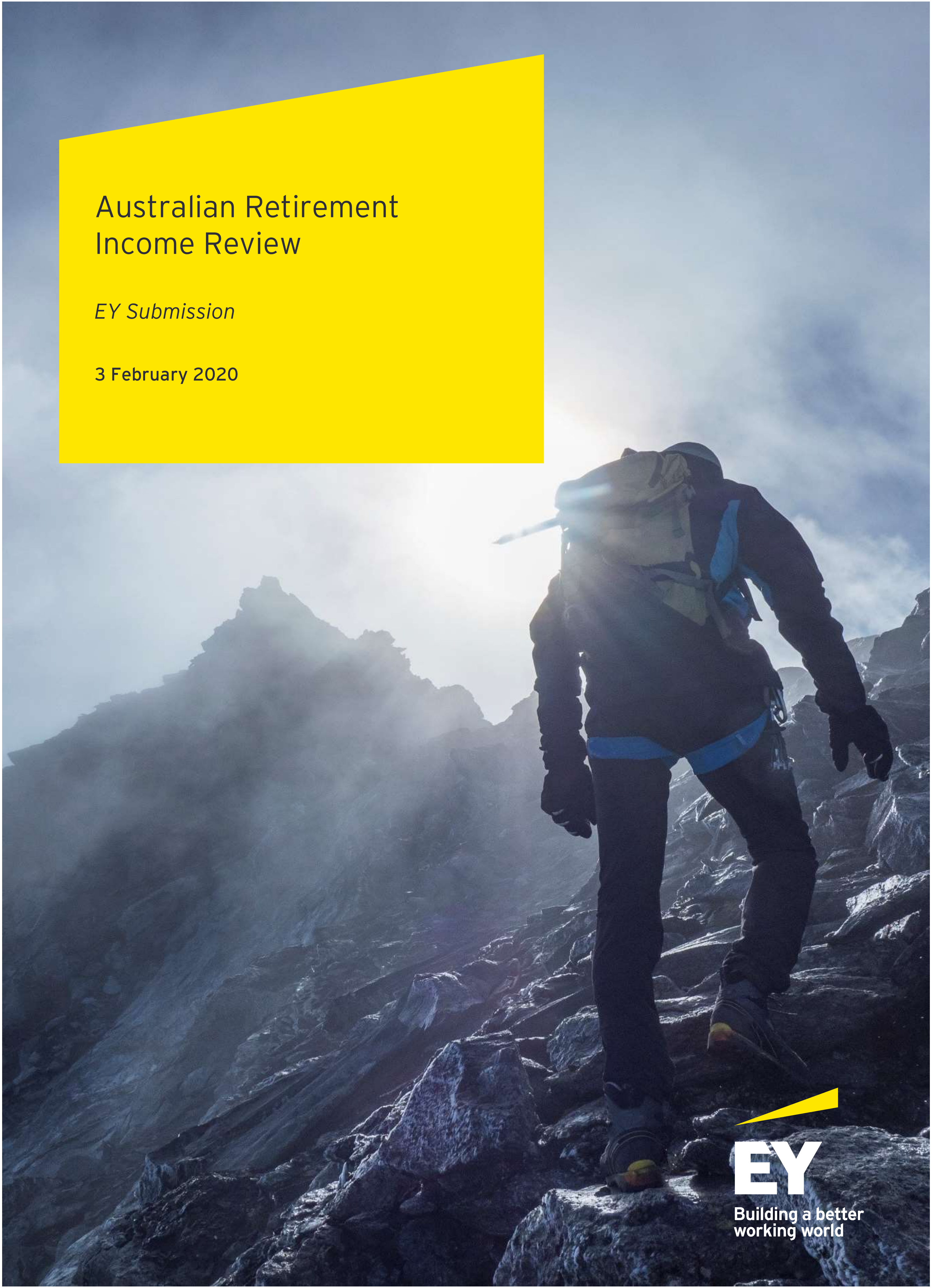

Australian Retirement Income Review

EY Submission

3 February 2020

EY
Building a better working world

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This report is supported by consumer research designed and run by EY's dedicated market research practice, EY Sweeney. A total of n=757 6-minute online surveys were completed between 20-24 January 2020. This included n=250 surveys with people aged 25-49 who are not yet retired, n=255 with people aged 50+ who are not yet retired, and n=252 people of any age who have retired from paid employment. Sample was sourced from an online market research panel. Data has been weighted based on gender for representativeness.

Introduction

As an active participant in the financial services industry and involved in many aspects of delivering important services across accounting, audit, taxation and consulting into the wealth and asset management sector, EY considers a response to the Retirement Income Review panel as an important role consistent with our firm focus on building a better working world.

We believe the Panel has the opportunity of highlighting the positive aspects of the current system, but importantly where the reset may need to occur to align for continued success in a changing population and economic landscape.

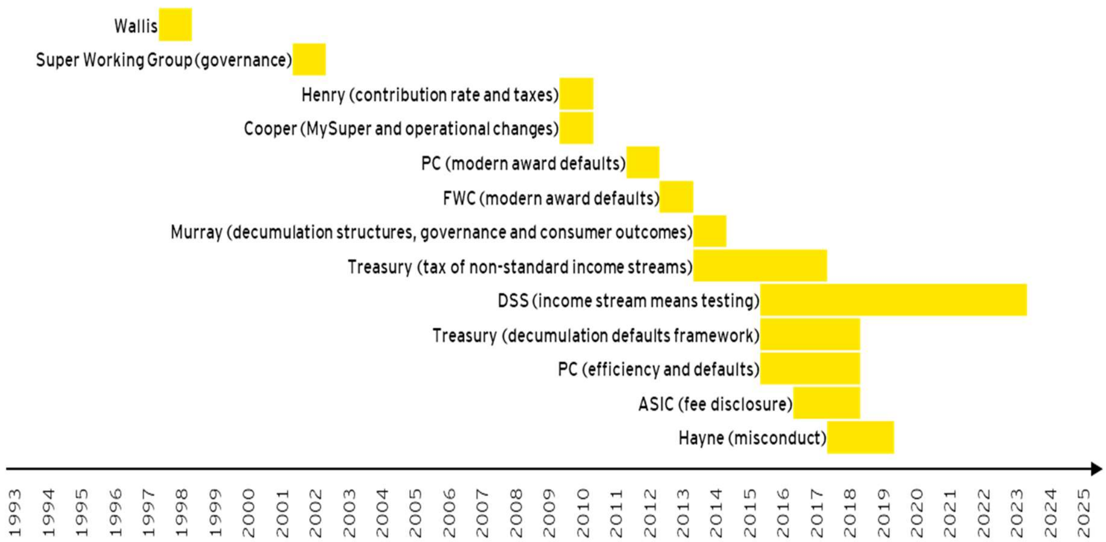
Our view of the current system

Our view of the current retirement income system and status quo against international standards and position globally

1. The retirement income system has not been reviewed holistically up until now:

There have been several reviews and inquiries into the health of Australia's financial system in recent times (Illustration 1) but this review is the first holistic review of Australia's retirement income system in decades.

Illustration 1 – Australian Financial System Reviews and Inquiries



Source: CEPAR (2018), Retirement income in Australia; EY desktop analysis

The retirement system has undergone several changes to improve various aspects but the one-off changes by both sides of politics have not been part of a broader cohesive policy and framework for the retirement system. This has caused confusion and uncertainty for participants, businesses and households who struggle to keep pace with the changes and impact on them.

Key reforms and changes to the system since 2005 include (not an exhaustive list):

2019

Protecting Your Super legislation designed to protect superannuation accounts from unnecessary erosion caused by insurance premiums and particular fees

APRA SPS 515: Member Outcomes: Requirements for Super funds to regularly assess the outcomes provided to members and identify opportunities for improving these outcomes, supported by sound strategic and business planning

2018

Downsizer scheme. People aged 65 and older can make a non-concessional (post-tax) contribution of up to $300,000 from the proceeds of selling their family home

2017

The qualifying age for the age pension increases until it reaches 67 years of age in January 2024

The First Home Super Saver scheme announced to allow tax effective saving for first home buyers within the superannuation system

2013

Additional rules about fees within MySuper were enacted including not charging a fee that relates to the payment of conflicted remuneration to a financial services licensee, arrangements for intra-fund advice, prohibition of entry fees and limiting exit fees, switching fees and buy-sell spreads to being charged on a cost-recovery basis.

Super trustees must provide MySuper members with insurance benefits that are for death and benefits that are consistent with the definition of permanent incapacity in the regulations. Members must have the option to opt-out of life and total permanent disability insurance unless the fund meets conditions prescribed in the regulations.

Government announced that it would make no 'major' changes to superannuation tax policy for five-year periods. The Government also announced that it would bring forward legislation to establish the Super Council to ensure any future changes to superannuation are consistent with an agreed Charter of Superannuation Adequacy and Sustainability.

Government announces final decision on 64 tax and superannuation measures. Measures which the Government indicated would proceed included the introduction of penalties for promoting illegal early release of superannuation, encouraging the take-up of deferred lifetime annuities, inter-fund consolidation of accounts less than $1,000

2012

Legislation to increase the super guarantee was introduced by the Labor government. The super guarantee was set to increase to 12% by July 2019. It increased to 9.5% in 2014 but it was then frozen by the Coalition government

2011

Government allows superannuation fund trustees to use tax file numbers (TFNs) to locate multiple member accounts to assist in account consolidation and extends the pause to the indexation of the income threshold for the superannuation co-contribution.

