Actuaries Institute Podcast

Title: ‘Options for reforming Australia’s retirement system’ - *Episode 2 of 2*

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Interviewer: Vanessa Beenders
Guests: Anthony Asher, David Knox, Michael Rice
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Introduction

Vanessa:

Hello and welcome to the second episode in our podcast series around the Actuaries Institute’s latest Green Paper called ***Options for an Improved and Integrated System of Retirement***. The authors of the paper are back to share their thoughts on the best way forward for the system. Anthony Asher, David Knox, Michael Rice. Thanks for joining us again.

Part of why this paper is so comprehensive and bold in the options that it explores is that each of you come with different backgrounds and experiences. We explored some of that in episode one and I want to probe a bit further now by asking each of you if there's any particular reform option in the paper that resonates particularly strongly with you, Anthony.

Anthony: Well the one I would like to talk about is simplifying the means tests and particularly the asset test. Australia is almost unique, I think unique really, in terms of having an asset test separately. They can easily be combined, which would simplify matters and enable people to plan more easily. The asset test also requires you to drawdown at a particularly fast rate early in retirement if you're going to get any benefit from the Age Pension. If you plan badly, you can actually end up being better off giving away the money than actually holding the money and living off your deposit interest rate, for instance.

Anthony: There are clearly very significant problems in the asset test. We've come up with a couple of possibilities. It’s not completely out of line to say, “Okay, well let’s basically say you've got to spend all your assets before you could get any Age Pension.” That would be harsh and-

Vanessa: and then it would be the full pension that you qualify.

Anthony: You get the full pension.

Vanessa: So, do away with part pensions and the complication of that.

Anthony: That would be quite tough on people who had saved a fair amount and then had to spend it before they got the Age Pension. But it's a possible way of doing it and at least people would be clear as to what they had to do.

I prefer a situation where the assets are spread over the lifetime and added to your income. And you can just make a decision beforehand how much you want to save in order to have a retirement income and you can expect a more or less level flow of income over your lifetime. That's the objective that I believe should be gone for. But we've put three options in the paper.

Vanessa: So, David, is there a particular option which resonates with you that you could talk us through please?

David: Thanks Vanessa. In the first podcast, we highlighted that the Age Pension is means tested on both assets and income. This is complicated and it means that retirees are confused and they're very conservative on the main about how they spend their money.

Because they're not sure whether they're going to get something from the government in five years or 10 years' time. I think the system would be a lot simpler if we had some form of universal benefit.

David: Let me give you a couple of examples. Firstly, in Denmark for example, half the pension is payable to everybody, and what that does is it provides the base for people to build on. At the moment, Australian retirees don't know whether they're going to get a pension or not after they retire with their super, so they're conservative. If they knew there was a base, then they would build on that and there would be a greater incentive for them to save during their working years as well.

David: I like the concept of a part pension that's universal and a part pension that is means tested that can concentrate and provide resources to those who are in poverty, or who need it.

And another alternative in the Australian context is the pensioner concession card. This is payable to those who reach a certain limit, but once you're above that limit, you don't get it. It's a cliff and people behave so they get below the limit.

David: And that again distorts behaviour. I think it would be beneficial to pay that to everybody. Again, what I'm saying is let's make a base that is very simple, simple to understand that people can build on rather than have everything that is subject to complicated means tests.

Vanessa: **Thanks David. You're keen to remove, if you like, some of the friction costs, or the administration costs, in the system and provide more certainty.**

David: That's correct. And to provide more certainty to encourage behaviour even amongst people as they approach retirement to recognise that if they’re going to save a little bit more, they will get the benefits from that saving, under the current system they may not.

Vanessa: **Michael?**

Michael: Sure. Okay. Well, one idea is to try and move government thinking away from short term fiscal adjustments back to a more sustainable long-term financing of retirees’ benefits. And we could do this by setting a target, really for the costs of ageing. That might be the Age Pension and aged care, but you could even expand it to health costs if you wanted to.

