

29 April 2016

Superannuation Productivity Commission  
Locked Bag 2, Collins St East  
Melbourne VIC 8003

Email: [alex.maevsky@pc.gov.au](mailto:alex.maevsky@pc.gov.au)

Dear Alex,

### **Superannuation efficiency and competitiveness - Productivity Commission review**

Thank you for meeting with representatives of the Actuaries Institute on 31 March 2016 to brief us on the matters being canvassed via the Issues Paper dated March 2016.

At the meeting, we noted that the Actuaries Institute has issued several relevant documents over the last few years, some directly commenting on the matters being raised in the Issues paper, and others mentioned in passing. We undertook to provide you with copies of the relevant material.

We have enclosed all of the relevant documents, and a summary list follows below. Later on in this letter, we provide a reference matrix summarising the documents which we believe are most relevant to each of the questions and sub-questions raised in the Issues paper. We would be happy to explain our views in more detail, if required.

In general, we note that the matters raised by the Issues Paper are extremely wide-ranging, and many would be difficult to address in more than a superficial way within the available timeframe. Accordingly, we expect that the best use of our resources will be to focus on issues where we have previously provided information, or where you have specifically asked for our assistance.

### **Supplementary questions for the Actuaries Institute**

At the meeting, you undertook to provide some guidance as to the areas where you specifically seek guidance from the Actuaries Institute. We note that a list of supplementary questions was provided to us by email from Alex Maevsky dated 7 April 2016.

Thank you for this additional detail. We will review the questions and provide our response as soon as possible.



## List of enclosed material

The following table summarises the material that we have enclosed.

Reference	Title	Dated
2012.04	Response to Default Superannuation Funds in Modern Awards Paper	13 April 2012
2012.08	Response to Default Superannuation Funds in Modern Awards Draft Report	1 August 2012
2014.02	Submission on the Government's Discussion paper – Better regulation and governance, enhanced transparency and improved competition in superannuation	12 February 2014
2014.03	Submission to the Financial System Inquiry"	30 March 2014
2014.08	FSI Interim report – Actuaries Institute Submission	25 August 2014
2014.12	Superannuation Fund Disclosure	12 December 2014
2015.10	Product Dashboards	8 October 2010
2016.01	Product Dashboard Comparison Metric	28 January 2016
2016.03	Indirect Costs and Product Dashboards	1 March 2016
2016.04	Objectives of Superannuation	6 April 2016

## Responses to specific questions

The following table summarises how the enclosed material relates to each of the questions raised in the Issues Paper. For ease of reference, we have numbered the questions.

Question Category	ID	Question	Relevant AI material
SYSTEM EFFICIENCY OBJECTIVES	1a.	Within the current policy settings, what are the objectives against which the efficiency and competitiveness of the superannuation system should be assessed? How prescriptively should the objectives be expressed?	2016.04 2014.03
COMMISSION'S APPROACH TO ASSESSMENT	2a.	Do you agree with the broad approach of combining performance benchmarks with a test of barriers to efficient or competitive outcomes in the superannuation system?	2014.02 2012.04 2012.08
	2b.	How should the unique features of the superannuation system (identified in section 2) be taken into account in developing criteria and indicators for assessing its competitiveness and efficiency? Are there other possible approaches?	2014.03 2014.08



	2c.	To what extent do different data reporting formats make it difficult to compare SMSFs and APRA-regulated funds, and hence to assess the performance of the superannuation system as a whole?	2014.08
	2d.	Which of the existing cross-country composite measures of pension system performance would be most relevant to this study and why? What are the challenges in using those measures to assess the efficiency and competitiveness of Australia's superannuation system? What measures and criteria are comparable across different countries?	Not specifically addressed
	2e.	Which of the existing composite measures of Australian superannuation fund and/or product performance would be relevant to this study and why?	Not specifically addressed
THE ROLE OF COMPETITION IN SUPERANNUATION	3a.	What are the key ways in which competition can improve efficiency in the superannuation system?	2014.08
	3b.	Is there sufficient emphasis on competition in the regulation of superannuation?	Not specifically addressed
	3c.	Are there any current circumstances where competition is not delivering efficient outcomes and why?	2014.08
	3d.	What are the key sources of economies of scale? What are the ways of realising economies of scale, in addition to fund mergers? Are there any parts of the system that may be operating with diseconomies of scale? What are the best indicators for measuring the current realisation of scale economies, and the scope for future increases?	Not specifically addressed
ASSESSING COMPETITION IN THE SUPERANNUATION SYSTEM: Market definition	4a.	For each of the levels in the vertical supply chain (figure 3), who are the relevant consumers, and which market participants within or outside of the superannuation system are the most likely source of competitive pressure?	Not specifically addressed
	4b.	For each of the levels in the vertical supply chain, is there evidence of competition on factors other than price, and if so what are they (for example, performance, investment options, any additional features)? What drives this choice?	Not specifically addressed



	4c.	On what factors and features do default funds compete in corporate tenders? What factors are relevant for the assessment and selection of platform service providers by funds?	2012.04 2012.08 2014.02
	4d.	What is the degree of substitutability between different types of superannuation funds and products? How can this be evaluated or measured?	2014.02
	4e.	What is the relative contribution to member fees from the various participants through the vertical value chain?	Not specifically addressed
<b>ASSESSING COMPETITION IN THE SUPERANNUATION SYSTEM: Criteria and indicators</b>	5a.	What are the most reliable and relevant assessment criteria and indicators for measuring the competitiveness of the superannuation system?	Not specifically addressed
	5b.	What are the barriers to efficiency-enhancing competition in the superannuation system? In particular, what are the policy impediments to competition? How can the impacts of these barriers be measured?	2014.08 2014.02
	5c.	How would you measure the effectiveness of regulation in promoting competition within the superannuation system?	Not specifically addressed
	5d.	How would you measure the extent of competitive pressure from the SMSF segment on the rest of the superannuation system?	Not specifically addressed
	5e.	Can levels of transparency on aspects such as conflicts of interest and details of reporting to members (for example, as income stream equivalents) be used as a measure of competition?	Not specifically addressed
<b>ASSESSING OPERATIONAL EFFICIENCY OF THE SYSTEM</b>	6a.	Do you agree with the proposed objectives for operational efficiency? If not, what should they be?	Not specifically addressed
<b>ASSESSING OPERATIONAL EFFICIENCY OF THE SYSTEM: Benchmarking</b>	7a.	What are the most reliable and relevant assessment criteria and indicators for benchmarking operational efficiency of the superannuation system? What are the evidence requirements and current gaps in using your proposed criteria and indicators?	Not specifically addressed



	7b.	What are the appropriate benchmarks against which the operational efficiency of Australia's superannuation system should be measured? Are there countries that have superannuation systems that could provide an appropriate benchmark?	Not specifically addressed
	7c.	What types of fees are relevant to assessing the competitiveness and efficiency of the superannuation system? How should these fees be measured? What data sources are available and to what extent are these comparable with one another?	2014.12 2016.01 2014.02 2015.10 2016.03
	7d.	What are the best measure(s) of (post-fee) risk adjusted rates of return? How comparable are these measures?	2015.10 2016.03
	7e.	What aspects of operational efficiency cannot be reliably measured using a benchmarking approach? How could this assessment incorporate aspects such as service quality?	2014.02
	7f.	What are the advantages and disadvantages of using techniques such as data envelopment analysis over conventional approaches such as simple benchmarking of a single criterion?	Not specifically addressed
ASSESSING OPERATIONAL EFFICIENCY OF THE SYSTEM: Barriers to operational efficiency	8a.	What elements of regulation have the greatest effect on the operational efficiency of the system and which aspects of operations are affected? How could those impacts be measured?	Not specifically addressed
ASSESSING ALLOCATIVE EFFICIENCY	9a.	Do you agree with the proposed objectives for allocative efficiency? If not, what should they be?	Not specifically addressed
ASSESSING ALLOCATIVE EFFICIENCY: Benchmarking	10a.	What are the advantages and disadvantages of using benchmarking to assess the allocative efficiency of the superannuation system? Which aspects of the system most lend themselves to such assessment?	Not specifically addressed
	10b.	Which criteria and measures are most relevant to assessing the allocative efficiency of the system, and how should they be interpreted? What are the evidence requirements and current gaps in using your proposed criteria and indicators?	Not specifically addressed



ASSESSING ALLOCATIVE EFFICIENCY: Barriers to allocative efficiency	11a.	How can the magnitude and cost of principal-agent problems be assessed?	Not specifically addressed
	11b.	Should the criteria and indicators for assessing the extent and magnitude of principal-agent and governance problems focus on outcomes or inputs and process, such as best practice governance principles, or a combination of both? What existing measures of governance could the Commission draw on, and what are their strengths and weaknesses?	Not specifically addressed
	11c.	What are the most important behavioural biases and cognitive constraints affecting the key superannuation saving, investment and withdrawal decisions of users? What are the best assessment criteria and indicators for examining the magnitude and effect of those biases and constraints? What are the key gaps in the evidence to enable such assessment?	Not specifically addressed
	11d.	What are the best assessment criteria and indicators for examining the extent to which the outcomes for users are optimal with respect to the current taxation settings?	Not specifically addressed
ASSESSING DYNAMIC EFFICIENCY	12a.	Do you agree with the proposed objectives for dynamic efficiency? If not, what should they be?	Not specifically addressed
ASSESSING DYNAMIC EFFICIENCY: Benchmarking	13a.	What are the most reliable and relevant assessment criteria and indicators for measuring the dynamic efficiency of the superannuation system? What are the evidence requirements and current gaps in using your proposed criteria and indicators?	Not specifically addressed
ASSESSING DYNAMIC EFFICIENCY: Barriers to dynamic efficiency	14a.	What are the key impediments to dynamic efficiency and how could they be measured?	Not specifically addressed



As indicated earlier, we will respond separately to the supplementary questions raised by Alex Maevsky. At the same time, we may provide specific response to the questions above that have not already been addressed in our previous submissions or other relevant material. If time permits, we may also expand on some of the other questions.

Yours sincerely

Andrew Boal  
Convenor, Superannuation Practice Committee

13 April 2012

Default Superannuation Funds in Modern Awards  
Productivity Commission  
LB2 Collins Street East  
MELBOURNE VIC 8003

By email to: [default.super@pc.gov.au](mailto:default.super@pc.gov.au)

Dear Sir/Madam

### **Response to Default Superannuation Funds in Modern Awards Issues Paper**

The Actuaries Institute ("the Institute") is the sole professional body for actuaries in Australia, providing independent, expert and ethical comment on public policy issues where there is uncertainty of future financial outcomes. It represents the interests of over 3,800 members, including more than 2,000 actuaries.

Some of the principles that guide the Institute's inputs into public policy are:

- Acceptance of public sector involvement where the market does not meet societal needs,
- The need to take a long term policy view, with appropriate transitional arrangements,
- Ensuring that consequences of risk taking behaviour are borne by the risk taker,
- Issues of intergenerational equity, and
- Clear and reliable information available for decision-making.

We refer to your Issues Paper dated February 2012 and thank you for the opportunity to provide our comments on some of the particular issues you have raised.

### **Selection Criteria**

Paragraph 3 of the Issues Paper addresses the crucial issue of whether or not it is sufficient for a superannuation fund to simply meet the requirements of the proposed MySuper standards in order to be eligible to be included as a default fund in an Award, or whether additional criteria are necessary.

Since the introduction of the Superannuation Guarantee (SG) in 1992, actuaries have regularly assisted employers in selecting a suitable default fund for receipt of SG contributions when their employees do not exercise their right to direct contributions to a different fund of their choice.

Often the selection process will go to a formal market tender with submissions requested from several possible funds. There are generally two main criteria involved in the selection process:

- a. What is an adequate set of standards for a fund to qualify as a possible default fund?
- b. What criteria should be used to evaluate the qualifying funds?

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*Applying this process to the question raised in the Issues Paper, we believe that the MySuper standards should be adequate to determine whether a fund should be able to qualify as a default fund in an Award. If they are not considered adequate, then it would be preferable to strengthen the MySuper standards in an appropriate way rather than adding an extra set of criteria for qualification as a default fund.*

In relation to what criteria could be used to evaluate the qualifying funds in the process of selecting a default fund under an Award or an individual enterprise agreement, we have provided an outline of the issues that would normally be considered in the Appendix to this letter.

Importantly, many of these issues require qualitative judgements and, as a result, we do not believe that the selection process can therefore be reduced to a mechanical sequence of decisions that could be codified. Consequently, it would therefore be preferable to simply codify the factors that should be considered.

Of course, a key objective of the selection process should be to ensure that the default fund selected for an Award or agreement is appropriate for the needs of the employees under that Award or agreement. It should also be incumbent on those who determine the default fund to demonstrate that a suitable process has been followed.

*There is a reasonable argument that with the advent of MySuper it should be unnecessary for awards and agreements to contain a limited list of eligible funds (i.e. any MySuper product should be a suitable default and can therefore be chosen by an employer). However, if it is determined that awards and agreements should continue to contain a limited list of eligible funds, then we would support a regulatory framework that codified the matters that should be taken into account as part of the process for selecting a default fund in an Award or agreement.*

*This framework should also be applied when a new fund is added to the list of eligible default funds in an Award or agreement, as well as any periodic review of the list of eligible default funds.*

*The limited list of funds contained in an Award or agreement could be either exclusive or non-exclusive. If it is non-exclusive, an employer could choose a fund outside the list but, in that situation, the employer should be required to follow the regulatory framework.*

### Specific Issues

The Issues Paper identifies two areas in which quantitative analysis is required. The Institute believes that care needs to be exercised when drawing conclusions from this analysis. Our comments on each of the questions raised in the Issues Paper are set out below.

#### 1. Fund Expertise and Performance

*Should a fund's investment management expertise be factored into the selection of default superannuation funds for inclusion in Awards, and if so, how?*

The long term investment return achieved by a default fund is one of the most important factors in determining the final benefits available to a member on their retirement. Therefore it is vital that a fund that is to be included in an Award has appropriate investment capabilities. The major factors that would be considered in determining that these capabilities are adequate are the quality and quantity of the investment management staff

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(taking into account their expertise and experience), the quality of the investment process used by the team, and the success of the team measured, in part, by past performance.

*How relevant is a fund's past net performance as an indicator of its potential future performance? What weight, if any, should be placed on the past performance of a fund in assessing its suitability for inclusion as a default fund in Awards?*

Past investment performance (net of investment fees and costs and investment taxes) is one of the many factors that should be considered when assessing the investment capabilities of a fund. However, the absolute level of past investment performance provides little, if any, guide to the absolute level of future investment performance, particularly when this is considered over relatively short periods of time.

Consideration of past investment performance against past index performance and, to a lesser extent, the past performance of other comparable funds, may provide some indication of the relative performance that might be expected in the future.

*If past performance is considered important in assessing a fund's suitability for inclusion as a default fund in Awards*

- *Over what time period should past net performance be assessed?*
- *How should funds with no net performance record (for instance, newly merged funds or new entrants to the market) be assessed?*
- *Should net performance be assessed in absolute or relative terms? That is, should the top performing funds be selected (regardless of their absolute returns), or would funds be required to meet a particular target level of performance?*

Past investment performance should be calculated according to the following criteria:

1. For comparison purposes, investment returns should be calculated for all funds for periods ending on 30 June. This will ensure that comparative returns will not be distorted by market movements varying during different time periods.
2. Investment returns should be net of investment fees and costs and investment taxes. Only investment related fees/costs/taxes should be allowed for in the calculation to avoid distortions resulting from allowing other fees/costs/taxes.
3. If possible, investment returns should be determined for three contiguous periods of four years; a total of 12 years. The use of separate contiguous periods is aimed at reducing the scope for trends in relative performance to be distorted by the performance in recent years.

As indicated above, consideration of past investment performance against past index performance and, to a lesser extent, the past performance of other comparable funds, may provide some indication of the relative performance that might be expected in the future.

Further, the imposition of a target level of investment performance would likely constrain the level of risk that a fund would then be prepared to accept, which would potentially lead to lower investment returns over the long term.



## 2. Fees

*Should fees be factored into the selection of default superannuation funds for inclusion in Awards and if so, how? For instance, are there circumstances in which paying higher fees could serve the interests of members of default funds? Does this differ across industries? Should maximum fees be set for funds that are selected for inclusion as default funds in Awards?*

Fees and costs need to be one of the factors considered when choosing a default fund in an Award or agreement. However, it is vital that both fees (those paid directly by members) and costs (fees that are effectively paid by members indirectly) are considered, and that fees and costs for administration services be considered separately from investment fees and costs for investment services.

With respect to investment fees and costs, the analysis of investment performance net of these fees and costs is an appropriate way to consider the impact of these fees and costs. With respect to administration fees and costs, there are a number of issues that need to be considered, including:

- a) A comparison of administration fees and costs must consider the impact of these on the final benefit payable to members and to take into account different contribution levels and different durations of membership.
- b) The fees and costs should be reported gross of "tax benefits", but the comparison of the impact of fees and costs should take into account the impact of tax.
- c) The level, extent and quality of the services provided by a fund should also be taken into account when comparing administration fees and costs.

In the past two years the Institute has made a number of submissions to Treasury, APRA and ASIC that relate to fees, costs, investment performance and MySuper. We would be happy to provide further information about these. Importantly, we do not believe that it is necessary to impose a maximum level on fees as transparent disclosure and competition amongst MySuper funds should ensure that administration fee and cost levels will be reasonable.

### Employers Choosing Between Default Funds in an Award

Whilst ideally employers would follow a similar process in deciding between default funds available in an Award or agreement, this could impose a large administrative burden that seems counter intuitive to the concept that MySuper funds are regarded as appropriate default funds for employees outside Awards. Therefore, an employer should be able to meet an Award requirement by choosing any fund on the default fund list in that Award or agreement without being required to demonstrate how they made that decision or the process for doing so.



Please do not hesitate to contact either Melinda Howes, Chief Executive of the Actuaries Institute or Andrew Boal, Convenor of the Actuaries Institute's Superannuation Practice Committee in this regard, or for any further information.

Yours faithfully

David Goodsall  
President



## Appendix

In the process of selecting a default fund under an Award or an individual enterprise agreement, qualifying funds could be evaluated with reference to:

1. Organisational expertise and strength.
2. Investment menu, investment management staff and expertise, experience, process and performance and investment risks.
3. Insurance benefits, terms, premiums, administration and claims history.
4. Fees and costs charged to members together with additional information on whether fees are gross or net of tax deductions to members and whether they include performance fees. Also, details of any other costs such as consulting fees and the cost of member protection. Also details of crediting rate/unit-pricing and reserve methodologies and information about transaction fees such as buy/sell spreads.
5. Details of administration and contact centre staff and experience, details of processes, systems, service standards, electronic processing capabilities, contact centre hours, internet facilities.
6. Details of employer-specific services that may be provided such as the provision of information and ability to tailor services or materials.
7. Details of member services, communication and education.
8. Details of financial planning services.

As indicated in the Issues Paper, assessing funds against a given set of selection criteria does not necessarily provide a clear 'winner'. The assessment of some criteria is qualitative and the judgement of the relative weights to be given to different criterion is subjective and, importantly, will differ for each circumstance. For example, the fee structure for fund A might favour members with low account balances while the fee structure for fund B might favour members with high account balances. However across all members the judgement might be that funds A and B are "equivalent".



1 August 2012

Default Superannuation Funds in Modern Awards  
Productivity Commission  
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By Email: [default.super@pc.gov.au](mailto:default.super@pc.gov.au)

Dear Sir/Madam

### **Response to Default Superannuation Funds in Modern Awards Draft Report**

The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of over 3,800 members, including more than 2,000 actuaries.

On 13 April 2012, the Institute wrote to the Productivity Commission in relation to the Default Superannuation Funds in Modern Awards Issues Paper. We wish to take this opportunity to make some additional comments on one of the issues raised in the June 2012 Draft Report.

#### **Management Expense Ratio**

Section 4.3 of the Draft Report refers to the use of a "management expense ratio (MER)" to compare the costs of superannuation funds. The MER expresses the investment and operating expenses of a fund as a percentage of the fund's net asset value.

We note that the Commission has identified deficiencies with the MER which the Draft Report expresses as follows:

"The MER may not allow a uniform comparison across all funds (Finch 2005), and it will underestimate operating and investment expenses where embedded fees are incurred."

The Institute agrees and also considers that there are a number of other deficiencies with the MER which makes it unsuitable to use in comparing fund costs, including:

1. The MER mixes investment and administration costs. We have previously submitted to Treasury, APRA and ASIC that these costs must be considered separately for a valid comparison. The extent and effectiveness of the investment and operational (or 'administration') services and the associated fees and costs should be considered separately to ensure that a meaningful comparison is achieved. We attach as Appendix A (3 pages), an extract from our submission to the Cooper Review, which summarises the reasons for this conclusion.
2. If the MER approach is used to compare (only) administration costs, expressing these costs as a percentage of the value of fund assets is still unsound. Expressing administration costs as dollars per member would be an improvement because most direct administration fees are currently expressed this way, and a significant part of ongoing administration expenses varies with changes in membership numbers.

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3. The Commission makes it clear that the assessment of a fund should be from the perspective of what is in the best interests of the members. Therefore, the administration costs should only include costs which impact on members' benefits. Hence if an employer is paying all or some of the administration costs then the costs payable by the employer should not be included in the calculation. From an employer perspective, it is appropriate to consider all administration expenses.

To illustrate point 2 above, consider this simplified example.

Assume two funds have an administration fee of \$1.50 per member per week and no other administration costs which directly or indirectly impact on members' benefits. Unless there is a difference in service levels, administration costs should not affect the choice between these two funds.

The following table shows how the ratio of administration costs to assets might vary in a particular year for members with different past membership periods.

Past Membership	Average Account Balance (\$)	Administration Fee Charged (\$)	MER(%)
1 year	2,250	78	3.47
2 years	6,863	78	1.14
3 years	11,706	78	0.67
4 years	16,791	78	0.46
5 years	22,130	78	0.35
6 years	27,737	78	0.28
7 years	33,624	78	0.23
8 years	39,805	78	0.20
9 years	46,295	78	0.17
10 years	53,110	78	0.15

Assume one fund has 20% of members with one year of membership, 60% with 5 years and 20% with 10 years, its MER would be 0.32. Assume the other fund has 30% of members with one year of membership and 70% with 5 years, its MER would be 0.48.

The MER approach suggests that the first fund has lower administration costs even though the funds' administration fees charged to individual members are identical. If dollar cost per member was used instead, this would give the correct conclusion (in these circumstances).

Section 4.3 of the Draft Report points out that: "The average MER of default superannuation funds has consistently trended below that of all superannuation funds (figure 4.2)". The above example demonstrates that this may not be due to lower administration costs. It may merely indicate that default funds, whose members would probably have greater periods of past membership, have higher account balances than non-default funds and hence lower MERs. Whether or not this is actually the case would of course require deeper analysis.



The comparison of administration expenses and their impact on members on a sound basis is not easy. The Institute has previously submitted an alternative approach to various enquiries, including the Cooper Review. This alternative approach uses projections prepared by funds on a specified basis illustrating the effect on benefits for say 5 membership periods, which would be included in Product Disclosure Statements. We attach, in Appendix B (5 pages), a further extract from our submission to the Cooper Review which explains this approach. We also attach, in Appendix C (4 pages), a letter we sent to APRA on 13 December 2011 about the form in which useful statistics on administration fee and costs could be collected and published.

### Our Recommendation

Having regard to our comments above we recommend the following:

1. Only fees and costs that impact on members' benefits should be considered.
2. The MER approach discussed in the Productivity Commission's Draft Report should not be used in the assessment of fees and costs.
3. The fees and costs associated with investments and the fund's operation should be considered separately.
4. Draft Recommendation 4.3 should be reworded as follows:

"The selection and ongoing assessment of superannuation funds for listing as default funds in modern awards should include consideration of the following:

- The appropriateness of the investment fees and costs charged by the MySuper product, given its stated investment return objective and risk profile; and
- The appropriateness of the operating fees and costs charged to members by the MySuper product given the services provided and the quality and timeliness of those services."

Please contact either Melinda Howes, Chief Executive of the Actuaries Institute  
or Andrew Boal, Convenor of the  
Actuaries Institute's Superannuation Practice Committee  
if you would like to discuss our comments, or for any  
further information.

Yours faithfully

David Goodsall  
**President**

Encls: Extract from Institute of Actuaries letter to Super System Review dated 18 November 2009  
Standardised Disclosure of Fees and Costs - the Way Forward  
Letter to APRA re Annual Statistics for MySuper Products dated 13 December 2011



Extract from Letter to Super System Review dated 18 November 2009

**REASONS FOR SEPARATING FEES AND COSTS  
INTO INVESTMENT AND NON-INVESTMENT COMPONENTS**

***[Five fruit or two apples and three oranges ?]***

The Institute's first recommendation is:

*All superannuation fund expenses and superannuation fees and costs which impact on members' benefits should be subdivided into an "investment" component and an "administration" component for all purposes.*

Without this it is not possible to give members and prospective members a sound basis for comparing the costs of two or more superannuation funds. To do this effectively, members need to know and consider:

- (1) The fund administration fees and costs (and the services provided for those fees and costs), and
- (2) The investment fees and costs (and the expected net investment returns) in respect of all the various investment options.

Administration fees and costs and investment fees and costs have different attributes which make it necessary to demonstrate their effect on members in different ways. This can only be done if the fees and costs are subdivided into administration and investment components. The most relevant attributes making subdivision essential are as follows:

**ATTRIBUTES OF ADMINISTRATION FEES AND COSTS**

1. Administration costs incurred by a fund are usually higher in the year the member is enrolled in the fund (marketing cost may also be significant) and in the year the member receives or commences to receive a benefit. In the intervening years servicing costs are lower and are often not expected to vary much from year to year. Funds seeking to allocate costs between members on an equitable basis reflect this pattern in the way fees and costs are deducted from member accounts. The costs to be met by a member should therefore be measured over the period of membership. As that period is not known in advance, figures for comparison between funds need to be provided for a number of membership periods - five periods are used in the recommended basis submitted.

2. Administration costs often vary according to the level of contribution (and/or the size of account balances) so that costs for more than one contribution level need to be provided for comparison of funds - two contribution levels are used, in the recommended basis submitted.

3. In addition to the above variations in administration costs, the general level of a fund's administration fees and costs can vary from year to year e.g. in the year a major upgrade of the fund's computer administration system is necessary. For a fund operated by an institution the costs charged to members from year to year may be relatively stable as the institution may absorb the fluctuations over a period and make less frequent revisions to the fees payable to the institution by the fund. For a mutual fund, such as the typical industry or corporate fund, the fee may be relatively stable where administration is outsourced. The service provider may absorb the fluctuations over a period. However for a mutual fund handling all or most administration in-house, the costs can vary significantly from year to year. As the fees deducted from members' accounts in any year will differ from the actual costs in that year the difference is typically deducted from or added to investment income for that year. This is disclosed as a positive or negative "percentage of assets" administration fee or cost and may be averaged over say two or three years. (Other funds address this problem by putting administration fees deducted from member accounts into an account and paying administration expenses from that account. If the amount in the account is not sufficient, administration fees have to be increased. The current balance in the account may be disclosed in the PDS.)

#### **ATTRIBUTES OF INVESTMENT FEES AND COSTS**

1. Investment costs vary significantly (and reasonably) for different types of investment, typically being higher for growth investments such as shares and property. Accordingly costs must be disclosed separately for each investment option offered by the fund. For a master trust or similar offering a choice of investment manager as well as a choice of investment types, the number of options can be very large.

2. Investment costs for a particular investment type or option are not expected to vary much from year to year as a percentage of assets (except for performance fees). Accordingly it is usually sufficient to provide fees and costs for a single year for a valid comparison of funds.

Some have suggested it would be easier for members if the level of investment and administration fees and costs could be illustrated using one combined figure for the fund. This would be done by using only the investment cost for one investment option being that for a "balanced investment option". First this would not overcome the need for separate administration costs for different membership periods and different contribution levels. Secondly there is no such thing as a standard "balanced investment option". Some might include the same proportion of share investments but use different proportions of Australian and International shares. Some include infrastructure assets while others do not. Some might include a higher level of passive investments in the example used in the PDS and reduce or even exclude any active investments from the example. Some funds do not even have an investment option which could be regarded as a balanced investment option. Two funds could have the same basic fees and costs for their administration but the figures in the PDS could be very different because of the asset-mix used to calculate the cost for the "balanced option". While it would be simple to have just one figure it could be misleading and therefore may lead to the selection of a fund that does not best meet a person's requirements.

Cost is not the only factor to be taken into account in selecting a fund. Different people want a different range of administration services. A person in stable employment and not close to retirement may only need basic administration services. A person who changes jobs frequently or is self employed or retired may have very different requirements. Likewise some want access to a wider range of product features (such as contribution, insurance, disablement and pension alternatives) and investment choices.

Having separate figures for administration and investment costs is not only more accurate for comparison purposes but makes it easier to select a fund providing the administration services required and the desired range of investment options.

The basis for disclosure submitted makes it easier for members and prospective members, not by compromising on the validity of the fund comparison but by using two simple tables, one for administration and one for investment. Also, where the administration element has more than one fee and cost component, the third step of the suggested disclosure regime avoids the need for the person to understand how each administration fee or cost component is calculated. It is the aggregate effect of these components as shown in the table which the person needs to know.

A beneficial consequence of the separation of fees and costs into “investment” and “administration” is that the unnecessary and confusing terms “management costs” and “other management costs”, which are currently specified in Corporations Regulations, can be dispensed with.

Splitting the fees and costs is consistent with the definition of “net earnings” in Corporations Regulation 7.9.01. Also, in the United States new legislation was recently passed which requires 401k plans to separate their fees into administration and investment management components. Our recommendations are consistent with overseas developments.

We believe that separation of administration fees and costs from investment fees and costs is not difficult. Trustees will usually know the investment component of fees and costs, or can make a reasonable estimate. In practice, we believe that many trustees will already be regularly making a subdivision of these costs as part of normal internal supervision of the costs of operating the fund. Guidelines could be issued to clarify some details and achieve consistency.

## Standardised Disclosure of Fees and Costs - the Way Forward

[Updated November 2009]

The first version of this note was published in the August 2003 edition of *Actuary Australia*, the monthly magazine of the Institute of Actuaries of Australia. To take into account refinements suggested by various industry participants an updated version was published in the May 2004 edition of that magazine and another was included in our April 2007 submission to the Parliamentary Joint Committee on Corporations and Financial Services. For this November 2009 update we have incorporated some changes resulting from the work of the Institute of Actuaries Benefit Projections Working Group (of which Colin Grenfell and Ray Stevens are members) for its submissions to ASIC on benefit projections.

To help consumers compare different superannuation plans and products requires some standardisation in the way that fees, charges and costs are disclosed in Product Disclosure Statements (or PDS's). In fact, the same can be said of any product with an investment component, such as a managed fund or a life office or friendly society investment-linked policy or bond.

Just over ten years ago, Colin Grenfell wrote an article “KFS Disclosure - no easy matter” which was published by the Association of Superannuation Funds of Australia (ASFA) in the December 1998/January 1999 edition of SuperFunds. The article summarised the then public views on fee disclosure as expressed by the Liberal-National Coalition, the Labor Party, the Australian Securities and Investments Commission (ASIC), the Industry Funds Forum and others.

The article also noted that the Institute of Actuaries of Australia recommended that:

- (1) Investment performance should be reported net of tax and investment transaction costs and net of all investment costs.
- (2) Key Features Statements should include a brief description of all fees and charges.
- (3) In addition there should be some form of analysis of the impact of fees and charges which should focus on all non-investment fees and charges.
- (4) The impact of these fees and charges should be shown net of employer subsidies but should include any costs in excess of fees and charges which impact on members' benefits.

