Outsider's View on the Australian Pension System

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This report is prepared for the ICPM Discussion Forum in Sydney, Australia taking place from October 27 to 29, 2019 by a group of international pension experts under the Research Committee of ICPM. The report is based on 10 informal interviews of key stakeholders of the Australian pension system primarily conducted on a fact-finding tour to Australia from October 23 to 27, 2019.

The working group acknowledges the work put in by many people to analyse the dilemmas in the Australian pension system and to propose solutions. The objective of the report is to provide an "outsider's view" on these dilemmas in the hope that this will make a constructive contribution to these efforts.

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Management Summary

The Australian retirement system is comprehensive, well developed and all knowledge available internationally is available and present in the Australian market. It has generated great returns in the passed decades and is internationally esteemed.

The retirement system in its current form is also relatively young though, and as it is set up as a 'savings machine', the transition into a proper retirement income provision appears more and more of a quantum leap. The mindset and thinking of participants, members and providers alike, are distorted by the sole focus on returns in the passed decades.

Combined with the other means tested, constantly changing and interacting old age, health care and housing provisions, retirees get lost in an impossibly complex world. The ones who most depended on it might be the least equipped to shape their own provision considering that the system might be too complex and fluid to do so at all.

The number of retirees and the Assets Under Management they hold, is growing rapidly, the choices they make gain in importance but at the same time they are not represented explicitly in the boards of trustees who seem to focus mainly on the typical 40 years old.

Especially if you compare it internationally, members are happy with the system and 'not making any promises' is often cited as the reason why. Nevertheless Australia will not get around setting explicit goals for this mandatory system with also 'for profit' providers. If no explicit goals are set, Australia runs the risk of a 'too big to fail' system just floating around, with regulators fire fighting on the edges to keep constant political controversy at bay. Regulators then become implicit and unintended goals setters. The CIPR initiatives and the Retirement Income Review could lead the way, although treasury seems over- and social affairs/welfare under represented in the latter.

The boards of trustees of Superannuations are facing important issues;

- the implementation of a trustworthy and effective decumulation phase with the proper derisking, member guidance and communication that goes with it.
- the move towards a more international and diversified investment portfolio with the appropriate knowledge base and risk management that goes with it as Assets Under Management will grow steeply and highly predictably.

Comparing retirement income systems internationally

The working group has not found an explicit reference to a specific model as a basis for the OECD work on an international comparison of pension systems in 'Pensions at a glance 2017'[1]. The OECD does, however, state objectives, risks and instruments a system can be compared to;
Objectives: poverty relief, redistribution, sustainability, consumption smoothing.
Risks: demographic, social, labour, macro-economic, financial
Instruments: a funded component, automatic mechanisms to retain alignment with economic and demographic realities, sustainability to provide some certainty.

Mercer, in its Melbourne Mercer Global Pension Index 2018 (MMGPI 2018), refers to the multipillar pension model of the World Bank[2] as a 'good basis for comparing retirement income systems around the world'[3]. The working group shares the view that the multipillar pension model of the World Bank is a thorough and informative way of evaluating a pension system.

The multipillar system consists of the following 5 pillars (numbered 0 to 4):
Pillar 0: a noncontributory provision in the form of a demogrant or social pension that provides a minimal level of protection;
Pillar 1: a contributory system that is linked to varying degrees to earnings and seeks to replace some portion of income;
Pillar 2: a mandatory system that is essentially an individual savings account but can be constructed in a variety of ways;
Pillar 3: voluntary arrangements that can take many forms (individual, employer sponsored, defined benefit, defined contribution) but are essentially flexible and discretionary in nature;
Pillar 4: informal intrafamily or intergenerational sources of both financial and nonfinancial support to the elderly, including access to health care and housing.

The World Bank stresses that an approach should be tailored to the specific circumstances of a country[4].

