

# Consultation on the Retirement Phase of Superannuation

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January 2024

Thank you for the opportunity to contribute to the consultation on the Retirement Phase of Superannuation.

There are two main issues we need to address if we want to improve the retirement income system for Australians who reach retirement age and wish to access their accumulated super.

The first problem is the sheer complexity of the rules.

The second is the lack of any simple superannuation products that transfer risk away from the retirees while still leaving them some capital flexibility.

Under the current system, retirees who have too much in super to qualify for a government pension have no way to guarantee an inflation-indexed income that is as easy to access and as secure as the pension they are forgoing by having contributed to super over their working life.

In this submission I will cover a few of the complexities that could be easily fixed, and suggest sensible changes to the current rules in these areas, as well as offering the framework for a new standard retirement income product which would be simple and flexible and would work for both retirees and providers. This could become a default retirement income product for retirees not wishing to manage their own investment, inflation and longevity risks.

## **The first problem is the complexity.**

For the average retiree, the biggest hurdle to planning for retirement income is the sheer complexity that the system has reached, with convoluted laws tacked on year after year to suit the desire of successive governments to reduce benefits, close loopholes (real or imagined), and benefit the financial advice sector (and the estate lawyers).

If we are to simplify the process for our retirees, then a few small targeted legislative changes to the current quagmire of rules and regulations would go a long way to accomplish this.

### **Retirees need to navigate:**

- transfer balance caps and the proposed new excess benefit tax
- the creation of a separate pension account each and every time a retiree makes a contribution that they wish to convert to pension mode

- superannuation guarantee contributions from ongoing employment, which cannot simply be added to existing pension balances (a separate accumulation account is required)
- the lack of opportunity for couples to pool their super into a joint account to take maximum advantage of caps and limits and to simplify processing super in the event of death or divorce
- estate planning, with super having entirely different inheritance rules from the remainder of a person's estate
- concern over closing out their super account before they die to avoid their heirs being charged death benefit taxes
- the hassle of keeping track of taxed and untaxed elements of super
- the nightmare for the remaining member of an SMSF when a trustee dies
- concern that they will lose the capacity to manage their super as they age (particularly for members of SMSFs)
- changes to the minimum withdrawal rates, both aged-based and those legislated in response to economic conditions
- worry that they will outlive their superannuation amount – longevity, inflation and investment risk
- lack of easily accessible products that guarantee a lifelong income but still leave access to capital (I will be suggesting one)
- most retirees are rightly cautious about the currently offered lifetime annuities, particularly their reliance on the integrity and solvency of the provider
- worry about retaining enough to cover a RAD for a decent standard of residential aged care
- constant threats to the refund of franking credits even though these are simply prepaid tax
- constant accusations that retirees are somehow cheating the system by having some of their balance remaining when they die.

In addition, those retirees who are not fully self-funded need to negotiate the interaction of superannuation income and the government age pension, with the ongoing requirement to report changes in assets and income.

Most retirees need considerable financial-planning help to cope with the system in its current form. This can be expensive and does not always result in the best advice for the retiree.

Instead of concentrating on increasing access to financial planning for retirees, why can't we simplify the system so most retirees no longer need it, and those who do are faced with less confusion when considering their options on how to manage their money.

I would like to suggest some small changes to the current legislation that would greatly simplify the system for retirees. I will cover in particular the proliferation of

pension accounts, the pooling of super between spouses, the inheritance rules and the death benefits tax.

## **Proliferation of Pension Mode Accounts**

There is currently no provision to add funds to a pension mode account. Every time you make a new non-concessional contribution to super that you want to convert to pension mode, you need a new pension account. There is only a complex (and to my mind completely unnecessary) process by which the separate pension accounts are converted back to accumulation mode, then merged and converted back again into a new single pension-mode account. This can be complicated, time-consuming and expensive.

These pension accounts could simply be combined, and the taxed and untaxed elements recalculated, without the need to switch to accumulation mode.

There is also no provision for retirees who are still employed part time to have their superannuation guarantee payments paid directly into their pension account. This results in the necessity for a separate accumulation account to be maintained, with the associated cost of maintaining the separate account, and for SMSFs, the additional cost of obtaining an actuarial certificate.

This could easily be fixed by allowing new contributions to be added to existing pension mode accounts, providing the minimum payments are increased in accordance with the increased balance. Any contributions tax owing on the contributions would be calculated and paid to the ATO either at the time the contribution is made or at the end of the year.

## **Pooling of super between spouses**

Allowing couples to set up a joint super account (if they so wish) would simplify money management for families and retirees.

