

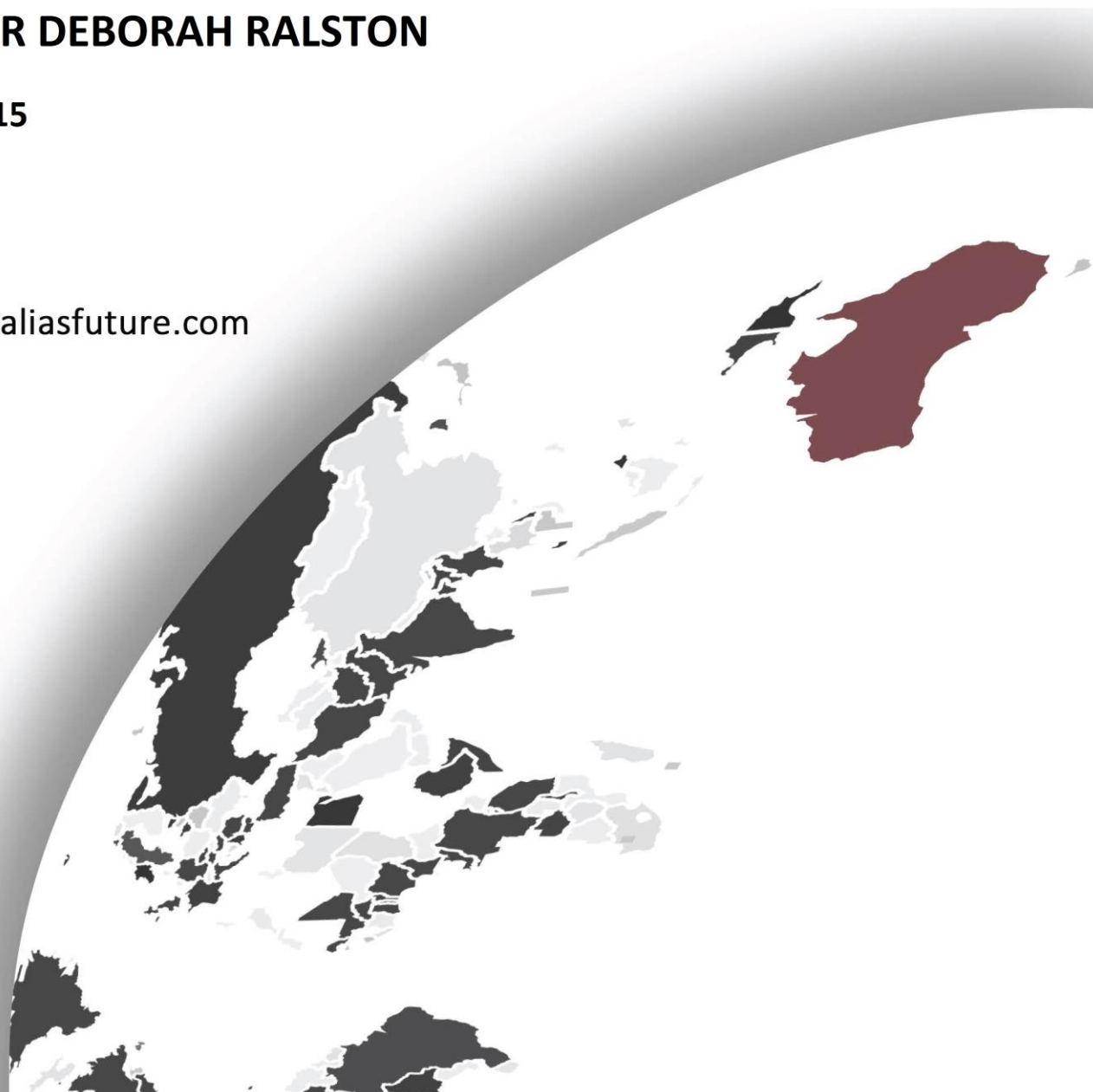
FUNDING AUSTRALIA'S FUTURE

FINANCIAL ISSUES IN RETIREMENT: THE SEARCH FOR POST-RETIREMENT PRODUCTS

PROFESSOR DEBORAH RALSTON

OCTOBER 2015

fundingaustraliasfuture.com



Funding Australia's Future

The Australian Centre for Financial Studies (ACFS) instigated the Funding Australia's Future project in 2012 to undertake a stocktake of the Australian financial system and analyse its role in facilitating economic growth within the wider economy.

In an economy which has enjoyed 24 years of consecutive economic growth and shown a resilience through the Global Financial Crisis (GFC) which was the envy of many nations, the financial sector has played a strong and pivotal role. The past decade, however, has been one of significant change. The growth of the superannuation sector, the impact of the GFC, and the subsequent wave of global re-regulation have had a profound effect on patterns of financing, financial sector structure, and attitudes towards financial sector regulation. Identifying the extent to which these changes are transitory or likely to be more permanent is crucial to understanding how financing patterns and the financial sector will develop over the next decade or so.

Stage Three of Funding Australia's Future explores three specific challenges to the financial sector highlighted by the Financial System Inquiry, Tax System Review and Intergenerational Report. While diverse, each of these topics has a bearing on the future of the financial system and its role serving the economy.

In undertaking this analysis, ACFS has worked with a group of financial sector stakeholders comprising Accenture, the Association of Superannuation Funds of Australia, Challenger Limited, IBM, Industry Super Australia, National Australia Bank, Self managed Super Fund Association and Vanguard Investments, as well as the Treasury.

This paper is one of three in Stage Three, which include:

1. Dividend imputation and the Australian financial system: What have been the consequences?
Professor Kevin Davis, University of Melbourne and Australian Centre for Financial Studies
2. Big and better data, innovation and the financial sector
Dr Ian Oppermann, CSIRO
3. Financial issues in retirement: the search for post-retirement products
Professor Deborah Ralston, Monash University

All Funding Australia's Future papers can be accessed through the Funding Australia's Future website: www.fundingaustraliasfuture.com

Notes on the Authors

Professor Kevin Davis: Kevin Davis is Professor of Finance at the University of Melbourne, Research Director of the Australian Centre for Financial Studies and a Professor of Finance at Monash University. His primary research interests are financial regulation, financial institutions and markets, financial innovation and corporate finance. He is co-author/editor of 16 books in the areas of finance, banking, monetary economics and macroeconomics and has published numerous journal articles and chapters in books. He is the Deputy Chair of SIRCA, a member of the Australian Competition Tribunal, and has undertaken an extensive range of consulting assignments for financial institutions, business and government. Professor Davis is a Senior Fellow of Finsia, a Fellow of FTA and holds Bachelor of Economics (Hons I) from Flinders University of South Australia and a Master of Economics from the Australian National University. He was appointed by the Federal Treasurer in December 2013 as a panel member of the Financial System Inquiry chaired by Mr David Murray.

Dr Ian Oppermann: Ian Oppermann has over 20 years experience in the ICT sector and, for 10 years, has led organizations with 100 people or more, delivering products and outcomes that have impacted hundreds of millions of people globally. He has held senior management roles in Europe and Australia as Director for Radio Access Performance at Nokia, Global Head of Sales Partnering (OSS) at Nokia Siemens Networks, and then Divisional Chief and then Flagship Director at CSIRO and CEO of Rozetta Technology, a knowledge infrastructure “Big Data” company.

Ian is considered a thought leader in the area of the Digital Economy and is a regular speaker on “Big Data”, broadband enabled services and the impact of technology on society. He has contributed to 6 books and co-authored more than 120 papers. Ian has an MBA from the University of London and a Doctor of Philosophy in Mobile Telecommunications from Sydney University. Ian is a Fellow of the Institute of Engineers Australia, a Fellow of the IEEE, a Fellow of the Australian Academy of Technological Sciences and Engineering, a Senior Member of the Australian Computer Society, and a member of the Australian Institute of Company Directors.

Professor Deborah Ralston: Deborah Ralston is Professor of Finance at Monash University and is Cluster Leader of the CSIRO-Monash Superannuation Research Cluster. Deborah has held a number of leadership positions in Australian Universities and is a researcher and recognized thought leader in financial services. Most recently Deborah has stepped down from her role as Executive Director of the Australian Centre for Financial Studies, a position which she held since 2009. Her research interests include the impact of financial regulation, the strategy and management of financial institutions, superannuation and innovation. She has published widely in these areas and is a co-author of the text Financial Institutions Management. Deborah has a PhD in finance from Bond University and a Master of Economics from the University of New England.

Deborah is a Fellow of the CPAA and AICD, and is a Senior Fellow of Finsia. She has over 20 years of experience as a non-executive director on public and private sector boards. She is currently a Director of ASX Listed Mortgage Choice where she is Chair of the Investment Committee for Mortgage Choice Financial Planning. She was recently appointed as the Chair of ASIC's Digital Finance Advisory Committee.

Abstract

Financial systems, their institutions, markets and regulatory bodies, are constantly evolving in response to the changing dynamics of technology, politics, demographics and cultural norms (Merton 2005). These pressures are evident in Australia today where Australia's ageing population provides a challenge to both public resources and the financial services sector in terms of meeting the needs of this generation of 'baby boomer' retirees who are the healthiest and wealthiest in the nation's history. Coincident with increased demand from the older generation is a wave of digital disruption, which provides opportunities for innovation and customisation in developing retirement solutions. This paper examines four key areas of concern for older Australians: retirement income stream products; options for managing the wealth stored in the family home; and financial aspects of providing for aged care and later life health costs. In doing so the paper explores areas of public policy and regulation, which may act as a barrier or catalyst to the private sector provision of financial products and services to assist older Australians with these challenges.

The paper finds that the provision of financial services and level of innovation with respect to each of these needs varies considerably. Where retirement income stream products are concerned there has been an increased focus on post-retirement guidance and products. This should accelerate with the much-anticipated removal of regulatory barriers through the *Review of Retirement Income Stream Regulation*, which will open the way for products such as deferred lifetime annuities.

On the other hand, current policy settings tend to impede rather than assist the development of equity release products to aid 'asset rich, income poor' retirees. While older Australians store around half of their wealth in the family home, policy settings provide a significant disincentive to drawing on this equity, and as a consequence, there is an evident lack of effective equity release products. Reform in the aged care sector demonstrates that a market driven, customer-centric approach, with a strong social safety net, can incentivise the private sector to participate in the provision of aged care services, although we have yet to see much innovation in financial products to assist with this potential cost. Where health services are concerned, the sheer complexity of the system, the lack of demarcation between the provision of public and private health insurance, and community rating in health insurance hinder the delivery of financial products to assist older Australians in preparing for and managing health-associated financial risks.

Over time, unless these policy barriers are addressed, the financial system is unlikely to evolve to provide the full range of integrated income and wealth-based solutions needed to assist an increasingly self-reliant population of older Australians.

Contents

Funding Australia's Future.....	2
Notes on the Authors.....	3
Abstract.....	4
Executive Summary.....	7
1. Introduction.....	15
2 Changing demographics, public costs and private wealth.....	16
2.1 A financial profile of Australian households	19
3.0 Retirement incomes	20
3.1 Retirement incomes policy.....	22
3.2 The Age Pension.....	23
3.3 Lump sums	24
3.4 Account-based pensions	25
3.4.1 Self Managed Super Funds	27
3.5 Annuities	31
3.6 Comprehensive Income Products in Retirement	31
3.6 The Future of Financial Advice and digital applications.....	34
3.7 Summary	35
4 Household wealth and the family home	36
4.1 Home ownership.....	37
4.2 Converting housing wealth to income	38
4.2.1 Downsizing	38
4.2.2 Borrowing against equity in the home – reverse mortgages.....	39
4.2.2 Selling equity in the home – home reversion products or shared sale agreements	40
4.2.3 Equity release through fractional property investment.....	41
4.2.4 Government schemes for equity release	42
4.3 Summary	43
5 Aged care.....	44
5.1 Reform of aged care services.....	44
5.2 Demand for, and cost of, aged care services for older Australians	45
5.3 Products to fund aged care	49
5.4 Summary	51
6 Health care in retirement.....	51

6.1	Health care policy in Australian	51
6.1.1	e-Health and Health Reform	53
6.1.2	Private health insurance policy	54
6.2	Ageing and health costs in retirement.....	55
6.3	The cost of health care for older Australians	56
6.4	Financial products for health care for older Australians.....	58
6.5	Summary	58
7	Conclusion	59
	References.....	61
	Appendix 1: types of annuities	66
	Appendix 2: Means testing for aged care	68
	Appendix 3: Coverage of health services and providers by public and private health insurance in Australia	70
	Appendix 4: The new market place for advice	71
	About the Australian Centre for Financial Studies	72
	ACFS Research Code of Conduct	72

Executive Summary

In this third stage of Funding Australia's Future, this paper examines the ways in which institutional structures, including financial institutions, markets, products, services and infrastructure, are developing to accommodate changing demographics, in particular the needs of older Australians.

Changing demographics, public costs and private wealth

Along with many developed countries around the world, Australia is facing the challenge of an aging population. A wave of around 5.5 million 'baby boomers' moving into retirement within the first few decades of this century. This is the wealthiest and healthiest generation in our nation's history, who will live longer than any previous generation. Indeed the proportion of Australians over 65 is expected to rise from 14.2 per cent in 2012 to 21.6 per cent in 2040. As of 30 June 2014, there were 3.5 million older Australians over the age of 65 years, comprising 15 per cent of the population (figure 1) (PC 2013; ABS 2014).

Objectives: This paper examines four key areas of concern for older Australians: retirement income stream products; options for managing the wealth stored in the family home; and financial aspects of providing for aged care and later life health costs. In doing so the paper explores areas of public policy and regulation, which may act as a barrier or catalyst to the private sector provision of financial products and services to assist retirees with these challenges.

Social safety net versus self-reliance: While the public sector might be expected to continue to provide a minimum adequate level of income and service provision for those without private means, with increased average wealth and higher superannuation balances, a growing proportion of older Australians will become self-reliant. And indeed, internationally, the public cost of aging populations has led to an increasing emphasis on the need for individuals to meet a proportion of their own costs in retirement. For many countries therefore, the fiscal imperative means focussing more directly on those in need to provide a strong social safety net, and forming public-private partnerships that can assist in delivering services in a more sustainable manner.

Household wealth: Average household net total assets in 2013-14 was \$810 000, almost half of which is wealth stored in owner occupied dwellings. Households in age groups 55-64 and 65-74 clearly enjoy the highest net wealth, of \$1 240 000 and \$1 230 000 respectively. Incomes for older Australians have grown faster than for other age groups. Households of persons aged 65-74 have had the greatest increase in wealth over the past decade, being \$400 000 wealthier than a household of the same age in 2003-04. The greatest single contributor to this increase in wealth was superannuation, followed closely by increase in property values and then other financial assets (figure 3).

Fiscal pressures: According to the Australian National Commission of Audit (NCOA), payments for the age pension are expected to rise from \$40 billion to \$72 billion over the next decade while aged care costs are expected to double, from \$13 billion to \$26 billion, primarily driven by greater numbers using such services (The Australian Government 2014). Health care, including Medicare, hospitals and pharmaceutical benefits, also show very substantial increases.

Retirement incomes

Within financial services there has been a growing awareness of the need for better retirement income planning to assist individuals to maximise their retirement savings and to manage longevity risk. Most recently the Financial System Inquiry (FSI) and Treasury's *Review of Retirement Income Stream Regulation*, have focused on the need for better retirement income streams, and the need to remove regulatory barriers that impeded innovation in this area.

Retirement incomes: Apart from private savings and any earnings, retirement income is formed from a combination of lump sums or account based pensions from superannuation funds, Age Pension income (where retirees are eligible), and products which can manage market, inflation and longevity risk, such as immediate lifetime annuities, deferred annuities and group annuities.

The Age Pension: According to the NCOA, despite the increasing wealth of households, reliance on the Age Pension is projected to remain at around 80 per cent over the next forty years, although reliance on the full pension declines from 60 to 30 per cent over that period as the proportion on the part pensioners increases (The Australian Government 2014). However more recent projections suggest that around 70 per cent of older Australians currently receive the Age Pension, and there are indications that a **more financially self-reliant generation of older Australians is emerging** where superannuation forms a greater part of income into the future, replacing reliance on the Age pension. (figure 6) (PC 2015).

Lump sums versus income streams: Payment of superannuation benefits as income streams has increased far more quickly than lump sums over the past decade, and by 2014 only around 16 per cent of those retiring took their benefits in the form of lump sums (ABS 2015a).

Superannuation balances: With the maturing of the superannuation system there is a greater diversity of superannuation outcomes. In 2013-14 the average superannuation balance for people approaching retirement age (55-64) was \$322 000 for men and \$180 000 for women, a significant increase on the corresponding balances in 2003-04 of \$160 000 and \$83 000 respectively. At the same time, around a quarter of the population has no superannuation (ABS 2015).

Self Managed Superannuation Funds (SMSF) balances and age profile: At 30 June 2013, the average SMSF member balance was \$524,000, with a median balance of \$313,000, which compares with the average account balance of non-SMSF members of \$36,000 (ATO 2014). Age profile varies, with 82 per cent of SMSF members aged 45 years or older, and the majority of non-SMSF members being under 50 years.

SMSF "light": An increasing number of institutional funds are offering products that appeal to the desire for control on the part of members, and retain those that might otherwise elect to establish an SMSF. Member direct investment options (MDIO) allow members of super funds to select their own stocks, rather than leaving it up to the fund manager.

Annuities: Despite a lack of incentives and remaining regulatory barriers, sales of annuities have increased considerably in the recent past due to growing awareness of the need to safeguard against longevity risk highlighted through public policy initiatives such as the FSI. Regulatory amendments contemplated in Treasury's much anticipated *Review of Retirement income Stream Regulation* are likely to make annuities more flexible and attractive to the retail market in the future.

Comprehensive Income Product for Retirement: In the wake of the FSI recommendation that all superannuation funds offer a default income product (or group of products) to their members, a number of innovations have occurred including (see Exhibit 2 for details):

VicSuper Guaranteed Income for Life and Guaranteed Fixed Term Income offers members the opportunity to purchase annuities from their retirement savings, in blocks of \$10,000. Guaranteed Income for Life or Guaranteed Fixed Term Income.

Equip MyPension is a product, using a “bucket” investment strategy where members elect their preferred post-retirement annual income, designed for members to withdraw a recommended 7 per cent of initial account balance as income per annum. Minimum investment is \$50 000, although members are encouraged to commit more to enjoy the full benefits.

Mercer LifetimePlus™, the world's first pooled mortality investment fund is an investment option added to an account-based pension within a customer's superannuation account.

Advice and technology: Within the Australian environment, the capabilities of automated advice models to provide low cost financial advice, potentially supplemented by human interaction, provide an opportunity for the financial sector to reach out to the wider community. Traditionally, only around 20 per cent of Australians seek financial advice formally, and this is largely confined to high net worth individuals. Not only are digital advice models providing accessible low cost advice, but they are introducing lower cost investment options which focus on portfolios constructed from ETFs and indexed funds.

Household wealth and the family home

Approximately 80 per cent of households aged 55-64 are home owners and among those aged 75 and over, 80 per cent own their homes outright. When compared internationally older Australians have relatively high levels of home ownership and wealth leading them to be termed ‘asset rich and income poor’.

Converting wealth to income: There are three main options for converting household wealth to income in retirement: to downsize by moving to a smaller less expensive residence, to borrow against the home using a product such as a reverse mortgage, or to access equity by selling a fraction of the home. In addition the government also plays a small role through the Pension Loans Scheme.

Downsizing: Only 9 per cent of households aged 50 and over are downsizing, with another 9 per cent moving to an equal or larger house (Judd et al 2014). The actual financial gain of downsizing can be uncertain, and after transaction costs and other financial expenditure is taken into account, often does not achieve the objective of freeing up any substantial amount of equity. Recent research by De Silva, Sinclair, Thomas and Fard (2015) estimates that downsizing to a home with one fewer bedrooms produces an average equity release of approximately \$70 000.

Reverse mortgages (debt product): There are almost 40 000 reverse mortgages on issue in Australia with an average loan size of \$92 000. With 2.3 million people over 70 living in Australia, of whom, 80 percent own their homes outright, it would appear that both the demand and the supply for this

product is limited. The commercial disincentives provided by the risks inherent in reverse mortgages of potential negative equity and difficulties in funding, are compounded by the very small size of this market relative to the overall mortgage market of almost \$1.5 trillion (ABS 2015b). Perhaps this explains why there has been so little innovation in reverse mortgage products.

Home reversion (equity product): Home reversion loans are a form of equity release product which involves a proportion of the home equity being sold and the older homeowner retaining the right to continue living in the home. There is only one provider in Australia of this product, Homesafe, and it has a very restricted market. While home reversion loans do not bear the potential risk of negative equity, the risk of funding these loans with uncertain longevity does limit the supply.

Fractional equity release on-line: Around the world there are a number of emerging companies using fractional property investment platforms. Such platforms connect investors with property owners and provide a platform whereby partial ownership of a property can be transferred to investors. By connecting property owners and investors, this option avoids the problem of funding that dogs both reverse mortgages and home reversion products.

Equity release policy issues: The disincentives that exist in converting the wealth stored in homes into retirement income are substantial. Converting wealth from a tax free, and means-test exempt asset to assessable income or assets is a major hurdle. Both bequest and precautionary motives may also create a resistance to home equity withdrawal. It would appear that unless there is some policy change to encourage older Australians to draw equity from their homes, there will be insufficient demand to act as a catalyst to create demand and engage the private sector in developing more innovative approaches to equity release products.

Aged care

Aged care services range from residential care to services provided to individuals within their own homes with Home Care Packages. Aged care is a large and growing industry. In 2014 there were approximately 190 000 aged care beds on offer in Australia, double the size of the hospital sector (ACFA 2015).