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[1] OECD (2017), "Pensions at a Glance 2017; OECD and G20 indicators", OECD Publishing, Paris, **http://dx.doi.org/10.1787/pension_glance-2017-en**, ISBN 978-92-64-28751-8.
[2] "Old Age Income Support in the 21st Century; An international Perspective on Pension Systems and Reform", R. Holzman & Richard Hinz, The World bank Washington, D.C., 2001, ISBN 0-8213-6040-X.
[3] MMGPI 2018, D. Knox, page 12.
[4] "The World Bank Pension Conceptual Framework", World Bank Pension Reform Primer, september 2008, www.worldbank.org/pensions

Comparing the main provisions in the Australian system to the World Bank model it broadly scores as follows:

Pillar 0[5]: max. AUD 1.341,80 per month means tested benefit, funded out of general revenues for inhabitants with means lower than AUD 250.000,=[6].
Pillar 1: not a substantial provision in Australia (anymore ?)
Pillar 2[7]: the extensive mandatory superannuation fund system with an individual account for every employee between the age of 17 and 70 who's monthly earnings exceed AUD 450,=, with an elaborate regime of income tested tax benefits (on payments) and restraints (on accumulated capital). Compulsory contribution at 9,5 % of income.
Pillar 3: a voluntary system of 'salary sacrifices' into the individual superannuation account for lower income employees, with a regime of income tested tax benefits.
Pillar 4: aged care system[8] (means & income tested), medicare[9], housing assistance[10] ('social housing' was 5 % of the population and dropping).

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[5] **https://www.pensionfundsonline.co.uk/content/country-profiles/australia/80**, 2017 figures.
[6] With a distinction in (non) home owners.
[7] Presentation "Australian Retirement Income System Change; Key Developments–Issues and Challenges" by The Honourable Nick Sherry, Former Minister for Superannuation and Corporate Law, Assistant Treasurer, Chair, FNZ APAC to "Forum: Retirement Policy in the Age of Uncertainty" at the University of Auckland, Business School, Retirement Policy and Research Centre, New Zealand given on 20 April 2017
[8]**https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/rp/rp1617/Quick_Guides/Aged_Care_a_quick_guide**
[9] **https://www.aihw.gov.au/reports/older-people/older-australia-at-a-glance/contents/health-aged-care-service-use**
[10] **https://www.aihw.gov.au/reports/housing-assistance/housing-assistance-in-australia-2018/contents/housing-in-australia**

History of the Australian system

Australia's Pillar 1 age pension, funded from the state budget, dates back to 1909[11] and the ground works for Pillar II, though voluntary at the time, were set in 1949. From an international perspective though, the most prominent feature of the Australian system is the introduction of the compulsory 3% contribution to Pillar II between 1987 and 1993 with an announced rise to 9 % between 1992 and 2002. The foreseen matching of the employer's contribution by employees was scrapped in 1996. An initial difference in retirement age between men and women was faded out in 1995 and over the course of time most Defined Benefit funds had been closed by 2006 and an increase of the overall pension age to 67 has been agreed.

This leaves Australia with a means tested Pillar 1 of 27.7 % of male total average earnings which equalled approximately AU$ 22.100,= in 2019, is income tested with the bottom at approximately AU$ 4.500,= from which the benefit is reduced up to an income of approximately AU$ 50.000,=[12]
An asset test also applies with a free threshold at approximately AU$ 263.250,= ranging to AU$ 1.227.500,=.
Amounts above change with circumstances like for example marital status, disability, mortgage, business assets, and such. The principal home is excluded from the asset test. [12]
In addition to cash payments provided by the Age Pension, Australian seniors can be eligible for a comprehensive system of concessions and assistance for health, rent, pharmaceuticals and other living expenses[13].

The mandatory contribution for employers into the superannuation system of Pillar II starts at a monthly income of AU$ 450,= if employees work more than 30 hours a week[13]. The upper limit above which no further contributions apply was AU$ 203.240 per annum in 2016. The government co-contributes 50 % of contributions made by low to middle-income earners who make personal (after tax) contributions to their superannuation fund.

This Pillar II superannuation system is characterized by freedom of- and choice in, for example, fund choice, investment profiles and rate of (lump sum) withdrawal at retirement. From September 2014 till September 2019 for example, the quarterly amount payed in regular periodic pensions on the one hand and lump sum withdrawals on the other, were equally divided[15].
A (sharply) declining number of superannuation funds are in the market ranging from some 500 in 2008 to some 190 in 2018[14]. Although there is a much larger number of retailfunds (#114 sept 2019) the Industry funds (#37) are larger in size (average AUM AU$ 5,5 billion vs AU$ 20 billion). Besides that the Self Managed funds are a noteworthy phenomenon in Australia with almost 600.000 funds holding AU$ 746 billion AUM[15].

