Introduction

This submission is in response to the Consultation Paper on *Revising Minimum Drawdowns* as part of the Review of Retirement Income Regulation.

It is largely based on the findings of two Workshops on retirement incomes policy conducted by the Academy of Social Sciences in Australia (ASSA). The most recent was held in November 2014 and comprised academic experts, industry representatives and representatives from Treasury, the Department of Social Services and the Australian Government Actuary.

The Workshop supported the objective, as stated in the Consultation Papers, that the primary objective of the superannuation scheme should be to provide income for retirement. Furthermore, the Workshop agreed that “the objective of the current regulatory regime in the retirement phase is to ensure that the capital underpinning a retirement product is drawn down over time in order to:

A. provide income over the course of a person’s retirement,
B. prevent large amounts of concessionally taxed superannuation savings being passed on as bequests, and
C. facilitate the provision of a ‘smooth’ level of income.”

Consideration of the Issues

What are the main issues that are relevant to policy on minimum drawdowns?

(a) For those with high balances, there tends to be too large a residual on death, contrary to B above. Consequently those receiving bequests from estates benefit greatly from the tax subsidies inherent in superannuation.

(b) Consequently, there are equity issues involved as those with high balances will be most likely to leave a significant residual.

(c) Individual’s cash balances in many superannuation funds grow for longer than required suggesting minimum drawdowns are too low for these funds.

(d) There does not seem to be much reliance on the actual expenditure patterns of retired persons in determining the level of drawdowns.

As an aside, Chart 1 would have been more useful if it showed real incomes eg discounted by the average CPI (2.5%) rather than the 6.0% used to estimate the NPV. In its present form, the graph gives the impression that real incomes steadily decline with age and that the real balance declines to close to zero.

For those not receiving part pensions, the ideal approach would be to have minimum withdrawals matching or exceeding actual expenditures at particular ages but leaving a reasonable residual at life expectancies. Research shows that consumption (privately and government funded) does not change much until people reach their mid-80s when there is an increase in consumption - most of which is government funded (see Rice, Temple and McDonald, 2015). This varies from one person to
another of course. However, this suggests that the minimum withdrawal should provide reasonably steady incomes across time (as proposed under C above) up until the mid-80s but leave some balance to manage the longevity risk (but see discussion on deferred annuities below).

We have not done the calculations but the current schedule of minimum drawdowns seems largely consistent with objective C but there may be a case for increasing the minimum drawdowns in the earlier retirement years by one percentage point. The necessary calculations should be done and adjusted if this objective is not met.

The problem of excess residuals in estates really only exists for those with high balances in their superannuation funds. They are less reliant on the allocated pension and can increase the balance in their superannuation funds for longer and receive the tax benefits. Also if the average rate of return on investments is 6% as it has been in the past, the minimum drawdown does not reach this level until age 75 or exceed it until age 80.

How do you address this?

1. There could be lower caps on the contributions you can make at certain ages, especially in the de-accumulation phase. This is unlikely to impact those with lower balances and/or;
2. There could be minimum drawdown rates for those with higher balances.

Many Workshop participants favoured mandating the purchase of deferred annuities when de-accumulation begins and to commence payment at, say, age 85. This would help address the problems discussed in the previous paragraphs. The Workshop did not discuss the proportion of accumulated savings to be directed into a deferred annuity although it was suggested that compulsion should only apply when total savings exceed some threshold.

The alternative approach favoured by other participants was similar to that proposed by the Financial System Inquiry. This is to mandate funds to offer comprehensive products that effectively include a deferred annuity but not make take up compulsory. We would regard this as a minimum. Given the tax support involved in accumulating superannuation savings, there is a strong case for making some form of annuity or deferred annuity compulsory especially if there is not widespread changes in behaviour that results in greater compliance with objectives A, B and C.

These arrangements were also seen as a way to reduce reliance on the age pension as insurance against longevity by those with the ability not to rely on taxpayers, and also to counter overly conservative behaviour of not drawing down accumulated savings but allowing them to increase and to be left in estates to the next generation. Requiring the purchase of a deferred annuity, or a comprehensive product that includes deferred annuities, would also address the problem of adverse selection (ie only those with a reasonably high life expectancy making the purchases thereby increasing their cost). The encouragement or mandating of deferred annuities might also require adjustment to age pension means test arrangements to ensure there is no inappropriate penalty involved.
The workshop also favoured a mandated default option if superannuants do not want to make decisions on drawdown, for complexity or other reasons, or do not have the capacity to do so. The latter will be pertinent when cognitive ability declines with age.

The paper raises concerns about the complexity of multiple superannuation accounts. This seems manageable. They all need to be reported now. The regulations should apply to total superannuation holdings. The onus should be on the superannuant to ensure they comply with the regulatory requirements, and include all superannuation accounts, with the threat of audits to ensure high compliance.

Conclusions

In conclusion we agree with the concept of having minimum and maximum drawdowns. Calculations should be made to ensure that the objective of having reasonably even real incomes over time is being met and the minimum drawdown level adjusted if required.

There certainly appears to be a case to increase the minimum drawdown for those with balances above a certain level. This may add complexity but it should be manageable as an individual’s equity in superannuation funds needs to be estimated and reported so the necessary data is available. The alternative is to decrease caps on contributions.

We also believe the mandated deferred annuities should be considered as part of the package as they will help address the problem of overly conservative behaviour and significant residuals at death.

Reference

J M Rice, J Temple and P McDonald, National Transfer Accounts for Australia, 2003-04 and 2009-10 (available on the Treasury web site)

Dennis Trewin, AO FASSA, on behalf of the Policy and Advocacy Committee

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