Michael: If we could set an overall budget as a percentage of GDP and let's say the Age Pension and age care was say four and a half percent of GDP, the government would then be able to work towards that. It could still adjust parameters, it could decide who's eligible and what they should get, but we could at least have an underlying structure that was more stable. And if you adjust parameters but not the structure, it's much easier. An example of that is if you think about adjusting tax thresholds, people understand the tax system.

Michael: They know that it's progressive and they live with that. And then every year or so the thresholds are changed and that's easy to understand because it's actually not changing the system as a whole. Now if we were to do this, it would also be reinforced by having a debate about who should be eligible for the Age Pension. Is it really a safety net? Or will it still be a supplementary benefit for middle income earners or people with middle wealth? And what are the rules about eligibility?

Vanessa: **Yeah. And just exploring that one a bit further. So, to set a target, you're not talking about anything that's like a very hard target here. You're talking perhaps more like an 'on average over the cycle' between this percent or that percent of GDP and that percentage GDP, isn't it?**

Michael: That's right.

Vanessa: **Something that still has a bit of flexibility to it.**

Michael: That's right. You're not trying to set a target that means you've got to cut the benefit each year. You're really saying, "This is affordable, this is what we're going to spend the money on. And then within that budget we're going to make sure we target needs better."

Vanessa: **Yes, yes. And so, to that very point, you're not suggesting that pensioners would for example, experience a sudden decrease, or for that matter increase, in the Age Pension to which they will be entitled. It's a much more-**

Michael: Not at all.

Vanessa: **... flexible or softer system than that**

Michael: It's a long-term gradual change.

Vanessa: **Yeah. Thanks Michael. So that's great to know what options that you find most interesting yourselves. There are some other options that are explored in this paper and let's take listeners through those now. One of those then is about removing the exemption for the family home. Now, a particularly bold option, Anthony, do you want to take us through that one please?**

Anthony: It may be bold in some respects. So there already is an allowance in the Age Pension for

the family home, but it's $200,000 which is unrealistic, should we say. I think most people agree that the home should be included in at some level. But the comment we often have is, “Oh it's politically unacceptable”. And that's the major point we want to challenge, is that we don't believe that something obviously beneficially and appropriate should be seen to be politically unacceptable.

Now, I fully understand that it may be disruptive and in some ways for the pensioner who would then run out, would not be funded at all by the Age Pension if they had a very valuable house. But there is already a system

Vanessa: **The Pension Loans Scheme?**

Anthony: ... the Pension Loans Scheme, which allows for such a person to draw a pension. And I don't believe that anyone would object if that Pension Loans Scheme was made even relatively more generous in order to facilitate the cash flows of anyone that was disadvantaged by this. But, if we believe in fairness, this is an area that is clearly unfair and does need to be addressed in a quite urgent fashion.

Michael: Anthony, we all agree with that. It brings us to another point when we talk about fairness, that was a good example of where the system clearly isn't fair but implementation is difficult. I think what government needs to do is start by saying, “Well, the family home above $5,000,000 say is included”. And then when you get the structure right, you can play with the parameters later. Similarly, if someone's got $100 million in their SMSF, well that's far too much. Let's either tax the investment income above three or four million at 45 or 50%, or make them take the money out when they get to an advanced age. There are things that you can do to get rid of the extremes

quickly and then over time move towards a fairer system.

Anthony: Absolutely.

David: The other point I would add in terms of fairness is that we must look at the system as a whole. I'm concerned when some commentators look at the fairness of superannuation and don't look at the fairness of the Age Pension, or the home, or some other component. The retirement income system has a combination of components as we have discussed. And it's the system as a whole that needs to be fair rather than each itty-bitty little bit.

Anthony: I absolutely agree with that and that's why it's important that at government level there's a central body that considers the system as a whole and can make the adjustments to the various parts to make them work together most efficiently and effectively.

