Modelling retirement adequacy

Submission by UniSuper

3 February 2020

About UniSuper

UniSuper is the super fund dedicated to people working in Australia's higher education and research sector. With 450,000 members and $85 billion in net funds under management, we're one of Australia's largest super funds.

UniSuper would welcome the opportunity to discuss the submission further and to provide additional information in respect of the comments made in this submission. Should you have further queries, please contact Benedict Davies on (03) 8831 6670 or benedict.davies@unisuper.com.au

Modelling retirement adequacy

UniSuper has a long history of providing retirement income to members. After all, since 1983, we have been offering salary-based defined benefit pensions for members who joined our Defined Benefit Divisions (DBD) prior to 1998. For those who have joined since 1998, we continue to offer the option of a purchased lifetime pension.

We should point out that our DBD remains open to new members employed in the higher education and research sector, and each year we receive approximately 12,000 new members into the DBD. UniSuper is the named fund in the enterprise agreements across the sector and the DBD remains the default option for permanent employees across the sector. These members also have an option to leave the DBD within the first 24 months and move to our Accumulation 2 option. Those defaulted into the DBD receive 17% employer contributions and these members, along with our Accumulation 2 members, are collectively referred to as 'Permanents'. More recently, many fixed term contractors now receive 17% employer contributions (although they are not eligible to join the DBD). We also have another important group of members who receive the SG rate of employer support. These members are collectively referred to as 'Casuals'.

These important groups of members can be distinguished by their employment arrangements (permanent or casual) which determines the amount of "second pillar" compulsory employer superannuation support they receive (17% or the SG).

Both groups of members have access to an account-based pension and a purchased lifetime pension (called our 'Commercial Rate Indexed Pension') in retirement.

Our adequacy research models the retirement adequacy of each of these groups of members to project a lump sum benefit at retirement and to convert these to annual projected retirement incomes compared against both an absolute measure (ASFA Comfortable Standard) and a relative measure (70% of salary).

Our research shows the different outcomes for each of these groups. While great care needs to be taken in interpreting the results, as members do move from casual to permanent employment, the two distinct membership groups represent what could be thought of as similar to a 'natural experiment' that compares retirement outcomes based on differing contribution rates.

While some of the findings are commercially sensitive, we would be very willing to meet with the Review to take you through our findings in more detail.

Retirement adequacy

In 2015, we commenced work on a Retirement Adequacy Study to model projected lump sum benefits at retirement and to convert these to annual projected retirement incomes for members. We project lump sum benefits at retirement and convert these to retirement incomes and compare the incomes against a number of adequacy measures. The resulting adequacy index is the ratio of the projected retirement income to the adequacy measure.

The index is used as a guide and long-term indicator of fulfilment of our purpose to deliver greater retirement outcomes for members.

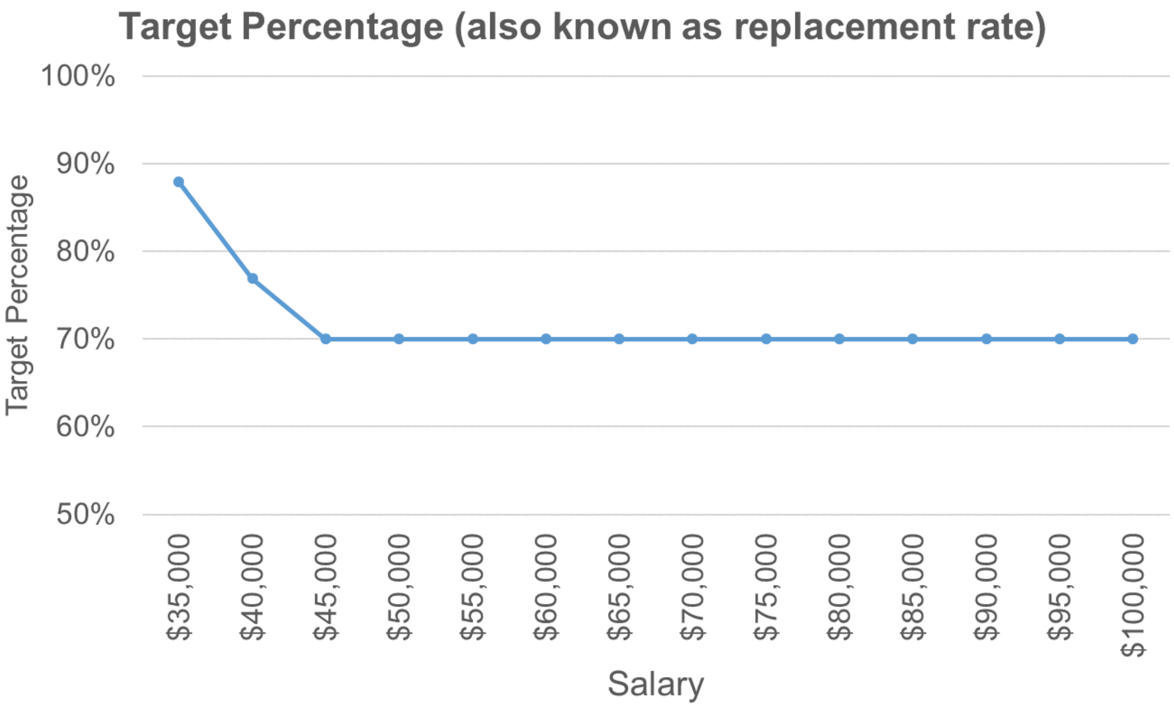
This work has been very valuable and we have integrated it into business planning and by using it as a key measure of member preparedness for retirement.

