HEALTH WEALTH CAREER

A REVIEW OF GRATTAN'S WORK ON SUPER

VERDICT: VERY MISLEADING

JULY 2019

MAKE TOMORROW, TODAY MERCER

EXECUTIVE SUMMARY

The Grattan Institute has recently published several research papers relating to Australia's superannuation industry. In particular, it has concluded that most Australians can look forward to a better living standard in retirement than they had while working.

This is simply not true and is based on a series of assumptions that are not realistic for the average Australian. For example:

- Grattan assumes that we are single when we retire whereas 70 per cent of us have a partner. This makes a big difference to the amount of age pension received in retirement.
- Grattan assumes that our desired lifestyle is based on the income received in our last five years of work before retirement. In fact, many Australian workers gradually transition to retirement and reduce their income in the last few years. Hence, this reduced income does not represent their long term standard of living.
- Grattan assumes that we will all work until the future pension eligibility age of 67. In fact, most Australians retire a few years before the pension age and rely on their superannuation and other savings for income in these years.

In short, the Grattan findings are very misleading. They conclude that the median income worker will have a net replacement rate of 89 per cent of their income before retirement whilst the average full time income worker will have a net replacement rate of 78 per cent, well above their objective of 70 per cent. However, the Grattan figures do not represent a realistic scenario for most Australian workers. The following table adjusts the Grattan figures for the impacts of several shortcomings in the model used.

	Median income earner	Average full time earner
Grattan base case	89%	78%
Shortcomings in the model		
Single person bias	-12%	-12%
Pre-retirement income measure	-5%	-5%
Assumed retirement age	-3%	-4%
Life expectancy	-4%	-5%
Risks during retirement	-2%	-3%
Revised Net Replacement Rate	**68%**	**58%**

These revised net replacement rates, provide a much more realistic picture of the future for most Australians entering the workforce today. Whilst the median income earner may be able to maintain their previous standard of living, the average full time earner will need to save additional funds, over and above compulsory superannuation, if they wish to have a reasonable likelihood of maintaining their previous standard of living throughout retirement. It should be noted that all these figures allow for the legislated increase in the Superannuation Guarantee to 12 per cent of earnings.

We must also recognise that future Australian retirees will face a range of new circumstances arising from the changing workforce, reduced home ownership, the new economic norm and possible legislative shifts arising from an ageing population. These changes call for new research using a broad range of cameos rather than developing policy based on a single cameo.

INTRODUCTION

In recent years the Grattan Institute has published several reports relating to the Australian superannuation industry including *Money in retirement: more than enough* published in November 2018 with a follow up presentation *Money in retirement: will we have enough* in April 2019.

The 2018 report concluded that

"the average worker today can expect a retirement income of at least 91 per cent of their pre-retirement income – well above the 70 per cent used in this report and endorsed by the OECD."[1]

Although the 2019 presentation reduced this replacement rate to 89 per cent[2], their overall findings and recommendations did not change. A major conclusion is:

"the current 9.5 per cent Super Guarantee is sufficient to deliver adequate retirement incomes to the vast majority of Australians, together with the Age Pension and other private savings."[3]

Indeed, their first recommendation is that the planned increase in the Superannuation Guarantee to 12 per cent by July 2025 should be abandoned[4].

However, the net replacement rate calculated by Grattan of 89 per cent stands in stark contrast to the net pension replacement rates for the average income earner in Australia, as calculated by the OECD, of 42.6 per cent for males and 38.8 per cent for females. These Australian figures are much lower than for most OECD countries where the average is 62.9 per cent (males) and 62.2 per cent (females)[5]. Given the significant differences in these results for Australia, further investigation is obviously needed.

Furthermore, in light of the forthcoming review of Australia's retirement income system, as recently announced by the federal Treasurer, it is critical that all interested stakeholders come to a better understanding of the benefits delivered by the existing system and whether or not they provide adequate retirement benefits for most Australians.

This paper begins with a discussion of the areas of agreement with Grattan before an analysis of their current model highlights several shortcomings which, in turn, influence their results and recommendations.

[1] Grattan (2018), page 3.
[2] Grattan (2019), page 24.
[3] Grattan (2018), page 87.
[4] Grattan (2018), page 4.
[5] OECD (2017), page 107.