Superannuations operate within the Australian financial industry which has been under investigation for some time now. From this broader financial context as well as from the

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[11] 'Australian Retirement Income System, Change, Key Developments–Issues and Challenges', presentation of N. Sherry to the forum; Retirement Policy in the Age of Uncertainty, on April 20th 2017 at the University of Auckland.

[12] **https://www.humanservices.gov.au/individuals/topics/income-test-pensions/30406**

[13] 'Pensions at a Glance 2017', OECD, Country profile Australia 2016.

[14] **https://www.apra.gov.au/data-find-number-of-apra-regulated-superannuation-funds-from-2008-to-2018**

[15] 'Quarterly Superannuation Performance Statistics', September 2019, APRA; **https://www.apra.gov.au/**

Superannuation world itself, several reports derived of which the working group found the 'Cooper report'[16], the 'Murray report'[17], the 'Royal commission report'[18] and the 'productivity commission report'[19] among the most noteworthy. Conclusions in these reports range from the organisational structure, rules of conduct within the industry, costs, supervision and performance of the superannuation industry which all seem to strive for the goal, as it was stated in one of the interviews, "to have, within this mandatory industry, a competitive dynamic which is beneficial to the member".

Investment strategy country wide;
40 % of equity in the hands of Superannuations (reference to be added; Andrew Boal)

Demographic and economic situation
Better demographic than many other developed countries
Lower percentage of budget to Pillar 1 (reference to be added: Alwin Oerlemans)

25 % of MySuper left when deceased (reference to be added: Eva Scheerlinck)

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[16] 'Review into the governance, efficiency, structure and operation of Australia's superannuation system', J. Cooper et al. 2010.

[17] 'Financial System Inquiry; Final Report', ISBN 978-1-925220-14-8, D. Murray et al. 2014.

[18] 'Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry', ISBN: 978-1-920838-64-5, K.M. Hayne et al., 2017.

[19] 'Superannuation: Assessing Efficiency and Competitiveness', ISBN 978-1-74037-667-9, A. MacRae et al., 2018.

Current political discussions

Key Findings

- There is ongoing debate about the scheduled increase to the employer superannuation guarantee, including whether it will have a negative impact on employee wages.
- Several government reports that were released in early 2019 appear to have motivated recent reform to the system. Reforms aim to reduce instances of multiple employee accounts, make changes to investment fees, and revise insurance provisions.
- A recent report from the Actuarial Institute flagged the need for greater integration between the country's retirement pillars.

Recent Political Reforms

Protecting Your Super Package

The Australian Government passed a package of reforms, Protecting Your Superannuation Package Act 2019 (the PYSP), that took effect in July 2019. The changes include:

- Superannuation accounts with balances under $6,000 that are inactive (i.e. they haven't received any contributions, rollovers or other transactions for 16 or more months) will be closed. Those funds will then be sent to the ATO to allow them to consolidate them with a member's active account.
- There will be an annual cap of 3% of the account balance on investment and administration fees, for all accounts with balances less than $6,000.
- Super accounts with insurance and that are inactive for 16 months will have their insurance cancelled.
- Exit fees will be banned, so super funds can no longer charge you a fee for moving all or part of your money to a different fund.[20]

Putting Member's Interested First Bill 2019

This bill has passed the Senate and House as of September 19, 2019. It will go next to the Governor-General for final assent. Starting in April 2020, the bill would make life insurance optional for people under 24 or with less than $6000 in their super fund. There is an exception for members in dangerous occupations.[21]

Reports

Government Reports

Two government reports released in early 2019 recommend more aggressive oversight, fewer fees and increased industry consolidation.[22]

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[20] Emma Duffy. "Nearly half of Australians have heard of superannuation reforms, research finds," *Savings.com.au,* August 26, 2019, https://www.savings.com.au/savings-accounts/nearly-half-of-australians-have-heard-of-superannuation-reforms-research-finds/

[21] "Big changes to superannuation funds pass the Senate," *The News Daily,* September 19, 2019, **https://thenewdaily.com.au/money/superannuation/2019/09/19/putting-members-interests-first-bill/**; Treasury Laws Amendment (Putting Members' Interests First) Bill 2019 **https://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r6331_aspassed/toc_pdf/19092b01.pdf;fileType=application%2Fpdf**

[22] Douglas Appell, "Australian superannuation reform efforts could accelerate industry consolidation," *Pensions & Investments,* February 25, 2019, **https://www.pionline.com/article/20190225/ONLINE/190229904/australian-superannuation-reform-efforts-could-accelerate-industry-consolidation**