Government releases key design aspects of the accepted recommendations from the Cooper review: MySuper products to have a single investment strategy and a standard set of fees except in certain circumstances and employers must make contributions for employees who have not chosen their fund to a fund offering a MySuper product.

2010

Government response to Australia's future tax system review (Henry Review) is released. The Government agrees to increase the super guarantee rate, increase the superannuation guarantee age, provide an annual superannuation contribution for Australians with low income and raise the concessional contribution cap for those over age 50 with less than $500k in super benefits.

Government formally accepts most of the Cooper Review's recommendations (Stronger Super), including implementation of low cost superannuation funds (MySuper), streamlined back office procedures (Super Stream), strengthening the oversight of self-managed superannuation funds, strengthening APRA's prudential supervision of the superannuation industry and increasing prudential requirements of trustees.

2009

The Matthews Report recommends that government superannuation pensions continue to be adjusted by increases in the Consumer Price Index (CPI) and is supported by Government.

2007

Most of the Simplified Superannuation amendments take effect such as no tax on a lump sum or on an income stream

2006

Contribution splitting takes effect

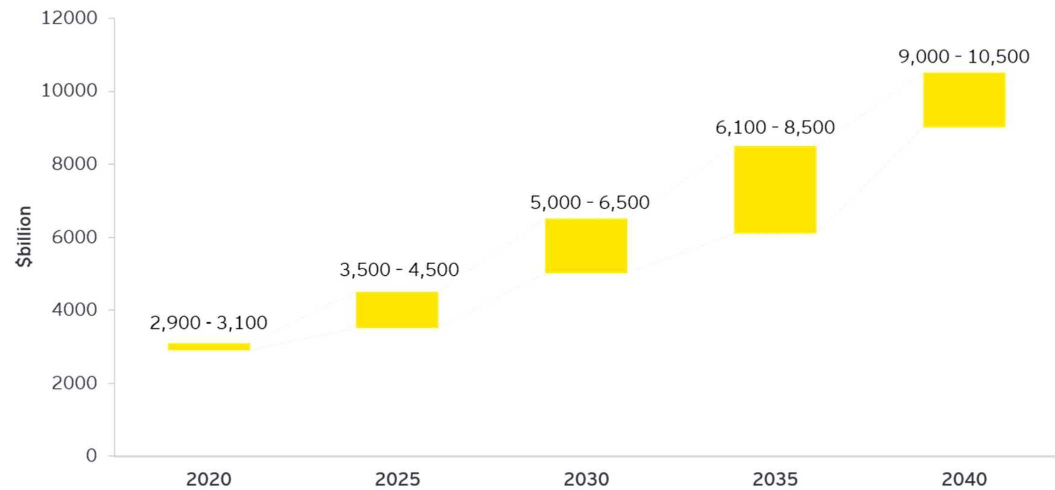
2005

Transition to Retirement pensions become available. Members can receive a transition to retirement pension without needing to leave the workforce or retire. Choice of Superannuation Fund and abolition of the Superannuation surcharge also take effect

Source: *aph.gov.au; EY desktop analysis*

- Most of these reforms have been designed to improve incentives for households to save for retirement and protect their private pension assets. However, collectively the reforms have not improved member engagement to the degree targeted due to the constant changes and additional complexity.
- The changes to super are making it more difficult for Australians to determine what their future sources of retirement income will be and when they can retire comfortably. Should their private retirement assets built-up through compulsory and voluntary super contributions supplement the government Age Pension or is it the other way around?
- There are clear signs that the existing system is not keeping pace and adapting to fundamental changes in the economy, how people create wealth and plan for retirement and ultimately how they want to live in retirement. Retiree expectations today on what they want to do in retirement are very different to previous retiree cohorts and no doubt will evolve into the future. The system should embrace this change and flex with it.
- Younger generations growing up today are at risk of living longer lives with less wealth compared to their parents. Our research indicates younger cohorts are less confident about reaching the level of retirement income they think they need compared to older cohorts; and this is despite younger generations having the advantage of contributing to Super all their working lives.
- There is opportunity to improve the current system. The current system is not necessarily broken and does not require a complete change in approach and direction. ASFA projects that the size of Australia's super assets will double in 10 years and almost double again in the following 10 years (Illustration 2). This statistic indicates the overall system is growing and working as intended. But it does mask concerns of retirement system equality and adequacy for Australians which is also reflective of broader societal equality issues and there is a need for a holistic framework that continues to lead to even better outcomes for Australians households and their retirement prospects.

Illustration 2: Projected superannuation assets from 2020 to 2040



Source: ASFA (December 2019), Superannuation Statistics

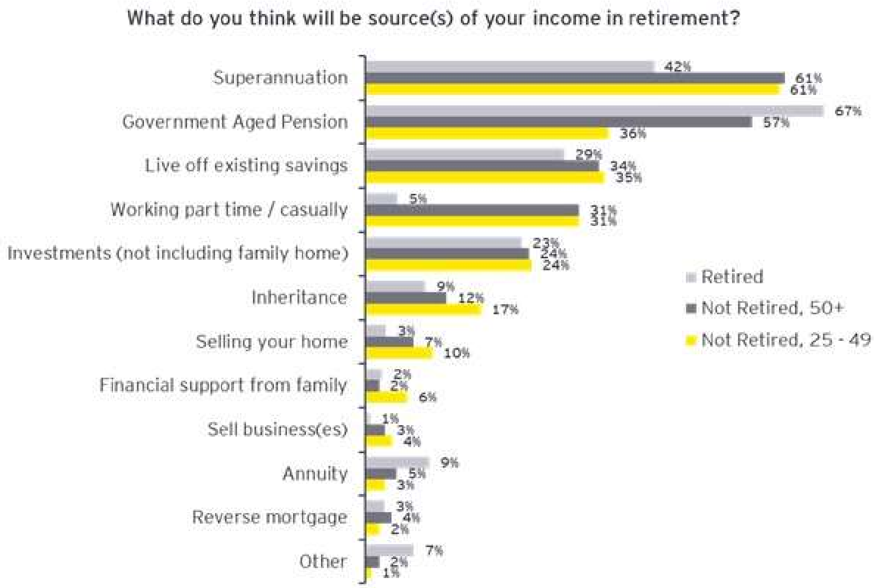
Australian retirement income system strengths:

1. Australia has a large savings pool of Super and retirement assets approaching A$3t and total retirement fund assets exceed our Gross Domestic Product (GDP)
2. Super balances have increased by 9% annually over the last 10 years
3. Superannuation fund fees are falling. According to Rainmaker research, fees across the super industry have fallen for the first time since 2014, down about 4 per cent to A$31.8 billion in FY19. Fees as a percentage of account balances have also fallen from an average of 1.23% to 1.11% over the past year. We expect fees will continue to fall as Super funds consolidate and achieve greater economies of scale, despite increasing regulatory costs such as implementation of Protecting Your Super legislation
4. More Australians are on track to self-fund their retirement. ASFA projects that 43% of Australians at retirement age will be self-funded by 2023, compared with 22% in 2000

2. People retiring in the future associate retirement incomes as compulsory superannuation, not the other pillars

We surveyed Australians to understand what their retirement income sources currently are (for retirees) or expected to be (for pre-retirees). About 6 in 10 (61%) 25-49 year old's (y/o) expect Super to feature prominently as a source of future retirement income (Illustration 3). It is quite a different story for retirees, with two thirds (67%) stating that the Age Pension is currently a retirement income source.

Illustration 3



Source: EY Consumer Research

The ABS also found that just over half (54%) of 3.9 million people aged 45 years and over who intend to retire from the labour force, expect their main source of retirement income at retirement will be from Super. Whereas the proportion selecting 'government pension/allowance' was significantly lower at 25% (source: ABS https://www.abs.gov.au/ausstats/abs@.nsf/mf/6238.0)

Given the importance of Super as a future retirement income source, we would expect most Australians to be actively managing their Super savings. But we find this is not the case with less than 10% of pre-retirees proactively managing their Super. It does raise the question, "why are Australians passive when it comes to managing their Super?" Perhaps they are too reliant and trusting of the government, institutions and employers to manage Super **well** on their behalf; or they feel they won't have enough Super to retire on; or they simply do not prioritise Super ahead of other day to day financial matters and concerns.

The good news with member engagement since the recent Royal Commission into Financial Services is evidence of increased fund rollover activity which indicates Australians are making more decisions around fund choice.

A real test for the health of the retirement system in future is the ability to track improvement in engagement levels. APRA's SPS 515 prudential standard will make Super and retirement funds consider strategic objectives and initiatives that are more aligned to member interests and values. This should help and is a step in the right direction.

This expected reliance on Super for future retirement income also has implications for other household income sources in retirement. For instance, analysis by SuperEd (https://supered.com.au/blog/102-the-most-expensive-mistake-retirees-can-make) finds that single retirees are on average losing $37,000 in Age Pension entitlements due to delays in applying for the Age Pension while couples are typically losing close to $60,000. SuperEd's review of data from its Retirement Essentials service indicates that Australians often apply for the Age Pension well after the time they become eligible, on average about 2.3 years after. Suggested reasons why include people:

- Are still working
- Assume (often incorrectly) they won't be eligible so don't bother
- Don't want to rely on the Age Pension, perhaps for reasons of pride
- Procrastination

Procrastination may be due to actual and perceived bad experiences with Centrelink. This offers opportunities where our institutions like banks and super funds could provide new services to their customers to help identify and streamline processing of Age Pension applications with Centrelink.

