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# Submission to the Retirement Income Review

*I am a former chairman of the Commonwealth Superannuation Schemes CSS and PSS, the NSW State Authorities Superannuation Board and First State Super. I welcome the opportunity to put forward a proposal to the Retirement Income Review that will enhance the retirement balance of retirees and increase government revenue.*

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The Australian Government Superannuation Scheme is recognised as one of the best in the world and is undoubtedly a huge success. It could be even better.

Since its inception 28 years ago, it has accumulated funds of approximately $3 trillion[1] and is predicted to reach $9 trillion[2] over the next 15-20 years. The scheme is designed to provide a comfortable and dignified retirement for all Australians and to defray the cost to government of providing for an ageing population.

It now has well over a million retirees[3] receiving super pension/income streams and is estimated to be providing $30 billion[4] in taxes to the government. This covers 60% of the $50 billion (2019-2020 Commonwealth Budget) cost to the government of the age pension. In a few years, tax revenue will fully cover the cost of the age pension.

However, under the current structure, the scheme is not taking full advantage of compound investment returns, which is limiting the retirement balance of retirees and the revenue government receives. This submission details a proposal to increase the retirement balance of retirees by:

1. Replacing government taxes with an asset-based dividend; and
2. Slashing Super Fund fees.

[1, 2, 3, 4] asfa Superannuation Statistics December 2019.

Government revenue would also be higher due to the extra wealth created by the proposed changes.

## 1. An asset-based dividend

In 1992, the government decided to utilise the power of compound interest by mandating a superannuation scheme for all Australians. The scheme requires employers to contribute to a Super Fund, for each employee, an amount of money equal to 9.5% of ordinary time earnings (OTE). This is known as the Superannuation Guarantee (SG) charge and is legislated to increase to 12% by 2025. This charge is hypothecated by the government to create a massive wealth fund for retirees and is owned by individual Australians.

The government applies an upfront tax of 15% to the SG charge. A further tax of 15% is also applied to the earnings of Super Funds in accumulation mode. The upfront tax limits the potential of the Super Scheme by reducing the SG to 8% of OTE before investment (e.g. a $10,000 SG is reduced to $8,500). This configuration of taxes reduces the return to individuals and government.

A far more effective system would be an annual asset-based fee or dividend of 1.25% on the super pool of funds in accumulation mode. This approach redistributes the tax burden from the earlier years of accumulation to the latter years. In so doing, it enables greater wealth to be created for all participants with the greatest benefit flowing to low income earners and those with low balances.

The dividend method would increase and stabilise government revenue with a predictable compound growth rate of 7% per annum for the next 15 years[5]. It also greatly simplifies the Super Scheme with government revenue requiring only one calculation per annum on the mandated 30th June balance of each Super account.

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[5] asfa Superannuation Statistics December 2019

The following table gives a good indication of the difference between funds accumulated under the current tax method and under the proposed dividend method for 9.5% SG and 12% SG. The figures are based on an estimated current tax revenue of $30 billion[6]. A dividend of 1.25% from an asset base of $2.4 trillion[7] (accumulation mode) would yield the same amount.

TABLE 1: **Accumulation balances over a working life for Superannuation Guarantee charge of 9.5% and 12%, taxed and dividend methods (based on a salary of $50,000 with 2.5% inflation and 8% compound return).**

| Years of Accumulation | 1<br>SG 9.5%<br>15% Taxes | 2<br>SG 9.5%<br>Dividend 1.25% | 3<br>SG 12%<br>15% Taxes | 4<br>SG 12%<br>Dividend 1.25% |
|---|---|---|---|---|
| 10 | $61,600 | $71,300 | $77,800 | $90,100 |
| 20 | $200,000 | $227,000 | $252,700 | $286,800 |
| 25 | $320,500 | $359,800 | $404,800 | $454,500 |
| 30 | $494,500 | $539,300 | $624,700 | $681,300 |
| 35 | $744,500 | $803,800 | $940,600 | $1,015,000 |
| 40 | $1,102,000 | $1,176,000 | $1,392,000 | $1,485,000 |
| 45 | $1,611,000 | $1,699,000 | $2,035,000 | $2,146,000 |

The figures above show that in each instance the dividend method gives a superior return to the tax method. They also show that by moving from an SG of 9.5% to SG 12% there is a big boost to retirement balances.

