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How can super reach its full potential?

**** CHECK AGAINST DELIVERY****

In 1909, Australia was a sparsely populated, largely rural nation. Its 4.2 million people were young, and the average person was not expected to live beyond 55 years[1].

It was at this time the federal government first introduced the Age Pension. Its access age was set at 65 – ten years beyond the average life expectancy for an Australian male[2]. One year later, in 1910, the government opened it up to women with an access age of 60[3].

The proportion of people expected to reach 65 was relatively low, and those who did could expect to live for around 11 years with their income funded by the government[4]. Without this in place, their circumstances would have been dire. Often in poor health, with no means to earn a wage, and a dwindling network of family and friends, these older Australians would essentially be left destitute.

There's no doubt that in 1909 we, as a nation, recognised our social responsibility to look after Australians who reached such advanced years. Thus the Age Pension served as a safety net, protecting these vulnerable people in our society from falling on tough times.

For more than 80 years, the Age Pension was the central pillar of our retirement income system. But against this constant, Australia continued to change.

Let's fast-forward to 1992, average life expectancy had shot up to 74 - a 19-year increase[5], but with the same Age Pension access age in place. With the demographic bulge of the baby boomers looming, it was clear that a taxpayer-funded universal pension scheme would fast become unaffordable.

The combination of an ageing population, increasing longevity, and fiscal decline meant we had to decouple retirement from a welfare model and find a

[1] Australian Life Tables 2005-2007 http://www.aga.gov.au/publications/life_tables_2005-07/downloads/Australian_Life_Tables_2005-07.pdf
[2] History of the Age Pension http://www.abs.gov.au/AUSSTATS/abs@.nsf/3d68c56307742d8fca257090002029cd/8e72c4526a94aaedca2569de00296978!OpenDocument
[3] Ibid
[4] Above n1
[5] Ibid

way to make workers contribute to their own retirement funds. While many white-collar workers were already doing this and accumulating private savings, for many blue-collar workers it was simply out of reach.

So with more people retiring, living longer, and less government capacity to provide them with an income, the superannuation system was born.

The idea was to have a universal system comprising of Three Pillars:

- A government-funded safety net in the form of the Age Pension
- Compulsory contributions made from employers into employee's superannuation accounts – the Superannuation Guarantee
- And the ability for people to make additional, Voluntary Contributions into their super fund with tax incentives to encourage this.

No matter which way you look at it, there is no doubt that this three-pillar system has been a success. Already it's delivering many benefits.

Each year,

- It saves the government more than $7 billion on Age Pension expenditure[6]
- It will shortly generate more than $11 billion in annual tax revenue for the federal budget[7]
- And in 2012/13 more than 155,000 retirees drew an income stream from their super, improving their quality of life and allowing them to live with greater dignity and comfort in retirement[8].

Our economy has also been a strong beneficiary of super. The more money retirees have in private savings, the more they can spend in our local businesses, travel to our country's attractions, and use the services of the next

[6] ASFA, Mythbusting Superannuation Tax Concessions, http://www.superannuation.asn.au/ArticleDocuments/116/1503-Mythbusting_superannuation_tax_concessions.pdf.aspx
[7] Budget 2016/16 http://budget.gov.au/2015-16/content/bp1/download/Budget_Paper_No_1.pdf
[8] ASFA, The Future of Australia's Superannuation System: A new framework for a better system http://www.superannuation.asn.au/ArticleDocuments/1089/ASFA_FutureAustraliaSuperSystem_Nov2014.pdf.aspx

generation of doctors, nurses, lawyers, tradespeople and many other professions.

Disappointingly, the championing of these benefits is often pushed aside, in favour of more headline-grabbing arguments such as the apparent injustice of the tax concessions provided to, quote, “the rich”.

Let me get this straight, I do believe that there are some things we can do to improve the system’s equity. But what I am concerned about is that these tactical issues are a distraction from the much more important discussion we need to have.

While we’ve had our eyes narrowed to these micro debates, we are missing the big picture. And in turn, if we’re not careful, we will miss an opportunity to design the best superannuation system we can for our children, and our nation’s future.

This is what we should be discussing; the superannuation framework for the future.

One that has bipartisan political support with consistency.

One that will help superannuation providers innovate and deliver to their members with stability.

One that will allow individuals to plan for their retirement with certainty.

