Stockbrokers
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Association Limited

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Retirement Income Review Secretariat
The Treasury
Langton Place
PARKES ACT 2600

By email: retirementincomereview@treasury.gov.au

RETIREMENT INCOME REVIEW — CONSULTATION PAPER
SUBMISSION BY STOCKBROKERS AND FINANCIAL ADVISERS ASSOCIATION

The Stockbrokers and Financial Advisers Association (SAFAA) appreciates the opportunity to provide comment on the Retirement Income Review Consultation Paper ("the Consultation Paper") released by Treasury for comment in November 2019. Our comments are set out below.

SAFAA is the peak body representing stockbroking and investment advisory firms in Australia. SAFAA members provide advice and dealing services to clients in the listed equities and derivatives markets.

SAFAA is a member of the Alliance for a Fairer Retirement System and supports the submission lodged by the Alliance in respect of the Consultation Paper.

SAFAA does not seek to repeat material that is in the submission from the Alliance. Rather, this submission sets out some additional comment that is directed at the interaction between any review of the Retirement Income framework and the securities and derivatives market in Australia.

SAFAA appreciates the great significance of the Retirement Income Review to the financial security and wellbeing of Australians and to the financial burden on public finances of the Commonwealth. SAFAA is supportive of the Review and the importance of reaching a settled and sustainable basis for the funding of retirement incomes for Australians.

SAFAA also wishes to stress the vital importance of the listed securities and derivatives markets to the financial wellbeing and prosperity of Australians as a whole, not just those approaching or in retirement. It is an oft-observed fact that the nations which enjoy the greatest wealth and prosperity are those which have strong and vibrant stock markets.

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SAFAA's submission is that any review of Australia's retirement income policy settings must acknowledge and leverage off the strength of Australia's securities markets. The securities market is vital to the pool of savings that must fund retirement income, if there is not to be an ongoing strain on Australia's public finances.

Conversely, Australia's retirement savings pool is already the envy of much of the world and has served as a vital source of investment funds underpinning the strength of Australia's equity and capital markets.

SAFAA submits in the strongest terms that any review of the retirement income framework must take into account this vital inter-relationship. Any changes to the framework that would adversely impact on this relationship could potentially have serious financial repercussions for the nation and SAFAA submits that this should be avoided.

Importance of securities market to retirement income

SAFAA agrees with the proposition that the Age Pension funded by government should be considered as a safety net for citizens who, for one reason or another, have not been able to save a sufficient amount to be self-funded in their retirement. We acknowledge that, due to the incentives built into the system, it has become the foundation of the system, with a concurrent sense of entitlement to the Age Pension (we refer to the Alliance submission which has further detail on this). SAFAA is of the view that the policy settings should encourage Australians to become self-funding in retirement, restoring the Age Pension to its role as a safety net.

Therefore, the Retirement Income Review should not consider the issue of funding retirement in isolation. A key component in the framework are the policies which facilitate the building of wealth throughout a working life, so that to the maximum extent possible, people have saved sufficient amounts, in addition to superannuation, to self-fund their retirement.

Importance of equities and dividend income

If Australians are to fund their own retirement, then it is unarguable in SAFAA's view that substantial investment in shares and in equity funds is essential.

Recent research shows that over the next twenty years only 30 per cent of Australians will rely on the full age pension, with another 30 per cent relying on a part age pension and 40 per cent being fully self-reliant.[1] This means that 60 per cent of Australians will be dependent on some form of government-funded pension over the next two decades. This shows that 70 per cent of Australians will need to rely on investments in equities to fund their retirement. Those building wealth towards retirement to provide an income stream also need to rely on investment in equities.

Fixed interest income will not be sufficient, particularly in view of what now appears to be a long-term low to negligible interest rate environment. It is primarily dividend income and share price appreciation that must be relied upon to build retirement savings for Australians.

Further, the increased life expectancy of Australians must mean inevitably that retirement balances will need to be higher than they are at present, unless some other means of addressing longevity risk is identified.

[1] Michael Rice and Nathan Bonarius, *What is the right level of superannuation guarantee?*, Rice Warner, 3-4 June 2019, page 13

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At present, longevity risk is primarily carried by the individual, subject to the government assuming liability through the Age Pension when an individual's retirement savings eventually fall below the assets threshold. The longer that people live, the more likely that the Age Pension will eventually be triggered, unless there is a way of increasing retirement balances significantly. If the government wishes to avert the extent to which retirees outlive their retirement balances and move onto the Age Pension, then facilitating higher superannuation balances and supporting voluntary contributions must be a priority.