Aged care policy reform: Over recent years the aged care industry has undergone widespread change, driven by regulatory reform that is striving for a more consumer driven and competitive industry. Central to recent reforms have been changes to the funding and financing arrangements for the sector introduced on 1 July 2014. These include greater emphasis on consumer-directed Home Care Packages as opposed to residential care to allow people to age at home, a system of Refundable (and Daily) Accommodation Deposits which provide interest free capital to providers; and the provision of better information and advice to consumers.

Private sector engagement: Demand from the private sector to engage with aged care provision has increased. In the 2014 Aged Care Approval Rounds (ACAR) for government supported aged care places, the 11,196 residential care places and 6,653 home care places on offer were well over subscribed with applications from private providers for 19,000 residential and 108,281 home care places respectively. There was a total investment of \$1.5 billion in residential facilities completed in 2013-14 – an increase of 69 per cent on the previous year.

Demand for aged care services: Around 80 per cent of those over 85 years receive some form of aged care, with a quarter being in residential care and the remainder receiving care at home. At 70 years, less than 10 per cent were in residential care, while a third were receiving care in their own homes (figure 12) (AFCA 2015).

Cost of aged care services: For individuals the cost of residential aged care places varies considerably, depending on location, provider and size of institution. A single comprehensive asset/income means test was introduced from 1 July 2014, designed to provide a strong social safety net for older Australians, but at the same time ensure that those who can afford to pay for this service do so. An average of around 40 per cent of aged care places across aged care providers is reserved for supported residents of low means, who can satisfy the single combined means test. For a person of low means a home care package will cost 17.5 per cent of the Age pension, or approximately \$3 600 per annum, and residential care will cost 85 per cent of the Age pension payment of \$17 420 per annum. Alternatively, a self-funded retiree will pay around \$13 800 for a Home Care Package, or an average of \$330 000 Refundable Accommodation Deposit for accommodation plus a maximum of \$43 000 per year in daily and means tested fees (as at September 2015). Those in residential accommodation may also pay an additional Extra Service charge for higher standard accommodation.

Products to fund aged care: Products which might potentially assist older Australians to fund aged care expenses include annuity type products, especially deferred lifetime annuities, reverse mortgages, or insurance product such as Long Term Care Insurance (LTCI).

Annuities are the obvious way in which individuals can guard against the on-going costs of aged care later in life by guaranteeing a certain level of income. Especially well suited for this purpose are Deferred Lifetime Annuities (DLA) which are purchased around the time of retirement. Annuity income, however, begins at a later date (for example, at age 85) and then is payable for life. The deferred payment can generate a relatively high income from a relatively modest investment.

Reverse Mortgages or other equity release products present a way to access wealth in the home for the payment of a Refundable Accommodation Deposit. This is especially true where a couple is concerned – one may need residential aged care while the other partner may elect to stay in the family home and possibly receive services such as a Home Care Package. Access to products that allow a partial withdrawal of equity would offer greater flexibility and provide a better outcome than leaving the remaining partner without a home and seeking new rental accommodation. However, as the previous section outlined, the supply of these products is limited.

Long Term Care Insurance is currently not on offer in Australia, however following the introduction of the new aged care reforms from 2012, with a greater user-pays philosophy, there has been increased interest in this form of insurance. Initiating this form of insurance would require a concerted effort from insurers, government and the aged care sector itself in order to generate the necessary awareness and momentum around the need to prepare for the possible costs of aged care services.

Given that DLAs and LTCI are not on offer in Australia, and reverse mortgages have a very limited market, it appears that funding products to manage the costs of health care are underdeveloped.

Health care in retirement

Australian Government real health expenditure, that is per person expenditure on public hospitals, Medicare and pharmaceuticals, is projected to more than double over the next 40 years. Rising health costs and rising private health insurance costs present a challenge for both public funding and for individuals, especially older Australians who have a greater need for such services.

Health care policy in Australia is complicated by the fact that Australia's health-care system is a multi-faceted web of public and private providers, settings, participants and supporting mechanisms. Not surprisingly given the complexity of the system, health policy is cumbersome and difficult to change given the need for co-operation between local, state and federal governments, not to mention the need for bi-partisan support at the political level.

eHealth: Just as with financial service, technology is playing a major role in achieving operational efficiencies, improving information and engagement, providing more customized consumer solutions in the health industry. There is potential for mHealth tools to better facilitate adherence to chronic disease management, and help older Australians overcome specific barriers to adherence.

Health insurance: The Australian health care system is underpinned by both public health insurance (Medicare) and private health insurance (PHI). These systems work in a parallel and complimentary fashion. The age group with the highest proportion covered by PHI is that between 40 and 44 years. At 55 years of age and beyond, the proportion of people covered by PHI begins to fall significantly. Among older people, in 2013, just over a half of those aged 65–74 had hospital coverage, compared with 38 per cent of those aged 85 and over (AIHW 2014).

Health costs and ageing: The relationship between ageing and health costs is a complex one. While the Productivity Commission (2013), estimated that only 10 per cent of the increase in health costs is due to an ageing population, older people are higher users of the health care system.

Government assistance: Medicare offers a safety net for older Australians with limited means, however there will still be out of pocket expenses, the costs of medication and health insurance. The Commonwealth Senior Health Card, a means-tested benefit for self-funded retirees who do not qualify for the age pension, and the Pensioner Concession card, for those on a full or part pension, can both be used to offset health costs.

The cost of health care for older Australians: The Association of Superannuation Funds of Australia Retirement Standard for older Australians suggests that when private health insurance, chemist, co-payments and out of pocket expenses are taken into account, along with a \$10 000 out of pocket expenses cost for one serious health incident amortised over 5 years, the health cost for individuals on the ASFA modest or comfortable income standards would approximate \$5 000 per person, or roughly 20 per cent of their income.

Financial products for health care for older Australians: Aside from private health insurance, which becomes increasingly unaffordable for those in retirement, there is little on offer for older Australian to manage the risk of high health costs later in life. The complexity of the health system mitigates against the development and provision of products to manage the costs of health care for older Australians, particularly the cost of maintaining private health insurance. Two types of product

appeal as a solution: lifetime private health insurance purchased with a single premium using a lifetime annuity structure and lifetime private health insurance purchased with multiple premiums using a DLA structure. The major barrier to these innovations is community rating which prohibits pricing on the basis of age and gender, which would be necessary to efficiently provide the pooled longevity risk component of these products.

Summary

The wave of 5.5 million older Australian moving into retirement is placing pressure on federal budgets and creating opportunities for the development of a range of new products and services to meet the needs of this growing potential market. However as this report has highlighted, there is much to be done.

- Where retirement income streams are concerned, there are some emerging examples of innovation and steps to increase the level of information and guidance to those approaching retirement. At the time of writing we await the response of the Treasury's *Retirement Income Review*, which will open the way for greater innovation, especially in the area of longevity risk products.
- Policy and regulatory responses are variable across the range of services in post-retirement, but there is a growing recognition of the need to proactively respond to reducing costs, encourage participation by the private sector, to accommodate new business models and remove the barriers to innovation.
- While there is increasing recognition of the potential for older Australians to draw on home ownership wealth to supplement retirement incomes, this is an area where market forces and policy response are not achieving an outcome in the interests of encouraging more self-reliant older Australians, and reducing pressure on public expenditure.
- In contrast to this, reforms in the aged care sector appear to be having success in incentivising providers to increase the supply and quality of services on offer in both home based care packages and in residential places. There is little evidence, however, of financial products emerging which will assist older Australian who do not satisfy means test criteria to provide for this cost.
- The very complex and tightly regulated health care sector, with the current public and private health insurance schemes, do not provide an enabling policy framework for product innovation to manage the cost of health care at older ages. Of real concern is the high cost of private health insurance for older Australians.

The way ahead:

- While there is evidence of a generation of increasingly self-reliant older Australians, for many Australians the challenge will be to make the most effective use of their limited resources.
- Better guidance and advice and innovative income stream products that assist older Australians to manage **longevity risk** are much needed.
- **Digital innovations** in information, advice, cost effective investment options, and health management tools can enhance outcomes for older Australians.
- Policy settings need adjusting to **create demand for an effective equity release** solution as an essential building block to convert wealth to income.
- Given the increasing user pays approach to **aged care** there is a real need for products that assist in preparing for these potential costs later in retirement for example deferred annuities, LTCI.
- The ongoing cost of health insurance in later life might be addressed through development of **lifetime private health insurance** purchased with a single premium using a lifetime annuity structure, or purchased with multiple premiums using a deferred lifetime annuity structure.
- Putting together the right **integrated solutions** of advice and products in the decumulation phase presents a challenge for those operating in the post-retirement area.

1. Introduction

Financial systems, their institutions, markets and regulatory bodies, are constantly evolving in response to the changing dynamics of technology, politics, demographics and cultural norms (Merton 2005). This evolution ensures that the system adapts to maximise the efficient allocation of funds from sources to users, thereby better facilitating economic growth and meeting the needs of businesses and households.

In this third stage of Funding Australia's Future, this paper examines the ways in which institutional structures, including financial institutions, markets, products, services and infrastructure, have developed to accommodate changing demographics, in particular the needs of older Australians. Along with many developed countries around the world, Australia is facing the challenge of an aging population. A wave of around 5.5 million 'baby boomers'¹ moving into retirement within the first few decades of this century. This is the wealthiest and healthiest generation in our nation's history, who will live longer than any previous generation. Indeed the proportion of Australians over 65 is expected to rise from 14.2 per cent in 2012 to 21.6 per cent in 2040 (PC 2013).

Technology and new digital processes assist the dynamics of institutional change by reducing information asymmetries, and allowing low cost product solutions, customised to each individual's needs. Technology also allows individuals to access such solutions directly, increasing the tendency for products to be market based, rather than intermediary based (Merton 2005).

Regulation and public policy can either enable or inhibit how the financial system evolves. As the recent FSI has identified, building a better financial system for older Australians requires reducing inflexibilities in the regulation of income stream products and creating a more open approach to the innovative digital solutions. Public policy settings with respect to the Age Pension, superannuation, aged care and health will also have a major bearing, not only on the well bearing of older Australians, but on how the financial system responds to changing consumer needs and preferences.

These demographic, technological, and public policy dynamics will provide a catalyst to financial sector evolution and private sector responses, while at the same time, the increasing demands of an ageing population are placing increasing fiscal pressures on the public provision of services.

While the public sector might be expected to continue to provide a minimum adequate level of income and service provision for those without private means, with increased average wealth and higher superannuation balances, a growing proportion of older Australians will become self-reliant. And indeed, internationally, the public cost of aging populations has led to an increasing emphasis on the need for individuals to meet a proportion of their own costs in retirement

Effective responses from the financial sector to meet the needs of older Australians will not only contribute to their quality of life, but allow for better planning. Evidence suggests that a strong precautionary motive ensures that many older Australians are reluctant to draw more than a minimum amount from their retirement savings for fear of running out of funds. Better access to,

¹ The generation referred to as 'Baby boomers' were born around 1946 to 1964, and therefore may be expected to reach the official retirement age 2011 to 2029.

and knowledge of, products and services would allow for better planning and risk management, and hence better use of retirement savings.

With this framework in mind, we examine four critical financial issues that are intertwined with lifestyle circumstances, where there will be an increasing need for the provision of appropriate products by the financial services sector. The first is for income stream products and services that assist individuals to maintain a reasonable standard of living over the retirement phase, to manage risk and ensure flexible access to capital. The second is access to most Australian's primary store of household wealth in the family home, the issue of equity release, the third is in the costs facing older Australians in the later part of retirement with suitable supported living arrangements aged care, and finally, health care services and associated costs.

This project will explore these issues, the likely financial impact on retirees and how the private market for financial products and services is evolving to meet the needs of older Australians.

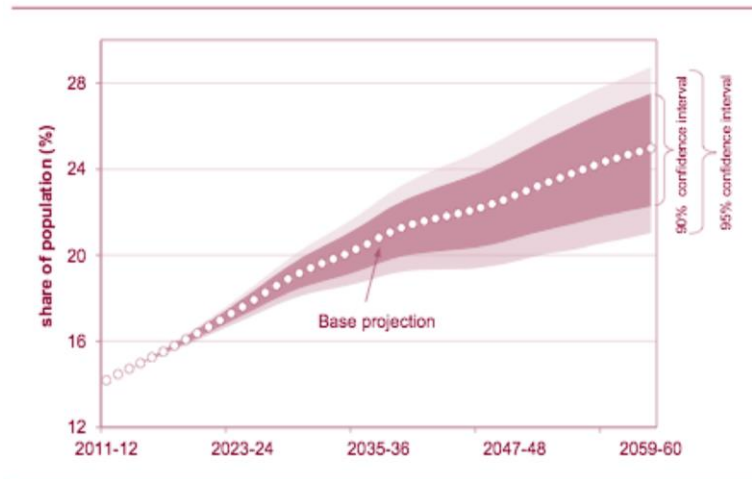
2 Changing demographics, public costs and private wealth

The provision of financial services for older Australians is subject to strong forces of change in terms of the demographic shift to an ageing population and resultant pressures on the public provision of age related services, which provide challenges to public policy and regulation.

Demographic projections from authoritative sources have presented a somewhat bleak picture of a rapidly aging nation, fiscal pressure and what looks to be an increasingly unsustainable retirement system. The 2013 Productivity Commission Report *An Ageing Australia* provides detailed population projections by age group, factoring in key variables such as projected life expectancy at birth, fertility rates, and net overseas migration. Behind each of these factors is a set of assumptions which, when considered collectively, provide a range of possible outcomes. It should be noted here that small changes in any of these variables can lead to big differences in projections.

In Figure 1 population projections are presented for the fifty-year period from 2011-12. Of key interest for this study is the period through to 2040, when we can expect to see the maturing of our current retirement system in that those leaving the workforce will have had the benefit of compulsory superannuation contributions for the length of their working life. According to the Productivity Commission the proportion of the population aged over 65 years is likely to increase from 14.2 per cent in 2012 to 21.6 per cent in 2040. The recent *Intergenerational Report* has very similar projections, assuming no further mortality reductions (Treasury 2015). As of June 2014 there were 3.5 million Australians over the age of 65 years (referee to hereon in as 'older Australians') (ABS 2014).

Figure 1: Stochastic projections of the share of people aged >65 years (2011-12 to 2059-60)



Source: PC 2013.

As a consequence of this change in demographics, spending in older-age related areas is expected to increase through to 2040, thereby imposing significant fiscal pressures. Indeed, since 2002 each edition of the Intergenerational Report has emphasised the impact of an ageing population on the Federal Budget.

While public costs such as education, family tax benefits and parenting payments fall with age, per capita spending on health, the age pension, and aged care increase with age. As the population ages, therefore, each of these areas of public expenditure will experience an increase.

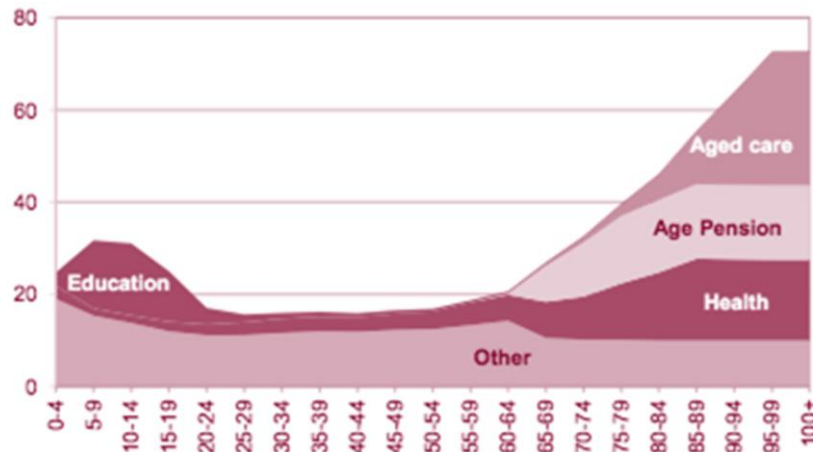
According to the Australian National Commission of Audit (NCOA), payments for the age pension are expected to rise from \$40 billion to \$72 billion over the next decade, due to indexation and an increase in the number of recipients (The Australian Government 2014). The *2015 Intergenerational Report* predicts that Age and Service Pension payments will increase to 3.6 per cent of GDP by 2054-55 (Treasury 2015).²

In view of these increasing costs of the Age Pension, the Henry Review (Australia's Future Tax System), and the NCOA both made recommendations regarding the need to increase the eligibility age of the Age Pension, indexation of payments, the need for a more targeted means test, replacing the current income and assets tests with a single comprehensive means test, and various proposals regarding the inclusion of the family home in the assets test.

² This figure assumes no change to Age Pension policy. Under the 'proposed policy' scenario expenditure on Age and Service Pensions decreases to 2.7 per cent of GDP by 2054-55. This modelling assumes a very gradual reduction in the proportion of retirees reliant on the Age Pension (see figure 5) (Treasury 2015). It should also be noted however that Australian expenditure on the Age Pension, as a proportion of GDP, is the sixth lowest of 34 countries surveyed (3.3 per cent compared to an OECD average of 6.1 per cent) (OECD 2013).

At the same time as Age Pension costs are increasing, aged care costs are expected to double, from \$13 billion to \$26 billion, primarily driven by greater numbers using such services (The Australian Government 2014). Health care, including Medicare, hospitals and pharmaceutical benefits, also show very substantial increases, although it is estimated that only 10 per cent of the increase in health costs is directly due to the demographics of an ageing population (PC 2013).

Figure 2: Age related expenditure and budget impact



Notes: Health and education include both Australian Government and state and territory expenditures. The 'Other' category includes the Disability Support Pension, Parenting Payment, Family Tax Benefit, Disability Support Services (both Australian Government and state and territory), Other social security and welfare payment, Defence and other expenditures and other state and territory expenditures not classified elsewhere.

Source: PC 2013.

In this regard Australia is not alone. Populations around the world in both emerging and developing economies are facing such pressures. The United Nations predicts that by 2050, one-third of the populations in developed countries and one-fifth of those in developing countries will be aged 60 or older (WEF, 2010).

Since the Global Financial Crisis (GFC), budget deficits have focused attention on age-related spending. Standard and Poor's *Global Ageing 2013: Rising to the Challenge* projects existing age-related public sector expenditure, under a "no policy change" scenario, and finds that due to the impact of ageing on budget deficits sovereign ratings decline over time. Where Australia is concerned, under this "no policy change" scenario, the sovereign rating declines from AAA in 2013 to 'a' by 2014, Canada declines from AAA to 'bbb', while the sovereign ratings for Japan, the UK and the US all fall from their current AA-, AAA, AA+ respectively, to speculative levels (Standard and Poors 2013).

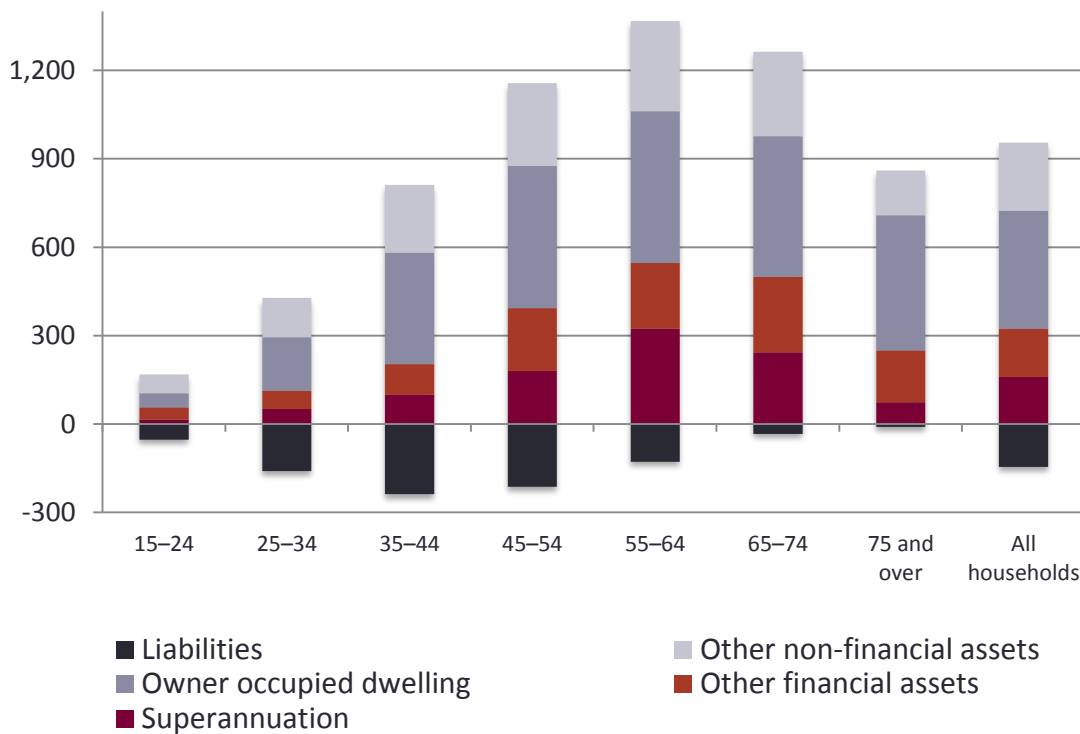
For many countries therefore, the fiscal imperative means focusing more directly on those in need and providing a strong social safety net, and forming public-private partnerships that can assist in delivering services in a more sustainable manner. Increasingly the private sector will provide solutions to assist and support individuals to in their self-reliance. Just as the superannuation system has supplemented public-funded retirement incomes, one might expect to see an increasing involvement of the private sector in aged care and health services for older Australians.

The role of the private sector in the provision of services in ageing economies is likely to increase for two main reasons. First, the continuing fiscal pressures of providing income support, health services and aged care is placing an unsustainable cost on public provision in such economies; and second, the increased wealth of households and the maturation of pension systems ensures that an increasing proportion of households are becoming more financially self-reliant in retirement.