**The authors of this note believe that these four recommendations reflect sound principles that remain valid today.**

The authors note that the Institute's principles include the need to show separately the effect of investment fees and costs and of non-investment (or broadly administration) fees and costs. The authors consider this split is essential for a sound comparison of funds. The split also facilitates member investment choices. It is noted that the Report commissioned by ASIC from Professor Ian Ramsay, released in September 2002, recommended that investment and administration fees should be separated. Investment fees and costs would be defined consistent with Corporations Regulation 7.9.01 which refers to “... relating to the management of investment of fund assets”.

In our previous work we have referred to non-investment fees and costs as “administration” fees and costs. The early material issued by the Cooper Review seems to have expressed a preference to call these non-investment fees and costs “superannuation” fees and costs rather than “administration” fees and costs. This is an innovative and very appropriate proposal which we support provided the new terminology is mandatory and clearly specified in regulatory guidance and/or legislation. We have therefore amended the terminology in this update to allow for this preference.

The August 2003 and May 2004 articles explain the background and relevant events since 1998. A further article in August 2005 expands on recommendations (1) and (3) above.

### What happens next?

**We suggest that the way forward should include the following three level fee and cost disclosure framework:**

#### **1. At a glance**

This component of the framework would summarise the existence of various fees and costs using standardised terminology, order of contents and grouping. For example;

INVESTMENT		SUPERANNUATION	
Ongoing fees	<i>Yes</i>	Initial fees	<i>No</i>
Ongoing extra costs	<i>Yes</i>	Ongoing fees	<i>Yes</i>
Switching fees	<i>Yes</i>	Ongoing extra costs	<i>Yes</i>
Buy-sell spread	<i>Yes</i>	Benefit fees	<i>Yes</i>
		Exit fees or penalties	<i>No</i>

<b>OTHER</b>	Any other fees or costs?	<i>No</i>
	Are any dollar fees indexed	<i>Yes</i>
	Are fee rates expected to increase in the next 5 years?	<i>No</i>
	Are some tax deductions withheld?	<i>No</i>

#### **2. Brief description**

This component would be similar to the brief descriptions of fees and charges used in Member Booklets and some PDS's, but there would be a few important constraints. For example;

- Must include brief descriptions of how each of the above "*Yes*" responses is calculated and charged.

- Must start a new paragraph for each fee or cost.
- Must be in the same order as the first component and use the same grouping.
- Must briefly describe the services provided.
- Must use standard terminology similar in style and depth to the requirements of Corporations Amendment Regulations 2005 (No. 1) but, primarily as a consequence of the separation of fees and costs into “investment” and “superannuation” components, without the unnecessary and confusing terms “management costs” and “other management costs”.

### 3. Impact of fees and costs

This third and final component would replace the current Corporations Regulations “example of annual fees and costs”. Like the current example it would exclude service fees. It would have two distinct parts, one for Investment fees and costs and one for Superannuation fees and costs. For example;

#### INVESTMENT

For each investment option, list:

- the ongoing net of tax fees and extra costs as a single annual dollar amount per \$10,000 of average assets (eg. if fees were .44% net of tax and the only other investment costs were Consultant's fees of .09% net of tax, then list \$53 per annum for this option), and
- the buy-sell spread (if any) and state whether this margin is paid to the fund manager or left in the fund for the benefit of other members.

#### SUPERANNUATION

A standardised superannuation fees and costs projection (similar to that now required in the United Kingdom) for at least two levels of contributions. This is probably the most important part of the framework.

This part includes the following five columns for initial annual contributions of \$5,000 and \$10,000 respectively:

- |   |                            |
|---|----------------------------|
| (1) At end of years   | 2, 5, 10, 20 and 40        |
| (2) Total paid in to date   | 3 or 4 significant figures |
| (3) Account balance without fees and costs deducted                 | 3 or 4 significant figures |
| (4) Effect of fees and costs to date                                | 2 or 3 significant figures |
| (5) Account balance with fees and costs deducted<br>[ = (3) - (4) ] | 3 or 4 significant figures |

The Institute of Actuaries of Australia's 6 November 2008 response to ASIC Consultation paper 101 suggested, in its answer to Question 4 in Section B5 (page 30 of the response), how the two contribution levels in 3. above should be determined from time-to-time. The Institute suggested that they should be based on the future SG rate (and any soft compulsion rate of member contributions) applied to say 75% and 150% of an average weekly earnings figure (annualized) with the resultant annual contributions rounded to the nearest \$1,000 and \$2,000 respectively. For example, if average weekly earnings were \$1,300 and the SG rate were 9%, then:

- Lower standard contribution =  $\$1,300 \times 0.75 \times 52 \times 9\% = \$4,563 = \$5,000$
- Higher standard contribution =  $\$1,300 \times 1.50 \times 52 \times 9\% = \$9,126 = \$10,000$

### Sample Product Disclosure Statements

Two sample Product Disclosure Statements, which reflect the principles that we consider should apply to fee and cost disclosure, have been prepared and can be supplied if required. One sample is for a hypothetical Retail superannuation fund and the other is for a hypothetical Industry plan named "ZIS". (They have not been updated to reflect legislative or taxation changes since 2004.)

The next page is an extract from the latter PDS to illustrate the third component of our recommended framework.

This extract has been updated to amend the terminology for non-investment fees and costs from "administration" fees and costs to "superannuation" fees and costs and to use initial contributions of \$5,000 and \$10,000 as determined above.

We consider that if our proposal is adopted, the Australian Government Actuary should be given the responsibility of setting and monitoring the superannuation fee and cost projection basis.

### **We draw to your attention the following three important features of "Table 5":**

- The first three columns would be common to all funds (when making a comparison of two or more funds, this feature gives the reader confidence that they are comparing "like with like").
- The fourth and fifth columns are unique to each fund since they depend directly on each fund's superannuation fees and costs.
- The fourth column shows that after 2 year's the effect of fees and costs (for ZIS) for a \$10,000 initial annual contribution is **115%** of that for a \$5,000 initial annual contribution but after 40 year's the effect of fees and costs for a \$10,000 initial annual contribution is **191%** of that for a \$5,000 initial annual contribution (this large relative difference demonstrates why with any comparator it is essential to have results for both short and long durations and for at least two contribution levels).

**Colin Grenfell and Ray Stevens**

[extract only]

**Table 4: ZIS Annual INVESTMENT Fees and Costs Summary per \$10,000 account balance in each investment option**

	<u>Option A</u>	<u>Option B</u>	<u>Option C</u>
Ongoing (and Extra)	\$161	\$140	\$124
Buy-sell spread	Nil	Nil	Nil

### Assumptions on which the following fee table is based

The table below uses the standard assumptions about account balance, contributions and investment returns that all funds must use to show the impact of their superannuation fees and costs. These assumptions are as follows:

- Account balance at start: nil.
- Initial Annual Employer contributions of \$5,000 or \$10,000 (before tax).
- Contributions payable mid-year (or say weekly) and increasing by 4.5% each year.
- Member contributions: nil.
- Net annual investment return of 7% (net of tax and net of investment fees and costs).
- Dollar fees increase by 3% each year.
- Results in “today’s dollars” (ie deflated using a salary increase assumption of 4.5% each year).
- No allowance for any tax payable on benefits.

**Table 5: Effect of ZIS SUPERANNUATION Fees and Costs**

If withdrawn	Total Paid in to date	Account Balance without fees and costs deducted	Effect of fees and costs to date *	Account Balance with fees and costs deducted *
<b><u>Initial Annual Contribution \$5,000</u></b>				
after 2 years	\$ 10,000	\$ 8,700	\$ 130	\$ 8,570
after 5 years	\$ 25,000	\$ 22,560	\$ 420	\$ 22,140
after 10 years	\$ 50,000	\$ 47,940	\$ 1,260	\$ 46,680
after 20 years	\$100,000	\$108,700	\$ 4,700	\$104,000
after 40 years	\$200,000	\$283,000	\$22,500	\$260,500
<b><u>Initial Annual Contribution \$10,000</u></b>				
after 2 years	\$ 20,000	\$ 17,400	\$ 150	\$ 17,250
after 5 years	\$ 50,000	\$ 45,120	\$ 610	\$ 44,510
after 10 years	\$100,000	\$ 95,880	\$ 2,080	\$ 93,800
after 20 years	\$200,000	\$217,400	\$ 8,500	\$208,900
after 40 years	\$400,000	\$566,000	\$43,000	\$523,000

\* The fees and costs include all fees and costs, except investment fees and costs and insurance charges. They include the benefit payment fee. For ZIS there are no other surrender penalties or exit fees and ZIS does not pay any commissions.

The last line of Table 5 (for an annual contribution of \$10,000) shows that over a 40 year period the effect of the total deductions could amount to \$43,000 (in today’s dollars). Putting it another way, this would have the same effect as bringing investment returns down from 7% a year to 6.63% a year.



13 December 2011

Mr Ross Jones  
Deputy Chairman  
Australian Prudential Regulation Authority  
400 George Street (Level 26)  
SYDNEY NSW 2000

Dear Sir

### **APRA ANNUAL STATISTICS FOR MYSUPER PRODUCTS**

The Actuaries Institute is the sole professional body for actuaries in Australia, providing independent, expert and ethical comment on public policy issues where there is uncertainty of future financial outcomes. It represents the interests of over 3,800 members, including more than 2,000 actuaries.

The Institute has made a number of submissions to the recent Super System Review and participated in other ways with the development of MySuper products.

We understand that APRA will be required to publish statistics relating to the fees and costs, and investment information, for MySuper and other superannuation products to facilitate comparisons by members. A Working Group of the Institute has done considerable work on these issues over recent years and has recently developed a discussion document on the form in which useful statistics on administration fees and costs of MySuper products could be collected and published.

The impact of administration fees and costs can be demonstrated in a number of ways. One approach is to calculate an "index" showing the projected benefit at the end of the membership period, expressed as a percentage of the projected benefit which would apply at the end of the membership period if there were no fees and costs affecting the member's benefit. Another is to show the "dollar reduction" in the projected end benefit (in today's dollars) caused by the administration fees and costs. We see merit in both these approaches.

Briefly, we believe that the main issues relating to reporting administration fees and costs to members are the effect of these fees and costs:

1. on members who have different contribution levels and different initial account balances, and
2. over different periods of membership.

We suggest that showing the impact of administration fees and costs given two contribution levels, say \$5,000 p.a. and \$10,000 p.a., and no initial account balance, would allow a member (or prospective member) of a fund to select the level which best matches the person's situation. We would not advocate showing the impact given a range of initial account balances, given the additional complexity that would be introduced.

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Comparisons over a 40 year membership period could be used for ranking funds, but a much shorter period, say 10 years, would highlight the fact that for some funds the effect of administration fees and costs can be different for shorter membership periods.

The attached document illustrates both the "index" and "dollar reduction" approaches described above, using \$5,000 p.a. and \$10,000 p.a. contribution levels. The impact of the administration fees and costs is shown over periods of 10 or 40 years for 27 Funds with administration fees and costs as described.

The Institute would welcome the opportunity to discuss with APRA the issues that we believe need to be considered. We propose to separately address the considerations in relation to investment statistics.

The calculations in the attached document are based on the principles that have been used in submissions relating to administration fees and costs in Product Disclosure Statements over a number of years by members of the Institute. We believe that consistency between APRA's data collection standards and ASIC's disclosure requirements is important.

We would welcome the opportunity of meeting with an appropriate person or group to provide more details of our proposal. Please do not hesitate to contact Melinda Howes, CEO in this regard, or for any further information.

Yours sincerely

Barry Rafe  
**President**

cc David Shade  
Advisor, Statistics  
Australian Prudential Regulation Authority

Prashanti Ravindra,  
Lawyer, Strategic Policy  
Australian Securities and Investments Commission

Ged Fitzpatrick  
Senior Executive Leader  
Investment Managers & Superannuation Team  
Australian Securities and Investments

## ADMINISTRATION FEES AND COSTS

The two tables below provide information about the administration fees and costs charged by superannuation funds and the effect of these on members' benefits. Both of the tables exclude all fees and costs relating to investment. They also exclude insurance premiums and advice fees. The tables assume zero initial fund balances. If a member has an existing superannuation balance, then the tables do not indicate the full effect of administration fees and costs on the member's overall superannuation benefits.

Annual Contribution \$5,000						
If your annual contribution exceeds \$7,500, see the blue table below						
	Index (note 3)		Effect of Fees and Costs (in today's dollars)		Rank	
	Membership		Membership		Membership	
	40 years (note 1)	10 years (note 2)	40 years (note 1)	10 years (note 2)	40 years (note 1)	10 years (note 2)
Fund 05	98.8	99.0	-\$3,861	-\$515	1	1
Fund 14	98.7	98.7	-\$4,093	-\$635	2	3
Fund 09	98.5	98.5	-\$4,750	-\$737	3	4
Fund 10	98.0	98.0	-\$6,333	-\$983	4	6
Fund 26	97.6	98.8	-\$7,584	-\$595	5	2
Fund 11	97.5	97.5	-\$7,917	-\$1,229	6	9
Fund 23	97.1	97.1	-\$9,238	-\$1,434	7	13
Fund 01	97.0	97.0	-\$9,374	-\$1,455	8	14
Fund 04	97.0	97.0	-\$9,500	-\$1,475	9	15
Fund 17	96.5	96.5	-\$11,084	-\$1,721	10	17
Fund 08	96.0	96.0	-\$12,667	-\$1,966	11	18
Fund 20	95.4	98.4	-\$14,565	-\$797	12	5
Fund 19	95.0	95.0	-\$15,834	-\$2,458	13	20
Fund 22	94.5	96.6	-\$17,387	-\$1,692	14	16
Fund 27	94.0	94.0	-\$19,000	-\$2,949	15	24
Fund 18	94.0	95.6	-\$19,126	-\$2,140	16	19
Fund 16	93.0	97.6	-\$22,136	-\$1,166	17	7
Fund 13	92.7	97.2	-\$22,998	-\$1,388	18	10
Fund 25	92.6	97.5	-\$23,299	-\$1,225	19	8
Fund 03	90.1	91.6	-\$31,292	-\$4,139	20	27
Fund 06	89.2	95.0	-\$34,071	-\$2,459	21	21
Fund 12	87.9	97.1	-\$38,440	-\$1,429	22	12
Fund 02	87.7	97.1	-\$38,975	-\$1,420	23	11
Fund 07	85.2	94.7	-\$46,832	-\$2,601	24	22
Fund 24	84.8	94.2	-\$48,054	-\$2,840	25	23
Fund 15	83.5	93.7	-\$52,409	-\$3,081	26	25
Fund 21	77.9	92.7	-\$69,852	-\$3,586	27	26

Please note:

- 1 This membership has been used to sort the above table (because 40 years is closer to the total potential membership of most people).
- 2 This membership has been included to illustrate how rankings may depend on the period of fund membership. Each fund's PDS shows the effect of fees and costs for periods of 2, 5, 10, 20 and 40 years.
- 3 The index provides a measure of how administration fees and costs effect members' benefits. The smaller the index the greater the effect on benefits. A fund where members incur no fees or costs (e.g. because they are paid by the employer) would have an index of 100.

Annual Contribution \$10,000
------------------------------

If your annual contribution is less than \$7,500, see the green table above

	Index (note 3)		Effect of Fees and Costs (in today's dollars)		Rank	
	Membership		Membership		Membership	
	40 years (note 1)	10 years (note 2)	40 years (note 1)	10 years (note 2)	40 years (note 1)	10 years (note 2)
Fund 14	99.4	99.4	-\$4,093	-\$635	1	2
Fund 05	99.3	99.5	-\$4,561	-\$539	2	1
Fund 09	99.3	99.3	-\$4,750	-\$737	3	3
Fund 10	99.0	99.0	-\$6,333	-\$983	4	5
Fund 11	98.8	98.8	-\$7,917	-\$1,229	5	6
Fund 23	98.5	98.5	-\$9,238	-\$1,434	6	8
Fund 04	98.5	98.5	-\$9,500	-\$1,475	7	9
Fund 17	98.3	98.3	-\$11,084	-\$1,721	8	10
Fund 26	98.0	99.2	-\$12,451	-\$763	9	4
Fund 08	98.0	98.0	-\$12,667	-\$1,966	10	12
Fund 01	97.5	97.5	-\$15,707	-\$2,438	11	16
Fund 19	97.5	97.5	-\$15,834	-\$2,458	12	17
Fund 27	97.0	97.0	-\$19,000	-\$2,949	13	20
Fund 22	95.8	97.8	-\$26,885	-\$2,133	14	14
Fund 20	95.6	98.5	-\$28,090	-\$1,428	15	7
Fund 18	94.8	96.5	-\$32,873	-\$3,430	16	21
Fund 03	94.0	95.6	-\$37,769	-\$4,363	17	23
Fund 16	93.5	98.1	-\$41,256	-\$1,840	18	11
Fund 13	93.5	97.9	-\$41,467	-\$2,038	19	13
Fund 25	92.9	97.8	-\$44,829	-\$2,161	20	15
Fund 06	89.3	95.1	-\$67,630	-\$4,833	21	24
Fund 12	87.9	97.1	-\$76,651	-\$2,819	22	18
Fund 02	87.7	97.1	-\$77,950	-\$2,839	23	19
Fund 24	86.1	95.6	-\$88,113	-\$4,302	24	22
Fund 07	85.4	95.0	-\$92,170	-\$4,945	25	25
Fund 15	83.5	93.8	-\$104,411	-\$6,091	26	27
Fund 21	78.9	93.9	-\$133,355	-\$5,999	27	26

Please note:

- 1 This membership has been used to sort the above table (because 40 years is closer to the total potential membership of most people).
- 2 This membership has been included to illustrate how rankings may depend on the period of fund membership. Each fund's PDS shows the effect of fees and costs for periods of 2, 5, 10, 20 and 40 years.
- 3 The index provides a measure of how administration fees and costs effect members' benefits. The smaller the index the greater the effect on benefits. A fund where members incur no fees or costs (e.g. because they are paid by the employer) would have an index of 100.



12 February 2014

Manager, Superannuation Unit  
Financial System Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Email: [superannuationconsultation@treasury.gov.au](mailto:superannuationconsultation@treasury.gov.au)

Dear Sir/Madam

**Submission on the Government's Discussion Paper – Better regulation and governance, enhanced transparency and improved competition in superannuation**

The Actuaries Institute is the sole professional body for actuaries in Australia. It represents the interests of over 4,100 members, including more than 2,200 actuaries. Our members have had significant involvement in the superannuation industry and the development of superannuation regulation, reporting and disclosure, interpreting financial statistics, risk management and related practices in Australia for many years.

The attached submission sets out the Actuaries Institute's response to the Government's superannuation discussion paper released for consultation on 28 November 2013.

Please do not hesitate to contact the Chief Executive Officer of the Actuaries Institute, David Bell to discuss any aspect of this paper.

Yours sincerely

Daniel Smith  
President

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Submission on the Government's Discussion Paper released on 28 November 2013  
Better regulation and governance, enhanced transparency and improved competition in superannuation

**PART 1: A better approach to regulation**

**Question 1:** *The Government has committed to identifying (in dollar terms) measures that offset the cost imposed to business of any new regulation. What suggestions do you have for how the regulator compliance burden can be reduced?*

The Institute has been concerned for some time about the potential additional regulation of actuarial services via the Tax Agent Services Act 2009. On 5 August 2008, the Institute sent a submission to Treasury in response to the Tax Agent Services Bill 2008 Exposure Draft. The Institute was concerned that, in the absence of a broad exemption applying to actuarial services, which typically involve the certification of amounts that are required to calculate a tax liability and are often required by legislation, the legislation may severely limit the existing scope of services that can be provided by actuaries without registering as tax agents. Further, it was (and still remains) our understanding that, in the framing of the draft legislation, there was no specific intention to introduce further regulation of actuarial services. We believe that it would be appropriate to exempt actuaries from the Tax Agent Services legislation, in particular in respect of services that are specified in tax legislation that require actuarial advice and/or certification.

As you would be aware, the "Sustaining the Superannuation Contribution Concession" legislation passed in June this year imposes an additional 15% tax on the concessional superannuation contributions of individuals with relevant incomes of \$300,000 or more. Implementation of this new tax requires regulations to be issued which specify the method of determining notional defined benefit contributions for this purpose. We strongly recommend that the Notional Taxed Contributions (NTCs) already in use for concessional contribution limit purposes also be used for the new tax. NTCs are already available for the vast majority of defined benefit arrangements - that is, all except a small number of public sector funds. Further, this approach would avoid the considerable confusion that is sure to arise if two different notional contribution amounts are required for each defined benefit member for tax purposes. Use of the 'surchargeable contributions' methodology would impose substantial additional compliance costs on (effectively) the employer sponsors of defined benefit funds - including many funds which may have no members affected by this new tax. In our view, it is unnecessary and inappropriate to impose these additional costs, given that NTCs could be used.

**PART 2: Better governance**

We do not have any comments on this Part.

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## PART 3A: Enhanced transparency – Choice product dashboard

**Question 13:** *Should a Choice product dashboard present the same information, in the same format, as a MySuper product dashboard? In answering this question you may wish to consider, if the choice product dashboard is to present different information, what should it include and why?*

Yes, it is the Institute's view that Choice dashboards should have the same principal sections as the MySuper product dashboards. However, as noted in the remainder of our responses we believe that there are aspects of the current information required on the MySuper dashboard which should be changed. These changes are summarised below and further explained in the Appendix which also provides reasons for these changes.

1. The Net Return and Net Return Targets as currently defined by APRA should not be disclosed on MySuper and Choice dashboards.
2. The Net Investment Return Target and historical Net Investment Returns should be disclosed on the MySuper and Choice dashboards.
3. Net Investment Return Targets should be based on AWOTE rather than CPI. Since it is impossible to change investment objectives from CPI to AWOTE 'overnight', it might be desirable for the Government to give notice that the change will not be compulsory for at least say two years.
4. A second metric to measure long term investment risk should be included with the current short term volatility risk measure. It should be based on the probability that the time-weighted annual net investment return will be less than the expected rate of increase in AWOTE plus 3% per annum over a twenty year period.
5. Risk Labels (i.e. High, Medium, Low) should not be included on MySuper and Choice dashboards, just Risk Measures (i.e. number of negative net investment returns over a 20 year period).
6. A liquidity metric, equal to the percentage of assets in each option that can be realised as cash within a 30 day period without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation), should be disclosed on at least the Choice dashboard. This is reasonably easy to define and determine and would provide an indication of liquidity. This indicator will provide a comparative metric which will highlight to a member considering a Choice product whether this issue requires further investigation.
7. MySuper and Choice dashboards should **compulsorily** include standardised administration, advice and investment fees and costs for two representative members in a simple table such as the following:

Statement of annual fees and other costs		
	Member with a \$10,000 account balance	Member with a \$50,000 account balance
Administration	\$xxx	\$yyy
Advice	\$ccc	\$ddd
Investment	\$aaa	\$bbb
Total	\$TTT	\$SSS

The amounts \$aaa and \$bbb should be included on the dashboard for all investment options.

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8. MySuper and Choice dashboards, where the fund does not fully pass on the benefit of tax deductions on administration or advice fees and costs to members, should **compulsorily** include an explanation of the impact of this on the above table. While it would be preferable for all funds to pass this tax benefit on to members on a consistent basis, even though it is quite a technical issue members should be warned about the impact of this different tax treatment on their accounts.
9. If fees and costs for a Choice product depend on contributions (or salary) then information must be added to explain that the statement of annual fees and other costs also assumes that the member with a \$10,000 account balance has annual contributions of \$1,000 and the member with a \$50,000 account balance has annual contributions of \$5,000 (or to explain the salary assumption).
10. Dashboards should provide clear direction as to how members can find further information relating to the investment, administration and advice services provided.
11. Choice dashboards should **optionally** include additional information regarding the Net Investment Return and the investment, administration and advice fees and costs that the trustees believe is necessary to provide superannuation fund members with a proper understanding of these services. For example this might include information about different fees and costs for active and non-active members, different categories or optional services.
12. More development work and consumer testing needs to be done with regard to how the dashboard is integrated into websites, PDS's and member statements. Our preliminary views are set out below:
  - a) Websites: It is feasible to have a dashboard for each investment option assuming the member is 100% invested in that option (subject to 10. above). The website dashboard should make it very clear that it has assumed a member is invested this way.
  - b) PDS's: We suggest that a full choice dashboard for each investment option is unnecessary and impractical. In a PDS, funds should be able to show the administration and advice fees and costs once for each product and then show the target net investment return, return history, risk metrics and investment fees and costs for each investment option separately.
  - c) Member's statements: The provision of a choice dashboard that is member specific is impossible to produce and therefore should not be sent to members. The member may have multiple investment options with different amounts in each option. The total return and fees and costs will be virtually impossible to calculate as this will depend on the mix of investment choices. The member's statement should include the information in 7 above and have a statement in it which directs the member to the relevant sections of the website where the information at the investment choice level is available.

**Question 14: *Is it appropriate to use a single benchmark (CPI plus percentage return) for all choice product returns?***

No, the Institute does not believe that a single standard benchmark is appropriate for all choice products. Where an "inflation plus percentage return" is used, the Institute believes that it should be based on a measure of wage inflation such as AWOTE, rather than CPI.

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*Question 15: Should both net investment return (investment return net of investment costs only) and net return (investment return net of all associated costs) be used to measure a product's investment return on the choice product dashboard? In considering this question, you may wish to consider:*

- If including an additional measure for a product's investment return would add unnecessary complexity.*
- If both net investment return and net return are used on the choice product dashboard, whether they should also be used on the MySuper product dashboard.*
- Whether it is appropriate to use a single time horizon, for example 10 years, when calculating target net return and net return for the range of possible choice products.*

No, only the Net Investment Return should be disclosed on both the MySuper and Choice dashboards. The Institute has indicated previously that we strongly believe that administration and advice fees and costs should **not** be deducted from investment returns when calculating net investment returns for the purposes of comparing the investment outcomes and capabilities of different superannuation funds (see the Appendix for a summary of our reasons).

**The Institute therefore believes that the Net Return as defined by APRA should not be disclosed on either the MySuper product dashboard or the Choice product dashboard.** We understand that this is also the view of the Association of Superannuation Funds of Australia (ASFA) and we strongly endorse that view. The only metric that is suitable for comparing the investment performance of different product providers is the Net Investment Return where only the fees and costs and taxes associated with the investment service are deducted from the investment return.

Therefore it is this Net Investment Return and only this return that should be disclosed on both the MySuper and Choice product dashboards. This would remove the issue of disclosure of two returns introducing unnecessary complexity in the dashboard. It will also remove the misleading aspect of the current proposals and support the Government's aim to reduce regulation and compliance costs. In any case, the disclosure of administration fees on the dashboard (as suggested in the summary of proposed changes on pages 1 and 2) achieves the same goal as deducting administration fees in the net return without distorting investment returns.

The Institute believes that ten years is a reasonable period to show actual past investment performance. It is sufficiently long enough to include more than one economic cycle and to provide evidence of trends in comparative performance. It is, however, short enough that it will allow most established superannuation funds to provide a full history of returns. Obviously those funds that have constructed a new MySuper option may have no return history. However, the ten year history will be gradually built up in the dashboard. Also, the lack of a ten-year record will clearly flag to a member that this is a specific area that requires further investigation.

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**Question 16:** *Should the choice product dashboard include both a short-term (volatility) and long-term (inflation) risk measure? In considering this question, you may wish to consider:*

- *Is the SRM model the best measure of short-term investment risk?*
- *What would be the most suitable measure of long-term risk to include on the product dashboard?*
- *Is it possible to present a long-term risk measure in a similar format to the short-term risk measure (that is High/Medium/Low)?*
- *Would including an additional risk measure add unnecessary complexity to the product dashboard?*

Yes, the Institute believes that the dashboard should disclose two metrics that measure investment risk. We believe that metrics relating to short term and long term investment objectives must be included. This is necessary to reduce the potential for members to make choices that reduce their final retirement benefits.

We agree that the Standard Risk Measure as proposed in the FSC/ASFA guidance note is an appropriate metric for the short term investment risk.

We propose that the metric to measure long term investment risk should be *the probability that the time-weighted annual net investment return will be less than the expected rate of increase in AWOTE plus 3% per annum over a twenty year period.*

This will mean there will be two risk measures. We acknowledge that this will increase the complexity of the dashboards. But we believe they can co-exist on the dashboard as long as a simplifying label such as high/medium/low is not used for each as, for a particular option, the label for the short-term measure may be quite different to the label for the long-term measure. The estimated number of negative net investment returns over a 20 year period and the probability of not meeting a reasonable long-term return over wage inflation should provide a good indication of risk, perhaps with some explanatory comments to guide members as to what certain ranges of these measures may indicate about each risk.

The dashboards currently must include a "Risk Label" as well as a "Risk Metric". The Institute does not support this. We are concerned that members will only focus on the Risk Label when choosing their investment option. If they did this, it is possible that members will choose options that have less risky short term risk labels. For superannuation fund members with long term investment horizons, it is likely that this will mean that they will achieve lower long term investment returns and therefore lower final retirement balances.

If two risk measures are included, Risk Labels should not be shown for each risk measure as it would confuse members since many investment options will be labelled as both more risky and less risky.

We note that our comments below apply equally to MySuper and Choice dashboards. However, they are particularly relevant to Choice dashboards as it is expected that members who select Choice products will base their choices on an examination of the material provided by the superannuation fund. This will include information disclosed on the dashboard. It is therefore vital that the information on the dashboard not be misleading.



**Question 17: Are additional carve outs from the choice product dashboard obligations required? If so, why are these additional carve outs required? In considering this question, you may also wish to consider identifying where the gaps in the current carve out provisions are.**

No, we do not recommend any additional carve outs, but we suggest a slight change to clarify the intention of the first carve out (see page 22).

**Question 18: Should a measure of liquidity be included on the choice and/or MySuper product dashboard? If so, what would a suitable measure be?**

Yes, there should be a measure of liquidity included on both the MySuper and Choice dashboards.

There is merit in the Cooper review's recommendation to include a measure of projected liquidity on the dashboard. Members should be alerted that the risk of not being able to access their money is substantially higher in certain options, especially if there is a material risk they may not be able to access their money within 30 days without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation) in some circumstances. It would also be desirable for members to be made aware if there was an option for withdrawals to be frozen and the general circumstances where this could occur.

Further, the liquidity of assets within an investment option which has a mix of different assets is important as the rebalancing that may be required when relative values of different asset classes change may generate investment losses when illiquid assets have to be sold.

However, it is difficult to construct an appropriate liquidity measure, as the liquidity of different assets can rapidly change, as occurred with mortgage-backed securities during the GFC. Nevertheless, it is still important to include some indicator of the level of illiquid assets. If an investment option is supported by a high level of illiquid assets, it is important that a member (particularly one selecting a Choice product) is alerted to the possibility that access to capital may be restricted in some circumstances.

On balance, the Institute recommends that a liquidity metric, equal to the percentage of assets in each option that can be realised as cash within a 30 day period without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation), be disclosed on at least the Choice dashboard. This is reasonably easy to define and determine and would provide an indication of liquidity. This indicator will provide a comparative metric which will highlight to a member considering a Choice product whether this issue requires further investigation.

**Question 19: Should the commencement date for the choice product dashboard be delayed beyond 1 July 2014? Is so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?**

Yes, the commencement date should be delayed until at least 1 July 2015 to allow for revision of the MySuper dashboard and the finalisation of Choice product dashboard requirements (which will take some time after the consultation period finishes) and then implementation by product providers.



The main issue the dashboard is trying to address is to provide the least engaged MySuper members with a simple way to evaluate and compare default options, which is where the vast majority of superannuation money is held. There is a need to extend this to the wider universe of Choice options but it is not as pressing as the MySuper dashboard and it is more important to get it right the first time to avoid unnecessary re-work costs.