AREAS OF AGREEMENT

The Grattan approach recognises that Australia's retirement income system is made up of four pillars, namely:

- The means-tested age pension paid by the Government and funded from general taxation.
- The Superannuation Guarantee, currently set at 9.5 per cent of wages, which is paid by employers for most employees. The self-employed are not included.
- Voluntary savings, which may occur within or outside the superannuation system.
- Home ownership which provides security for many retirees.

This is broadly consistent with the multi pillar frameworks adopted by the World Bank and OECD.[6] Comparing Australia to many other systems, the major difference is that Australia does not have an earnings-related social security system managed by the Government which is common in Europe and North America.

We agree that the Australian system has these four pillars and each has a role to play in the provision of financial security in retirement. Whilst there has recently been some discussion on the objective of superannuation, it would be preferable that agreement is reached on the objective of the overall system and only then, the objective of each pillar within the system.

We also agree with Grattan that a benchmark replacement of 70 per cent of pre-retirement income is a good target for retirees who own their home. As they note, retirees who rent will need a higher replacement rate to cover their higher housing costs. In essence, a replacement rate of 70 per cent will enable most retirees to maintain the living standards they enjoyed before retirement.

It is also appropriate that this target of 70 per cent is modified for each end of the income spectrum. That is, those on very low incomes are likely to need a replacement rate closer to 100 per cent while those on very high incomes should be satisfied with a target below 70 per cent.

Nevertheless, for the vast majority of Australian households, a target replacement rate of 70 per cent represents a suitable objective. As Grattan notes:

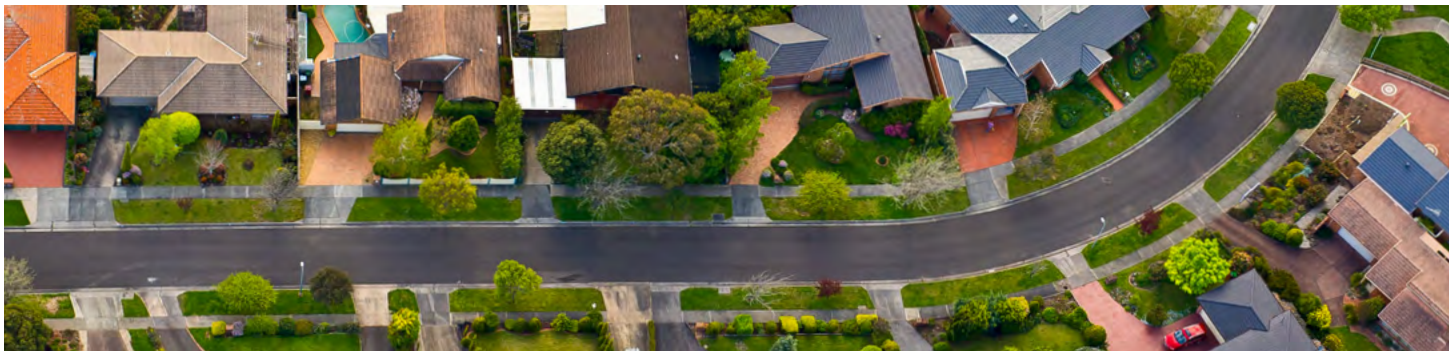
> "the retirement income system should ensure individuals have the resources to sustain their pre-retirement living standard"[7].

We agree. Retirees should be able to live out their retirement years in dignity and not suffer a fall in their living standard.

We also agree with Grattan that retirees face several risks during retirement including market risk (linked to the value of their investments); inflation risk (which will reduce their future purchasing power, for the same level of income); and longevity risk, as the period of their retirement is unknown. Some of these risks may be reduced or removed through the purchase of particular products (such as lifetime annuities) whilst the availability of the wage-indexed age pension will mitigate these risks for some households.

Notwithstanding these potential offsets, it needs to be recognised that the future is unknown and retirees who are not in receipt of an indexed lifetime pension will be subject to these risks which have the potential to reduce their standard of living.

Of course, any model projecting the future must make a series of assumptions about future economic conditions as well as the financial decisions of the individual and their lifespan. Inevitably the Grattan Retirement Income Projector (or GRIP model) makes a series of these assumptions. We are generally comfortable with the long term economic assumptions relating to investment earnings and long term wage growth. However, some of the assumptions relating to individual behaviour are problematic and these will be discussed in the next section. We will also discuss the deflator used.



[6] Cepar (2018), Part 1, page 4.

