ATCHISON
CONSULTANTS

August 2021

Retirement Income Covenant

Atchison Consultants provides bespoke investment strategy solutions for investors and fiduciaries for investors.

Ken Atchison has been involved in in financial markets since the early 1970s.

In November 2020, the Retirement Income Review Report was released with the finding that "the Australian retirement income system is effective, sound and costs are broadly sustainable."

Government advised that a retirement income covenant for superannuation trustees would be introduced. A position paper has been released and comments sought.

In comments which follow it is stated that Trustees of superannuation funds cannot provide a solution in retirement for members which addresses the three pillars.

Funding of age pension at an individual level would provide the prospect of a solution being provided.

Funding would be provided by issuing inflation linked bonds as an individual account.

Trustees of public offer superannuation funds cannot provide a retirement solution for individual members without knowledge of the age pension status of members. Funding the age pension at an individual level would quantify the circumstances of members regarding two of the three pillars. Then a retirement solution could be provided by Trustees.

Consideration of the three pillars of the retirement income system being the age pension, compulsory superannuation contributions and voluntary savings (including home ownership) is required. Lack of integration of the three pillars is evident. There is evidence that government policy considers age pension as social security rather than as part of retirement income. Social security has a perspective of needs of the recipient. Retirement income has a perspective of entitlement.

A covenant for superannuation trustees which largely addresses the compulsory superannuation system only is flawed. In the retirement income review it is stated that 71% of individuals over age pension eligibility age receive age or other pension.

Improved understanding of retirement income following the review is intended, resulting in more informed decisions about participation in the system.

The objective for the retirement income system is clear. "Deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way".

Level 3, 155 Queen Street, Melbourne VIC 3000 ABN: 58 097 703 047 AFSL Number: 230846
enquiries@atchison.com.au www.atchison.com.au P: +61 3 9642 3835 F: +61 3 9642 8886

Objectives for trustees of superannuation lack clarity through the proposed covenant. Trustees in an SMSF for compulsory superannuation may be able to accommodate the other two pillars. Establishing an individual account within a public offer superannuation fund for compulsory superannuation and acknowledging age pension is fraught with complexity and individual privacy issues. A notion that a Trustee might also have regard for voluntary savings is not conceivable.

Compulsory superannuation provides enhanced retirement income for the majority of the population. Compulsory superannuation has shifted responsibility from sponsors to individuals except for defined benefit funds. Individual members of superannuation funds have choice of fund and choice of investments within a fund. In the covenant, it is implied that Trustees are being asked to take responsibility for choices by individual members. Trustees should have responsibility only for the range of option choices which are made available for members of funds.

The retirement income system is complex. In the retirement income review it was found that there was a need to improve the understanding of the system, citing complexity, misconceptions and financial literacy as key reasons for insufficient planning for retirement by Australians.

Age pension provides a base for retirement income for individuals and longevity insurance. Funding of age pension at an individual level, by issue of debt securities and providing the funding securities to individuals in a nominated superannuation fund is proposed. Collective longevity insurance would be retained as it is the most efficient solution.

Funded age pension plus compulsory superannuation as an individual responsibility would reduce complexity. A Trustee could validly provide a solution when two of the three pillars are integrated.

A primary philosophy behind the Australian taxation system is that it is progressive. Individuals earning higher incomes pay higher rates of tax.

Unfortunately, taxation of each of the three pillars deliver mixed messages and complicate the progressive tax system. Introduction of a flat tax rate system for age pension and superannuation and applying a progressive system through personal taxation would be a major simplification and more efficient delivery of progressive outcomes.

Although the age pension helps offset inequities in retirement outcomes, the design of the superannuation tax concessions increases inequality in the system.

Changing the mindset from age pension as social security to retirement income would permit consideration of a more efficient taxation treatment. Introducing tax on age pension payments and retirement drawings at personal marginal tax rates is proposed. This would re-introduce a progressive structure. Inequitable retirement outcomes for various groups would be addressed, most efficiently, by variable income tax rates.

Intergenerational issues are integral in the age pension with age thresholds, superannuation with tax allowances in retirement and personal tax through tax allowances based on age.

Intergenerational inequity is most prevalent in the payment of age pensions on an emerging cost basis. Compulsory superannuation is funded but age pension is not. The intergenerational burden in favour of the older generation through the age pension is immense.

Funding of the age pension liability is proposed. This would address the intergenerational inequity. Funding would be made initially for the liability for pensions in payment which is estimated at $650 billion.

It is proposed that the funding initially be made through an issue of inflation linked government bonds and transfer of the bonds to individual accounts. Individuals would have the option of transferring this asset into a superannuation account and subsequently changing the investment mix. Alternatively, a central account could be established, and superannuation account balances transferred into the account. Management would be required by the superannuation fund or the central account.

An outcome would be that each individual would be aware of the assets available in retirement. They would be made clearly aware of the longevity insurance provided through age pension.

Aggregation of age pension and superannuation may encourage greater utilisation of superannuation. Certainty about longevity insurance through age pension would reduce concerns over drawing on savings.