Subject to these modifications, we believe the dashboard can become a useful source of information for superannuation fund members.

### **PART 3B: Enhanced transparency – Portfolio holdings disclosure**

We do not have any comments on this Part.

### **PART 4: Enhancing competition in the default superannuation market**

#### ***Question 27: Does the existing model (which commences on 1 January 2014) meet the objectives for a fully transparent and contestable default superannuation fund system for awards, with a minimum of red tape?***

No. It does not meet the objectives for a fully transparent and contestable default superannuation fund system for awards, with a minimum of red tape.

The industrial relations system was extremely important in the development of meaningful retirement savings for all Australians through superannuation. However, with the passage of subsequent legislation, and in particular the Superannuation Guarantee, APRA governance and MySuper, we believe that having named default superannuation funds determined through the Fair Work Commission is now an additional and unnecessary level of red tape and complexity.

The first stage of the default fund selection process for awards is complex and time consuming. It sees an Expert Panel of the Fair Work Commission (FWC) select a Default Superannuation List which is a sub-set of funds with authorised MySuper products. At today's date, there are only about 80 funds with authorised generic MySuper products (excluding single employer MySuper products), all of which have already been reviewed by APRA against a set of criteria to ensure they meet certain standards. The value add of the Expert Panel's List is questionable.

The second stage of the default fund selection process lacks full contestability and transparency. It sees the Full Bench of the FWC decide which 2 to 15 funds are selected to be named in each particular award from the Default Superannuation List. The selection process allows prescribed persons to make submissions to the Full Bench for funds to be named in each award. Prescribed persons excludes superannuation funds, but includes the unions and employer associations which established many of the industry superannuation funds competing for a place on the awards, causing other funds to be concerned about full contestability. The process will also lack full transparency as it will be extremely difficult for the FWC to justify the sub-set of funds named in each award given the increased similarity between superannuation funds with MySuper products.

The outcome of the review process will constrain competition and contestability, and will very much advantage the growth of funds which are named in awards as compared to other funds with MySuper products.

It will increase the red tape to which employers are subject, and cause disruption not only to employers but also to members as it potentially creates:

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- the need for a large number of employers to review their current default superannuation arrangements, even when they may recently have been through a review process;
- the requirement for employers to pay superannuation to several default funds for different groups of employees if their workforce is covered by multiple awards; and
- reduced retirement outcomes for default members, with more duplicate member accounts, confusion regarding insurance coverage, and the potential for increased fees and costs.

**Question 28: *If not, is the model presented by the Productivity Commission the most appropriate one for governing the selection and ongoing assessment of default superannuation funds in modern awards or should MySuper authorisation alone be sufficient?***

No. As stated in the Actuaries Institute's submissions of 13 April 2012 and 1 August 2012 to the Productivity Commission, we believe that MySuper authorisation alone should be adequate to determine whether a fund should be able to qualify as a default fund in an award. If they are not considered adequate, then we believe it would be preferable to strengthen the MySuper standards in an appropriate way rather than adding an extra set of criteria for qualification as a default fund.

Having said this, the model presented by the Productivity Commission does have several advantages over the existing model which commenced on 1 January 2014, including:

- the Expert Panel is involved right through until the end of the naming process of specific default funds on Modern Awards, providing a greater degree of transparency;
- all parties, including superannuation funds, have the opportunity to make submissions to be included under specific Modern Awards, improving contestability;
- the number of named funds under a specific Modern Award is not limited (the Productivity Commission recommended the Expert Panel have a longer list rather than a shorter list where a decision about whether or not to list a product is marginal).

The recommendation by the Productivity Commission that a filter (over and above MySuper authorisation) should be applied when selecting a default fund was based on the views that:

- MySuper authorisation alone may not ensure that the funds selected would meet the best interests of employees covered by the award; and
- there is an administrative burden for employers (particularly new employers) being required to choose from a potentially large number of diverse MySuper products.

We would argue that both views have been sufficiently addressed now that there is a list of authorised MySuper products, and the number of authorised MySuper products is significantly less than the number envisaged when the Productivity Commission delivered its report. (refer pages 189 and 190 of the report). The Productivity Commission acknowledged that MySuper authorisation could form an appropriate filter in due course, stating (page 190) *"The Commission agrees that industry consolidation over time will mean that the number of MySuper products will decrease, and considers that this would potentially make Option 1 (use of any authorised MySuper product) a more appropriate solution over time."*

Given all existing employers will already have a nominated default fund, permitting choice for new employers (or existing employers reviewing their default fund) from a list of approximately 80 funds does not appear too great an administrative burden, certainly as

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compared to the greater red tape and administrative burden created if employers with existing defaults are required to select a new default fund when the existing named fund is removed, or when the grandfathering terms can no longer be applied.

**Question 29:** *If the Productivity Commission's model is appropriate, which organisation is best placed to assess superannuation funds using a 'quality filter'? For example, should this be done by an expert panel in the Fair Work Commission or is there another more suitable process?*

Our view is that the Productivity Commission model is no longer the most appropriate model (refer response to question 28. above). However, if the Productivity Commission model were to be introduced, an expert panel of the Fair Work Commission would appear as suitable an organisation as any to apply a quality filter.

**Question 30:** *Would a model where modern awards allow employers to choose to make contributions to any fund offering a MySuper product, but an advisory list of high quality funds is also published to assist them in their choice, improve competition in the default superannuation market while still helping employers to make a choice? In this model, the advisory list of high quality funds could be chosen by the same organisation referred to in focus question 29.*

No, because the criteria that used to establish high quality funds would likely lead to a long list of high quality funds, given analysis of the 80 authorised MySuper products. As a result, the limited assistance potentially provided by having the high quality list would fail a cost-benefit analysis test.

**Question 31:** *If changes are made to the selection and assessment of default superannuation funds in modern awards, how should corporate funds be treated?*

If changes are made to the selection and assessment of default superannuation funds, we would recommend that an employer can automatically use any authorised employer MySuper product as a default fund.





## Appendix: detailed responses and comments to Part 3A

This Appendix contains our detailed analysis and conclusions regarding our responses to Part 3A of the discussion paper. For clarity, we have retained the headings and sub-headings from the discussion paper.

The format of each response includes a further 'comments' section which sets out the reasons behind our response and in many cases further explanation of the matters which we believe should be taken into consideration

### CHOICE DASHBOARD VERSUS MYSUPER

**Question 13:** *Should a Choice product dashboard present the same information, in the same format, as a MySuper product dashboard? In answering this question you may wish to consider, if the choice product dashboard is to present different information, what should it include and why?*

Yes, it is the Institute's view that Choice dashboards should have the same principal sections as the MySuper product dashboards. However, as noted in the remainder of our responses we believe that there are aspects of the current information required on the MySuper dashboard which should be changed. These changes are summarised in our Response to Question 13 at pages three and four of this submission.

Our views on disclosure relating to investment performance, investment risk and liquidity are set out below under the detailed responses to each focus question. We are also of the view that the section on Fees and Costs should be changed.

It is our view that MySuper and Choice dashboards should compulsorily include standardised administration, advice and investment fees and costs for two representative members in a simple table such as the following:

Statement of annual fees and other costs		
	Member with a \$10,000 account balance	Member with a \$50,000 account balance
Administration	\$xxx	\$yyy
Advice	\$ccc	\$ddd
Investment	\$aaa	\$bbb
Total	\$TTT	\$SSS

The amounts \$aaa and \$bbb should be included on the dashboard for all investment options.

We also believe that the dashboards should provide clear direction as to how members can find further information relating to the investment, administration and advice services provided.

Further, we believe that funds should be given the flexibility to include additional information that they believe will help superannuation fund members better understand the particular Choice product or option the member is considering and that more development work and consumer testing needs to be done with regard to how the dashboard is integrated into websites, PDS's and member statements.

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## Comments

The Institute believes that the first step that a member considering a Choice product will take will usually be to compare their default MySuper product with a comparable Choice product. It is therefore important that, at a minimum, any Choice product has information comparable to that provided by the MySuper dashboard in a format that allows the two sources of information to be compared easily.

However, as indicated in our response to Question 14 below, we do not believe that a totally standardised content and format should be specified for all Choice products. Although all Choice products should be required to provide a Target Net Investment Return and historical Net Investment Return information, the product provider should be able to tailor this information to the specifics of each investment option.

Further, we expect that Choice products will offer a range of different administration and advice services. Choice dashboards should be required to provide information relating to the fees and costs of their administration and advice services. However, funds should be able to tailor this information (i.e. add to the specified minimum information) to provide superannuation fund members with a proper understanding of the options available and the cost of these options.

## Fee and cost disclosure

The Institute believes that administration and advice fees and costs of one fund can only be properly compared to the fees and costs for another fund **separately from investment fees** and must take into account the level of the administration and advice services provided and the quality and timeliness of these services. We recognize that it is difficult to compare administration service (and the quality) of these services. However, if a service provider wishes to differentiate their product by adding different services or ensuring higher service levels (e.g. by providing a more personal website experience) it is important that dashboard reporting requirements do not reduce the possibility that members will have access to these additional services. Similarly it is only possible to compare investment options if investment fees and costs are separately disclosed from total fees and costs.

We note that our suggested table above discloses the **total** of the fees and costs. We have included the totals because we believe that it is currently the view of APRA that total fees and costs must be shown. However, the Institute believes that, at least for Choice products, the total of administration, advice and investment fees and costs has little comparative value for a member and should not be a compulsory inclusion in the table. We believe the total of these fees and costs is likely to mislead members unless they pay close attention to all the specific administration, advice and investment features which underlie the total fees and costs, to ensure they are comparing like-with-like.

Excluding the total fees and costs also reduces and simplifies the volume of information disclosed, particularly for Choice products with many investment options - for most Choice products (which have the same administration and advice fees for all investment options) it also can avoid unnecessary repeats of the administration and advice and total fees for every investment option.

A member, particularly a member considering a Choice product, should consider the relative value and costs of the administration, advice and investment services separately.

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Experience since the latest fees and costs template was introduced in 2004 has also highlighted that market competition has been affected by the inclusion of passive, indexed based, investments. These assets will normally attract lower total fees and costs. In these cases, where currently only the total of all fees is quoted on the Dashboard, the total fees disclosed is reduced substantially because of the lower fees incurred with passive investments. Members, who can only compare total fees, may select lower cost funds without considering the impact of passive investments on their overall net investment return.

**Further, if the administration and advice fee component is “standardised” for only a \$50,000 balance, it will still be potentially misleading for the vast majority of “non-standardised” members.** Calculations made by the Institute have demonstrated that deducting administration and advice fees and costs from the investment return may mislead members who expect to have low account balances throughout their membership. As the Net Return is based on a \$50,000 balance, this Return may incorrectly indicate the attractiveness of some funds for members with lower account balances. If this is the case, these funds may unfairly attract members who expect to have lower account balances prior to their retirement. A related problem arises with the “Statement of [total] fees and costs” displayed on the MySuper dashboard because only one [total] standardised result is shown.

The problems addressed in the two preceding paragraphs arise primarily because Australian accumulation-based superannuation funds express their administration fees and costs in one of the following formats:

- A. Solely as a dollar amount per member (11 out of 100 Funds), or
- B. Solely based on account balances (34 out of 100 Funds), or
- C. Partly as a dollar amount per member and partly based on account balances (54 out of 100 Funds), or
- D. Zero, because administration fees and costs are payable by the employer (1 out of 100 Funds).

*[The above numbers are sourced from the August 2013 Chant West Super Fund Fee Survey, adjusted for known changes in late 2013].*

The impact of administration fees and costs on the overall return to a member depends on the member’s account balance. A simple way to alert members to this is to illustrate the annual administration and advice fees and costs for two representative members with, we suggest, account balances of \$10,000 and \$50,000 (and annual contributions, if relevant for Choice products, of \$1,000 and \$5,000 respectively).

Why do we suggest two representative members?

1. For Type A funds the administration fee and costs for the two representative members will be the same,
2. For Type B funds the administration fee and costs for the second representative members will be five times the first.
3. For Type C funds the administration fee and costs for the second representative members will be between one and five times the first.
4. For Type D funds the administration fee and costs will be (or should be) zero if paid by the employer.

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Further, **the growth in the impact of administration and advice fees and costs is important.** The growth in administration and advice fees and costs of a Type A member is significantly different to that of a Type B member. **To properly address this requires a projection but having two representative members will help to indicate that further information, and perhaps a projection, might be desirable.**

We also note that the investment fees and costs are typically a percentage of assets. Disclosing these fees and costs for only one balance may mislead a member with larger account balances if they do not read the “small print” relating to the \$50,000. Disclosing these fees and costs for two members with different account balances will immediately highlight the impact of the size of a member’s balance on the investment fees.

## SINGLE BENCHMARK

### ***Question 14 Is it appropriate to use a single benchmark (CPI plus percentage return) for all choice product returns?***

No, the Institute does not believe that a single standard benchmark is appropriate for all choice products. The reasons for our view are set out below.

Where an “inflation plus percentage return” is used, the Institute believes that it should be based on a measure of wage inflation such as AWOTE, rather than CPI (see our response to Question 16).

#### ***Comments***

The primary issue is whether a single standard benchmark should be set for all choice products. The secondary issue is if a single standard benchmark is to be set, what should it be.

Choice products have been introduced to enable funds to develop superannuation products that meet a range of different member needs. It is our expectation that these products will provide a wide selection of different investment options, some of which will have return and risk objectives that will be significantly different to any one benchmark. If a single benchmark has to apply to every investment option, the Institute believes that this would stifle innovation and ultimately disadvantage those superannuation members who are looking for specialist investment options.

A fundamental characteristic of a member who is investigating a Choice product is that the member is not willing to take the default option offered by a MySuper product. These members will be willing to, and will want to, obtain more detailed information about the Choice products they are considering. This will mean that these members will be willing to make the effort to investigate what investment products with different benchmarks really offer. These members are less likely to be confused by the additional complexity introduced by having more than one benchmark. They will see it as an opportunity to tailor their superannuation fund to their specific investment objectives. Examples of different objectives might include ‘Cash plus 3%’ or ‘the ASX200 + 2%’.

Where an “inflation plus percentage return” is used, the Institute believes that it should be based on a measure of wage inflation such as AWOTE, rather than CPI.

The reasons for using a wage-based inflation measure follow from a consideration of how the stakeholders in a superannuation fund will use this target.

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We believe that, for accumulation style funds, the net investment return target will be used for two purposes:

1. Members will use the stated level of the investment return target to compare the expected returns that different investment options (both in the same product or in different products) will potentially provide for the member; and
2. Members will use a comparison of actual investment performance with the net investment return target to assess whether the goals established by the members are likely to be achieved.

For accumulation style funds, the final benefit payable to the member is directly affected by the level of investment return achieved. The Institute believes that the investment goals of these members should be to achieve a retirement benefit equal to a nominated proportion of their wage at or close to retirement. It is important to note that the rate of wage increase over time includes the impact of general productivity increases in the economy. Therefore, the rate of increase in wages over the long term is normally higher than increases in prices as increases in productivity feed through to wages.

To assess the impact of using CPI or AWOTE as the base for the Net Investment Return Target, consider a person aged 25 whose goal is to achieve an income of 65% of their final wage on retirement at 65. If we assume net investment earnings of 7% pa, wage increases of 4% pa and the income conversion factor set out in Class Order 11/1227, net contributions (after taxes, fees, costs, insurance etc) of 15% of wage every year for 40 years would achieve this goal. This final benefit is achieved with an investment target of 3% above the rate of wage increases. If we assume that CPI price inflation is 2.5% pa (i.e. 1.5% less than wage inflation), the equivalent price inflation target is 4.5% above CPI.

Now consider how each of these targets would meet the two purposes of the Net Investment Return Target set out above.

The first purpose of the investment target could be achieved if either of these investment targets were used as each option (in the same product or different products) is compared on the same basis.

However, what happens if the gap between wage increases and price inflation is greater than 1.5% because productivity increases are higher than assumed in the original assumptions?

If, in the above example, wages increased by 5% pa rather than 4% pa with the same net investment return and price inflation, the net investment return would be only 2% above wage inflation and the income produced in retirement would be only 52% of final wages, a substantial reduction on the 65% goal established by the member. If the price inflation investment target has been used, the investment would still have achieved its target of 4.5% above price inflation. However, if the investment target is based on wage increases, the actual investment return is 1% below target. If the dashboard provides information on actual investment returns based on the wages increase base, the member will be able to see that this performance is below their long term target. The member will also be able to see that, if this trend continues, they will not achieve their long term goals. This information would not be provided if the price inflation target of CPI was used.



It is therefore clear that an investment return target based on AWOTE will provide more relevant information for members of accumulation funds than a comparable target based on price inflation.

We also have to consider whether members will understand what AWOTE represents and the implications of using AWOTE rather than CPI. Because most members will not be familiar with AWOTE it will be important that material be made available to members that explains what AWOTE is and how an investment return target based on AWOTE differs from one based on CPI. In the main target return disclosure, it could simply be described as 'wage inflation' and then a separate note can disclose that this means AWOTE (which is similar to what was suggested in the results of consumer testing of the dashboard). We expect that members considering a Choice product will be willing to take the time to understand this explanatory material.

The Institute believes that the results that are included in the dashboard (the target and the actual performance relative to this target) will therefore achieve the two objectives discussed above even if the member does not fully understand the fine details relating to the target.

#### NET INVESTMENT RETURN VERSUS NET RETURN

*Question 15: Should both net investment return (investment return net of investment costs only) and net return (investment return net of all associated costs) be used to measure a product's investment return on the choice product dashboard? In considering this question, you may wish to consider:*

- *If including an additional measure for a product's investment return would add unnecessary complexity.*
- *If both net investment return and net return are used on the choice product dashboard, whether they should also be used on the MySuper product dashboard.*
- *Whether it is appropriate to use a single time horizon, for example 10 years, when calculating target net return and net return for the range of possible choice products.*

No, only the Net Investment Return should be disclosed on both the MySuper and Choice dashboards.

The Institute has indicated previously that we strongly believe that administration and advice fees and costs should **not** be deducted from investment returns when calculating net investment returns for the purposes of comparing the investment outcomes and capabilities of different superannuation funds.

The Institute therefore believes that the Net Return as defined by APRA should not be disclosed on either the MySuper product dashboard or the Choice product dashboard. The only metric that is suitable for comparing the investment performance of different product providers is the Net Investment Return where only the fees and costs and tax associated with the investment service are deducted from the investment return. Therefore it is this Net Investment Return and only this return that should be disclosed on both the MySuper and Choice product dashboards. This would remove the issue of disclosure of two returns introducing unnecessary complexity in the dashboard. It will also remove the misleading aspect of the current proposals and supports the Government's aim to reduce regulation and compliance costs.

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The Institute believes that a ten year period is a reasonable period to show actual past investment performance. It is sufficiently long enough to include more than one economic cycle and to provide evidence of trends in comparative performance. It is, however, short enough that it will allow most established superannuation funds to provide a full history of returns. Obviously those funds that have constructed a new MySuper option may have no return history. However, the ten year history will be gradually built up in the dashboard. Also, the lack of a ten-year record will clearly flag to a member that this is a specific area that requires further investigation.

### **Comments**

The Institute strongly believes that the Net Return as disclosed on the MySuper product dashboard should never be used "to measure a product's investment return". The deduction of administration and advice fees and costs is technically unsound and may lead members to make incorrect conclusions about the investment capabilities of a superannuation fund.

Consider for example two funds which have exactly the same past investment performance after investment fees and costs and taxes but where the first fund provides a greater level of general member services than the second fund and therefore charges a higher administration fee to all members. If these administration fees are deducted from the investment return to obtain the net return, the second fund will have a higher net return. Members comparing the two net returns could conclude that the investment capabilities of the first fund are inferior to those of the second fund. This is obviously incorrect.

This will be particularly relevant for Choice products where the level or quality of administration and advice services and the cost of these services can vary from product to product and potentially from member to member. Although there may not currently be significant variation, funds should not be inhibited from adding services because of dashboard reporting requirements.

The deduction of administration and advice fees and costs from the investment return will discourage funds from providing additional services if the additional cost of these services decreases the return disclosed on their product dashboard and this places them at a competitive disadvantage.

An area where this could have an important impact is on the provision of advice. For many superannuation fund members the cost of specific financial advice provided by a financial planner will prevent these members from obtaining even basic levels of advice.

Superannuation funds can however provide scaled financial advice that will have relevance to these members. It would be highly undesirable for the way that investment performance is reported to inhibit the provision of this important service. This will be particularly important where the scaled advice is tailored to the personal circumstances of the member and the member will receive a specific recommendation and statement of advice (SOA) as we expect that these services will involve additional costs. General advice is provided by all funds but scaled advice, where a member can get a recommendation and SOA is a more valuable service that will be provided by most but not all funds. It is the main battleground on the advice side. Scaled advice teams are growing rapidly for most funds and will probably continue to do so.

If the net return as currently defined by APRA is disclosed on the Choice product dashboard, it will mean that the fees and costs for three, totally unrelated, services - investment,

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administration and advice – have to be deducted. Therefore, the comparison of the investment capabilities of two funds will be distorted by the level and type of the administration and advice services offered by different Choice products and the fees and costs charged for these services.

The Institute also believes that if the Return Target disclosed on the dashboard has administration and advice fees and costs deducted it will not be the Investment Return Objective used to actually manage the fund's assets. Funds have never set investment objectives (or targets) net of administration and advice fees and costs. The use of the Return Target disclosed on the dashboard would be particularly inappropriate given that the administration and advice component of the Return Target is set for a "representative" member who may, or may not be, indicative of the actual membership of the fund. The Return Targets will therefore have less relevance to the way that the assets of a superannuation fund are invested.

Further, investment professionals (and investment consultants) analyse and compare investment capabilities by considering Net Investment Return. The introduction of the Net Return calculated as specified will simply complicate and not simplify this analysis.

It has been argued that the dashboard should disclose a Net Return which has administration and advice fees and costs deducted from the investment return as this represents the "overall return" a member receives in their accounts. The Institute believes any discussion on this issue is not relevant to what should be disclosed to members to allow them to assess the investment capabilities of superannuation funds. As discussed above, the Net Return, as currently defined by APRA, measures (misleadingly) the impact of three services. It does not provide information on the investment capabilities of a fund. It also only relates to a "representative" member and can therefore potentially mislead the majority of "non-representative" members.

We also refer to the separate issue as to whether a single time horizon should be used when calculating the target investment return.

With respect to what period should be used when reporting actual historic returns, one must choose a period that can be expected to show the longer term relative performance of superannuation funds. It is important that this comparison should not be overly dominated by one year of superior performance. One must, however, choose a period that will be relevant to most superannuation funds. The Institute believes that a ten year period is a reasonable period to show actual past investment performance.

It is sufficiently long enough to include more than one economic cycle and to provide evidence of trends in comparative performance. It is however, short enough that it will allow most established superannuation funds to provide a full history of returns. Obviously those funds that have constructed a new MySuper option may have no return history. However, the ten year history will be gradually built up in the dashboard. Also, the lack of a ten-year record will clearly flag to a member that this is a specific area that requires further investigation.

In considering this issue we must differentiate between the historical net return and the future target net return.

When calculating the future target net return it is necessary to make assumptions about the level and volatility of future investment returns. The Institute believes that the only practical basis on which to make these assumptions relate to what is expected over the long term. This means that current market conditions will not be taken into account. If current market



conditions were to be taken into account then the target return will have to be changed on a regular basis as it will change as market conditions change. Therefore the target will not be the expected return over any specific ten year period.

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## MEASURING A PRODUCT'S INVESTMENT RISK

**Question 16:** *Should the choice product dashboard include both a short-term (volatility) and long-term (inflation) risk measure? In considering this question, you may wish to consider:*

- *Is the SRM model the best measure of short-term investment risk?*
- *What would be the most suitable measure of long-term risk to include on the product dashboard?*
- *Is it possible to present a long-term risk measure in a similar format to the short-term risk measure) that is High/Medium/Low)?*
- *Would including an additional risk measure add unnecessary complexity to the product dashboard?*

Yes, the Institute believes that the dashboard should disclose two metrics that measure investment risk.

We believe that metrics relating to short term and long term investment objectives must be included. This is necessary to reduce the potential for members to make choices that reduce their final retirement benefits.

We agree that the Standard Risk Measure as proposed in the FSC/ASFA guidance note is an appropriate metric for the short term investment risk.

We propose that the metric to measure long term investment risk should be *the probability that the time-weighted annual net investment return will be less than the expected rate of increase in AWOTE plus 3% per annum over a twenty year period.*

This will mean there will be two risk measures. We acknowledge that this will increase the complexity of the dashboards. We believe they can co-exist on the dashboard as long as a simplifying label such as high/medium/low is not used for each.

The estimated number of negative net investment returns over a 20 year period and the probability of not meeting a reasonable long-term return over wage inflation should provide a good indication of risk, perhaps with some explanatory comments to guide members as to what certain ranges of these measures may indicate about each risk.

The dashboards currently must include a "Risk Label" as well as a "Risk Metric". The Actuaries Institute does not support this. We are concerned that members will only focus on the Risk Label when choosing their investment option. If they did this, it is possible that members will choose options that have less risky short term risk labels. For superannuation fund members with long term investment horizons, it is likely that this will mean that they will achieve lower long term investment returns and therefore lower final retirement balances.

If two risk measures are included, Risk Labels should not be shown for each risk measure as it would confuse members since many investment options will be labelled as both more risky and less risky.

We note that our comments below apply equally to MySuper and Choice dashboards. However, they are particularly relevant to Choice dashboards as it is expected that members who select Choice products will base their choices on an examination of the material





provided by the superannuation fund. This will include information disclosed on the dashboard. It is therefore vital that the information on the dashboard not be misleading.

### **Comments**

The Institute believes that it is desirable for the product dashboard to include an indicator of the investment risk of the product. In assessing the potential investment return that any product can achieve, it is always important to consider the level of investment risk associated with that product. However, it is entirely inappropriate for only a measure of short-term risk to be included in the dashboard, particularly if a risk label is included with the risk metric.

The Actuaries Institute believes that “Investment Risk” should be defined as the risk that a particular investment product does not achieve the investment goals of a member. The difficulty of providing members with investment risk metrics in respect of a specific investment product is that investment objectives vary between members and will depend on their personal circumstances. Notwithstanding this difficulty, we believe that there are two principal goals that a superannuation fund member may have.

1. A member may have a short term investment horizon and therefore wish to protect the capital value of their superannuation balance or part of their balance. For such members, the investment risk is that the investment product will suffer negative returns.
2. Other members may have long term investment horizons and therefore may wish to ensure that their final superannuation balance will allow them to achieve a required standard of living in retirement. For such members, the investment risk is that the investment product does not produce a specified real rate of return.

Addressing each of these needs in turn:

#### **1. Measuring the risk of capital loss**

The Institute accepts that the metric that measures the risk of a negative return in any twelve month period is an acceptable metric for this investment risk. This metric is the “Standard Risk Measure” defined in the joint 2011 FSC/ASFA guidance paper.

We would, however, stress that the methodology used in that paper calculates the risk of a negative return over a one year period and then re-expresses this as a number of negative returns over a twenty year period. It is important to understand that it is not the number of negative returns that are expected over any specific twenty year period. The calculation of this metric would require the impact of the investment return in one year on the next year’s return to be taken into account. The FSC/ASFA approach effectively assumes that each year’s return is independent of the previous year’s return. Notwithstanding this issue, we are generally in agreement with the metric developed by FSC/ASFA.

However, there are a number of technical issues that need further consideration. The Institute has written to ASFA outlining these issues and would be happy to participate in a review of this standard.

#### **2. Measuring the risk of not achieving an adequate long term return**

The Actuaries Institute suggests that the metric to measure this risk should be the probability that the investment return will be less than a specified margin over the rate of salary increases over a twenty year period.

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We believe that members with long term investment horizons will want their retirement benefit to enable them to maintain a predetermined standard of living in retirement. Typically this will be represented by a specified proportion of their salary at, or close to, their retirement.

Over time, salaries tend to increase at a faster rate than price inflation (i.e. inflation measured by changes in the CPI) as the impact of productivity increases is shared between capital and labour. Without these “productivity” increases the income produced by a member's account balance would gradually fall behind increases in community living standards. We therefore prefer long term investment objectives to be based on wage inflation rather than price inflation (Refer to our answer to Question 14 as to why.)

One option would be to make the margin equal to zero i.e. simply use AWOTE as the benchmark rate of net investment return. However, our investigations indicate that this margin will not differentiate between the long term risks for a wide range of investment strategies. For example, the probability of the net investment return exceeding the rate of increase in AWOTE over say twenty years for a capital stable investment strategy would not be significantly different to the probability for a growth oriented balanced fund. This means that a positive margin is required.

To determine the level of this margin we need to consider what an appropriate investment strategy would be for a member with a long term investment horizon. It is generally accepted that a growth orientated balanced investment strategy is the most appropriate for such members (i.e. options with about 70% growth assets). Our analysis indicates that a margin of 3% is reasonable for this type of investment strategy. Our analysis also indicates that this margin is required to ensure acceptable differentiation between the various investment options available to members. If lower margins are used, then most investment options will all have the same risk metric.

We note that in Class Order 11/1227 a margin of 3% above AWOTE has been used as the net investment return for long term projections. It can therefore also be argued that our proposed long term risk metric is the probability that a member will not achieve the projected retirement benefit calculated in accordance with this class order (assuming that all other assumptions are borne out in practice).

We have suggested that a twenty year period is an appropriate length of time over which to measure this metric for the following reasons:

- Although most members will be in the work force for a much longer period than twenty years, most members will have already been working for a number of years and twenty years for the average member's remaining working life time is reasonable.
- Underperformance in the last twenty years of a superannuation fund member's working life has a greater impact on the final benefit than underperformance in the first twenty years.
- During the first twenty years of a member's working life time, the effect of promotions, job changes, etc will have as much, if not more, impact on the final benefit of that member as investment return. In the last twenty years of a member's working life time the investment return will, in most cases, be the most important driver of the member's final benefit.

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We also note that the investment return target of each investment product is to be disclosed in the dashboard. As it is expected that this investment return target will be based on a targeted real rate of return, it is important that the long term investment risk measure be based on the same measure (i.e. if the investment return target is based on AWOTE then the long term risk measure should be based on AWOTE).

### Assumptions used in calculating the metrics

We believe that the assumptions used in calculating the risk metrics should be best estimates of the long term return and risk characteristics of the assets included in each investment product assuming that all assets are at “fair value”. These assumptions will remain constant over time unless there is a significant change to the fundamental factors that determine the return and/or the risk characteristics of any asset class. This will mean that the risk information set out in the dashboard will not need to be changed regularly.

It is, however, important for superannuation fund members to understand that a metric calculated on this basis does not necessarily provide an indication of the risk of an investment product over the next ten or twenty years.

If, alternatively, the return and risk assumptions used to calculate the metrics were to reflect the current position of markets from time to time, the risk metrics would change frequently. The return characteristics of asset classes (even over a ten to twenty year period) are affected significantly by whether the asset class is overvalued or undervalued at the start of the period. Further, the correlations between the returns of asset classes vary over time and will depend on the level of risk in the markets generally at the start of the period. This would mean that if the current state of investment markets had to be taken into account in determining the level of risk disclosed on the dashboard, the information disclosed would change frequently. It would also potentially mean that the relative risk of different investment products would change over time. This would increase the cost of providing this information and would be very confusing for members.

### ADDITIONAL CARVE-OUTS

***Question 17: Are additional carve outs from the choice product dashboard obligations required? If so, why are these additional carve outs required? In considering this question, you may also wish to consider identifying where the gaps in the current carve out provisions are.***

No, we do not recommend any additional carve outs but we suggest a slight change to clarify the intention of the first carve out (see below).