Methodology

A member's RAI is defined as the ratio of projected retirement income (including the age pension where eligible) to an absolute adequacy measure which is a fixed dollar annual income based on the ASFA Comfortable Target.

Where we hold reliable salary data for those receiving 17% employer contributions, our Defined Benefit and Accumulation 2 members (collectively referred to as 'Permanents', who also generally receive higher salaries), we also calculate an alternative RAI result, based on an alternative personalised salary-based target.

For some members with low salaries, a fixed replacement rate could result in target incomes that may be considered close to poverty level. Therefore, for the purpose of the alternative RAI calculation, we adopt a sliding scale for replacement rates based on salary level – see the chart below. This has the same effect as having a hybrid of absolute and relative measures mentioned in the retirement income review consultation paper, as this sliding scale replacement rate is equivalent to having a target income equal to the greater of 70% of salary and the ASFA Comfortable Target.



Findings

ACCUMULATION 1 MEMBERS – ASFA COMFORTABLE TARGET

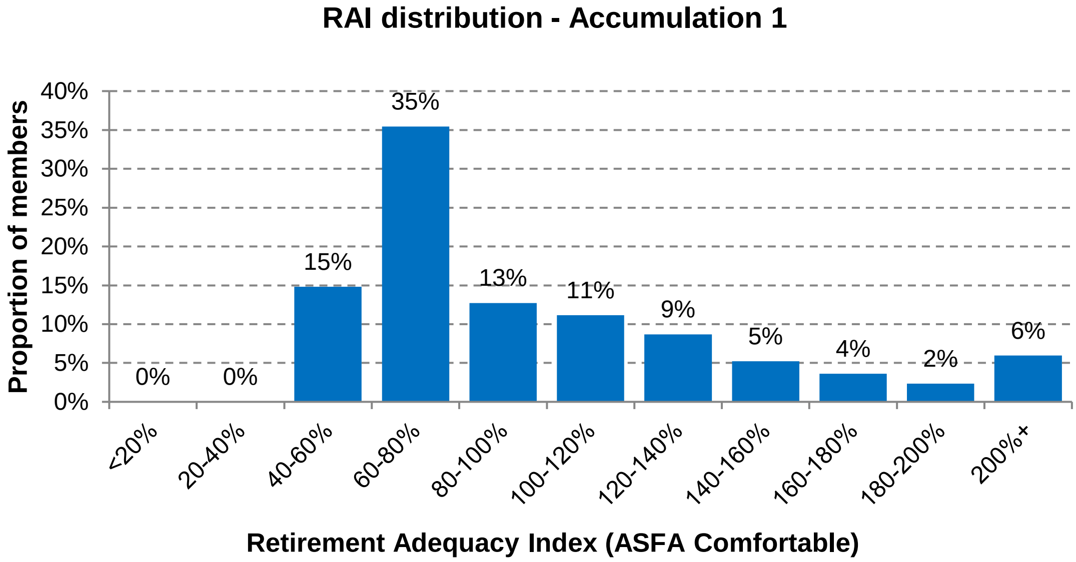
As shown in the table below, based on 30 June 2018 data, 37% of Accumulation 1 members are projected to achieve an income in retirement greater than or equal to the ASFA Comfortable target – a 3% improvement on results from the 2017 Study. The average RAI has increased from 98% to 102%, reflecting increased adequacy for Accumulation 1 members overall.

