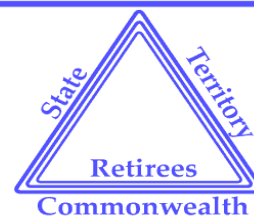

Australian Council of Public Sector Retiree Organisations Inc.

ABN74202015642

Peak Council representing Commonwealth, including military, State, Territory and other public sector retirees.



Mr Michael Callaghan AM, PSM
Chairman
Retirement Incomes Review
Office of the Treasurer
Parliament House
Canberra ACT

30 January 2020

Dear Mr Callaghan

Thank you for the opportunity to make a submission to your inquiry. The Australian Council of Public Sector Retiree Organisations, ACPSRO is the peak apolitical not for profit organisation that represents the retirement interests of former State and Commonwealth public sector employees and also former members of the Defence Force and includes the spouses/partners of these groups of retirees. Those we represent number in excess of one million.

Their average Defined Benefit, (DB) pensions approximate the combined married rate of Age Pension and mostly support both members of a couple. Many also receive and rely on a part Age Pension and the associated pensioner concession card.

Most of those we represent do not enjoy the tax free arrangements applicable to account-based superannuants. This is because successive Governments did not make ongoing contributions to a taxed superannuation fund from which to pay their pensions. As a result their superannuation pensions are not exempt from income tax.

Whilst their pensions are indexed, the indexation increase is added to their **pre-tax** pension, thereby causing a steady decline in their pension's real value. This is not an issue for account based superannuation pensioners because their super is tax free for those aged sixty or more.

The CPI indexation of the pensions of those we represent makes no provision for increases in community living standards.

To a large extent their defined benefit superannuation schemes should be seen as a pre cursor to the superannuation component of Australia's three pillar retirement income system. Their employment in the public service or the military compelled them to belong to a defined benefit superannuation scheme to which they had to make contributions. Their pensions plus their lump sum payments consequently reduce or sometimes even deny them an Age Pension. They were allowed no choice of superannuation fund, unlike account based superannuants.

Correcting an Unfair System

The concerns that underpin this submission are that successive Governments have made retirement income policy decisions that very often strip away access to or reduce entitlements associated with non-account based superannuants' retirement income. This has adversely affected their ability to maintain even a quite basic standard of living; e.g. tightening of the Age Pension means tests which some can understandably call a "tax", progressively increasing the qualifying Age Pension age etc.

Conversely, other retirement income decisions have significantly boosted the retirement incomes of those already enjoying a standard of living that many Australians would understandably envy, e.g. the most generous tax concessions on superannuation income for those often already receiving very large incomes from account based superannuation schemes and superannuation income from a taxed source which for some years was not counted for the Age Pension income test etc.

ACPSRO forwarded a submission to your inquiry on 20 November last year. Your Consultation paper makes it clear that the Review intends to restrict its focus to the Age Pension, superannuation arrangements and voluntary savings. This is perhaps understandable in that the task ahead of the Review in bringing some sanity to the meanness of the Age Pension conditions on the one hand and the profligate extravagances of the concessions to the account based superannuation system on the other is monumental.

A visitor to our planet would be forgiven for coming to the view that the Australian Government is committed to using public funds to assist the most wealthy. Some of our members have made personal submissions to the Review that make clear the massive failings of the present system. See for example the submission by John Pauley of Tasmania. We do not intend to go over that ground again here or indeed deal with many problems.

However we are obliged to focus on what we consider are some of the most relevant retirement income issues for those we represent. We've done so because your review's terms of reference did invite submissions that might venture outside the three pillar arrangements, provided they were retirement income related.

Further, the people we represent number in excess of one million and they say that they have serious concerns about the present retirement income policies they know are letting them down, relative to some other Australian retirees. Fundamentally they see it as a fairness issue.

The CPI

It is probable that a Review of Retirement Incomes will have to deal with what is a liveable retirement income and how it changes with the passage of time due to changes in the cost of goods and services. DB pensions are mostly indexed to the

CPI. The experience of DB pensioners is that the CPI is an inadequate way to index a retirement income for two reasons.

It is insensitive to the changes in the unavoidable expenditures that retirees face as they advance well into retirement. In the experience of DB pensioners the subset of the CPI called the Pensioner and Beneficiary Living Cost Index (PBLCI) is very little better than the CPI in this respect because it is but two of the four sub sets of the CPI and thereby carries with it the flaws inherent in the CPI. Age pensioners especially have very low incomes. They face a completely different CPI to that of the average person and those on higher incomes. A large proportion of their income must go to non-discretionary items where costs are rising much faster than what the underlying CPI suggests.