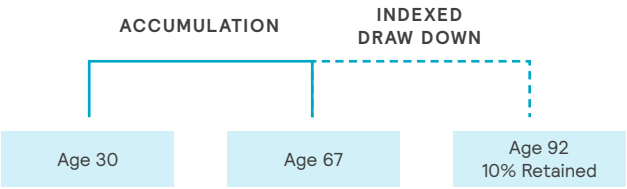
[7] Grattan (2018), page 123.

AREAS OF CONCERN AND DISAGREEMENT

Before discussing our concerns about the Grattan model and the consequential results, it's important we understand the basic construct of the model. The main features are as follows:

- The single individual joins the workforce at age 30 and retires at the future age pension eligibility age of 67. The entry age of 30 allows for some years out of the workforce.
- The SG is assumed to increase from 9.5 per cent to 12 per cent of earnings, in line with the current legislation.
- The superannuation benefit (and any non-super savings) is gradually drawn down from age 67 to age 92 at a constant rate, indexed to CPI.
- The retiree owns their own home.
- At age 92, retirees retain 10 per cent of their initial retirement savings (CPI indexed).
- The replacement rate is based on the average income received over the 25 years of retirement, including both the drawdown of savings and any age pension.

This can be summarised in the following diagram:



The replacement rate (as used throughout the Grattan research) is calculated as follows:

$$\frac{\text{The average real income throughout the 25 years of retirement}}{\text{The average income during the last five years of the working life}}$$

At this stage it should be noted that the use of the average real income overstates the income during the early years of retirement due to the wage indexation of the age pension. For example, while Grattan (2018) shows that the income replacement is 91 per cent averaged over the 25 years of retirement, it is only 63 per cent in the first five years of retirement.

The following sections discuss several concerns or shortcomings with the model.

A BIAS TOWARDS SINGLE RETIREES

The GRIP model assumes the individual is a single person and a homeowner when they reach retirement. This is a simplification and does not reflect reality.

Whilst most retirees are currently homeowners, it should be recognised that most people retire as a couple. That is, the household has two superannuation accounts based on two different working histories and is treated as a couple for the age pension means tests. This can have a significant effect.

Table 1 compares the age pension received by two single persons, with balances of $200,000 and $400,000 respectively, and the age pension that would be received if these two persons were a couple[8].

Table 1: The impact on age pension payments for a couple

	Single person 1	Single person 2	Couple
Super balance at retirement	$200,000	$400,000	$600,000
Super income (5%)	$10,000	$20,000	$30,000
Age pension in year 1	$23,861	$13,415	$20,272
Total income	**$33,861**	**$33,415**	**$50,272**

The table show that the age pension received by the couple in the first year of retirement is $17,004 less than the total age pension that would have been received by the two single persons. Of course, there is good reason for this reduced age pension for a couple as they have reduced living costs compared to two single persons living separately.

However, Grattan calculates their replacement rates assuming the individual is a single person and therefore receives the higher age pension. This is not the norm as 70 per cent of people retire as a couple and will therefore receive a much lower age pension, at least for a few years, until one person dies.

This age pension effect means that the actual replacement rates experienced by most retirees are much lower than shown in the Grattan research. In brief, it is misleading to assume that all retirees are single persons for the purpose of the age pension.

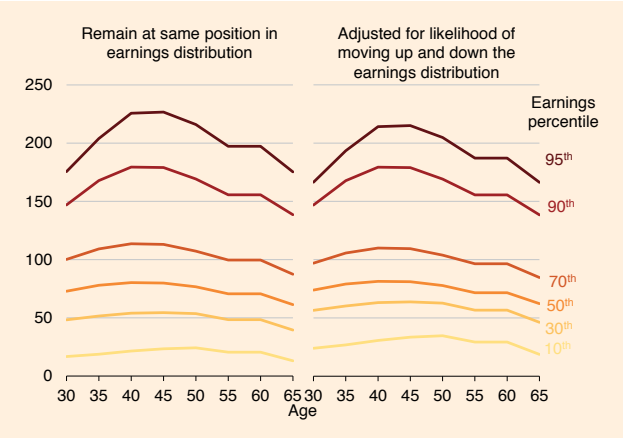
[8] These figures have been updated for the new deeming rates announced in July 2019.

