In need of repair: Australia's retirement income system

Submission to the Senate Economics References Committee

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Introduction

Grattan Institute welcomes the opportunity to make a submission to the Senate Standing Committees on Economics inquiry into improving consumer experiences, choice, and outcomes in Australia's retirement system.

Grattan Institute has produced a large volume of work on superannuation and the retirement income system that is relevant to this inquiry. This submission summarises that work.

Most Australians are on track for a comfortable retirement

Australia's retirement income system is generally working well. Australians are broadly on track for a comfortable retirement. Existing retirees of all income levels have a retirement income of at least 70 per cent of their pre-retirement income.[1] Most retirees today also feel more comfortable financially than younger Australians who are still working.[2] Retirees are less likely than working-age Australians to suffer financial stress such as not being able to pay a bill on time, and are more likely to be able to afford optional extras such as annual holidays.[3]

As for future retirees, our research shows that most working Australians today can look forward to a standard of living in retirement that's on par with their standard of living while working, and often higher.[4] Retirement incomes also remain adequate for most Australians even when they work part-time or take significant career breaks, such as to care for children.[5] These findings accord with those of the 2020 Retirement Income Review.[6]

These findings mean that the further increase in compulsory super from 11 per cent to 12 per cent of wages by 2025 should be abandoned. That increase would compel most people to save for a higher living standard in retirement than in working-life; it would do little to boost the retirement incomes of many low- and middle-income earners; it would cost the budget more than $1 billion in super tax breaks; and it would widen the gender gap in retirement incomes.[7]

Australians should also be offered the opportunity to 'cash out' a portion of their compulsory superannuation contributions each year – anything beyond 9 per cent of their wage – when they submit their personal income tax return. This change would give Australians greater flexibility in managing their finances during their working life, particularly in securing a home of their own. It would save the budget, since any super contributions cashed out would be taxed as wage and salary income on individuals' personal income tax returns.[8] And it would not compromise the adequacy of Australians' retirement incomes, since most are already saving more than they will need for retirement.

But while the retirement system is broadly delivering for most Australians, there are five big concerns.

1. Coates and Nolan (2020, p. 56).
2. Ibid (p. 55).
3. Ibid (Figure 2.5).
4. Ibid (p. 56).
5. Ibid (Figure 4.7).
6. The consensus tool to measure adequacy is replacement rates – retirement income as a share of pre-retirement income. A replacement rate of 65-to-75 per cent for middle-income earners is typically deemed adequate. See: Callaghan et al (2020).
7. Estimated budgetary savings from fewer super tax breaks is scaled from Wood et al (2022, p. 101).
8. Most pre-tax super contributions are taxed at a rate of 15 per cent in the fund.

1. Australians pay too much in superannuation fees

Australians continue to pay too much in fees to super funds for managing their retirement savings. Australians spend more than $30 billion a year on super fees – more than they spend on energy bills.[9]

Fees are too high because there is too little competition between funds for members. Australians are not well informed about their superannuation fund or the fees they pay. Most do not actively select their fund, and very few switch funds in search of a better deal.

Governments of both political stripes have spent the past 15 years trying to fix the high-fees problem. The Rudd-Gillard government introduced *MySuper* as a licensing regime for default products. The Morrison government went further – capping fees, consolidating multiple accounts, 'stapling' super accounts to fund members to prevent the creation of new duplicate accounts, and, most importantly, introducing a performance test to weed out the worst-performing funds.

The performance test, implemented in 2021, has already led to better outcomes for super fund members, with several under-performing funds merging with better-performing ones, and other funds lowering their fees.[10]

Yet more work still needs to be done. In particular, the superannuation system needs a wholesale competitive process for default status. The government's focus should be on implementing the remaining Productivity Commission recommendations, including the 'best-in-show' process for selecting default funds.[11]

9. Coates and Moloney (2022).
10. Ibid.
11. Wood et al (Chapter 9, 2022).

2. Retirees get too little guidance and support in the drawdown phase

The retirement income system provides too little guidance and support to Australians as they transition to retirement. Retirement involves some of the biggest and most complex financial decisions Australians will ever make.

People's needs in retirement are more complicated than in accumulation. Rather than just high returns and low fees, people typically want reliable income, some access to capital, and insurance against risks such as inflation, investment, and longevity risk. Few other countries provide so little guidance to retirees – in the form of retirement defaults – than Australia.

Stronger intervention is also necessary to ensure the products that Australians access in retirement offer value for money. Retirement-phase products are currently regulated more lightly than default accumulation-phase products. Yet the stakes are so much higher in retirement: balances are larger; individuals' needs are more complicated; and products are often more complex.

'Pooled' products – such as annuities and collective pooled arrangements offered by some super funds – present a particular challenge. It is hard for buyers to determine whether they are good value. And they are often a one-shot game: members are locked into the pool for the duration of their retirement. While there is scope for innovation in retirement-phase products, that has to be balanced against the risks of consumer harm.

The recently-legislated Retirement Income Covenant is designed to prompt funds to offer more tailored products and guidance to help their members achieve their objectives. The Levy Inquiry recommendation to allow super funds to provide more individualised advice is in the same vein. But this approach is unlikely to lead to good outcomes. It will leave funds more able to advise people into their own products, and leave those products more lightly regulated than those available in the accumulation phase.