2.1 A financial profile of Australian households

Average household total assets in 2013-14 were \$955 000, with liabilities of \$145 000, leaving average net household wealth at \$810 000. Almost half of wealth is in owner occupied dwellings. Households in age groups 55-64 and 65-74 clearly enjoy the highest net wealth, of \$1 240 000 and \$1 230 000 respectively (figure 3).

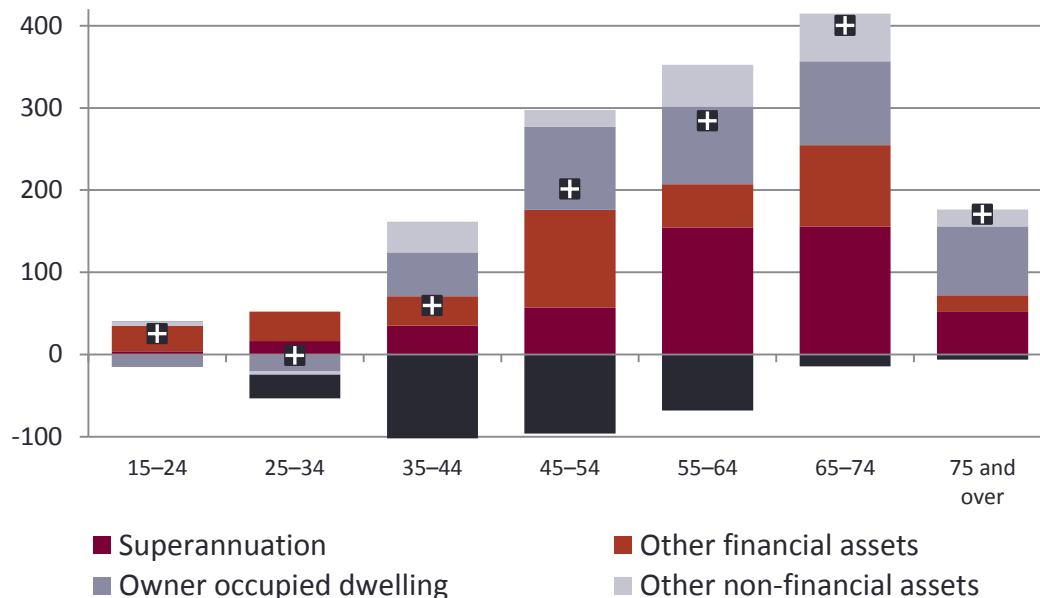
Figure 3: Net household wealth by age groups in Australia 2013-14 (\$'000)



Source: ABS 2015b.

Incomes and wealth for older Australians have grown faster than for other age groups. Households of persons aged 65-74 are now \$400 000 wealthier than a household of the same age in in 2003-04. The greatest single contributor to the increase in wealth in these age groups was Savings (including superannuation), followed closely by increase in property values and then other financial assets (figure 4). While debt also has increased over the past decade, this appears to be largely repaid by the time individuals retire.

Figure 4: Change in household wealth 2003-04 to 2013-14 by age group (\$'000)



Source: ABS 2015b.

A word of warning however – averages can be deceptive as a small proportion of very high wealth individuals distort the picture. For those approaching retirement (age 55-64) 27 per cent have no superannuation (ASFA 2015). However, the typical retiree in 2015 will have an average superannuation balance of \$322,000 for men, and \$180,000 for women. The majority of retirees are homeowners (84.5 per cent of people aged 65 and over) (ABS 2015a).

3.0 Retirement incomes

The challenges in funding retirement on a global basis are summarised by Nobel Laureate Robert Merton (2014) as:

- Target inflation protected income at retirement, not wealth accumulation;
- Offer meaningful information and choices to individuals to improve chances of achieving their income goals;
- Offer seamless transition to retirement from accumulation phase to post-retirement draw down phase with flexible options;
- Customise goals for each individual;
- Seek to manage retirement income shortfall risk;
- Integrate pension retirement savings scheme with other retirement assets;
- Incorporate human capital into asset allocation strategy; and
- Eliminate balance sheet and risk for plan sponsors.

These issues have relevance for retirement incomes in Australia. For example, regular reports to superannuation fund members have in the past focussed on wealth accumulation and rates or return on savings, rather than likely projected income in retirement. The 2014 *Melbourne Mercer Global Pension Index* noted that Australia was one of 14 out of 25 countries that did not provide information to members on their likely income in retirement. More recently, however, there has been a discernible change in this regard with a growing number of funds extending this information on a regular basis. The Chief Executive Officer of CBus Superannuation fund noted recently that this small change in communication within the CBus Super Fund has resulted in a marked change in members' financial literacy.³

Similarly communicating information and appropriate advice on retirement incomes, structuring a smooth transition to retirement, and the provision of an appropriate default option in retirement, have received considerable attention from both funds and policy-makers. Most recently these issues were taken up in the Financial System Review (FSR), which recommended that trustees develop a Comprehensive Income Product for Retirement (CIPR) as a default for members, which manages longevity risk.

Along with the provision of increased information, comes the need for guidance and to customise retirement income solutions to individuals' needs. Customisation is required to reflect the diversity of older Australians' income and wealth levels, risk tolerance and expectations with respect to standards of living. In this regard, increased access to personal financial advice, and the emergence of cost effective automated digital finance models present solutions.

In seeking to manage retirement income shortfall, portfolio selection is of importance, but so too is an awareness of potential costs of retirement in terms of aged care and health costs. In the same vein, private pension, or superannuation savings cannot be seen in isolation from potential income from the Age Pension and income from other private savings, including income that may arise from drawing on the equity held in the home. For those continuing in the workforce in later years, possibly on a part-time basis, potential income from labour is also a factor.

Overall planning for retirement is something of a complex jigsaw puzzle with many elements to be considered. As a number of studies have identified, the financial needs of older Australians are multiple and to some extent, have some competing objectives. Most specifically retirees want:

- an adequate and stable level of retirement income;
- the ability to manage investment, longevity and inflation risk in accordance with the individuals risk tolerance; and,
- the flexibility to access capital, particularly in response to unexpected expenses (such as health care).

It is also contended that retirees require growth in capital to ensure earning capacity into the future and combat longevity risk, and easy to understand products with low fees (Mercer 2013). Further, and to a lesser extent, many retirees express a motivation to ensure a bequest.

³ Superannuation Reform and Post-Retirement Conference, Marriott Hotel Melbourne, 23 August 2015.

3.1 Retirement incomes policy

At the time of writing a number of aspects of retirement income policy are under review. These include the outcomes of the Financial System Inquiry and the Treasury's *Review of Retirement Income Stream Regulation*. We have yet to receive the responses to these undertakings, however they might be expected to have a major bearing on retirement incomes.

Retirement incomes: The retirement phase of superannuation received particular attention in the 2014 Financial System Inquiry (FSI). Recommendations were made concerning clarification of the objectives of superannuation, the need for retirement income projections to be advised to members on a regular basis, a smoother transitions from accumulation to decumulation phases, and in particular, for trustees to develop a Comprehensive Income Retirement Product, for the purpose of ensuring better retirement income streams and assisting members to manage their longevity risk. Prior to completion of the FSI, the Federal Treasury commenced a *Review of Retirement Income Stream Regulation*, which focuses on the regulatory arrangements for superannuation retirement income streams (including annuity and pension rules). Key issues examined rules that may act as a barrier to innovation in annuities and pensions, drawdown rates, and Deferred Lifetime Annuities (DLAs).

Annuity and pension rules: At the present time legislation regarding annuity and pension rules requires income streams to drawdown on the capital underpinning the product over time, so that the superannuation balance is gradually depleted. Further, payments from such products are required to be at least annual and be a fixed amount, or varied only in line with a benchmark such as the consumer price index or average wages. These rules can be a barrier to innovation as they preclude products that may involve a deferred income stream such as a Deferred Lifetime Annuities, or products that have variable payments such as may arise from pooling mortality risk. The discussion papers canvass a number of options to increase the flexibility of these rules, but at the same express concerns that such products may be open to exploitation of tax concessions if made too liberal.

Rules concerning the minimum drawdown in superannuation balances: Currently retirement income products are subject to age-based minimum withdrawal rates to ensure that superannuation savings are used in retirement, that older Australians have access to a steady stream of income and that funds with superannuation tax concessions are withdrawn over time. While the current system has the advantage of simplicity, and ensures that balances are maintained over the period of retirement, a number of submissions noted that many older Australians, in adhering to the minimum drawdown are not achieving an adequate level of income in earlier retirement, but are accumulating large balances that effectively become bequests. Various options have been canvassed to vary the drawdown rules.

Rules concerning Deferred Lifetime Annuities (DLA): under existing rules, a pension or annuity can only be purchased from capital accrued by way of a superannuation contribution or a rollover. These rules do not allow the purchase of a DLA via multiple premiums, including premiums made during the accumulation phase. This restricts the take up of products aimed at reducing longevity risk, and

is the type of restriction referred to in both the Henry Tax Review and the Financial System Inquiry as impediments to such products that need to be removed.

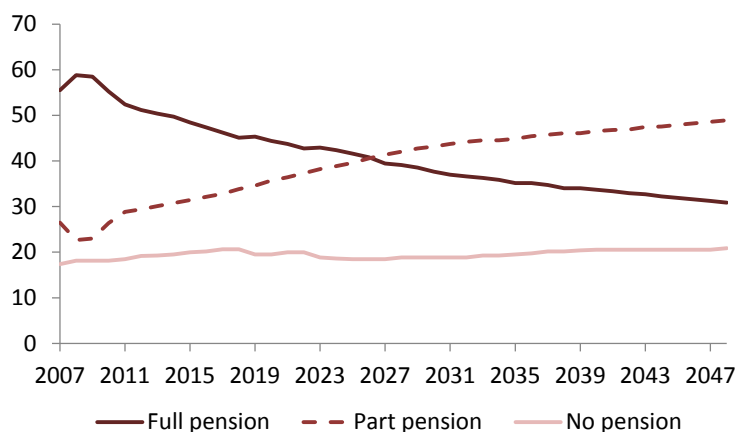
Retirement income streams are formed from a combination of lump sums or account based pensions from superannuation funds, Age Pension income (where retirees are eligible), and products which can manage market, inflation and longevity risk, such as immediate lifetime annuities, deferred annuities and group annuities.

3.2 The Age Pension

The Age Pension provides an income for the majority of retirees. A means-tested indexed, social safety net, the Age Pension is available to Australian residents who have lived in Australia for over 10 years and are in Australia when they apply for the payment (with some exceptions for refugees, widows and residents of some countries). The qualifying age for the pension depends on the year of birth, and has increased over the past decade in order to reduce budget pressure and encourage later retirement.⁴

Around 70 per cent of older Australians currently receive the Age Pension (PC 2015). According to the NCOA, despite the increasing wealth of households, reliance on either full or part pension is projected to decrease only marginally into the future. These projections suggest that the proportion of older Australians eligible for the Age Pension remaining relatively constant at around 80 per cent over the next forty years or so (figure 5). The proportion of individuals on the full Age Pension, however, halves over that time from around 60 per cent to just 30 per cent.

Figure 5: Commission of Audit projections of reliance on Age Pension 2007-2047 (% of relevant population)



Source: The Australian Government 2014.

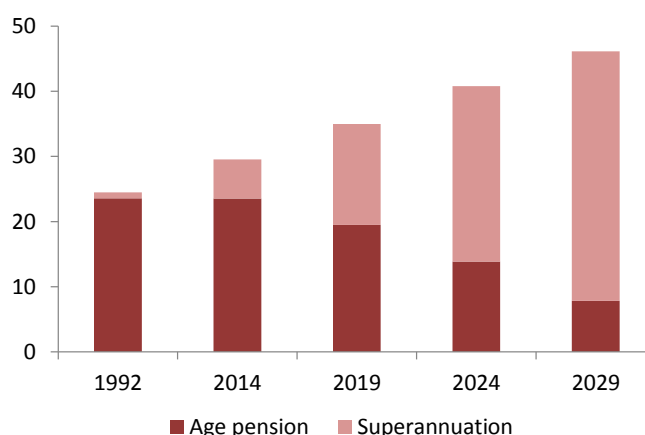
Interpolating these projections, in 2014 it was expected that approximately 50 per cent of the eligible population would be on a full pension, 30 per cent on a part pension and around 20 per cent on no pension at all. More recent figures suggest however, that there has been some shift in these

⁴ Retirees born before 31 December 1948 are eligible for the Age Pension at 65 years for men and 64.5 years for women, while those born after January 1975 are eligible at age 67 years for both sexes (DHS 2015).

numbers, possibly as a result of better returns on superannuation balances following the financial crisis, increased superannuation guarantee contribution, and higher rates of older worker participation.

Indeed, projections from the Association of Superannuation Funds of Australia (ASFA) suggest a much more financially self-reliant generation of older Australians in the future. Higher contribution rates and longer working lives with compulsory contributions, will ensure higher levels of retirement savings. As figure 6 demonstrates, at the point where individuals become eligible for the Age Pension and transition into retirement, there is a lessening reliance on this source of income. While superannuation in 2014 comprises only a small part of income in early retirement and Age pension income comprises the major part, by 2029 the situation is reversed and superannuation comprises the vast majority of retirement income in the early years of retirement. As these calculations do not include assets outside of superannuation, this projected reduced reliance on the Age Pension may be an underestimate (PC 2015).

Figure 6: Average retirement income at Age Pension qualifying age⁵ (in 2014 dollars)



Source: PC 2015.

This picture of fairly rapidly increasing self-reliance needs to be tempered however, with the recognition that as the superannuation system has developed there has been an increased disparity in superannuation balances. The Age Pension will remain an important source of income for Australians on lower incomes, or for those who do not participate in the workforce for the majority of their working lives. Those retiring with lower superannuation balances are likely to fairly quickly exhaust their modest savings, leading to reliance on the Age Pension in later years.

3.3 Lump sums

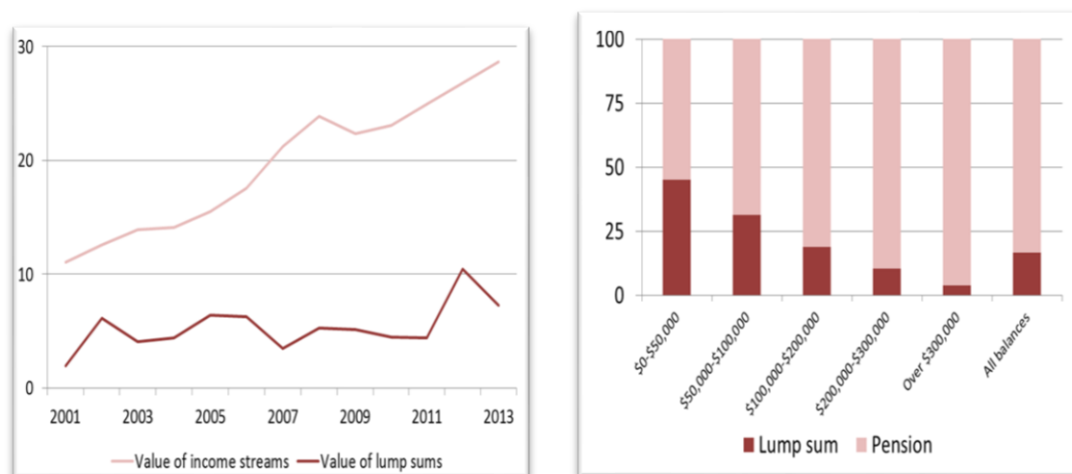
It has been claimed that Australia has a lump-sum culture, in which retirees withdraw their superannuation savings at retirement and spend them frivolously, in the knowledge that they can rely on income from the Age Pension. Payment of superannuation benefits as income streams has

⁵ a Average balance for all single individuals above Age Pension age including those who do not receive the Age Pension. b Age Pension entitlement calculation is based on superannuation assets only, it does not include any other assets. Data source: ASFA pers. comm., 20 May 2015 (updated values from ASFA (2014b)).

increased far more quickly than lump sums over the past decade, and by 2014 only around 16 per cent of those retiring took their benefits in the form of lump sums (PC 2015).

Low balance superannuation accounts are more likely to be withdrawn as lump sums (figure 7). Lump sum use was highest among women, particularly single, low net wealth, and non-homeowner females (PC 2015, p. 85). The FSI noted that taking a lump sum may be the optimal choice for retirees with low account balances as they avoid the relatively high costs associated with income streams (Treasury 2014).

Figure 7: Value of superannuation benefits paid as lump sums and income streams (\$bn) (LHS) and proportion of superannuation benefits taken as lump sum, by account balance (%) (RHS)



Source: PC 2015.

Far from squandering their lump sums, most retirees spend their retirement savings on goods and service that improve their quality of life in retirement. Around one quarter of lump sums are used to pay off mortgages or make home improvements, while another 20 per cent are used to clear debts, or buy or pay off a car. Given that the groups most likely to take lump sums have low levels of wealth, this may be one of their only opportunities to make purchases and repayments of this size (PC 2015).

3.4 Account-based pensions

The overwhelming majority of Australian retirees – 94 per cent – who purchase a retirement income product choose an account-based pension (ABP), while around 5 per cent chose an annuity product, and another 1 per cent elect a hybrid product (Mercer 2014).

According to *Super Guide* an ABP is defined as ‘a flexible retirement income stream that gives you unlimited access to your capital but no guarantees on how long the money will last’ (Power 2015). An ABP is purchased with a lump sum of superannuation savings at the point of retirement, generally by transferring savings from an accumulation account to an ABP. ABPs act like a tax-advantaged at call investment account, invested earnings are tax-exempted and minimum withdrawals are mandated by Schedule 7 of the *SIS Regulations*⁶. Minimum drawdown rates

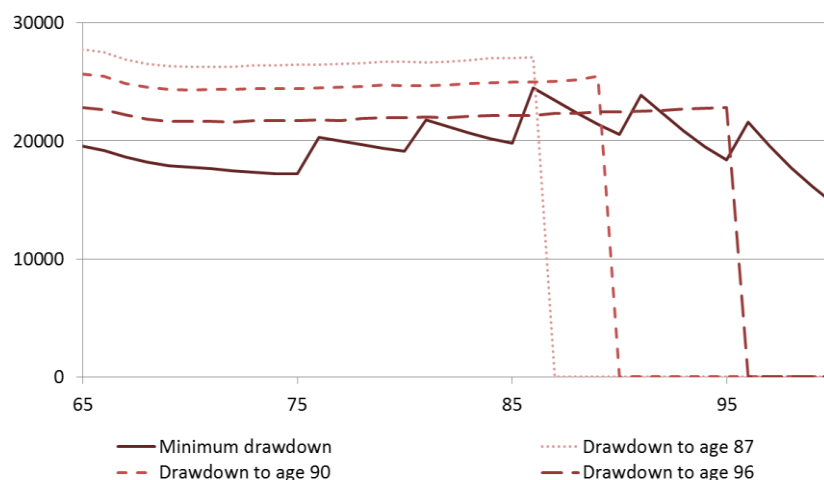
⁶ *Superannuation Industry (Supervision) Regulations 1994* (Cth) sch 7 cls1-5.

commence at 5 per cent for the ages 65 to 74 years, gradually increasing to 14 per cent at age 95 (Australian Government Actuary 2014). Any balance remaining at death is payable to the retiree's estate.

Withdrawals can be made monthly, quarterly, half-yearly or yearly and continue until the account is exhausted. ABPs provide flexibility with access to capital at any time, no tax on income payments, investment choice and relatively low fees. The major drawbacks of ABPs are that they expose retirees to market risk and longevity risk. To minimise the risk of outliving their savings the majority of retirees draw down their ABP at the minimum rate (even when these rates were lowered during the GFC). Analysis in the FSI found that ABPs are more income efficient when drawn down faster than the mandatory minimum rate⁷ (Treasury 2014).

Figure 8 shows different drawdown patterns for a retiree who purchases an ABP with \$400 000 and commences drawdown at age 65. If the account is drawdown at the minimum rate the retiree will have a relatively low income, which lasts beyond 100 year of age (and will likely leave a sizeable bequest). In order to achieve a higher income, the retiree may choose to withdraw above the minimum rate, although this will hasten the depletion of the account.

Figure 8: Annual income using different account-based pension draw down patterns (\$)



Source: Australian Government Actuary 2014.

On average, default ABPs have 57 per cent exposure to growth assets (with some difference across superannuation fund sectors). Around half of funds change their asset allocation between their default accumulation products and default ABP, with those which do change their asset allocation generally reducing their exposure to growth assets as members enter retirement (Mercer 2014). Although as Drew, Walk, and West (2014) point out, a higher risk investment strategy through the decumulation phase can be an optimal investment approach for investors who incur a significant health or aged-care cost liability at some point during retirement, particularly when examining the investment behaviour over long time horizons. They find a dynamic lifecycle investment philosophy can reduce volatility but still achieve higher returns to offset these costs.

⁷ Income efficiency refers to the expected present value of income in retirement.

In assessing the level of income an Australian can expect in retirement, the most important factor is the superannuation balance at retirement. In 2013-14 the average superannuation balance for people approaching retirement age (55-64) was \$322 000 for men and \$180 000 for women, a significant increase on the corresponding balances in 2003-04 of \$160 000 and \$83 000 respectively (ABS 2015a).⁸

These relatively low average balances are not surprising given that people retiring at present have only had the benefit of compulsory superannuation since 1993, just half of their working lives, and have contributed for most of that time at far less than the current 9.5 per cent of earnings.⁹ By 2035 older Australians will have had the benefit of compulsory superannuation saving through the full extent of their working lives, and will be contributing at higher rates, moving to a 12 per cent contribution rate by 2025-26.¹⁰

While averages balances present one view, there is a broad diversity of experience in this regard. In particular, there is a marked difference in experience across institutional funds and Self Managed Superannuation Funds (SMSFs).

3.4.1 Self Managed Super Funds

As the system matures and average superannuation balances grow the disparity in individual balances widens. Given that contributions are primarily based on earnings, disparities are driven by salary levels and hence the size of compulsory contributions, length of time in the workforce, and the level of voluntary contributions.