These results are mainly due to members' projected retirement incomes increasing at a rate (over 3%) greater than the increase (just under 1%) in the ASFA Comfortable Target over the one-year period. Over half of Accumulation 1 members are still projected to receive the full Age Pension, assuming no other assets/income outside superannuation and members are part of a couple. An important assumption is that members own their own home. Changes in rates of home ownership over time are likely to have a material impact on retirement adequacy and we suggest the Review look closely at the importance of rent assistance and social housing as a key part of the broader retirement income system.

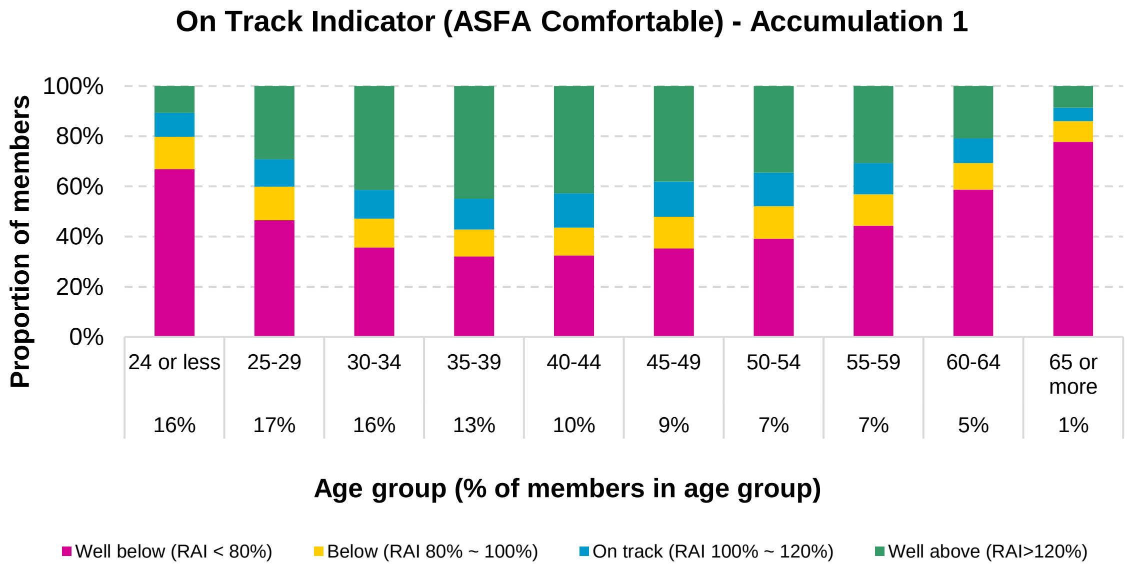
KEY RESULTS	30 June 2018
	Accumulation 1
Number of members	256,259
Average age (years)	40
Average effective salary	$44,200
Average account balance	$69,400
Average projected income in retirement ($)	$30,900
Average RAI	102%
% with RAI > 100%	37%
% of members projected to receive full Age Pension	56%

Distribution of RAI for Accumulation 1 against ASFA Comfortable target

The chart below shows the distribution of RAI for Accumulation 1 members. Approximately 37% of members are projected to achieve a RAI of 100% or more - reflecting a 3% improvement from 30 June 2017. This group is still our most vulnerable, with 63% (66% a year ago) not currently on track to achieve the ASFA Comfortable Target in retirement.



The 'On Track' indicators for Accumulation 1 members by age group show the 'On Track' indicators for Accumulation 1 members by age group. Members aged 30-50 years are most likely to be identified as 'On Track' or 'Well above'- as illustrated in Chart 3 below. Over the one-year period since the last Study, the proportion of members identified as 'On Track' or 'Well above' has increased across all members aged 35 or above. It is important to note that about one-third of Accumulation 1 members are currently not receiving contributions and are assumed to receive no further contributions in the projections.



