Retirement Incomes Taskforce

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Global trends in pension reform

1994 World Bank model of three pillars

- Was considered to be a solution to the problem of increasing public debt in developed countries

Resulted in

- Move to funded individual DC from DB
- Move away from risk pooling and redistribution
- Move to individual accumulation at time of increasing longevity and lower real returns
- Highly variable replacement rates

Global trends in pension reform

Now accepted that the 1994 model does not achieve adequate social security protection

Learnings

- Individual ownership of accounts does not encourage people to contribute
- Reforms have not generated increased labour force coverage
- Private sector administration and competition has not resulted in low costs
- There is no single pension reform model that works for all countries

2005 World bank model

Revised reform model

- No single preferred structure, focus on objectives and criteria instead
  - Limited value arguing on universal vs. non-universal pensions, DB vs. DC
- Encourage diversification of approaches, systems and resources
  - Move from three to five pillars and from Pillars 1 and 2 to a range of options
- Reform has to take account of existing country environment
- Need to cater to three groups in society
  - Lifetime poor
  - Informal sector workers who will become poor once they stop working
  - Formal sector workers
- Keep formal, earnings related system small, simple and universal
- Pay attention to process in addition to design
  - Avoid conflicts of interest and high administration costs

World bank models compared

Pillar	1994 three pillars	2005 five pillars	Australian system
0		Non-contributory, publicly-funded, minimum protection for lifetime poor	
1	Mandated, unfunded, publicly-managed DB	Mandated, unfunded, publicly-managed DB or NDC with longevity insurance	Non-contributory, publicly-funded, means tested Age Pension
2	Mandated, funded, privately-managed DC	Mandated, funded, privately-managed DC or DB	Superannuation Guarantee
3	Voluntary savings	Voluntary savings	Voluntary savings
4		Family or intergenerational support for elderly	

World bank reform goals

Primary goals

- Adequate – absolute and relative
- Affordable – for individuals and society
- Sustainable – current and future
- Robust – can withstand major economic, political and demographic shocks

Secondary goals

- Minimise negative impacts e.g. labour and asset market distortions
- Maximise positive impacts e.g. financial market development

Additional goals we have added

- Flexibility – maximise flexibility between work, retirement, leisure and training
- Simplicity
- Equity

Objectives of RIT Taskforce

Objectives are

- Increased retirement savings whilst working
- Increased workforce participation rates in older ages
- Better use of savings in retirement

Strategy to achieve objectives to include

- Policy reform with focus on Social Security and integration, not taxation
- Product development
- Identification of any key benchmark indices

Outcomes

- Improved fiscal impact of ageing population on community
- Improved standard of living in retirement for individuals

The case for change

Fiscal impact of ageing population

- Age related costs projected to increase 44% from 13% to 19% GDP in 2040
- Projected ageing deficit 6% GDP would require average tax rates to increase 21%

Workforce participation rates need to increase

- Aggregate participation rates expected to reduce from 63% to 56% over 40 years
- Aim to improve participation rates for 55-64 year olds and over 65s

Retirees not expected to achieve target retirement income

- Target is 70%-80% pre retirement net income or 60%-65% gross income
- Treasury and IFSA projections indicate shortfall

Most retirees will continue to rely on Age Pension

- 80% of retirees now rely on all or part Age Pension
- Only expected to reduce to 75% by 2040

Complexity of means test results in

- Inequity, high error rate, high administration costs and intrusion factor
- Planning focus on getting the Age Pension

Impediments from Age Pension

No incentive to work beyond age 65

– Incomes of between $15,000 - $35,000 incur marginal tax rates of 40%-80%
  - Due to loss of Age Pension and reduction in tax offsets

Income test not designed for income earned post age 65

– Income is annualised resulting in loss of Age Pension for short periods of work

Means test is impediment for increased savings

– For median incomes of around $35,000-$40,000, additional super savings over SG do not result in additional retirement incomes

– Additional savings buy the Age Pension under current Asset test rules

Means test encourages early retirement

– No real reduction in retirement income when people reduce savings from $300,000 to $150,000 prior to age 65 and fund their early retirement instead

Other impediments

Existing annuities offer a poor choice

Lifetime annuities

- Lifetime annuities are the only real form of longevity insurance
- Supply limited due to lack of longevity re-insurance, prudential requirements and scarcity of inflation linked bonds for asset matching
- Demand limited due to a modest investment return at best
  - A 65 yr old would need to live to 94 to get a 5% pa return
- Dramatic fall in sales when asset test exemption reduced to 50%

Account based annuities

- No longevity component
- Lack of flexibility in term allocated pensions

Reform

Key areas of proposed reform

- Age pension reform including means test reform
- Annuity reform
- Other product reform

Age pension reform

One option - Deferred Age Pension

- Asset test determines “eligible” Age pension entitlement, as now
- Person can defer this entitlement for unlimited time
- Deferred Age pension increases at say 8% pa
  - Lump sum option instead of up to $30,000 after 5 years
- Income test removed
  - Income earned whilst in receipt of Age Pension incurs higher tax rates
- Value of home capped in asset test exemption
- Existing restrictions on claiming Pension Bonus removed
- Gifting rules extended to pick up lump sum amounts pre age 65
  - Alternatively, treat lump sums pre age 65 as income
- Option needs testing and modelling against reform objectives

Benefits

Increased retirement savings whilst working

- Asset test extension
  - Ensures median incomes of $35,000-$40,000 benefit from additional savings over SG
  - Targets incomes of around $23,000-$25,000 vs. $20,000 under current rules

Increased workforce participation rates in older ages

- Deferral option for Age Pension removes implicit tax on working post age 65
  - Removes high MTRs from loss of pension
- Discourages people from spending savings before age 65

Simplification

- Removal of income test simplifies system and reduces intrusiveness
- Asset test simplified to annual assessments with quarterly exception reporting only

Other reforms

Possible product reform to encourage better use of savings

- Reintroduce (better controlled) form of variable income annuities?
- Greater flexibility on existing allocated/term allocated pensions
    - Re-spreading options for allocated/term allocated pensions for surplus income?
    - Easier mechanisms to stop, start and rollover
    - Additional contributions post retirement
- Deferral options for annuities as longevity stop/loss measure
- Pre-funding for specific expenditures, e.g. health?
- Home equity release encouraged
    - Asset test exemption for home equity release for specified expenditures
    - Asset test cap on value of home counted in exempt assets

Re-examine inflation linked issuance

- Future fund could facilitate increased debt issues without increased net debt

Where to

More research required on policy suggestions

More work on reasonable KPIs or indicators

More modelling

More testing of ideas with policy makers