THE INCOME MEASURE USED IN THE DENOMINATOR

Grattan expresses the replacement rate as a percentage of an individual's average income during the last five years of their working life; that is, from age 62 to age 66.

Yet it is well known that earnings typically peak before age 60. The following graph is from the Grattan report and has been adjusted for people moving up and down the earnings distribution[9].

Figure 1: Salary income as a proportion of Average Weekly Ordinary Time Earnings (AWOTE)



The reasons for the decline in earnings after age 55 are many and varied but it is worth noting that the percentage of part time workers increases from 28 per cent for those aged 55-59 to 37 per cent for ages 60-64 and then to 55 per cent for those aged 65 and over[10]. In other words, some people move from full time to part time as part of their transition to retirement. Inevitably this behaviour affects their earnings in the final years.

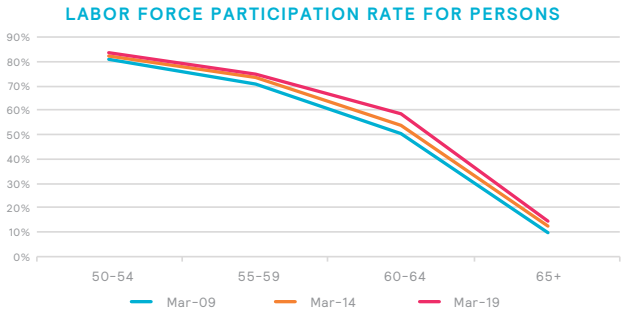
However, an individual's living standard is not determined by their earnings after age 60. In most cases, the living standards of a household are determined between ages 40 and 60. As some costs reduce during the 50s and 60s, it is feasible for many households to reduce their workload and the related income, say after age 60, whilst maintaining their standard of living. Therefore, in many cases the decision to reduce working hours does not mean that the reduced earnings should be used as the denominator to determine the desired standard of living.

It would be a much better analysis to use a denominator based on income from say ages 40 to 55, and then index that figure by wages, through to age 67.

THE ASSUMED RETIREMENT AGE OF 67

The GRIP model assumes that everyone will work through to the future age pension eligibility age of 67. This is extremely unlikely and is not consistent with current behaviour. Figure 2 shows labour force participation rates for older ages in 2009, 2014 and 2019[11].

Figure 2: Labour force participation rates at older ages



Whilst there has been a slight increase in these labour force participation rates during the last decade, it is apparent that many people retire before the previous pension eligibility age of 65. As the eligibility age increases to 67, it is unreasonable to assume everybody will work through to this age.

The reasons for this behaviour are many but include:

- The availability of superannuation benefits from the preservation which will be age 60 from 2024
- Being made redundant after age 60 with the related difficulty of finding another job
- The declining health of the individual
- The need to retire early to care for a parent or partner in failing health
- The desire to become a carer for grandchildren so both partners of the next generation can continue to work

Most individuals who retire at say ages 63 or 64, will be insufficiently disabled to receive the Disability Support Pension. In addition, many retirees will not meet the activity test requirements for the Newstart Allowance. Hence, they will need to use some of their superannuation money to live on, thereby reducing the amount available in future years.

It would therefore be more realistic for the model to allow for a period of 2-4 years prior to the age pension eligibility age where the superannuation benefit provides an income to the retiree.

[9] Grattan (2018), page 46.

[10] ABS (2018), Table 2.3.

[11] ABS (2019)

LIFE EXPECTANCY AT AGE 92

The GRIP model assumes that the retirement income is received from age 67 to age 92 with 10 per cent of the initial retirement savings (indexed to CPI) being available at that age for unexpected expenses or a bequest[12]. The age of 92 has been based on the projected average life expectancy for those reaching age 70 in 2055[13].

It is important to note that Grattan has used the average life expectancy; in other words, about half the population will live beyond age 92. The Grattan report suggests that those who live beyond age 92 will be well supported by the age pension, which is indexed to wages and therefore of increasing value when compared to prices. This is not sufficient for many retirees and inconsistent with the objective of maintaining living standards throughout retirement.

It should also be noted that the average life expectancy for the population should not be used for all socioeconomic groups. It is well known that life expectancy increases with income and wealth so that retirees with incomes around, say, the 80th earnings percentile would be expected to have an average life expectancy in excess of the population average. Further, these retirees are likely to receive a reduced level of age pension than those on lower incomes.