A framework so clear that we can easily measure its success.

So how do we achieve this? The first step is to look at who we are making policy for.

If you consider our welfare system, it contains a myriad of different policies that are designed to help people with the challenges they face based on their personal circumstances.

So why is it we don’t look at super in the same way? While super has universal application, the challenges members face are not uniform.

We need to recognise that we essentially have two ‘phases’ of superannuation members who we need to cater for.

The first are those in the system as it currently stands, which I would guess would be everyone in this room today.

This is the system that is still maturing. It is only 22 years old. It started with a contribution rate of 3 per cent, only reached 9 per cent in 2002 and will not get to 12 per cent until 2025[9]. Importantly, most people working today have not and will not spend the majority of their working lives in it at a full 12 per cent.

This means we will face different challenges in saving for our retirement, in particular when it comes to reaching an adequate balance.

The other phase is what I call the ‘mature’ system. Those who enter the workforce in 2025 – today’s 9 and 10 year olds - will spend their entire working lives with an SG of 12 per cent – who knows, maybe it will even be higher. They will also certainly live longer on average than anyone who is in the ‘maturing’ system today. They should enter into a mature, well-structured system. This throws down a whole new gauntlet of policy challenges in itself.

I believe that it’s time governments, policymakers, academics and researchers, as well as the superannuation industry and the broader community, started looking at superannuation through these two separate lenses.

A maturing system and a mature system.

The policy challenges for the people in each system are different.

Each requires a different policy framework to achieve its success.

I want to first talk briefly about the maturing system. This is the one we spend most of our time talking about, and as I said before, its tax concessions are a key focus.

[9] ATO, 20 years of the Superannuation Guarantee, https://www.ato.gov.au/Media-centre/Commissioners-online-updates/20-years-of-super-guarantee/

I will say that I think it's entirely appropriate, and necessary, to place a limit on the tax concessions people receive.

The guiding principle should be that tax concessions remain in place as long as they are being used to build savings that generate an income in retirement that affords a decent quality of life.

I will say that again because I think it's important we realise this. Super is meant to be used to generate replacement income in retirement.

Beyond this, I do not think it's appropriate for people to use its tax-free status to build incredibly high levels of wealth or serve as a proxy estate planning tool.

So how do you ensure that the system is being used for its intended purpose? In my view, there should be a cap on the amount that people are able to roll over from accumulation to pension. Recognising that super is intended to generate an income in retirement, the question has to be asked… to what level? I believe the fairest and simplest benchmark for this debate should be the gauge of average weekly ordinary time earnings.

For many households a single person's superannuation will be funding the retirement of a couple. Therefore in retirement, if a person has a balance high enough to draw an income stream that is twice AWOTE, then I believe this is the point that taxpayer funded tax concessions should fall away. If people want to generate more income capacity, then of course they should be free to do this, but it should be outside the superannuation system and without the taxpayer-funded concessions.

At present, average earnings are $75,000 per year[10]. This would mean that the cap on what self-funded retirees can pay themselves would be $150,000. Even on the most conservative calculations, the maximum balance you would need to draw this income stream annually throughout your retirement is $2.5 million.

However I want to pause on talking about the $2.5 million cap in pension phase for one reason. Currently, in the maturing system, the number of Australians

[10] ABS, Average weekly earnings, http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0

who have superannuation balances in excess of $2.5 million is One Half of One Per Cent.[11].

So while such a change is important, it is only a small piece of a much larger puzzle. A bigger issue is how we improve retirement outcomes for low income Australians.

In this regard, I believe in the maturing system we must maintain the Low Income Superannuation Contribution. It's unfair that our poorest super savers are taxed on their compulsory superannuation contributions and it makes even less sense that they are taxed on their voluntary contributions. If you make less than $37,000 a year, why would you sacrifice income that you pay no tax on and put it in your super where it will be taxed at 15 per cent on the way in?

Now I recognise that the Abbott government has committed to not make any adverse, unexpected changes to superannuation. But in the maturing system, if we tighten things up at the top, it gives us scope to address some anomalies at the bottom. This would generate fairer outcomes for the community, and better retirements for more Australians.

Regardless, we should use this period of promised policy stability to talk about the design of our mature system.