3. The objective of the overall retirement income system hasn't really changed which is to provide a safety net supplemented by other sources of retirement funds

Australia's first comprehensive policy on retirement income was outlined in 1989. The policy was made to Parliament by the Hon Brian Howe MP, the Minister for Social Security in that year. The objective of the system was to deliver better incomes for those retired now and those who will retire in the future. The policy statement "reaffirms our firm commitment to the Age Pension system and to tax assisted superannuation" of the government (Source: Better Incomes: Retirement Income Policy into the Next Century, statement made to parliament)

The government has more recently attempted to enshrine in legislation the purpose of superannuation as "providing income in retirement to substitute or supplement the Age Pension" (Superannuation (Objective) Bill 2016). However, this was not passed by the Senate.

Per EY's submission to the discussion paper relevant to this Bill, we considered that a more equitable primary objective of superannuation would be:

> "To promote the creation of wealth to be used solely to provide a "comfortable" standard of living throughout retirement, with or without Age Pension support, for all Australians. With the proviso that determining what constitutes a "comfortable" standard of living should be against an agreed benchmark, such as proportionate replacement of pre-retirement income (perhaps with certain caps). It should also contemplate funding expenditure on health care and aged care needs, which clearly increase during the retirement years"

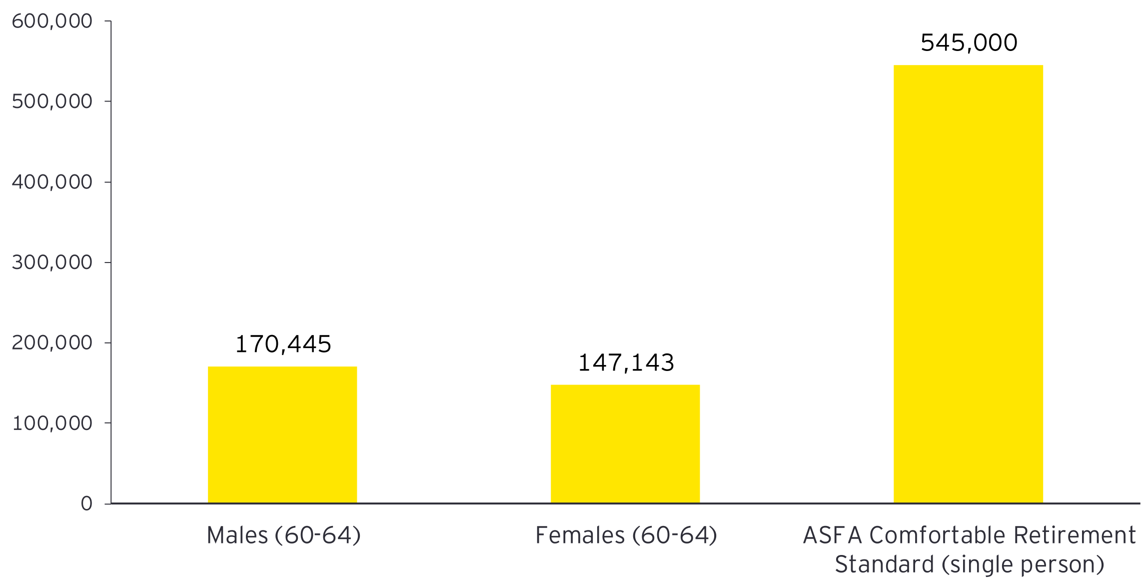
Source: EY - Objective of Superannuation submission dated 6 April 2016. Submitted by Maree Pallisco

It would appear the stated official objective of our retirement income system has not changed much at all over the last 30 years. Perhaps more emphasis is required on the importance of superannuation and compulsory and voluntary contributions as the primary sources of retirement income, supported by the Age Pension where there are gaps, retirement income funding shortfalls and inequality in the system.

4. The retirement system has grown rapidly but still average balances are low and this raises equity considerations

The size of Australia's super and retirement assets has grown by 9% p.a. since 2008. Overall therefore it would suggest that most Australians are at or close to retiring comfortably. However, the reality is most Australians have inadequate super and retirement savings in comparison to what would constitute a comfortable current or future retirement income. The most recognised comfortable retirement index is the ASFA Retirement Standard (Illustration 4).

Illustration 4: Average superannuation balance for 2017-2018



Source: APRA (June 2018), Annual Superannuation Bulletin, ASFA (2018), ASFA Retirement Standard

Recent average balances for males and females nearing retirement age compared to the ASFA Comfortable Retirement Standard indicate that a significant proportion of Australians are not on track to retire comfortably and would be dependent on other sources of income at retirement if they wanted to have a comfortable retirement and be fully self-funded.

ASFA also published research in 2019 called "Better Retirement Outcomes: A Snapshot of Account Balances in Australia" which provides further evidence of participation and retirement income inequality in the current system:

- One in three women and one in four men, across all ages, have no superannuation account.
- Approximately 25% of women and 13% of men are retiring with no superannuation. Further, our research indicates that for 50+ y/o yet to retire, approx. 54% either have less than $100k in super or simply don't know how much they have in Super.
- Most people retiring in the next few years will rely partially or substantially on the Age Pension for their retirement income as they have inadequate super savings (the research also points out that the proportion of new retirees who are fully self-funded has been increasing).
- It's projected that 43% of Australians at retirement age will be self-funded by 2023, compared with 22% in 2000.
- Many people will still need to contribute over and above compulsory contributions to their superannuation to ensure they have adequate retirement savings.

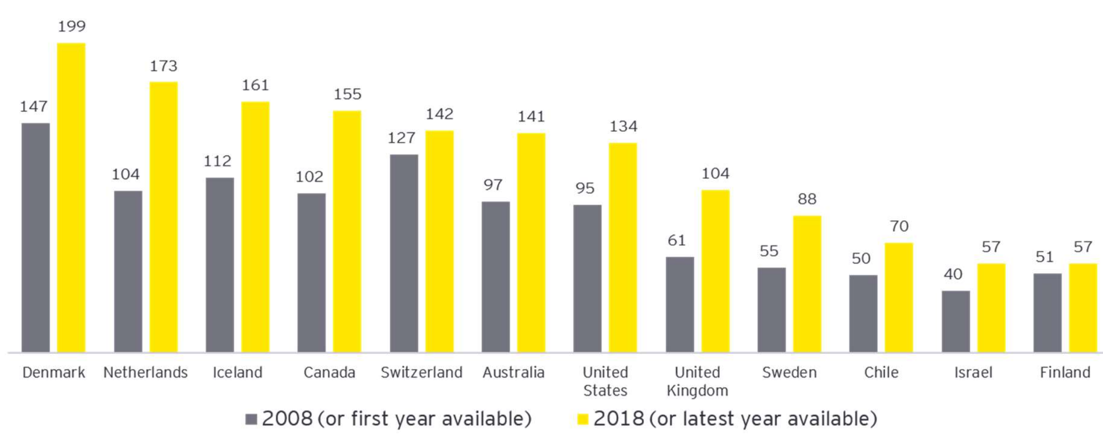
Are these inequalities as bad as they sound? The analysis does not take into account the possibility of achieving the ASFA comfortable retirement income amount through a combination of Age Pension, work and retirement savings through Super. A realistic combination of these three factors across several household scenarios nearing retirement is covered in detail in "The Barefoot Investor" by Scott Pape. The book has sold over 1.6m copies and proven very popular for those at or nearing retirement and their families.

5. Australia's retirement income system isn't global best practice but it does compare favourably to most other systems around the world

Australia's retirement income system is not recognised as the world's best retirement income system but it does consistently feature in the top quartile of most studies and metrics comparing retirement income systems.

Comparing the size of our retirement income system to GDP against other private pension fund assets globally, we currently rank 6th with 141% of GDP (Illustration 5). From 2008 to 2018 our annual retirement asset growth rate as a % of GDP was 4%. This has grown at a slower rate compared to regions such as The Netherlands, UK and Sweden but on par with other developed nations.