Hence the standard use of age 92 for all retirees is unreasonable on two counts. First, about half the population are expected to live beyond this age and, second, the average life expectancy for white collar workers is likely to be about two years longer than the population average.

As Grattan notes[14], an extension from age 92 to age 97 results in a significantly lower replacement rate because the retirement needs to be spread over a longer period.

THE EXISTENCE OF RISKS AND UNCERTAINTIES

Retirees face considerable uncertainty during their retirement years. Many unexpected events can occur. These include:

- Reduced real investment returns over the long term
- Uneven investment returns which can lead to capital loss in the early years
- Increased inflation
- An unexpected increase in life expectancy due to significant medical breakthroughs
- Significant unexpected expenditure relating to medical, dental or home refurbishment costs
- The cost of moving into aged care
- A reduction in the age pension payments due to changes in the means tests, as occurred in January 2017

It is unrealistic to assume that the long term economic assumptions underlying the model will be borne out exactly as assumed. Of course, the outcomes could be better or worse than expected. We do not know. However, it is reasonable to assume that retirees will adopt a risk averse position. In response to this need, they could behave in several ways, including:

- Insuring the risks by passing it on to a third party which will incur a cost
- Setting aside some funds for the possibility of a future "rainy day" – in effect, self-insuring
- Reducing their expenditure in response to market events or Government decisions

Whatever the actual behaviour, it is unrealistic to assume that retirees will not respond to these risks. They are facing considerable uncertainty and will respond. For example, the purchase of a lifetime annuity would remove some risks and pass them onto a third party. This is common practice in many developed economies.

However, such practice is not without a cost and one cannot assume that the provider of the annuity will assume the same investment return as an account-based pension. Whilst account-based pensions are by far the most popular post-retirement product in Australia, they are not without risk and retirees act accordingly.

Hence, it is reasonable to assume that say, 15 per cent of the initial retirement benefit is used to remove or mitigate these risks through the purchase of an annuity or the setting aside of a buffer for unexpected events. It should be noted that the OECD allows for 10 per cent of the accumulated benefit to cover the cost of buying an annuity thereby removing the related risks from the individual. However, an annuity purchase does not cover all uncertainties.

[12] Grattan (2018), page 45.

[13] Grattan (2018), page 47.

[14] Grattan (2018), page 126.

THE DEFLATOR USED

An important assumption in all retirement projection models is the level of indexation that should be assumed during the retirement years. In brief, should it be indexed to prices or wages? As wages normally increase at a rate higher than prices, wage indexation leads to a lower replacement rate than prices. For example, Grattan (2018) shows that the 91 per cent replacement rate for a median income earner drops to 77 per cent if wage indexation is used instead of prices[15].

Whilst there is an argument that retirees should share in any productivity growth within the economy, it is also acknowledged that the expenditure needs for retirees gradually reduce in real terms during their retirement. Hence, a reasonable balance is achieved if price indexation is used during the retirement years.

However, a similar decision needs to be made in calculating the average income earned during the pre-retirement years. Should these be indexed by prices or wages? Whilst it may appear a relatively trivial issue if one is looking at the income during the five years before retirement, it becomes more significant if one goes further back, as suggested above. The indexation of these annual earnings by wages and not prices recognises the fact that living standards during the working years are normally determined by the level of after-tax income. This approach would increase the denominator in the GRIP model and thereby reduce the calculated replacement rate.

[15] Grattan (2018), page 60.

SO, WHAT'S THE IMPACT?

The Grattan research suggests that the replacement rate for the median income earner is 89 per cent of their pre-retirement income. This conclusion is misleading for several reasons which were outlined above.

Before attempting to determine the impact of these shortcomings, it is important to realise that the median income earner in the Grattan research allows for all tax-paying income earners. Hence, it includes casuals and part-timers as well as those in the full time workforce. Hence, to obtain the impact on average full time earners, we need to consider the 70th percentile income earner, as well as the 50th percentile, which represents the median. The impact of the above factors is also likely to be different at these different income levels.

SINGLE PERSON BIAS

Seventy per cent of Australians aged 65-69 are in either a registered or de facto marriage. This figure gradually reduces to 62 per cent for those aged 75-79 and 39 per cent at ages 85-89[16]. It is therefore inappropriate to assume that most Australians are single at retirement.