ALTERNATIVE DBD AND ACCUMULATION 2 RESULTS

Under the alternative benchmark - of which the relative measure is based on a personalised salary-based target - the proportions of DBD and Accumulation 2 members projected to achieve an income in retirement greater than or equal to the salary-based target are broadly in line with the results from the previous year.

As shown in the table below, 22% of the DBD members are projected to achieve at least the salary-based target compared to 51% of Accumulation 2 members.

Key results – Alternative DBD and Accumulation 2 (salary-based target)

KEY RESULTS	30 June 2018	
	DBD	Accumulation 2
Average RAI (Salary-based Target)	79%	105%
% with RAI > 100% (Salary-based Target)	22%	51%

GENDER-BASED RESULTS

On a national level, while women now have increased superannuation benefits, they continue to lag men when it comes to average balances. Analysis from ASFA showed that the average account balance for males in 2015-16 was approximately $111,853, compared to $68,499 for females (39% lower).[1]

The 2018 Financy Women's Index[2] report outlined that, based on the latest data from the Australian Bureau of Statistics, the average superannuation balance for those aged 15 and over was $101,700 for women, compared to $153,000 for men (a 34% gap).

The table below depicts the average balance of UniSuper's Permanents and Accumulation 1 members by gender as at 30 June 2018, as well as the percentage gap between male and female members of each cohort.

Average member account balance by gender – the Fund

Gender-Based Results	Men	Women	Gap
Permanents - Average balance as at 30 June 2018 ($)	$316,100	$224,500	29%
Accumulation 1 - Average balance as at 30 June 2018 ($)	$77,600	$63,200	19%

The average balance of the Fund's Permanents member group is significantly higher than the national average, and the gap between men and women is smaller (29%).

[1] Superannuation account balances by age and gender October 2017 Ross Clare, Director of Research ASFA Research and Resource Centre, https://www.superannuation.asn.au/ArticleDocuments/359/1710_Superannuation_account_balances_by_age_and_gender.pdf.aspx

[2] https://financy.com.au/financy-womens-index/

For Accumulation 1 members, while the average balance is significantly lower than that of the Permanents, the gap between genders is smaller.

Impact on projected retirement balances and income of Age Pension support

Projected retirement outcomes paint a slightly more positive picture, particularly when Age Pension support is included as retirement income, as shown in Charts 9, 10 and 11.

The first table below shows the gender-based results for Permanents. The average projected balance for males at retirement is $1,026,000, compared to $797,500 for females (22% lower than males). In terms of average projected retirement income, the gap (18%) is narrower because of the means-tested age pension.

Permanents	Male	Female	Gap
Average projected balance at retirement ($)	$1,026,000	$797,500	22%
Average income in retirement ($)	$71,400	$58,500	18%

About 32% of Accumulation 1 members are inactive (not receiving employer SG contributions) so the results for Accumulation 1 members are shown separately by contribution status.

Accumulation 1 – Active	Male	Female	Gap
Average projected balance at retirement ($)	$342,000	$266,200	22%
Average income in retirement ($)	$35,600	$31,700	11%

Accumulation 1 – Inactive	Male	Female	Gap
Average projected balance at retirement ($)	$159,900	$133,500	17%
Average income in retirement ($)	$26,500	$25,100	5%

Similar gaps between men and women are observed for Accumulation 1 members in terms of average projected balance at retirement. Again, the gap is narrower in terms of average projected retirement income because of the Age Pension.

The gap is even smaller for inactive members because most are projected to receive a full Age Pension, which is assumed to be the main source of retirement income for these inactive members.

Observations based on sensitivity analysis

The model used relies on assumptions and is indicative of future retirement income adequacy. The sensitivity of retirement adequacy results to changes in different assumptions can give further insight into the factors that could potentially impact members' retirement adequacy levels. The sensitivity analysis illustrates the impact on retirement income adequacy in the event of:

- Pension drawdown rates being higher or lower
- Investment returns being lower
- Life expectancy being longer
- Insurance premiums being higher.

The adequacy results are lower under alternative drawdown scenarios

The base case of the study assumes that members draw down from the account-based pension such that the account balance is fully extinguished at life expectancy and no bequest is left. This assumption was adopted as it is consistent with the view that retirement savings should ensure individuals have sufficient resources for consumption in retirement and should not be used to provide inheritances. This assumption is also consistent with the underlying assumptions of intra-statement projections prescribed by ASIC.