One area of marked difference is in the balances of members in APRA regulated funds compared with Self Managed Superannuation Funds (SMSFs). Over recent years rapid growth in this sector has ensured that SMSFs now comprise around 30 per cent of superannuation savings. At 30 June 2013, the average SMSF member balance was \$524,000, with a median balance of \$313,000, which compares with the average account balance of non-SMSF members of \$36,000 (ATO 2014).

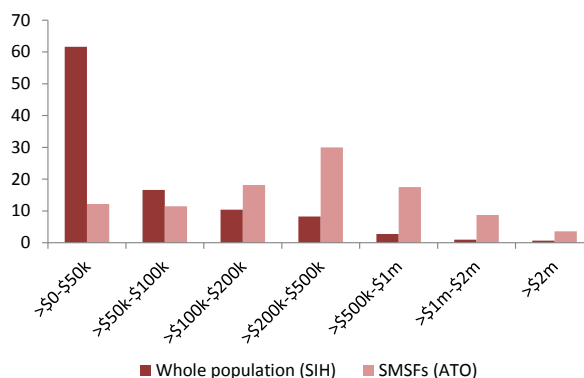
Figure 9: Distribution of SMSF balances compared with total population 2011-12¹¹

8 Note: these figures exclude people with zero balances

9 The Superannuation Contribution Guarantee (SCG) commenced at the rate of 4 per cent as from 1st July 1992, rising to 9 per cent by 2002.

10 The SCG is expected to increase from the current 9.5 per cent to 12 per cent in 2025-26.

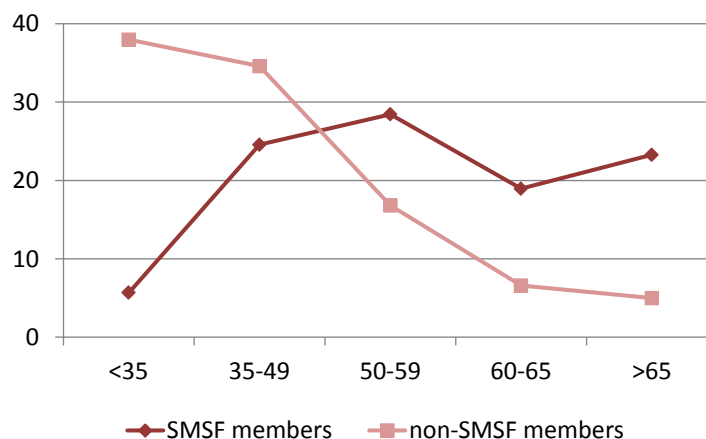
11 Compared to those with any positive superannuation balance aged 15 years or older. Data sources: Commission estimates based on ATO (2014) and ABS (Survey of Income and Housing, 2011-12, Cat. no. 6553.0, basic CURF).



Source: PC 2015.

The difference in balances between SMSF and non-SMSF members is reflected in age profile. SMSF trustees tend to be older on average. At 30 June 2014, 82 per cent of SMSF members were aged 45 years or older. While the majority of SMSF members were between 35 and 59 years, the majority of non-SMSF members or those in APRA regulated funds, were under 50 years (figure 10) (ATO 2014).

Figure 10: Age distribution of SMSF members and non-SMSF members, June 30 2013



Source: ATO 2014 .

There are a number of other distinct features of SMSFs in the retirement phase that warrant exploration:

1. Transition to retirement

Moving from accumulation to decumulation is easier for SMSF trustees than it is for those in institutional funds. In the former case the process is simply to indicate that the assets are moved to pension phase, signifying the move to drawdown and a change in taxation status. When not all trustees within an SMSF move to retirement phase at the same time, the assets that apply to the relevant retiree are segmented for that purpose. This process contrasts with the complexities facing a retiree in an institutional fund. In that case the retiree opens a new pension account, transfers funds from the accumulation account, elects an investment option and selects a drawdown strategy.

2. Portfolio differences – innovation in products and platforms

When compared with APRA regulated funds it is evident that SMSFs are less diversified, especially where fixed interest and international exposure are concerned.

The growing SMSF sector, has spurred demand for a more diversified pool of investment products for the retail sector. SMSF portfolios have been highly concentrated around Australian equities, cash and property. Portfolio allocations vary significantly with size and it is evident that smaller funds under around \$200 000 tend to be overweight with cash and term deposits. A broad comparison between portfolio allocations in SMSFs and APRA-regulated funds is shown in Table 1, however it should be noted that some definitional issues preclude a strict comparison of each asset class.

Recent innovations in fixed interest and development of a retail bond market provide opportunity for a broader diversification. Similarly, the growth in m-funds and ETFs allow SMSFs to diversify into a broader range of international investments, and sectors such as technology that are not represented well on the Australian Equity Market.

Table 1: Portfolio distribution of selected asset classes for SMSFs by fund size and average of APRA regulated funds (June 2013)

	\$1- \$50k	>\$50- \$100k	>\$100- 150k	>\$150- 200k	>\$200- \$500k	>\$500k -\$1m	>\$1- \$2m	>\$2- \$5m	>\$5- \$10m	>\$10 m	Average SMSF	Ave. APRA Fund
Cash and term deposits	56%	52%	51%	48%	38%	34%	32%	28%	25%	20%	38%	8%
Debt securities	0%	0%	0%	0%	1%	1%	1%	1%	1%	2%	1%	15%
Total equity	24%	26%	26%	27%	28%	30%	32%	33%	34%	35%	30%	51%
Australian listed shares	22%	24%	24%	25%	27%	29%	31%	32%	32%	30%	28%	26%
Listed Overseas shares	1%	0%	0%	0%	0%	0%	0%	0%	1%	1%	0%	25%
Unlisted shares	2%	2%	2%	1%	1%	1%	1%	1%	1%	4%	2%	NA
Unlisted property	2%	3%	5%	6%	13%	15%	15%	16%	16%	14%	10%	7%
Listed trusts, unlisted trusts, other MIS Schemes	5%	8%	10%	12%	14%	15%	16%	17%	19%	21%	14%	NA
Other assets	14%	13%	12%	13%	20%	20%	20%	21%	21%	22%	18%	26%
Total % portfolio	86%	87%	88%	87%	80%	80%	80%	79%	79%	78%	82%	74%

Source: APRA 2014; ATO data 2013.

With advances in digital technology, a range of service providers offer platforms that allow SMSF trustees to manage and report on their investment. Costs of professional services such as establishment, audit, taxation, and actuarial certificates have reduced considerably from around \$3000 per annum to just \$600 per annum. Hence SMSFs become more cost effective on lower balances.

At the same time, however, while costs are lower for smaller funds, the above asset allocations would suggest that funds under around \$200 000, which tend to have on average half their assets in cash, may not be achieving the returns they might otherwise enjoy in a default fund.

3. Advice

The need for professional advice in this sector is high, and SMSF trustees are far more likely than members of APRA regulated funds to be seeking financial advice (52.8 per cent versus 29.5 per cent). Possibly as a consequence of this, SMSF trustees are more likely to be confident that they are on track to achieve their desired retirement income (71.8 per cent vs. 66.2 per cent) (Nabtrade 2015).

As of 1st July 2016, accountants will be required to be licensed to provide services and advice to SMSF. Those with limited Australian Financial Services Licenses (AFSL) will be able to provide advice on establishment of SMSFs, and advice on classes of product (rather than individual products) such as insurance deposits shares etc. To provide the full range of advice an AFSL licence will be required.

4. Exit strategy

A particular aspect of advice that is yet to be resolved for SMSF trustees, is the establishment of an exit strategy. With many SMSF trustees belonging to older age groups, there is a very real possibility of cognitive decline, or the earlier death of a spouse who has had primary control of the SMSF (usually the male in a marriage). There is no standardised approach to these events, and indeed no regular testing procedure, to ascertain whether cognitive decline is present, such as driver's license tests for those over 75 years. At present the options available to deal with this issue are including children in the SMSF as a succession planning device (not common), winding up the SMSF and transferring into retail or public offer fund, or establishing a small APRA fund with a legal trustee. Although the ability to outsource the administration of an SMSF to professional advisers does to some extent mitigate this issue, there is yet to be a standardised procedure to ensure that the assets of the SMSF are well preserved.

5. SMSF 'light'

An increasing number of institutional funds are offering products that appeal to the desire for control on the part of members, and retain those that might otherwise elect to establish an SMSF. Member direct investment options (MDIO) allow members of super funds to select their own stocks, rather than leaving it up to the fund manager. MDIOs allow greater flexibility and personal choice on the part of members and combine elements of the platforms also established to serve the SMSF market such as on-line transactions, real time trading, transaction accounts, access to shares, ETFs, term deposits and cash, company research and recommendations portfolio and tax reporting.

However, this degree of freedom may not be in the members' best interests, as recent feedback on the performance of this product at HostPlus indicates. According to CIO Sam Sicilia, over the past two years returns from the fund's MDIO option, Choiceplus, were negative 5 per cent, compared with around 19 per cent cumulatively for Hostplus' balanced option. Lower returns for members in the MDIO option have been attributed to a lack diversification when compared with a balanced fund, a portfolio over weight in cash, and generally the members' lack of investing experience. It has also been suggested that bad advice, higher fees and an unprofessional approach to investing, such as over-trading, are also likely to blame for other MDIOs underperforming (King 2015).

Despite what would appear to be less than optimal performance, it is likely that involvement in MDIO options will grow. In a recent survey by CoreData for Nabtrade and the SMSF Association of 532 APRA fund members, while only one in five (19.9 per cent) non-trustees are already invested in

a DIO within their fund, more than two in five (41.4 per cent) would be interested in investing in one (Nabtrade 2015).

Failure to optimize retirement income through lack of financial literacy is not only a loss for the individual, but may mean that members ultimately require higher levels of public funding. It can be seen that with increasing sophistication of technology and the ability to customize retirement accounts to suit individual's needs, the clear distinction between SMSFs and institutional funds is becoming blurred.

3.5 Annuities

Annuities present an important part of retirement incomes in that they offer older Australians a guaranteed level of income, and guard against longevity risk, market risk, and for many products which are inflation-linked, inflation risk. Annuities come in many forms: immediate lifetime, deferred lifetime, term, variable, and group annuities (see Appendix 1 for details).

Despite the obvious benefits of annuities the market in Australia has been slow to build. This slow growth has been attributed to a range of factors including lack of consumer awareness, behavioural factors, lack of incentives or compulsion, and legislative and political barriers (Howes 2012; ASFA 2013). The history of annuities in Australia would suggest that the latter two factors of incentives, legislative and regulatory barriers have had the most marked impact on the development of the market.

The small annuities market in Australia greatly expanded in 1990 when incentives were introduced by way of a full exemption to the Age Pension means test and income test concessions. However, the fledgling market declined when the exemption under the assets test was cut to 50 per cent in 2004, and then fell even further with the removal of benefits taxation to retirees over the age of 60 in 2007. Between 2007 and 2008, the market declined further and by 2009 only 29 life annuity policies were sold out of a total of only 4 202 immediate annuity policies (Bateman and Kingsford 2010).

Despite a lack of incentives and remaining regulatory barriers, sales of annuities have increased considerably in the recent past due to growing awareness of the need to safeguard against longevity risk highlighted through public policy initiatives such as the Financial System Inquiry. Australia's major annuity provider Challenger, recently announced a record in retail annuity sales of \$2.1 billion, made up of record retail sales of \$1.6 billion in retail sales and \$549 million in institutional sales (Pash 2015). In addition, we have recently seen the re-entry of another major annuity provider Comminsure to the annuities market.

Regulatory amendments contemplated in Treasury's much anticipated Retirement Income Review outlined in section 2.2 are likely to make annuities more flexible and attractive to the retail market in the future. In particular, there is an the opportunity for deferred annuities to provide for the aged care and health costs of older Australians.

3.6 Comprehensive Income Products in Retirement

Acknowledging that many older Australians do not make optimal decisions when converting their superannuation savings to retirement income, the FSI recommended all superannuation funds offer a default income product (or group of products) to their members:

Recommendation 11: Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed. (Treasury 2014)

The requirement for funds to offer a 'default' comprehensive income product for retirement (CIPR) is consistent with the policy approach to the accumulation phase, where around 70 per cent of employees are members of the default fund selected by their employer (PC 2012). The requirement to offer a default product is based on the growing evidence that complex decision making at critical junctures, such as at retirement, can lead to poor outcomes for individuals (Speelman, Clark-Murphy, and Gerrans 2013; Society of Actuaries 2014). This in turn leads to poor outcomes for the community, through increased reliance on the Age Pension. Instead, the proposed default option exploits consumers' passive behavioural bias, encouraging them to choose retirement income products that manage their risk, without limiting their personal choice.

Under *Recommendation 11* funds would be required to preselect a CIPR for members and, at retirement, members would have the opportunity to opt-out of this product if they so desire. While the Government response to the FSI has yet to be received, some features of the default CIPR may be mandated such as requirements to include an income stream, longevity risk management and some flexibility. The FSI also recommended that the design of 'default' income products should vary to reflect the characteristics of each funds' members, and acknowledged that regulatory changes would be required to facilitate the development and uptake of certain products (for example deferred annuities).

The FSI proposal for a default CIPR would also greatly reduce the complexity of decision-making for the majority of older Australians. Under the existing system the retiree needs to seek advice at retirement, elect either a lump sum or ABP, and in the case of the latter, select an investment strategy, and decide on a rate of drawdown. Alternatively with the proposed system, the retiree wishing to take advantage of the default option would simply need to advise their fund of the date of their retirement.

At the time of writing we are still awaiting the government response to the FSI, but it is evident that there has been considerable response from superannuation funds regarding the need to innovate and offer retirees a broader range of options to manage risk in retirement (see Exhibit 2).

Innovation in retirement income stream products is increasingly recognising the need to manage longevity risk. For many retirees with no or relatively low superannuation balances, the Age Pension provides a form of longevity risk protection.

Exhibit 2: Innovation in post-retirement products

A number of new products are emerging in response to the need to develop more comprehensive income products for retirement that safeguard against longevity risk. The following demonstrates

three examples incorporating life and term annuities from VicSuper, a multiple 'bucket' approach to investment from EquipSuper, and a product based on a group annuity which has been developed by Mercer.

VicSuper Guaranteed Income for Life and Guaranteed Fixed Term Income offers members the opportunity to purchase annuities from their retirement savings, in blocks of \$10,000.

- Guaranteed Income for Life, is a form of lifetime annuity, withdrawal period of 10 years min.
- Guaranteed Fixed Term Income, is a fixed term annuity of from 1 to 40 years.

With both options a withdrawal period is nominated where the member has the right to either fully withdraw, or in the event of the member dying, the beneficiaries or estate receive a partial refund. There are no ongoing direct fees or charges and income payments are tax-free and receive favourable assessment for Centrelink Age Pension eligibility, particularly under the income test.

Equip MyPension is a product, where members elect their preferred post-retirement annual income, designed for members to withdraw a recommended 7 per cent of initial account balance as income per annum. Minimum investment is \$50 000, although members are encouraged to commit more to enjoy the full benefits.

Equip MyPension takes a '3-bucket approach' to managing retirement income with investment allocated across three buckets of Cash, Conservative, and Growth. The Cash bucket initially contains 3 times the nominated annual income. The buckets are rebalanced annually, with the cash bucket being replenished from earnings under the Conservative and Growth buckets. The objective is to maintain a minimum of two years worth of pension payments in the Cash bucket.

Members can make full or partial withdrawals at any time and any remaining benefit goes to your dependents, or other qualifying recipients nominated by the member on death.

Mercer LifetimePlus™, the world's first pooled mortality investment fund is an investment option added to an account-based pension within a customer's superannuation account.

The features of Mercer's longevity solution include: an income for life from an account based pension with no insurance premiums; a constant investment profile; access to up to 95 per cent of capital up to the age of 75 years; with quarterly investment returns, capital returns after 15 years, and a living bonus (mortality credits) from the day of investment. The product claims to require around half the amount of capital as an annuity to secure a similar annual income.

It's anticipated retirees would invest around 25 per cent of their super retirement benefit into Mercer LifetimePlus – a customer who invests \$100,000 from a \$400,000 super balance could expect up to \$10,000 pa above the age pension after their super runs out.

Source: *Equip 2015; Mercer 2015; VicSuper 2015.*

Recent modelling by the Australian Centre for Financial Studies (2015) for AIST has shown that, under the current means test, those with superannuation balances of \$100 000 who own their own home but who have few other assets, might expect their ABP income to supplement their full Age Pension entitlements throughout their non working years. These older Australians enjoy an

adequate standard of living \$5 000 above the ASFA modest standard¹² (\$28 489 in 2015 dollars), with a residual balance in their superannuation account of around \$50 000 by age 90.

For older Australians with higher superannuation balances of \$250 000 or \$500 000, assuming few assets outside the home and their superannuation, the income from the ABP supplements the part Age Pension in earlier retirement, and then the full Age Pension from their mid to late 80s. These older Australians benefit from an investment in an annuity product of around 25 per cent of their balance on retirement, and can enjoy a fairly comfortable lifestyle of \$17 500 or \$25 000 above the ASFA modest standard (\$35,989 and \$48,489 in 2015 dollars respectively) throughout their retirement (ACFS 2015).

In each case the retiree is drawing down more than the regulatory minimum of 5 per cent in the earlier years of retirement to achieve an adequate income.

In examining these retirement income profiles, it is evident that advice concerning how to maximise retirement incomes, the best product options, and the level of drawdown in retirement becomes critical.

3.6 The Future of Financial Advice and digital applications

The Future of Financial Advice (FOFA) legislation has been in place since July 2013. These reforms were introduced in the wake of financial advice collapses in Australia between 2006 and 2010 that resulted in more than \$6 billion in losses and involved more than 120,000 people. Cases such as Storm Financial and Commonwealth Financial Planning, the collapses of Opes Prime, Trio and WestPoint have all involved conflicted remuneration structures and high commissions as fundamental issues. At the heart of the FOFA legislation are two key “gatekeeper” requirements to address conflicted remuneration. First, planners must prioritize their clients interests over their own, and second, the advice must be appropriate to the client’s own situation. FOFA distinguishes between general (sales) and personal financial advice, requires clients of financial advisers to ‘opt-in’ or indicate annually that they wish to continue the service, the need for an annual fee disclosure for clients engaging before 1st July 2013, and the implementation of the “best interest” duty and provisions directed at removing conflicted remuneration, that is the payment of commissions.

The emergence of new disruptive digital finance technologies, or “fintech”, especially new platforms and automated (or “robo”) advice models are having a marked impact internationally¹³, and

¹² The ASFA Retirement Standard benchmarks the annual budget needed by Australians to fund either a ‘comfortable’ or ‘modest’ standard of living in retirement. It is updated quarterly to reflect inflation, and provides detailed budgets of what singles and couples need to spend to support their chosen lifestyle. In 2015 the ASFA modest standard for retirees 65 to 89 was \$23 489 (ASFA 2015).

¹³ In the US, the most developed market in terms of automated advice offerings and business models, the 11 leading start-ups in the robo advice space were managing \$15.7 billion in client assets in July 2014 (Jackson-Maynes 2015). In the UK new financial advice regulations prohibiting the charging of commissions on investment advice has seen the number of advisors fall from 40,000 at the end of 2011 to 31,000 by the start of 2013, according to the Financial Services Authority (EY 2015). Digital advice models have stepped in to assist in filling this gap, and new firms such as Nutmeg, which builds a portfolio from ETFs, and Wealth Horizon, which combines automated advice with human advisers, and are growing rapidly.

increasingly in Australia. The capabilities of automated advice to provide low cost delivery of guidance and advice, potentially supplemented by human advice, provide an opportunity for the financial sector to reach out to the wider community. Traditionally, only around 20 per cent of Australians seek financial advice formally, and this is largely confined to high net worth individuals.

Not only are digital advice models providing accessible low cost advice, but they are introducing lower cost investment options which focus on portfolios constructed from ETFs and indexed funds. Automated advice models, including those assisted by a telephone adviser, are being used for investment management in addition to financial planning (Appendix 4).

While automated advice models offer real opportunities for large scale funds wishing to cost effectively provide guidance and advice to a large number of members, the investment models with portfolio construction capabilities are sure to appeal to the self-directed investment market, such as SMSF trustees. In the US companies that focus primarily on self-directed investors such as Vanguard, Fidelity, and Charles Schwab have been early adopters (Davenport 2015).

In terms of consumer acceptance, a recent survey by A.T. Kearney of 4,000 consumers with investable assets indicated that awareness of online investing vehicles was fairly low at 20 per cent (Hedges et al. 2015). However, the majority indicated a willingness to use the technology. According to a 2015 survey conducted by Midwinter of 288 advisers, there is widespread industry acceptance with almost half of respondents seeing automated advice as a technology tool for advisers rather than simply as advisers' competition¹⁴.

There is no specific regulatory framework for automated advice tools in Australia; instead robo advisers must fit themselves within the existing regime for financial advisers – primarily Chapter 7 of the *Corporations Act 2001* (Cth).

Some questions are raised by the application of the FOFA legislative framework to automated advice models, and in particular whether such tools are offering general or personal advice. Most models purport to offer general advice, and therefore do not have to generate a statement of advice or comply with the best interests obligations. It has been argued that this is questionable given the level of personal information involved in deriving automated advice. As no financial service is provided, there is some potential for relief under the existing financial calculator relief and asset allocation exemption. Further it can be argued that such automated advice models, under ASIC's Regulatory Guide 244, provide general advice, and that the personal information is being used to provide general advice that is "more relevant to the client" (Jackson-Maynes, 2015) These and other issues surrounding the regulation of fintech are currently under review by ASIC's Innovation Hub.

3.7 Summary

From the above it can be seen that the retirement sector is responding to the challenges of an ageing population moving into the decumulation phase. With growing superannuation balances, there is a greater proportion of older Australians emerging with a potential to become financially self-reliant.

