Future proofing super

A response to the Australian Government Treasury Financial System Inquiry discussion paper:

'The objective of superannuation'

A submission by Dixon Advisory

Contents

It's time to take superannuation into the future
An executive summary

One of the biggest challenges of our ageing population and increasing life expectancy rates is understanding how Australians support themselves after they retire. This is a critical element in the support of the future of our country and why, as a nation, that we must take every opportunity to make sure we are best placed for the future when it comes to our superannuation system.

An agreed set of superannuation objectives would provide a significant boost in confidence for the almost 80 per cent of working Australians who have superannuation savings[1] as well as future superannuation members. Treasury modelling shows that the number of people transitioning off the full age pension over to part age pension has continued to grow over the last decade[2] – so while the system is working, we must always be looking for new ways to build public confidence in our superannuation system.

The objective of superannuation

To improve stability in policy settings, the Australian Government announced in October 2015 that it would develop legislation to enshrine the objective of superannuation as part of its response to the Financial System Inquiry (FSI). The Government accepts the recommendation of the FSI that the objective of the superannuation system is "*to provide income in retirement to substitute or supplement the age pension"*[3]. They subsequently released a discussion paper: 'The objective of superannuation', which provides background and questions for consultation on a number of other factors in supporting this and other proposed subsidiary objectives of the superannuation system.

As a leading financial firm committed to supporting Australians with professional advice on superannuation, Dixon Advisory welcomes the opportunity to address the objective of superannuation and provide advice on how the system and policy settings impact Australians. As a firm at the forefront of supporting Australians to be well prepared financially for retirement and all that goes with it, we know that due to the diversity in the financial situations of Australian people there can not be a one-size-fits-all approach to financial well-being in retirement.

Theories must be tested against practical realities

When discussing the costs of superannuation tax concessions, in many cases the savings made to the age pension budget are not accounted for, yet over the last decade the eligibility for full age pension has dropped by about nine per cent[4]. The majority of households are not saving outside of the superannuation system. Reports that show average households have high levels of savings outside of super are in fact distorted by a small proportion of households that hold material wealth.

[1] Australian Government, 'Objective of Superannuation' Discussion paper, 9 March 2016, viewed on 1 April 2016, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Objective%20of%20superannuation/Key%20Documents/PDF/objective_super_DP.ashx
[2] The Australian Government the Treasury, 'A Super Charter: Fewer Changes, Better Outcomes, A report to the Treasurer and Minister Assisting for Financial Services and Superannuation' 2013, p,13, viewed 4 April, 2016, http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/supercharter/~/media/Treasury/Policy%20Topics/Superannuation/supercharter/Downloads/PDF/super_charter_report.ashx
[3] Australian Government, 'Objective of Superannuation' Discussion paper, 9 March 2016, viewed on 1 April 2016, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Objective%20of%20superannuation/Key%20Documents/PDF/objective_super_DP.ashx
[4] The Australian Government the Treasury, A Super Charter: Fewer Changes, Better Outcomes" ibid. p13

Driving confidence for markets and individuals

Without superannuation the impact of the global financial crisis (GFC) on Australia's share market would have been far worse. About one-third of the current Australian Stock Exchange (ASX) market capitalisation value is owned by superannuation fund trustees[5]. During the GFC, the long term focus from these investors and the on-going regular savings from members helped provide support to vulnerable capital markets.

Public confidence in our superannuation system is crucial. In particular, measures that assist Australians to have more confidence in the system so they feel more comfortable taking control of their finances and planning for their retirement can only be described as positive policy by the Government. But there are also some key challenges facing superannuation over the coming decades. These include:

- **Systemic barriers for women in achieving financial well-being in retirement**
  Women are more likely to take on the responsibilities of unpaid caring roles in our communities, are more likely to work part-time, and are more likely to have employment positions that pay below the average weekly earnings level. Women have a pay gap of 17 per cent[6], and from age 20 a lower median super balance than their male counterparts[7].
- **Uncertainty around having employment through to age 65**
  48 per cent of men and 36 per cent of women aged 60-64 who retire are forced to do so involuntarily due to health, caring responsibilities or the lack of suitable work[8]. Further increases to the superannuation preservation age and age pension eligibility age are not practical given the systemic issues associated with involuntary retirement including access to employment for mature age workers and the importance of caring roles.
- **Changing work patterns**
  Over the next decade, trends such as an increase in the number of self-employed workers and more men taking on unpaid carer roles in the family may also require policy settings to be re-considered.

The future is now

Securing bipartisan support for the final objectives of superannuation will be essential in ensuring good policy outcomes for retirees and all Australians. We welcome the Government's discussion paper as the future most certainly is now. It is an opportune time for the industry to agree on a set of objectives and guide policy decisions to boost confidence. We look forward to being instrumental in fostering that process.

[5] APRA Statistical data; 'Statistics Quarterly Superannuation Performance December 2015' September 2015 quarter p13; Based on ATO Statistical Data; 'Self-managed-super-fund-statistical-report – Asset Allocation', September-2015; Based on ASX statistical Data, 'Corporate Overview', viewed 4 April 2016, http://www.asx.com.au/about/corporate-overview.htm
[6] Workplace Gender Equality Agency, March 2016, 'WGEA Gender Pay Gap Statistics Fact Sheet', viewed 4 April 2016, ww.wgea.gov.au/sites/default/files/Gender_Pay_Gap_Factsheet.pdf
[7] The Association of Superannuation Funds of Australia, 2015, 'Superannuation account balances by age and gender', Sydney, p.7
[8] Australian Government Productivity Commission, 2015, 'Superannuation policy for post-retirement', Commission Research Paper, Canberra p9, viewed 4April 2016, http://www.pc.gov.au/research/completed/superannuation-post-retirement/super-post-retirement-volume1.pdf

The objectives

A sustainable framework for the future

Australia's superannuation system is a very important part of the solution to help people achieve a stable financial position in retirement. Age pension, compulsory super savings and voluntary savings into super or private investments are most commonly included as the three pillars to Australia's retirement income system. However, financial needs must be balanced over an individual's entire life. Accordingly, settings for superannuation must interact sensibly with age pension and also with home ownership, private savings, access to age and health care and access to employment.

To effectively enshrine the purpose of superannuation, the proposed reforms should delineate the intended interaction of the other pillars of the retirement income system – the age pension and voluntary private savings. The subsidiary objectives should provide clarity to the boundaries and priorities, yet be broad enough that they will be useful and sustained for the long term.