Much like the conversation about a self-funded retirement started many years before the Superannuation Guarantee was born, now is the time to discuss its future framework; when we have time on our side, the wisdom of lessons learnt and knowledge of new demographic trends.

The system that will have come of age in 10 years from now; in which most people will work for more than 40 years; who will contribute at a rate of 12 per cent or higher the entire way through; and who will retire for more than 25 years.

We need to discuss this framework, so that everyone can clearly understand the purpose of superannuation and, most importantly, measure the system's

[11] ASFA Super and high account balances report http://www.superannuation.asn.au/ArticleDocuments/1089/ASFA_Super-and-high-account-balances_Apr2015.pdf.aspx

success against it. Right now is the time to be having this discussion; in a period of policy stability and with a maturing super system about to graduate to mature.

In my view there are two key components to this framework.

First, we need to build in real targets for retirement savings.

This all starts with the question of adequacy.

There are various benchmarks that people can currently use, which give a picture of what they would need, on average, to fund a comfortable lifestyle in retirement. These are dollar measures, and are normally based on a pre-determined 'basket of goods', whose prices are adjusted in line with CPI.

They focus on a relatively subsistent living, but we need more than that. With around 23 per cent of our population projected to be over 65 by 2054-55[12], we need a system that helps retirees save more, so they can be active participants in our economy.

This is why I believe a better measure of superannuation adequacy is the income replacement ratio. That is, the percentage of your final few years' working income that you want to replace in retirement. It has the benefit of being both personally relevant to each retirement saver, yet can also be enshrined in public policy.

In this respect, I believe aiming for a replacement ratio of 65 per cent is the most meaningful. This was put forward by a Senate Inquiry in 2002, and I believe it is an achievable target for the bulk of the community[13].

Government, industry and savers would all be helped by enshrining an agreed income replacement ratio – after all, that's what superannuation is supposed to do. Replace your income.

[12] Treasury, 2015 Intergenerational Report, http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2015/2015%20Intergenerational%20Report/Downloads/PDF/04_Chapter_1.ashx

[13] Senate Select Committee Inquiry into Superannuation and Standards of Living in Retirement, September 2002

For many people, particularly those on average earnings or below, replacing this income will include a part Age Pension.

I do not think this represents a failure of the system. The Age Pension is the first pillar, and was always intended to be the safety net.

We need to acknowledge that even with higher compulsory contribution rates, some people will just not have the financial capacity to make additional contributions to their super, without seriously compromising their living standards while working.

However the basic principle should be that those who can afford to put away extra, should. And we should continue to provide them with the incentives to do so.

In my opinion this is a compelling argument for carrying the maturing system's tax concessions framework into the mature system. It's fair to say that if a person becomes fully self-funded, and the government is not going to be spending up to $23,000 each year on a person's Age Pension, that they should receive a tax break in exchange.

What's more, by capping the total amount people can roll over into pension phase, you can ensure that these tax breaks are being used for this purpose, and not for others.

So this is the first part of the framework. Enshrining a target superannuation balance capable of producing 65 per cent income replacement to a maximum of 2 times average weekly earnings.

This will not be enough in itself. Adequacy is critical but it's not the only component.

Longevity is just as important.

People not only need to know how much of their income they need to replace, they also need to know for how long they will need to replace it for. Knowing how long they will live is clearly the key input here.

One of the biggest structural issues with our retirement income system is that it has not had the inbuilt flexibility to allow it to adapt as our population characteristics have changed.

Take the Age Pension for example. Access to it was set originally at age 65. 108 years will have passed by the time it rises to 65.5 in 2017[14] and 114 years til it reaches 67. It also remains dependent on the government of the day to make changes. Given this can be a politically unpalatable decision, it's not an easy one for any government to make.

What if, instead, we set access age to superannuation and the age pension against an actuarial benchmark of on life expectancy?

In my view, this would deliver better outcomes. As the average life expectancy of our population rose, access to superannuation and age pension would also rise. This would allow our system to adapt itself to Australia's changing demographics, and not be reliant on the politics of the day to make changes.

For example, if you look at the system today, average life expectancy at retirement is 86. Access to superannuation is set at 60, or 71 per cent of average life expectancy, and pension access at 67, or 79 per cent of average life expectancy[15]. As average life expectancies increase, we could calibrate these access ages in line with the increase. This is just one idea, but it highlights how important it is to have inherent flexibility in the system.