¹⁴ <http://www.midwinter.com.au/midwinters-robo-advice-survey-results/>

In terms of Merton's objectives for a retirement income system, funds are increasingly advising member of likely retirement income, rather than the latest quarter's earnings, digital tools are providing an additional means of conveying meaningful information and customised advice to assist in achieving retirement income goals, and there is a growing recognition of the need to manage longevity risk, and integrate all retirement income sources, that is Age Pension, ABPs and annuity style products.

Where ABPs are concerned, alternative investment strategies can be considered to reduce volatility but ensure the ability to meet unexpected costs of aged care and health expenses.

Some remaining impediments to innovation in retirement products remain however, with respect to the development of more annuity products, especially deferred and group annuities. The imminent release of the *Retirement Income Stream Regulation* and response to the FSI may help in that regard.

On the downside, however, while on-line platforms and MDIOs provide greater access for investors, there is some evidence to suggest that where superannuation is concerned, this may not always be in either the public or individual's best interest in terms of maximising retirement savings.

Good planning and financing of retirement also needs to incorporate income flows from wealth, and to recognise and plan for the potential cost of aged care and adverse health outcomes to safeguard against a shortfall. These issues are explored in the remainder of this report.

4 Household wealth and the family home

Residential property in Australia is the key means of storing household wealth. The total value of residential property is estimated to be \$5.76 trillion, of which Australians aged over 65 hold more than \$500 billion. The mean value of this property is \$604,700 and around 80 per cent of older Australians own their homes outright (ABS 2015).

Home ownership is an important contributor to quality of life in retirement. Under the traditional three-pillar view of retirement savings home ownership falls under the category of 'voluntary savings' (World Bank 1994). But while housing wealth has traditionally been an important pillar supporting Australian retirement policy (Baxter and McDonald 2005), it has not been seen as a source of retirement income. Throughout the past half century, homeownership has been considered a central pillar of Australian retirement planning, reinforced by tax and benefit subsidies for owner occupation. For example, government incentives to encourage investment in housing and the exemption from the means test suggest housing is an important element of retirement income policy.¹⁵

¹⁵ Historically home ownership has been encouraged through government schemes such as Commonwealth War Homes Service Act (1918-19), Commonwealth Housing Act (1927-28), War Homes Service Act (1918-19) provided low-interest loans to special groups. State Housing Authorities providing home finance to low-income earners started in the 1930s and continued with Commonwealth-State Housing Agreement 1945 which led to massive boost in housing stock. In 1986 the last interest rate to be deregulated in the Australian economy was the discounted/controlled interest rates for home mortgages. Other government incentives to home ownership have included the First Home Owners Scheme (1983) and the First Home Saver Accounts (2007) with Government co-contributions and concessional tax treatment on interest earned. More recently Aged Care policies such as 'ageing in place' strategy and increased investment in Home and Community Care reinforce homeownership.

The high home ownership rate in Australia has meant that governments have had to provide only a modest Age Pension payment as most older Australians are home-owners and thus tend to have lower living expenses than non-home owners. When compared with five other countries (Canada, United Kingdom, United States of America, Italy and Finland), Yates and Bradbury (2010) find that while Australia has the highest before-housing poverty rate among those aged 65 years or over, it has one of the lowest after-housing poverty rates in this same age group.¹⁶

Hence it has also become increasingly evident that the store of wealth in the family home provides a valuable asset that could well be drawn on in retirement to supplement incomes, and potentially reduce the need for publicly subsidised income support. In an economy with few wealth taxes, and no death duties, the family home has become a means of wealth transfer, or bequest to the next generation. These issues have sparked debate regarding whether the value of the family home, either entirely or up to some capped amount, be included in the means test to overcome what might be seen as publicly subsidised intergenerational wealth transfer (Daley and Wood 2014).

Equity release products that allow older Australians to draw on the equity in their homes have been around for some time in the form of reverse mortgages, however the take up of these products has been low. The compounding liability at the heart of the reverse mortgage structure, and the potential for equity erosion over time, has made them an unpopular product with consumers. For providers there have been significant reputational issues through the potential for negative equity and funding issues for products with uncertain tenor. While some have suggested various government schemes to allow older Australians to effectively borrow on their home as an alternative to drawing on the age pension, with the liability being repaid on death, this would seem to be an unlikely outcome given the need to reduce public age-related spending and improve sustainability of the retirement system. There are however some emerging innovations in home equity release, home reversion loans and those based around digital platforms which may allow partial release of equity while allowing the home owner to remain in situ.

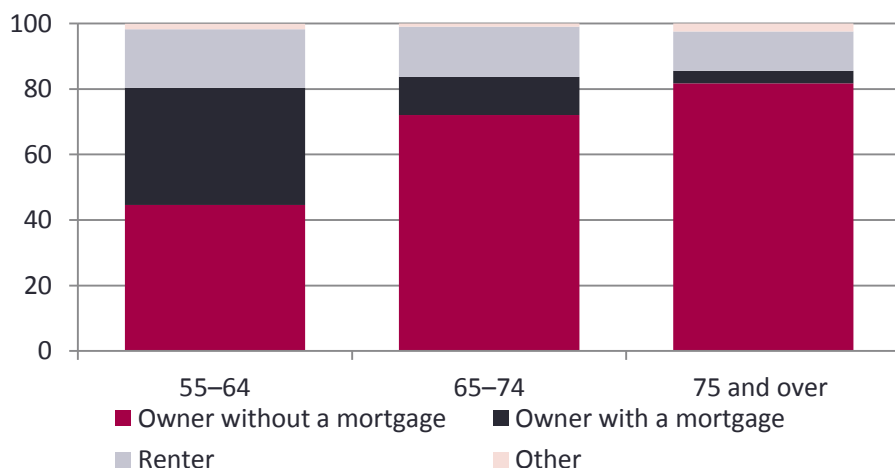
The challenge then falls to the private sector to provide a solution in terms of equity release products that appeal to the market and allow Australians access to their greatest form of wealth at a time when they are most likely to be in need of it.

4.1 Home ownership

The family home is the largest asset for most households approaching or in retirement. For households aged 55-64 and 65-74 the family home accounted for 38 per cent of their total assets, and for those aged 75 and above the family home was over 50 per cent of their assets. These groups similarly have high rates of home ownership. Approximately 80 per cent of households aged 55-64 are home owners (including those with mortgages) and among those aged 75 and over 80 per cent own their homes outright (figure 11).

¹⁶ For retirees who are non-homeowners housing costs are largely unmet by welfare payments. The maximum rate of Rent Assistance available for a single retiree is approximately \$3300 per year compared to rental costs estimated at approximately \$9000 per year (ACFS 2015). This shortfall puts non-homeowner retirees at higher risk of economic hardship.

Figure 11: homeownership by age group, 2013-14 (%)



Source: ABS 2015b.

When compared internationally older Australians have relatively high levels of home ownership and (housing) wealth leading them to be termed ‘asset rich and income poor’ (PC 2013).

4.2 Converting housing wealth to income

As retiring generations amass stores of private wealth in their homes, there are increasing calls for these individuals to draw on their own resources to fund retirement instead of relying on welfare payments. In the future this may mean a retirement income derived primarily from superannuation savings is supplemented by drawings from the wealth stored in property.

There are three main options for accessing household wealth to provide income in retirement: are to downsize by moving to a smaller less expensive residence, to borrow against the home using a product such as a reverse mortgage, or to access equity by selling a fraction of the home. In addition the government also plays a small role through the Pension Loans Scheme.

4.2.1 Downsizing

At first glance downsizing makes sense as households in retirement generally have fewer members and therefore require smaller dwellings (for example 84 per cent of households aged 65 and over comprise a lone person or couple only, compared with 32.7 per cent of households aged 45-54) (ABS 2015b).

As National Seniors (2014) reports, the most frequently cited motivation for older Australians to wish to downsize their homes is the effort and cost of maintaining their existing residence, while the factor that most discouraged them from downsizing is that it would take too much effort. Other barriers to downsizing are the difficulty of finding age-friendly dwellings in suitable locations, most

especially in familiar neighbourhoods, the financial disincentives of moving including transaction taxes (stamp duty), adverse Age Pension eligibility consequences that can arise from converting wealth from a means-test exempt asset, and the physical exertion and emotional challenges of moving to an unfamiliar location (Judd 2014). Further, other work by Johnson, Worthington and Brimble (2015) has found that those who downsize can face additional expenditure in the purchase of whitegoods or home modifications.

Possibly as a consequence, only 9 per cent of households aged 50 and over are downsizing, with another 9 per cent moving to an equal or larger house (Judd et al 2014). The actual financial gain of downsizing can be uncertain, and after transaction costs and other financial expenditure is taken into account, often does not achieve the objective of freeing up any substantial amount of equity. Recent research by De Silva, Sinclair, Thomas and Fard (2015) estimates that downsizing to a home with one fewer bedrooms produces an equity release of approximately \$70 000.

4.2.2 Borrowing against equity in the home – reverse mortgages

Under a reverse mortgage a older Australian takes out a loan using their home as security. The principal accumulates (with interest) until the home is sold. The loan can be taken as a lump sum, income stream or line of credit. There are a number of risks for both consumers and providers of equity release products, which have made them slow to develop in the Australian market.

On the supply side, risks occur for the lender on a number of fronts. Should the borrower live for an unexpectedly long period there is a potential for the loan to accumulate to such a point where negative equity can occur, a situation that generated reputation risk prior to the introduction of legislation now prohibits this situation occurring, the No Negative Equity Guarantee (NNEG)¹⁷. De Silva et al (2015) model this risk and find that the potential for negative equity to occur in a reverse mortgage loan is greatly enhanced once the loan to value ratio (LVR) exceeds 45 per cent. Consequently LVRs are limited to avoid this situation, although falling asset values can add to that risk.

There is also the potential for a borrower to fail to maintain the property, thereby reducing its market value when the sale occurs to acquit the loan, and the uncertainty of tenor also creates funding risk. The number of providers of such loans contracted sharply after the GFC due to inability to access funding from 15 to seven (Brownfield 2014).

Possibly as a result of these issues, the market for reverse mortgages in Australia remains small, and growth has slowed since the GFC, which has increased funding challenges (table 2).

¹⁷ Since 2012 a statutory negative equity protection is available, under which the loan value cannot exceed the value of the property, though this may not apply to reverse mortgages entered into prior to 18 September 2012.

Table 2: Size and growth of reverse mortgage market in Australia

Date	Debt (\$ billion)	Year on year growth
2005	0.85	-
2006	1.51	78%
2007	2.02	34%
2008	2.48	23%
2009	2.71	9%
2010	3.01	11%
2011	3.32	10%
2012	3.56	7%

Source: Brownfield 2014.

The latest data from Deloitte show a growth of 3 per cent in loans outstanding for 2014, with total loans reaching \$3.66 billion. There are almost 40 000 reverse mortgages on issue in Australia with an average loan size of \$92 000, up from \$86 000 in 2013. In addition to new borrowers, 4,900 borrowers voluntarily repaid their reverse mortgage loan in 2014 (representing 12% of total borrowers). Deloitte suggests that this pattern of borrowing and repayment shows that many borrowers are using the product to cover short terms needs and then repay the mortgage once they are ready to finally downsize their home (Deloitte 2015).

A total market of 40,000 reverse mortgages is small indeed when compared with the total home equity in the hands of older Australians. Johnson, Worthington and Brimble (2015) have estimated the size of this market at \$540 billion.¹⁸ It would appear that both the demand and the supply for this product is limited, reflecting international experience. The commercial disincentives provided by the risks inherent in reverse mortgages of potential negative equity and difficulties in funding, are compounded by the very small size of this market relative to the overall mortgage market of almost \$1.5 trillion (ABS 2015b). Perhaps this explains why there has been so little innovation in reverse mortgage products.

4.2.2 Selling equity in the home – home reversion products or shared sale agreements

Home reversion loans, also referred to as shared sale agreements, are a newer form of equity release product which involves a proportion of the home equity being sold and the senior homeowner retaining the right to continue living in the home. The homeowner sells a share of the “reversionary interest” or a specified proportion of the future sale value of the home, but retains

¹⁸ Authors’ calculations based on 3.1 million Australians aged over 65 (ABS 2012–13 from Census 2011), with 56 per cent sharing the household with a spouse (ABS 2012–13 from Census 2011), resulting in approximately 2.2 million households, 82 per cent of which (1.8 million) are owner occupied (ABS 2011), with a conservative estimate of median house price of \$300,000 (HILDA) = \$540 billion in housing equity. (Johnson, Worthington and Brimble, 2015).

100 per cent of the “life interest.” The life interest is the right to use the home (or the income produced by the home) until the homeowner(s) die or sell the home.

The homeowner has certainty about the share of the home that will be retained when the home reversion contract completes; for example if 60 per cent of the reversionary interest is sold, then at the end of the contract the homeowner/estate will be entitled to 40 per cent of the sale proceeds.

The product offers a homeowner a form of longevity protection as the right to continue living in the home has no end date. From a product provider perspective, the longevity risk exists but is partially “hedged” in that if the contract continues for longer than expected, there will be more years of property appreciation than expected. In this way it differs from the longevity risk taken on in providing some other retirement products, such as lifetime annuities.

There is only one such supplier of this product in Australia, Homesafe, offered by Bendigo and Adelaide Bank. With only limited supply the product is restricted to homeowners in approved postcodes, which include around 90 per cent of metropolitan Sydney and Melbourne, and who can satisfy a number of other conditions including that the property is the principle place of residence and is either free-standing homes or in a block of four or fewer units.¹⁹

While home reversion loans do not bear the potential risk of negative equity, the risk of funding these loans with uncertain longevity does limit the supply. A potential solution to the problem of funding may lie in new digital finance models that allow fractional property investment.

4.2.3 Equity release through fractional property investment

Around the world there are a number of emerging companies using fractional property investment platforms. Such platforms connect investors with property owners and provide a platform whereby partial ownership of a property can be transferred to investors. From the investors point of view such platforms allow the purchase of a fraction rather than the whole of a property, allowing investors to diversify geographic risk across their property portfolio, and providing an alternative direct property investment mechanism for investors such as SMSFs. The investor receives an interest rate yield on the property and is also able to participate in any capital appreciation that might accrue over the life of the investment.

This mechanism is being used for commercial development on a number of platforms, where a retiree is concerned the partial and possibly progressive sale of equity in the family home can be used to access wealth as the need arises. Although this is very new territory, several new companies in Australia have adopted this model. DomaCom, has brought a fractional property investment model to the market, in the belief that fractional investment will be a viable alternative to the existing reverse mortgage model for older Australians. Another on-line fractional property company POPI, (Property Options for Pensioners and Investors) offers different products are available, depending on the allocation of income flow from investor to home-owner and the distribution of capital gain.

¹⁹ www.homesafe.com.au

German company Bergfurst has been operating on line since 2012 and has 11 000 users²⁰. It offers a range of investment opportunities outside the standard asset classes, including in individual homes for the purpose of equity release. Coupled with a peer-to-peer crowd-sourced funding platform, fractional property investment could well be the way of the future for older Australians wishing to release equity in their homes.

4.2.4 Government schemes for equity release

The Australian government's Pension Loans Scheme (PLS) operates through CentreLink and acts as a low cost 'reverse mortgages' scheme. The PLS allows eligible Australians to receive payments equivalent to the full age pension paid into their bank account on a fortnightly basis, borrowed from the government and secured against the value of property owned by the recipient. The loan is only available as a regular payment and not a lump sum.

The Pension Loans Scheme is offered by the Commonwealth Government to part-rate Age Pensioners and some self-funded retirees. Under the scheme a loan is obtained (against the value of any Australian real estate owned) which increases fortnightly pension payments up to the maximum rate. Repayments can be made at any time or recovered from the person's estate. Due to the rather strict eligibility criteria, the take up of this scheme has been low. There were only 710 loans outstanding in 2010, representing 0.04 per cent of Age Pension households (PC 2013, p.220).

As Johnson, Worthington and Brimble suggest (2015), attention may now be warranted for a form of government-guaranteed "retiree housing bond" that allows retired homeowners to decumulate some of their housing equity, through a supportive intermediary, as an exchange-traded housing bond to provide income in later retirement when other liquid forms of assets have diminished. The authors argue that such an instrument would be consistent, at least at face value, with moves towards asset-based welfare reform and help ease fiscal pressure on governments.

A recent study from the Centre for Independent Studies (Cowan and Taylor 2015) proposes a three-step solution to encourage greater use of reverse mortgages and access to wealth stored in the home. First, including the family home in the Age pension assets test, thereby removing the current home-owner/non-home owner distinction; second, legislating a default reverse mortgage product, offered by the private sector but guaranteed and insured by government to provide a regular annuity payment; and third, including deemed income from the reverse mortgage in the income means test, as is done for other financial assets. The authors argue that this would remove the distortion caused by the treatment of housing assets, ensure pensioners have access to additional means, and allow the Age Pension to be better targeted at those most in need.

These and other measures have been proposed over time to encourage greater use of equity release products. And indeed it would seem unlikely that this market will grow unless policy intervention stimulates demand from older Australians. It is unclear however, whether the public sector would have an appetite to increase the costs of funding additional aspects of the ageing population.

²⁰ <https://de.bergfuerst.com>

4.3 Summary

Australians store a vast amount of personal wealth in the family home. This has been encouraged by a range of government policies, which have allowed government to pay a lower Age Pension as most older Australians do not pay rent. This policy stance is supported by the exemption of the home from the Age Pension assets test, exemption from the capital gains tax (after 12 months), and the current policy direction of “Ageing In Place” which seeks to keep people in their homes as they age.

This current generation of Australian is wealthier than any previous generation, and the age groups 55-64 and 65-74 have seen substantial increases in wealth over the past decade, due to increasing superannuation balances and increases in property values.

Older Australians could access the equity in their homes through three main approaches: downsizing, borrowing against the equity with a reverse mortgage or selling some part of the equity through a home reversion loan. The disincentives that exist in converting the wealth stored in homes into retirement income are substantial however. Converting wealth from a tax free, and means-tested exempt asset to a means-tested asset, is a major hurdle. Downsizing also involves inconvenience, difficulties finding suitable smaller properties, and transaction taxes. Equity release products are more expensive²¹ than normal loans for consumers, have a potential for negative equity at higher loan to value ratios, and are difficult for institutions to fund, given their uncertain tenor. While home reversion products offer a more attractive alternative, these are in very short supply, and again suffer from the problem of funding. There is some indication that a new market for fractional sale of properties such as homes is opening up to investors through on-line platforms, but this innovation is in its infancy.

Both bequest and precautionary motives may create a resistance to home equity withdrawal. Not only are there practical and policy disincentives to older Australians in drawing equity from their homes, but the bequest motive is strong in preserving family home wealth for the next generation.²² It could also be argued that wealth stored in the family home is the obvious source of funding for aged care accommodation or major health costs.²³

However, it would appear that unless there is some policy change²⁴ to encourage older Australians to draw equity from their homes, there will be insufficient demand to act as a catalyst to engage the private sector in developing more innovative approaches to equity release products.

²¹ Reverse mortgages are priced higher than regular mortgages and Alai et al (2013) found that both reverse mortgage and home reversion loans are poorly priced in Australia in favour of providers.

²² A study for National Seniors Australia found a difference in attitude among those aged 50 and over between bequeathing the family home and other assets, with more than 51% of people believing that it was somewhat or very important to leave the family home to their children and nearly 10% more people believing it was very important to leave the family home to their children than to leave other assets (National Seniors Australia and Challenger 2013).

²⁴ Such policy changes might include exempting equity drawn from the home from the Age Pension means test, or alternatively some amendment to the means test. This could include replacing the assets and income tests with a single comprehensive asset and income test, as recommended by the Henry Review and the NCOA, or including either a capped value, or the whole value of the home in the assets test.

5 Aged care

Part of the reluctance of older Australians to draw down on their retirement savings can be attributed to a precautionary motive, driven by concerns about unforeseen costs of aged care or adverse health events. While only a minority will have a major health or accommodation cost in retirement, this can come at significant personal expense.

Aged care services range from residential care (such as nursing homes) to services provided to individuals within their own homes (such as Home Care Packages). These services are used predominately by those aged over 80 years. Aged care is a large and growing industry. In 2014 there were approximately 190 000 aged care beds on offer in Australia, double the size of the hospital sector (ACFA 2015).

5.1 Reform of aged care services

Exhibit 3: Program of Aged Care Reforms

- *Phase 1 (2012-13 – 2013-14) Initial Aged Care Reform.* This phase saw the announcement of the *Living Longer Living Better* reforms, including: a phased increase in the service provision target ratio and an increased proportion of home care places; the introduction of the new home care package levels; commencement of Consumer Directed Care for new Home Care packages; and accommodation price publishing. The My Aged Care website and Contact Centre and the Australian Aged Care Quality Agency and the Aged Care Pricing Commissioner were also introduced, along with the Aged Care Financing Authority.
- *Phase 2 (2014-15) Financing reforms.* This phase included reforms to accommodation payment arrangements, new means testing arrangements and a higher maximum accommodation supplement for new and significantly refurbished homes.
- *Phase 3 (2015-16) Consumer choice.* This phase will see further enhancement to the My Aged Care functionality to include standardised assessment and a central record that underpins assessment, referral and service provision, extension of Consumer Directed Care to all existing Home Care Package recipients and the formation of the Commonwealth Home Support Programme.
- *Phase 4 (2016-17– 2021-22) Further consumer choice, sustainability and review.* Implementation of 2015-16 Budget measures including allowing home care package recipients full choice of preferred provider, the intention to combine the Home Care Package Programme and Commonwealth Home Support Programme into a single program, and the extension of short-term restorative care places. In addition, an independent review of the reforms already introduced is scheduled to table a report in Parliament by August 2017, and further reform is likely to ensure continued sustainability, growth and quality care for older Australians.

Source: www.myagedcare.com.