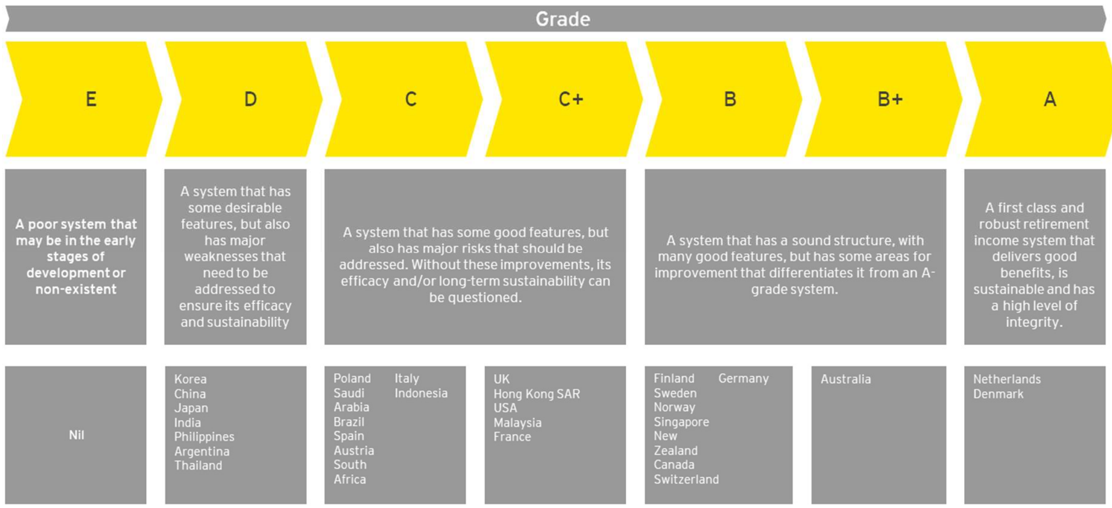
Illustration 5 - Private pension fund assets as % of GDP (2018 compared to 2008)



Source: OECD (2019), Pension Markets in Focus

There are also studies that focus on various attributes of retirement income systems such as the Melbourne Mercer Global Pension Index. In this study, Australia received a B+ score (Illustration 6). Only the Netherlands and Denmark received a better score than Australia.

Illustration 6



Source: *Mercer (2019), Melbourne Mercer Global Pension Index)*

Despite Australia performing well in these types of studies, we shouldn't be complacent and assume the system in its current form will keep us in good stead, particularly when other countries and regions are considering significant improvements to their systems.

Retirement income system pillars

EY observations across each of the pillars

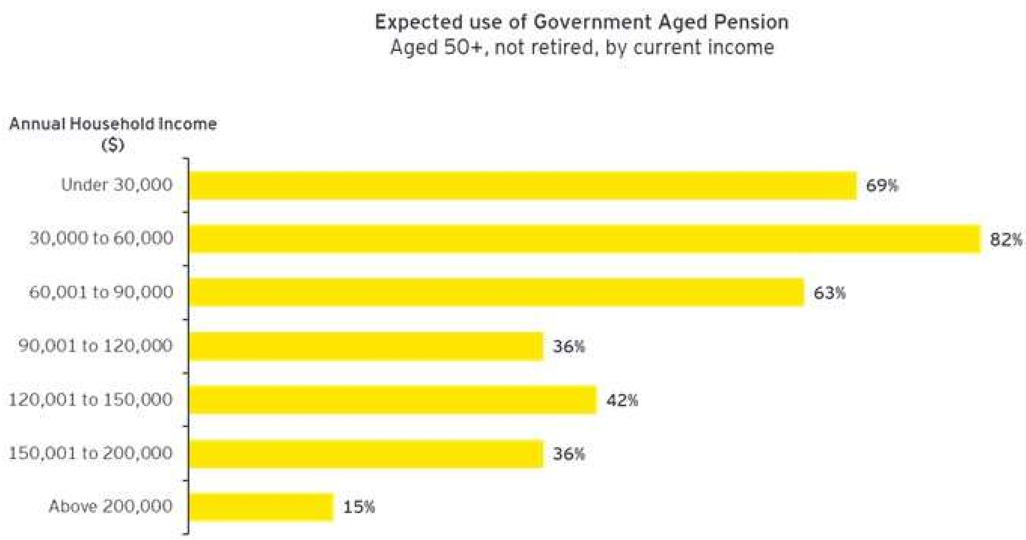
The Australian retirement income system consists of a means tested Age Pension (Pillar 1), a compulsory defined contribution scheme called the Superannuation Guarantee (Pillar 2), and voluntary superannuation contributions taxed concessionally (Pillar 3).

1. Pillar 1: Age Pension

- **Lower socio-economic households expect to receive the Age Pension**

Based on our research, most of those aged 50+ and not retired earning less than $90k in income expect to receive the Age Pension (Illustration 7). Reliance peaks when income is between $30-60k with 82% earning this amount expecting to receive the Age Pension in retirement. This expectation falls away sharply once income exceeds $90k.

Illustration 7 – Future sources of income in retirement



***Source**: EY Consumer Research*

- **The Age Pension should be viewed as one of several retirement income sources and strategies available to Australians**

According to a CEPAR 2018 report on Retirement Income in Australia, public spending on pensions was below 3% of GDP from 2010 to 2015, the third lowest among developed countries and much lower than countries like Spain, France and Italy. Australia's spending rate is expected to stay relatively flat between now and 2050, despite an aging population.

From a fiscal and budgetary perspective, Australia is trending in the right direction on this measure compared to other countries. Apart from the modest maximum Age Pension entitlement below 30% of average earnings and the means test impacting on this measure, an expected increase in the number and proportion of future retirees fully funding their own retirement will also directly impact this spend.

Albeit somewhat confusing, the current Age Pension structure does provide a reasonable incentive for pensioners to work additional hours from age 65 and earn an income whilst still receiving the full

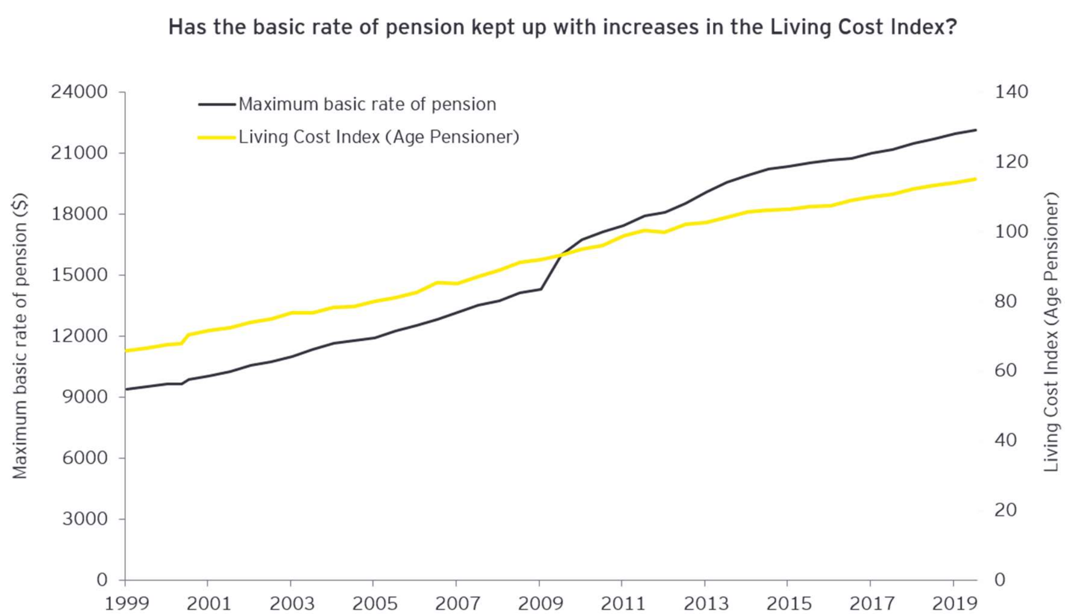
Age Pension. By utilising the Work Bonus, it is possible for a single pensioner to earn up to $474 a fortnight and still receive the maximum rate of pension. The Work Bonus can also be used as an income bank to offset against future income and carried forward if unused.

Therefore, a single pensioner on the full Age Pension and earning up to $474 per fortnight could receive ~$36,500 p.a. in retirement income. This still falls short of the ASFA comfortable retirement standard for single pensioners of $43,787 p.a. but assuming the single pensioner also had a modest amount of Super at retirement and can convert this to a retirement income stream, they would likely get close to the ASFA retirement income standard.

Retirees that rely solely on the Age Pension for retirement income likely struggle more with basic cost of living pressures compared to self-funded retirees. The basic rate of Age Pension is indexed to inflation and has seen gradual increases over the last 20 years, with the exception of 2009 when there was a one-off increase in the rate of pension (the maximum single rate of pension was increased by $65.00 a fortnight; $60 in the base rate + $5 in the new Pension Supplement).

A comparison of the Age Pension increase over time with the Living Cost Index for Age Pensioners (Illustration 8) indicates that the increase in both the pension and cost index is fairly similar. What this comparison does not show is that retiree costs can escalate quickly and unexpectedly. A flexible Age Pension system that caters for and incentivises work flexibility will be an important consideration going forward.