So that is the second part of the proposed framework - linking access to superannuation and Age Pension to average life expectancy to make it easier for the system to evolve with society.

Now that we are clear on **what** the purpose of super should be; **how** do we make it a reality?

The next step is clear: stop super being hijacked by the politics of the day.

We all know that superannuation is a long-term game, but for many years it has been subject to short-term change. Each year when the Treasurer brings down

[14] Above n2
[15] Above n1 above n2

the federal budget, the annual ‘kick the superannuation football’ game begins. Often this means super gets tinkered with in the Budget each year as well.

But what if we took it out of this short-termism and into a longer-term game?

In this regard, I believe a much better place for superannuation to be assessed, and for policy recommendations to be made is within the Intergenerational Report, or the IGR.

Unlike the annual Budget, it is published every five years and has a much longer time horizon of 40 years compared to four. It also contains the important demographic, actuarial and financial information that would help policymakers set superannuation policy against long-term adequacy and longevity benchmarks.

In particular, there are three components of superannuation policy that should be enshrined within it:

1. First and foremost, the IGR should be the place where the long-term costs and benefits of superannuation are published, rather than in the annual budget Tax Expenditure Statement.

   Focusing on an annual “cost” of tax concessions creates a distracting debate and perpetuates a flawed conversation about tax concessions. It’s much more suited to the long-term horizon of the IGR.

2. Next, we should allow the IGR to make recommendations on the appropriate access age for the Age Pension and for superannuation. As discussed, these should be set using a measure of average life expectancy, and would be recalibrated every five years as new census information becomes available.

3. Finally, the IGR should recommend a cap for the maximum balance allowable in pension phase, taking into account the 65 per cent income replacement benchmark, plus perhaps any dramatic changes to the cost of living that are forecast to occur.

The IGR could also play a role in better informing superannuation policy settings more broadly. One way it could do this is through more detailed projections of system outcomes. That is, not only look at what the ageing population costs, but how self-funded retirees interact with those costs and the benefits of their contributions to the economy.

For example, will retirees be able to afford private health insurance? What might be asked of self-funded retirees in paying for healthcare? How might they be able to contribute to their own aged care costs?

No one has all the answers, but I have no doubt that with informed input from the IGR we can have a better conversation.

If we put in place a stable, depoliticised framework for our mature system, then I have no doubt we will be able to better cater for fund members throughout their superannuation journey.

The next step is painting a clearer picture of what this journey looks like for the majority of Australians.

At present, we often think about a person's journey as having two phases – accumulation and retirement. It's possible that this narrow thinking is one of the reasons we are largely behind the curve when it comes to innovative retirement products.

I'd like to put forward a new way to conceptualise this, which, I think, will galvanise superannuation product providers – such as BT – behind true product innovation.

We can clearly see 3 phases we all need to consider.

1. The accumulation phase, which for most people will be the bulk of their lives. In this phase the goal is to accrue, though compulsory and voluntary contributions, and compounding returns, a superannuation balance that can generate an income replacement rate of 65 per cent, to a maximum balance in retirement of $2.5M

2. The next phase is ‘active retirement’. This period starts when a person is able to access their superannuation and finishes when they reach mean mortality, or average life expectancy. During this phase, retirees want to convert their accumulated superannuation balance to an income equal to 65 per cent of their pre-retirement income, whilst making sure they still have enough capital available for the next phase.

3. Finally, we have the frail years of retirement, or from average life expectancy to death. Because of continual improvements to life expectancy, slightly more than half the retired population will actually make it to this phase. And those who do can expect to live 13 years past it. During this time, many will need aged care.

In each of these phases a person’s needs and wants vary greatly. As an industry, we need to understand this, and design products and services to meet these diverse needs.

Underpinning this must be an understanding that the enduring need is certainty.

In accumulation, members are working and contributing to their super. They want to be certain that their superannuation contributions are going to be managed well, make good returns, and at a reasonable cost. I believe as an industry we have come in leaps and bounds in addressing this.

During the active retirement years replacing income to a reasonable level becomes the most important. However people also want enough flexibility to be able draw a lump sum to pay off debt, meet medical expenses or undertake home repairs. We need to design products that are flexible and cost effective so that retirees can achieve this.

I would also argue that it’s during these years that people want the most certainty around making sure they don’t outlive their retirement savings. This is when, at the very latest, retirees should invest in products like annuities.