Couples would be able to take advantage of two lots of transfer balance cap and, in some cases, to avoid the proposed extra tax on balances above \$3m. The limit for a couple would be \$6m.

On breakup of a marriage, the joint account could simply be split 50-50.

On the death of a retiree, their share of the joint account would automatically revert to the surviving partner, with any adjustments needed to cater for transfer balance caps.

There would no longer be any need for spouse contribution rules, and women with broken work patterns due to time out for looking after children would be advantaged financially by having an undisputed half share of the couple's super.

At the very least, allow couples a one-off opportunity to balance their accounts at retirement, by transferring some of the super from one partner to the other.

## **Estate Planning**

A person's super is not currently automatically part of their estate when they die. This can result in complex and often unexpected situations where the beneficiaries specified in a person's will are not the beneficiaries of their super.

There are myriad examples on the internet and in the newspapers of family disputes where the current superannuation law appears unfair to some of the beneficiaries of the estate of the retiree.

There are situations where Binding Death Benefit Nomination forms, although submitted to their super fund in good faith by the retirees, are lost, out of date or simply deemed invalid.

Some superannuation funds can take an excessive amount of time to pay benefits while they establish the correct beneficiary.

It would only take a small change in superannuation law to have all super automatically revert to the estate on the death of the retiree and be distributed as part of the estate, according to the will of the deceased retiree, unless it is jointly owned (as in my suggestion above), when it would pass directly to the surviving spouse, and could remain inside super.

As well as simplifying the process of winding up an estate, this would reduce paperwork for the super funds, as the BDBN forms would no longer be required.

At the same time, something could be done to simplify SMSF administration when a member dies and a new trustee must be appointed.

There has to be some way to avoid the nightmare of finding a new trustee at a time when the surviving member is in the midst of grief at losing a partner (or a close relative who is acting as second trustee for a single member fund) and is involved in the often-complex process of winding up their partner's affairs. Having a company as a trustee just doesn't cut it, as it causes more complication and cost in running the fund, and it merely shifts the problem from changing trustees to changing directors.

My suggestion on this would be to allow a single member fund to have one trustee only. This would apply to SMSFs originally set up with a single member, and those that revert to being a single member fund when one member dies. SMSFs are audited, so an errant trustee would be picked up at that stage, and the member is only in charge of their own money, not someone else's, which limits the damage they can do.

If super automatically reverted to the estate as I have suggested above, then on the death of the final member and trustee of the fund, the executor of the estate would

be given control of the assets of the SMSF, and they would be distributed according to the person's will.

## **Death Benefit Tax on Untaxed Elements of Super**

Does this tax really raise sufficient revenue to compensate for the effort of both the beneficiaries calculating it and the ATO collecting it?

As the bulk of large inherited superannuation balances would come from after-tax contributions (which are already taxed so not subject to death benefit tax), the overall death benefit tax raised would be quite small.

The tax can be avoided by retirees cashing out their super before they die, particularly if they know they are close to their mortal end. However this apparent loophole can be something of a lottery.



And do we really want to have relatives arriving at the deathbed of a sick and dying retiree with a form to close the super account for the retiree to sign in order to save tax for the relatives?

There may then be ensuing disputes over whether the form to close the account was received and acted on by the fund before the person actually died, whether the retiree was of sound mind when they signed it, and even whether the deceased retiree was coerced into signing it. If the closing request form is deemed invalid, the next step can be a dispute over who is the beneficiary, as the outcome may differ according to whether the assets are no longer in super and therefore part of the estate, or are still in super and subject to different rules. All this can result in stress, delays and legal costs for the beneficiaries.

Please can we just eliminate this tax altogether, saving worry for retirees and accusations of avarice for heirs.

It would also save work for superannuation funds and SMSF administrators who are currently keeping track of taxed and untaxed elements of pension-mode super, as this distinction would no longer be relevant.

## **My Suggestion for a New Retirement Income Product**

An ideal retirement income product would be simple to understand and would shift the risks of longevity, inflation and investment returns away from the retiree, so they receive a reasonable amount of income on their capital for as long as they live, adjusted for inflation, while still retaining the right to access some of their original capital if they wish to do so.

Most retirees would accept that they need to pay some cost to transfer these risks from themselves to their income provider. However most retirees also do not want this to be a complete game of chance, with all of their capital lost if they drop off the perch the day after they retire, and with no provision to change their mind.

Retirees are also wary of their income provider going broke, leaving them with nothing. Any credible income product would need to come with some sort of guarantee against this risk.

We need products that are a compromise, shifting risk to the provider (the super fund) at a reasonable cost to the retiree, and with some likelihood of profit for the provider, so both parties are happy with their side of the contract.