The first report, **Superannuation: Assessing Efficiency and Competitiveness**, was produced by the Australian Productivity Commission. This report flagged a number of flaws with the superannuation system including members having multiple accounts, underperforming funds (including default options), excessive fees, and insurance policies that do not provide value and erode member accounts. Many individuals end up with unintentional multiple accounts when a new default account is opened for a member when they change jobs or industries. Multiple accounts cost members in excess insurance premiums and excess administrative fees. Furthermore, there are issues with too many fund options and underperforming funds; the commission looked at a sample of default options and found that nearly half were underperforming their benchmark, some by more 0.25 percentage points.
The report makes the following recommendations: reduce unintentional multiple accounts and stop the practice defaulting members into a new super fund whenever they change jobs or industries; increase assessment and testing for funds; make it easier for members to compare products; improve value of insurance that members get from super accounts including making insurance opt-in for members under 25; and improve governance and regulators to support members.[23]

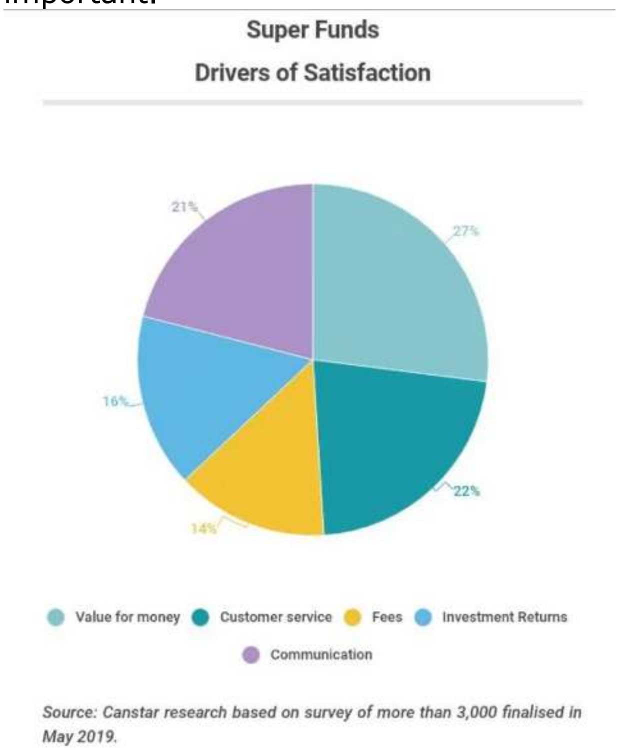
The other document, **Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry**, made recommendations around ensuring members have only one default account, improve regulation, prohibit the selling of super products to members, strengthening fund trustees' conflict of interest rules and limit scope for deducting advice fees from member accounts.
Both reports seem to have motivated and guided the recent reforms to the superannuation system.[24]

[23] Australian Government Productivity Commission, "Superannuation: Assessing Efficiency and Competativness," No. 91, December 21, 2018, **https://www.pc.gov.au/inquiries/completed/superannuation/assessment/report/superannuation-assessment-overview.pdf**.
[24] Douglas Appell, "Australian superannuation reform efforts could accelerate industry consolidation," *Pensions & Investments,* February 25, 2019, **https://www.pionline.com/article/20190225/ONLINE/190229904/australian-superannuation-reform-efforts-could-accelerate-industry-consolidation**

Consumer Perceptions Australian system

Whilst Australians support the super system in principle and seem to feel it delivers at some level, these attitudes are in part a function of limited engagement and little genuine understanding of supers and the fact that a promise on what the system would or should deliver was never made.

Perhaps it is interesting to review research[25], which analysed customer satisfaction scores to identify the relative importance of different factors in driving customer satisfaction among members. Value for money was the biggest driver of customer satisfaction, closely followed by customer service and communication and only then investment returns (see more detail in below chart). It is interesting to note that the influence of these different factors is relatively evenly spread (it was not the case, for example, that one factor dominated dramatically more than the others), and it also suggests that Australian consumers do in fact look at more than the financial performance of their super. Customer experience and a sense of 'good value' are also important.