### Comments

The currently proposed carve outs from the choice dashboard are shown in Section 1017BA(4) (a)-(c) of the Corporations Act 2001.

The first set of carve outs, S1017BA(4)(a), covers options where negative investment performance does not reduce members' benefits. These carve outs are warranted as the performance of these options has little relevance to the member, as long as the providing institution has the necessary reserves to support the guarantee. Levels of such reserves are monitored by the product actuary and reviewed by APRA and would not be appropriate to show on a dashboard.

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The first carve out includes the following: ‘an investment account contract that is held solely for the benefit of that member, and relatives and dependants of that member – to cover legacy products such as endowment and whole of life policies’.

While the text provides the example of endowment and whole-of-life policies, the description is not sufficient to make that clear without the example. We suggest that the wording of this part of the first carve-out be changed to make it more clearly apply to such policies. The current wording could possibly be used to exempt a number of different types of product, depending on the definition of ‘investment account’ contract.

The second carve out, S1017BA(4)(b), relates to pension only options. This carve out is also warranted as the purpose of the dashboard is to provide transparency and comparability between superannuation products in the accumulation phase, not the pension phase. The returns of pension options are not comparable with accumulation options as they have a different tax structure. Any side-by-side comparison of returns that includes both accumulation and pension options would be misleading.

The third carve out, S1017BA(4)(c), has the greatest impact on the number of options requiring a product dashboard. It specifically excludes options invested in a single asset, which is intended to exclude options available on a wrap platform. Such an exclusion is warranted, as wrap platforms are simply providing access to investment products already available in the market – the platform provider is not constructing a new investment option/product. Most wrap platforms include several hundred options and there would seem to be little value in having a dashboard for each one. Also such wrap platforms are sophisticated financial products that provide a similar level of flexibility to SMSFs. They require a high level of sophistication from adviser and/or client and therefore the same high degree of consumer protection appropriate for MySuper options is not necessary.

The third carve out does not exempt traditional master trust platforms that employ a mandate structure for each option. This is where the product provider, often under instructions from an investment manager, invests in a number of different assets to create a portfolio that may be diversified across asset classes or focussed on one asset class. It is not appropriate to exempt such options from the product dashboard as such options do not generally exist separately outside the product but are constructed by the product provider. It is helpful for members invested in these options to have access to information on these options on the dashboard. The number of such options in traditional master trusts is generally much less than the number of wrap options, making it feasible to produce product dashboards for these options.

No doubt other carve outs will be considered such as closed options, legacy products etc. But even if an option/product is not open to new money, if a member has money invested in the option/product, they should be provided with easy-to-access information on these options/products. We do not recommend additional carve outs for closed options and legacy products (except for whole-life and endowment assurance products and unbundled life products based on notional accumulations).



## A LIQUIDITY MEASURE

**Question 18: Should a measure of liquidity be included on the choice and/or MySuper product dashboard? If so, what would a suitable measure be?**

Yes, there should be a measure of liquidity included on both the MySuper and Choice dashboards.

There is merit in the Cooper review's recommendation to include a measure of projected liquidity on the dashboard. Members should be alerted that the risk of not being able to access their money is substantially higher in certain options, especially if there is a material risk they may not be able to access their money within 30 days without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation) in some circumstances. It would also be desirable for members to be made aware if there was an option for withdrawals to be frozen and the general circumstances where this could occur.

Further, the liquidity of assets within an investment option which has a mix of different assets is important as the rebalancing that may be required as the relative values of different asset classes change may generate investment losses when illiquid assets have to be sold.

However, it is difficult to construct an appropriate liquidity measure, as the liquidity of different assets can rapidly change, as occurred with mortgage-backed securities during the GFC. Nevertheless, it is still important to include some indicator of the level of illiquid assets. If an investment option is supported by a high level of illiquid assets, it is important that a member (particularly one selecting a Choice product) is alerted to the possibility that access to capital may be restricted in some circumstances.

On balance, the Institute recommends that a liquidity metric equal to the percentage of assets in each option that can be realised as cash within a 30 day period without having a significant adverse impact on the realisable value of the investment (refer to the definition of "Illiquid investment" in the SIS legislation) be disclosed on at least the Choice dashboard. This is reasonably easy to define and determine and would provide an indication of liquidity. This indicator will provide a comparative metric which will highlight to a member considering a Choice product whether this issue requires further investigation.

### Comments

A measure could be used that showed the ability of the product provider to pay x% (perhaps 50%) of the option's assets if overall listed markets fell by, say, 20%. However this would remain a difficult exercise as a range of assumptions would need to be made on the impact of falling markets on the value and liquidity of the underlying assets of the option. It would also be difficult to standardise these assumptions across all Choice products to ensure the results were comparable. In any case, this will not solve the rebalancing issue.

A potential danger with a liquidity measure is that, depending on how it is formulated, it may discourage some members from investing in funds with high quality diversified investment options that have significant unlisted assets but where the fund has sufficient assets and cash flow to warrant it – and where investment choice does not cause equity problems between different options. This is the case in most of the major industry funds that tend to have 20-35% in unlisted assets. Highlighting that a fund has, say, 30% illiquid assets and therefore a medium liquidity measure, may scare off some members, while this allocation to illiquid assets may be entirely appropriate and unlikely to cause a significant liquidity problem.

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The most critical options for which liquidity should be highlighted are single asset sector options with a material liquidity risk in adverse conditions. Such options may include unlisted property options, options investing in mortgage-backed securities etc. The liquidity measure should focus on these types of options without causing undue concern over diversified options with a reasonable level of unlisted assets.

## IMPLEMENTATION ISSUES

***Question 19: Should the commencement date for the choice product dashboard be delayed beyond 1 July 2014? Is so, what date would be suitable for its commencement? What would be the benefits and costs to such a delay?***

Yes, the commencement date should be delayed until at least 1 July 2015 to allow for revision of the MySuper dashboard and the finalisation of Choice product dashboard requirements (which will take some time after the consultation period finishes) and then implementation by product providers.

The main issue the dashboard is trying to address is to provide the least engaged MySuper members with a simple way to evaluate and compare default options, which is where the vast majority of superannuation money is held. There is a need to extend this to the wider universe of Choice options but it is not as pressing as the MySuper dashboard and it is more important to get it right the first time to avoid unnecessary re-work costs.

### ***Comments***

Too often product providers have been required to report certain information (to APRA, ASIC or the public) based on draft standards, only for those standards to be materially altered. This means product providers need to engage in significant re-work, the costs of which are ultimately passed on to members.

It would be better for ASIC and APRA to consult widely with industry on the Choice product dashboard, produce a draft for discussion, finalise the reporting requirement and then allow enough time for product providers to build the tools required to produce the reporting.

The lead-time for such reporting projects is invariably several months and product providers need to be allowed the time to do it properly, especially given that some providers will have a large number of options (with some across several different products) requiring a Choice dashboard. If some aspects of the revised dashboard suggested by ASIC's consumer testing of the MySuper dashboard are added, such as the ability to choose from a range of balances and a link to an asset allocation chart, it will take considerable time for each provider to add these elements to its dashboard reporting. It is in the interests of ASIC, APRA and product providers to get the Choice dashboard right the first time and to avoid a series of re-works brought about by changing requirements. Likewise, not allowing enough time for implementation will mean a rushed implementation that is likely to lead to the need for re-work for many product providers.

There should be a period of at least three months between passing of the final regulations and the commencement dates of the revised MySuper dashboard and finalisation of Choice product dashboard requirements.

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# Submission to the Financial System Inquiry

30 March 2014

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## Executive Summary

### Major Recommendations

1. To prepare the financial system to deal with the challenges of significant demographic change, the Government should adopt a **comprehensive framework for policy formulation** to manage all issues relating to sustainable financing of our ageing population.
2. The Government should establish a **Financial System Policy Commission (FSPC)** whose role is to put forward comprehensive policy options on how to manage the financial system over the longer term to ensure it delivers optimal outcomes for the consumer and the nation.
3. Create an **open data regime** to allow increased access to and analysis of important government held data and modelling information to better manage macro risks to the financial system.

The Australian Financial System has demonstrated advances in efficiency, resilience, innovation and security since the completion of the Wallis Committee Inquiry in 1997. Over the intervening 17 years we have seen continued convergence within the financial system, in particular the advance of financial service conglomerates and the significant growth of superannuation funds. Enhanced licensing and education standards for advisers have been introduced, but the general level of financial literacy within the community remains problematic.

The pace of change has been frenetic and non-traditional players such as telcos, retailers, and technology companies have emerged as potential competitors to established financial institutions. System shocks and corporate failures both domestic and international have also occurred. Nevertheless, the financial system has generally withstood the impacts of the global financial crisis and served the interests of the broader Australian economy and consumers well.

However, major global trends - economic, demographic, technological and societal - continue to bear upon the financial system and the environment is anticipated to become even more dynamic with the introduction of new products, new distribution channels and new payment systems. This change in the landscape also creates new risks (cyber risks, intellectual property issues, innovations in the payments systems and internet purchasing) and quite different expectations and societal behaviours. The continued globalisation of world trade means Australia must maintain its international competitiveness, as well as stability, and ensure its financial system can dynamically react to advances and risks.

With this environment in mind, the Actuaries Institute recognises the significance of this Inquiry and welcomes the opportunity to make a submission on matters that are germane to the expertise of the profession. Rather than comment on each of the Inquiry's terms of reference, the Institute has concentrated on what it sees are several systemic drivers that have implications for the sustainability of the Australian financial system. They are:



- ▶ Demographic change.
- ▶ Regulation effects on competition and efficiency.
- ▶ Data collection and dissemination.

The Institute's contention is that the absence of a comprehensive retirement income policy framework, the lack of a dedicated mechanism to guide policy development and limited access to relevant government held data, constrains the nation's capacity to protect and enhance the financial system.

### Demographic change

The Actuaries Institute considers that Australia's changing demographics are adding significant pressure to our retirement income system and to the wider financial system, over the mid to long term. In Australia, over the next 30 years, the over 65's will double from 3.5 million (15% of the population) to 7 million people (22% of the population) and will outnumber the under 18's. The over 85's population nearly triples from under 0.5 million to 1.4 million people, which will significantly increase demand for acute health care and aged care (see Section 4). Our view is that without public policy changes demographic developments will adversely affect society's ability to finance a desirable standard of living during retirement. Changes to the retirement income system cannot be undertaken in isolation without consideration of age pension costs, aged care costs and all sources of potential funding, including housing wealth.

The retirement income system is a major component of the overall financial system and one that continues to grow steadily. Retirement assets within superannuation are currently \$1.7 trillion and are anticipated to reach \$3.4 trillion (in 2013 \$ terms) by 2028<sup>1</sup>. Significantly, 60% of the current \$1.7 trillion is held by the over 50s and will move into draw down phase over the next 20 years. The sheer size of the system and its impacts on the wider economy as the population ages and accumulation now starts to give way to expenditure requires careful policy planning.

We have intentionally refrained from putting forward a list of potential changes to the superannuation and Age Pension rules (although our attached 2012 White Paper *Australia's Longevity Tsunami What Should We Do?* does include recommendations). We have instead put forward an approach to ensure that a suitable framework is established so that all such decisions whether now or in the future can be made in an appropriate manner that balances all facets of ageing such as retirement income, Age Pension and aged care along with short-term and long-term budgetary constraints.

A coherent overarching framework will allow development of an efficient long-term strategy and reduce the incidence of short-term policy changes. For example, there were 96 superannuation tax changes announced under the previous Government of which 75 are now slated to be rescinded. Constant short-term change involves a significant and perhaps unnecessary cost for the industry and consumers to bear.

We consider that anticipated demographic changes and the resultant increases in aged care and health costs will result in an unsustainable level of government spending over time unless we establish consistent policies with agreed long term targets. We therefore recommend **adoption of a comprehensive framework for policy formulation on all issues relating to the sustainable financing of our ageing population.**

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<sup>1</sup> Rice Warner Personal Investments Market Projections Report, December 2013



## Regulation effects on competition and efficiency

There are a number of challenges facing the current regulatory system. Examples include;

- ▶ Lack of a formal mechanism to clarify or resolve policy differences across regulators.
- ▶ Lack of a 'public lens' when assessing the impact and benefits of financial system policy.
- ▶ Inappropriate time frames for dealing with emerging critical issues.
- ▶ A reactive rather than a proactive approach to emerging challenges.
- ▶ No overarching coordination of policy development related to demographics.

The Institute considers that a dedicated policy mechanism should be created to alleviate these problems with a view to making policy more effective and regulation more efficient. A major recommendation of the Institute is that a dedicated financial services policy mechanism – the Financial System Policy Commission (FSPC) - be established to put forward comprehensive policy options on how to manage the financial system over the longer term to ensure it delivers optimal outcomes for the consumer and the nation.

The Inquiry is also looking to understand how the principles of competition, efficiency, stability and consumer protection underpin the financial system and what risks exist to maintaining a strong regulatory system. Actuaries combine specialist knowledge and technical expertise to help understand risks and assist enterprises to formulate strategies to manage adverse outcomes. Regulation cannot, and should not, completely de-risk the system but should aim to strike the right balance between innovation, competition and stability. All these elements are required to create and maintain a resilient financial system that will satisfy society's needs.

There is a view that domestic regulation may be overly focussed on reducing risk without balancing it against the associated costs. Part of the problem is that the current regulatory framework does not work effectively to manage issues that fall across more than one regulator or is outside all regulator regimes. The Institute believes that a mechanism is required that can develop comprehensive policy recommendations to manage the broader risks to the financial system. We are not looking for more regulation just more efficient regulation.

Accordingly, the Institute recommends the **Government should establish a Financial System Policy Commission (FSPC) whose role is to put forward comprehensive policy options on how to manage the financial system over the longer term to ensure it delivers optimal outcomes for the consumer and the nation.**

## Data collection and dissemination

An actuary's technical skills include the collection and analysis of data to build the models that allow many sectors of the financial system (e.g. general and life insurance, superannuation and banking) to manage risks. While currently available statistics provide insights into particular financial sector activities, it is far more difficult to obtain a system-wide, sector, market or individual view of emerging risk dynamics and behaviours. This information is important and will be needed to help formulate the most effective policies for managing future macro risks to the financial system.

Adequacy of retirement income is a complex function of taxation, home ownership, marital status, superannuation and social security. One area where accurate data would be particularly helpful is in identifying the impact of policy settings. For instance, it would be beneficial in discussing retirement incomes policy questions if we had a better understanding of the extent to which Australian retirees draw down on their assets so they could benefit



from the pension, or conversely, are living too frugally so as to ensure that their assets last their lifetime. This is a critical and evolving risk that needs to be better understood.

Given the impact of changing demographics on the size of retirement savings pools, the effects on investment funds in the post-accumulation phase and rising future health costs it is important for market efficiency that the private sector has access to relevant data so that it can develop the products that will assist consumers best manage their evolving retirement needs. For example, the modelling that underpins Treasury's *Intergenerational Report* 2010 would enable the retirement income sector to better understand and manage the risks that have shaped Government policy, in this area.

The Institute considers that greater discipline across agencies in requesting data combined with expanding access to this more focussed data could allow for better risk signalling leading to improved market efficiency, finer pricing and greater innovation.

We therefore recommend the **creation of an open data regime to allow increased access to and analysis of important government held data and modelling information to better manage macro risks to the financial system**. However, the cost of data collection by the industry needs to be offset against perceived benefits.



# 1. Demographic change

## Recommendations

The Institute considers that enhancements are required to improve the capacity of the current financial system to better manage the ageing demographic challenges.

- ▶ Adopt a comprehensive framework for policy formulation to manage all issues relating to sustainable financing of our ageing population.
- ▶ Encourage bipartisan political agreement for the targets and principles of the comprehensive framework.
- ▶ Under this new policy framework the following issues should be considered:
  - Funding the aged (including the potential role of housing wealth).
  - Greater focus on measures to optimise capital allocation.
  - Reinforcement of the imperative to allocate capital to meet retirement policy obligations and to reject proposals for mandated capital allocation.
  - Consideration of the establishment of an appropriate industry insurance scheme or other forms of support to mitigate annuity counterparty risk.
  - Elimination of barriers to product innovation.

Demographic change, especially the ageing of the population, has been a key driver in the development of Australia's retirement income system. The predicament of an ageing population is well documented (see 2012 White Paper *Australia's Longevity Tsunami What should We Do?* and Treasury's 2010 *Intergenerational Report*).

Since the late 1800s life expectancy for boys and girls, at birth, has increased by over 30 years. By 2050 almost a quarter of the population will be aged over 65 compared to 14% now. Australians are already one of the longest lived populations on the planet and our longevity is steadily improving. As a result, ageing and health pressures are projected to result in an increase in total government spending from 22.4% of GDP in 2015-16 to 27.1% of GDP by 2049-50. Consequently, spending is projected to exceed revenue by 2.75% of GDP in 40 years time.

Accordingly, because the retirement income sector is such a significant accumulator and allocator of capital within the overall economy, there needs to be a mechanism for formulating the best policy outcome for the 'public good' and ensuring strong governance structures to maintain the overall integrity of the retirement income system. Specifically, regulation needs to be considered in the context of a comprehensive policy framework that involves:

- ▶ Setting overall targets for financing the ageing population e.g.
  - Retirement income levels
  - Age pension costs, levels and coverage
  - Aged care costs
- ▶ Establishing principles for policy formulation:
  - Consistency
  - Adequacy
  - Affordability



- Sustainability
- Simplicity
- Flexibility
- Equity
- Certainty
- Clarity

The current structure of the retirement income system results in the vast majority of retirement assets being invested in products where the individual retains the risk – market (including sequencing risk), inflation, longevity (both individual longevity and overall population) and morbidity risk. The taxpayer (through the Age Pension safety net) bears the risk of adverse outcomes in market, inflation, longevity or morbidity risk for the individual. This pension safety net can influence consumers' investment decisions knowing that they will benefit from any upside, but be protected on the downside.

### Longevity risk

It is often inefficient for diversifiable risks, such as an individual's longevity, to be retained, and they are better addressed through a pooling mechanism where they can be shared. There may be a range of mechanisms that can manage risk pooling. The more risk is borne by the private sector or other pooling mechanism the more the overall risk to the taxpayer will be reduced.

Policy focus at the moment is concentrated on the retirement fund accumulation process but attention needs to be refocused on the impacts of the de-accumulation phase as retirees begin to draw down from their superannuation assets. This will potentially have macro-economic and consumer impacts. Product innovation needs to be encouraged to promote flexible products (e.g. indexed linked annuities or annuities with reduced guarantees) to make pricing attractive and boost demand. It is in the community's interest to have effective retirement products that ensure de-accumulation is orderly and retirement goals continue to be met.

Given that the taxpayer ultimately bears the risk related to how individuals access and invest their retirement savings, it is reasonable that the Government proposes various incentives and/or restrictions on how superannuation fund assets can be drawn down (see 2012 White Paper *Australia's Longevity Tsunami What Should We Do?*) Underestimating life expectancy will have major implications for retirement incomes policy and also drive up economy-wide costs to levels significantly higher than currently projected.

The rise in Australians' life expectancy is not commonly understood although underestimating longevity risk has enormous tax, retirement, health and economic policy implications for the nation. Life expectancy quoted by media and even organisations such as the ABS is consistently understated. For example, life expectancy at birth is often quoted as being 79 for males and 84 for females. However, this increases to 93 and 94 respectively when the mortality improvements published by the Australian Government Actuary are taken into account.

### Capital allocation

The mandatory Superannuation Guarantee charge, tax concessions and policy responses to demographic changes, have all driven the development and expansion of superannuation pools. The Institute believes that capital allocation may become problematic as investment pools continue to deepen and become increasingly attractive as potential funding sources for infrastructure and social development. There is clear logic for superannuation funds to



support longer term investments in infrastructure but regulatory impediments currently exist (e.g. SIS 30/3 day liquidity rules). The sector as a whole must retain its ability to allocate capital in a manner consistent with retirement goals and free of mandatory allocation directives.

### Counterparty risk

Products with long-term payment guarantees to retirees issued by life companies are regulated by APRA and are subject to very strong capital and risk management requirements. However, there is still a potential risk that insurers may not be able to fulfil their obligations over the long term. Consumer concerns about counterparty risk may pose constraints for future development of lifetime annuity markets and products.

The GFC gave explicit form to the implicit guarantee to the global banking sector. The guarantee further encourages older investors to place a large proportion of their assets in short-term deposits. These are not always suitable investments for the generation of long-term income. Therefore to level the playing field and encourage long-term investments (such as infrastructure), to allay consumer concerns about counterparty risk, and to promote innovation in the longevity insurance market, consideration could be given to the introduction of an industry scheme, or other forms of support, to provide financial assistance to consumers that suffer loss through counterparty failure.

Nevertheless, any such guarantees need to be costed and paid for by the consumers to minimise cross-subsidisation between product consumers and the taxpayer. US state-based guarantee associations and the UK Financial Services Compensation Scheme are two options for consumer protection that could be explored. These guarantees may be limited to specific products or amounts so as not to impede product development of low or non-guaranteed products.



## 2. Regulation: stability, competition and efficiency

### Recommendations

- ▶ Establish a Financial System Policy Commission (FSPC) whose role is to recommend comprehensive policy options on how to manage the financial system over the longer term to ensure it delivers optimal outcomes for the consumer and the nation. Issues that could fall into the FSPC's domain could include:
  - Establishment of a comprehensive framework for policy formulation on all issues relating to sustainable financing of our ageing population.
  - The framework to balance prudential regulation against the broader public interest of cost and competition.
  - The framework for consideration of the competitiveness of Australian-based insurance capital on the global stage.
  - The cost of risk including the question of 'Too Big to Fail'.
  - Affordability and distortionary effects of financial system policy.
  - Efficiency and effectiveness of consumer disclosure.
  - Rationalisation of legacy products.
  - Clarification of regulatory inconsistencies.
- ▶ Require Mandatory Regulatory Impact Statements for all government initiatives related to retirement income and the aged to ensure consistency with accepted principles and clear understanding of social and economic impacts.
- ▶ Formalise and expand the role of the Council of Financial Regulators (Treasury, RBA, APRA, and ASIC) to include the proposed FSPC.

### Regulation -v- Cost

We note that this Inquiry intends to recommend initiatives that make the financial system more efficient, competitive and flexible consistent with financial stability, prudence, public confidence and capacity to meet the needs of stakeholders. The Institute believes that improved regulation and better policy formulation can drive efficiency within the financial system, particularly in the retirement income sector.

The regulatory framework established after the Wallis Committee has served the financial system well and helped it withstand its sternest test: the GFC. Nevertheless, regulation continues and, while policy objectives may be achieved, related costs are also imposed upon the system and ultimately consumers.

Globalisation has prompted the imposition of internationally formulated regulation that also adds cost to the Australian financial system and affects capital allocation. Despite its performance, the Australian financial sector is leading regulatory change ahead of its international counterparts. Moreover, Australian domiciled companies face additional costs both in terms of financing and in the usage of capital in overseas ventures relative to many of their international competitors.





The regulatory responses to the collapse of HIH, the Commonwealth Bank acquisition of Bankwest and the GFC highlight the tension between the imperative to ensure financial stability and the desire to maintain the benefits of competitive markets. Initially governments decided to err on the side of stability although different regulators have argued about the balancing point. It should be recognised that excessive regulation can also lead to a transfer of risk outside the regulatory regime (shadow banking, hedge funds) or offshore (internet-based insurance products) with the resultant loss of Australian regulator protection, services to the domestic consumer and loss of domestic jobs. However, excessive competition does not necessarily lead to positive consumer outcomes.

Two recent regulatory trends that have the ability to distort the effective risk signalling and efficient management of the various sectors are harmonisation and principles -v- prescription.

#### ► Harmonisation between sectors in the financial services

Regulatory harmonisation within the financial system makes sense in some aspects, such as business continuity and fit and proper standards. However, in other areas there are fundamental differences in the types of risks faced by life insurers, general insurers and banks. For instance, applying operation risk reserve requirements to corporate superannuation defined benefit schemes could be considered unnecessary, especially for AAA rated corporates. The transfer of regulatory concepts from one sector to another, e.g. banking to general insurance, without differentiating between them is counter to prudent risk management which must allow companies and sectors to manage their principal risks.

On the other hand, the broader financial system needs a consistent regulatory overlay to avoid any regulatory arbitrage of products or inconsistency that may reduce competitive neutrality.

#### ► The move from principles-based to a prescriptive regulatory regime

Principles-based regulation has been a strong theme of Australian regulation that has come under challenge since the GFC with several regulators applying more prescriptive regimes. For example, financial product disclosure and communication guidance are quite prescriptive about providing paper policy documents for internet sales even when consumers did not want them.

The Australian financial system needs to remain dynamic and adaptive in the face of broader societal changes that are occurring. Although prescription-based regulation can have a role the Institute considers that principles-based systems are better equipped to respond to change.

### Financial System Policy Commission

There are a number of challenges facing the current regulatory system. Examples include:

- Lack of a formal mechanism to clarify or resolve policy differences across regulators.
- Lack of a 'public benefit' lens when assessing the impact and benefits of financial system policy.
- Inappropriate time frames for dealing with emerging critical issues.
- A reactive rather than a proactive approach to emerging challenges.
- No overarching coordination of policy development related to demographics.



The Institute considers that a dedicated policy mechanism should be created to alleviate these problems with a view to making policy more effective and regulation more efficient. We recommend that a dedicated financial services policy mechanism - the Financial System Policy Commission (FSPC) - be established to put forward comprehensive policy options on how to manage the financial system over the longer term to ensure it delivers optimal outcomes for the consumer and the nation.

This Commission would be independent of current sector regulators, have the authority and commercial expertise to intervene when regulatory inconsistencies emerge and consider the need to weigh the risk/return elements of competition against the need for prudence and desire for resilience. Importantly a 'public benefit' lens should be applied to ensure the balance between stability and competition is finely tuned.

It is acknowledged that the Commonwealth Treasury has the primary role in formulating financial sector policy and is the key economic adviser to the Treasurer. The FSPC would not assume those roles but could function in a similar manner to the Australian Government Productivity Commission which is the Government's independent research and advisory body on all aspects of microeconomic reform.

The Institute envisages that the FSPC would have a similar aim to that of the Productivity Commission i.e. to help governments make better policies in the long-term interests of the Australian community. The FSPC would also be independent of government and its policy scope would be wider than just productivity. Importantly, the FSPC would work with related agencies - RBA, APRA, ASIC, Treasury - to develop comprehensive policies to manage the financial system over the longer term to ensure it delivers optimal outcomes for the consumer and the nation. The FSPC would undertake independent research into relevant issues. Its research findings and policy positions would be made available to the public to better inform important policy debates.

The FSPC would also be expected to act as a 'third umpire' in clarifying or resolving policy positions adopted by different regulators or at least assist the Council of Financial Regulators (COFR) reach determinations that remove regulatory uncertainty from the system. The FSPC could consider major policy topics such as those listed below.

## Areas of Investigation

### ► The cost of risk

Currently capital requirements are often set in isolation without consideration of the broader macro-economic impacts. For example, increasing capital backing for particular risks, products and services could lead to credit rationing or withdrawal of product. Consideration of the cost of risk also requires an understanding of who really bears that risk (customers, shareholders, taxpayers or others) and how they are rewarded for doing so. The existence of 'Too Big to Fail' institutions highlights this issue since it is not clear that taxpayers are adequately rewarded for the risks such institutions impose upon them. Mitigations to consider include the imposition of guarantee charges and operating conditions on relevant institutions. Of course sometimes when risks are transferred the market may be inefficient and risks can be under-priced which leads to an even greater amount of risk taking.

### ► Affordability and distortions

We use taxation to encourage or discourage certain behaviours (e.g. saving through superannuation) and capital charges can have similar impacts - although not necessarily by design. Price controls such as community rating are used to improve affordability for those



who otherwise would be locked out. These measures mean that there is cross-subsidisation within the financial system which should be tested periodically to ensure that policy goals are being met.

#### ► Effectiveness and efficiency of customer disclosure

Government attempts to encourage behaviour by tax incentives or other measures are thwarted by factors that reduce consumers' ability to make informed choice. Comprehensive product descriptions do not get read and financial literacy programs have had little impact, to date. The FSPC could examine the concept of a set of products with standard terms, conditions and structures enabling very short product disclosure statements. The UK, for example, has a small set of standard products called the 'stakeholder suite' that exhibit these characteristics. This option is not intended to impede innovation but simply to provide another product option for consumers.

### Current issues

#### ► Pricing and risk signalling

Another area of investigation by the FSPC could be the impact of natural disasters on general insurance affordability. When no flood cover was available and no risk signal was given to the community, properties were developed in high risk flood areas. Now that cover is available and information on the risk has improved, many insurers now estimate a price for each individual customer incorporating data at the address level. This has resulted in many inherent cross subsidies previously incorporated in premiums being eroded, with the most-at-risk customers paying the highest price.

Although this should in the long-term result in a price signal that encourages mitigation, in the short-term it results in a large number of people in flood exposed areas unable to afford their flood premiums and not insuring. Not insuring means communities are less likely to be resilient and that disasters are funded post the event by government. It is also not clear that these price signals are being borne by those in a position to actually mitigate the risk e.g. property developers.

The FSPC could also consider recent losses in the life insurance business which are expected to result in higher prices and increasing affordability issues. There are a number of factors affecting insurers' increasing claims and expense experience in recent years. The FSPC could assist with enabling the industry and different regulatory bodies to fast track a solution that is in the public interest by developing an overarching strategy to resolve these issues, many of which fall outside the areas of specific regulatory control.

#### ► Legacy products

Regulatory friction is also demonstrated by the system's inability to rationalise legacy products due to conflicting regulator priorities (ATO/APRA/ASIC) and a lack of a mechanism for changing existing products. This creates a drag on wealth management businesses in Australia and present a number of risks to consumers and businesses alike, including:

- Legacy products may no longer be servicing consumers' insurance and investment needs.
- Expensive maintenance costs are worn by consumers.
- Complex and outdated administration systems.
- Lack of investment in IT platforms and increased compliance risk.



- ▶ A resultant impediment to innovation as companies will not want to launch new products that could be on the books for many years even if they are not successful.

The introduction of a mechanism for rationalising legacy financial services products (subject to a no disadvantage test) will generate significant benefits for the economy, consumers and industry players. Rationalisation would also enable better data to be gathered to assist our understanding and management of underlying risks e.g. mental health claims within life insurance. Reforms of this nature will facilitate product rationalisation across all wealth management products and increased development of modern products, leading to better servicing of the population's insurance and investment needs, businesses cost and efficiency benefits for an overall reduction in compliance costs.

### Council of Financial Regulators

The FSPC could engage in the deliberations of the Council of Financial Regulators (COFR) - the regulator coalition that includes the RBA, Treasury, APRA and ASIC - to drive more consistent policy outcomes and achieve efficiency by:

- ▶ Taking a strategic view of the impacts, benefits and costs of sector regulation through the 'public benefit' lens.
- ▶ Balancing the views of multiple government stakeholders; APRA, Treasury, ATO and ASIC etc. in policy debates and acting as a "third umpire".
- ▶ De-politicising the retirement income system and reduce 'system tinkering'. The community's desire for simplicity and certainty is undermined by continuous change.
- ▶ Driving rationalisation of legacy products that are causing a drag on wealth management businesses through higher systems costs, increased compliance risk and act as a disincentive for product innovation.

On a broader note, the Institute sees benefit in formalising and expanding the role of the Council of Financial Regulators. The revamped COFR, including the Financial System Policy Commissioner, would meet formally and regularly to adjudicate on policy and regulatory conflicts emerging from the domestic sector or through international developments, e.g.

- ▶ Dealing with distressed entities.
- ▶ Coherent regulation of SMSFs.
- ▶ Competition aspects of consolidation of superannuation funds.