Over recent years the aged care industry has undergone widespread change, driven by regulatory reform that is striving for a more consumer driven and competitive industry

Central to recent reforms have been changes to the funding and financing arrangements for the sector introduced on 1 July 2014. These include greater emphasis on consumer-directed Home Care Packages as opposed to residential care to allow people to age at home²⁵; a system of Refundable (and Daily) Accommodation Deposits which provide interest free capital to providers; and the provision of better information and advice to consumers.

While access to aged care places is means tested, allowing a strong social safety net for those with lower incomes and wealth, with a growing number of self-reliant older Australians there will be increased demand for privately funded places. There is significant investment activity and interest from the private sector in participating in this growing industry. During 2013-14 and 2014-15, three aged care providers floated their companies on the Australian Stock Exchange with a combined total market capitalisation of \$1.7 billion, which by 30 June 2015 was \$3.3 billion (ACFA 2015 p. 140).

Demand from the private sector to engage with aged care provision has increased. In the 2014 Aged Care Approval Rounds (ACAR) for government supported aged care places, the 11,196 residential care places and 6,653 home care places on offer were well over subscribed with applications from private providers for 19,000 residential and 108,281 home care places respectively. There has been a total of \$1.5 billion of new work on residential facilities completed in 2013-14 – an increase of 69 per cent on the previous year, and the lump sum accommodation pool has grown to around \$2 billion.

For consumer this means an increase in the supply and quality of aged care services, greater opportunity to age at home (at lower cost) through extended community support, and this together with the increased information and transparency of the system, allows for better planning and preparation for the potential costs that might occur. Price controls on services protect consumer interest.

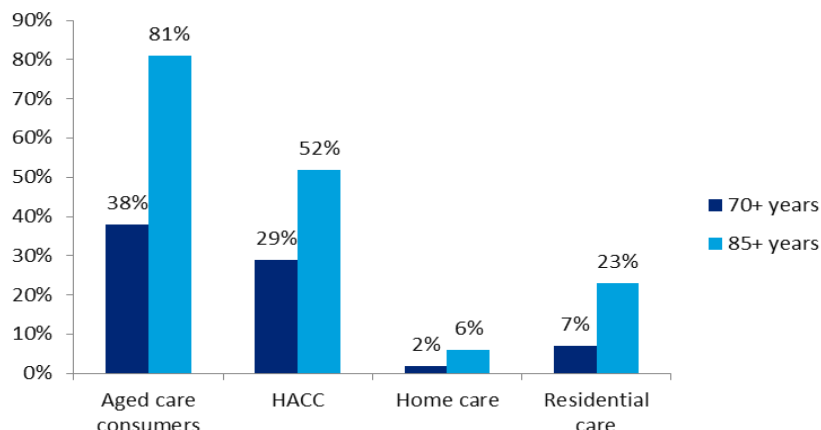
5.2 Demand for, and cost of, aged care services for older Australians

In Australia aged care costs are projected to rise from around 0.8 per cent of GDP in 2009-10 to 1.8 per cent in 2049-50. Residential care accounts for 85 per cent of aged care costs (PC 2011). While government directly provided only 6 per cent of aged care places, \$9.2 billion was paid to aged care providers in FY2013, while a further \$4.7 billion, or 34 per cent, was provided by residents (ACFA 2015).

As at 30 June 2014, there were 2.3 million people aged over 70 living in Australia. Of these, 38 per cent over 70 years cohort and 81 per cent over 85 years were receiving some form of aged care. In the younger cohort, almost one third remained in their homes and were receiving Government subsidised aged care services, while 9 per cent were utilising residential aged care. Almost one quarter of those over 85 years were accessing residential care (AFCA 2015) (figure 12).

²⁵ The target for home care packages will increase from 27 to 45 and the residential target will reduce from 86 to 80. The change in mix between home care and residential care from 25:88 to 45:80 is intended to respond to the reported consumer preference to stay at home where possible. (ACFA 2015)

Figure 12: Proportion of people 70+ and 85+ accessing aged care at 30 June 2014



Source ACFA 2015.

The cost of residential places: For individuals the cost of residential aged care places varies considerably, depending on location, provider and size of institution. Comprehensive means testing, using a combination of assets and income, was introduced from 1 July 2014 and is designed to provide a strong social safety net for older Australians, but at the same time ensure that those who can afford to pay for this service do so (see Appendix 3). The means test creates three tiers of consumer contribution:

- consumers with low means, who are required to pay only the basic daily fee (85 per cent of the single basic age pension) as a contribution towards their daily living expenses while their accommodation and care costs are funded by the Australian Government;
- consumers with moderate means, who in addition to contributing towards their daily living expenses by paying the basic daily fee, also make a capped contribution towards their accommodation costs; and
- consumers with greater means, who in addition to contributing towards their daily living expenses, also pay the basic daily fee for their accommodation costs in full and make a capped contribution towards their care costs.

Around 40 per cent of aged care places on average across aged care providers are reserved for supported residents of low means, who can satisfy the single combined means test as shown in Appendix 3. For those of moderate and greater means there are three main costs to consider.

- **Accommodation cost** – A Refundable Accommodation Deposit (RAD) is an amount paid as a lump sum by a care recipient for their accommodation costs in a residential aged care facility which is returned to the estate on the death of the resident. A Daily Accommodation Payment (DAP) is the same lump sum amount, calculated on a daily basis DAP is paid periodically. Payments under the DAP method are not returned to the estate.
- **The basic daily fee** is capped at 85 per cent of the Age pension.

- **The means tested fee**, which varies depending on the assessment under the combined assets/income means test and is capped at \$25 529 per annum.²⁶

In some cases residents may also pay an Extra Service fee, for higher standard care, which is strictly regulated. Under the reforms, the number of providers charging extra service fees is declining.

Agreed prices²⁷ for the RAD as at 30 June 2015, ranged from \$44 000 in the Northern Territory, to \$598 000 in New South Wales, presumably in Sydney (table 3). The maximum RAD that can be charged without prior approval from the Aged Care Pricing Commission is \$550 000.

As at 30 June 2015, the average actual prices paid for residential aged care places were \$333,000 by the lump sum or RAD method, or \$58.02 per day by the DAP or daily accommodation method, with prices higher in city areas. The costs of aged care accommodation are published for this purpose on the *My Aged Care Website* to assist with regard to the standard of care required which help anticipate the likely cost involved.

²⁶ Annual and lifetime caps apply, with an annual cap of \$25 529 applying to the means tested care fee and a lifetime cap of \$61 269 for care contributions across home care and residential care (July 2015 rate) (ACFA 2015).

²⁷ It should be noted that agreed prices differ by approximately 10 per cent from advertised prices, a factor attributed by AFCA to possible consumer negotiation (the advertised prices represent the maximum price), the fact that retention payments can no longer be taken from the lump sum by providers as they previously were from bonds, and the average published price does not take into account the number of rooms offered at each price and prices are averaged across rooms. (ACFA 2015)

Table 3: Average agreed prices as at 30 June 2015, by ownership, location and jurisdiction

	Average	5th Percentile	Quartile 1	Median	Quartile 3	95th Percentile
Overall	\$333,000	\$120,000	\$240,000	\$320,000	\$400,000	\$550,000
Ownership type						
Not-for-profit	\$334,000	\$104,000	\$250,000	\$325,000	\$400,000	\$550,000
For-profit	\$335,000	\$150,000	\$230,000	\$300,000	\$400,000	\$550,000
Government	\$319,000	\$95,000	\$248,000	\$310,000	\$400,000	\$550,000
Location						
Major cities	\$354,000	\$147,000	\$250,000	\$350,000	\$450,000	\$565,000
Regional Areas	\$287,000	\$90,000	\$219,000	\$299,000	\$350,000	\$450,000
Remote Areas	\$230,000	\$66,000	\$188,000	\$220,000	\$299,000	\$390,000
Jurisdiction						
NSW	\$332,000	\$125,000	\$230,000	\$300,000	\$400,000	\$598,000
VIC	\$352,000	\$113,000	\$269,000	\$350,000	\$450,000	\$550,000
QLD	\$321,000	\$102,000	\$250,000	\$322,000	\$395,000	\$500,000
WA	\$320,000	\$97,000	\$200,000	\$320,000	\$400,000	\$550,000
SA	\$330,000	\$150,000	\$240,000	\$320,000	\$400,000	\$510,000
TAS	\$286,000	\$175,000	\$230,000	\$290,000	\$350,000	\$400,000
ACT	\$379,000	\$156,000	\$250,000	\$400,000	\$510,000	\$550,000
NT	\$316,000	\$44,000	\$200,000	\$300,000	\$320,000	\$550,000

Source: ACFA 2015.

The cost of Home Care Packages – two fees are paid:

- **The basic daily fee** equivalent to 17.5 per cent of the single basic Age Pension, and
- an **income-tested care fee** if the individual's income is the single basic Age Pension rate, capped at \$5 105.74 for part-pensioners and \$10 211 for non-pensioners (July 2015 rate).

A lifetime cap of \$61 269 per consumer currently applies for care contributions across home care and residential care (July 2015 rate) (AFCA 2015).

Consequently for the half of the population over 85 years accessing Home Care Packages, and the further quarter that will require residential care, they might expect the following costs:

Table 4: Summary of costs for Home Care Packages and Residential Aged Care

	Consumer Means	Accommodation	Basic daily fee*	Means tested fee
Home Care Packages	Low	NA	17.5% age Pension	NA
	Moderate	NA	17.5% age Pension	Part-pension Capped @\$5 106 pa
	Greater	NA	17.5% age Pension	Self-funded Capped @ \$10 211 pa
Residential Aged Care	Low	NA	85% Age Pension	NA
	Moderate	Capped contribution	85% Age Pension	variable
	Greater	Ave RAD (DAP) \$330k	85% Age Pension	Capped at @ \$25 529

** Basic daily fee HCP \$138 per fortnight (\$3 588 pa), Residential Aged Care \$670 per fortnight (\$17 420 pa) (all prices at September 2015)*

As this table highlights the costs of aged care are highly variable depending on the means of the consumer. For a person of low means a home care package will cost 17.5 per cent of the Age pension, or approximately \$3 600 per annum, and residential care will cost 85 per cent of the Age pension payment of \$17 420 per annum. Alternatively, a self-funded retiree will pay around \$13 800 for the home care package, or an average of \$330 000 RAD for accommodation plus a maximum of \$43 000 per year in daily and means tested fees (as at September 2015).

5.3 Products to fund aged care

Products which might assist retirees to fund aged care expenses include annuity type products, which can guarantee an income cash flow, an equity release product which might assist in paying an accommodation fee, or an insurance product such as Long Term Care Insurance (LTCI).

Account based pensions are the fundamental building block for income in retirement. Drew Walk and West (2014) have shown that a dynamic life cycle approach to asset allocation can be used to offset the costs of an unexpected aged care or health event. By adjusting the investment strategy towards a higher risk investment portfolio, the negative impact of unexpected health or aged care costs can be recovered.

Annuities are the obvious way in which individuals can guard against the on-going costs of aged care, later in life by guaranteeing a certain level of income. Especially well suited for this purpose are Deferred Lifetime Annuities (DLA) which are purchased around the time of retirement. Annuity income, however, begins at a later date (for example, at age 85) and then is payable for life. The deferred payment can generate a relatively high income from a relatively modest investment. For example, modelling for the FSI in 2014 showed a 20 year DLA purchased by a 65 year old man would pay \$2390 per \$10 000 invested compared to \$570 for \$10 000 invested in an ILA (Australian Government Actuary 2014a, p 55).

In 2013 the Government indicated DLAs would receive the same concessional tax treatment given to superannuation assets invested income streams. This reform aims to encourage the development of deferred annuity products. The tax and social security treatment of DLAs are currently being explored in the Commonwealth Government's *Review of Retirement Income Stream Regulation*.

Despite the regulatory inertia, there has been some innovation in this regard with Challenger launching its CarePlus product to fund on-going residential aged care costs (exhibit 4).

Reverse Mortgages or other equity release products present a way to access wealth in the home for the payment of a Refundable Accommodation Deposit. This is especially true where a couple is concerned – one may need residential aged care while the other partner may elect to stay in the family home and possibly receive services such as a Home Care Package. Access to products that allow a partial withdrawal of equity would offer greater flexibility and provide a better outcome than leaving the remaining partner without a home and seeking new rental accommodation. However, as the previous section outlined, the supply of these products is limited.

Long Term Care Insurance is currently not on offer in Australia, however following the introduction of the new Aged care reforms from 2012, with a greater user-pays philosophy, there has been increased interest in this form of insurance.

In the USA, LTCI provides 7 per cent of aged care expenditure, and in France, LTCI is taken up by 15 per cent of the population (CEPAR 2014). A number of studies have explored the potential market for LTCI in Australia (Browne 2013; CEPAR 2014). While it is generally thought that potential exists for such a market, a number of barriers are identified to both the supply and demand for this type of insurance. Amongst those barriers is uncertainty about the extent of consumer demand for such a product.

In a survey of potential providers, respondents stated that they are unlikely to attempt to develop LTCI products until they are confident that government has laid necessary groundwork, because of many other failed attempts around the world. Seventy-three per cent of respondents (n=19) believe that a private, voluntary insurance product covering long term care needs could be a worthwhile product in the Australian context, and that demand will grow in the future due to demographic change, increasing awareness of long term care risk and the government's likely response to these issues. However, the view also was expressed that it may require a concerted effort from insurers, government and possibly also the aged care sector itself in order to generate the necessary awareness and momentum around the need to prepare for the possible costs of aged care services. It was stressed that similarly to health care, such insurance products need to interact with government regulation and the framework they are operating in. Respondents called for government to be as clear as possible about what it can and can't provide in terms of services and funding – ideally over the long term. In addition, respondents saw a role for government to provide incentives to make an insurance product more attractive to individuals, possibly via taxation mechanisms. Some respondents went further and suggested that some form of compulsion may be necessary for an insurance market to develop, although this is perhaps unlikely in an Australian setting. (Browne 2013).

Exhibit 4: Challenger launches CarePlus

Challenger has launched a new aged care product aimed at providing financial certainty for retirees in aged care. CarePlus is aimed at retirees entering or already in aged care and is designed to provide certainty about regular income to help meet care costs and estate planning.

CarePlus consists of two separate products. A CarePlus Annuity, which provides the regular income needed for aged care costs, and CarePlus Insurance, which is a life policy that makes a payment to beneficiaries on the death of the policyholder.

Consumers can purchase the annuity alone, or the combination of the annuity and the life policy. The minimum investment amount is \$10 000 for the combined product.

CarePlus is only available to Australians who are approved by the government's Aged Care Assessment Team to receive government-subsidised aged care services, either at home or in residential aged care.

Source: Independent Financial Adviser 2015.

5.4 Summary

Recent reforms in the aged care sector appear to have had some initial success in developing a more consumer focused and commercially driven sector. Increased engagement of the private sector is increasing the supply of services, and the funding structure clearly differentiates between different cohorts of consumers and their ability to pay. A Review of these reforms will be conducted in 2017.

The combined single income/assets means test encourages a more neutral approach from consumers, between the use of income and wealth to fund their needs in retirement. While a strong social security safety net is evident for those of limited means, those who can afford to pay are required to do so. Given the consequent financial demands on those of both moderate means and self-funded retirees, products and services that can assist older Australians to anticipate and manage aged care costs. Further to that point, technology and the *Myagedcare* website provides detailed information and a mean test calculator to assist older Australians with their planning.

At present products to assist with these funding needs are largely underdeveloped. While annuity based products, especially DLAs offer a number of advantages for funding this type of later life service, we await regulatory reform through the *Review of Retirement Income Stream Regulation* to allow for innovative use of these tools. Reverse mortgages would also be of use in this regard and LTCI is a distant possibility.

6 Health care in retirement

For older Australians facing retirement, a major concern is on-going health costs and the potential for a major adverse health event. Rising health costs and rising private health insurance costs present a challenge for both public funding and for individuals, especially older Australians who have a greater need for such services.

Australian Government real health expenditure per person is projected to more than double over the next 40 years. Health expenditure includes expenditure on public hospitals, Medicare and pharmaceuticals. Projections are that health care expenditures by Australian governments will increase from around 6.5 per cent of GDP in 2011-12 to nearly 11 per cent of GDP in 2059-60 (PC 2013). During 2011-12, almost 70 per cent of total health expenditure was funded by governments, with the remaining 30 per cent was paid for by patients (17 per cent), private health insurers (8%) and accident compensation schemes (5 per cent) (AHIW 2015 p. 27).

While health costs are accelerating, the ageing of the population is having only a small impact on these costs and is only one of the demographic factors driving demand for health care. Among the non-demographic factors driving increased health expenditure is technological change which has lead to better quality outcomes, and enabled interventions where none would have been available before. Relative health prices can also impact on costs as can impact on cost, especially the degree to which they facilitate or impede productivity. It is also notable that there is an income effect with health services in that rising incomes tend to increase expectations about the quality and nature of health care (PC 2013, p. 129).

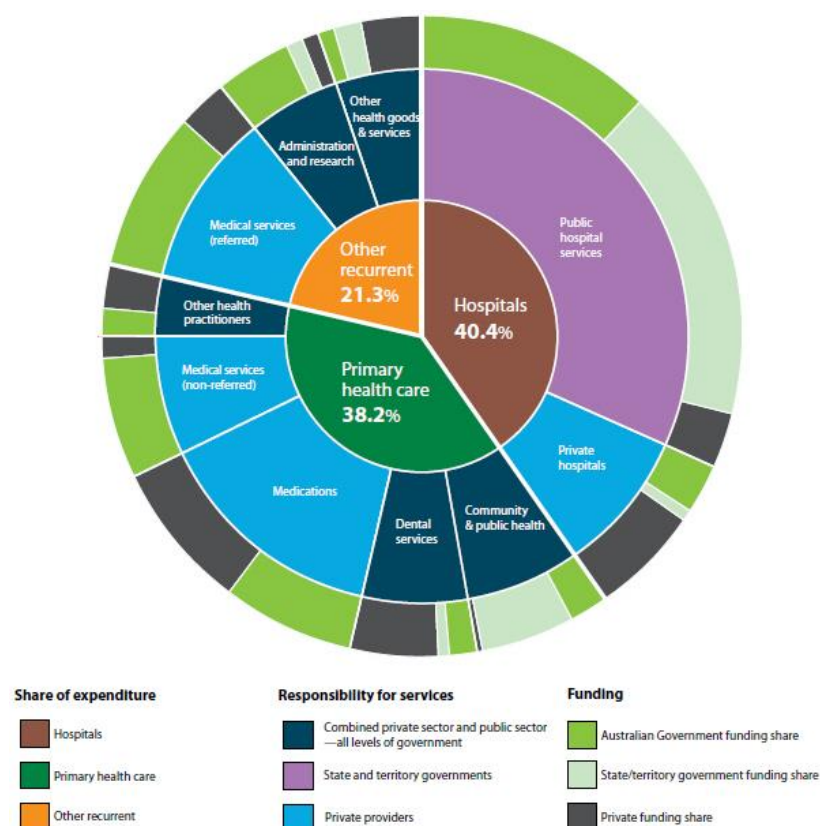
6.1 Health care policy in Australian

Health care policy in Australia is complicated by the fact that Australia's health-care system is a multi-faceted web of public and private providers, settings, participants and supporting mechanisms. Providers include medical practitioners, nurses, allied and other health professionals, hospitals, clinics and government and non-government agencies. Services include public health and preventive services in the community, to primary health care, emergency health services, hospital-based treatment, and rehabilitation and palliative care.

All levels of government are involved in the provision of public sector health services. Public hospitals are funded by the state, territory and Australian governments, and are managed by state and territory governments. Federal, state and territory governments fund and deliver a range of other health services, including population health programs, community health services, health and medical research, Aboriginal and Torres Strait Islander health services, mental health services, and health infrastructure. Private sector health service providers include private hospitals, medical practices and pharmacies. Private hospitals are owned and operated by the private sector.

Figure 13 provides an overview of the main services, funding responsibilities and providers of health care in Australia, and indicates the relative size of funding to each service.

Figure 13: Health services-funding and responsibility in Australia



Source: AIHW 2014.

Not surprisingly given the complexity of the system, health policy is cumbersome and difficult to change given the need for co-operation between local, state and federal governments, not to mention the need for bi-partisan support at the political level.

The full detail of health care reform is beyond the scope of this study, however, in summary it can be said that health care reforms to date have been directed at improving productivity in the system through measures such as encouraging and incentivizing organisational efficiencies, through workforce demarcation and regulation, through aggregated procurement, an increased emphasis on preventative measures, and more cost effective use of pharmaceuticals and technology (PC 2013). But perhaps the greatest potential for reforming health and improving well-being amongst the aged population comes from eHealth (AIHW 2014).

6.1.1 e-Health and Health Reform

Just as with financial service, technology is playing a major role in achieving operational efficiencies, improving information and engagement, providing more customized consumer solutions in the health industry.

E-health has been viewed positively in Europe, where many countries have been challenged in funding the health care system. According to the *Digital Agenda for Europe* (2015) digital technology can empower users to better manage their health, leading to a better quality of life for European citizens, innovation and growth for a competitive EU industry, and more sustainable healthcare systems for society. The report notes that the global telecare and telehealth market is forecast to grow from €7.6 to €17.6 billion by 2017.

In Australia, digital solutions have been part of the reform agenda, especially in terms of improving administrative processes, developing transportable individual health records, and increasingly in managing and monitoring chronic disease.

Introduction of these new technologies is not always plain sailing, however, as the federal government's attempt to introduce Personally Controlled Electronic Health Record (PCEHR) has shown. A personally controlled electronic health (e-health) records allows patients and their doctors, hospitals and other health-care providers to view and share the patient's health information, if the person has given prior consent, and a summary of medications, hospital discharge records, allergies and immunisations. Low adoption of PCEHR has forced a rethink and in the 2015 Budget plans were announced for a relaunch of the system as My Health Record with an opt-out philosophy, a more user-friendly record system, and better training for clinicians (Egan 2015). A key focus of this program is on the aged care sector, where a million older Australians are engaged.