As such, we support Treasury's view that a single primary objective cannot possibly encompass all aspects of the purpose and attributes of the superannuation system and we recommend that the following subsidiary recommendations be included with the primary objective:

- "Facilitate *flexible* consumption smoothing over the course of an individual's life"
- "Alleviate fiscal pressures on Government from the retirement income system"
- "Be simple and efficient; and provide safeguards; *including insurance benefits"*
- "Be invested in the best interests of superannuation fund members"
  This objective is broad enough to encompass managing longevity risk, investment risk and inflation risk as well as proving flexibility for innovative ideas to help home ownership.

Our attitude to retirement

How Australians are saving for their future

The total wealth of the majority of Australians remains well short of levels required to fund retirement through to life expectancy without significant support from the age pension. Average household wealth data collected by the Australian Bureau of Statistics (ABS)[9], Household, Income and Labour Dynamics in Australia Survey (HILDA)[10] and Reserve Bank of Australia (RBA)[11] at first glance appears to show that a significant level of wealth is being accumulated outside of superannuation, however when the distribution of this non-super wealth is considered, it shows a very different picture.

We aren't really saving outside of super

Analysis such as *"superannuation savings are the least important part of Australia's retirement income system"*[12] and *"households of all ages, incomes and wealth typically have other investments that are greater than their superannuation assets"*[13] does not discuss the small number of households that hold material non-super wealth and how this narrow distribution can create distortions in average figures. When assessing the level of savings across households, the proportion of households with savings outside of super and the family home are relatively low.

One in five households hold investment properties

Although an average net figure of approximately $85,000[14]-$90,000[15] is included in the "Other Assets" figures when averaging across the full household population, it is important to consider that only one in five households hold an investment property.

One in eight households hold business assets

Although an average net figure of approximately $30,000[16]-$45,000[17] is included within the "Other Assets" figures when averaging across the full household population, it is important to consider that only one in eight households hold any business assets. High net worth households and high Income percentiles households do have high levels of wealth in business assets but even in these population segments it is only one in four households that have exposure to business assets[18].

[9] Based on Australian Bureau of Statistics, 2016, '6523.0 –Household income and wealth, Australia, 2013-14: Income, Wealth and Debt', Canberra, viewed 4 April 2016, http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/6523.0~2013-14~Main%20Features~Household%20Income%20and%20Wealth%20Levels~5
[10] Based on Melbourne Institute of Applied Economic and Social Research, 2013, 'Families, Incomes and Jobs, Volume 8: A statistical report on Waves 1 to 10 of the Household, Income and Labour Dynamics in Australia Survey', Table 14.1.' The composition of household net wealth', The University of Melbourne, Melbourne, p. 83
[11] Based on Reserve Bank of Australia, 2016, Statistical tables: E5- E7 Household non-financial assets – distribution, Sydney, viewed 4 April 2016, http://www.rba.gov.au/statistics/tables/index.html
[12] Daley, J., Coates, B., Wood, D., and Parsonage, H., 2015, Super tax targeting, Grattan Institute
[13] Daley, J. et al, ibid.
[14] Based on Australian Bureau of Statistics, 2016, loc.cit.
[15] Based on Melbourne Institute of Applied Economic and Social Research, 2013, loc.cit., p. 83
[16] Based on Reserve Bank of Australia, 2016, loc.cit.
[17] Based on Melbourne Institute of Applied Economic and Social Research, 2013 loc.cit, p. 83
[18] Based on Reserve Bank of Australia, 2016, loc.cit.

One in three households hold equities

Although an average net figure of approximately $37,500[19][20] is included within the "Other Assets" figures when averaging across the full household population, it is important to consider that only one in three households hold equities. A material portion of these equities are expected to have been received as part of demutualisations (for example, IAG, AMP) and heavily discounted government asset sales (for example, CBA and TLS) rather than being accumulated through a savings program. Even within high net worth households (where proportion of households with equities is at a much higher 67 per cent) the median value of equities held is $55,000[21].

Three per cent of households hold trusts

Although an average figure of approximately $60,000[22] is included within the "Other Assets" figures when averaging across the full household population, it is important to consider that only three per cent of households hold trusts. The distribution of wealth in trusts is highly skewed to low and high income brackets, representing the use of these structures to hold significant family wealth across generations. Wealth from trusts in Victoria is two-and-a-half times the wealth in trusts in NSW. Higher value trusts are held by older age groups, which is likely to indicate people who were not able to access super earlier in their life to hold wealth[23].

Policy that does not mirror reality is failing to engage public

The danger is that policy proposals formulated on the basis that households will save the same or similar amounts outside of the superannuation system (i.e. through private savings) will not be successful in improving financial wellbeing of Australians in retirement or in improving the fiscal sustainability of the Government's long-term outlays. For example, individuals earning a $100,000 annual income are estimated to be around $70,000 worse off at retirement if they undertake a voluntary ten-year savings program outside of super compared to using salary sacrifice or concessional super contributions (refer Appendix Table A1- A2 for further detail and assumptions).

Apart from requiring a significant shift in the existing behaviours of people, there are a number of significant consequences that will reduce the effectiveness and efficiency of efforts to save outside of the superannuation system:

1. Barriers to entry

Although superannuation is complicated and full of jargon, investing outside of super adds another layer of complexity. With another language to learn and the significant administration, tax reporting and record keeping requirements; the process of building investments outside of super is discouraging to a large number of the population without experience in investment markets. For those with moderate sums to invest it may be difficult to access support. For example, compare the level of information and general advice available at nil or very little cost to even low balance super

[19] Based on Reserve Bank of Australia, 2016, loc.cit.
[20] Based on Melbourne Institute of Applied Economic and Social Research, 2013, loc.cit., p. 83
[21] Based on Reserve Bank of Australia, 2016, loc.cit.
[22] Based on Reserve Bank of Australia, 2016, loc.cit.
[23] Based on Reserve Bank of Australia, 2016, loc.cit.

members through their fund trustee to being able get tax advice, administration support and product selection advice for non-super.