[6,7] asfa Superannuation Statistics December 2019

Take the example of a worker on a starting salary of $50,000 who contributes for 45 years. Under the current system of taxes, SG 9.5% (Col. 1), that worker would accumulate $1,611,000. Under the proposed dividend system and moving to SG 12% (Col. 4) that worker would amass $2,146,000, over $500,000 more.

This equates to $715,000 (in 2020 dollars) and would sustain an indexed pension/income stream commencing at $42,000 for 30 years (2.5% inflation, 7% earning rate). Retirement balances below $700,000 (2020 dollars) will require assistance from the age pension safety net.

The removal of the crippling effect of the upfront tax, by adopting the asset-based dividend method, will enhance all retirement balances and government revenue.

## 2. Slashing Super Fund fees

Superannuation Funds charge fees to cover administration and investment costs. The major portion of these fees are asset-based and have little relationship to the actual cost to the Fund. Most Funds claim to be low-cost operators, but fees vary considerably between Funds.

Take the example of a retiree aged 65 who wishes to commence an income stream/pension with an account balance, at the cap, of $1.6M. First State Super, a large industry Fund, charges a fee of $19,412 per annum whereas UniSuper, a comparable industry Fund, charges $7,746 per annum. The breakdown between administration and investment fees is as follows:

TABLE 2: Breakdown of administration and investment fees at First State Super and UniSuper.

| | First State Super | UniSuper |
|---|---|---|
| Administration Fee | $6,448 | $1,346 |
| Investment Fee | $12,964 | $6,400 |
| TOTAL FEES | **$19,412** | **$7,746** |
| Percent of $1.6M | 1.21% | 0.48% |

*(Chant West Pension Apple Check)*

There is a massive difference between these two Funds with First State Super's administration fee nearly five times that of UniSuper, and the investment fee double.

Investment fees vary considerably depending on the extent to which Active Investment Managers are used. These managers traditionally charge large asset-based fees and aim to produce above-index returns for the various asset classes. In practice, over time, most do not achieve the market index.

In the past few years, we have seen the rise of the Passive Investment Manager who invests through ETFs (exchange traded funds) which replicate market indices. This type of investment captures the market return and can be adopted to achieve the asset mix desired. Passive Investment Managers charge very low fees.

Hostplus, another large industry Fund, has a pre-mixed Balanced option (Active Manager) as well as a pre-mixed Indexed Balanced option (Passive Manager) with the following fee structure for an account balance of $1.6M (Accumulation):

TABLE 3: Balanced versus Indexed Balanced fees at Hostplus.

| | Balanced (Active) | Indexed Balanced (Passive) |
|---|---|---|
| Hostplus | $16,960 | $1,120 |
| Percent of $1.6M | 1.06% | 0.07% |

*(Hostplus Product Disclosure Statement)*

In this example the Indexed Balanced (Passive) option is a small fraction of the cost of the Balanced (Active) option.

Superannuation is a long-term investment relying on the compounding effect of consistent returns. Passive ETF investment captures market returns at very low cost. The Active investment approach is very costly and there is no evidence to date it has consistently produced superior returns.

The judicious use of ETFs has the potential to more than halve the cost of Super Fund fees. UniSuper provides a model for other Funds, with its modest fees and excellent returns.

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The combination of replacing government taxes with an asset-based dividend, halving Super Fund fees and SG of 12%, will produce a significant increase in retirement balances and government revenue. Low income earners and those with low balances will benefit the most. Retirement balances for this group, with a range of 10-25 years until retirement, will be up to 50% more than under the present system.

By adopting these recommendations, the goal of a comfortable and dignified retirement for all Australians will be achieved.

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