Telehealth services use communication technologies, such as video-conferencing, to deliver health services and transmit health information. Telehealth technology can improve access to services for people living in regional, rural and remote areas. Patients who previously had to travel to the nearest major city to see a specialist can instead use video-conferencing, which might be offered at their local general practitioner or another local health-care venue.

Mobile technologies are increasingly being used in health care and public health practice (mHealth) for patient communication, monitoring, and education, and to facilitate adherence to chronic diseases management (mAdherence). Hamine et al (2015) conducted a systematic review of the literature to evaluate the effectiveness of mHealth in supporting the adherence of patients to chronic diseases management, and the usability, feasibility, and acceptability of mAdherence tools

and platforms in chronic disease management among patients and health care providers. The authors concluded that there is potential for mHealth tools to better facilitate adherence to chronic disease management, and that research should focus on understanding and improving how mHealth tools can overcome specific barriers to adherence. A number of such trials are being undertaken in Australia currently and CSIRO has recently established an eHealth research Centre for this purpose.

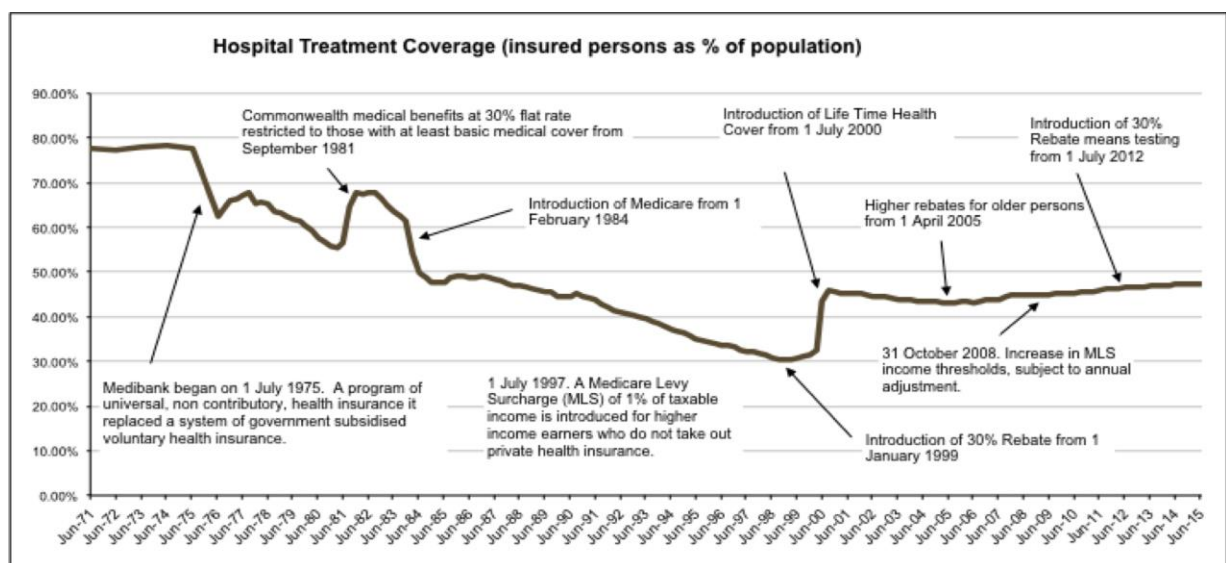
6.1.2 Private health insurance policy

The Australian health care system is underpinned by both public health insurance (Medicare) and private health insurance (PHI). These systems work in a parallel and complimentary fashion (see Appendix 3 for the division of responsibilities).

PHI covers hospitalisation either in private hospitals or in public hospitals for individuals choosing to be admitted as private patients, and also provides cover for ancillary services not insured by Medicare. However, funds have historically not been allowed to cover the medical costs already subsidised by Medicare, because such duplication was perceived to undermine universal insurance. This has resulted in a prohibition to offer PHI products for medical care received in outpatient settings, such as GPs and specialist consultants etc. It also resulted in Medicare reimbursing a share of the in-hospital medical costs for treatments received by private patients.

PHI is taken out by almost half of the population (Wu et al. 2015). The broad population coverage and the perceived value of the choice afforded by private cover may explain why several public policy interventions continued to be applied to PHI even after the introduction of Medicare (figure 14). Australia tightly regulates premium rating and insurers' offering for all private insurees, which reveals a desire to maintain broad participation in the PHI market across different risk cohorts. The core principles of community rating and open enrolment have been maintained (OECD 2008).

Figure 14: policy changes and impact on PHI cover for hospital treatment 1971 to 2015



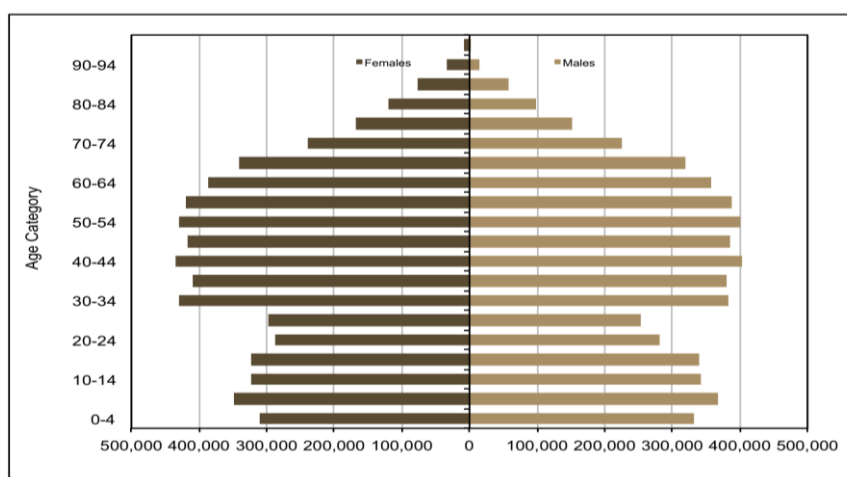
Source: APRA 2015.

While the industry was in decline prior to 2000, growth has since revived with the introduction of several government initiatives to increase participation. These initiatives include the Medicare Levy

Surcharge (MLS), the Lifetime Health Cover scheme and the PHI rebate. Increases in the Medicare Levy Surcharge (MLS) thresholds since 2008 have had a significant effect on the health insurance industry. While a large number of young people have dropped their PHI, due to the increase in the MLS, overall membership has increased due to greater adoption among older individuals, who generally have much higher benefit expenses. Anticipated falls in overall PHI membership resulting from the changes in the MLS did not materialize, however, due it is asserted to the 'poor state of public hospitals' and concerns about rising health costs which prompted many older Australians to either maintain or take up cover (Wu 2015).

The age group with the highest proportion covered by PHI is that between 40 and 44 years. At 55 years of age and beyond, the proportion of people covered by PHI begins to fall significantly. This is because most of these people are retired so they do not incur the MLS and their income is usually less, making PHI relatively expensive for people in this age group (Wu 2015) (figure 15).

Figure 15: Persons with PHI hospital coverage by age and gender, June 2015



Source: APRA 2015.

Among older people, in 2013, just over a half of those aged 65–74 had hospital coverage, compared with 38 per cent of those aged 85 and over. A slightly smaller proportion of each age group also had ancillary coverage. From the age of 65 onwards, higher proportions of the population were covered by hospital insurance than by ancillary (AIHW 2014).

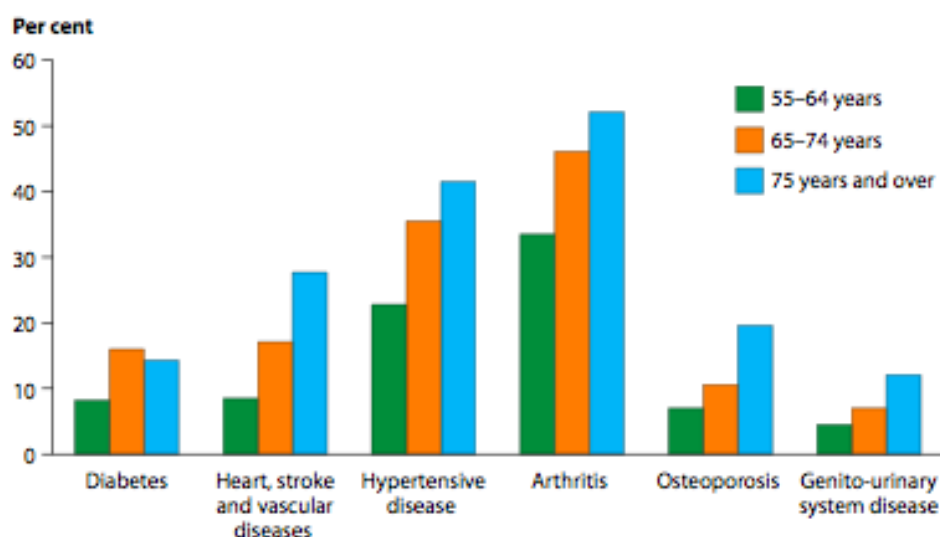
The NCOA made several recommendations regarding private health insurance. These include recommendations that high income earners take out PHI in place of Medicare, precluding them from the private health insurance rebate, and increasing the MLS for such earners. There were also recommendations concerning reform of the private health insurance market, including changing the premium setting process from price approval to price monitoring, reforming the Risk Equalisation Trust and relaxing the community rating system, which would allow insurers to charge premiums based on different lifestyle factors, such as smoking.

6.2 Ageing and health costs in retirement

The relationship between ageing and health costs is a complex one. While the Productivity Commission (2103), estimated that only 10 per cent of the increase in health costs is due to an ageing population, older people are higher users of the health care system. Further, the new generation of baby boomer retirees generally have a greater understanding and awareness of health issues and greater expectations of health services, which are likely to influence future models of health-care delivery and engagement.

Chronic disease and its prevalence amongst older age groups are major concerns. In Australia over 70 per cent of costs can be attributed to chronic disease, and 87.5 per cent of total recurrent health care expenditure can be attributed to the 12 major chronic disease groups (Paolucci and McRae 2012). There is an increasing proportion of the population over 85 years who have a range of age-related diseases such as arthritis, dementia and cancer, and amongst the younger cohort entering retirement, a larger propensity to lifestyle diseases such as type 2 diabetes than previous generations (figure 16).

Figure 16: Prevalence of chronic diseases by age group



Source: AIHW 2014.

Older people tend to consume more health care than others in value terms, reflecting the higher incidence of disease among this group and the complexities associated with comorbidities. For example, people aged 65 years received just over half of total Government expenditure on the Pharmaceutical Benefits Scheme (PBS), but represented only 14 per cent of the population. The probability of having four or more chronic conditions was around 2 per cent for the overall Australian population, compared to 8 per cent for those aged 65 years or more (PC 2013).

6.3 The cost of health care for older Australians

Medicare offers a safety net for older Australians with limited means, however there will still be out of pocket expenses, the costs of medication and health insurance. The Commonwealth Senior Health Card, and the Pensioner Concession card can both be used to offset health costs.

The Commonwealth Seniors Health Card is for those self-funded retirees who do not qualify for the age pension. It entitles the holder to discounts on prescription medicines and lower fees on medical services. The card is means-tested but that test is very generous. The threshold is an income of about \$80 000 a year for a couple combined and about \$50 000 a year for singles. For new recipient from January 1, 2015 the income test includes superannuation benefits.

The Pensioner Concession Card entitles those on a full or part Age Pension to reduced medicine costs under the Pharmaceutical Benefits Scheme, bulk billing for doctor's appointments (at the doctors discretion), further refunds for medical expenses through the Medicare Safety Net and assistance with hearing services.

The ASFA Retirement Standard for older Australians indicates that health costs increase quite considerably in later years. In this standard estimates are made for each of the main categories of health costs facing older Australians. Health insurance is included as while many procedures are available through the public system at minimal cost to the patient, such services can in effect be rationed or are at least subject to substantial waiting lists in the public health system. Many older Australian households therefore maintain private health insurance so that they have more options in regard to medical procedures. Also included are increased costs for pharmaceuticals, co-payments and out of pocket expenses. The estimate also includes an amortised cost for a major medical procedure, on the assumption that such a cost may be amortised over a number of years. Here it is assumed that the annual amortised cost for such a procedure with a gap payment of \$10 000 would be \$2 000 per annum (see Table 5).

Table 5: ASFA Retirement Standard: estimated health cost for older Australians

Expenditure items	Comfortable couple	Modest couple	Comfortable single female	Modest single female
Health insurance	\$79	\$63	\$40	\$32
Chemist	\$40	\$20	\$22	\$10
Co-payment and out of pocket	\$35	\$15	\$20	\$8
Cost of major medical procedure	\$38	\$38	\$38	\$38
Total health services (per week)	\$192	\$137	\$120	\$88
Total Health costs (per annum)	\$9,990	\$7,099	\$6,262	\$4,572
Total expenditure per year	\$53,123	\$33,744	\$37,875	\$22,670
% of expenditure	19%	21%	17%	20%

Source: Based on ASFA 2014.

What is most remarkable about this estimate is that health costs represent around 20 per cent of retirement income for this cohort of older Australians, with health insurance representing one third to one half of this cost. This level of expenditure is validated by a survey undertaken by National Seniors (2012) which finds that 570 000 people aged 55 years and over spend more than 10 per cent of their income on health and about 250 000 spend over 20 per cent. The research showed that on average, older Australians spend \$353 per quarter on out-of-pocket health care costs, and those with five or more chronic conditions spend \$882 per quarter which is almost six times as much as those with no chronic conditions. Not surprisingly then, many older Australians find themselves unable to afford private health insurance. On average it would appear that health costs for older Australians, when health insurance is included, approximates \$5 000 per year.

6.4 Financial products for health care for older Australians

The complexity of the health system mitigates against the development and provision of products to manage the costs of health care for older Australians, particularly the cost of maintaining private health insurance. Products to assist older Australians in dealing with the costs of health care in later retirement include the following.

Account based pensions are a key source of income in retirement. Paradoxically, as Drew Walk and West (2014) point out, higher health costs earlier in retirement can increase longevity risk by extending life. Consequently investment strategies, such as a dynamic life approach, can assist in recovering the cost of adverse health impacts by adjusting the investment strategy towards a higher risk investment portfolio.

As mentioned in the previous section, **Deferred Lifetime Annuities (DLAs)** also present a possible solution in a more generic sense to provide for these later life costs.

In terms of guarding against the cost of PHI, two types of product appeal as a solution.

Lifetime private health insurance purchased with a single premium using a lifetime annuity structure and lifetime private health insurance purchased with multiple premiums using a deferred lifetime annuity structure.

The major barrier to these innovations is community rating which prohibits pricing on the basis of age and gender, which would be necessary to efficiently provide the pooled longevity risk component of these products. Pooling longevity risk should be less expensive than continuing self-provision of private health insurance premiums to life expectancy because the early deaths are worth more to the pool than the cost of long lives. For regulatory purposes the longevity insurance component, which would be provided by a life office, could be separated from the private health insurance component, which would be provided by a private health insurance provider. Government would also have to provide certainty in relation to the tax and social security treatment of the combined product.

6.5 Summary

The reality of higher health costs for older Australians is a major factor driving the precautionary spending habits of retirees. While advances in medical services are reducing the incidence of some chronic diseases, for those managing chronic diseases in retirement the costs will be high.

The potential for mHealth to assist older Australians in the cost effective management of chronic disease presents an opportunity for preventative action, to the benefit of both individuals and public expenditure.

The fall off in participation of older Australians in PHI in later years is concerning, as this is the time they are most likely to be accessing health services. While community rating works to the advantage of older Australians in that premiums do not increase with age, at the same time community rating is an impediment to risk-pricing and incentivising better health behaviour such as imposing higher premiums on smokers.

Innovation in the financial sector is nascent, and the inability to provide tailored solutions to older Australians to assist them in preparing for the increased costs of health in later life. The complexity of the health system, the public and private insurance schemes, mitigate against innovation and the development of products to cater for the ageing population.

The universal access to health services does not discriminate between those who can afford to pay and those who cannot. However, were the NCOA Recommendation 17 to be adopted, there would be increased demand from older Australians for financial services to assist with health costs, and the catalyst to innovate.

7 Conclusion

Australia's ageing population is placing pressure on federal budgets and creating opportunities for the development of a range of new products and services to meet the needs of this sector. The wave of 5.5 million older Australian moving into retirement is creating an awareness of a growing potential market. However as this report has highlighted, there is much to be done.

Where retirement income streams are concerned, there are some emerging examples of innovation and steps to increase the level of information and guidance to those approaching retirement. Reporting on projected consumption in retirement, reducing the complexity of decision-making at the point of retirement and the development of a broader suite of income stream products all auger well for the future. At the time of writing we await the response of the Treasury's *Review of Retirement Income Stream Regulation*, which will open the way for greater innovation, especially in the area of longevity products.

Policy and regulatory responses are variable across the range of services in post retirement, but there is a growing recognition of the need to proactively respond to reducing costs, increasing services provided by the private sector, and for regulators to accommodate new business models and remove the barriers to innovation.

While there is increasing recognition of the potential for wealth in the form of home ownership as a means of supplementing retirement incomes, this is an area where market forces and policy response are not achieving an outcome in the interests of encouraging more self-reliant older Australians, and reducing pressure on public expenditure. The structure of the current asset and income means tests provide a disincentive to older Australians to draw on their home equity. Problems associated with existing reverse mortgages have ensure both limited supply and demand for this product. While fractional equity release appears to offer a better way forward this style of equity release is still emerging.

In contrast to this, reforms in the aged care sector appear to be having success in incentivised providers to increase the supply and quality of services on offer in both home based care packages and in residential places. While a means-tested system provides for those without the means to contribute to their own costs, early indications of the new Refundable Accommodation Deposits suggest that those who are in a position to pay for the service are capable of doing so. Increased transparency and information in this sector also allow retirees to be aware of likely costs and factor them into planning. There is little evidence, however, of financial products emerging which will assist

older Australian who have the means to provide for this cost. This is an area where equity release or deferred annuity products could assist.

The other area of concern for retirees that engenders a strong precautionary motive in how retirees spend down their retirement savings is in providing for later life health costs. The very complex and tightly regulated health care sector, with the current public and private health insurance schemes, do not provide an enabling policy framework for product innovation. Of real concern is the high cost of private health insurance for older Australians.

Given that much of the cost for aged care and potential health issues tend to occur later in retirement, the use of deferred annuities which yield benefits at 75 or 80 years would seem to present a very real opportunity to prepare for these expenses in a cost effective way, and reduce the risk of poverty later in life. These products together with the right income stream products, an effective equity release solution would provide the essential building blocks to ensure better retirement outcomes for older Australians. Putting together the right combination of advice and products for those in retirement will require an integrated approach from financial service provider, especially superannuation funds.

References

- ABS (Australian Bureau of Statistics) 2014. Household Wealth and Wealth Distribution, 2011–12.
- 2015a. Gender Indicators, Australia.
- 2015b. Household Income and Wealth, Australia, 2013-14.
- ACFA (Aged Care Financing Authority) 2015. Third report on the Funding and Financing of the Aged Care Sector, July.
- ACFS (Australian Centre for Financial Studies) 2015. Superannuation in the post-retirement phase.
- Agnew, J, Bateman, H, and Thorp, S, 2012, Financial Literacy and Retirement Planning in Australia, ARC Centre of Population Ageing and Research Working Paper, December.
- AIHW (Australian Institute of Health and Welfare, 2014, Ageing and the health system: challenges, opportunities and adaptations, Australia's health 2014, Australia's health series no. 14. Cat. no. AUS 178. Canberra: AIHW.
- Alai DH; Chen H; Cho D; Hanewald K; Sherris M, 2013, 'Developing Equity Release Markets: Risk Analysis for Reverse Mortgages and Home Reversions', CEPAR Working Paper, 2013/1.
- ASFA (Association of Superannuation Funds of Australia), 2013, Removing the seven impediments to retirement income stream products, Media Release, 9 October.
- 2014a. An Update on the Level and Distribution of Retirement Savings.
- 2014b. Financial System Inquiry Submission.
- 2014c. ASFA Retirement Standard September Quarter 2014.
- 2014, Spending patterns of older retirees: New ASFA Retirement Standard – September quarter 2014
- 2015a. ASFA Retirement Standard.
- 2015b. Superannuation and High Account Balances.
- ATO (Australian Tax Office) 2013. SMSF Annual Review
- 2014. Self-managed super fund statistical report – June 2014.
- Australian Government Actuary, 2014a, Towards More Efficient Retirement Income Products", <http://fsi.gov.au/files/2014/12/Towards-more-efficient-retirement-income-products.pdf>.
- Australian Prudential Regulation Authority (APRA), 2013, Annual Superannuation Bulletin June 2013 (Revised 5 February 2014) Table 18.
- Bateman, Hazel and Kingston Geoffrey, Tax and super – unfinished business, Melbourne Money and Finance Conference, June 2010
- Baxter, J., and P. McDonald. 2005. Why is the Rate of Home Ownership Falling in Australia? Research and Bulletin Update. Melbourne: Australian Housing and Urban Research Institute.
- Bovenberg, L., 2011, European pension reform as a way forward, Pension, Vol. 16, 2 pp.75-79.

Bradbury, B 2010a, 'Asset rich, but income poor: Australian housing wealth and retirement in an international context', Social Policy Research Paper, no. 41, Social Policy Research Centre, University of New South Wales.

Browne, B., 2013, Long Term Care Insurance: A Survey of Providers' Attitudes, National Seniors Centre for Productive Ageing, May.

Brownfield, Christine, 2014, The Fourth Pillar – The Role of Home Equity Release in Retirement Funding, Actuaries Institute Financial Services Forum, Sydney, May.

CEPAR (Centre for Excellence in Population Ageing Research). 2014a. Aged Care in Australia: Part I – Policy, Demand and Funding, CEPAR Research Brief 2014/01.

