Retirees should splash on themselves, and save the economy

Super savings

How can cautious seniors be persuaded to dip into their nest eggs more often?

Jeremy Cooper

David Knox

One of the observations of the recent Retirement Income Review was that it would be good for retirees to save less and spend more in retirement.

The final report talked about a more efficient use of retirement savings and better outcomes for older Australians, but it really meant more spending, less saving, leading to a better standard of living in retirement. The review found that many retirees leave most of their super as an inheritance, rather than spending it.

Recently, the Association of Superannuation Funds of Australia issued a research report challenging this finding, but it was largely focused on much older retirees, many of whom never had any or much super to begin with.

Our focus is on younger retirees and the future, where super balances will be larger.

An important reason for this saving-oriented behaviour is retirees worry about running out of money and are uncertain about future aged care and health costs.

To guard against these unknowns, they underspend. This means that many retirees have a lower standard of living than they could afford.

If these worries could be reduced, retirees could improve their standard of living in retirement by spending more of their super.

To change this behaviour, retirees would need more confidence about both their future income and ongoing government support. This would not only benefit retirees but also be a boost to the economy.

The RIR found the minimum drawdown rules that apply to account-based pensions act as an anchor or guide for many retirees as they spend their super. Mercer research showed that about half of all retirees drawing on their super do not exceed the required minimum amount.

Retirees are in the habit of underspending.
PHOTO: ROS HOLCOMBE

Trustees of super funds will need to be more actively engaged in providing retirement income solutions to their members.

The minimum rates are conservative and were never intended as a guide for an adequate standard of living in retirement.

Using the minimum rates for that purpose can have some surprising outcomes. For example, assuming a constant 5 per cent annual investment return, a 65-year-old retiree drawing at the minimum rates would still have 32 per cent of their initial retirement balance left at age 100.

Even if drawdowns were increased by two whole percentage points of their balance each year, the amount left at age 100 would still be 15.5 per cent of the level at retirement.

There is clearly scope for more spending, and less saving, in retirement, but how can this be achieved in the face of entrenched retiree behaviour?

The RIR expressed support for some changes the government proposes to achieve this very outcome – a new duty for super fund trustees to have a strategy for their retired members that, importantly, provides those members with options to create income that lasts for life.

The intention is that retirees would become more confident to spend their super in the knowledge that it will last as long as they will. The proposal is that a retirement income "covenant" creating this new duty will be added to the superannuation legislation, commencing on July 1, 2022.

To make the covenant work, super funds will need to provide guidance to members about how the fund's retirement income products will work for them.

Trustees of super funds will need to be more actively engaged in providing retirement income solutions to their members. In particular, helping members understand that they can, in many circumstances, draw down more than the minimum rate on the basis that they will not run out of money. Funds shifting their focus to a consumption frame in retirement, as opposed to a saving frame, will be key to the success of the covenant.

If retirees spend instead of saving, this is good for the economy.

According to the Australian Prudential Regulation Authority, at June 30, 2020, there was $485 billion in retirement-phase accounts held by members of large superannuation funds, with an average account balance of $289,000.

If we assume, broadly in line with the analysis in the RIR, that each retiree in these funds will, in future, draw down an extra 1.5 per cent of their super balance each year, then this extra income would equate to $7.3 billion in aggregate – or, to put it another way, the average retiree would be able to spend an extra $4300 a year.

This extra expenditure in the economy should have a multiplier effect of about 1.2 over the first two years. These additional drawdowns would result in almost $9 billion of additional annual spending throughout the economy. This would be a significant boost to the economy, equal to about 0.5 per cent of Australian GDP.

Increased spending by retirees would provide a boost to the economy, and this boost would not be from the budget, but from retirees spending more on themselves; a win-win for retirees and the economy.

Jeremy Cooper is chairman of retirement income at Challenger Limited.
David Knox is senior partner at Mercer.