Illustration 8 – Age Pension vs pensioner living cost index



Source: ABS, The Australian Department of Social Services. Note: The Maximum Basic Rate of pension excludes any supplementary benefits

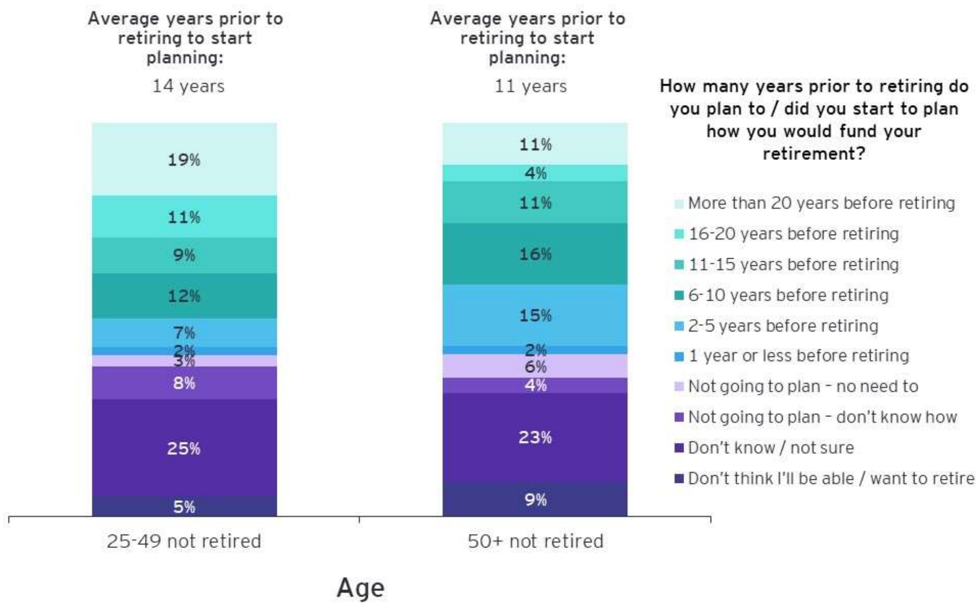
2. Pillar 2: Compulsory

► **Compulsory Super is not front of mind for most people until it is too late**

Illustration 9 demonstrates the number of years prior to retirement that people start planning for it. For 25-49 y/o on average they intend to start planning 14 years from retirement compared to 50+ y/o at 11 years on average (among those that intend to plan for retirement). Worryingly, 41% of 25-49 y/o and 42% of 50+ y/o say they are not going to plan or don't know how they will be able to plan for retirement.

We expect a proportion of 25-49 y/o and even 50+ y/o just assume that the Super Guarantee contributions they have made and will continue to make will be adequate upon retirement and therefore delay or defer retirement planning until it's too late.

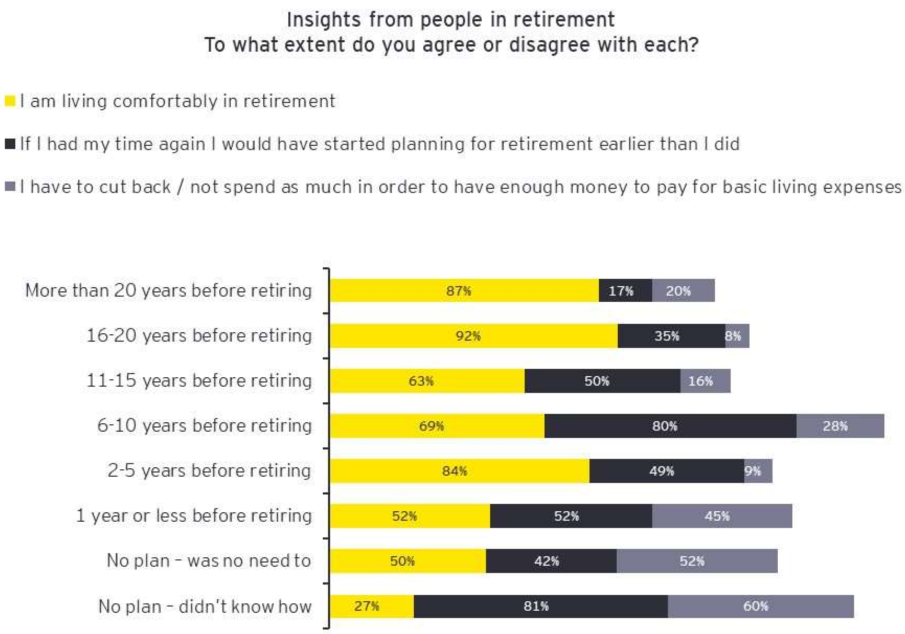
Illustration 9 – Years prior to retiring to start planning



***Source**: EY Consumer Research*

Retirement outcomes for Australian households would significantly improve if more people started to plan 15+ years from retirement. We know this based on retiree responses to when they first started planning for retirement. Those that planned 16 years or more from retirement are much more likely to say they are currently living comfortably in retirement (Illustration 10). A high proportion (~90%) of those that planned 16 years or more from retirement age say they are now living comfortably in retirement.

Illustration 10 – Range of perspectives from retirees



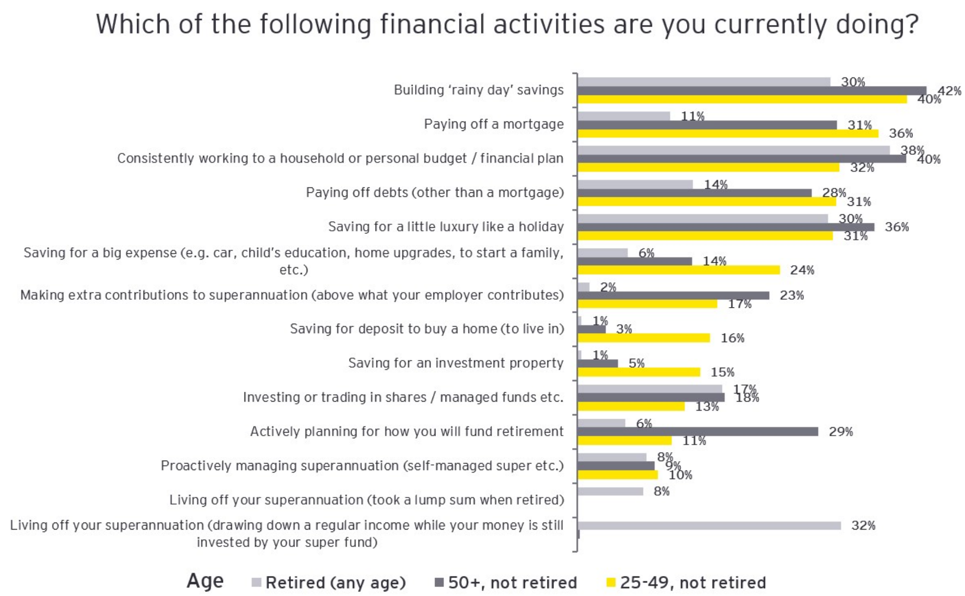
Source: *EY Consumer Research*

Government and industry could influence how early pre-retirees start planning with awareness campaigns. For example, a clear message that says once you reach the age of 50, you should start thinking and planning for retirement. Similar to how the National Bowel Cancer Screening Program (NBCSP) invites eligible people starting at age 50.

Illustration 11 below compares the proportion of people currently planning for how they will fund retirement with other financial activities. About one third (29%) of 50+ y/o yet to retire say they are actively planning for how they will fund retirement. Therefore about 7 in 10 are not actively planning for retirement.

This cohort appears to be more concerned and focused on other financial activities such as 42% building 'rainy day' savings, 40% working to a personal budget, 36% saving for a little luxury like a holiday and 31% paying off a mortgage. There is also 28% saying they are paying off debts other than a mortgage. With such high proportions paying off debt, it probably comes as no surprise that active planning to fund retirement is on the back burner for most.

Illustration 11 – Financial activities



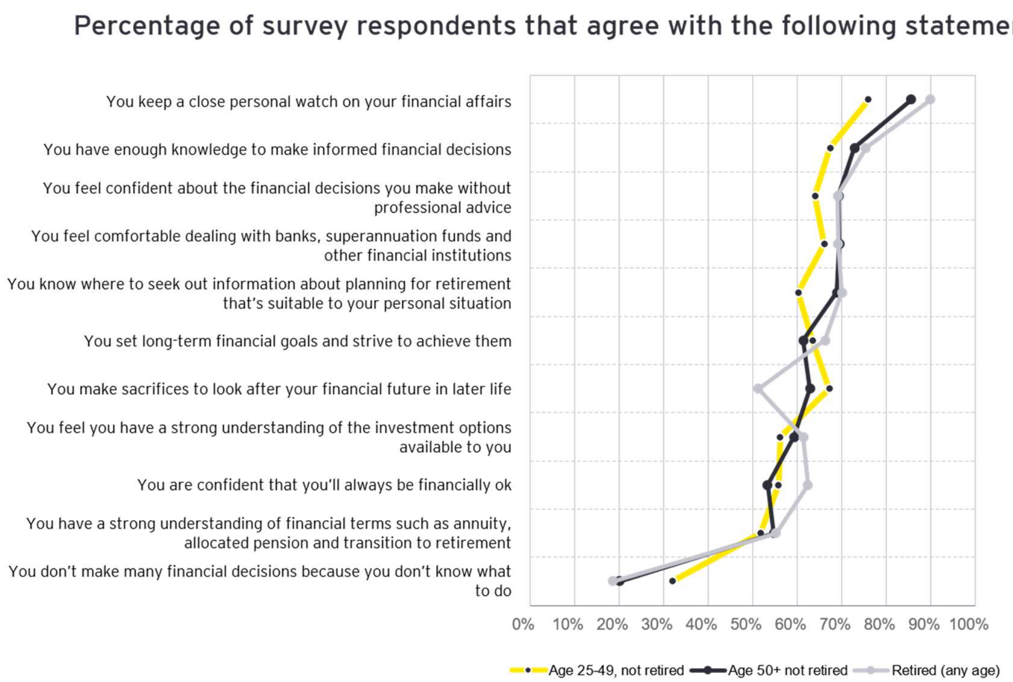
Source: *EY Consumer Research*

3. Pillar 3: Voluntary – savings and home ownership

► No plan to utilise and optimise assets

In contrast to the low level of engagement with Super, our survey indicates that most people keep a close personal watch on their financial affairs and the level of monitoring improves with age (Illustration 12). The survey also suggests that most people feel they have enough knowledge to make informed financial decisions and are reasonably confident about the financial decisions they make without professional advice.