An example of where FSPC could apply a community 'public benefit' lens is to assist product development in the annuity market, which is currently constrained by a number of factors including: the differing policy objectives of individual regulators, a lack of consumer awareness of longevity risk and APRA's significant capital requirements.

Consequently, a number of annuity products that are readily available internationally are effectively absent in Australia. These include various forms of linked, with-profit and deferred annuities. The consumer benefits of such annuity products are that retirees can transfer their longevity risk but absorb the investment risk thereby reducing their overall cost.



### 3. Financial sector data collection

#### Recommendations

- ▶ Create an open data regime to allow increased access to and analysis of important government held data and modelling information to better manage macro risks to the financial system.
- ▶ Refer regulator data collection requests to FSPC or COFR to assess the costs, confidentiality and benefits of the request. Potentially representatives from the professions and universities that are likely to be users of the data and the industry as the providers of data could also be involved.
- ▶ Utilise the open data regime to better understand the growing impact of the capital flows in and out of the retirement income system, and their macro-economic implications.

Along with demographic changes, rapid technological advancement is one of the key drivers of system change and increased risk within the financial sector. Exponential increases in computing power, more extensive computer use, particularly internet use, and technological innovation such as big data analytics have changed our potential to collect and analyse government, company and industry data. However to benefit from this wealth of information there needs to be expanded access to it.

As actuaries, we have expertise in the monitoring of financial security systems. We believe that the industry could benefit as a whole from having better feedback mechanisms in place, in order to understand much more completely and dynamically the changes in the financial services “system”. Given the size and impact of the industry, we believe it would be beneficial to create an open data regime to allow increased access and analysis of important government information to help ensure the financial system achieves its goals with minimal negative impacts. The resultant transparency would spur competition and improve systemic and emerging risk management. It could also enhance Australia’s Pillar 3 public data disclosures by improving transparency and market discipline.

Currently there is very limited government data released on the insurance and banking industries and almost non-existent data on housing/mortgage markets and the broader changes in the accumulation, distribution and use of wealth that will define the financial services landscape over the coming decades. Much of this data is still displayed in 1980’s style reports and simple spreadsheets, compared to where other industries are at such as communications, media, mining, energy, transport, retail etc. This review could be the catalyst for making a transformational rather than incremental shift.

Although confidentiality needs to be considered to protect intellectual property and support innovation there are still advantages to be gained from the public collation and analysis of financial industry data including:

- ▶ **Competition** – frictionless information underpins fully competitive markets.



- ▶ **Market efficiency** – more information on insurance and financial risk allows it to be more finely priced, allowing companies to compete on an equal footing and for more extensive coverage.
- ▶ **Risk management** – more accurate information about the nature and uncertainty of risks allows for a better understanding of the total risk environment, more finely-tuned risk signalling, more comprehensive risk assessment and management, better regulation and more appropriate and efficient determination and allocation of capital.
- ▶ **Innovation** – the G8 describes the opportunities for open data, as follows:  
*Freely-available government data can be used in innovative ways to create useful tools and products that help people navigate modern life more easily. Used in this way, open data are a catalyst for innovation in the private sector, supporting the creation of new markets, businesses, and jobs. Beyond government, these benefits can multiply as more businesses adopt open data practices modelled by government and share their own data with the public."*
- ▶ **Testing policy efficacy** – policy effectiveness is ultimately tested on evidence. Evidence accumulates in data. Moreover, policy can operate across portfolio responsibilities and is often interdependent. Where data is uncollected or partial, policy impacts can only be hypothesised or approximated. In such cases policy may be poorly understood (effects under- or over-estimated) or be ineffective or even redundant. Data needs should be anticipated.
- ▶ **Improving the quality of policy debate** - relevant government data and modelling should also be made available to the private sector to foster constructive debate. Naturally, confidentiality and privacy concerns need to be managed.
- ▶ **Data protection** – privacy risks associated with data sharing are well understood by both private and public sectors and protection principles and regimes are being continually improved.

Open data systems also invite private sector data aggregators and analytical firms with greater propensity to innovate which may accelerate knowledge dissemination. Regulators collect significant volumes of data from financial institutions. There are often significant costs associated with the collection and collation of that data but once consolidated the marginal cost of sharing the data is comparatively small. Nevertheless, cost benefit analysis should underpin all data collection and aggregation.

One area where accurate data would be particularly helpful is in identifying the impacts of policy settings. For instance, it would be beneficial in discussing retirement incomes policy questions if we knew the extent to which Australian retirees spent down their assets so they could benefit from the pension, or conversely, are living too frugally so as to ensure that their assets last their lifetime. This information is not well known and we acknowledge it may be difficult to obtain.

Given the impact of changing demographics on the size of retirement savings pools, the effects on investment funds in the post-accumulation phase and rising future health costs it is important for market efficiency that the private sector has access to relevant data so that it can develop the products that will assist consumers best manage their retirement. For example, the modelling that underpins Treasury's *Intergenerational Report* (2010) would enable the retirement income sector to better understand the rationale for retirement policy settings and improve the retirement income sector's understanding of potential risks.

## 4. Demographics: the case for change

### In Australia in the next 30 years...

**22%** of the population will be over 65

**4%** of the population will be over 85

Age Range	2014 (M)	2025 (M)	2035 (M)	2045 (M)
0 - 17	5.2	5.8	6.2	6.6
18 - 44	8.8	9.7	10.4	11.1
45 - 64	5.8	6.4	7.1	7.9
65 - 84	3.0	4.3	5.1	5.7
85+	0.5	0.6	1.0	1.4
<b>Total</b>	<b>23.3</b>	<b>26.9</b>	<b>30.0</b>	<b>32.7</b>

ABS Series 3222.0 Table B9 Population projections by age and sex.

### 45 will be the new 25 and 85 will be the new 65



1 in 2 people will be aged 45 or over compared to age 25 in 1900



1 in 25 people will be aged 85 or over compared to age 65 in 1900

In Australia in the next 30 years, the over 65's will double from 3.5 million (15% of the population) to 7.0 million (22% of the population) and will outnumber the under 18's.

Whereas currently there are 4.2 people of working age (18-64) for every person aged 65 and over, in 30 years, this will reduce to 2.7. Hence the need to encourage our over 65's to remain active and in work for as long as possible.

The over 85's population nearly triples from under 0.5 million to 1.4 million people, which will significantly increase demand for acute health care and aged care.

The ageing population is a global phenomenon that is certain, the causes are known (decreasing fertility and increasing longevity) and it is not reversible.

### The baby boomers (1946-65) will own the major share of household wealth and will gradually move into drawdown phase.

**47%** of total net household wealth will be owned by the over 65s in 2030 (up from 22% in 2000)<sup>2</sup>

**60%** of the \$1.7 trillion invested in superannuation today is held by the over 50's and hence, will move into a drawdown phase over the next 20 years<sup>3</sup>

### but averages can be deceptive



of baby boomers own 60% of total household wealth of \$1.6 trillion (average personal wealth is \$910,000)

of baby boomers own just 4% of total wealth (average personal wealth is \$68,000)<sup>4</sup>

2 Productivity Commission Inquiry Report Volume 1: Caring for Older Australians 2011 Page 60

3 Actuaries Institute Australia's Longevity Tsunami What Should We Do? 2012 Page 11

4 Productivity Commission Inquiry Report Volume 1: Caring for Older Australians 2011 Page 61



## Life expectancy is consistently understated

Life expectancy quoted by media and even organisations such as the ABS is consistently understated. For example, life expectancy at birth is often quoted as being 79 for males and 84 for females. However, this increases to 93 and 94 when the future mortality improvements as published by the Australian Government Actuary are taken into account<sup>5</sup>.

### Life expectancy at 65

The average 65 year old is already expected to live well in the late 80's. Within 50 years, this will increase to the mid-90s.



### Life expectancy at birth

Life expectancy at birth has increased by over 35 years since 1908, when the Age pension was first introduced in Australia for age 65 for men and 60 for females.



## What do these demographic challenges mean for Government spending?

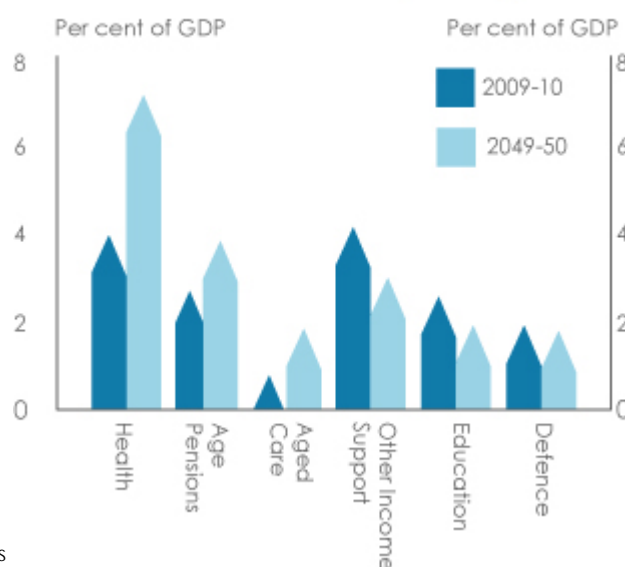
Government projections show that the means tested Age pension costs over the next 50 years is not in itself a problem (2.7% to 3.7% GDP). However, when combined with aged care and health costs, the total costs increase from 7.6% to 13.3% GDP<sup>6</sup>.

When State and Territory costs are included, the costs increase from 10.0% to 17.1% GDP<sup>7</sup>.

The Intergenerational Report 2010 states that:

*"Ageing and health pressures are projected to result in an increase in total government spending from 22.4 per cent of GDP in 2015-16 to 27.1 per cent of GDP by 2049-50. As a consequence, spending is projected to exceed revenue by 2¾ per cent of GDP in 40 years' time."*

### Government Spending



<sup>5</sup> Australian Life Tables 2005-2007 with mortality improvements

<sup>6</sup> Intergenerational Report 2010

<sup>7</sup> Productivity Commission Research Paper: An Ageing Australia: Preparing for the Future 2013





## How will we fund our older years?

Expenditure needs of individuals will be broadly split between personal living costs and accommodation/health/aged care costs. It is likely that our personal living costs will be largely funded by a combination of work, superannuation/savings and the Age Pension. Our accommodation/ health/aged care costs will be largely funded by our housing wealth.

### Personal living costs



The ASFA Retirement Standard benchmarks the annual budget needed by Australians to fund either a "modest" or "comfortable" standard of living in the years post-work.

	 single	 couple
"Modest" lifestyle	\$23,000 pa	\$33,000 pa
"Comfortable" lifestyle	\$42,000 pa	\$57,000 pa
Age Pension	\$21,500 pa	\$32,500 pa

### Retirement savings

Superannuation account balances are increasing but will remain modest for most people and are not in themselves sufficient to meet even a modest level of personal living costs.

### Current level of savings

	 single	 couple
Average superannuation account balance (2009-10)	\$72,000	\$40,000
Average superannuation payout on retirement (2009-10) <sup>9</sup>	\$192,000	\$113,000

### Projected future level of savings

#### \$300K/\$380K

Projected superannuation account balance where a worker on \$65,000 pa receives 9.25%/12% Superannuation Guarantee contribution for 35 years.

#### \$15K – \$20K pa

The annual income which could be funded from this level of savings for a 65 year old. However, an Age Pension would also currently be paid (after allowing for the means tests), which would take total annual income to around \$30,000-\$35,000 pa, which is between the modest to comfortable level of living costs noted above<sup>8</sup>.

Not all super will fund retirement income as 1 in 3 homeowners approaching retirement had mortgage debt in 2010, up from 1 in 6 in 2002.

## The role of the Age Pension

As the compulsory superannuation contribution will not generate sufficient savings to replace the Age Pension, the majority of workers will continue to be at least partially reliant on the Age Pension in their older ages.

**Now...**  
**80%** of retirees currently receive all or part Age Pension (60% on full age pension).

**In 40 years...**  
**75%** of retirees will still receive all or part Age Pension (35% on full age pension) in 40 years' time<sup>10</sup>.

<sup>8</sup> 6.5% investment return in accumulation, 5.5% investment return in retirement, 3.75% salary inflator and deflator, 35 years accumulation and ASIC Money Smart Retirement calculator

<sup>9</sup> ASFA Insight, 26 September 2011 Developments in the level and distribution of retirement savings

<sup>10</sup> Intergenerational Report 2010 Page 60

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## Accommodation/aged care costs

The need for aged care rapidly expands after age 85 due to the likelihood of dementia (over 20%) and disabilities requiring assistance with daily living (50%)<sup>11</sup> and the cost of aged care is increasing. The previous government, as part of the Living Longer Living Better reforms, clarified that self-funded retirees will be responsible for accommodation and personal living care costs, and the government will provide for health care costs. People with means will pay more in the future for aged care costs.

---

82

Average age of entry to permanent residential care for both sexes

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70%

of people in residential care receive high level care<sup>12</sup>



3/5 men and 3/4 women aged 65 will experience disability severe enough to require long term care in their lifetimes<sup>13</sup>.

---

Older people are often asset rich but income poor. As superannuation savings, work and the Age Pension is only expected to meet the personal expenditure costs, our home will be the source of funds for aged care costs.

---

80%

of over 65's own their own home<sup>14</sup>

---

\$400k

mean household value for over 65s<sup>15</sup>

---

Over 60%

of net wealth for 65-74 is in the home

---

Over 70%

of net wealth for over 75's is in the home<sup>16</sup>

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*(Information provided by Catherine Nance, Actuary, PwC)*

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<sup>11</sup> Productivity Commission Report, Caring for older Australians, August 2011 Pages 41 and 44

<sup>12</sup> CEPAR ARC Centre of excellence in Population Ageing Research November 2012

<sup>13</sup> Productivity Commission Report, Caring for older Australians, August 2011

<sup>14</sup> HILDA survey 6554.0 2013

<sup>15</sup> Productivity Commission Report Caring for Older Australians page 61 2011

<sup>16</sup> HILDA survey 6554.0 2013



## 5. The Actuarial Profession

### Actuaries' Role in the Financial Services Industry

Actuaries have a reputation for intellectual depth, for technical expertise and for integrity. They apply their risk management expertise to allocate capital efficiently, identify and mitigate emerging risks and to help maintain system integrity across multiple segments of the financial and other sectors.

Within the community we rely on engineers to stop things breaking down. We rely on actuaries to do a similar process in the financial system. They provide a control cycle with regard to pricing, reserving and risk management.

They have performed this control function in the life industry ever since it began, in general insurance over the last 30 years and more recently in health insurance. Within superannuation they have particularly assisted in defined benefit superannuation schemes.

Actuaries also work in other areas in non-statutory roles such as risk management, banking and data mining. By combining commercial acumen with mathematical rigour and deep analytical skills, actuaries have the ability to find pure, honest insights within business data. Insights which are then used to inform business and government and drive change.

In many instances, an actuary's role complements that of the government regulator by bringing attention to the board and management, issues that represent regulatory needs. As such, Actuaries are well placed to comment on the fitness of the current financial system to continue to support consumer needs into the future.

Although actuaries are embedded in the financial services industry, they have rigorous practice requirements, quality practice guidance and valuable continuing professional development, all of which ensure their integrity and effectiveness.

### The Actuaries Institute

The Actuaries Institute ("the Institute") is the sole professional body for actuaries in Australia.

This submission's recommendations are underpinned by the Institute's adherence to the following policy principles:

#### ► Public benefit

The Institute holds the 'public interest' or 'the common good' of the Australian community, or to a particular group of consumers, as a key principle of policy development. The financial services system should fundamentally serve the broadest public benefit whilst satisfying individual consumer needs.

#### ► Risk focus

In considering solutions to public policy issues actuaries take an evidenced based approach that focuses on identification and management of risks – what they are, who carries them, who should carry them and how those risks should be best managed.



### ► Transparency and disclosure

The careful analysis that actuaries can provide is underpinned by the availability of data. Broadly, the more data that is available and the better the quality of that data the more accurately risk can be assessed. Actuaries also value clear, concise and standardised disclosure of information to consumers on the basis that such disclosure enables consumers to exercise choice more confidently.

### ► Equity

Individual consumers should be given fair treatment and commercial enterprises should be allowed to compete on a 'level playing field'. Technological advancement is fostering new sources of competition from non-traditional players. As long as required capital standards are met consumers can benefit from this increased level of competition. Nevertheless regulation should be neutral for all competitors to avoid any arbitrage that can undermine consumer protection.

### ► 'Good' regulation

Excessive or unnecessary regulation can diminish market efficiency and undermine public benefit. Good regulation should balance cost and benefit. Self regulation is favoured as it is often efficient and reduces consumer costs although prescription can sometimes be more appropriate.

# Australia's Longevity Tsunami

What Should We Do?



WHITE PAPER

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# Executive Summary



Australia is experiencing a major demographic and societal transformation. By 2050, almost a quarter of the population will be aged over 65 compared to 14% now. Australians are already **one of the longest lived populations on the planet**, and our longevity is steadily improving.

Australian life expectancies are rising much faster than commonly understood and this has serious social policy implications – especially in economic, retirement incomes, health and welfare policy.

Public commentary on life expectancies is normally driven by the annual release of the Australian Bureau of Statistics reports<sup>1</sup>. These 'reported' life expectancies are a snapshot that capture past longevity improvements but make no allowance for expected future **improvements**.

There are efforts made by various arms of Government and other organisations to predict cohort life expectancies, i.e. life expectancies which include projected future mortality improvements. While more realistic, owing to uncertainty of future outcomes there are plausible scenarios where this approach too will underestimate life expectancy.

**Underestimating life expectancy will have major implications** for retirement incomes policy. An effective retirement incomes policy should take into account the uncertainty that an individual faces in understanding the financial implications of their own longevity. It should also anticipate that the **economy-wide costs** of providing for older people could be significantly higher than currently projected.

**What can policy-makers do** to protect Australians against the risk that we have underestimated future life expectancies?

In this White Paper the **Actuaries Institute** is contributing to the debate on this **Longevity Tsunami**, by identifying the issues that should be on the table when the Government is developing **retirement incomes policy**. This discussion builds on our Policy position on retirement incomes<sup>2</sup>, and previous submissions we have made to the Government, in particular the Cooper Review<sup>3</sup> in 2010 and pre budget submissions in 2011<sup>4</sup> and 2012<sup>5</sup>.

We explore some important ways in which the Government can address these problems, including a discussion on how post-retirement financial services products – and the Government's approach to their regulation – could contribute to the solution.

The objective of this discussion is to highlight structural changes in the current retirement incomes rules that are needed to mitigate the financial risks of unpredictable increases in life expectancy.

<sup>1</sup> ABS 4125.0 - Gender Indicators, Australia, Jan 2012

<sup>2</sup> [http://www.actuaries.asn.au/Libraries/PublicPolicy/PolicyPositionRetirement\\_IncomesMarch2012.sflb.ashx](http://www.actuaries.asn.au/Libraries/PublicPolicy/PolicyPositionRetirement_IncomesMarch2012.sflb.ashx)

<sup>3</sup> [http://www.actuaries.asn.au/Library/2010\\_0219\\_Sub\\_Super\\_System\\_Review\\_Phase\\_3\\_Structure\\_Final.pdf](http://www.actuaries.asn.au/Library/2010_0219_Sub_Super_System_Review_Phase_3_Structure_Final.pdf)

<sup>4</sup> [http://www.actuaries.asn.au/Library/2011\\_0124\\_Treasury\\_Pre\\_Budget\\_Submission.pdf](http://www.actuaries.asn.au/Library/2011_0124_Treasury_Pre_Budget_Submission.pdf)

<sup>5</sup> <http://www.actuaries.asn.au/Library/Submissions/reBudgetSubmissions/2012/PreBudgetSubmission2012.pdf>

# Executive Summary CONTINUED



These changes include:

1. **Providing greater incentives to individuals to take the majority of their retirement benefits as an income stream.** Currently there is no tax payable on lump sums drawn from superannuation funds for members aged 60 and over, although there are some tax incentives for assets to remain invested in the superannuation system in retirement. There is therefore potential for people to draw all of their retirement funds at the earliest opportunity, spend these savings, and then fall back on the Age Pension. Whilst there is little evidence that a material number of retirees do this, there may be a case for the Government to consider providing greater incentives for post-retirement assets to be used to provide an income stream. In particular, those retirees that can afford to should be incentivised to protect themselves against their own longevity.
2. **Increasing the preservation age to three to five years less than the Age Pension age.**
3. **Extending the MySuper regime to include post-retirement solutions with “intelligent defaults” that provide retirees with secure income streams.** In particular, we propose that if a person has retired from full-time employment and does not choose a specific retirement product (e.g. they are already in a MySuper default superannuation product), then they are placed into an income stream product that allows flexibility and control of capital in the younger retirement years, and then potentially provides a guaranteed income in later years to supplement the Age Pension.
4. **Removing the impediments that discourage older people who want to work.** In particular remove the age limits on superannuation contributions, encourage workforce participation by changing the Means Test, and consider introducing an increased Age Pension or a lump sum payment for people who continue to work past the Age Pension age.
5. **Removing the legislative barriers preventing innovation in developing post-retirement income stream products such as annuities.** There are a number of well documented legislative and taxation barriers to innovation in the annuities market.
6. **Moving to link changes in the Age Pension eligibility age to improvements in life expectancy.** We recognise that the Government has recently acted to increase the qualifying age for the Age Pension to age 67. This increase is to be phased in over six years, commencing from 1 July 2017. Over the longer term, we suggest that the Government consider increasing the Age Pension eligibility age in line with increases to life expectancy.



# What do we know?



The average global life expectancy has doubled over the past 100 years<sup>6</sup>. Half of all the people who have ever lived to age 65 are *currently alive*<sup>7</sup>.

A 2002 United Nations report<sup>8</sup> states that:

***“Population ageing is unprecedented, without parallel in human history...Population ageing is enduring: we will not return to the young populations that our ancestors knew...Population ageing has profound implications for many facets of human life.”***

Underfunding of retirement is a global issue. We have seen the problems in Europe and the need for severe austerity measures including the lifting of the retirement age and the reductions in age pensions in some countries. In the United States it has been noted that:

***“Social Security remains in a period of permanent cash deficits, with slower economic growth moving the looming bankruptcy date up to 2033. When its trust fund is exhausted, seniors can expect a 25 percent cut in their benefits.”***<sup>9</sup>

Chapter 4 of the International Monetary Fund's April 2012 Global Financial Stability Report<sup>10</sup> highlights the potentially significant global financial implications of longevity risk, that is, the risk that people may live longer than expected, and shows its magnitude – amounting to 25% – 50% of 2010 Global GDP, if people live three years longer than expected which they state is in line with underestimations in the past. The Report states that:

***“More attention to longevity risk is warranted now, given the potential size of these effects on already weakened public and private balance sheets, and because the effective mitigation measures take years to bear fruit. Governments need to acknowledge their exposure to longevity risk; put in place methods for better risk sharing between governments, private sector pension sponsors, and individuals; and promote the growth of markets for the transfer of longevity risk.”***<sup>11</sup>

In Australia, this problem is well understood and policymakers have been focused on the issue for a number of years. Treasury's Intergenerational Report 2010<sup>12</sup> identifies the future increases in Commonwealth Government spending (expressed as a % of Australia's GDP) from our ageing population, especially in the areas of health costs (from 4% to 7% of GDP) and Age Pensions (from 2.7% to 3.9% of GDP).

<sup>6</sup> The World Health Report 2998: Primary Health Care (Now More Than Ever), [http://www.who.int/whr/1998/media\\_centre/press\\_release/en/index1.html](http://www.who.int/whr/1998/media_centre/press_release/en/index1.html).

<sup>7</sup> Prime Time, Marc Freedman, Public Affairs Books, 1999

<sup>8</sup> <http://www.un.org/esa/population/publications/worldageing19502050/>

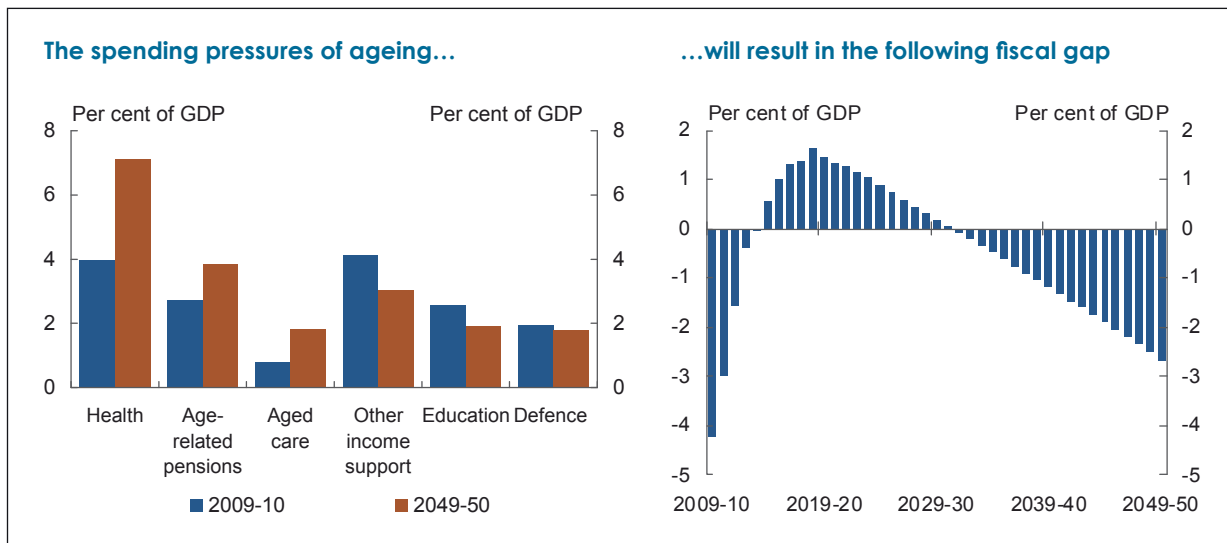
<sup>9</sup> Ryan, P Chairman Ryan: Seniors Deserve Better from President Obama, April 23 2012. Found at: <http://budget.house.gov/News/DocumentSingle.aspx?DocumentID=292036>.

<sup>10</sup> International Monetary Fund, Global Financial Stability Report: The Quest for Lasting Stability, April 2012. Found at: <http://www.imf.org/External/Pubs/FT/GFSR/2012/01/pdf/text.pdf>.

<sup>11</sup> International Monetary Fund, Global Financial Stability Report: The Quest for Lasting Stability, April 2012, page xii. Found at: <http://www.imf.org/External/Pubs/FT/GFSR/2012/01/pdf/text.pdf>.

<sup>12</sup> Intergenerational Report 2010, Australia to 2050: Future Challenges, The Treasury, January 2010. Found at: <http://archive.treasury.gov.au/igr/igr2010/default.asp>.

# What do we know? CONTINUED



Source: [http://archive.treasury.gov.au/igr/igr2010/Overview/pdf/IGR\\_2010\\_Overview.pdf](http://archive.treasury.gov.au/igr/igr2010/Overview/pdf/IGR_2010_Overview.pdf)

The Report states that:

***“Ageing and health pressures are projected to result in an increase in total government spending from 22.4 per cent of GDP in 2015–16 to 27.1 per cent of GDP by 2049–50. As a consequence, spending is projected to exceed revenue by 2¾ per cent of GDP in 40 years’ time.”***<sup>13</sup>

Australians are already one of the longest lived populations on the planet<sup>14</sup>, and our longevity is steadily improving. The Australian Bureau of Statistics recently stated that:

***“Since the late 1800s, life expectancy for Australian boys and girls has increased by over 30 years...”***

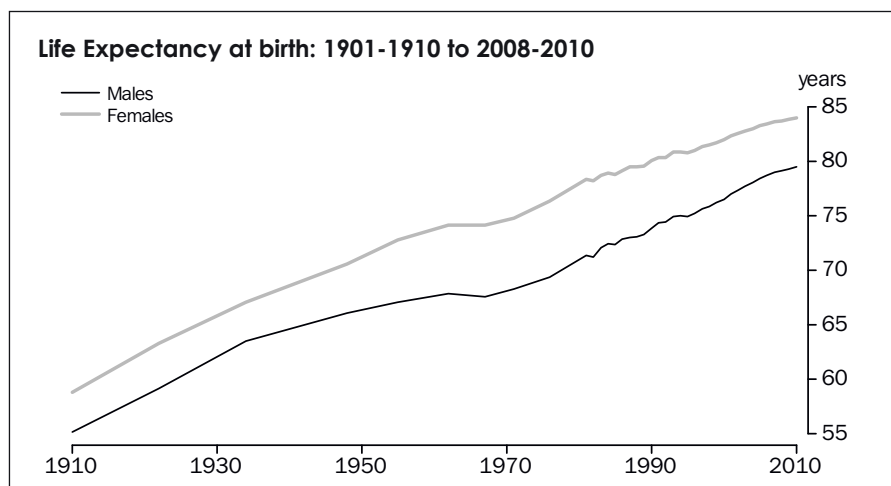
***The past two decades have seen further increases in life expectancy. These increases have been partly due to lower infant mortality, fewer young people dying in motor vehicle accidents, and fewer older men dying from heart disease. The reduction in deaths from heart disease has been linked to medical advances and behavioural changes such as improvements in diet and less smoking.”***<sup>15</sup>

<sup>13</sup> Intergenerational Report 2010, Australia to 2050: Future Challenges, The Treasury, January 2010. Page x. Found at: <http://archive.treasury.gov.au/igr/igr2010/default.asp>.

<sup>14</sup> Population Division of the Department of Economic and Social Affairs of the United Nations Secretariat (2007). World Population Prospects: The 2006 Revision, Highlights. New York: United Nations. For more information, see Appendix A – Life Expectancy.

<sup>15</sup> Australian Social Trends: Using Statistics to Paint a Picture of Australian Society, Australian Bureau of Statistics, March 2011, ABS Catalogue No. 4102.0, page.1.

Source: Australian Historical Population Statistics (3105.0.65.001); Deaths Australia (3302.0).



# What is the problem?

## COMMON UNDERSTANDING VS. THE REALITY OF FUTURE LIFE EXPECTANCY

The latest ABS data reports the life expectancy at birth for a male as 79 and a female as 84<sup>16</sup>. These figures are reported in the media and most Australian retirees base their views on how long they will live on this information.

The more realistic predicted scenario is much more dramatic. After allowing for mortality improvements on a cohort basis (refer to Appendix A), it's estimated that **retirees** aged 65 now (i.e. in 2010) will live until 86 for men and 89 for women. So rather than living 14 years after age 65, men are expected to live 21 years i.e. 50% longer! Similarly women will be living 26% longer! By 2050 the average life expectancy for people aged 65 is projected to have improved to 92 for men and 93 for women.

And this is an average. Many will live longer than this.

So what is the longevity problem? We have nearly 40 years to prepare for increased life expectancies of younger and middle aged Australians. We have ample warning – we know it is coming, and policy-makers have plenty of time to react.

The problem is that it's notoriously difficult to predict improvements in longevity. What if life expectancies begin to improve even faster than the trend over the last 25 years? If that's the case, both individuals and policymakers may be underestimating longevity and hence significantly underestimating the cost of the aged on younger generations.

Exacerbating the underestimation issue is the fact that there appears to be no general community awareness of increasing longevity. The constant focus in the media on the ABS reported life expectancies, results in most people significantly underestimating their own life expectancy. Whilst retirees appear to be frugal because of specific uncertainty about their own life expectancy, for the whole community, the real risk is the UNCERTAINTY surrounding life expectancy.

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**65 year old men  
are projected to live  
50% longer than  
many expect.**

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<sup>16</sup> Australian Life Tables 2005-07. Australian Government Actuary, Commonwealth of Australia, 2009. For more information, see Appendix A – Life Expectancy.