One additional factor that is relevant is the ever-increasing size of accommodation bonds required by aged care facilities. With the increase in the numbers of retirees who will eventually progress to be cared for in aged care facilities and not by family members, then amounts saved for retirement will also need to factor in the high potential that a significant bond payment and/or significant daily fees will need to be paid in later years.

If it is accepted that retirement balances must be significantly higher, then policy settings facilitating this must be incorporated into the retirement framework.

It is important therefore that two key areas of policy should be settled:

1. Policies which encourage share ownership, including franking credits and the capital gains discount, need to be retained.

2. The policy framework should be geared towards increasing the access to and affordability of investment advice for Australians. The extent to which poor decisions might be made by unadvised investors should be mitigated by ensuring all Australians, not only the wealthy, have access to investment advice.

In relation to (1), balances can be enhanced by mandating the level of superannuation contributions, from the current 9% per annum to 12.5% or higher. If increased contributions are not mandated, however, then the only other alternative is to encourage extra contributions through incentives.

Even with an increase in the level of compulsory contributions, it is likely in our view that additional contributions from individuals will be needed.

Some concerns have understandably been expressed about the affordability of tax concessions which support investment by Australians, either through superannuation or investment generally. In SAFAA's submission, there is an important cost-benefit analysis that should be carried out between the government revenue that may be gained at present if tax concessions were removed or reduced, and the additional cost to government revenue that would be imposed at a later point if Australians were less able to self-fund their retirement if incentives to invest were removed.

While many focus on the cost of superannuation concessions to the Federal Budget, seeing them as a cost to the budget of compulsory superannuation when compared to any savings that may arise from the reduction in future age pension payments, the savings to government are not realised until the member reaches the age pension eligibility age. As such, tax concessions attached to superannuation are consistently seen by governments and

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Treasury as expenses (liabilities) rather than as investments. Yet, despite an ageing population, a maturing superannuation system means age pension expenditure remains stable.

Shifting the impact on government revenue to a later point in time is not a positive outcome. Foregoing tax revenue now that will save the public purse in funding age pension entitlements in later years should properly be viewed as a prudent investment.

Importance of derivatives market to retirement income

One important topic that has not been the subject of any significant discussion is the prudent protection of superannuation funds from adverse market movements.

There are many commercial and private activities for which insurance is mandated by law. A person who does not insure their home or its contents is regarded as less than prudent. However, the protection of superannuation funds by fund managers is left entirely to their individual commercial judgement.

A correction in the equities market of 20%-30% is not an unprecedented event and the time taken to recover from such correction may take years. We have seen how the GFC negatively affected superannuation balances at that time and how deleterious that was to those who were about to or had just entered retirement. The impact of any such future market correction on retirement balances of individuals will be major.

The use of exchange traded options ("ETOs") by fund managers has fallen away in recent years. While derivatives are often regarded by some with suspicion, they represent a significant tool in the protection of portfolios and should therefore be viewed as akin to insurance.

Taking out options incurs transaction costs, which therefore represent an additional cost to the relevant fund. In the highly competitive world of fund management, it may be that fund managers will avoid any costs where possible that may reduce the annual rate of return to investors. A single fund manager who chose to use derivatives to protect their fund may suffer in comparative performance in any single year or even over a period of years against other fund managers who did not. It would only be when the extreme event of a significant market correction occurs that the prudent fund manager would outperform all others because of the protection which they had taken out.

Because of the significance of maximising superannuation balances to the retirement income framework, there is merit in SAFAA's view in considering whether superannuation prudential requirements should include some minimum mandatory level of capital protection for equities holdings through the use of ETO's or similar to ensure that retirees do not have their balances suddenly decimated by extreme market events. Consideration should be given to extending this requirement not only to industry and retail superannuation funds, but also to self-managed super funds.

The involvement of the securities exchanges and market participants will be needed to develop products that can be tailored to suit different types of portfolios and which can be structured at costs which are affordable.

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CONCLUSION

On a final note, a crucial outcome from the Review should be the settling of a framework that can be agreed upon and then not be changed or tampered with on a regular basis by a government seeking short-term revenue gains. Continual changes disrupt strategies that have been put in place and relied upon for some time, potentially imposing a significant financial detriment.

In the case of those either in or near retirement, there also may not be enough time left to adjust the strategies that were put in place, and this can visit great anxiety on individuals. This is unfair and should be avoided.

SAFAA appreciates the opportunity to provide this input into the Retirement Income Review. We would be happy to assist with further information or elaboration on any of our submissions should this be desired by the Review Panel.

Yours sincerely

Judith Fox
Chief Executive Officer

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