There seems little evidence to assume that Australians would like 'to rock the boat' and fundamentally change the system. Indeed, attitudes towards the system in principle are positive. In a recent national survey[26], a significant majority (over 90%) supported, or strongly supported, compulsory superannuation. Most respondents also supported the scheduled increase in contributions from 9.5% to 12%. In both cases, attitudes are much the same across different income levels and a range of demographics. Opposition to the contribution increase seems to be more politically motivated and driven by vested interests. However, it is interesting to note that one argument for holding off the

[25] https://www.canstar.com.au/superannuation/canstars-most-satisfied-customers-super-fund-award/
[26] https://www.superannuation.asn.au/media/media-releases/2019/media-release-31-may-2019

increase is that it would be "immoral to ask workers to put more money into an inefficient system."[27]

Though there have been numerous reviews and revisions to the Australian super system over the years in recognition of its shortcomings and inefficiencies, these most recent investigations have highlighted particularly clearly the potential damage to member outcomes. We expect that consumer attitudes (and behaviours) are likely to change as a result.
It would be useful to validate whether these assumptions about existing attitudes towards supers are correct, what will happen when Australian consumers become more active in dealing with their supers and what the industry response might be.

[27] **https://www.smh.com.au/politics/federal/really-no-limit-push-to-include-super-pension-aged-care-in-review-of-retirement-income-20190723-p529uh.html**

Joint observations of the working group

Originated in the 80's the Australian Superannuation system is relatively young. It is nevertheless well developed with strong market participants and a sound position in Australian society.

At its creation we could not find a clear set retirement objectives and other administrative goals, like inflation reduction, seem to have played a role. This absence of a clearly set and communicated intended level op retirement income was often stated in the interviews as a reason why Australians seem satisfied with their Superannuation, though the retirement level is lower than in countries where participants are far less content.

Not withstanding this level of satisfaction, the working group observes an extremely complex situation for retirees with interacting, means tested and constantly changing retirement, health and welfare services with only their accumulated risky assets as a rudder to navigate.

We also see Superannuations, in a highly competitive situation, targeting the 40-years old with far less attention for those going into retirement. As these retirees are no longer union members they have no seat at all at the table. Employer seats occupied by an individual who happens to be retired is different from an individual holding a retiree seat with retirees interests as main perspective and who is accountable to retirees.

High levels of returns seem to be the main focus of participants. The alignment of risks with preferences and tolerance going with one's stage in life seem less of a concern.

During the desk research as well as the interviews the working group found that, it being a well-developed market, all the information available internationally is available in a translated manner to the Australian market. First initiatives to implement views and knowledge in Australia are visible but the political landscape and market dynamics seem to make an important, real shift towards, for example, the clear setting of goals and adjusting the system to these goals, difficult. Regulators appear keen to these needs but seem guided primarily by the treasury department and not by departments with social welfare as a responsibility.

Individual observations of the working group members

Chile
UK
The Netherlands
South Africa
Canada
USA
Denmark

Conclusions & recommendations

Set goals for this mandatory system, with ‘for profit’ market dynamics, in terms of minimum- and intended average income at retirement and adjust the system to these goals.
Acknowledge that for a large group, that probably needs it the most, choice and the costly assisting them in choosing, is not the most effective way to counteract the immense complexity for retirees who often have more corresponding- than different needs.
Dare to ask the question if the current infrastructure indeed provides the competitive dynamics beneficiary to members.
Increase awareness around the reduced risk tolerance- the smaller margins for error- in the decumulation phase. This is not embedded enough systemically.
More effort should be given to make boards of trustees equipped for the upcoming, highly predictable developments of sharply growing assets under management which will have to be more and more invested internationally, its corresponding risk management, the fast growing number of retirees with a higher stake in the assets under management and the weighing of interests, guidance and communication that go with it.

Appendix

LIST OF INTERVIEWEES

- ***Andrew Boal***, *CEO, Rice Warner, Consultant-Actuaries*
- ***Eva Scheerlinck***, *CEO, AIST, organisation of Superannuation Trustees*
- ***Hazel Bateman***, *Professor of Economics, University of New South Wales*
- ***Jeremy Cooper***, *Chairman Retirement Income, Challenger, investment company*
- ***Angela MacRae***, *Productivity Commission, Government Research Institute*
- ***Susan Thorp***, *Professor of Finance, University of Sydney Business School*
- ***Ian Yates***, *CEO, COTA, Council On The Ageing for older Australians*
- ***Helen Rowell***, *Deputy chair, APRA, Prudential supervisor/regulator*
- ***Nick Sherry***, *former Minister for Financial Services and Superannuations*
- ***David Knox,*** *Mercer, as our liaison officer*