# What is the problem? CONTINUED



## WHY IS IT DIFFICULT TO PREDICT LONGEVITY IMPROVEMENTS?

Actuaries estimate future improvements to life expectancy by looking at how fast life expectancy has improved over past years. This is all the data we have. However, projections based on past trends may not adequately recognise the impact of new medical and other technological advances that could significantly increase life expectancy. Appendix B shows that despite best efforts, some past projections of life expectancy have consistently underestimated actual life expectancies.

Even when allowing for future improvements to longevity (refer to Appendix A) the Government Actuary in the Life Tables Report acknowledges the uncertainty and states that these numbers "should be regarded as indicative rather than firm forecasts of life expectancy."<sup>17</sup>

## UNDERESTIMATION OF FUTURE LIFE EXPECTANCY

Although it is not possible to provide reliable predictions of life expectancy, this discussion anticipates that current projections based on past data (including those in the Intergenerational Report 2010) are likely to underestimate actual life expectancies. As stated in the actuarial paper Longevity in the 21st Century<sup>18</sup> (refer Appendix B):

*"The pace of scientific development appears to be accelerating, and it is possible that this explosion in knowledge will drive increasingly rapid advances in medicine. These advances may cause mortality rates to fall with increasing speed."*

Continued improvements in treatments for cancer and cardiovascular disease (the big killers), as well as the wealth of research currently underway into treating the physical impacts of ageing and even slowing the ageing process<sup>19</sup>, mean that it's plausible that life expectancies of the current middle-aged population could jump beyond expectations.

On the other hand there has been much debate about the so-called "obesity epidemic". If current trends continue it is expected that 80% of Australians will be overweight or obese by 2020<sup>20</sup>. Currently around 61% of Australians are either overweight or obese<sup>21</sup>. It has been noted that people who are overweight or obese suffer medical conditions that can materially reduce their life expectancy compared to their peers who have a healthy weight<sup>22</sup>. It could be argued therefore that increasing obesity reduces the financial risk of longevity. We agree that if the "obesity epidemic" cannot be arrested, this may dampen the potential increase in life expectancies for the unhealthy segment of the population.

However this trend may not continue, and even if it does medical advances will also improve the longevity of the unhealthy segment of the population. This paper argues that healthy people may have significantly increased longevity and public policy should recognise their needs. Whilst we are not specifically discussing health care costs it would also be expected that overweight or obese people may consume more healthcare over their shorter lives.

<sup>17</sup> Australian Life Tables 2005-07. Australian Government Actuary, Commonwealth of Australia, 2009, pg.21.

<sup>18</sup> Refer Appendix B.

<sup>19</sup> The Futurist May June 2012 page 21

<sup>20</sup> <http://www.modi.monash.edu.au/obesity-facts-figures/obesity-in-australia/>

<sup>21</sup> <http://www.health.gov.au/internet/healthyactive/publishing.nsf/Content/overweight-obesity>

<sup>22</sup> Australian Institute of Health and Welfare 2008, Australia's health 2008, Cat No. AUS99

# What is the problem? CONTINUED

**Historically, we have underestimated improvements in longevity, if this holds true, there is a tsunami coming.**

If the average expected life expectancy of 65 year olds in 2050 is 92 for men and 93 for women, then given the uncertainty of predicting life expectancies, and the fact that historically we have underestimated improvements in longevity, there are plausible scenarios where people who are currently aged 65 and healthy will be expected to live past 100. The life expectancy for younger generations could exceed 120 years.<sup>23</sup>

There's a tsunami coming...are we prepared?

## **CURRENT AGED BASED RULES ENCOURAGE PEOPLE TO RETIRE.**

It could be argued that Australia's age-based rules encourage people to retire earlier than they may otherwise because:

- We currently have access to superannuation assets from age 55 moving to age 60 (Preservation Age);
- The Disability Support Pension – provides half a million people above age 55 with an early age pension;
- There is unlimited access to super benefits tax-free from age 60 although, it should be said that there is little evidence that retirees are removing significant assets on retirement; and
- There is a specified Age Pension age (65 moving to 67) which does not suit everyone.

Increasing life expectancies, continued early retirement (with a median retirement age of 61 and an intention to retire at 63<sup>24</sup>), and the lack of either incentives or compulsion to take an income stream on retirement, are putting pressure on the Age Pension system. Whilst the Intergenerational Report 2010 predicted that the cost of the Age Pension would increase from 2.7% to 3.9% of GDP by 2050<sup>25</sup>, our view is that Government policy should anticipate that there could be a higher increase in the cost of the Age Pension due to longer than anticipated life expectancies.

<sup>23</sup> The October 2011 edition of the UK Wired magazine (<http://www.wired.co.uk/magazine/archive/2011/10/features/darwin-for-the-dna-age?page=all>) published an interview with Juan Enriquez – the founding director of the Life Sciences Project at Harvard Business School and a fellow at Harvard's Centre for International Affairs, where he says that lifespan will double over the next century because of advances such as:

- Researchers are growing new body parts using stem cells e.g. tracheas for people with TB, regrown ears for wounded soldiers, new bladders instead of colostomy bags.
- Researchers have found a way to transfer skin cells into stem cells. So the combination of these two technologies means you can take a piece of your skin and grow it into almost anything in your body.

<sup>24</sup> See Appendix D – Retirement and Retirement Intentions.

<sup>25</sup> Intergenerational Report 2010, Australia to 2050: Future Challenges, The Treasury, January 2010. Page 47. Found at: <http://archive.treasury.gov.au/igr/igr2010/default.asp>.





# What should we do?



## POLICY LEVERS

There are a number of areas where structural changes in the current retirement incomes rules can mitigate some of the financial risks of unpredictable increases in life expectancy.

This discussion does not include an assessment of the adequacy of the current Age Pension (other than observing that, on its own, it is set at a level sufficient to provide only a very modest standard of living), or an assessment of the implications that unpredictable increases in life expectancy will have on the costs of health care. We do not discuss the adequacy of the 12% superannuation compulsory contribution rate.<sup>26</sup> Our focus here is on the existing retirement savings system and how this integrates with the Age Pension.

The nature of the Australian accumulation-based superannuation system with, amongst other things, account balances primarily invested in riskier growth assets (approximately 70%<sup>27</sup> in the largest superannuation funds), means that there is already a sharing in the financial risks of adequacy of post-retirement incomes between the individual retiree and the community as a whole.

The risks for the individual retiree include:

- **Adequacy** – insufficient savings by retirement;
- **Investment** – capital values eroded by market movements in retirement;
- **Inflation** – the retiree's standard of living is eroded over time as income does not keep up with inflation; and
- **Longevity** – outliving accumulated retirement savings and falling back on the Age Pension. Longevity also exacerbates the above three risks.

The community as a whole also bears some of these risks. In particular, the Age Pension protects individual retirees if their assets are insufficient for any reason or if they live materially longer than expected. The families of the retired and the taxpayer generally provide the backstop to individual risks, including the risks that individuals themselves choose to take.

Since the community bears a risk related to how individuals access and invest their retirement savings, the Actuaries Institute believes that it is reasonable for the Government to propose various incentives and/or restrictions on how superannuation fund assets can be drawn down. There needs to be a balance between the rights of the individual to retain flexibility in how they access and invest their post-retirement assets, and the overall community need to ensure that the retirement system is integrated with the social security system.

As mentioned above, we believe that policy should be set in anticipation that life expectancies could be significantly higher than currently planned and costed, and that this change will affect existing generations. Our objective is to outline a suite of proposals that we believe will provide improved adequacy and predictability of retirement incomes from the perspectives of the individual and the community.

<sup>26</sup> The Actuaries Institute supported the increase in the compulsory superannuation contribution rate from 9% to 12%, because we recognised the need for each generation of retirees to carry a greater burden for funding their own retirement benefits.

<sup>27</sup> APRA Statistics Superannuation Bulletin June 2011 issued February 2012 Table 18. Assuming that Default funds are indicative of aggregated investment strategies of funds.

# Key Principles and Summary of Positions

**A deeper, more developed post-retirement market is vital to provide greater choices for people looking to sensibly invest their retirement savings – over what may be a 30+ year period for many.**

The Actuaries Institute considers that policy-making in this area should be guided by the following principles:

**a. Development of a long-term regulatory outlook which facilitates:**

- A goal of achieving a secure flow of income over an appropriate period;
- Adequacy of income for the relevant period of retirement; and
- Recognition that complexity in the superannuation system has a real financial cost and increases the chance that individuals will make the wrong decision.

**b. The need for flexibility within the regulatory framework in order to:**

- Reflect different individuals' retirement income needs and varying capacity to bear risk and exercise choice;
- Encourage competition and not impede innovation unless there are significant offsetting benefits; and
- Ensure proportionality between the social objectives of regulation and the implications for individual retirees.

**c. The need to encourage intergenerational equity whereby, to the extent possible, each generation funds their own costs of retirement.**

The Actuaries Institute believes that there is an immediate need to undertake some structural reform. We propose the following:

1. Providing greater incentives to individuals to take the majority of their retirement benefits as an income stream.
2. Increasing the preservation age to three to five years less than the Age Pension age.
3. Extending the MySuper regime to include post-retirement solutions with "intelligent defaults" that provide retirees with secure income streams.
4. Removing the impediments that discourage older people who want to work.
5. Removing the legislative barriers preventing innovation in developing post-retirement income stream products such as annuities.
6. Moving to link changes in the Age Pension eligibility age to improvements in life expectancy.



## STRUCTURAL REFORM TO ENABLE AUSTRALIANS TO SECURE A PREDICTABLE INCOME IN POST-RETIREMENT

Australia is experiencing a major demographic and societal transformation. The Intergenerational Report 2010 reveals that by 2050, almost a quarter of the population will be aged over 65 compared to 14% now.<sup>28</sup>

As part of this transformation, there is the potential that Australia will witness a significant outflow of money from superannuation funds in the next 15 years, as the baby boomers move into retirement. Currently, Australia's ageing population has a relatively limited range of options regarding how to invest their superannuation in a way that will provide the right balance of security and predictability of income in retirement.

The amount of money moving from the accumulation phase of the superannuation system into the retirement phase is likely to be substantial. This is a natural progression as the superannuation system matures. Relevant statistics at 30 June 2011 are:

- \$325 billion of assets is vested in people over the age of 60 and a total of \$645 billion is vested in people over the age of 50. That is, over the next 15 years more than 60% of all fund assets are expected to flow out of the accumulation phase and enter the retirement phase.<sup>29</sup>
- In addition, there is around \$418 billion of assets in the self-managed superannuation fund (SMSF) segment, the vast majority of which is vested in members over aged 50.<sup>30</sup>

The expected outflow of money from the accumulation to the retirement phase of the superannuation system means that those superannuation funds who are well placed with suitable retirement options will be those most likely to retain their existing members, and perhaps attract new retired members. On the other hand, a lack of intelligent defaults for retirement could leave many superannuation funds unable to retain members. Many retirees will be left without a sufficient choice of suitable products to protect themselves against the post-retirement financial risks, and for this reason may decide to withdraw their retirement savings from superannuation more rapidly than is consistent with their life expectancy.

A deeper, more developed post-retirement market is vital to provide greater choices for people looking to sensibly invest their retirement savings – over what may be a 30+ year period for many. However, a wide range of barriers needs to be better understood and then tackled in order to help new and innovative retirement solutions to enter the mainstream financial services system.

The Actuaries Institute has previously recommended to Government a range of changes to Australia's regulatory and taxation system to help overcome obstacles to having deferred lifetime annuities (DLAs) and innovative guaranteed income stream products available.<sup>31</sup>



<sup>28</sup> Intergenerational Report 2010, Australia to 2050: Future Challenges, The Treasury, January 2010. Found at: <http://archive.treasury.gov.au/igr/igr2010/default.asp>.

<sup>29</sup> APRA, Annual Superannuation Bulletin June 2011. Issued 29 February 2012. Table 5

<sup>30</sup> ATO, SMSF Statistical Overview 2009-10. Published April 2012.

<sup>31</sup> In our Pre-Budget Submission of 27 January 2012, we recommended the following changes:

- Amend Superannuation Industry Supervision Regulation 106, which is a block to the development in the annuities market of products which protect against the risk of individuals outliving their retirement savings and the market risk of losing superannuation capital in retirement.
- Reverse the unfavourable treatment of annuities under aged care and Centrelink rules.
- Allow annuities and deferred annuities to be issued as a component of an account based pension.
- Change the tax rules on deferred annuities so that, if taken out in the drawdown phase, the product is regarded as a pension (rather than a non-pension) for tax purposes.

For more information, see: <http://www.actuaries.asn.au/Library/Submissions/reBudgetSubmissions/2012/PreBudgetSubmission2012.pdf>



# Key Principles and Summary of Positions CONTINUED



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The Actuaries Institute proposes that the Government require that all approved superannuation funds develop a set of intelligent post-retirement default products.

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## 1.1 Greater Incentives to Take Retirement Assets as Income Streams

Currently, there is no tax payable on lump sums drawn from superannuation funds for members aged 60 and over, although there are some tax incentives for assets to remain invested in the superannuation system in retirement. There is therefore potential for people to draw all of their retirement funds at the earliest opportunity, spend these savings, and then fall back on the Age Pension. Whilst there is little evidence to indicate that a material number of retirees do this, there may be a case for the Government to consider providing greater incentives for post-retirement assets to be used to provide an income stream. In particular, those retirees that can afford to should be incentivised to protect themselves against their own longevity.

There are arguments that the Government should make the purchase of a guaranteed income stream (such as an immediate or deferred lifetime annuity) compulsory for people with more than a pre-determined amount invested in superannuation. The argument could be made that compulsory superannuation for pre-retirees already exists and should be extended to the drawdown phase.

The Actuaries Institute does not support the argument that a retiree should be compelled to purchase a specific type of product in post-retirement. We do, however, think that the Government should provide retirees with an incentive to enter into an income type product (we describe some typical products in Appendix F) or, if there is no active choice made by the retiree, there should be an approved set of intelligent type default products designed to provide some level of security and predictability of post-retirement income.

In effect, the Actuaries Institute believes that the Government should introduce disincentives for individuals with assets above a threshold amount, to take a large proportion of these as lump sums. The assets would need to be drawn down over the long term. There would need to be an appropriate phase-in period for this change.

## 1.2 Preservation age

In line with the idea of placing restrictions on the amount of lump sum that may be withdrawn from superannuation, we also recommend that **the Government increase the Preservation Age gradually to (say) three to five years or less than the Age Pension eligibility age**. Based on the current phased increase in the Age Pension age, this could see the Preservation Age move to above age 62 by 2023.

## 1.3 The Introduction of a System of Intelligent Defaults

While removing barriers and providing incentives to take out income streams would be a positive step forward, the Actuaries Institute also proposes that the Government require that all MySuper approved superannuation funds develop a set of intelligent post-retirement default products.

# Key Principles and Summary of Positions CONTINUED

In particular, we propose that if a person has retired from full-time employment and does not choose a specific retirement product (e.g. they are already in a MySuper default superannuation product), then they are placed into an income stream product that allows flexibility and control of capital in the younger retirement years, and then potentially provides a guaranteed income in later years to supplement the Age Pension. This product may be organised into two parts, i.e. to provide liquidity and to provide longevity protection. Flexibility in the early years may include access to a capped lump sum.

The rationale underlining this suggestion is that the Government is currently prescribing a system of pre-retirement defaults through the MySuper initiative. We are proposing that retirees benefit from the same system of defaults post-retirement, where retirees are otherwise much more exposed to the consequences of poor decision-making.

The Government should seek feedback from the superannuation industry with regard to the most appropriate types of default products. As with the MySuper initiative, the trustees of the various superannuation funds would be required to licence their default products and they would be accountable to their members for the design. In designing post-retirement default products it also needs to be recognised that the retiree will need to engage with the product provider if only to organise where the income should be paid.

## **1.4 Removing Existing Impediments for Older Australians who Want to Work**

One of the most powerful levers available to influence the level of post-retirement consumption is the retirement date, as this signifies the date that a person chooses to start drawing down on their retirement income and become eligible to receive the Age Pension. Many people are keen to keep working but, whilst there is no legal retirement age in Australia, there is a community idea about what age it is appropriate to retire (i.e. when the Age Pension commences).

There are significant benefits to both the individual and the community if individuals are able to work for longer. First, since a person continues working their superannuation account balance continues to grow through a combination of additional contributions and investment. If the person had retired, they would have started to drawdown their assets. Second, the community benefits from a productive taxpaying individual who is not drawing the Age Pension.

The Actuaries Institute specifically recommends that the Government:

- Removes age limits on superannuation contributions;
- Encourages workforce participation by changing the Means Test; and
- Considers introducing an increased Age Pension, or a lump sum payment, for people who continue to work past retirement.

Appendix E – The Case for Removing Barriers to Working Longer provides some background for these recommendations.

## 1.5 The Development of a Vibrant and Competitive Superannuation Annuities Market

The Actuaries Institute suggests that the Government considers placing limits on the amount of money that individuals may draw out of the superannuation system in post-retirement. In effect, we suggest that high net worth retirees should be required to draw down the majority of their funds over an extended period.

There are a number of potential products that could be made available to retirees to assist in this regard. We have described these products as annuity products although they each have significantly different features.

Appendix F – Annuity Products, provides detail on this recommendation.

## 1.6 Move to Link the Age Pension Age to the Life Expectancy

The Actuaries Institute recognises that the Government has recently enacted to increase the qualifying age for the Age Pension to 67. This increase is to be phased in over six years, commencing from 1 July 2017.

Over the longer term, we suggest that the Government consider increasing the Age Pension age in line with increases to life expectancy. This recognises the effect of increasing longevity and improved health, and offsets some of the effects of an ageing population on social security costs.

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We suggest that the Government consider increasing the Age Pension age in line with increases in life expectancy.

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The background of the page is a solid blue color. Overlaid on this background is a complex, abstract pattern of numerous blue pipes and tubes. These pipes are of varying lengths and are arranged in a chaotic, overlapping manner, creating a dense, web-like structure that fills the entire page. The pipes have a slightly glossy texture, with some highlights and shadows that give them a three-dimensional appearance. The overall effect is a visually busy and textured background.

# Appendices

# Appendix A Life Expectancy

## AUSTRALIANS HAVE A LONG LIFE EXPECTANCY

Australians are one of the longest lived populations in the world.

TABLE S.15.								
THE TEN COUNTRIES OR AREAS WITH THE HIGHEST AND THE TEN COUNTRIES OR AREAS WITH THE LOWEST LIFE EXPECTANCY AT BIRTH, 2005-2010, 2045-2050 AND 2095-2100								
2005 – 2010			2045 – 2050			2095 – 2100		
Rank	Country or area	Life expectancy	Rank	Country or area	Life expectancy	Rank	Country or area	Life expectancy
<b>A. Highest life expectancy at birth</b>								
1.	Japan	82.7	1.	Japan	87.4	1.	Japan	92.3
2.	Switzerland	81.8	2.	China, Hong Kong SAR	87.2	2.	China, Hong Kong SAR	91.8
3.	China, Hong Kong SAR	81.6	3.	Switzerland	86.4	3.	Switzerland	91.4
4.	<b>Australia</b>	<b>81.4</b>	4.	Israel	86.3	4.	Israel	91.2
5.	Italy	81.4	5.	<b>Australia</b>	<b>86.0</b>	5.	<b>Australia</b>	<b>91.0</b>
6.	Iceland	81.3	6.	Iceland	85.8	6.	Iceland	90.8
7.	France	81.0	7.	France	85.8	7.	Spain	90.8
8.	Sweden	80.9	8.	Spain	85.8	8.	France	90.8
9.	Israel	80.7	9.	Italy	85.7	9.	Sweden	90.7
10.	Singapore	80.6	10.	Sweden	85.7	10.	Italy	90.6
<b>B. Lowest life expectancy at birth</b>								
1.	Central African Republic	45.9	1.	Lesotho	58.0	1.	Sierra Leone	74.1
2.	Lesotho	46.0	2.	Dem. Republic of Congo	61.5	2.	Dem. Republic of Congo	74.1

United Nations Department of Economic and Social Affairs/Population Division  
World Population Prospects: The 2010 Revision, Highlights and Advanced Tables

## Appendix A Life Expectancy CONTINUED

### Australian life expectancies are improving rapidly

The following data from the Australian Bureau of Statistics demonstrates how Australian life expectancy at all ages has improved dramatically over the last 100 years:

#### Complete expectation of life at selected ages:

Males				Females			
Life Tables	0	Age 30	65	Life Tables	0	Age 30	65
1881-90	47.20	33.64	11.06	1881-90	50.84	36.13	12.27
1891-00	51.08	35.11	11.25	1891-00	54.76	37.86	12.75
1901-10	55.20	36.52	11.31	1901-10	58.84	39.33	12.88
1920-22	59.15	38.44	12.01	1920-22	63.31	41.48	13.60
1932-34	63.48	39.90	12.40	1932-34	67.14	42.77	14.15
1946-48	66.07	40.40	12.25	1946-48	70.63	44.08	14.44
1953-55	67.14	40.90	12.33	1953-55	72.75	45.43	15.02
1960-62	67.92	41.12	12.47	1960-62	74.18	46.49	15.68
1965-67	67.63	40.72	12.16	1965-67	74.15	46.34	15.70
1970-72	68.10	41.10	12.37	1970-72	74.80	46.86	16.09
1975-77	69.56	42.18	13.13	1975-77	76.56	48.26	17.13
1980-82	71.23	43.51	13.80	1980-82	78.27	49.67	18.00
1985-87	72.74	44.84	14.60	1985-87	79.20	50.49	18.56
1990-92	74.32	46.07	15.41	1990-92	80.39	51.48	19.26
1995-97	75.69	47.26	16.21	1995-97	81.37	52.30	19.88
2000-02	77.64	49.07	17.70	2000-02	82.87	53.72	21.15
2005-07	79.02	50.20	18.54	2005-07	83.67	54.44	21.62

Source: Australian Life Tables 2005-07 [http://www.abs.gov.au/publications/life\\_tables\\_2005-07/downloads/Australian\\_Life\\_Tables\\_2005-07.pdf](http://www.abs.gov.au/publications/life_tables_2005-07/downloads/Australian_Life_Tables_2005-07.pdf).

During this 103 year period:

- Life expectancy at birth has lengthened by 67% for men and 65% for women; and
- Life expectancy at age 65 has lengthened by 68% for men and 76% for women.



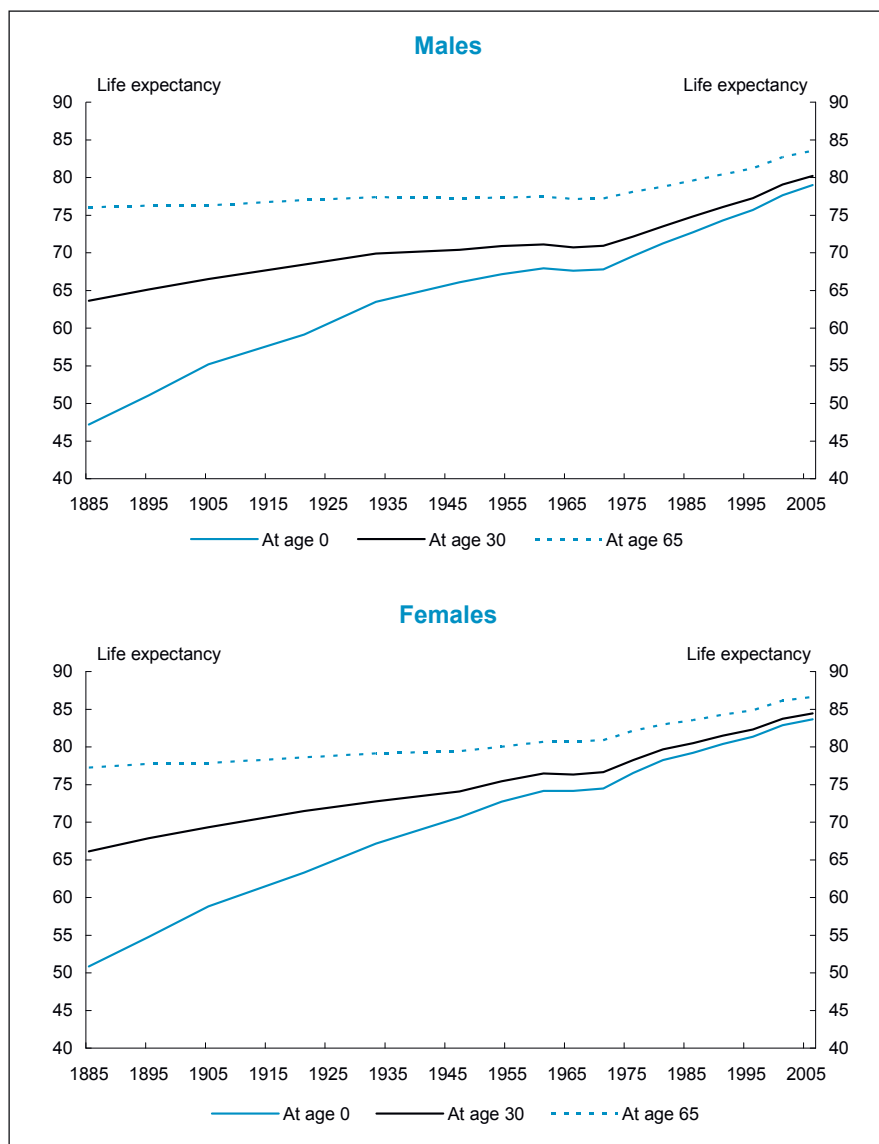
## Appendix A Life Expectancy CONTINUED



Source: The Australian Life Tables 2005-07 [http://www.aga.gov.au/publications/life\\_tables\\_2005-07/downloads/Australian\\_Life\\_Tables\\_2005-07.pdf](http://www.aga.gov.au/publications/life_tables_2005-07/downloads/Australian_Life_Tables_2005-07.pdf)

The improvements in recent years, especially the last 40, have been more rapid than in previous years – as the following charts illustrate:

### Total life expectancy at selected ages\*



\* Note that these life expectancies do not make allowance for the improvements in mortality experienced over a person's lifetime.

The Australian Life Tables 2005-07 Report<sup>32</sup> states:

***“Reported life expectancy at birth has shown dramatic improvement, increasing by over 30 years for both males and females... At older ages, the substantial improvements in mortality rates for this group over the past thirty years have flowed through into significantly increased life expectancies, with expectation of life at age 65 increasing by around six years for both males and females. This represents an increase of more than 50 per cent for males and 37 per cent for females in the expectation of life at this age.”***

<sup>32</sup> Australian Life Tables 2005-07 Report. Australian Government Actuary, Commonwealth of Australia, 2009. Pages 12-13.

# Appendix A Life Expectancy CONTINUED

## Reported figures don't include all the mortality improvements we can expect

The latest ABS data, based on the 2005-07 Life Tables, reports the life expectancy at birth for a male as 79 and a female as 84. These figures are reported in the media and hence most Australians base their views on how long they will live on this information. Reported life expectancies are based on actual deaths in the investigation period. They do not project future life expectancy of people currently alive.

The following table compares the reported life expectancies with life expectancies allowing for mortality improvements derived by using 25 year mortality improvement factors.

	LIFE EXPECTANCY AT BIRTH					
	In 2010		Expected in 2050		Additional years of life 2050 vs. 2010**	
	Males	Females	Males	Females	Males	Females
ABS reported in annual stats <sup>33</sup>	79.5	84.0				
Cohort expectancy allowing for faster improvements over last 25 years*	92.4	93.9	96.7	97.3	17.2	13.3

\* Figures in the last row are sourced from the Australian Life Tables 2005-07 Report, Australian Government Actuary, on page 19.

\*\* This is the increase in life expectancy between reported and cohort.

## What's the difference between the figures?

When you are looking at the likely life expectancy of future Australians, a cohort life expectancy measure is more realistic. As stated by the Government Actuary in the Australian Life Tables 2005-07 Report:

*"Cohort life expectancy... takes into account the improvements that could be experienced over the lifetime of the individual... Cohort life expectancies can be thought of as being a more realistic representation of the unfolding mortality experience of the Australian population."*<sup>34</sup>



<sup>33</sup> ABS 4125.0 - Gender Indicators, Australia, Jan 2012

<sup>34</sup> Australian Life Tables 2005-07 Report. Australian Government Actuary, Commonwealth of Australia, 2009. Page 18.



## Appendix A Life Expectancy CONTINUED

Whilst the government uses cohort life expectancies to guide its policy settings, these figures are not widely publicised and the average Australian is unaware of their likely true life expectancy when they reach retirement.

So why are the media not reporting cohort life expectancies? Maybe because these figures involve making a series of assumptions, and as a result are somewhat volatile and jump around from census to census. Forecasting mortality improvements is not an exact science. The Government Actuary issues this word of caution about using cohort data to estimate future life expectancy:

***“The period and cohort life expectancies ... illustrate what would occur if mortality continued to improve at the rates observed in the past. Measured mortality improvement can change appreciably between successive Tables...”***

***As a result, the 25 year mortality improvement factor at this age has more than doubled from 0.8 per cent per annum to 1.8 per cent per annum between the 2000-02 Tables and the current Tables.***

***Furthermore, the effects of these movements are magnified because the projections assume that mortality improvement will be constant for a particular age...***

***History demonstrates that mortality improvement is not constant at a particular age and, indeed, can vary within a quite considerable range...***

***Thus, the estimates of cohort mortality included here must be accepted as projections of outcomes under assumptions that have a certain historical basis. They should be regarded as indicative rather than firm forecasts of life expectancy.”<sup>35</sup>***

Cohort life expectancies are only an indication, but they may be the best indication that we have, and are more realistic than the reported life expectancies.

### What’s the potential impact on retirees?

The above discussion looked at life expectancy from birth. This was useful to illustrate the use of cohort life expectancies and the difference they can make. What matters for this discussion however is the life expectancy of retirees. So let’s now use cohort life expectancies to see what mortality improvements people aged 65 can expect.

Total life expectancy at age 65 is longer than life expectancy at birth, because by age 65 some people have already died. However we can expect improvements in life expectancies for 65 year olds in 2050 to be smaller than those for a new baby being born in 2050.

<sup>35</sup> Australian Life Tables 2005-07 Report. Australian Government Actuary, Commonwealth of Australia, 2009. Page 21.

## Appendix A Life Expectancy CONTINUED

The table below repeats the previous analysis, but looks at life expectancies at age 65 rather than at birth.

	LIFE EXPECTANCY (EXPRESSED AS TOTAL LIFE SPAN) AT AGE 65					
	In 2010		Expected in 2050		Additional years of life 2050 vs. 2010**	
	Males	Females	Males	Females	Males	Females
ABS reported in annual stats <sup>36</sup>	83.9	86.8				
Cohort expectancy allowing for faster improvements over last 25 years*	86.3	89.0	92.0	93.3	8.1	6.5

**We could realistically be living longer in retirement, 30% longer for women and 44% longer for men, than currently.**

\* Figures in the last row are sourced from the Australian Life Tables 2005-07 Report, Australian Government Actuary, Projected Cohort Life Expectancy, on page 19.

\*\* This is the increase in life expectancy between reported and cohort.

The above figures indicate that the more realistic scenario based on the cohort figures is that 65 year olds in 2050 will actually be living an extra six to eight years in retirement above the current reported life expectancy.

That's 30% longer for women and 44% longer for men than currently.

But it could be longer. What if life expectancies begin to improve even faster than the trend over the last 25 years? **You can see from the above analysis how uncertain projecting longevity improvements is. In Appendix B we claim that there is a chance that the above analysis, even the longer "cohort" figures, will underestimate future longevity improvements, as it has done in the past.**

### What figures are policymakers using?

Treasury in their Intergenerational Report 2010<sup>37</sup> has the following analysis:

These mortality and life expectancy trends are projected to continue (Table 1.3).