Commonwealth of Australia, 2014, Reform of the Federation White Paper: Roles and Responsibilities in Health, Issues Paper 3, December.

Cowan, Simon, and Matthew Taylor. 2015. The Age Old Problem of Old Age: Fixing the Pension. CIS. <http://cis.org.au/images/stories/research-reports/rr3.pdf>.

Daley J and Wood C, 2014, The Wealth of Generations, Grattan Institute, December.

Davenport, Thomas H., Are You Ready For Robo-Advice? Mar 24, 2015, <http://ianalytics.com/research/are-you-ready-for-robo-advice>

De Silva, Sinclair, Thomas and Fard 2015. Home equity release: opportunities and challenges, a commissioned paper for the Australian Centre for Financial Studies.

DHS (Department of Human Services) 2015. Age Pension. Australian Government Department of Human Services, February. <http://www.humanservices.gov.au/customer/services/centrelink/age>

Digital Agenda for Europe 2015. ICT for health and ageing: a triple win, <http://ec.europa.eu/digital-agenda/en/ehealth-and-ageing>

Drew, Michael E., Walk, Adam N., and Wes, Jason M 2014. Withdrawal Capacity in the Face of Expected and Unexpected Health and Aged-Care Expenses during Retirement, a CSIRO-Monash Working Paper.

Earl, Joanne K, Gerrans, Paul , Asher Anthony, Woodside, Julia 2015. Financial literacy, financial judgement, and retirement self-efficacy of older trustees of self-managed superannuation funds, Australian Journal of Management August 40: 435-458.

Egan, Natasha, 2015. Budget: Call for aged care to be part of opt-out e-health trials, in Technology Review, May 13

Equip, 2015. Equip MyPension - Ready to fill your retirement with confidence.

EY, 2015. Advice goes virtual in asset management.

Hamine, S, Gerth-Guyette, E, Faulx, D, Green, B, Ginsburg, A 2015. Impact of mHealth Chronic Disease Management on Treatment Adherence and Patient Outcomes: A Systematic Review, Journal of Medical Internet Research, Vol 17, No 2 (2015): FebruaryHenry Review

Hedges, Bob, Singh, Uday, Gabel, Monica 2015. Hype vs. Reality: The Coming Waves of “Robo” Adoption, Insights from the A.T. Kearney 2015 Robo-Advisory Services Study, June 18.

Henry Review 2009. Australia's Future Tax System: The Retirement Income System : Report on Strategic Issues AFTS (Australia's Future Tax System), Commonwealth of Australia, The Treasury, Canberra.

Hickey, J 2015. Deloitte Reverse Mortgage Report, September 7.

Howes, Melinda 2012. Discussion Paper Exploring barriers to Australia's annuities market, Actuaries Institute, 23 February.

Jackson-Maynes, Kate, 2015, The rise of Robo Advice tools in financial planning, King & Wood Mallesons, 16 July .

Johnson, Dianne, Worthington Andrew & Brimble Mark, (2015), The Potential Role of Housing Equity in a Looming Baby Boomer Retirement Cash-flow Crisis: An Australian Perspective, Housing, Theory and Society, 32:3, 266-288, DOI: 10.1080/14036096.2015.1012275

Judd, Bruce, Liu, Edgar, Easthope, Hazel, Davy Laura, and Bridge Catherine 2014, Downsizing amongst older Australians, AHURI Final Report No. 214, Australian Housing and Urban Research Institute, UNSW, January.

King, M, 2015, Why an SMSF is better than member direct investing, The Motley Fool, Sept. 21.

Mercer, 2013, Meeting the Retirement Income Challenge,

<http://www.mercer.com.au/content/dam/mercer/attachments/asiapacific/australia/SRI-Retirement-Incomes-0413.pdf>.

--- 2014, Post-Retirement Market Trends in Australia,

http://www.mercer.com.au/content/dam/mercer/attachments/asiapacific/australia/investment/Mercer_Post-Retirement-Market-Trends-In-Australia-June2014.pdf.

--- 2015, Mercer Lifetime Plus.

Merton, Robert C., 2005, Financial Innovation And Economic Performance, Journal of Applied Corporate Finance, April.

Merton, Robert, C., 2014, The crisis in retirement planning, Harvard Business Review, July-August, pp. 43-50.

Nabtrade (2015) Intimate with Self-Managed Superannuation – Snapshot of Trustee Findings An annual study of Self-Managed Superannuation Funds Prepared by CoreData for nabtrade and SMSF Association

National Seniors, 2012, Out-of-pocket health care costs a burden for chronic health sufferers, National Seniors Productive Ageing Centre.

--- 2014, Downsizing Decisions of Senior Australians: What are the motivating and discouraging factors?, National Seniors Productive Ageing Centre, June,

National Seniors and Challenger, 2013, Retiree's needs and their (in)tolerance of risk, National Seniors Productive Ageing Centre.

OECD, 2015, Focus on Health Spending, Health Statistics 2015.

OECD, 2013, Pensions at a Glance 2013: OECD and G20 Indicators, OECD Publishing.
http://dx.doi.org/10.1787/pension_glance-2013-en

Paolucci F and McRae I, 2012, Healthcare delivery for our ageing population: What does Australia need to do? In Jonathan Pincus and Graeme Hugo (Eds), A Greater Australia: Population, Policies And Governance, CEDA.

Pash, Chris, 2015, Australian baby boomers are buying up big on annuities as they hit retirement, Business Insider, February 17 2015.

Power, Trish. 2015. Super for Beginners, Part 22: How Do You Speak 'superannuation' (... in 20 Words)? - SuperGuide. Super Guide. Accessed June 23.

PC (Productivity Commission) 2011, Caring for Older Australians, Commissioned Research Paper, Canberra.

--- 2013, An Ageing Australia: Preparing for the Future, Commissioned Research Paper, Canberra.

--- 2015, Superannuation Policy for Post Retirement, Commissioned Research Paper, Canberra.

Rice Warner, 2014, Ageing and Capital Flows,

<http://www.actuaries.asn.au/Library/Reports/2014/AgeingandCapitalFlows.pdf>.

Power, Trish. 2015. Super for Beginners, Part 22: How Do You Speak 'superannuation' (... in 20 Words)? - SuperGuide. Super Guide. Accessed June 23. <http://www.superguide.com.au/how-super-works/how-do-you-speak- superannuation>.

Sherris and Alai (2013)

Speelman, Craig P, Marilyn Clark-Murphy, and Paul Gerrans. 2013. Decision Making Clusters in Retirement Savings: Preliminary Findings, University of NSW, Centre for Pensions and Superannuation.

Standard and Poor's, 2013, Global Ageing 2013: Rising to the Challenge.

Treasury 2014. Financial System Inquiry

---, 2015. 2015 Intergenerational Report.

VicSuper 2015. Guaranteed Income.

The World Bank, 1994, Averting the Old Age Crisis.

World Economic Forum (WEF), 2010, The Future of Pensions and Healthcare in a Rapidly Ageing World Scenarios to 2030.

Wu, S, Asher, A, Meyricke, R, Thorp, S, 2015, Age Pensioner Profiles: A Longitudinal Study of Income, Assets and Decumulation, ARC Centre of Population Ageing and Research Working Paper 2015/17.

Wu, Tommy, 2015, Health kick: Membership growth and higher premium prices drive industry revenue, Health Insurance in Australia, IBISWorld Industry Report K6321, August.

Yates J; Bradbury B, 2010, 'Home ownership as a (crumbling) fourth pillar of social insurance in Australia', Journal of Housing and the Built Environment, vol. 25, no. 2, pp. 193 - 211, <http://dx.doi.org/10.1007/s10901-010-9187-4>

Appendix 1: types of annuities

Immediate lifetime Annuities: Lifetime annuities are available in Australia with many options (for example guaranteed payment periods, death benefits, nominal or inflation linked payments, and some liquidity options). Lifetime annuities provide a stable income for retirees without the danger of longevity risk and are relatively easy to understand. Modern variations of annuities also overcome two of the perceived disadvantages of earlier products. First, whereas traditionally an annuity pools mortality risk and retains the balance on the death, it is now possible for a death benefit to be paid to a beneficiary (although this reduced the rate paid). Second, while traditionally lifetime annuities do not provide retirees with investment choice, more recent products with liquidity options offer increased flexibility. The number of companies selling lifetime annuities in Australia has dropped over the past decade, with only two remaining. This reflects a change in 2005 to the treatment of lifetime annuities when assessing Age Pension eligibility, thereby making them less attractive to retirees. Recent changes to the social security treatment of ABPs have improved the relative attractiveness of annuities, however low interest rates have kept demand for annuities low.

Deferred lifetime annuities: Deferred lifetime annuities are purchased around the time of retirement. Annuity income, however, begins at a later date (for example, at age 85) and then is payable for life. The deferred payment can generate a relatively high income from a relatively modest investment. For example, modelling for the FSI in 2014 showed a 20 year DLA purchased by a 65 year old man would pay \$2390 per \$10 000 invested compared to \$570 for \$10 000 invested in an ILA (Australian Government Actuary 2014). In 2013 the Government indicated DLA would receive the same concessional tax treatment given to superannuation assets invested income streams. This reform aims to encourage the development of deferred annuity products. The tax and social security treatment of DLAs are currently being explored in the Commonwealth Government's Review Of Retirement Income Stream Regulation (The Australian Government the Treasury 2014b).

Term annuities: Term annuities pay an income over a predetermined period with or without a return of the initial capital investment. There are a number of options for term annuities including varying payout frequencies, residual capital values and terms. Term annuities can be thought of as an investment choice (similar to a term deposit) rather than a traditional retirement income product. Term annuities provide flexibility as policy holders can access their capital if needed (with a surrender value). Term annuities are generally bought as short term annuities with return of capital, and rolled over when they mature. The income paid varies with interest rates, but the capital returned is unaffected. Reinvestment and longevity risks are borne by the policyholder.

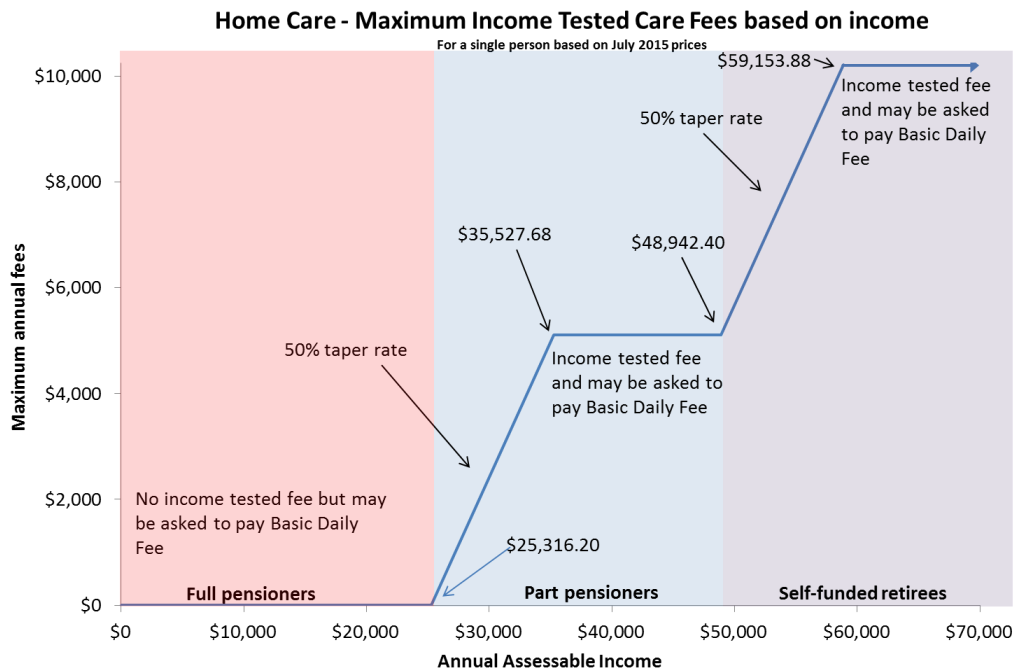
Variable annuities: Variable annuities provide some choice over the asset allocation of their investment. This choice may be limited or use index tracking, and the investment comes with a rider protecting the investor from downside risk. Variable annuities tend to have higher fees, which incorporate the cost of any riders and the investment management and administration fees. Variable annuities provide flexibility with access to capital and a degree of investment choice (generally a subset of that available for an allocated pension). They make up a very small proportion of the market and are considered expensive and complicated.

Pooled annuities: Pooled annuities are also known as 'with-profit annuities' and are offered in some defined benefit schemes. The initial payment on pooled annuities is determined using an assumed interest rate and an estimate of mortality rates. The amount actually paid varies depending on investment returns and mortality experience. A deviation in investment returns from the assumed interest rate leads to a proportional change to amount being paid. Deviations from mortality experience, similarly, alter the income paid.

Appendix 2: Means testing for aged care

Home care

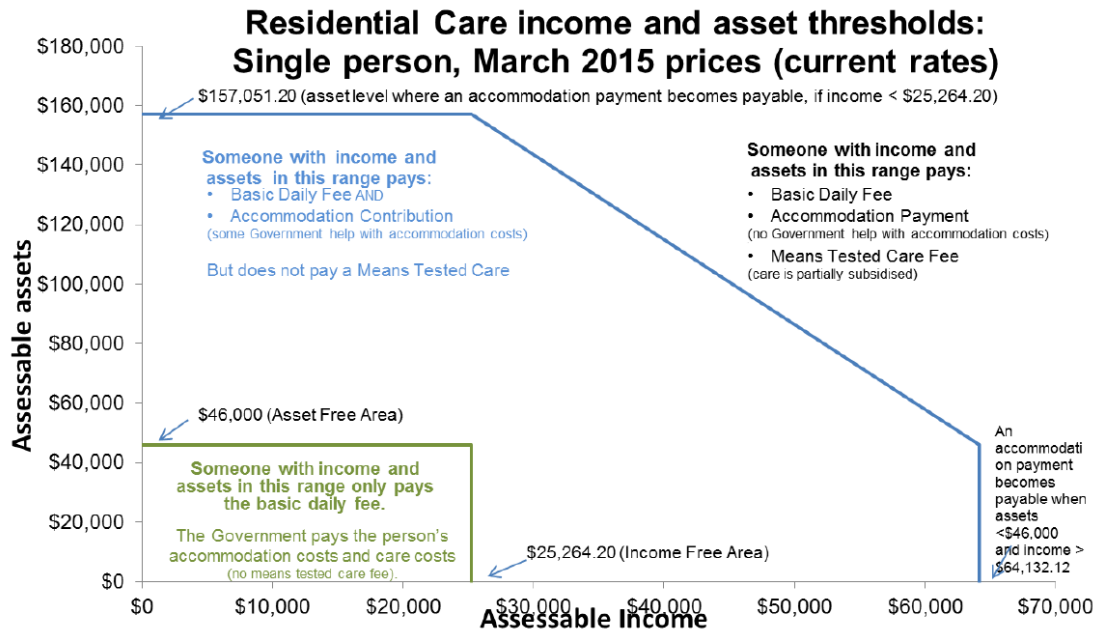
In addition to the basic daily fee, an income tested fee was introduced in home care from 1 July 2014. The following diagram describes the current income testing for home care (post 1 July 2014)



Note. Income tested care fees could be charged up to 50 per cent of income over \$48,942.40 but this is capped for an income over \$59,153.88

Residential care

Changes to residential care from 1 July 2014 introduced more comprehensive means testing arrangements by way of a combined assets and income assessment and a new fee structure as described below.



Source: AFCA 2015.

Appendix 3: Coverage of health services and providers by public and private health insurance in Australia

	PUBLIC HEALTH INSURANCE (Medicare, PBS, other public funding)	PRIVATE HEALTH INSURANCE (Private hospitals and private ancillary insurance)
Hospital care		
<i>Hospital charges</i>	<u>Public patients (in public hospitals)</u> <ul style="list-style-type: none"> Universal free care under Medicare Medicare covers the full cost of public patients' in-patient stay (theatre, basic accommodation) Upgraded accommodation not covered by Medicare 	<u>Private patients (in public or private hospitals)</u> <ul style="list-style-type: none"> Private hospital insurance covers hospital in-patient charges for private patients, subject to cost-sharing imposed by the PHI policy (e.g., deductibles) In public hospitals, the benefit paid by the funds is equal to the Medicare Benefit Schedule (MBS) daily rates In private hospitals, the benefit paid by the fund is negotiated if funds enter into contractual agreement, or is otherwise a default payment set by the government
<i>Drugs</i>	<u>Public and private patients</u> <ul style="list-style-type: none"> The Pharmaceutical Benefit Scheme (PBS) covers the cost of listed drugs 	<ul style="list-style-type: none"> Private hospital insurance covers part or all of the cost of drugs that are not reimbursed by the PBS
<i>Medical charges</i>	<u>Public patients (public hospitals)</u> <ul style="list-style-type: none"> Medicare covers doctors' fee in public hospitals, with no co-payments No choice of doctor <u>Private patients (public & private hospitals)</u> <ul style="list-style-type: none"> Medicare subsidises private patients' fees for 75% of MBS rates 	<u>Public and private hospitals</u> <ul style="list-style-type: none"> Private hospital insurance must cover 25% of MBS rates Private hospitals insurance may cover the remaining gap above the MBS rates, based on non-contractual agreements with doctors Choice of doctor by patients Medical fees are unregulated (but funds can reach agreements with doctors on fees)
Ambulatory physician services (GPs and specialists)	<ul style="list-style-type: none"> Medicare offers a universal rebate on these medical costs equal to 85% of MBS rates. Doctors' fees are unregulated: <ul style="list-style-type: none"> Doctor can bill Medicare directly and accept the MBS rate as full payment (bulk-billing). Doctors are allowed to charge above the MBS rate. In this case, individuals pay in advance and bear themselves out-of-pocket payments equal to 15% of MBS fee and any extra billing. 	<ul style="list-style-type: none"> Private health insurance coverage NOT allowed
Long-term care and home care	<ul style="list-style-type: none"> Predominantly publicly financed (but not by Medicare). 	<ul style="list-style-type: none"> Private health insurance is allowed but is not common.
Drugs <i>Prescription drugs</i> <i>Other drugs</i>	<ul style="list-style-type: none"> All Australians are covered through the Pharmaceutical Benefit Scheme (PBS) Individuals are liable for co-payments Not covered 	<ul style="list-style-type: none"> Private health insurance coverage of co-payments not allowed Private health insurance (hospitals and/or ancillary PHI) can cover the cost of these drugs
Ancillary benefits	<ul style="list-style-type: none"> Not covered by Medicare 	<ul style="list-style-type: none"> Private ancillary insurance covers services not insured by Medicare (e.g., alternative medicine, optical, dental, physiotherapy, etc)

Source: OECD, 2008.

Appendix 4: The new market place for advice

	Digital wealth manager		V.	Traditional wealth management firms
	Fully automated	Advisor-assisted		
Business model	Software-based delivery of customized and automated investment advice	Phone-based financial advisor (FA) accessible through digital channels to deliver personal advice		Face-to-face advice mainly through branch network offering comprehensive wealth management
Typical investor	Millennial, tech-savvy, price-sensitive; wants to match market returns and pay low fees	Mass market and mass affluent* clients who value human guidance and technology		Affluent, high net worth*** and ultra-high net worth**** clients who value guidance from a trusted FA
Value proposition	Convenient and easy-to-use, low-cost online platform offered directly to consumers	Digital platform combined with advisor relationship; affordable pricing for fully diversified portfolio		Dedicated FA with full range of investment choices and comprehensive wealth planning
Fee structure	0.25%–0.50% fee on assets managed; minimums may apply	0.30%–0.90% fee on assets managed; monthly fees per planning program; minimums may apply		0.75%–1.5%+fee on assets managed; minimums may apply, varies by investment type
Investment process overview	Risk profile, target asset allocation, managed investment account, automated rebalancing, easy access	Virtual FA meeting, financial planning, risk profile, target asset allocation, managed investment account, automated rebalancing, easy access, periodic reviews		In-person meeting with dedicated advisor, financial planning, investment proposal, target asset allocation, brokerage and managed accounts, automated rebalancing, in-person access and reviews.
Investment vehicles	Exchange-traded funds (ETFs), direct indexing**	ETFs, stocks		Stocks, bonds, ETFs, mutual funds, options, alternative investments, commodities, structured products

Source: [http://www.ey.com/Publication/vwLUAssets/Advice_goes_virtual_in_asset_management/\\$FILE/ey-digital-investment-services.pdf](http://www.ey.com/Publication/vwLUAssets/Advice_goes_virtual_in_asset_management/$FILE/ey-digital-investment-services.pdf)

*US households with between US\$250k and US\$1m in financial assets
 Wealthfront offers direct indexing to accounts >US\$500k in assets through individual stock selection *US households with between US\$1m and US\$10m in financial assets ****US households with greater than US\$10m in financial assets

About the Australian Centre for Financial Studies

The Australian Centre for Financial Studies (ACFS) seeks to enhance excellence in financial services by promoting a strong research network among industry, government and academic institutions. The Centre specialises in industry-oriented research and events, aiming to boost the global credentials of Australia's financial sector and support Australia as an international centre for finance research, practice, and education.

The Centre is a consortium of Monash University, RMIT, and the professional body Finsia, with Associate University members the University of Melbourne, Griffith University and Victoria University. ACFS receives support from a number of corporate sponsors, and the Victorian Government.

www.australiancentre.com.au

ACFS Research Code of Conduct

ACFS conducts independent research and thought leadership into issues related to the financial sector. Contracted research is undertaken for industry research partners, or for the purpose of generating public debate about issues of importance to the sector and the wider community.

The strength of ACFS research is that it is well informed by industry practice and input, and is undertaken with a high level of expertise, by ACFS research staff and by drawing on our wide network of academic and practitioner collaborators.

We produce accessible and relevant research that is non-partisan, and non-sectoral in its perspective. While we welcome a diversity of views, the value of our work is underpinned by its independence.