Table 1 showed that for a typical example the total retirement income for a single person dropped by 25 per cent if they were married, after allowing for both superannuation and age pension income. If the total superannuation balance was $450,000 instead of $600,000, the reduction in total income was 20 per cent whereas if the total balance was $750,000, the reduction in total income is 30 per cent[17].

Of course, not every married retiree will remain married throughout their retirement as one partner will die before the other, thereby reverting the surviving retiree to a single status. Hence, to be conservative, we will assume there is a reduction of 12 per cent in the total income (or net replacement rate) received during retirement.

PRE-RETIREMENT INCOME MEASURE (THE DENOMINATOR)

As noted above, the Grattan model considers the income during the individual's last five years in the workforce. However, the living standards for most individuals are not established in these five years; they are established some years earlier. Indeed, real incomes tend to peak between ages 45 and 60, not in the five years leading up to age 67. At most income levels, the level of earnings during the 50s is at least five per cent higher than during the 60s. Hence the denominator used should be at least five per cent higher. An increase in the denominator by slightly more than five per cent reduces the net replacement rate by about five per cent in both cases.

EARLIER RETIREMENT

As discussed above, the assumption that average Australians will retire at age 67 (the future age pension eligibility age) is unrealistic. Many Australians will retire before this age and live on their accumulated superannuation benefit for some years before pension age. Of course, the percentage of the benefit that will be used during this period will vary considerably between individuals. However, it is reasonable to assume that for most individuals 10 per cent of the superannuation benefit will be consumed so that only 90 per cent is available at age 67.

Such a reduction in the available superannuation assets will inevitably have an impact on retirement income although the extent will also depend on the relative importance of the age pension. For this reason, the reduction is likely to be more for higher income earners. We have therefore assumed a reduction in the total income of three per cent and four per cent respectively.

LONGEVITY

Most retirees cannot assume they will die at age 92; that is unrealistic. Of course, the age pension will continue to be paid whilst the retiree survives. However, the superannuation benefit also needs to be spread over additional years. Again, the impact is likely to be more significant for higher income earners. Hence we have suggested a reduction in the net replacement rate of four per cent and five per cent respectively. This is much less than the reduction of more than 10 per cent in this rate quoted by Grattan[18] for an increase from age 92 to 97 for the median income earner.

UNEXPECTED RISKS

It has been suggested previously that 15 per cent of the initial retirement benefit will be used by retirees to protect themselves from risks such as inflation, market risk and unexpected expenditure. In brief, retirees will hold this money back as part of their risk aversion (or protection) strategy. Whilst Grattan has allowed for a 10 per cent buffer, this will be insufficient for many retirees, given the considerable uncertainty they face over many decades. The impact of these risks (in addition to the 10 per cent allowance) is likely to be a reduction in the net replacement rate of two per cent and three per cent respectively.

THE OVERALL IMPACT

Table 2 shows an estimate of the combined impact of all these factors. Whilst these effects have not been able to be calculated accurately, they represent reasonable estimates for each item. Indeed, some estimates are likely to be conservative.

[16] ABS, Census 2016, Marital Status by Age by Sex.

[17] These figures assumed a drawdown of 5 per cent from superannuation. If this rate is increased to 8 per cent (a realistic maximum), the reductions are 20 per cent, 16 per cent and 23 per cent respectively.

[18] Grattan (2018), page 126.

Table 2: The impact of each factor on the Net Replacement Rate (NRR)

	Median income earner		Average full time earner	
	Effect	*Adjusted NRR*	*Effect*	*Adjusted NRR*
Base case	na	89%	Na	78%
Shortcoming in model				
Single person bias	-12%	78%	-12%	69%
Pre-retirement income measure	-5%	74%	-5%	65%
Assumed retirement age	-3%	72%	-4%	63%
Life expectancy	-4%	69%	-5%	59%
Risks during retirement	-2%	68%	-3%	58%
Revised Net Replacement Rate		**68%**		**58%**

Note: The adjusted net replacement rate column shows the (rounded) impact of each effect as well as allowing for the impact of the previous effects.

After taking into account these factors and assuming that the Superannuation Guarantee will increase to 12 per cent (as currently legislated), the net replacement rate for the median income earner is 68 per cent, or slightly below the benchmark replacement rate. The revised net replacement rate for the average full time income earner is well below this benchmark.