2. Fees

Super has become a lot more competitive in fees and features, yet for non-super products fees are most often higher, particularly when relative to features. Fee ranges are also huge. Efficiency gains should continue to be a focus of the superannuation industry and the government has the leverage to make this a priority. Some examples of fees that may apply include:

- stamp duty
- conveyancing costs for property
- landlord insurance for property
- unit trust/managed fund annual investment management charges
- brokerage to buy and sell
- accounting advice and fees
- administration costs
- lost time in managing record keeping and paperwork
- low cost solutions (i.e. online brokers) are generally only appropriate to experienced or sophisticated investors and are less likely to satisfy the needs of the disengaged.
- robo advice platforms are not widely spread in Australia and due to the size of the Australian market are likely to take a number of years to launch and are expected to be more appropriate for experienced or sophisticated investors.

3. Greater risks

Most other tax effective investments have greater risk than superannuation. Investors who do look to save outside of super may be attracted to investing in residential investment property using borrowed funds. In addition to the tax advantages associated with negative gearing, this interest in property is driven by a greater comprehension of the concepts of investing in property compared to investing in many other types of investments. Interest in other types of tax effective investments, such as structured products or agri-business schemes have higher degrees of risk, which impacts on the certainty of meeting a retirement goal.

For most Aussies, super is simpler

Superannuation can be simple and efficient. The tax effective savings method of salary sacrifice is straightforward in comparison to investing in non-super products. Implementation is simple and flexible to turn on and off or to increase as salary levels allow. But it is also very effective as a savings tool as people adjust their spending around the commitment as the funds are locked away for the long term. No additional tax reporting is required for the individual. Diversification and choice of investments are available through the super fund and low cost options are now widely available.

One size does not fit all
A framework for superannuation needs flexibility

> "Facilitate flexible consumption smoothing over the course of an individual's life."

The role of 'consumption smoothing'—assisting individuals to put away money while they are working to fund non-working years—has become ever more important as life expectancies stretch. Compounding this need for flexibility is increasingly diverse work patterns and employment arrangements.

We are living longer

In 1983, an Australian female reaching the age of 65 could expect to live, on average, for another 18 years, while an Australian male could expect to live for a further 14 years[24]. Fast forward almost 30 years and a 65-year-old female will now likely live until 87 (four years longer) and her male counterpart until he is 84 (an additional five years). There is also an increasing proportion of retirees living until they're 90 – an expected 40 per cent of females and 26 per cent of males[25].

Gender disparity is real

Women in particular face systemic barriers in achieving financial well-being in retirement and they need flexibility in the superannuation system to help overcome these challenges. The fact is women are more likely to have breaks from paid employment, are more likely to work part-time, and are more likely to have employment positions that pay below the average weekly earnings level. And women have a pay gap currently at 17 per cent[26] and from age 20 onwards, a lower median super balance than their male counterparts[27].

The face of Australia is changing

Experts predict significant changes to the shape of the workforce over the next decade. Trends such as an increasing percentage of self-employed workers, the rise of the shared economy, an increase in flexible – but less stable – employment contracts and the anticipation that more men may take on unpaid carer roles mean that policy settings need to be flexible.

[24] The Association of Superannuation Funds of Australia, 2014, 'Spending patterns of older retirees: New ASFA Retirement Standard: September quarter 2014', Sydney, p.4
[25] The Association of Superannuation Funds of Australia, 2014, ibid. p.4
[26] Workplace Gender Equality Agency, March 2016, loc.cit.
[27] The Association of Superannuation Funds of Australia, 2015, 'Superannuation account balances by age and gender, loc. cit.

Involuntary retirement

In response to the longer life expectancy predictions, adjustments were legislated to increase the age at which people can access their superannuation (preservation age) to 60 years of age and to increase the age pension eligibility age to 67. Yet because 48 per cent of men and 36 per cent of women aged 60-64 who do retire are doing so involuntarily due to health, caring responsibilities or the lack of suitable work[28], further increases to the superannuation preservation age and age pension eligibility age are simply not practical. This is largely due to the systemic issues associated with involuntary retirement, which include access to employment for mature age workers and insufficient recognition for carers.

The history of superannuation contributions

In 1972, only 32 per cent of Australia's working population had superannuation savings, but it wasn't until 1992 that the Superannuation Guarantee (SG) was implemented requiring employers to pay compulsory level of superannuation contributions for employees. Originally set at three per cent, it is currently prescribed at 9.5 per cent with a schedule of increases legislated to take the contribution rate to 12 per cent at 1 July 2025.

Employees can make additional contributions to super on top of the SG contribution up to a maximum level of $35,000 if aged 49 or over or $30,000 for individuals aged 48 or under. These types of contributions are called concessional contributions (commonly referred to as 'salary sacrifice') and are taxed at 15 per cent by the super fund when they are received. Individuals with incomes of more than $300,000 pay an additional 15 per cent tax on concessional contributions.

Self employed people are also not covered. They are able to receive the same level of tax deductions as employees do through concessional salary sacrifice by making their own concessional self-employed contributions to super, but it is voluntary for them to do so. Other contributions can be made – most commonly non-concessional contributions - but only after paying marginal tax rate and annual limits of $180,000 apply.

How far will compulsory saving take us?

Individuals face choices every day with regard to how they consume their income, thus tax concessions are an appropriate way to incentivise people to lock away some of their funds for latter consumption in favour of immediate enjoyment. But without voluntary savings, the SG contribution alone will not be sufficient to fund the retirement needs of the significant majority of today's working population (refer table A).

For example, today's 30-year-old woman has a median superannuation balance of $18,000[29] and with a salary equivalent to average weekly earnings of $78,000[30] could expect to accumulate a superannuation balance of approximately $555,000 by age 65 through SG contributions[31] alone. Graph 1 illustrates that this level of capital is estimated to be slightly below the maximum level of

[28] Australian Government Productivity Commission, 2015, loc.cit.
[29] The Association of Superannuation Funds of Australia, 2015, 'Superannuation account balances by age and gender', loc. cit.
[30] Australian Bureau of Statistics, 2015, '6302.0 – Average Weekly Earnings, Australia, Nov 2015: November key figures', viewed 31 March 2016, http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0/
[31] SG contribution patterns are based on the schedule of increases legislated to occur from 2021 to 2025 unless otherwise stated.

allowable assets for age pension purposes[32] (based on 1 January 2017 assets threshold) and eligibility for a small fortnightly part age pension could be expected from age 67.