- Men born in 2050 are now projected to live an average of 7.6 years longer than those born in 2010, and women an average of 6.1 years longer.
- Men aged 60 in 2050 are projected to live an average of 5.8 years longer than those aged 60 in 2010, and women an average of 4.8 years longer.

**Importantly, Treasury's predictions are lower than the life expectancy indicated by the cohort analysis.**

<sup>36</sup> ABS 4125.0 - Gender Indicators, Australia, Jan 2012

<sup>37</sup> [http://archive.treasury.gov.au/igr/igr2010/report/pdf/IGR\\_2010.pdf](http://archive.treasury.gov.au/igr/igr2010/report/pdf/IGR_2010.pdf)

## Appendix A Life Expectancy CONTINUED

**Table 1.3: Australians' projected life expectancy (years)**

	2010	2020	2030	2040	2050
<b>Life expectancy at birth</b>					
Men	80.1	82.5	84.5	86.1	87.7
Women	84.4	86.2	87.8	89.2	90.5
<b>Life expectancy at age 60</b>					
Men	23.4	25.2	26.7	28.0	29.2
Women	26.6	27.9	29.2	30.4	31.4
<b>Life expectancy at age 67</b>					
Men	17.6	19.1	20.4	21.6	22.6
Women	20.4	21.6	22.8	23.8	24.8

Source: Treasury.

So at age 67 in 2050, Treasury are predicting that men will live until 89.6 and women until 91.8. This is lower than the life expectancy indicated by the cohort analysis outlined above, and actual life expectancies could be longer again.

# Appendix B Why We Underestimate Life Expectancy

The following is an extract from the paper "Living Until 120: The Implications for Absolutely Everything" by actuaries Barry Rafe and Melinda Howes.<sup>38</sup>

<sup>38</sup> This Paper was presented at the Actuaries Institute Financial Services Forum, Melbourne, 30th April 2012 and the IAA Colloquium, Hong Kong, 7th May 2012.

<sup>39</sup> Longevity Management Issues for Australia's Future Tax System, The Treasury", Mike Sherris & John Evans, UNSW, Aug 2009.

Normal modelling techniques cannot handle discontinuities – things like major medical breakthroughs, a cure for cancer or viruses.

Actuaries have been modelling mortality for more than 100 years. We are very good at predicting gradual increases in life expectancy. However, we have a problem.

In a paper written for the Henry Review of the Tax System<sup>39</sup>, actuaries Mike Sherris and John Evans contend that longevity risk can be considered as being made up of:

- The "known/knowns" – A general improvement trend from socioeconomic improvements – as we can see on this chart;
- The "known/unknowns" – Some variation around the longer term improvement trend; and
- The "unknown/unknowns" – Sudden changes from wars, pandemics that may shorten life expectancies and disease management which may substantially increase life expectancies.

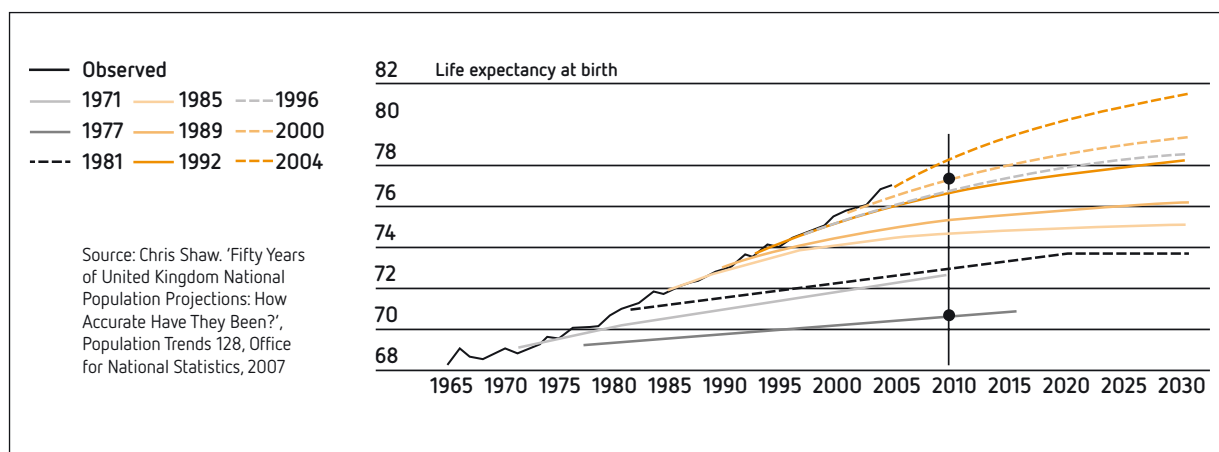
They go on to say:

*"Whilst the known/known risk is easily managed as it can be modelled and therefore appropriate allowances made in pricing, the known/unknown risk is more difficult as its modelling is uncertain, and the unknown/unknown risk is impossible to manage as it is not predictable, and therefore appropriate allowances for these possible changes is not feasible."*

The problem is **DISCONTINUITIES** – normal modelling techniques cannot handle things like major medical breakthroughs, a cure for cancer or viruses. If normal modelling techniques are unable to anticipate discontinuities then there are difficulties in developing policy.

The following chart shows the success rate UK actuaries have had in the past with predicting mortality improvements – as you can see it clearly illustrates the difficulty of predicting the future based on past improvement trends.

Actual and projected life expectancy at birth, UK males



## Appendix B Why We Underestimate Life Expectancy CONTINUED

<sup>40</sup> "A window into the Future: Understanding and Predicting Longevity," SwissRe, 2011.

The list below<sup>40</sup> sets out some of the medical advances that took place between 2000 and 2010. Each of these can have a significant impact on life expectancy and quality of life.

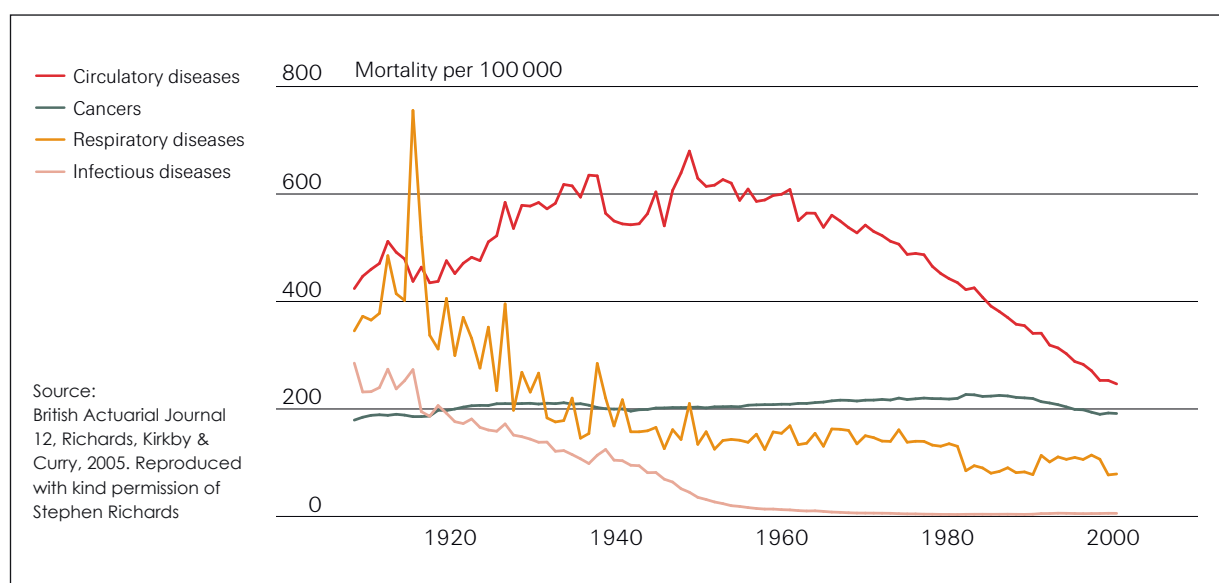
### ABC News and Med Page Today's top-ten US medical advances of 2000-2010

1. Human genome discoveries reach the bedside
2. Doctors and patients harness information technology
3. Anti-smoking laws and campaigns reduce public smoking
4. Heart disease drops by 40%
5. Stem-cell research: laboratory breakthroughs and some clinical advances
6. Targeted therapies for cancer expand with new drugs
7. Combination drug therapy extends HIV survival
8. Minimally invasive and robotic techniques revolutionise surgery
9. Study finds heart and cancer risk with hormone replacement therapy
10. Scientists peer into mind with functional MRI

Deaths from some of our major diseases are on their way down as a direct result of medical advances.

In addition, we can see from the chart below that deaths from some of our major diseases are on their way down as a direct result of these medical advances. Only cancer is stable.

**Mortality by cause, England and Wales**



# Appendix B Why We Underestimate Life Expectancy CONTINUED

The following is an extract from the actuarial paper “Longevity in the 21st Century” by R. C. Willets, A. P. Gallop, P. A. Leandro, J. L. C. Lu, A. S. Macdonald, K. A. Miller, S. J. Richards, N. Robjohns, J. P. Ryan and H. R. Waters.<sup>41</sup>

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**Rapid advances in medicine may cause mortality rates to fall with increasing speed.**

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## 4. MEDICAL ADVANCES

### 4.1 Introduction

- 4.1.1 In Section 2 it was observed that a substantial part of current mortality improvement is being driven by advances in medicine. The reduced number of heart disease deaths has been partly due to the development of new treatments, such as beta-blockers, and new surgical procedures, such as bypass grafts and angioplasties. Improvements in cancer mortality have been largely due to advances in detection and treatment of cancers; underlying incidence rates appear to have remained broadly level or increased for many cancer types.
- 4.1.2 At the beginning of the 21st century, the results of scientific development are increasingly altering the way in which we live our lives. A prime example was the project to decode the entire human genome, which has provided us with a map of the DNA making up our chromosomes. This task was only possible because of the enormous developments in computing technology that have occurred over the past few decades. The human genome project is now likely to sow the seeds for a whole range of scientific and medical progress.
- 4.1.3 The battle against cancer is progressing on a number of fronts, with much of the research having a genetic basis (one aspect of this is discussed later in this section). The growth of replacement organs for transplantation is another area in which progress is likely in the 21st century, and new surgical procedures for combating heart disease are also likely.
- 4.1.4 The pace of scientific development appears to be accelerating, and it is possible that this explosion in knowledge will drive increasingly rapid advances in medicine. These advances may cause mortality rates to fall with increasing speed.
- 4.1.5 A comprehensive analysis of future trends in medicine is beyond the scope of this paper. However, two particular areas of medicine will be explored: firstly, a potential development in the treatment of cardiovascular disease; and secondly, research into the ageing process.

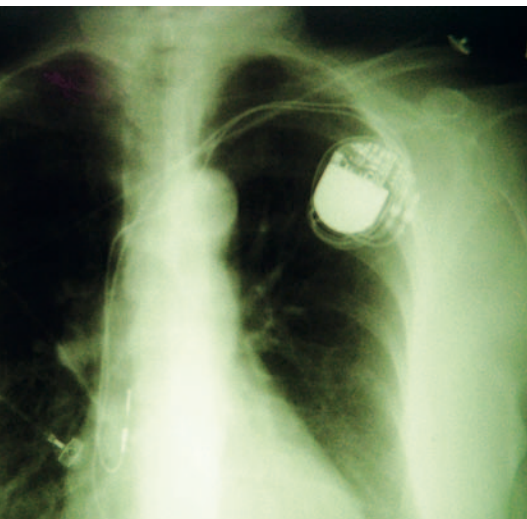
...

### 4.2 Drug Treatments for Cardiovascular Disease

- 4.2.1 In this section, some recent developments in the treatment and prevention of heart disease and stroke are discussed. These developments are of considerable interest in themselves, and also provide some insight into how medical advances may occur in future. Heart disease and stroke are major causes of mortality in the U.K. In Sections 2.5 and 2.6 we saw that over 40% of deaths for people aged over 70 in England and Wales are due to circulatory disorders, such as heart disease and stroke. Clearly, any

<sup>41</sup> This Paper was presented at the Faculty of Actuaries, 15 March 2004, and to the Institute of Actuaries, 26 April 2004.

## Appendix B Why We Underestimate Life Expectancy CONTINUED



developments which reduce the incidence of heart disease and stroke are likely to have a major impact on population mortality.

4.2.3 Some of the developments discussed in this section have been established medical practice for a number of years. However, the most recent development has not yet even been tested. This was announced in a series of three papers in a June 2003 issue of the British Medical Journal, one of which was entitled, 'A strategy to reduce cardiovascular disease by more than 80%' (Wald & Law, 2003). These papers were highlighted by two editorial articles in the same issue, entitled, 'A cure for cardiovascular disease?' (Rodgers, 2003), and, 'The most important BMJ for 50 years?' (Smith, 2003).

...

4.2.8 The claims that cardiovascular disease could be reduced by more than 80%, mentioned previously, are based on the research of Professors Law and Wald. Their concept, for which they are currently seeking a patent, is appealingly simple. They propose that a single pill, consisting of six drugs already used individually to treat risk factors for cardiovascular disease, should be taken by everyone over the age of 55, irrespective of their pre-treatment levels of these risk factors. The ingredients of this 'polypill', a name for which Professors Law and Wald have applied for a trademark, are:

- a statin to reduce LDL;
- a combination of low doses of three blood pressure reducing drugs;
- folic acid to reduce the level of homocysteine in the blood; and
- aspirin to regulate blood platelet function.

...

This paper was published in 2004. A search of "polypill" on Wikipedia gives the latest state of play:

The polypill could reduce mortality due to heart disease and strokes by up to 80%.

### CARDIOVASCULAR POLYPILL

In their paper *A strategy to reduce cardiovascular disease by more than 80%* (published in the British Medical Journal) on June 28, 2003, Wald and Law postulated that by using a combination of well known, cheap medications in one pill (the "Polypill") would be a particularly effective treatment against cardiovascular disease. They presented a statistical model which suggested widespread use of the polypill could reduce mortality due to heart disease and strokes by up to 80%. The treatment is potentially cheap, with few side effects (in perhaps 10-15% of recipients) and the research was based on data from many trials relating to the individual components.

The concepts they present are based on these principles: reducing blood pressure, cholesterol and taking a low dose of aspirin to help prevent heart disease and stroke. (In the interim, however, there is concern that the use of aspirin in a healthy population causes more harm than good.<sup>[4]</sup>) Tests of the Wald and Law polypill have been recommended in 2005. Additionally, "polypills" are currently available in India. Any GP can currently prescribe



## Appendix B Why We Underestimate Life Expectancy CONTINUED

Continuing the  
extract from the  
actuarial paper  
“Longevity in the 21st  
Century” by  
R. C. Willets,  
A. P. Gallop,  
P. A. Leandro,  
J. L. C. Lu,  
A. S. Macdonald,  
K. A. Miller,  
S. J. Richards,  
N. Robjohns,  
J. P. Ryan and  
H. R. Waters.

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**The cure for ageing  
must now be taken  
seriously as it is no  
longer science fiction.**

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all the components of the polypill separately for her/his patients. The ingredients of the polypill are off patent. Since this would make the polypill quite cheap (some estimates on the BMJ rapid responses were less than 70 pounds per year), there is little financial incentive for pharmaceutical companies to pay the high costs of a clinical trial. (Naturally, however, large insurers, or national healthcare systems, may have considerable financial incentive to pay for such trials).

Cardiologists in Spain (Sanz and Fuster, 2009) are currently developing a polypill for secondary cardiovascular prevention. This project is being done in collaboration with Ferrer-Internacional, which is a Spanish pharmaceutical company based in Barcelona with experience in the development and launching of international projects. These authors believe that this polypill delivered at a low price could improve adherence to treatment, reduce the cost and make treatment affordable in low-income countries. Furthermore, they preview that success in this area of prevention could lead to the development of polypills for several other diseases, such as diabetes and stroke.

### 4.5 Theories of Ageing

4.5.1 Whilst there is a lack of complete understanding, there has been a lot of progress, in the field of ageing research. There are plenty of ideas and a 748 Longevity in the 21st Century large range of different theories. In his review paper, Held (2002) cited the example of the Russian gerontologist Medvedev, who had reportedly listed and categorised over 300 theories of ageing. Some of these ideas overlap, and others appear quite independent. One challenge facing researchers is the development of a ‘unified theory of ageing’. A few decades ago this appeared to be a long way off. However, in recent years scientists have been getting more optimistic, as the quotes listed below demonstrate:

*“With the knowledge that is accumulating now about the nutritional and neuroendocrine aspects of ageing, and if we develop ways to repair ageing tissues with the help of embryonic cells, we could add 30 years to human life in the next decade. And beyond that, as we learn to control the genes involved in ageing, the possibilities of lengthening life appear practically unlimited.” – William Regelson - Professor of Medicine at the Medical College of Virginia - quotation in Medina (1996)*

*“I believe ... in 25 years time we could see the creation of the first products that can postpone human ageing significantly. This would be only the beginning of a long process of technological development in which human life span would be aggressively extended. The only practical limit to human life span is the limit of human technology.” – Michael Rose - University of California - quotation in Medina (1996)*

*“The cure for ageing must now be taken seriously by responsible gerontologists, because it is no longer science fiction.” – Aubrey de Grey (2003) - Department of Genetics, University of Cambridge*



# Appendix B Why We Underestimate Life Expectancy CONTINUED

<sup>42</sup> de Grey, Aubrey D. N. J. (June 15, 2004), "Escape Velocity: Why the Prospect of Extreme Human Life Extension Matters Now", PLoS Biol 2 (6): 723–726, DOI:10.1371/journal.pbio.0020187, <http://biology.plosjournals.org/perlserv/plosonline/%3Frequest%3Dget-document&doi%3D10.1371/journal.pbio.0000045?request=get-document&doi=10.1371/journal.pbio.0020187>, retrieved 2007-02-12.

<sup>43</sup> Traister, Rebecca (November 22, 2006), "Diet your way to a long, miserable life!", Salon.com, [http://www.salon.com/mwt/feature/2006/11/22/cr\\_diets/index.html](http://www.salon.com/mwt/feature/2006/11/22/cr_diets/index.html), retrieved 2008-10-31

<sup>44</sup> Dibble, Julian (October 23, 2006), "The Fast Supper", New York Magazine

<sup>45</sup> de Grey, Aubrey; & Rae, Michael (September 2007), Ending Aging: The Rejuvenation Breakthroughs that Could Reverse Human Aging in Our Lifetime, New York, NY: St. Martin's Press, p. 416, ISBN 0-312-36706-6

<sup>46</sup> Birnbaum, Ben (2006), "Extension program", Boston College Magazine

This paper was published in 2004. (Latest state of play)



4.5.2 The work of Dr Aubrey de Grey has become more widely known amongst actuaries in the U.K. through his participation in a recent seminar (October 2003) on mortality improvement, jointly sponsored by the CMI Bureau and the GAD. In his presentation at the seminar, de Grey described how the 'war on ageing' could be only a decade away, and discussed what actuaries should be doing in the run-up to a 'post ageing world'. He explained how advances in medicine could lead to 'engineered negligible senescence', and described a set of milestones on the path to achieving this goal. De Grey's theories are founded on the belief that there are only seven mechanisms for accumulating damage to the human body. Furthermore, therapies for reversing or obviating all of these types of damage are clearly foreseeable. He felt that, given sufficient commitment and resources, the goal of 'engineered negligible senescence' could be achieved by the year 2025.

4.5.3 Obviously, not everyone agrees with these views; but should we completely ignore what these scientists are saying? The general consensus suggests that we are unlikely to see a cure for ageing in the next few decades. However, looking further into the future – say 30 or 40 years – it is very difficult to tell whether the optimism of some scientists will prove to be correct. With the accelerating pace of scientific development, a great deal can change in 30 or 40 years. Yet, the youngest members of final salary schemes may well be alive 60 or 70 years from now, perhaps even longer.

...

De Grey has an article in The Futurist in May 2012 called "A Thousand Years Young" where he identifies the medical and biochemical advances that could eventually eliminate all the wear and tear that our bodies and minds suffer as we grow old. A link to the article is here: <http://www.wfs.org/futurist/may-june-2012-vol-46-no-3/thousand-years-young> (subscription required).

You can hear de Grey talk about his ideas at TED through this link: [http://www.ted.com/talks/aubrey\\_de\\_grey\\_says\\_we\\_can\\_avoid\\_aging.html](http://www.ted.com/talks/aubrey_de_grey_says_we_can_avoid_aging.html)

## ACTUARIAL ESCAPE VELOCITY

Wikipedia provides the following definition:

***"Life expectancy increases slightly every year as treatment strategies and technologies improve. At present, more than one year of research is required for each additional year of expected life. Actuarial escape velocity occurs when this ratio reverses, so that life expectancy increases faster than one year per one year of research, as long as that rate of advance is sustainable."***<sup>42,43,44</sup>

The concept was first publicly proposed by David Gobel, founder of the Methuselah Foundation. The idea has been championed by biogerontologist Aubrey de Grey<sup>45</sup> and futurist Ray Kurzweil.<sup>46</sup>

# Appendix C Amendments to Facilitate Innovation in the Annuities Market

Legislation should be sufficiently broad to allow different product solutions to be developed.

## 1. Amend Regulations 1.05 and 1.06 of the Superannuation Industry (Supervision) Regulations to ensure that they allow product innovation in pensions and annuities.

The current regulations are overly complex and prescriptive and discourage or prevent the introduction of most of the annuity products that have been successful internationally.

In particular, the Actuaries Institute's view is that the following product designs, which are "mainstream" internationally, and meet all of current policy objectives (mainly of a revenue nature), are either prohibited or difficult to implement:

- Variable annuities with the pooling or guarantee of longevity risk.
- With profit annuities, where investment and longevity profits and losses are shared with the pensioners.
- Income stream packages that incorporate a deferred annuity from an advanced age.

In each case, the product design should specifically allow payments to be varied to limit fluctuations in the combined payments from the pension/annuity and the Age Pension.

We suggest that the legislation should not define an annuity as a product that has one or two named features, and should instead be sufficiently broad to allow different product solutions to be developed.

## 2. Change the tax rules on deferred lifetime annuities so that, if taken out in the drawdown phase, the product is regarded as a pension (rather than a non-pension) and therefore exempt from income tax.

The Actuaries Institute is not aware of any provider issuing deferred lifetime annuities largely due to the product's classification as a non-pension. Challenger has estimated that the price of a deferred lifetime annuity is 14% higher because of the current taxable classification.<sup>47</sup>

We understand that the Government is concerned about the impact on revenue from changing the tax status.

Introduction of deferred annuities into the Australian superannuation system would involve a short term cost to government finances. By buying a deferred annuity, a retiree is deferring retirement income that will result in a reduction in retirement income during the deferral period. If the retiree is eligible for a part Age Pension this would result in a small increase in pension outlays. Provided retirees are complying with the minimum draw down rules they have the option to defer private income and take a larger Age Pension whether they are buying a deferred annuities or not. The Institute notes, however, that any rule changes would need to be carefully framed to apply tax free status to genuine retirement deferred lifetime annuities purchased with superannuation money, and not extend such treatment to other deferred annuities.

<sup>47</sup> Challenger's figures are based on a deferred annuity at age 65 commencing payment at age 85 i.e. a 20 year deferral period.

## Appendix C Amendments to Facilitate Innovation in the Annuities Market CONTINUED



The Actuaries Institute contends that if the proposed tax treatment is limited to non-commutable income streams purchased with superannuation money, there is no opportunity to exploit the system. People will not attempt to “hide” capital in something that is non-commutable, because they can never get the money back.

The Actuaries Institute believes that there is no justification to have different tax treatment for deferred annuities compared to other income streams that can be purchased with superannuation money. The special tax treatment of annuities was put in place a number of years ago to prevent exploitation in a different part of the market. The resulting application to superannuation deferred annuities appears to be an unintended consequence.

### **3. Issue longer dated Government (and corporate) bonds.**

The Actuaries Institute recognises that product providers currently experience problems finding investments to back annuity products.

A key element which could facilitate product development, but which is currently missing, is the availability of longer dated government (and corporate) bonds. Superannuation funds can try to create their own fixed term annuity type products, but the lack of available longer dated government bonds has made this a difficult exercise. (There are even fewer corporate bonds - having a deeper /longer dated market there would help too.)

Having the Government issue longer dated bonds (say 30 or 40 years) could also be of use in the life / deferred annuity market (as well as the fixed term market).

### **4. Reverse the unfavourable treatment of annuities under aged care and social security rules and make lifetime non-commutable annuities exempt from the Centrelink Assets Test.**

The Actuaries Institute believes that a non-commutable guaranteed annuity should be excluded from the Centrelink assets test; however we understand that there are revenue implications for this measure that have not been costed here.

### **5. Do away with minimum surrender values.**

APRA Prudential Standard *LPS4.02 Minimum Surrender Values and Paid-Up Values (28 June 2010)* treats deferred annuities as an investment product during the deferral period and requires a surrender value. This would render a deferred annuity uneconomic to provide as a lifetime product, or would defeat the attractive pricing, which is the basis of deferred lifetime annuities as having a role in an ageing society.

### **6. Remove deferred lifetime annuities from being subject to minimum drawdown rules.**

The rule requiring a minimum payment to be made from a pension every year does not cater for deferred annuities.

## Appendix D Retirement and Retirement Intentions

The following is an extract from ABS Publication 6238.0 – Retirement and Retirement Intentions, Australia, July 2010 to June 2011. Issued 13 December 2011. Found at: [http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/C4C9530A2947002ACA25796400145D56/\\$File/62380\\_july%202010%20to%20june%202011.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/C4C9530A2947002ACA25796400145D56/$File/62380_july%202010%20to%20june%202011.pdf)

### Average Retirement Age

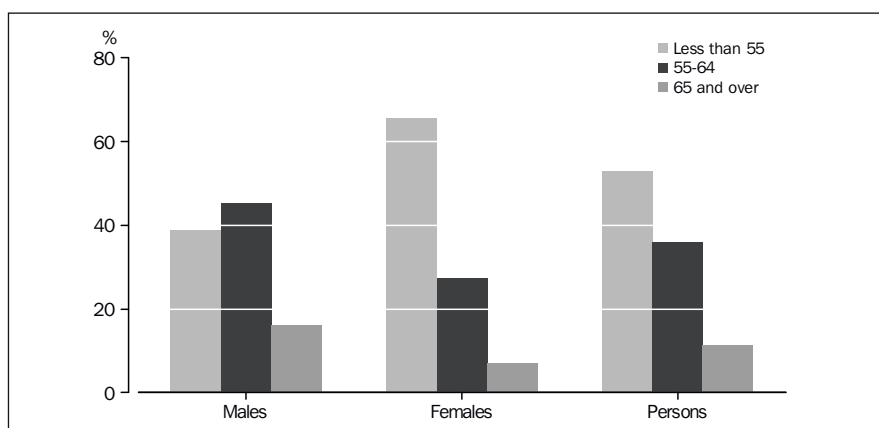
The average age at retirement from the labour force for people aged 45 years and over in 2010-11 was 53.3 years (57.9 years for men and 49.6 years for women). Of the 1.4 million men who had retired from the labour force:

- 27% had retired aged less than 55 years;
- 53% had retired aged 55-64 years; and
- 20% had retired aged 65 years and over.

The 1.8 million women who had retired from the labour force had retired on average at a younger age than men. The ages at which women retirees had retired from the labour force were as follows:

- 57% had retired aged less than 55 years;
- 35% had retired aged 55-64 years; and
- 8% had retired aged 65 years and over.

### Persons retired from the Labour Force – Age at retirement (years) – by sex



The average age at retirement for recent retirees (those who have retired in the last five years) was 61.4 years. Within this group, the difference between the retirement age of men and women was relatively small, with women retiring a little younger than men (the average retirement ages for this group were 62.5 years for men and 60.3 years for women).

### Age Intends to Retire

Of the 3.9 million people in the labour force who indicated that they intend to retire from the labour force, 1.6 million people (40%) did not know the age at which they would retire (38% of men and 43% of women). Of those who did indicate an age:

- 14% intend to retire aged 70 years and over (17% of men and 10% of women);
- 47% intend to retire aged 65-69 years (53% of men and 40% of women);
- 28% intend to retire aged 60-64 years (22% of men and 35% of women); and
- 12% intend to retire aged 45-59 years (9% of men and 15% of women).

The average age at which people intended to retire was 62.9 years (63.5 years for men and 62.0 years for women).



## Appendix E The Case for Removing Barriers to Working Longer



The Actuaries Institute recommends that the Government:

- Remove age limits on superannuation contributions;
- Encourage workforce participation by changing the Means Test; and
- Consider introducing an increased Age Pension, or a lump sum payment, for people who continue to work past retirement.

More people are gradually winding down to retirement instead of stopping work completely.

According to the Australian Bureau of Statistics (Multipurpose Household Survey 2011), about 40% of older workers expect to wind back their hours for several years before eventually retiring, while another 13% intend to never retire but just keep working – at least part time.

According to Australian Super General Manager of Strategy, Paul Schroder, the notion of 'retirement' no longer exists: ***"People are working part time, changing careers, learning new skills and all kinds of transitions. People are morphing into retirement these days, there is no big race to the finish line."***<sup>48</sup>

Appendix D sets out an indication of intended retirement age. In particular 12% expect to retire before age 60 and 14% intend to retire after age 70.

In its 2011 Report to the Federal Government – ***"Realising the Economic Potential of Senior Australians: Turning Grey into Gold"*** – the Advisory Panel on the Economic Potential of Senior Australians made the following recommendation: ***"The Federal Government conduct a review of how the retirement income system interacts with mature age workforce participation, for completion by the end of 2013."***<sup>49</sup>

The Age Discrimination Commissioner, The Hon Susan Ryan AO, says that: ***"As a society, we have been slow to recognise that millions of older Australians are locked out of the workforce by age discrimination."***<sup>50</sup>

The Federal Government's commitment to removing the superannuation guarantee age limit (from 1 July 2013) should be commended. However, age limits on some contributions, for example salary sacrifice contributions, remain within the superannuation system, restricting older Australians aged 75 and over from making these contributions.

The Federal Government could encourage workforce participation by removing earned income from the Means Test for the Age Pension so retirees are not penalised for working if and when they can.

To assess the financial impact of continuing to work and earn an income post Age Pension age, a retiree currently needs to determine the reduction in the Age Pension due to earned income and the complex marginal tax rates payable on earned income.

The impact of this confusing system of Age Pension reductions, personal tax rates and tax offsets is that it is extremely complicated for a person of Age Pension age who is in receipt of the Age Pension to even know the "cost" of earning additional income.

<sup>48</sup> "Don't Stop Working – Ever?" Tuesday 27 March 2012. [http://www.agedcareguide.com.au/news.asp?newsid=7075&utm\\_source=feedburner&utm\\_medium=feed&utm\\_campaign=Feed%3A+AgedCareLatestNews+%28Aged+Care+Latest+News%29](http://www.agedcareguide.com.au/news.asp?newsid=7075&utm_source=feedburner&utm_medium=feed&utm_campaign=Feed%3A+AgedCareLatestNews+%28Aged+Care+Latest+News%29)

<sup>49</sup> Recommendation 19.

<sup>50</sup> Source Working past our 60s: Reforming laws and policies for the older worker [http://www.hreoc.gov.au/age/publications/Working\\_past\\_60\\_2012.html](http://www.hreoc.gov.au/age/publications/Working_past_60_2012.html)



## Appendix E The Case for Removing Barriers to Working Longer CONTINUED

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More people are gradually winding down to retirement instead of stopping work completely.

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The Actuaries Institute recommends that earned income be removed entirely from the Means Test and that simpler means testing rules be applied to assets, with a view to both reducing complexity and improving labour market participation amongst older workers.