One final note of caution. The Grattan model and the revisions discussed above have been based on a particular set of pre-determined assumptions. One thing is certain: these assumptions will not occur. Of course, it is impossible to know whether the actual outcome will deliver a better or worse outcome for retirees. However, it is inevitable that some retirees will suffer negative outcomes.

A good example is sequencing risk. This occurs when investment returns shortly after retirement are poor, and possibly negative, such that the value of the superannuation assets is lower than expected. In many cases, the asset values never recover as the same withdrawals are made from a reduced capital base.

It is therefore important that modelling of future retirement incomes recognises the shortcomings of deterministic models (including those with sensitivity analysis) and ideally uses stochastic models which allow for interactions of economic variables and produce a distribution of results for each individual cameo.

THE OECD COMPARISON

Before closing it is important to understand some of the differences between the OECD and Grattan models. After all, the OECD calculated the net pension replacement rate for an average income earner in Australia as 42.6 per cent for males and 38.8 per cent for females whereas the Grattan figure (even with the above reductions) is 58 per cent.

The assumed economic variables in the two models are reasonably similar although some of the other underlying assumptions are quite different.

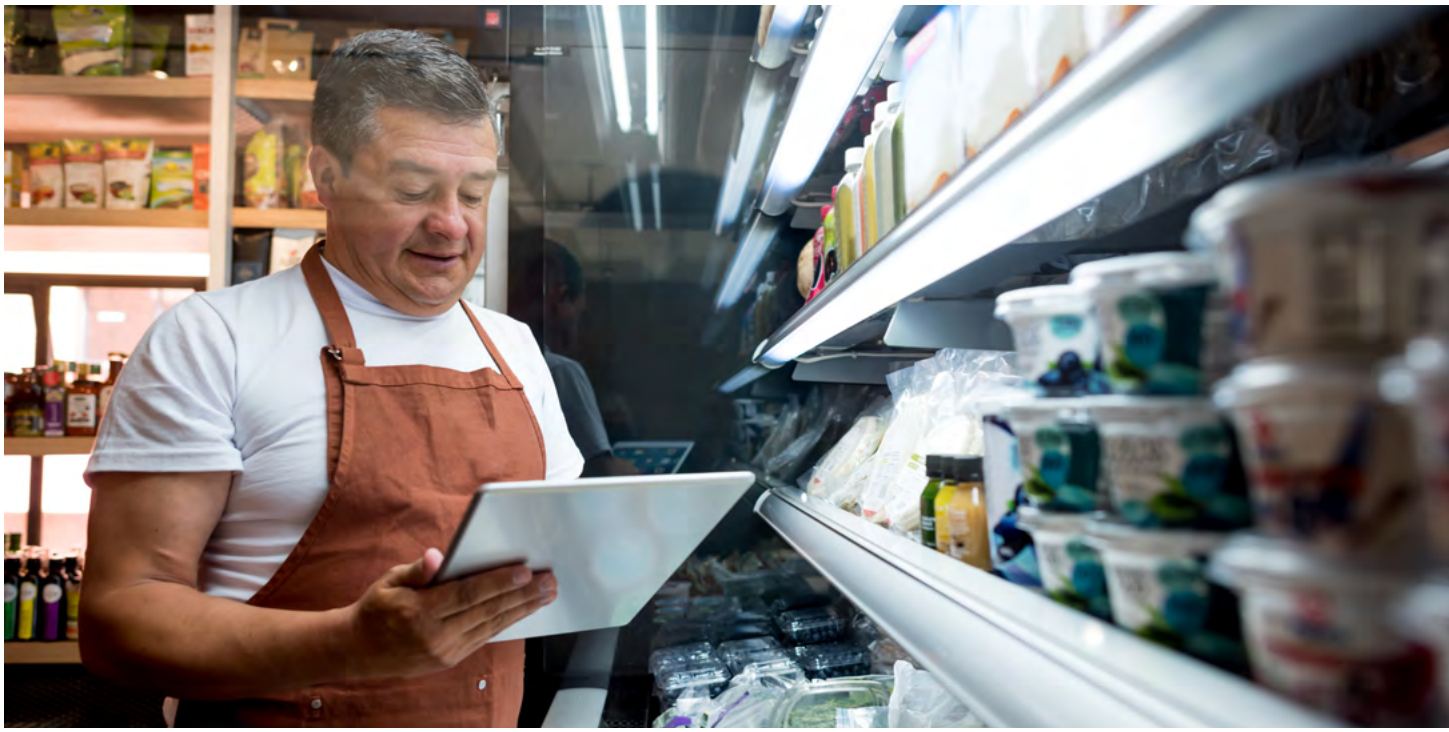
The OECD assumes price inflation of 2 per cent p.a., real wages growth of 1.25 per cent p.a., a real rate of investment return of 3 per cent p.a., and then assumes the purchase of a lifetime price-indexed annuity with the superannuation benefit, after allowing for a cost of 10 per cent. The income calculated by the OECD is for the first year of retirement and the average income earner is assumed to receive virtually no age pension in that year, due to the financial resources available to the retiree at that time.