The CPI and the PBLCI measure only “pure” price changes. The concept of a world that experiences only pure price changes is totally artificial. It would be a world without change in the quality of goods or services. The reality is that we are faced with constant and unavoidable change in what is offered in the marketplace for goods and services. Economists regard these unavoidable cost increases as a reflection of improvements in community living standards.

From 5 December 2019 the Australian Securities and Investment Commission has required that calculators used by the superannuation/finance industry to bring the value of a future pension back to present value must use an inflation rate that is a combination of the CPI and an allowance to include “a component that reflects changes in the cost of meeting increases in community living standards.” See ASIC press release 19-129MR. Currently the rate of indexation that ASIC requires these calculators to use is 3.2% per annum, being 2% for CPI and 1.2% for increases in community living standards.

The thorny issue of the adequacy of the CPI for indexing an income over a long period is also relevant for annuities. It would be a dereliction of duty and contrary to the ASIC requirement not to make clear that an annuity intended to provide for a retirement over twenty or more years will be inadequate if indexed only by CPI.

The Capital Value of a DB Pension

Government action to limit to \$1.6m the amount that can be accumulated in a superannuation pension account with all existing tax privileges was in the right direction but was by no means all that was required to make those arrangements more equitable. The capital value of a DB pension must be included within this cap. This value was set at sixteen times the annual value of the pension irrespective of the life expectancy of the pensioner. This is an unnecessarily crude approach. Mercers, an actuarial firm regularly used by the Government, recommended a simple table to take some account of life expectancy but this recommendation was not taken up. The opportunity should be taken in any extensive recasting of the accumulation limits to correct this significant anomaly.

Further, setting a \$1.6m cap unfairly ignores the fact that most DB pensions are taxable. Because successive Governments have chosen not to contribute to a superannuation fund/s from which to pay Commonwealth superannuants' DB pensions, the capital value of those pensions "dies" on the death of the superannuant or subsequently on the death of their spouse/partner. On the other hand, the capital value of account based pensions survives for distribution to the nominated beneficiary/ies.

Retirement Income Data

There is an urgent need for more detailed information about the sources of income for retired people. This information should be collected in the Population Census, so that the government has the appropriate data to use in their modelling of any proposals for changes to retirement incomes and the methods of taxing them. At present, the Census data are mainly about the characteristics of the working age population, which might have been appropriate thirty years ago when most people died fairly soon after they retired, but now that the retired proportion of the population has become so large, it is time to do something about collecting more data about them.

The many major retirement income policy decisions made over the past decade or two without this data surely calls into question the appropriateness and/or fairness of our present retirement income arrangements, including the associated tax policies. We strongly urge the Review to recommend in its Report to Government, the collection of this essential data as a high priority.

Tax Free Superannuation

This policy arose from the 2002 *Superannuation and Standards of Living in Retirement* Senate inquiry. The clear intention of the report's recommendations was to ease budgetary pressure due to escalating Age Pension expenditure by offering significant incentives for Australians to invest in superannuation, in the belief that more self-funded retirees would mean less reliance on the Age Pension.

On the surface this decision seemed reasonable. However it failed to recognise that most working Australians could not afford to direct much if any of their salaries into super because of mortgage commitments and general family cost of living pressures. Even for those who could afford to do so, it's most likely that many chose not to in the mistaken belief that their superannuation guarantee levy would be adequate to provide a retirement income that would provide for them a reasonable standard of living in retirement. Also, it's not unreasonable to assume that workers who are a long way from retirement age direct their finances to present day matters more so than to what they may require in retirement.

However those with greater wealth who could afford to do so understandably redirected their investments to superannuation because of the incredibly generous tax benefits, and who could blame them!

It will be a very brave Government that decides to rein in the superannuation tax concession largesse. The following points may however help the Government to justify to voters any decisions to reduce the massive tax concessions that apparently now approximate Age Pension expenditure.

- i) The self-employed who contributed to super already enjoyed tax relief by being able to claim their contributions as a tax deduction.
- ii) It's our understanding that super fund earnings were not taxed until the mid 1980's so why should super payments that accumulated prior to then be tax free?
- iii) The value of paying no tax on superannuation at the point of draw down does, depending on the marginal tax rate of the recipient, exceed the tax paid on the individual's super fund earnings, 15% and contributions tax, 15%.
- iv) Those who pay no tax on their super pay a lower tax rate on any of their non-super income than they otherwise would. That's because their super income is not added to their non-super income to set the tax rate for the latter. Conversely, those in receipt of DB pensions have their super added to their non-super income to determine the tax rate for the latter. We were advised by a member of the Government team that developed the present superannuation tax policy, that this was an oversight when developing the policy.

Yours sincerely

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President

Australian Council of Public Sector Retiree Organisations - ACPSRO