Table A: Estimated retirement balances when contributing SG only

Age	Current median super balance [33]	Years to retirement	Salary $78,000 p.a.	Salary $100,000 p.a.	Salary $150,000 p.a.
30 #	$18,000	35	$520,000	$650,000	$940,000
30	$18,000	35	$555,000	$700,000	$1,015,000
45	$35,000	20	$275,000	$330,000	$465,000
50	$42,000	15	$205,000	$245,000	$335,000
55	$38,000	10	$130,000	$155,000	$205,000

Notes: # includes two-year break from paid employment gap from age 32.[34] Based only on 1 January 2017 assets test, green shaded cells indicate no age pension eligibility, orange shaded cells indicate eligibility for part age pension and red shaded cells indicate eligibility for full age pension. Assumptions apply to all calculations in this paper: Figures are shown in today's dollar terms. Superannuation guarantee rate increases based on legislated schedule. Average real rate of return 3.5 per cent per annum. Some rounding has been applied.

Meet today's salary earners

Jane, 30

Jane is a sales manager with a salary of $100,000 therefore can expect to reach a super balance of approximately $700,000 by age 65 by making only SG contributions. This level of accumulated super would not allow eligibility for age pension.

Maria, 45

Maria is a lawyer earning $100,000 while she works part-time and can expect to accumulate about $330,000 in super. Even if Maria increased her work hours so her salary increased to $150,000, with just SG contributions she could expect to accumulate about $465,000 by age 65.

In either case, eligibility for a fortnightly part age pension could be expected from age 67. For Maria to achieve a superannuation balance in the vicinity of what Jane is expected to accumulate with SG alone, Maria must make a much higher total saving of around $25,000 for the remaining twenty years until retirement.

Sue, 53

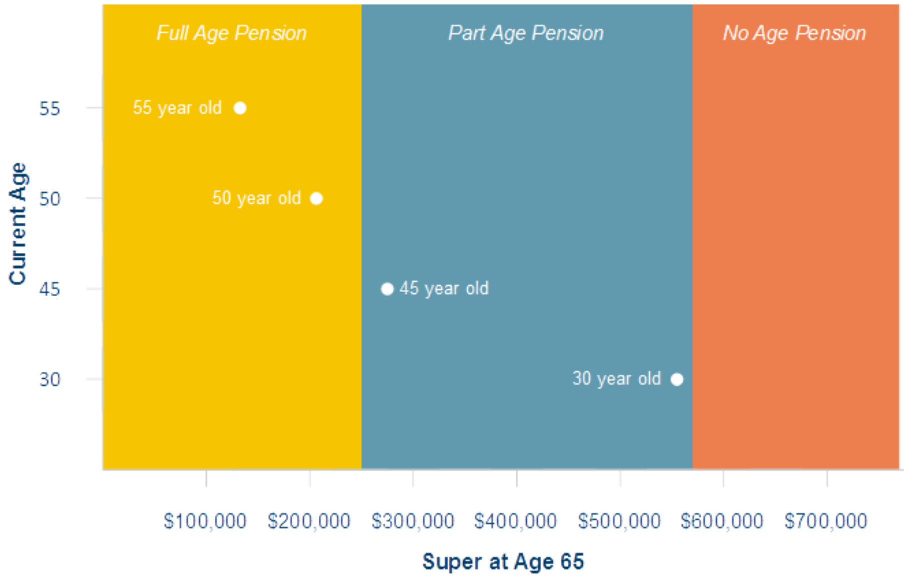
Sue manages a childcare centre earning about $100,000 and her full age pension eligibility (or close to it) is expected to occur from age 67.

Even when a 55-year-old woman with a median super balance is earning a very high income of $150,000 and is able to make the maximum salary sacrifice contribution of $35,000 for the remaining 10 years of her career, she could expect to accumulate $380,000 in super for retirement.

[32] Based on 1 January 2017 age pension assets thresholds
[33] The Association of Superannuation Funds of Australia, 2015, 'Superannuation account balances by age and gender', loc.cit.
[34] Suncorp Superannuation, 2012, 'Steps to avoid a 'Super Baby Debt', viewed 31 March 2016, http://www.suncorp.com.au/super/tools-and-resources/updates-super/steps-avoid-super-baby-debt

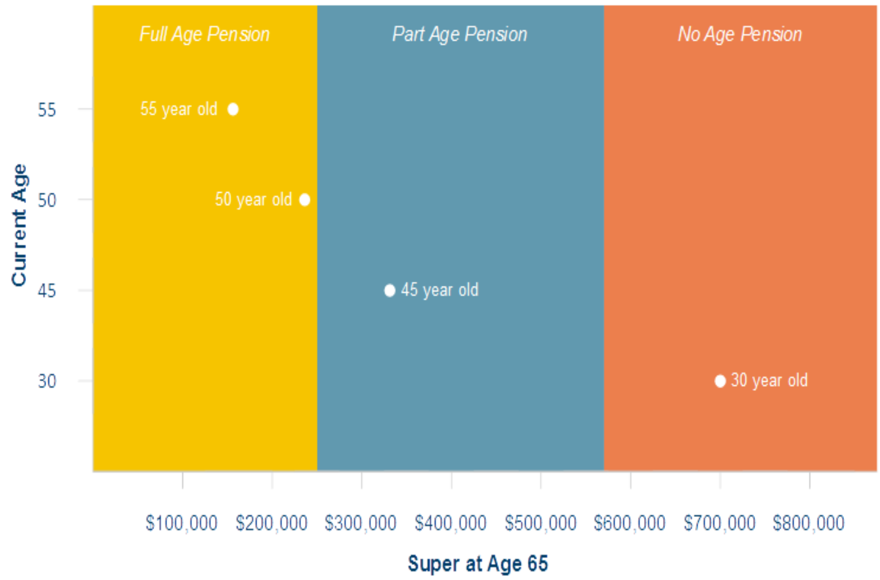
How estimated retirement balances compare to age pension asset cut-off thresholds

