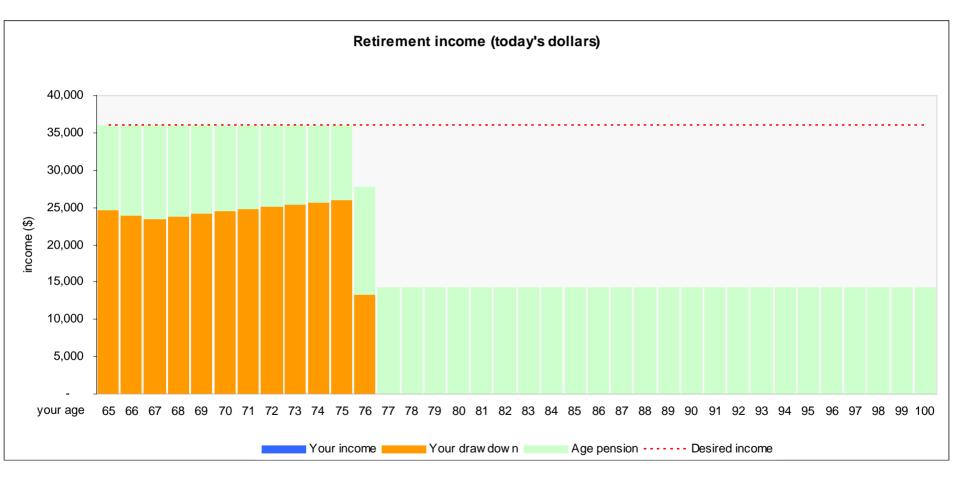
Example: Median income (75% AWOTE), 9% SG 40 years



Annual income \$26,000 in retirement (65% pre ret income)

ASIC retirement calculator

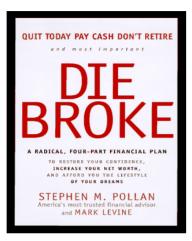
Example: Average income (100% AWOTE), 9% SG 40 years



Annual income \$38,000 in retirement (comfortable, 62% pre ret_inc)

ASIC retirement calculator

Our retirees face significant risks



"The last cheque you write should be to your undertaker... and it should bounce." Stephen M. Pollan

- System based on individual accumulations plus Age Pension
- Leave retirees with following risks
 - Save too little
 - Retire too soon
 - Spend too much too soon in retirement
 - Live too long
 - Investment and inflation risks
 - Lumpy cash flow needs eg aged care
 - Credit/provider risks on long term products
 - Home equity release risks
- Risks for Government as well



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Solutions

- Strong financial incentives to carry on working
- Sound financial product
- Eliminate subsidised pathways to early retirement
- Encourage Employers
- Encourage older employees
- Change attitudes



Policy options

- Increase Age Pension age
 - Compulsory option with pros and cons
- Introduce Deferred Age Pension
 - Voluntary option
- Remove income test for Age Pension
- Increase single Age Pension



Deferred Age Pension

- Age Pension annual entitlement
 - determined by Means Test
- Can elect to defer your Age Pension
- Deferred Age Pension increases 5%-8% pa
- Example
 - \$14,400 pa at age 65
 - \$20,000 pa at age 70
 - \$28,000 pa at age 75
- No limit on deferral period
- Replaces Pension bonus scheme
 - Lump Sum option up to Pension Bonus
- All other Age Pension entitlements remain



Deferred Age Pension

Benefits

- Removes financial penalty for working beyond 65
- Cost neutral to Government
- Enables people to plan & better manage longevity
- Encourages use of "own resources" first
- Enables Age Pension to be integrated with work
- Voluntary approach to increasing Pension Age
- Take up rates likely to depend on
 - Increase in pension versus risk of early death
- Not "the solution" but removes "the penalty"

Remove Income Test

- Age Pension annual entitlement
 - determined by Asset Test
- Individual chooses to "take" or "defer" Age Pension
- "Take" the Age Pension
 - No means testing of Income
 - Tax rates the same as others under age 65
 - No mature age based tax offsets
 - Tax rates apply to all income plus Age Pension
- "Defer" the Age Pension
 - No means testing of Income
 - Tax rates include mature age based tax offset
- Need simplified mature age tax offset
 - for self funded retirees and pensioners in deferral