Vanessa: **Thanks, so there's also some options then here in the paper which we should discuss here. One of those, an interesting one, is about embedding automatic adjustments to reflect changes in life expectancy. So putting in automatic links to what the Age Pension eligibility age is and the super preservation age. Maybe David, could you talk us through just briefly what that option looks, or could, look like.**

David: Sure. Thanks Vanessa. I think we're all recognising that over the last 20, 30, 40 years, we're living a lot longer than previously. And in particular when people reach age 60 or 65 their life expectancy is no longer 15 years, but it's 20, 25 years and we expect that to continue to increase with improved medical advances. Traditionally, the retirement or pension age in many countries has been 65 for men, and 60 for women. It has taken a long time around the world to shift that, even to 65

for men and women. Australia is now moving that gradually to 67. And yet, most countries don't have an automatic adjustment. Our preservation age for superannuation is not yet 60, it will get there in a few years' time.

David: But we need to think about, "Where will that go when our life expectancy continues to rise?" For instance, half the baby girls born today are expected to live beyond 95. What are we doing with these ages? Will they be stuck at 60 or 67? I think if that's the case, we will be encouraging inappropriate behaviour and we will be actually adding cost to government. We need to reflect movements in life expectancy in those ages.

I should add, it doesn't need to be one for one. If the life expectancy goes up one year, maybe the preservation age or the pension age can go up half a year. So there's a sharing between extending the working years and extending the retirement period.

Vanessa: **And on that, it's really important, isn't it David, to do both the super preservation age as well as the Age Pension eligibility age, if only because increasingly as people have large balances in super as the system matures, that's the behavioural age, isn't it, which then influences your decision of when you're going to retire. So, it is important that that one in particular does keep up with changes in life expectancy, isn't it?**

David: That's absolutely right. We need to recognise, of course, not everyone has average health or ... and some people's bodies wear out so there needs to be appropriate government support for those who need to retire early. But if we keep the preservation age at 60, there will be some people who will be incentivised to retire at that point and take their super money, when in fact they're in perfectly good health

and they could work another three, four, even 10 years.

Michael: Perhaps I could add a little bit to that, David. I think society has a real issue about keeping people in work at older ages. And some of the solutions will be getting people to transition gradually into retirement; moving to part time work and other things might be changing occupations If you're stressed out high powered actuary, you might move to teaching or mentoring and doing an easier job as you get older because let's face it, we all slow down.

Vanessa: And let me assure you listeners, I am surrounded here by three stressed out actuaries.

Anthony: One of whom is teaching.

All [Laughs]

Vanessa: **OK, so let's turn to the practicalities then. Michael, how can reform options, which some people will consider major, be made palatable for implementation?**

Michael: Well, the first thing to remember is that everybody who retires has a vote. So, you try and minimise disruption. You don't want to upset them too much. So, that might involve grandfathering of some benefits, or possibly easier, introducing them over a long period of time. Now, there is a good example of this and that was when the government in the 1990’s increased the female retirement age from 60 to 65. It happened over the 20 years to 2014 and at the time, there was no objection because the change was made to people who were then quite young. The women of 45 were going to have to retire at 65, but they were still 15 years away from 60 and didn't know what was happening.

Vanessa: **And they had enough time in their working life to be able to prepare for the change.**

Michael: Exactly. And that came in very smoothly. I think that's an example of what can be done. So, others that might be more difficult, for example, introducing the family home in the means test, you might need to take a few decades for that. An example of how it might happen is you could assess an imputed rent, count that with other income, you would then increase the income test threshold to reflect that we don't want to exclude too many people from retiring. Because if you don't do that and you introduce an asset straight away, then no one will be on the pension except the very poor.

Vanessa: **You set a high threshold for when it does begin, which seems very reasonable then. Is that what you're suggesting?**

Michael: Yes. And you adjust it over time. And this of course takes into account who do you want to receive the pension, how much do you want them to receive, and at what time do they become eligible. And I think we need some guidelines on that before you make major changes.

Vanessa: **Well, this actually brings it back to one of the points earlier that we talked about as to why there's no financial modelling, that was in the first episode. These are exactly the sort of things that we need to know what is the in-principle support or otherwise for, before you can then start to get down to what are the parameters or what are the specifics of how you do these things.**

Michael: Yes. And you need to explain to people why you're doing it, because the first instinct will be someone will say, "I've got a home, I don't want it counted, why me?" You need to talk

about the unsustainable costs if you give too many wealthy people too much money and also getting some fairness in the whole system.