Graph 1: Today's $78,000 salary earners



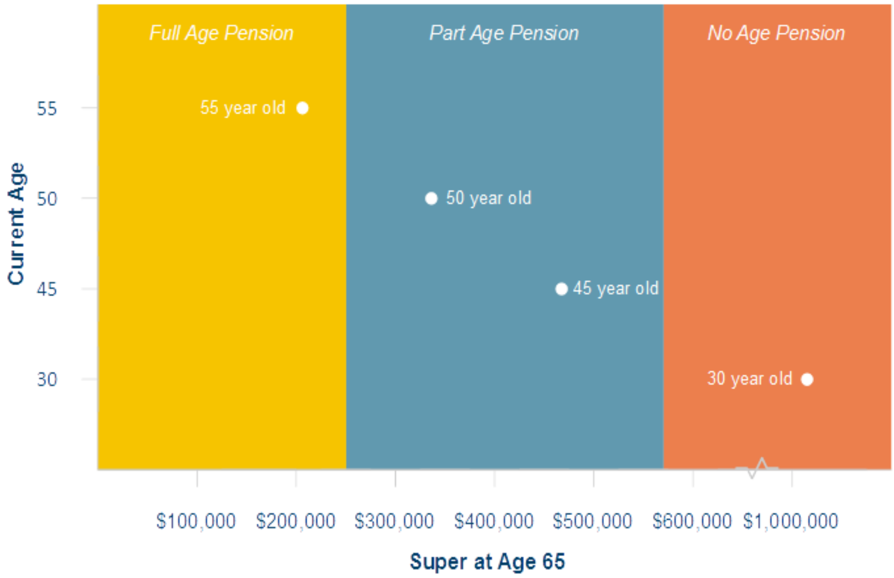
Notes: Plotted based on $78,000 salary, SG contributions only, 1 January 2017 age pension assets thresholds

Graph 2: Today's $100,000 salary earners



Notes: Plotted based on $100,000 salary, SG contributions only, 1 January 2017 age pension assets thresholds

Graph 3: Today's $150,000 salary earners



Notes: Plotted based on $150,000 salary, SG contributions only, 1 January 2017 age pension assets thresholds

So is the future looking super?

With significantly higher SG contribution rates for their entire working lives, today's under 30s are looking towards a strong largely self funded financial position in retirement. Lower income earners will continue to rely on the age pension system but even low income earners under 30 are likely to be able to accumulate a good amount in super to supplement their needs. For example, a $30,000 income earner, with 35 years until retirement could accumulate approximately $250,000 in super with SG only. And considering that women are more likely to have breaks from paid employment, work part-time, and have employment positions that pay below the average weekly earnings level[35] it is worth noting that, as an example, even a two-year break from paid employment from age 32 could result in a superannuation balance $35,000-$75,000 lower than a counterpart in continuous paid employment. While there are examples of people with strong superannuation balances, they are not in the majority. If we don't make adjustments to address these systemic issues now, then women and other workers with broken work patterns will face poorer outcomes in retirement for another 30-40 years.

What we decide now can make all the difference

Proposals that recommend reductions to the annual net amount that can be saved into the superannuation system will significantly reduce the ability of today's cohort of 40-65-year-olds to build a retirement capital reserve that allows them to be fully or significantly self funded and therefore improve the fiscal position over the long term.

Flexibility in policy settings are required for younger people who are expected to have higher superannuation balances than their comparable historical cohorts but less access to home

[35] Workplace Gender Equality Agency, March 2016, loc.cit.

ownership. Across all income levels increasing savings to super when children are still at school and mortgage payments are a significant household cost is challenging. It is often not until after age 45 or 50 when household expenses stabilise that putting in place a long-term savings plan is practical.

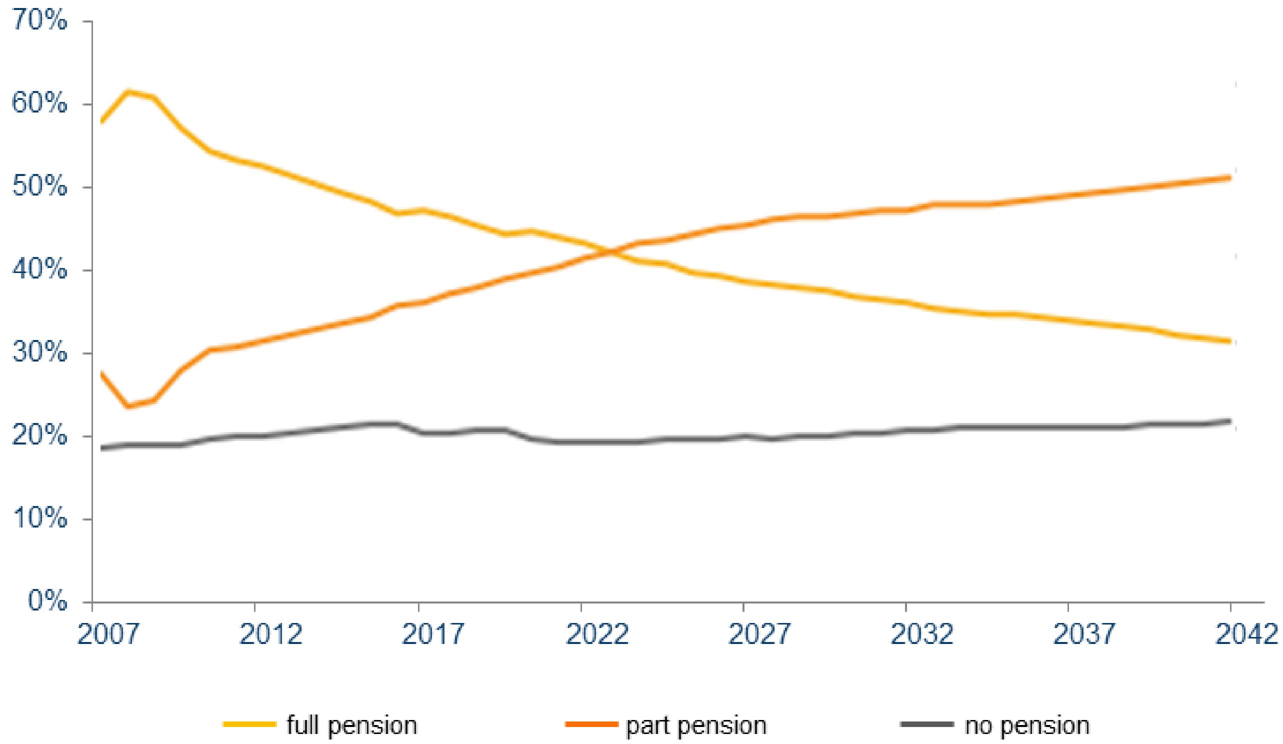
The greatest expectations around being able to reach a fully self funded retirement are directed towards high income earners. But it cannot be ignored that most high income earners take many decades to reach a salary level that puts them into the top one or two marginal tax brackets. Policy settings need to also recognise that even with the best made plans devastating financial shocks can occur such as the global financial crisis, job loss, divorce or significant illness. They must provide a flexible framework to assist individuals impacted by these types of events towards financial recovery.