In the frail years, retirees desire certainty of income, and need longevity protection so that this income will last the rest of their lives. However, given around half the population will not reach this phase, I think it is inefficient for everyone to save for it individually.

Instead, it would be far better to develop pooled products such as insurance and deferred lifetime annuities, which can be purchased for a reasonable premium either during the accumulation phase or during the active retirement phase, and that kick in when you reach average life expectancy.

In addition, many people who reach this phase will encounter health issues that will require them to draw down on capital assets for income and for access to aged care. This is where more sophisticated reverse mortgages could be appropriate, or other product solutions that allow you to deplete assets over time.

Regardless of what the solutions might be, conceptualising retirement in these distinct phases, agreeing the framework for a mature super system, coupled with a stable superannuation system that has bipartisan political support, will instil confidence in all.

Australians will no longer fear change to **their** super and product providers will have greater freedom to innovate and develop the cost effective suite of financial products required to help retirees manage their savings throughout their years.

However, even with all that done, there remain a few groups where I think superannuation policy needs to be refined to cater for their circumstance.

Our Indigenous Australians are the first that come to mind. The average life expectancy for the Indigenous community is much lower than the rest of Australia. In fact the equivalent mean mortality rate for indigenous people is around 75 compared to 86 for non-indigenous[16] - an 11 year gap.

I therefore do not believe it is fair to set their superannuation access age the same. We need to make sure we are giving all Australians the time to enjoy

[16] ABS, Average life expectancies, http://www.aihw.gov.au/deaths/life-expectancy

their retirement savings in proportion to how long they've worked, and how long they are expected to live.

For example, if you set access age at 70 per cent of Indigenous average life expectancy, they would be able access their super at 53, giving them, on average, 22 years in retirement.

The second group is women. While we know they have a longer life expectancy than men, I don't advocate making women work for longer than men or giving them access to their super later.

However, we know that women, on average, have far less super than men. This is true across all groups, but is most visible at retirement[17]. A major contributor to this is the income differential between men and women – on average women are paid around 17 per cent less[18].

So what about having a lower contributions tax rate for women? While I know this raises all sorts of issues, including the not so insignificant fact that it goes against our Constitution, could it be delivered through rebates or offsets that are placed directly into a woman's superannuation account?

Finally, we need to look at how we can enable people who have broken working patterns or have not been able to contribute from a young age to 'catch up' on their superannuation contributions. The answer to this ultimately lies in making the annual SG caps as flexible as possible. Capping the total amount you can roll over into retirement at $2.5 million gives us great scope to relax these caps without the tax concessions being abused – another logical argument to do this.

Yes these solutions might be complex, but the fact is until we have fixed the 17 per cent wage gap; until we address the health issues impacting indigenous mortality; and until we have a super system designed to accommodate different working patterns, we need to start thinking about creative ways to address the superannuation gap.

[17] ASFA, An update on the level and distribution of retirement savings, http://www.superannuation.asn.au/ArticleDocuments/1089/1403-LevelAndDistributionRetirementSavings.pdf.aspx
[18] Australian Government Workplace Gender Equality Agency, https://www.wgea.gov.au/media-releases/national-gender-pay-gap-rises-182

It’s simple – we either fix the superannuation gap, or fix the underlying issues that create the inequity.

So today I advocate for a framework that defines the goals of superannuation – a framework within which governments can legislate, policymakers can advise, superannuation providers can operate and people can plan their retirements.

And I hope I have put some meaning to the current industry buzz words …

Adequacy. The system must provide adequate income replacement – that’s why I put income replacement at the heart of the framework. If it doesn’t do this, it fails.

Sustainability. Superannuation will only be sustainable if it has the flexibility to adapt to changing demographics and caters for the longer lives we are all living.

Equality. It will only achieve equality if everyone who works – Indigenous, women, broken-pattern workers, the low-paid – can all see how super works for them.

Simplicity. This can only be achieved by limiting the opportunities to meddle with rules, limits and tax rates – this simply disengages people with the complexity it brings.

Let’s celebrate superannuation’s successful childhood by defining how it will now mature into an adult system that delivers comfort and dignity in retirement to the bulk of the population.

We’ve proven we can make superannuation work – now let’s make it work for all Australians, for many years to come.

Thank you.