Illustration 12



Source: *EY Consumer Research*

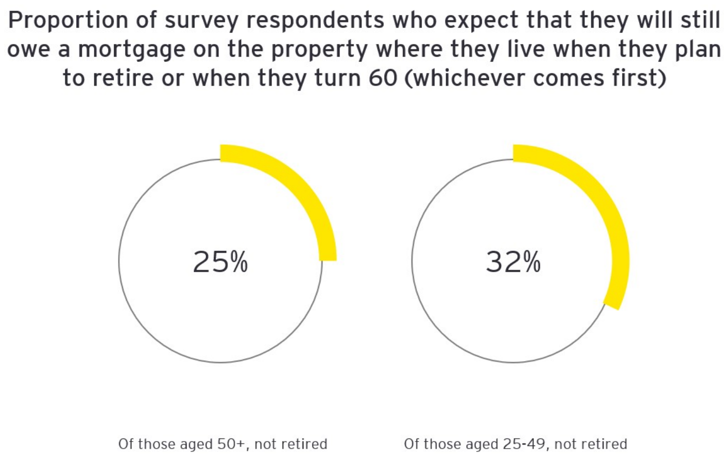
However, when we asked respondents about the financial activities they currently perform, the findings differ. It is probably more useful to focus on the financial activities (or lack thereof) that people are performing as a proxy for just how in control they are of their financial situation. Across the total sample of people surveyed:

- 64% are not consistently working to a household budget / financial plan
- 84% are not investing in shares or managed funds
- 86% are not making additional contributions to Super
- 91% are not actively managing Super

► Mortgages and debt look set to significantly erode future private retirement assets

A key finding from the research is that one in three (32%) future retirees aged 25-49 y/o expect to have a mortgage at retirement, compared to 50+ y/o (25%) (Illustration 13).

Illustration 13

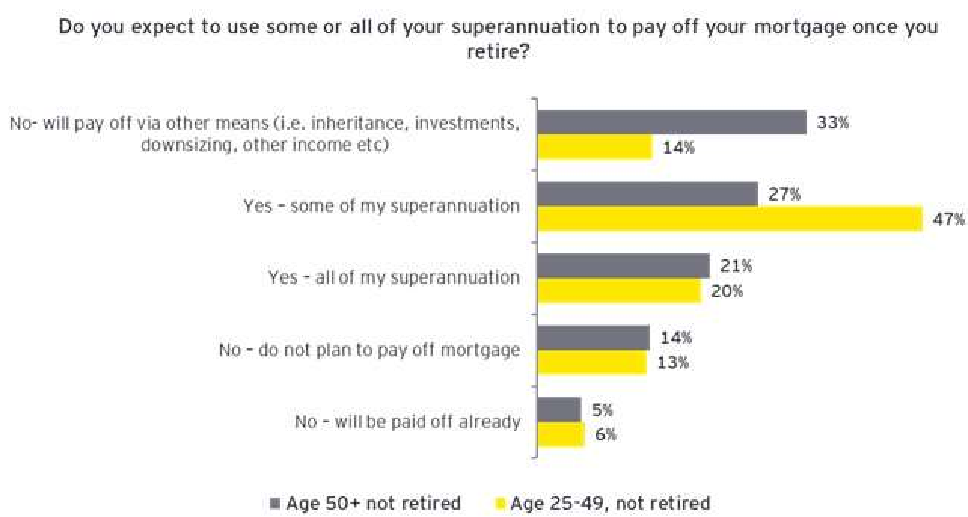


Source: *EY Consumer Research*

Perhaps more worrying is that of those that expect to have a mortgage at retirement, the majority intend to use some or all of their Super to pay off the mortgage once they retire (Illustration 14). The proportion for 25-49 y/o is noticeably higher at 67%, than that of those aged 50+ (48%). This could lead to an increase in the number of future retirees relying on the Age Pension for retirement income.

This possible shift to use Super to pay off mortgages is not one of the stated objectives of Australia's retirement income system. The objective could be updated to account for this or new rules could be introduced to prevent Super being taken as a partial or full lump sum payment.

Illustration 14 – Using Super to pay off mortgages

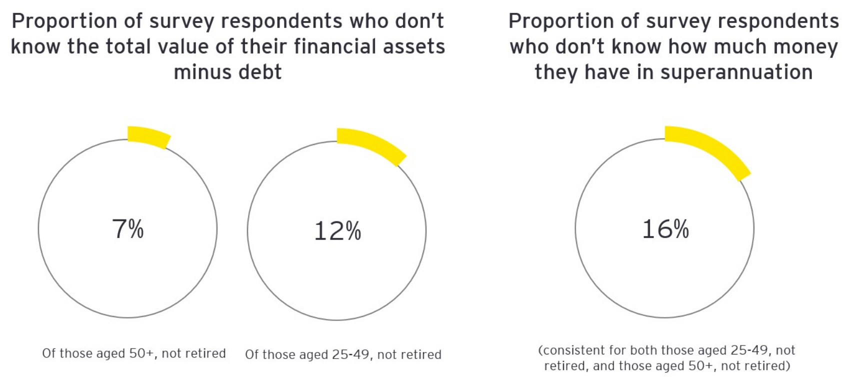


Source: *EY Consumer Research*

► **No real stocktake of complete wealth position**

Despite an overwhelming majority of respondents saying they keep a close watch over their financial affairs, there were mixed responses to understanding of simple metrics such as knowing how much Super they have and total value of financial assets. These findings further support the view that many households do not really know their current financial position, even if they say they do.

Illustration 15 – Understanding of personal financial assets and super balances



Source: *EY Consumer Research*

Super

- 15% of those aged 50+ and not retired don't know how much money they have in superannuation

- 18% of those aged 25-49 and not retired don't know how much money they have in superannuation

Challenges and drivers of system problems

What are the root causes?

► **Highly complex system & products/services**

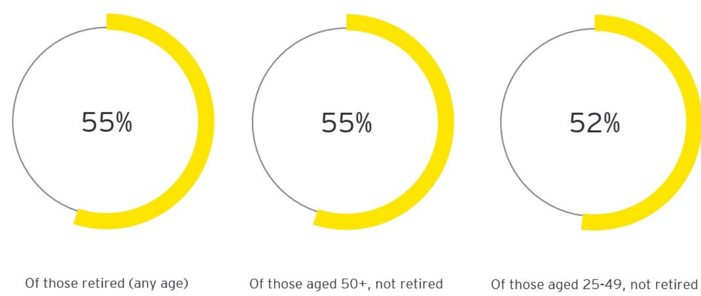
The retirement income system was never intentionally designed to be complex but for many households it is. An entire ecosystem has been created around Super including hundreds of fund managers and thousands of financial advisers. Attempts to simplify the system have eroded trust and added to complexity and confusion. It is likely that the lack of trust and fear to engage and be 'ripped off' is creating a barrier to actively manage one's affairs.

► **Industry terms like Pension, Annuity and longevity do not resonate**

Understanding of industry terms like annuity and longevity is low and less relevant to future retirees that are seeking flexibility and lifestyle

Illustration 16

Proportion of respondents who agree (rated 6-10 out of 10) that they have a strong understanding of financial terms such as annuity, allocated pension and transition to retirement



***Source**: EY Consumer Research*

► **Tax complexity intertwined**

Tax complexity is built into the retirement system. The treatment of tax on Super and retirement assets is based on an array of rules, caps and limitations. It is not easy for most to understand, particularly for those that do not have a background in finance. This is where financial advisers offer real value to clients when planning for retirement.

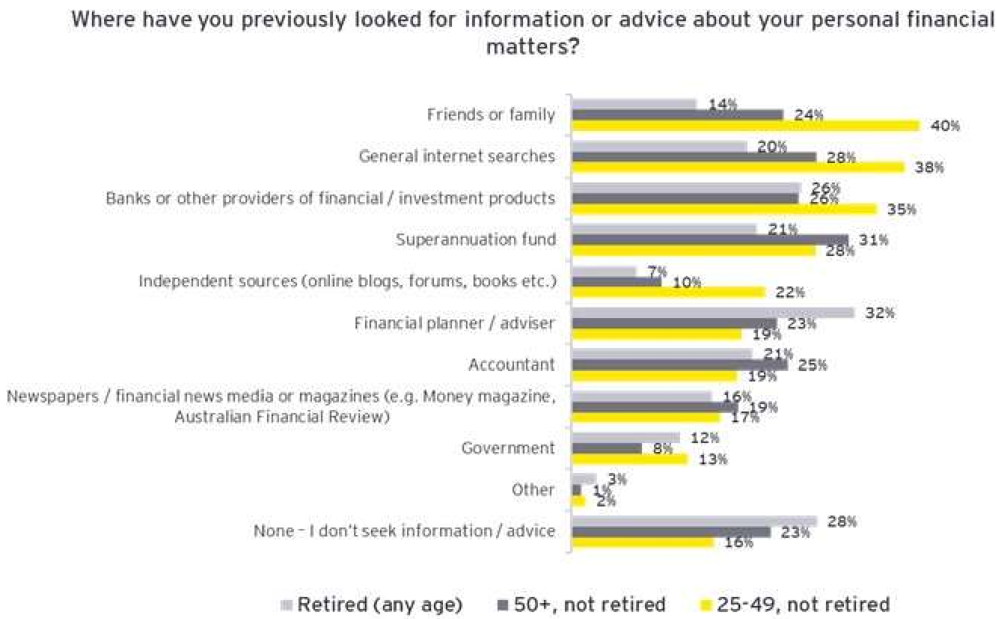
It is also not easy to understand the treatment of tax on retirement savings in comparison to taxes on incomes, businesses and negative gearing on investment property. In Australia there is also a high degree of 'co-mingling' of personal and small business affairs.