Fiscal sustainability
Concessions generate long-term savings

> "Alleviate fiscal pressures on Government from the retirement income system."

The cost of tax concessions

Graph 4: Proportion of people of eligible age receiving full, part or no age or service pension[36]



Graph 4 shows the projected change in the proportion of the population of eligible age receiving full, part or no age or service pension. As the superannuation system starts to mature the proportion of the eligible population receiving a full age pension has dropped by about nine per cent over the last decade and is expected to fall to around 30 per cent by 2047[37]. This does not consider the 1 January 2017 age pension asset threshold changes that are estimated to reduce further the number of part age pensioners.

[36] Based on The Australian Government the Treasury, 2013 loc.cit. p.13
[37] Based on The Australian Government the Treasury, 2013 loc.cit. p.13

The true value of super

When discussing the costs of superannuation tax concessions, in many cases the savings made to the age pension budget are not accounted for. Proposals to assess tax concessions for super are often costed on the basis that people will not change their financial arrangements but incur the additional tax via the marginal tax rate system.

Treasury has acknowledged that the estimates of superannuation concessions do not bring all factors[38] into consideration and addressed the criticisms, but these caveats are often overlooked in recent debates about super. Long-term super policy experts from the Association of Superannuation Funds of Australia state that the true cost of super tax concessions is actually around $16 billion[39] rather than the often quoted figure of $30 billion. This analysis is supported by the SMSF Association although their calculations indicated concessions costs are lower at around only $11 billion[40].

[38] The Australian Government the Treasury, 2013 loc.cit. pp.9-12
[39] The Association of Superannuation Funds of Australia, 2015, 'Mythbusting superannuation tax concessions', Sydney, p.4
[40] SMSF Association, 2016,' TES is no basis to assess merits of super tax incentives', viewed 30 March 2016, http://www.smsfassociation.com/library/media-releases/tes-is-'no-basis'-to-assess-merits-of-super-tax-incentives.aspx?categoryid=1371#.VvuP-eJ96Uk

Efficiency is more than fees

Simple is a super choice

> "Be simple and efficient; and provide safeguards; including insurance benefits."

Helping retirement funds to go further

Retirement results are impacted by increases to costs through a rise in direct fees and indirect costs such as inefficient arrangements. Changes to policy settings and regulations create stress and disruption to the day-to-day financial arrangements of retirees and pre-retirees. This can create increased costs and inefficiencies through adjusting strategies, obtaining new advice, and in some cases the sale of investments at inopportune times. For example:

- The allowable concessional contribution limits have changed five times since the significant 'simpler super' reforms commenced from 1 July 2007.
- On 20 September 2007, the level of assets allowable while still being eligible for some fortnightly age pension was increased significantly. From 1 January 2017, the maximum level of allowable assets is legislated to reduce significantly.

A focus on efficiency and simplicity

This lack of certainty about where future policy settings will land significantly impacts on long-term decision-making for individuals across all income levels trying to save for retirement. The Government and industry must continue to focus on this need to be simple, efficient and to provide safeguards to cater for individuals of varying needs and interest.

- The 2009 Government-commissioned 'Super System Review' examined the governance, operation, efficiency and structure of Australia's superannuation system. A number of recommendations were taken up by the then-Government to enhance access to low cost and simple superannuation arrangements to help the retirement savings of Australians—particularly disengaged members—to go further[41].
- It is crucial to continue to monitor efficiency and implementations of reforms to drive our superannuation system to its full potential. The recently commenced review by the Productivity Commission to develop criteria to assess the efficiency and competitiveness of the superannuation system is an important next step towards this.
- Life insurance also provides important safeguards and is provided through super. Although this is not specified in the objectives discussion paper, it is appropriate to include it as a consideration within the broader context of *"...providing safeguards to members"* that is included within the sixth subsidiary objective.

[41] The Australian Government the Treasury, 2010, 'Stronger super – Government Response to the Super System Review', Canberra, p.9,viewed 1 April 2016 http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf

The super benefit
For the member

> “Be invested in the best interests of superannuation fund members.”

This objective is broad enough to encompass managing longevity risk, investment risk and inflation risk as well as proving flexibility for innovative ideas to help home ownership.

It is the member’s money after all

Superannuation must always be for the benefit of members. The Superannuation Industry (Supervision) Act 1993, s. 62 (SIS Act) sets out that superannuation funds need to be maintained for the sole purpose of providing retirement benefits to members or to dependants if a member dies before retirement. This places an expectation on trustees to be relentless in seeking benefits for members – including through their focus on investments that are suitable for the individual member through the accumulation and post retirement phase. Self Managed Super Fund (SMSF) members have a unique advantage in aligning the interests of the trustee, as the member of a SMSF is generally also the trustee.

The interests, investments and risks

It is vital to monitor safeguards to ensure disengaged members are not paying for benefits and features they do not take up, such as high levels of investment choice, advice or reporting. A review has already been commissioned by the Government to the Productivity Commission to assess the success to date of the MySuper reforms to address this issue. It will be important to assess the work and conclusion arising from that review to protect the interests of members – even those who may not be engaged.

In highlighting the need for professional superannuation managers to consider members interests first, the final report from the 2009 ‘Super System Review’ cautioned *“The super system exists to enhance retirement incomes for working Australians, not simply to accumulate assets*[42]*”.*

Over the next 30 years, as super balances grow, individual members must have the choice and autonomy to invest not only according to their preferred level of risk, but also in accordance with their individual asset class preferences. SMSF members may have experience with a particular type of investment such as Australian shares and due to their knowledge of markets and preference for direct ownership and transparency the risks associated with this type of portfolio has been considered but determined to be acceptable to this individual. Conversely, some retirees have a high need for stability and immediate access to funds and may make a fully informed decision to hold the bulk of their retirement capital in cash or short dated term deposits. This is not

[42] The Australian Government the Treasury, 2010, ‘Super system review final report: Part one – Overview and Recommendations’, p.10, viewed 1 April 2016, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2009/supersystem/Documents/Final%20Report/PDF/Final_Report_Part_1_Consolidated.ashx

uncommon in the early transition to full retirement where other significant life or financial changes such as changing over properties is also in progress. Retirees with significant health or caring costs may also need this type of flexibility.