Example: Pensioner earning \$3,500 Super assets < \$100,000, AP = \$14,438

| | Current rules \$'000 | Current rules +\$10k \$'000 | New rules \$'000 | New rules +\$10k \$'000 |
|--------------------------|-------------------------|-----------------------------------|---------------------|-------------------------------|
| Income | 3.5 | 3.5 | | 3.5 |
| Additional earned income | 0.0 | 10.0 | | 10.0 |
| Age Pension Asset test | 14.4 | 14.4 | 14.4 | 14.4 |
| Total income | 17.9 | 27.9 | 17.9 | 27.9 |
| Age Pension reduction IT | | (4.0) | | |
| Tax less LITO offset | (1.0) | (1.9) | (1.0) | (2.5) |
| SATO + MATO offset | 1.0 | 1.9 | | |
| Net income | 17.9 | 23.9 | 16.9 | 25.4 |
| MTR on Earned Income | | 40% | | 15% |
| Government costs: | | | | |
| Age Pension paid | 14.4 | 10.4 | 14.4 | 14.4 |
| Tax recouped | | | (1.0) | (2.5) |
| Net cost to Government | 14 | 10 | 13 | 12 |

Example: Pensioner earning \$25,000 Super assets < \$350,000, AP = \$7,221

| | Current rules \$'000 | Current rules +\$10k \$'000 | New rules \$'000 | New rules +\$10k \$'000 | Deferred +\$10k \$'000 |
|--------------------------|-------------------------|-----------------------------------|---------------------|-------------------------------|------------------------------|
| Income | 25.0 | 25.0 | 25.0 | 25.0 | \$'000 |
| Additional earned income | | 10.0 | | 10.0 | 10.0 |
| Age Pension Asset test | 7.2 | 7.2 | 7.2 | 7.2 | |
| Total income | 32.2 | 42.2 | 32.2 | 42.2 | 35.0 |
| Age Pension reduction IT | (1.5) | (5.5) | | | |
| Tax less LITO offset | (3.1) | (5.1) | (3.6) | (7.0) | (4.5) |
| SATO + MATO offset | 2.1 | 1.4 | | | 1.6 |
| Net income | 29.8 | 33.0 | 28.6 | 35.2 | 32.0 |
| MTR on Earned Income | | 68% | | 34% | 30% |
| Government costs: | | | | | |
| Age Pension paid | 5.7 | 1.7 | 7.2 | 7.2 | 0.0 |
| Tax recouped | (1.0) | (3.8) | (3.6) | (7.0) | (3.0) |
| Net cost to Government | 4.8 | (2.0) | 3.6 | (0.2) | (3.0) |
| Age Pension deferred | | | | | 7.2 |

Remove Income test

Benefits

- Government financially better off if people work
- Means testing regime simpler, cheaper and less intrusive
- Makes sense to give "mature age" tax benefit only to self-funded retirees and AP deferrals

Issues

- Some Age Pensioners initially worse off
- Some limits may be required
- Pressure on Assets test as sole test



Capital market options

- Product is very limited
 - No market in lifetime annuities since Sept 2007
 - Fixed term annuities leaves longevity risk with retiree
 - Investment guaranteed products cost of guarantee??
 - Pooled lifetime annuity products marketability & credit risks?
- Size of market in Australia is small
 - No ability to transfer/ hedge longevity & inflation risks
- Reverse mortgages small but growing, concerns:
 - Regulation, disclosure, complexity and not integrated with AP
- Account based pensions are it for now!!
 - Longevity, inflation and investment risks with retiree
 - Outcome being over or under spending in retirement



Government role

- Product provide or facilitator
- Product provider
 - Longevity risk insurer or pooling facilitator
 - Issue capital instruments
 - Allow purchase of Age Pension
- Problems with this option
 - Government not in this "business"
 - Crowds out private market
 - Government takes on even more longevity risk
- Facilitator
 - Government can and should ensure regulatory environment is conducive to good product development



How do we move forward

- Savings need to increase
- Work needs to continue beyond age 61
 - Employer attitudes to change
 - Individual attitudes to change
- Age pension needs to drive positive behaviours
 - Integrated with work and savings
- Financial products are needed
 - Enable people to manage their post age 65 risks
 - Integrated with phasing up and down of work
 - Integrated with Age Pension
 - Lump sum needs inconsistent with over-annuitising wealth
 - Simple to understand and secure long term products



IAA Retirement Incomes Taskforce

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