However, this assumption is not entirely consistent with the behaviour of current retirees, many of whom do not draw down on much of their savings in retirement. Hence, it is appropriate to re-calculate the results using minimum drawdown rates.

Under the legislated minimum drawdown rates (consistent with the drawdown behaviour observed among 50% of Flexi Pension members), the average RAI for Accumulation 1 members reduces from 102% to 85% and the average RAI for Permanents reduces from 211% to 154%. This demonstrates that the adequacy results are very sensitive to drawdown rates which can in turn be influenced by default drawdown options and other external factors.

As a separate piece of work, we have modelled higher minimum withdrawals from account-based pensions (1% or 2% higher) and have found slightly higher withdrawal rates to be sustainable (i.e. members do not run out of money) from a member's perspective. We suggest the Review further investigate sustainability using Treasury's MARIA model to analyse impacts on Age Pension, the earnings tax concession and the Senior Australian Pensioner Tax Offset (SAPTO).

Lower investment return and longer life expectancy both reduce the adequacy level

The average RAI for Accumulation 1 members reduces from 102% to 92% and the average RAI for Permanents reduces from 211% to 186% if the assumed long-term real investment return were to decrease by 1% per annum. Similar impacts were observed when the assumed life expectancy increases from age 89 to age 94 for a 67-year-old retiree.

The insurance premium increases effective from 1 July 2019 have minimal impact on retirement adequacy

UniSuper has recently re-run the model to estimate the impact on retirement income adequacy levels due to insurance premium increases that became effective from 1 July 2019, because the increases were not allowed for in the base case of the most recent Study. The analysis indicates that the impact on retirement adequacy is minimal for Accumulation 1 and DBD members. It is estimated that only about 40% of Accumulation 1 members and 50% of DBD members have any external insurance cover (and even fewer have income protection cover). The impact is slightly more pronounced for Accumulation 2 members due to higher level of cover than for Accumulation 1 members. Nonetheless, the impact remains minor, reducing the average RAI of Accumulation 2 members by only 1.4%.

The importance of modelling retirement adequacy

We believe it is important for funds to model their members' retirement adequacy and we plan to continue to use our model for a number of important purposes, including:

- Examining member retirement adequacy over time
- Measuring the impact of additional engagement campaigns to support vulnerable groups of members, including Accumulation 1 and older members, over time
- Quantifying the impact on member retirement adequacy of potential product and legislative changes. Examples include the impact of fees, default insurance, any changes in the means-testing of the Age Pension and any potential change in default drawdown options
- Identifying the demographics and wealth profile of the Fund's future retirees

We are also in the process of further refining/incorporating the study into the Business Performance Review / Cohort Analysis as part of the SPS 515 framework as a forward-looking way to assess member outcomes.

Towards an income maintenance objective

The underlying philosophy of a system with contributions related directly to income is to move over time from the basic poverty alleviation objective of the present retirement income provision system, with most retirees depending on the means tested age pension, towards an income maintenance objective.

But is the ultimate objective a 50 per cent replacement of pre-retirement income? Or 70 per cent as in a number of European countries?

FitzGerald Report (1993)[3]

In 1993, the National Saving report to the Treasurer noted, under the heading "The Full potential of superannuation: issues to resolve", that we should move to an income maintenance objective.

We support such an approach, noting that our retirement adequacy research uses an explicit retirement income objective for our DBD and Accumulation 2 members. While research suggest that income maintenance rates can vary by income, say, between 50% for the highest income earners to 70% for those on middling and lower incomes, we strongly believe in the importance of such rates. Ultimately, we believe that the way to deliver greater retirement outcomes to our members is to ensure that as many members as possible are able to maintain their standard of living in retirement.

We strongly encourage the Review to closely examine the evidence-base for an income maintenance objective based, partly, on the findings of superannuation funds' own research.

[3] FitzGerald VW (1993), 'National Saving: A Report to the Treasurer'

UniSuper's view is that the default 17% employer contribution rate is (knowing the power of default, behavioural biases, etc) the best way to ensure that its membership base has the best chance of achieving a high level of adequacy in retirement based on a relative measure (i.e. salary-based).

It should be recognised that SG is relevant as a compulsory minimum level of retirement saving implemented at the national level and should not be used as an ideal rate that is applicable or appropriate for UniSuper members.