Here is my suggestion for a new retirement income product that I am calling a Basic Retirement Income (BRI). I have summarised the characteristics of the BRI, then covered them in more detail, along with some other considerations. I have also included a table at the end showing how this would work financially for both retirees and providers.

### **The BRI would have all of the following characteristics:**

- It would be entirely voluntary, but would be the default product at age 67
- It would be simple to understand and consistent across providers
- There would be a maximum initial amount of contributed capital
- Couples could take up a joint BRI
- The income would be indexed, lifelong, tax free and guaranteed
- The retiree would be transferring longevity, inflation and investment risk to the provider
- The income would begin at 5% of the original capital
- The capital would be accessible, but would diminish by 4% per year, reaching zero after 25 years
- The residual capital would pass to the estate of the retiree on their death
- The super fund would provide regular statements of the current income and the current residual capital
- The super fund would provide income and asset details to Centrelink for retirees who were not fully self-funded.

### **The BRI would be entirely voluntary.**

The BRI would be available from age 65, but would normally be taken up at retirement at age 67, and would become the default retirement income product. The retiree would always be offered the choice of whether to take it or not.

The retiree could alternatively retain their super in accumulation mode, stay with the current system of account-based pensions, or take part or all of their super as a lump sum.

### **The BRI would be simple and consistent across providers.**

The BRI would be offered with exactly the same conditions by all large established superannuation providers (but not SMSFs – more on that later).

The rules would be simple to understand, with a set percentage of the original capital paid out as income, and a set percentage of the capital being deducted each year.

Retirees who do not wish to engage a financial planner, or who cannot afford to do so, would be confident that they would be choosing a standardised product that was likely to suit their needs.

Although the Discussion Paper calls for more competition in retirement income products, having the product uniform across providers would simplify decision making for the retiree, who could then simply remain with their current provider.

We want moving their super into retirement mode to be simple for those retirees who are not familiar with the rules, and offering them a myriad of choices from different providers would be stressful for them. They could face a range of options even more confusing than choosing a mobile-phone plan.

In addition, competition between providers could result in a proliferation of too-good-to-be-true offerings by shonky operators who take the life savings of retirees on the promise of unrealistically-high lifelong payments, then disappear with the capital, leaving their clients destitute. We have had a range of schemes in the past where advisers have set up self-managed super funds for people with promises of investing the money in property or bitcoin schemes which have subsequently failed, leaving the clients (but often not the organisers) with nothing. This is bad enough for accumulation super, but would be disastrous for pension-mode super.

If there is to be competition for lifelong retirement income products, at least have them confined to long-established providers, have the providers registered, and offer a government-backed guarantee.

### **There would be a maximum initial amount of contributed capital.**

The maximum allowed initial capital would be equal to the transfer balance cap, currently \$1.9m, and would form part or all of the retiree's transfer balance.

Alternatively, a lower amount could be set, for example 50% of the transfer balance cap, or a set amount of \$1m per retiree.

### **Couples could take up a joint BRI.**

The BRI could be taken up jointly by a couple, with their super pooled together, and a limit of twice the maximum. On the death of one partner, the whole amount would revert to the surviving partner. For simplicity there would be no transfer balance adjustment.

### **The BRI income would be indexed, lifelong, tax free and guaranteed.**

The BRI payments would be lifelong, regardless of how long the retiree lived, and would be indexed for inflation. The income would be guaranteed as a last resort by the government, so retirees would never need to worry about their superannuation fund going broke.

However this would be unlikely to occur, as the fund would be earning investment income on the original capital which should easily cover the indexed increase each year and the risk associated with the payments continuing beyond 25 years for some members. The table shows how this would work for providers as well as retirees.

The retiree would be transferring longevity risk, inflation risk and investment risk to the provider in exchange for the provider making some profit on all but the most long-lived retirees.

The BRI payments would be totally tax free, in the same way as all income from pension-mode super is currently tax free. This would avoid the need for tax-related calculations of how much of the income is a capital return.

### **The income would begin at 5% of the original capital.**

Once the BRI was set up, each year the retiree would be paid 5% of the value of their original capital, paid in fortnightly or monthly instalments, and this amount would be indexed for inflation in line with the government age pension.

So if you started with \$1m, you would be paid \$50k in the first year, then around \$51k in year two, depending on the inflation rate, and this slowly-increasing income would be paid for the remainder of your life.

The table at the end of this submission shows how the payments would increase with time.

### **The capital would be accessible, but would diminish by 4% per year.**

For the first 25 years, you could take out some of your initial capital. The amount available (the residual) would reduce by 4% of the original balance each year. This would be calculated monthly. So for your original \$1m, after two years you could withdraw the remaining \$920k. Your income would reduce proportionately, to around \$4k, as your remaining initial capital was now only \$80k (although your residual capital would now be zero).