Vanessa: **Yes.**

David: Yes I think that's right Michael. I think a really important discussion we will have following this paper is what is the objective of each component or pillar of our system. For instance, is the Age Pension just there to alleviate poverty amongst the small proportion of the retired population? Or is it there to provide a base for everybody? Or is it some way between those two extremes? When we understand and agree on the purpose of the Age Pension, we're then in a much better position to understand the objectives of compulsory superannuation, and indeed voluntary savings. Understanding how they work together and what we're trying to deliver is a really important point.

Anthony: Yes. If I may just add to that. The importance of actually knowing what is happening to groups and individuals within the system. If one wants fairness, one really needs to understand who's benefiting and who's not. And we've identified, as have many, currently the problems of old age renters, but we don't have much data really on who's suffering. We know some are actually living with their families and some are living in social housing and are possibly okay. But there are some that are really having it tough. And it's quite important that any policy decisions are taken with an understanding of who's fair and who's not.

Anthony: And that any changes to the upper end where pensions are taken away or taxes increased, are not such that they actually cause hardship. And that's debatable and that we believe is a parameter that the politicians need to decide over time, but they just need the levers in the system to be able to make those adjustments

to meet fiscal priorities, and to be certain that they're fair in the way that everyone is treated.

Vanessa: **Thank you everyone. Lastly, just checking in if you've got any any final observations that you want to make. I can see Anthony that you'd like to make a comment here?**

Anthony: Well, yes. I'm playing with my one-year old grandchildren frequently in the morning and toys are very good, but after they've left, it's very higgledy-piggledy and that seems to me to be a good image of the current system. The building blocks are there, but they're all over the floor. And what I'd really like to see is a centralised management that really has set its objectives for the three systems we've been talking about. That measures the effects of those systems on people and then takes a holistic position that really provides the retiree with dignity because it is simple, it is fair, and it is efficient.

David: Can I build on that? To say that I think what we want to come out of this paper is the engagement with all stakeholders. Within our retirement system, there are a range of stakeholders from naturally the retirees, through to the providers, through to the government, through to policy makers and so on. I want to encourage all the stakeholders to contribute to the discussion so we actually build up a community census that will go forward, that we're all happy with, and I think that will help stability and moving us forward that everybody understands the system. It's really important that we work together and not in isolation.

Michael: And just to add to that David. Really, we need bipartisan support because when the politicians disagree, it's a real barrier to progress and actuaries are very well placed to do the education, to show the options that are available and to perhaps help them decide. At the end of the day, it's a political decision, but

	the more we can get them to understand the issues and make sensible decisions, the better off we'll all be.
Vanessa:	Yeah. So, to really help bring together the evidence base so that there are informed decisions made.
Anthony:	And finally, from me is, what really gets my goat is when people say, "it can't be done, it's politically unacceptable". And I think what we would really like to start is a debate where people say, "Yes, it can be done. Let's get it right".

Vanessa:

Thank you. So on that note, if you do have feedback on the Green Paper, the Actuaries Institute and these authors would love to hear from you. The email address is included in the Green Paper, but it is if you email your thoughts to Actuaries@actuaries.asn.au.

So, thanks for joining us, Michael, David and Anthony, it's great to hear your thoughts on the best way forward.

We sincerely appreciate your insight and the absolutely tremendous effort that each of you have made to develop this important piece of research, and as you've said, to help push forward this debate in a constructive manner.

Listeners, we hope you enjoyed this discussion.

Find out more about the Green Paper by visiting the Thought Leadership section of the Actuaries Institute website.

See the link in our show notes in the podcast's description. Check out the Actuaries Institute's Podcast Channel on your Apple or Android Podcast App, or wherever you listen, for more discussions on important areas where actuaries are leading policy research and the debate.

As always, please write in with your questions and comments on the show. We do love to hear from you. I'm Vanessa Beenders. Bye for now.