Home ownership should not compete with superannuation

Investing for the best interests of the member also involves considering innovative ways to improve the overall financial well being of members. For example, the Australian Bureau of Statistics (ABS) reveals in their discussion of '2013-14 Household Income and Wealth' data that the variations in wealth across the population base is *"mainly due to home ownership rates,"*[43] noting:

- average household wealth for households who were renting was about $183,000
- average wealth of owner occupied households with a mortgage $857,900
- average wealth owner occupiers who owned their home outright $1.4 million.

Individuals who own their own home have more stability in retirement and most often better financial outcomes. Home ownership should be included as part of the retirement income system and this should work together with superannuation and age pension policies to help people achieve overall financial well-being through their working lives and in retirement.

Allowing super fund members to choose to invest their accumulated super balance into a mortgage offset account would provide the individual with immediate interest savings and improve the proportion of mortgage repayments that are reducing the principal on their home loan debt. The process for the member should be as straightforward as selecting a new investment option in their chosen super fund, just as they might do now if they moved from the default fund to a sustainable shares investment option.

Flexibility is needed for investments

A flexible investment mandate also allows superannuation members to consider a range of ways to manage longevity risk, inflation risk and investment risk. In facilitating the individual to fund consumption in retirement, the individual's needs, their risk tolerance, investment approach, overall wealth position including non-super assets and assets relative to needs must be considered.

Apart from annuities, there are other methods for managing longevity risk during the pension phase – particularly through informed financial advice and appropriate asset allocation strategies. Advice is important in helping people understand their retirement phase income stream and in managing realistic expectations.

The existing account-based pension system provides flexibility for managing the drawdown of retirement savings to provide income streams and can be used to manage longevity, inflation and investment risks.

Amid falling interest rates and rising longevity sending payments to historic lows in 2014, the UK government abolished the compulsory requirement for retirees to buy an annuity, and now allows retirees much greater freedom over how they access their pension savings. Noting the relatively

[43] Australian Bureau of Statistics, 2015, 'Household income and Wealth, Australia, 2013-14: Key findings', viewed 31 March 2016, http://www.abs.gov.au/ausstats/abs@.nsf/mf/6523.0

small size of the Australian investment market, the cost of funding annuity style products is ultimately likely to be borne by the Australian Government and result in no net savings and increased fiscal pressure compared to the funding of those people who live beyond their capital from the existing age pension system.

It is widely recognised that many people would like more funds available at the early stages of their retirement. Not withstanding that life expectancy rates are increasing, locking up capital for the potential of an improved later retirement limits the autonomy of retirees. It is not unreasonable to expect many people to place a much higher significance on having access to funds in the early stages of retirement when people are generally more active.

Final thoughts
In conclusion

There is a great benefit to bringing our focus on the purpose of superannuation and enshrining the objectives into legislation – that is to provide stability to the system for the benefit of individual members.

What is adequate?

Adequate retirement capital is impossible to define into a single figure. The discussion paper acknowledges this, saying: *"…while adequacy provides a sense of targeting superannuation and is consistent with fiscal sustainability, there is no consensus of what adequacy means"*.

Adequacy relates not only the needs and requirements of each individual but must also reflect the state of the global economy and other policy settings such as Government support for healthcare, aged care and other services.

A range of factors impact on the living expenses of an individual such as mobility, health situation, where you live, caring responsibilities, transport costs, proximity to family, home ownership, age of home and many more. Costs of aged care are also changing rapidly and along with health expenditure costs, are rising at rates far beyond expectations. Healthcare is rising at a rate much faster than inflation while aged care costs have also increased ahead of inflation over the last two decades. It is therefore very unlikely a realistic budget figure to cover these future costs can be calculated now for even five years into the future.

A word on returns

It should be noted for the super and non-super savings calculations in this paper, for the purposes of simplifying comparisons we have used a constant average rate of real return of 3.5 per cent in calculating the estimated capital at retirement. In fact, the range of possible returns each year is huge and consequently the range of final outcomes for retirement capital is very broad. Importantly the greater the proportion of funds invested in volatile growth assets the broader the cone of possible retirement outcomes.

As economic conditions change, interest rates and earnings also change and this can create significant differences in final capital accumulated even with the same level of savings. It is expected that the global economy may face a decade of low economic growth that may hamper returns across all investment markets. For retirees this may mean lower levels of annual income from their invested capital amount and a need to reduce expenditure.

Conclusion

Setting into legislation a considered framework for superannuation that will guide policy settings and improve stability for individual members for the next thirty years is challenging. But with 82 per cent of households[44] holding savings in superannuation, the efficiency of the system and the success of policy settings will impact on the financial and emotional well-being of millions of Australians in retirement. Accordingly, it a challenge we must put our best efforts toward solving with a bipartisan approach.

[44] Reserve Bank of Australia, 2016, loc.cit.

About the author

Dixon Advisory
Local firm, global outlook

Dixon Advisory is a privately-owned provider of premier wealth advisory services focused on retirement, superannuation and self managed super funds (SMSFs). Founded by Daryl and Kate Dixon in 1986, the firm has been helping Australians build wealth through super for 30 years.

Through their supported SMSF service, Dixon Advisory assist their clients with everything from paperwork to compliance and provide expert advice on navigating market volatility and succession planning for SMSF management in later years. The Dixon Advisory Investment Committee also shares proactive investment insights on global financial and investment issues. Dixon Advisory's commitment to service excellence drives their goal to help clients achieve security in retirement and make informed financial decisions at every life stage.

For further information, please contact:

Nerida Cole
Managing Director, Financial Advisory
Dixon Advisory
T: 1300 883 158
E: nerida.cole@dixon.com.au

A highly respected expert on superannuation, including SMSFs, retirement planning and wealth-building strategies, Nerida Cole works with Dixon Advisory's Executive Chairman Daryl Dixon to keep the firm's financial strategies at the forefront of the latest legislative requirements.

Appendix

Table A1: Saving with salary sacrifice versus non-super (private) savings, median super balance $35,000

	Estimated accumulated funds at retirement (65 years)
Scenario 1: Superannuation guarantee only from age 45-65	$330,000
Scenario 2: Superannuation guarantee only from age 45-55, maximum $35,000 salary sacrifice from age 55-65	$560,000
Scenario 3: Superannuation guarantee only from age 45-55, save into non-super investment the equivalent amount to maximum salary sacrifice from age 55-65	$485,000
Difference between saving maximum levels in super versus non-super savings program (approximate)	**($75,000)**

Assumptions: 45-year-old female, median ($35,000) super balance, $100,000 salary. Figures are shown in today's dollar terms. Superannuation guarantee rate increases based on legislated schedule. Annual fee differential of 1.5 per cent between super and non-super investment. Investment earnings are 3.5 per cent in both scenarios. Some rounding has been applied. Sale of non-super investment to occur over 10-year timeframe post retirement such that capital gains realised below tax free threshold This is unlikely to be an option for investors that accumulate large portfolios outside of super and may result in a further cost of between 17.5 per cent and 24.5 per cent on capital profits.