A provision would be made for those who wanted to exit altogether, perhaps a lump sum payment of a few years' income at the reduced \$4k rate.

You could also make a partial withdrawal. If you withdrew \$200k (20% of your original balance), your income going forward would reduce by 20%.

It may be possible to allow recontribution of capital amounts withdrawn, provided the initial capital balance was not exceeded, and this would result in the income being restored at the current indexed level.

If you survive longer than 25 years, the pension would continue at the normal indexed rate, but there would be no remaining residual. For a retiree starting at age 67, the 25 years equates roughly to their life expectancy.

### **The residual capital would be available to the estate of the retiree.**

If you die within 25 years, the calculated residual would be paid directly to your estate. However, if you die after 25 years, there would be no residual left for your heirs.

For a couple with a joint BRI, the share of the income and the residual of the deceased retiree would pass directly to the survivor, so any residual would only pass to the estate on the death of the second partner.

To keep things simple, no death benefit tax would be levied on the residual.

### **The super fund would issue regular statements.**

The super fund would provide regular statements of the payments made as well as the current income rate and the current residual capital. The retiree would then know how much they could withdraw if they wished to.

### **Assessment and reporting for non-self-funded retirees.**

There would need to be some decisions on how this product would be assessed by Centrelink for those retirees who are not fully self-funded.

If you qualify for a government pension in addition to your BRI, then your assets for the pension could be calculated using the residual value of your BRI, and this could easily be automated by Centrelink.

However part of your income from the BRI would then need to be assessed as income by Centrelink, perhaps the income for the year less the annual reduction in capital.

If you allow the asset value to diminish, and include only the deemed income on this, while disregarding the real income from the BRI, then eventually almost all retirees would qualify for a full age pension in addition to their indexed BRI.

Alternatively the full amount of the original capital could remain as an asset for Centrelink calculations, with the income deemed on this amount, and the BRI income disregarded.

Any assessed changes in assets or income would be reported directly to Centrelink by the super fund, to avoid reporting requirements for the retiree.

### **Effect on Residential Aged Care.**

If you need residential aged care and no longer have enough residual for the RAD, you would be able to show the aged care provider that you have a guaranteed income to cover paying a DAP as an alternative. This gives the aged care provider confidence that you can always afford the care at the level they are providing. (RADs for aged care homes act as a *de facto* guarantee to the aged care provider that they will be paid for your care).

### **How the BRI would apply for SMSFs.**

It would not be practical for SMSFs to offer this BRI product, but all industry and retail funds would be obliged to. An SMSF member wishing to take this up would need to transfer to a larger fund with the capacity to insure (or self-insure) against the longevity component of the payments. The Future Fund could offer this product to SMSFs, and to members of small APRA-regulated funds unable or unwilling to take on the risk of offering a lifetime product.

### **Benefits for Retirees.**

Retirees would be giving up some of the income they could earn by managing the capital themselves, as well as a portion of their capital, in exchange for their payment being indexed and the confidence that their income would be lifelong. The fund would make some profit to compensate for the risk involved in supplying the guaranteed income. This fund profit would be the cost to the retiree for transferring longevity risk, inflation risk, and investment-income risk to the provider.

Benefits of this product for retirees:

- Straightforward to set up and easy to understand
- The same standard product across all funds to avoid complex choices
- You are guaranteed an indexed income for as long as you live
- The income is predictable – no changes except for inflation increases
- If you lose mental capacity as you age, there is no risk to your income
- You are transferring longevity, inflation and investment risk to the fund
- You are not losing total control of your capital – a diminishing proportion of it is available at any time during the first 25 years, and passes to your estate if you die within that time
- If you die before your life expectancy your heirs get some benefit
- If you spend less than your BRI income, the remainder is available to you to save outside of super
- If you spend less than your BRI income, your heirs will receive any amount you save outside of the BRI
- There are no tax issues – the income is entirely tax free
- The asset value of the residual and the assessable income component of the BRI can be calculated automatically by Centrelink for age pension adjustments for non-self-funded retirees

Overall, this would be an attractive set-and-forget option for their super for most people reaching retirement age.

### **Benefit to super funds providing the income.**

I have included below a table of how this system would work from the point of view of both the retiree and the superannuation provider, assuming a steady inflation rate of 2.5%. Provided the fund can earn 6% after costs on the original capital invested by the retiree, the retiree would be aged 102 before the fund is out of pocket. As very few of the members would reach this age, and the fund gets to keep the remaining balance from those who do not, the risk to the fund is very low.