► **No one to trust for advice**

We expect the number of financial advisers in Australia to decrease by about one third overall and bottom out by 2022/2023. Many advisers that remain will service wealthier client segments due to a number of factors that have been well publicised. There is a supply issue emerging for middle Australian households to access good financial advice.

But is there also a demand gap for financial advice? Our survey suggests households consider a variety of different sources for information and advice on personal financial matters (Illustration 17). Patterns in usage have changed with the advent of the mobile phone, online aggregation sites and the introduction of intra fund advice.

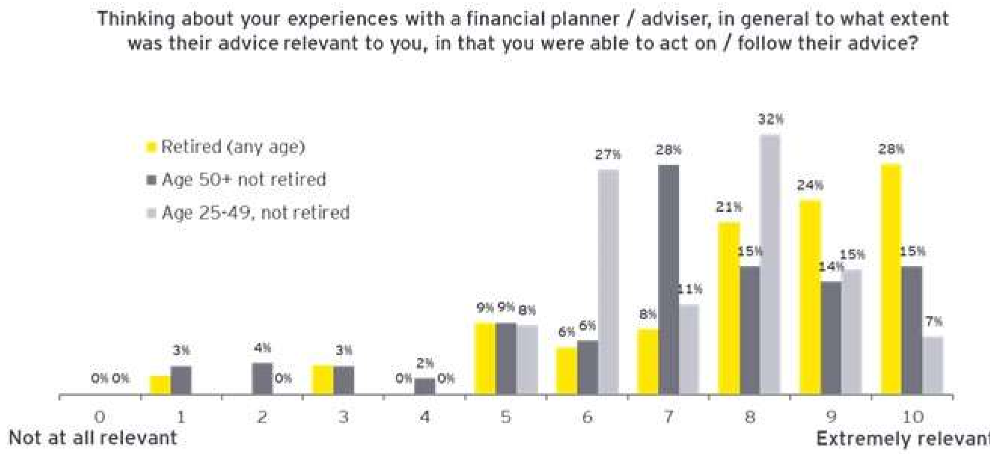
Illustration 17 – Information and advice sources



Source: EY Consumer Research

- 25-49 y/o yet to retire: More likely to use a variety of different sources, the main ones being friends/family (40%) and internet searches (38%). Advice from family members is not always objective and can lead to bad financial decisions being passed down from parents to children.
- 50+ y/o yet to retire: The highest proportion (31%) stated they have used their Super fund for information and advice.
- Retirees are likely to use the least amount of sources with 28% stating they don't seek information or advice.
- One in four (25%) respondents stated that they have used a financial adviser for advice on personal financial matters. Usage of financial advisers for personal financial matters is similar to the use of super funds and accountants.
- For those that have used a financial adviser, most stated that the experience was relevant to them and were able to act on the advice. This was particularly the case for retirees whereas relevance for 25-49 y/o was not as strong in comparison.

Illustration 18 – Relevance of financial advice



***Source**: EY Consumer Research*

The issue with financial advice therefore seems to be more about 'access' than quality or relevance. What's not well understood is whether financial advice can be relevant once more to a far greater proportion of households?

- **Poor financial literacy**

  The HILDA survey reported on financial literacy in 2018:

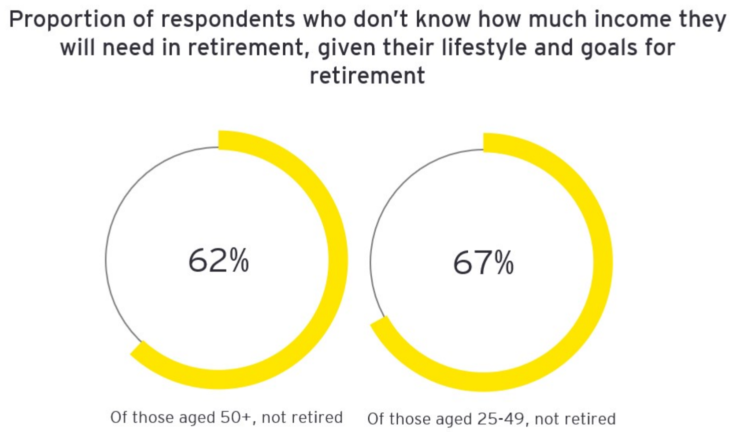
  - Less than half (42.5%) got all five questions correct
  - About 50% of men correctly answered all questions, compared with only about 35% of women
  - The young – aged under 25 – are the least financially literate, with about 25% correctly answering all questions. Those approaching retirement – aged 55 to 64 – are the most financially literate, with about 55% getting all questions correct

The HILDA report went on to say that different surveys conducted over the years have shown that financial literacy in Australia is generally poor.

- **How to determine what income households need to maintain a lifestyle in retirement is not well defined**

The retirement income industry would be broadly familiar with the ASFA Retirement Standard. It is a simple measure that should be easy for households to understand as well. However, our survey suggests most pre-retiree's (67% of 25-49 y/o and 62% of 50+ y/o) do not know how much income they will need in retirement, let alone changes in retirement income to accommodate movements in spending and expenses throughout retirement. This means that, surprisingly, only 38%, or a little more than one in three, of 50+ y/o yet to retire believe they know how much income they will need in retirement.

Illustration 19 – Estimating income needs in retirement



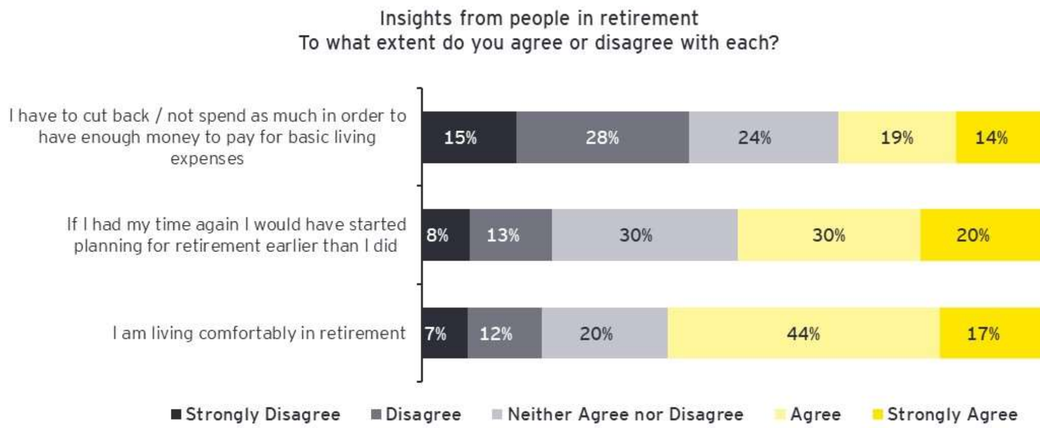
Source: EY Consumer Research

Our survey asked retirees some questions around how they are coping in retirement: have they cut back on spending, are they living comfortably in retirement, and would they plan for retirement earlier than they did?

Illustration 20 indicates 33% of retirees have cut back / not spent as much to have enough money to pay for living expenses. We would expect a significant proportion of this cohort did not know how much income they would need in retirement before retiring. The main implication of planning too late or not at all could well be spending less in retirement.

There also appears to be widespread regret for not planning retirement earlier with half (50%) stating if they had their time again they would start planning for retirement earlier than they actually did.

Illustration 20 – Retiree actual lifestyles versus plan



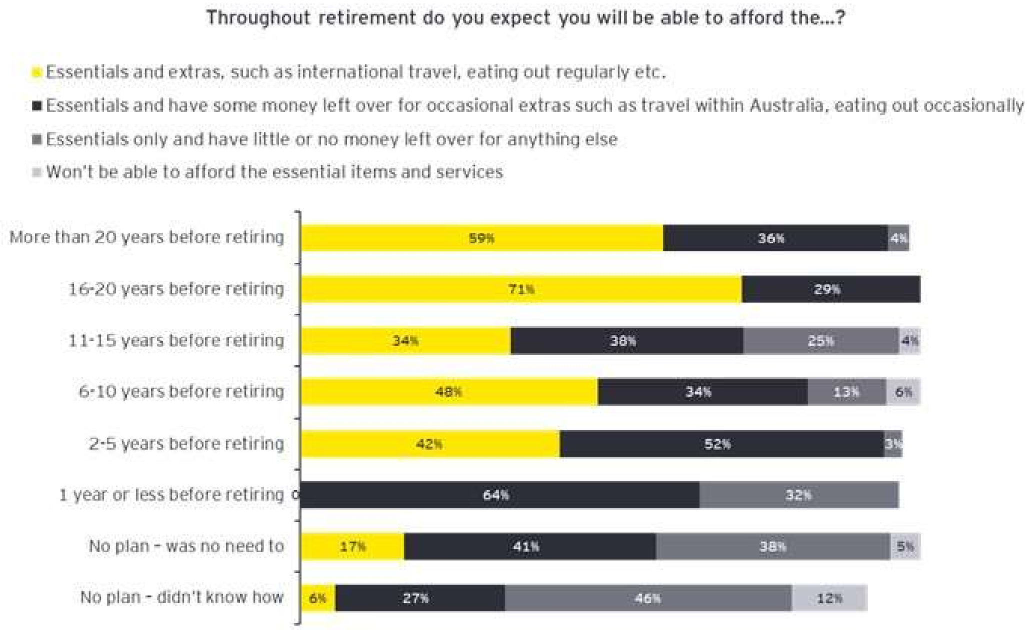
Source: EY Consumer Research

- ► **How to determine what you spend in retirement and adjust for spending and consumption irregularities also not well defined**

We fully expect that those about to retire and those recently retired simply do not know how to determine what they will spend in retirement and how this will change. This would be a big cause of financial stress and a motivator to draw down as little income as possible in case expenses increase significantly at some point.