Table A2: Saving with salary sacrifice versus non-super (private) savings, median super balance $75,000

	Estimated accumulated funds at retirement (65 years)
Scenario 1: Superannuation guarantee only from age 45-65	$410,000
Scenario 2: Superannuation guarantee only from age 45-55, maximum $35,000 salary sacrifice from age 55-65	$640,000
Scenario 3: Superannuation guarantee only from age 45-55, Save into non-super investment the equivalent amount to maximum salary sacrifice from age 55-65	$565,000
Difference between saving maximum levels in super versus non-super savings program (approximate)	**($75,000)**

Assumptions: 45-year-old male, median ($75,000) super balance, $100,000 salary. Figures are shown in today's dollar terms. Superannuation guarantee rate increases based on legislated schedule. Annual fee differential of 1.5 per cent between super and non super investment. Investment earnings are 3.5 per cent in both scenarios. Some rounding has been applied. Sale of non-super investment to occur over 10-year timeframe post retirement such that capital gains realised below tax free threshold This is unlikely to be an option for investors that accumulate large portfolios outside of super and may result in a further cost of between 17.5 per cent and 24.5 per cent on capital profits.

Bibliography

- **Australian Bureau of Statistics**, 2016, '6523.0 –Household income and wealth, Australia, 2013-14: Income, Wealth and Debt', Canberra, viewed 1 April 2016, http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/by%20Subject/6523.0~2013-14~Main%20Features~Household%20Income%20and%20Wealth%20Levels~5
- **Australian Bureau of Statistics**, 2015, 'Household income and Wealth, Australia, 2013-14: Key findings', viewed 31 March 2016, http://www.abs.gov.au/ausstats/abs@.nsf/mf/6523.0
- **Australian Bureau of Statistics**, 2015, '6302.0 – Average Weekly Earnings, Australia, Nov 2015: November key figures', viewed 31 March 2016, http://www.abs.gov.au/ausstats/abs@.nsf/mf/6302.0/
- **Australian Government**, 'Objective of Superannuation' discussion paper, 9 March 2016, viewed on 1 April 2016, http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2016/Objective%20of%20superannuation/Key%20Documents/PDF/objective_super_DP.ashx
- **Australian Government Productivity Commission**, 2015, Superannuation policy for post-retirement, Commission Research Paper, Canberra, viewed 4 April 2016 http://www.pc.gov.au/research/completed/superannuation-post-retirement/super-post-retirement-volume1.pdf
- **Australian Government the Treasury**, 'A Super Charter: Fewer Changes, Better Outcomes, A report to the Treasurer and Minister Assisting for Financial Services and Superannuation' 2013, viewed 4 April, 2016, http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/supercharter/~/media/Treasury/Policy%20Topics/Superannuation/supercharter/Downloads/PDF/super_charter_report.ashx
- **Australian Government the Treasury**, 2010, 'Stronger super – Government Response to the Super System Review', Canberra, viewed 1 April 2106, http://strongersuper.treasury.gov.au/content/publications/government_response/downloads/Stronger_Super.pdf
- **Australian Government the Treasury**, 2010, 'Super system review final report: Part one – Overview and Recommendations', viewed 1 April 2016, *http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Reviews%20and%20Inquiries/2009/supersystem/Documents/Final%20Report/PDF/Final_Report_Part_1_Consolidated.ashx*
- **Australian Stock Exchange**, 'Statistics Quarterly Superannuation Performance December 2015' September 2015 quarter p13; "Self-managed-super-fund-statistical-report – Asset Allocation, September-2015; "Corporate Overview", viewed 4 April 2016, http://www.asx.com.au/about/corporate-overview.htm
- **Daley, J., Coates, B., Wood, D., and Parsonage, H.**, 2015, 'Super tax targeting', Grattan Institute, viewed 1 April 2016 http://grattan.edu.au/wp-content/uploads/2015/11/832-Super-tax-targeting.pdf
- **Melbourne Institute of Applied Economic and Social Research**, 2013, 'Families, Incomes and Jobs, Volume 8: A statistical report on Waves 1 to 10 of the Household,

Income and Labour Dynamics in Australia Survey', *Table 14.1. The composition of household net wealth*, The University of Melbourne, Melbourne, viewed 1 April 2016, https://www.melbourneinstitute.com/downloads/hilda/Stat_Report/statreport-v8-2013.pdf
- **Reserve Bank of Australia**, 2016, 'Statistical tables: E5- E7 Household non-financial assets – distribution', Sydney, viewed 4 April 2016, http://www.rba.gov.au/statistics/tables/index.html
- **SMSF Association**, 2016, 'TES is no basis to assess merits of super tax incentives', viewed 30 March 2016, http://www.smsfassociation.com/library/media-releases/tes-is-'no-basis'-to-assess-merits-of-super-tax-incentives.aspx?categoryid=1371#.VvuP-eJ96Uk
- **Suncorp Superannuation**, 2012, 'Steps to avoid a 'Super Baby Debt', viewed 31 March 2016, http://www.suncorp.com.au/super/tools-and-resources/updates-super/steps-avoid-super-baby-debt
- **The Association of Superannuation Funds of Australia**, 2015, 'Superannuation account balances by age and gender', Sydney, viewed 4 April 2016, http://www.superannuation.asn.au/policy/reports
- **The Association of Superannuation Funds of Australia**, 2015, 'Mythbusting superannuation tax concessions', Sydney, viewed 4 April 2016, http://www.superannuation.asn.au/policy/reports
- **The Association of Superannuation Funds of Australia**, 2014, 'Spending patterns of older retirees: New ASFA Retirement Standard': September quarter 2014, Sydney, viewed 4 April 2016, http://www.superannuation.asn.au/policy/reports
- **Workplace Gender Equality Agency**, March 2016, 'WGEA Gender Pay Gap Statistics Fact Sheet', viewed 4 April 2016, www.wgea.gov.au/sites/default/files/Gender_Pay_Gap_Factsheet.pdf