The fund profit is the amount left over when the retiree dies and the fund pays out any remaining residual capital to their estate. The fund makes the maximum profit where a retiree lives to around the current life expectancy between 86 and 92 years of age, and also retains the excess if their investment return is greater than 6%.

The fund could pay a 15% tax on the amount remaining after the residual is paid out when a retiree dies. This would compensate the government for being a guarantor of last resort for the income of the retirees, and would replace the superannuation death benefit tax normally paid by the beneficiaries.

The percentages I have used in the calculations are just suggestions, but they work to illustrate the concept, and they would be easily understood and calculated by retirees. They could be tweaked by a competent actuary to more accurately reflect

the reality of investment returns and the risk premium that the super funds providing the BRI would require.

## **Re-cap**

In this submission, I have suggested some simple changes to the current system to make life easier for retirees.

These are:

- Make it easier to combine pension-mode accounts and add new contributions
- Allow couples to hold their super in a combined joint account
- Have superannuation automatically revert to a person's estate when they die
- Allow a single trustee for single-member SMSFs
- Eliminate death benefits tax

In addition, I have suggested the framework for a simple retirement-income product that is lifelong, indexed, tax-free, consistent across providers and guaranteed.

## **Thank you.**

Thank you for reading this submission. Please feel free to contact me to discuss any aspects of these suggestions further.

**Table 1: BRI calculations for Retiree and Income Provider**

Original Principal	1,000,000	Fund Profit = Remainder after residual paid					
Capital Reduction	4.0%						
Income to Retiree	5.0%						
Inflation	2.5%						
Investment Return	6.0%						
Initial Income	50,000						
Year End	Retiree Age	Retiree Income	Retiree Residual	Fund Invest Inc	Fund Payment	Fund Balance	Fund Profit
1	67	50,000	960,000	60,000	50,000	1,010,000	50,000
2	68	51,250	920,000	60,600	51,250	1,019,350	99,350
3	69	52,531	880,000	61,161	52,531	1,027,980	147,980
4	70	53,845	840,000	61,679	53,845	1,035,814	195,814
5	71	55,191	800,000	62,149	55,191	1,042,772	242,772
6	72	56,570	760,000	62,566	56,570	1,048,768	288,768
7	73	57,985	720,000	62,926	57,985	1,053,710	333,710
8	74	59,434	680,000	63,223	59,434	1,057,498	377,498
9	75	60,920	640,000	63,450	60,920	1,060,028	420,028
10	76	62,443	600,000	63,602	62,443	1,061,186	461,186
11	77	64,004	560,000	63,671	64,004	1,060,853	500,853
12	78	65,604	520,000	63,651	65,604	1,058,900	538,900
13	79	67,244	480,000	63,534	67,244	1,055,189	575,189
14	80	68,926	440,000	63,311	68,926	1,049,575	609,575
15	81	70,649	400,000	62,975	70,649	1,041,901	641,901
16	82	72,415	360,000	62,514	72,415	1,032,000	672,000
17	83	74,225	320,000	61,920	74,225	1,019,695	699,695
18	84	76,081	280,000	61,182	76,081	1,004,796	724,796
19	85	77,983	240,000	60,288	77,983	987,100	747,100
20	86	79,933	200,000	59,226	79,933	966,394	766,394
21	87	81,931	160,000	57,984	81,931	942,447	782,447
22	88	83,979	120,000	56,547	83,979	915,015	795,015
23	89	86,079	80,000	54,901	86,079	883,837	803,837
24	90	88,231	40,000	53,030	88,231	848,637	808,637
25	91	90,436	0	50,918	90,436	809,118	809,118
26	92	92,697	0	48,547	92,697	764,968	764,968
27	93	95,015	0	45,898	95,015	715,852	715,852
28	94	97,390	0	42,951	97,390	661,413	661,413
29	95	99,825	0	39,685	99,825	601,273	601,273
30	96	102,320	0	36,076	102,320	535,029	535,029
31	97	104,878	0	32,102	104,878	462,252	462,252
32	98	107,500	0	27,735	107,500	382,487	382,487
33	99	110,188	0	22,949	110,188	295,248	295,248
34	100	112,943	0	17,715	112,943	200,021	200,021
35	101	115,766	0	12,001	115,766	96,256	96,256
36	102	118,660	0	5,775	118,660	-16,629	-16,629
37	103	121,627	0	0	121,627	-138,256	-138,256
38	104	124,667	0	0	124,667	-262,923	-262,923
39	105	127,784	0	0	127,784	-390,707	-390,707
40	106	130,979	0	0	130,979	-521,686	-521,686