The GRIP model assumes price inflation of 2.5 per cent p.a., real wages growth of 1.0 per cent p.a., a real rate of return of 3.5 per cent before fees but after tax, and a CPI-indexed drawdown of their superannuation and non-superannuation assets over 25 years, with 10 per cent of their CPI-indexed savings remaining at age 92.

Grattan calculates their replacement rates by taking the average income over the 25 years of retirement and dividing this average by the income in the last five years of the working life. This averaging is misleading. For example, their 2019 report[19] shows the real annual income for the median income earner rising from about $35,000 at age 67 to more than $60,000 at age 92 in real terms (CPI adjusted). The cause of this result is that the wage-indexed age pension payments increase as the superannuation and other assets are run down during retirement. Similarly, Grattan (2018) showed that whilst the average replacement rate over the 25 years of retirement is 91 per cent, the replacement rate in the first five years of retirement was only 63 per cent[20].

Grattan's quoted replacement rate for the first year of retirement for a median income worker is only 58 per cent[21], before allowing for any reductions discussed earlier to obtain a more realistic figure. After these reductions, it is reasonable to suggest that the net replacement rate in the first year of retirement is in the order of 50 per cent. This figure is between the OECD's net replacement rates for a full time earner with income of 50 per cent and 100 per cent of the average wage respectively.

Hence, whichever approach is used, both results show that in the early years of retirement many Australians will not be able to maintain the living standards enjoyed during most of their working life.



[19] Grattan (2019), page 18.

[20] Grattan (2018), page 52

[21] Grattan (2018), page 52.

CONCLUSIONS

Recent Mercer research[22] has shown that retirees want a stable income for their whole life as well as access to capital, to provide them with some protection from unexpected expenses that can easily occur during retirement. This is consistent with the findings of the Financial System Inquiry which highlighted that the desired features of retirement income products were income, flexibility and risk management features[23].

In other words, retirees need both regular income and access to some capital. Concentration on retirement income only, as occurs in the Grattan reports, ignores an important feature of retirement products – namely, the availability of some capital throughout retirement. This objective does not imply we should concentrate on lump sum benefits; the provision of retirement income should be the major objective. However, we should not assume it's appropriate to run down a retiree's capital close to zero as they approach their later years. Such an outcome would cause significant concern amongst many older retirees.

This objective of some capital access also highlights the difference between superannuation benefits (where some capital is available) and the age pension where a regular indexed income is the only benefit. Australia's retirement system needs both – a superannuation system that provides both future income and capital access on a fully funded basis and a pay-as-you-go age pension which provides income support to those without sufficient financial resources.

The Grattan Institute's research makes no allowance for the provision of any capital needs during the retirement years, apart from leaving a limited residual capital amount at age 92. In so doing, it concentrates on replacement rates and concludes that the "vast majority of retirees today and in the future are likely to be financially comfortable."[24]

As discussed in this paper, this conclusion is based on a series of assumptions used in their modelling, many of which do not represent the behaviour of the average or typical Australian. Hence, their conclusions are very misleading. As a result, some of their recommendations need to be treated with considerable caution.

Australians are in a diverse range of circumstances when they retire depending on their marital status, health, home ownership situation and the availability of savings beyond superannuation as well as the possibility of some ongoing employment options. It is therefore critical that any modelling of retirement incomes considers a significant number of cameos to provide policymakers with a better understanding of the implications of different policies.

Furthermore, it is important to recognise that the next generation will face the effects of the changing workforce, reduced home ownership, the new economic norm and ongoing legislative changes arising from an ageing population. We cannot assume that the future will reflect our past experience. It is much more complex than that.

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Important notices

For any questions regarding this report, please contact Senior Partner Dr. David Knox,
david.knox@mercer.com

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