Under current policy settings, there is a substantial risk that there will be a proliferation of complicated, expensive products that individuals struggle to understand.

3. Unaffordable housing is the biggest threat to a comfortable retirement

The biggest threat to the adequacy of Australians' retirement incomes is the inadequacy of income support available to renters.

Senior Australians who rent in the private market are much more likely to suffer financial stress than homeowners, or renters in public housing. Nearly half of retirees who rent are living in poverty.[12]

And this problem will get worse, because home ownership is falling. If current trends continue, by 2056 just two-thirds of retirees will own their homes, down from nearly 80 per cent in 2020.[13]

Raising Commonwealth Rent Assistance is the most effective way to help renting retirees who are living in poverty. Last year's 15 per cent increase in Rent Assistance should be turned into at least a 40 per cent increase. This would provide an extra $1,000 a year to nearly one-third of all renters, at a cost to the budget of about $1.2 billion a year.[14] Rent Assistance should also be indexed to changes in rents typically paid by people receiving income support, so that its value is maintained.

As well as boosting Rent Assistance, the federal government should boost funding of social housing. But it would be prohibitively expensive to provide enough social housing to accommodate all rent pensioners who rent, let alone all working-age Australians on low incomes. So the boost to social housing should be reserved for people at greatest risk of long-term homelessness.

The government should increase the size of the Housing Australia Future Fund (HAFF) to $20 billion during this term of parliament. This would support subsidies for social housing of $1 billion a year, up from $500 million a year currently. An expanded HAFF could deliver an extra 1,700 social housing units each year in perpetuity via the provision of capital grants.[15]

But in the long term, the only way to make housing more affordable is to build more of it.

National Cabinet in August last year agreed to build 1.2 million homes over five years. If that happens, rents should be 4 per cent lower than otherwise, saving renters more than $8 billion in total.[16] This would benefits all renters, including low-income renters, because each additional dwelling, no matter how expensive, adds to total supply, which ultimately improves affordability for everyone.

The onus is now on the states and territories to introduce reforms – especially to land-use planning rules – to turn this welcome plan into reality.

4. Superannuation tax breaks need to be reined in

Tax breaks on superannuation mean less tax is paid on super savings than other forms of income. These tax breaks are excessively generous – extending well beyond any plausible purpose for Australia's superannuation system to provide for income in retirement – and their costs are unsustainable.

12. Callaghan et al (2020).
13. Coates (2020).
14. Coates and Moloney (2023a).
15. Assuming an average capital grant of $300,000 per social housing dwelling. See Coates and Moloney (2023b).
16. Ibid.

Super tax breaks cost $45 billion a year – 2 per cent of GDP – and will soon exceed the cost of the Age Pension. Two-thirds of the value of super tax breaks go to the top 20 per cent of income earners, who are already saving enough for retirement and whose savings choices aren't much affected by tax rates.

Superannuation should not be a taxpayer-funded inheritance scheme. Yet that is exactly what it has become in Australia. Much of the boost to super balances from tax breaks is never spent. By 2060, one-third of all withdrawals from super will be via bequests – up from one-fifth today.[17]

Nor do super tax breaks materially reduce Age Pension spending. That's because the cost of super tax breaks far outweighs the Age Pension savings they produce, with the bulk of the benefits going to higher-income earners who would never receive the Age Pension.[18]

With the federal budget facing a deep structural deficit, and big spending pressures looming, curbing super tax breaks should be an urgent priority. Without reform, super tax breaks will increasingly just end up boosting the inheritances received by children of well-off parents.

5. We should reevaluate the role of default insurance in superannuation

Australians spend about $10 billion each year in default income protection, life, and total and permanent disability (TPD) insurance via their superannuation fund.[19] The *Protecting Your Super and Putting Members' Interests First* reforms eliminated the more egregious and regressive impacts of opt-out insurance within super by abolishing opt-out insurance cover for under-25s and people with low account balances, and limiting the number of multiple accounts paying duplicate insurance premiums.

17. Callaghan et al (2020, p. 435).
18. Coates and Moloney (2023c).
19. Wood et al (2022, p. 103).

But broader questions around opt-out insurance in super remain unanswered. For instance, it is unclear if insurance premiums offer value for money to members. It is also unclear how default insurance interacts with other insurance arrangements such as workers compensation.[20]

The federal government should adopt the Productivity Commission recommendation for a review of default insurance in superannuation. Such an inquiry should evaluate whether members get value for money for insurance offered through superannuation, and whether insurance should continue to be offered on an opt-out basis. It should consider alternative approaches to providing default insurance cover outside of superannuation.

Further information

For further information please see:

- Our 2023 report *Super savings: Practical policies for fairer superannuation and a stronger budget*.
- Our 2021 submission to the *Your Future, Your Super* review.
- Our 2020 paper *Balancing Act: Managing the trade-offs in retirement incomes policy*.
- Our 2020 paper *Unaffordable housing is the biggest threat to a comfortable retirement*, which projects declining rates of home ownership among older Australians.
- Our 2021 analysis showing that most low-income renters have few superannuation savings.
- Our 2016 submission to the Senate Standing Economics Committee Inquiry into the Superannuation (Objective) Bill 2016.

20. Productivity Commission (2018, Chapter 8).

We would welcome an opportunity to appear before the committee. For further information please contact Brendan Coates, Economic Policy Program Director, Grattan Institute: brendan.coates@grattan.edu.au.

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