Again, forward planning seems to be the key. Illustration 21 below asks future retirees what they expect to be able to afford in retirement. Those that intend to plan further out expect to afford essentials and a range of extras.

Illustration 21 – Confidence to spend in future retirement



Source: EY Consumer Research

► **People living longer and working longer**

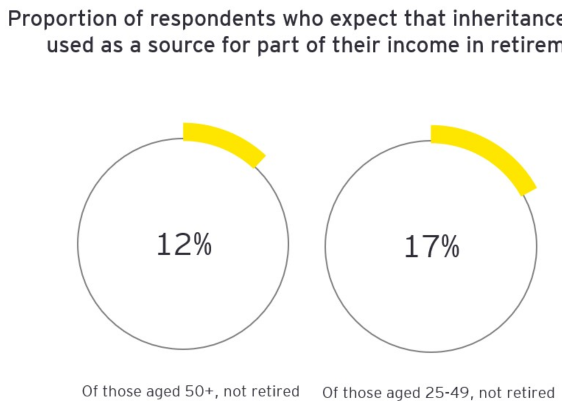
Between 2015 and 2055 the share of the population aged 65 and over is projected to increase from 15% to 23%, the number of people aged 65+ will more than double and the 85+ group will more than quadruple, and the dependency ratio will drop from 4.5 working-age people per person aged 65+ to 2.7 (source: CEPAR (2018), Retirement income in Australia).

Retirees living longer are worried they will outlive their retirement savings. This would also motivate retirees to spend less in retirement and draw down the least amount possible each year. Assistance with forward planning and improving financial literacy in the lead up to retirement could really have a significant impact here. Complex, inflexible and expensive products to manage longevity risk in retirement may be less effective.

► **Not many expect to receive an inheritance to fund retirement yet many would like to leave an inheritance to their children and grandchildren**

The industry talks about the massive intergenerational wealth transfer of assets and funds now underway. However, our survey indicated expectations around receiving inheritance as a source of income in retirement was fairly low (Illustration 22).

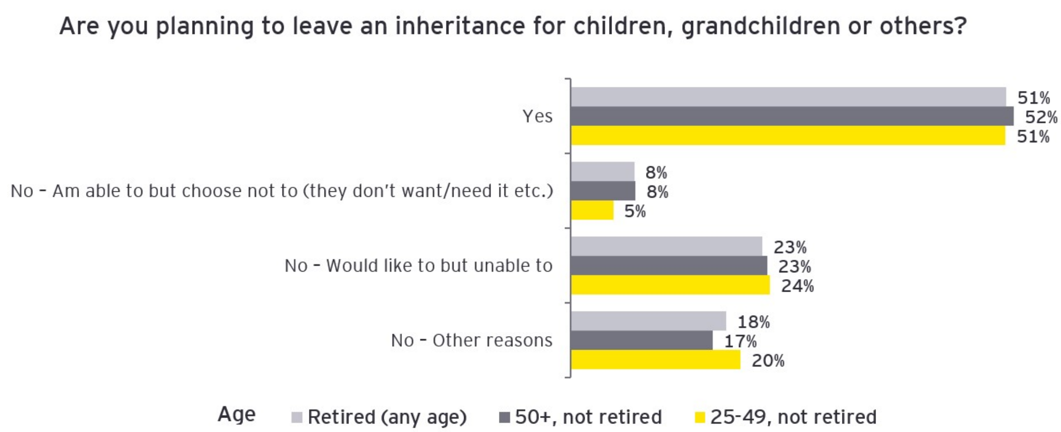
Illustration 22 – Expected future retirement income sources - Inheritance



Source: EY Consumer Research

The response was quite different when we asked if pre-retiree segments would like to leave an inheritance with around one in two (see data below) saying they would like to and were also able to (Illustration 23).

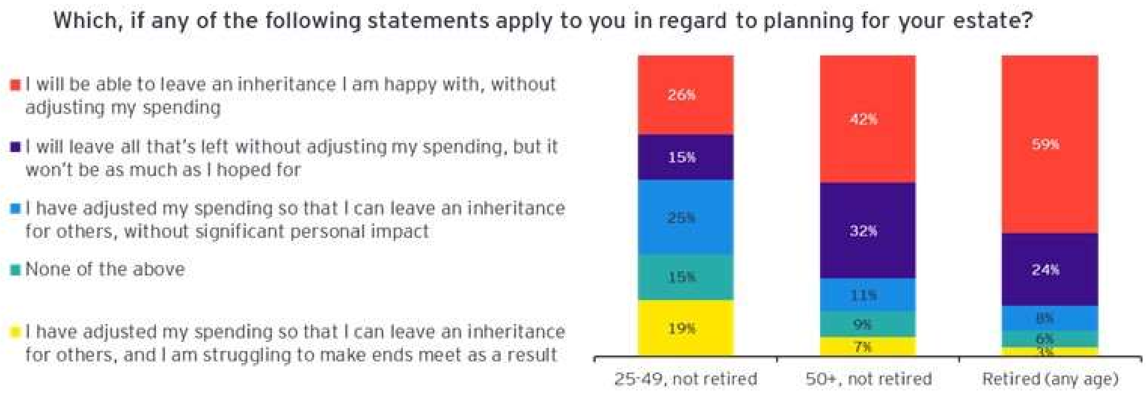
Illustration 23 – Desire to leave an inheritance



***Source**: EY Consumer Research*

With around one in two saying they plan to leave an inheritance, demand for estate planning services and advice in this area should be strong. Particularly as a significant proportion of pre-retirees segments expect to leave less than they would hope, or need to adjust their own spending (Illustration 24).

Illustration 24



Source: *EY Consumer Research*

What needs to change

- What is evident from the range of reviews, supplemented by our own research and experience in the sector suggests we are at an important juncture to address and remediate a series of changing facts and circumstances in our population demographics, along with addressing some significant needs of the population in both financial literacy and supply of a 'trusted' framework for advice.
- Financial literacy needs to improve and that needs to convert to an increase in financial activity and households making decisions on their situation to improve their prospects of retiring comfortably. Improvements in financial literacy can occur in schools for children but equally, improvements can be made for those thinking about retirement choices and options.
- Holistic alignment of how to prepare people for retirement not just components of it. Most households expect to rely on a variety of sources for retirement income. Yet we seem to focus on Super balances and contributions in isolation and neglect other sources and associated needs such as aged care, financial counselling, mental health, career advice and health and wellbeing.
- The current financial advice framework needs re-design to appeal to younger clients and older clients that cannot afford it. The process is inconsistent and complex. Changes to regulations that simplify AFSL processes and requirements, which may need to embrace disruption and innovative forms of advice emerging in the fintech sector, along with new incentives to work with an adviser should be explored.
- Mortality and working life flexibility within the system. The current assumptions around mortality and work life are outdated and need to shift with evolving changes in older household lifestyle, health needs and work patterns.
- System flexibility and optionality to support different life stages. This could be to support younger household property ownership aspirations or increase concessional contribution caps for those close to retirement and furthest away from retiring comfortably. Changes here also require a reset in the overall objective of the retirement income system.
- Additional rules and regulations that force people to convert their Super to a retirement income stream at retirement may be counter-productive and reduce overall engagement with Super further. This trade-off between flexibility and certainty is a key consideration for many other jurisdictions around the world, particularly those with ageing populations. Whilst our submission has not studied in detail what changes have been made by other jurisdictions and impacts on their retirement systems, we would encourage Treasury to investigate and assess further before any changes to Australia's retirement income system are made.
- Super and retirement funds should be able to enhance digital tools and statements to show members if they are on track for a comfortable retirement (based on a set of agreed assumptions). This includes gamification techniques to compare the member situation to 'someone like them' by age and location.
- Super and retirement funds should also consider carefully what enhancements to retirement products will benefit members most. There are interesting global examples emerging such as the Schwab Intelligent Income Portfolio which acts like a virtual annuity. The product can warn retirees if their monthly withdrawal rate is at risk, based on market movements and other factors. These enhancements seem to be targeting mass market and affluent customer segments and guides mostly "predictable" income by steering consumption up or down - but with no guarantee. This type of retirement product innovation has application in Australia and something our sophisticated Super funds should explore further.

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