We believe that there would be significant administrative and efficiency advantages in making these changes to the means testing regime, as well as improvements in the behavioural and financial incentives to keep working.

In turn, this would then make it easier for retirees to provide additional post-retirement income for themselves from multiple sources.

The Actuaries Institute believes that the Government should revisit the idea of allowing the Age Pension to be deferred, so that if a person who is eligible for the Age Pension keeps working for a limited (or unlimited) deferral period after the Age Pension commencement age, their Age Pension entitlement increases. This means retirees can fund the first part of their retirement through their superannuation savings for a known period and rely on a higher Age Pension to manage their longevity risk.

A deferred Age Pension is a policy that is used in a number of OECD countries, including the United Kingdom and United States. As an example in Australia, an option could be to increase the Age Pension by 5% for each year that it is deferred up to a maximum increase of 50% after 10 years of deferment. The relevant means testing will still need to be applied each year of payment or deferment, in particular if the retiree is not eligible for the Age Pension then they would not be eligible to defer it. The objective therefore will be to encourage age pension eligible persons to keep working.

It could be argued that deferring the age pension could create a larger liability for the Government than it gains from the lower period of payment. Detailed modelling would be required but we believe that the benefits from securing productive work and tax from people who would otherwise have retired could more than compensate for any additional cost. We note that there would need to be rules that ensured that more wealthy people will not qualify for the increasing pension payments if they were not eligible for the Age Pension. Rather than deferring the age pension and receiving higher payments later there may be an option for the retiree to receive a lump sum from the Government in recognition of the deferral, this may be a small one off payment or may be a contribution to the individuals superannuation fund for example in the form of a co-contribution.

Whilst the Government should remove barriers to working longer there are also the social issues around providing opportunities for older persons to find meaningful employment. These issues are outside the scope of this discussion.



## Appendix F Annuity Products

The Actuaries Institute is suggesting that the Government place limits on the amounts of money that may be drawn out of the superannuation system post-retirement. In effect the high net worth retirees would need to draw down the majority of their funds over an extended period of time. This section discusses some potential products available to retirees. We have termed these annuity products although they have significantly different features.

Annuities are income stream products that provide an income in retirement. There are different types of annuities that can be made available by superannuation funds or financial services businesses. The following is a summary of the range of products available:

- **Account-Based Annuity** (Note that these are currently referred to as account based pensions) – Retiree manages their own individual account. Features include: choice of investments, no guarantee of balance or income, flexible income with a minimum annual draw-down, complete access to capital for transfer to another annuity product or withdrawal as determined by the Government rules. There is no insurance component to this product.
- **Term Annuity** – Retiree purchases product from an annuity provider. The income is not flexible but is fixed or indexed to a specified indicator, income is guaranteed to be paid for a certain term. Some annuities return the capital at the end (100% RCV), others utilise the capital to make regular payments so there is no residual capital value (zero RCV). Under current legislation there must also be a benefit paid on death.
- **Lifetime Annuity** – Retiree purchases product from an annuity provider, income is not flexible but is fixed or indexed, income is guaranteed to be paid for life, there is usually no residual capital value (zero RCV) on death – although “insurance” can be bought which may provide for a payment guarantee or a death benefit.
- **Deferred Lifetime Annuity** – As for lifetime annuity, these may be purchased at retirement or over a number of years, but the payments are “deferred” – they do not commence immediately but start in future. E.g. a 20 year deferred annuity bought at age 65 will commence payments at age 85 if the retiree is still alive. There is generally no return of capital on earlier death.
- **Variable Annuities** – Variable annuities are unit linked savings contracts with attaching guarantees, for example they may provide capital guarantees or minimum annuity rates.
- **Other new innovative products** These are a hybrid of some of the above types of annuity. E.g. a variable annuity may start as an account-based annuity then “morph” into a guaranteed annuity at say age 85.

Over the past 15 years, account-based pensions have become the most popular choice for retirees with substantial superannuation balances. Investment markets were strong up until 2007, and high equity returns boosted account balances. Retirees are attracted to the payment flexibility and access to capital in the early, active stage of their retirement. The disadvantage with these products is that they offer no protection of capital





## Appendix F Annuity Products CONTINUED

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**Current lifetime annuities products are becoming increasingly unattractive and insurers should be enabled to develop further options for future retirees.**

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and many retirees have had their capital reduced by low investment returns since 2008. In addition, there is no longevity guarantee so when the account balance is used up, the payments cease.

Lifetime annuities were popular when interest rates were high (and retirees could lock in this high rate of return for life) and investments in lifetime or long term certain annuities were exempt from the Age Pension asset test. Lifetime annuities provide the greatest protection against both investment and longevity risk, and can also protect against inflation if they are indexed. However, these products are unattractive to today's retirees because, amongst other things:

- They do not allow access to capital;
- They do not allow flexibility of payments;
- They introduce a counterparty risk, because annuity payments are dependent on the provider or insurance company's ability to meet future payments over a potentially longer period; and
- The products appear expensive because the risks and uncertainties are significant from a provider's perspective which is reflected in the pricing and prudential capital requirements.

In the absence of the reintroduction of major tax or other incentives, it is unlikely that lifetime annuities will become popular with today's retirees. However, the Actuaries Institute believes that there is an important role for deferred lifetime annuities as an "insurance policy" against longevity.

Purchasing a deferred lifetime annuity on retirement (which starts payments say 20 years later) may be a cost effective way for a retiree to lock in an income above the Age Pension in their later years. Deferred annuities deliver a guaranteed income stream in addition to the Age Pension in old age when most retirees want certainty and do not want to be burdened with looking after complex financial affairs.

A deferred annuity can be viewed as the opposite of life insurance; it insures the retiree against not dying! It is also not an investment product, although the upfront premium is invested by the insurance company. There is no payment on death prior to the commencement age.

Deferred annuities face a range of legislative and regulatory impediments that make them inefficient. The Actuaries Institute believes the Government needs to remove these barriers to retirement product innovation. We have summarised these changes in Appendix C.

Removing the legislative barriers to lifetime, deferred lifetime and variable annuities, and drafting legislation flexible enough to accommodate product innovation, will enable insurers to develop products that can compete with the other options available to the retiree.

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# Notes

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## Contacts



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### **About the Actuaries Institute**

The Actuaries Institute is the sole professional body for actuaries in Australia. It is the public face of the profession which represents the interests of its members within Government, the business community and the general public.

### **Australia's Longevity Tsunami – What Should We Do?**

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## **FROM 14 APRIL 2014**

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25 August 2014

Mr David Murray AO  
Chairman  
Financial System Inquiry  
GPO Box 89  
SYDNEY NSW 2001

Dear Mr Murray

### **FSI Interim Report – Actuaries Institute Submission**

I enclose for your attention a submission prepared by the Actuaries Institute in response to the FSI Interim Report. The Institute welcomes this opportunity to comment on the Committee's observations and is pleased that a number of our original recommendations have been thoughtfully considered.

Members of the Institute have also been pleased to contribute to research projects conducted by the FSI Secretariat. We trust those contributions have helped inform the Committee's deliberations on managing Australia's longevity risk.

If you would like to clarify any aspects of the Institute's submission, please do not hesitate to contact David Bell, Chief Executive Officer,

Yours sincerely

Daniel Smith  
President



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# Response to the FSI Interim Report

## 1 Introduction

The Actuaries Institute welcomes the opportunity to provide further comment on issues pertinent to the Financial System Inquiry (FSI) and on a number of policy options contained in the Interim Report. The Institute is pleased to note that many views contained in our original submission particularly concerning retirement income and longevity risk products have been strongly considered by the Committee.

The Institute reiterates its previous recommendations to the FSI, especially the need for an overarching policy framework to manage retirement income related issues. A policy blueprint is essential if we are to effectively assist our ageing population.

In Australia we currently have a large superannuation system that focuses on wealth accumulation but lacks the same focus on retirement income streams that will sustain retirees' future living standards. The current system is complex and individuals often lack the financial skills to make critical decisions about retirement funding.

Therefore, given the Institute's deep interest in retirement income policy and demography, we think it is important that policymakers consider default options for channelling accumulated superannuation benefits into retirement income streams, where appropriate, to protect against inflation and longevity risk. We also call for the removal of impediments that constrain the development of a wider range of retirement income products.

## 2 Key Recommendations

The Institute reiterates key recommendations contained in our original submission to the FSI:

1. **The Government to adopt a comprehensive framework to manage all issues relating to a sustainable financing of our ageing population (see [4.4 Superannuation policy](#)).**

Many submissions to the FSI have identified the lack of a coherent unifying strategy to deal with the interaction of the various financial elements of retirement – Age Pension, aged care, health care and the family home. Given that superannuation funds under management are currently around \$1.6 trillion and expected to grow to \$5 trillion over the next 30 years the lack of an agreed policy framework is a major risk to the system.

The Institute agrees with the FSI that there is no legislative or formal statement of the guiding objectives for the retirement income system (FSI 2-97). This lack of policy clarity has constrained the development of a cohesive retirement income policy that integrates Age Pension, private income streams and aged care objectives. We call for the establishment of a comprehensive policy framework to manage all issues related to the sustainable financing of our ageing population. This should be one of the priority recommendations of the FSI.

2. **The government to establish a mechanism to develop coordinate and drive retirement incomes policy (see [6.2 Regulatory architecture](#)).**

The Government should also consider the establishment of a Government agency similar to the NZ Commission for Financial Literacy and Retirement Income to carry out policy research and report to the Government on a regular basis. This initiative will provide the impetus for policy development and monitoring of emerging issues.





The Council of Financial Regulators (CFR) could be accountable for coordinating and managing financial system policy and eliminating regulatory arbitrage. The CFR's activities should be widely reported on a regular basis to ensure transparency.

3. **Creation of an open data regime to allow increased access to relevant government held data and modelling information to better manage macro risks to the financial system (see [6.1 Financial System Data](#)).**

The FSI itself has experienced the difficulty of accessing system-wide economic data to guide its deliberations. The Government should streamline the data collection methods of agencies to reduce costs and it should allow greater access to relevant agency held information that can assist private and public sectors to make more informed policy decisions.

4. **Remove regulatory and other policy impediments to developing retirement income default options and a wider range of annuity products with risk management features that could benefit retirees (see [S7.1 – 7.5](#)).**

Australian retirees are currently limited to choosing between lump sums, account based pensions and guaranteed immediate annuities to provide their income in retirement. Lump sums and account-based pensions provide no longevity protection, whereas guaranteed immediate annuities reduce the flexibility available to retirees.

This recommendation aims to promote retirement income streams to help manage the longevity risk that the FSI has confirmed is an emerging issue of serious consequence to the financial system.

## FSI Observations

In addition to the above recommendations the Institute also makes a number of points in response to a selection of the Committee's observations to assist its current deliberations.

### 3 Funding

#### 3.1 Future capital flows (2-85)

What effects will the trends in the size and composition of superannuation have on the broader flow of funds in the economy over the next few decades, including on international capital flows to and from Australia?

##### *Response*

The assets within the superannuation industry are expected to grow from \$1.6 trillion to more than \$5 trillion over the next 30 years – and represent approximately 160% of GDP. By that stage around 44% of assets will be held in the pension or drawdown phase. Superannuation cash flows will move towards neutrality as pension drawdowns compensate for contribution inflows<sup>1</sup>.

As the shift from the accumulation to drawdown phase progresses superannuants' risk aversion and preference for greater capital security (possibly including some life time annuities), will see a shift over time to more conservative investments which will boost demand for long-term defensive asset classes such as government and corporate bonds.

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<sup>1</sup> RiceWarner - Ageing and Capital Flows, FSI submission, May 2014  
*Report commissioned by Actuaries Institute.*



## 4 Superannuation

### 4.1 Operating costs and fees (2-99)

The Interim Report suggests there is little evidence of strong fee-based competition and that operating costs and fees appear high by international standards.

#### *Response*

The Institute believes the complexity of our superannuation system generates costs (administration fees related to tax, insurance, compliance etc.) that often appear high and we support the general impetus to lower fund fees. However, care should be taken when comparing different types of funds especially when making international comparisons. Many domestic funds are 'choice' funds not default plans. Additional costs for financial advice, insurance, distribution and legacy system maintenance also come into play. The system, at the moment, is complex and currently transitioning from a paper-based system to an electronic one. The fundamental issue is whether or not consumers are receiving value for money on a risk adjusted basis.

The SuperStream and MySuper reforms are significant but have not yet had time to dampen the level of operating costs. Moreover, ongoing fund consolidation is expected to add scale that will further drive down costs. This is an issue that should be monitored independently on a regular basis.

### 4.2 Liquidity: 3-day portability rule (2-114)

Should the 3-day portability rule be replaced?

#### *Response*

The Institute believes there is a clear logic for superannuation funds to support longer term investments including infrastructure. A constraint is the need to meet the 3-day portability rule. Although we do not believe this is currently an issue, the regulator should be given the discretion to provide general industry relief from the rule in periods of systemic stress.

### 4.3 Short-term investment focus (2-115)

#### *Response*

There is much debate about active versus passive investment approaches. Different approaches will deliver contrasting results in different time periods and investment environments. There is a recent trend for retail MySuper products to adopt a more passive low cost approach, but the preliminary information to date would indicate that the more active and diversified strategies typically adopted by the larger industry funds (including investments in unlisted classes like infrastructure and private equity) have the potential to deliver better risk adjusted returns net of all fees. Over time increased levels of consumer information about retirement income returns as opposed to accumulated asset figures may eventually encourage more interest in long-term returns.

### 4.4 Superannuation policy - Observation (2-118)

Superannuation policy settings lack stability, which adds to costs and reduces long-term confidence and trust in the system.



## Response

The Institute agrees that there is no legislative or formal statement of the guiding objectives for the retirement income system (FSI 2-97). This lack of policy clarity has constrained the development of a cohesive retirement income policy that integrates Age Pension, private income streams and aged care objectives. We call for the establishment of a comprehensive policy framework to manage all issues related to the sustainable financing of our ageing population. This should be one of the priority recommendations of the FSI.

It is recognised that the establishment of a comprehensive retirement policy is no easy task especially given the overlapping of regulatory perimeters of critical government departments and agencies. One option would be to establish an independent Government body similar to the NZ Commission for Financial Literacy and Retirement Income (see 6.2) with accountability for framing retirement income policy and carrying out periodic reviews to maintain its efficacy.

## 5 Consumer Outcomes

### 5.1 Insurance Pooling - Observation (3-75)

Technological developments have the potential to reduce insurance pooling. This will reduce premiums for some consumers; however, others will face increased premiums, or be excluded from access to insurance. Underinsurance may occur for a number of reasons, including: personal choice, behavioural biases, affordability, and lack of adequate information or advice on the level of insurance needed.

## Response

As technology improves information availability means many insurers are now able to price risk at the “address” level. Consequently, risk pooling and many inherent cross-subsidies previously incorporated in premiums have been eroded and the most ‘at-risk’ customers now pay a higher price. Reduced affordability can lead to underinsurance. In general insurance, flood mitigation is a strong potential solution for the mid-term.

### 5.2 Rationalisation of legacy products (3-87)

The FSI proposes the Government should renew consideration of 2009 proposals on product rationalisation.

## Response

Legacy products may no longer be servicing consumers’ insurance and investment needs. Other flow-on effects include:

- Expensive system maintenance costs are met by consumers.
- Complex and outdated administration systems are preserved to handle legacy products.
- New investment in IT platforms and increased compliance risk are constrained.
- Innovation is impeded as companies will not want to launch new products that could be on the books for many years even if they are not successful.

The introduction of a mechanism for rationalising legacy financial services products (subject to a no disadvantage test or a net system benefit with no substantial individual disadvantage) will generate significant benefits for the economy, consumers and industry participants.



Rationalisation would also enable better data to be gathered to assist our understanding and management of underlying risks e.g. mental health claims within life insurance.

Reforms of this nature will facilitate product rationalisation across all wealth management products and increased development of modern products, leading to better servicing of the population's insurance and investment needs, businesses cost and efficiency benefits for an overall reduction in compliance costs.

## 6 Regulatory Architecture

### 6.1 Financial System Data (3-97)

Financial system data is useful for policymakers, regulators, industry, academics and others.

#### *Response*

The FSI has identified 'data gaps' with its own investigations into aspects of the financial system. The Government should create an open data regime to allow increased access to and analysis of important government held data and modelling information to better manage macro risks to the financial system.

While currently available statistics provide insight into particular financial sector activities, it is far more difficult to obtain a system-wide sector, market or individual view of emerging risk dynamics and behaviours. This information is important and will be needed to help formulate the most effective policies for managing future macro risks to the financial system. Some consideration should be given to:

- ways of streamlining data collection by government agencies.
- making suitably anonymised data more widely available
- reviewing current data reports – are they still necessary/relevant?
- development of national standards and data dictionaries to enable more efficient collection of data.

### 6.2 Regulatory perimeters (3-99)

The regulatory perimeters could be re-examined in a number of areas to ensure each is targeted appropriately and can capture emerging risks.

#### *Response*

In our original submission to the FSI the Institute proposed the establishment of a Financial System Policy Commission (FSPC) whose role would be to put forward policy options on how to best manage the financial system over the longer term. We said that the FSPC could fulfil a similar function to the Productivity Commission and review policy issues across a range of sectors; banking, insurance, superannuation etc.

The Institute thinks FSI should also consider the merits of another model – the NZ Commission for Financial Literacy and Retirement Income. The Commission is an independent Crown body that has a responsibility to carry out research and consultations and report to government every three years. A primary function of the Commission is to ensure New Zealand's retirement income policy is stable and effective. The benefit of the NZ model is that it is ongoing, maintains a constant eye on the system, raises emerging issues in a timely fashion and is divorced from short



term political debates. The three year time frame for reports to government allows ample time to reflect on strategic issues but short enough to react to emerging systemic problems.

The current regulatory perimeter surrounding the SMSF market segment should receive further consideration. SMSF is a segment that currently manages assets in excess of \$500 billion yet is lightly regulated by the ATO whereas commercial and industry schemes (\$1.1 trillion) are supervised by APRA/ASIC. There is a need to confirm that the level of prudential oversight for the SMSF sector is appropriate to manage the potential for systemic risk in the event of, for example, widespread inappropriate investment strategies such as excessive property gearing or large scale mis-selling.

### **6.3 Regulator cooperation and coordination - Observation (3-120)**

During the GFC and beyond, Australia's regulatory coordination mechanisms have been strong although there may be room to enhance transparency by formalising the role of the Council of Financial regulators (CFR), expanding its membership and increasing its reporting.

#### **Response**

The CFR is an appropriate regulatory vehicle to coordinate and clarify financial sector policy issues. It should also have an input into the development of a comprehensive policy framework for the sustainable financing of our ageing population. The membership of CFR could also be expanded to include at least the ATO and, if established, the Australian equivalent of the NZ Financial Literacy & Retirement Income Commissioner. In addition CFR could be the mechanism to clarify or determine the appropriate position when cross-regulatory issues arise and to eliminate regulatory arbitrage. Whatever mechanism is used its deliberations should be transparent.

## **7 Retirement Income**

### **7.1 Approach to retirement income (4-3)**

Australia has an inconsistent approach to its retirement income system.

#### **Response**

Australia lacks a coherent approach to its retirement income system and requires a comprehensive policy framework and a clearly designated policymaker to ensure the system delivers optimal outcomes for the consumer and the nation. The interaction between retirement incomes, Age Pension, aged care, health care and home wealth is complex and critical to the overall sustainable functioning of the economy. A retirement income blueprint needs to be formulated to increase consumer confidence in the system. The Actuaries Institute is assisting the FSI Secretariat formulate a paper, separate to this submission, that is examining options for the development of retirement income products to manage longevity, inflation and investment risks.

### **7.2 Longevity risk - Observation (4-8)**

The retirement phase of superannuation is underdeveloped and does not meet the risk management needs of many retirees.

#### **Response**

This issue was well covered in the Institute's original submission to the Inquiry. Longevity risk management is a major weakness of Australia's retirement income system. Given that the taxpayer ultimately bears the risk related to how individuals access and invest their retirement



savings, it is reasonable that the Government proposes various incentives and/or restrictions on how superannuation fund assets can be drawn down.

The Government should, as part of its development of an overarching retirement income policy, consider options for boosting the uptake of income stream products including the introduction of sensible default options for retirees transitioning to or in the superannuation drawdown phase.

### **7.3 Counterparty risk (4-17)**

The Financial Claims scheme removes counterparty risk for retirees who save through bank deposit products and term deposits, but not annuities.

#### **Response**

Products with long-term payment guarantees to retirees issued by life companies are regulated by APRA and are subject to very strong capital and risk management requirements. However, consumer concerns about counterparty risk may pose constraints for future development of lifetime annuity markets and products.

The GFC gave explicit form to the implicit guarantee to the global banking sector. The guarantee further encourages older investors to place a large proportion of their assets in short-term deposits. These are not always suitable investments for the generation of long-term income. Therefore to level the playing field and encourage long-term investments (such as infrastructure), to allay consumer concerns about counterparty risk, and to promote innovation in the longevity insurance market, consideration could be given to the introduction of some support mechanism, to provide financial assistance to consumers that suffer loss through counterparty failure.

### **7.4 Defaults (4-21)**

Defaults have powerful effects on (non)decisions and can address the problems associated with the low level of financial literacy among retirees.

#### **Response**

In Australia we currently have a large superannuation system that focuses on wealth accumulation but lacks the same focus on retirement income streams that will sustain retirees' future living standards. Default products can assist those who do not have the financial skills or confidence to make investment decisions that have enormous potential consequences for their quality of life in retirement. It is important to ensure that evolving default products retain some flexibility for retirees to access some capital if, for example, hardship arises that requires funding in excess of regular income amounts. A critical issue will be establishing the appropriate criteria that trigger the direction of a retiree's assets to the default option.

### **7.5 Retirement income products - Observation (4-25)**

There are regulatory and other policy impediments to developing income products with risk management features, such as annuities, that could benefit retirees.



## Response

There are a number of impediments that constrain institutions from developing retirement income products including the following supply-side issues:

- |  |                |
|--|----------------|
| 1. SIS Regulations – standards for products to qualify for the tax exemption | Regulatory     |
| 2. Age Pension assets test and income test                                   | Tax/Social Sec |
| 3. Need for multiple approvals, by organisations with different interests    | Regulatory     |
| 4. APRA Minimum Surrender Value requirements in LPS360                       | Regulatory     |

As a result, Australian retirees are currently limited to choosing between lump sums, account-based pensions and guaranteed immediate annuities to provide their income in retirement. Lump sums and account-based pensions provide no longevity protection, whereas guaranteed immediate annuities reduce the flexibility available to retirees.

None of the impediments are considered insurmountable although the cost of guarantees associated with these products is high and act as a disincentive. The Government should look to develop a policy and a mechanism that could remove or reduce current regulatory, economic and consumer impediments to development and innovation in the retirement income segment.

## 7.6 Home equity (4-33)

What regulations, if any, impede the development of products to help retirees access the equity in their homes?

## Response

Currently there are no explicit regulatory impediments constraining the development of home equity release products. However, there is a supply-side issue with a lack of funding from lenders/ investors. There are also demand side issues, in particular arising from the exemption of the family home for the age pension assets test compared with the treatment of other assets, which can be an impediment to retirees releasing housing wealth. These sorts of issues should be considered by the relevant policy agencies in order to encourage the use of housing wealth as a more widely used source of retirement funding.

## 8 About Actuaries

### Actuaries' role in the Financial Services Industry

Actuaries have a reputation for a high level of technical financial expertise and integrity. They apply their risk management expertise to allocate capital efficiently, identify and mitigate emerging risks and to help maintain system integrity across multiple segments of the financial and other sectors.

Within the community we rely on engineers to stop things breaking down. We rely on actuaries to do a similar process in the financial system. They provide a control cycle with regard to pricing, reserving and risk management.

They have performed this control function in the life industry ever since it began, in general insurance over the last 30 years and more recently in health insurance. Within superannuation they have particularly assisted in defined benefit superannuation schemes.





Actuaries also work in other areas in non-statutory roles such as risk management, banking and data mining. By combining commercial acumen with mathematical rigour and deep analytical skills, actuaries have the ability to find pure, honest insights within business data. Insights which are then used to inform business and government and drive change.

In many instances, an actuary's role complements that of the government regulator by bringing attention to the board and management, issues that represent regulatory needs. As such, Actuaries are well placed to comment on the fitness of the current financial system to continue to support consumer needs into the future.

Although actuaries are embedded in the financial services industry, they have rigorous practice requirements, quality practice guidance and valuable continuing professional development, all of which ensure their integrity and effectiveness.

## **The Actuaries Institute**

The Actuaries Institute (Institute) is the sole professional body for actuaries in Australia.

This submission's recommendations are underpinned by the Institute's adherence to the following policy principles:

### ***Public benefit***

The Institute holds the 'public interest' or 'the common good' of the Australian community, or to a particular group of consumers, as a key principle of policy development. The financial services system should fundamentally serve the broadest public benefit whilst satisfying individual consumer needs.

### ***Risk focus***

In considering solutions to public policy issues actuaries take an evidenced based approach that focuses on identification and management of risks – what they are, who carries them, who should carry them and how those risks should be best managed.

### ***Transparency and disclosure***

The careful analysis that actuaries can provide is underpinned by the availability of data. Broadly, the more data that is available and the better the quality of that data the more accurately risk can be assessed. Actuaries also value clear, concise and standardised disclosure of information to consumers on the basis that such disclosure enables consumers to exercise choice more confidently.

### ***Equity***

Individual consumers should be given fair treatment and commercial enterprises should be allowed to compete on a 'level playing field'. Technological advancement is fostering new sources of competition from non-traditional players. As long as required capital standards are met consumers can benefit from this increased level of competition. Nevertheless regulation should be neutral for all competitors to avoid any arbitrage that can undermine consumer protection.

### ***'Good' regulation***

Excessive or unnecessary regulation can diminish market efficiency and undermine public benefit. Good regulation should balance cost and benefit. Self regulation is favoured as it is often efficient and reduces consumer costs although prescription can sometimes be more appropriate.



12 December 2014

Alicia Da Costa  
Analyst, Financial System Division  
Markets Group  
The Treasury  
Langton Crescent  
PARKES ACT 2600

Dear Alicia,

### **Superannuation Fund Disclosure**

Thank you once again for meeting with Institute representatives on 5 November 2014. Given your policy responsibilities relating to superannuation fund disclosure the Institute would like to outline some guiding disclosure principles which we believe would best assist fund members whilst achieving the government's policy intent.

Members of the Institute have been and are involved in the provision of information to superannuation funds members. The Institute therefore wishes to ensure that this information is not incorrect or misleading. We also want to ensure that the information provided achieves the Government's objectives relating to that information.

The introduction of Product Dashboards is a major change to how superannuation fund information is disclosed to members. The Institute is particularly interested in which metrics should be disclosed on Product Dashboards. As indicated in previous submissions we strongly believe that many of the metrics currently included on the Product Dashboards do not achieve what we believe are the Government's objectives for Product Dashboards.

We are also interested in what is the best approach to allow members to properly compare the services provided by superannuation funds and the costs of these services. We have therefore developed some alternatives that we believe could potentially help enable members and other stakeholders to properly compare the investment performance of superannuation funds and the costs of their various services.

### **MAJOR DISCLOSURE PRINCIPLES**

The legislation that governs what information is provided to superannuation fund members and other stakeholders sets out the general requirements that must be followed. However, APRA and ASIC have the responsibility to determine the actual methodology used to calculate this information and to determine how it is disclosed. In our discussions with ASIC and APRA it is apparent that both parties see their role as implementing their interpretation of the government policy in this area. Accordingly the Institute believes it is important to establish that principles that reflect the government's intentions.

The Actuaries Institute has also long held the view that, when disclosing fees and costs to superannuation fund members, each type of fee/cost should be related to the services that are provided when those fees/costs are incurred. We therefore believe that this view should be reflected in any principles that are to be established.

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Accordingly we believe the following should be established as a matter of policy so that the regulatory agencies responsible for implementing Government policy have clear directions as to the approaches they should use.

- (a) Investment performance (for comparison purposes) should be measured using the time-weighted net investment returns generated by the assets underlying the superannuation product.
- (b) Investment fees and costs should be judged against expected investment returns. Therefore only investment fees/costs should be deducted when disclosing any investment performance metric that is to be used to compare the investment skills of different product providers or the potential future returns generated by different investment products.
- (c) Administration and Advice fees and costs should be judged by considering the service related to those fees/costs.
- (d) The requirement for simplicity sometimes inhibits the ability to provide complex calculations that best allow the cost of different services to be compared. Any simple metrics must demonstrate the impact of these costs, especially if the impact varies between superannuation fund members.

If we assume that these principles properly reflect Government objectives, then the return disclosed on Product Dashboards should be the Net Investment Return for the assets underlying the product. This means that administration and advice fees and costs should not be deducted from the Net Investment Return as is required by the methodology currently set down by APRA.

Further, with respect to administration fees and costs, as the effect on final benefits may depend on the size of a member's super balance, we favour having two representative members in PDS and Dashboard standard fee and cost tables - the likely very different results for the two account balances will help to indicate to a member or potential member that further information, and perhaps a projection, might be desirable. The prime reason for this is that different fee types **grow at VERY different rates** (refer page 5 of our 7 August 2014 submission to APRA).



## DISCLOSURE METHODOLOGIES

We set out in the correspondence discussed at our last meeting our suggested approach to the methodologies that should be used to calculate the metrics included on Product Dashboards. Importantly, if the above principles are established, then the Net Investment Return and Net Investment Return Target should replace the Net Return and Return Target. Further, the Representative Member should be replaced by two Representative Members with different account balances.

The requirement that Product Dashboards provide unsophisticated superannuation members with a series of metrics that allow them to compare the investment, administration and advice services provided by superannuation funds means that more complex metrics are unsuitable for Product Dashboards. However:

- 1) We expect that many members (particularly those close to retirement or with substantial accumulations) will want to have access to more information regarding the various superannuation products available.
- 2) Further, these members will generally be willing to spend the time understanding more complex comparison metrics.
- 3) From its various publications, we also note that APRA produces a range of metrics that provide a snapshot of the comparative position of all superannuation funds.
- 4) As a secondary objective, the full range of investment performance, fee/cost and other metrics allow APRA to identify funds which may have potential issues.

To meet the needs of 1) to 4) above, we therefore believe that more sophisticated metrics should also be made available to superannuation fund members and the industry.

The above views form the basis of the two "League Tables" that the Institute has provided to you.

With regard to the projection of the impact of administration fees on member benefits, we realise that some stakeholders see projections as too complicated. However, highly standardised projections need not be complicated. They have been used for a long time in the United Kingdom. "Highly standardised" does not mean just assumptions. Highly standardised means contribution levels, years projected and format. An example of what we have in mind is described on pages 3 to 5 of the enclosed.

Note that the only difference in the projection table that would be shown in the PDS for each fund is the difference due to the administration fees and costs of the fund. Users would not have to understand the details of the fees and costs of the fund, just note their effect on how the fund's results compare with other funds. Page 4 of the enclosed explains that:

- The first three columns would be common to all funds (when making a comparison of two or more funds, this feature gives the reader confidence that they are comparing "like with like").
- The fourth and fifth columns are unique to each fund since they depend directly on each fund's administration fees and costs.



As we mentioned to you, the attached document was prepared by Ray Stevens and Colin Grenfell. In late 2009 the Actuaries Institute decided to support the "Way Forward" proposal and recommended that it should be subject to rigorous consumer testing to confirm its suitability and to identify further improvements. We expect that the proposal would also benefit from further consultation with other industry bodies and regulators.

## CONCLUSION

APRA and ASIC have, and are introducing, a disclosure regime for superannuation funds that reflects their understanding of the previous Government's policy in this area. As indicated, we believe that the outcomes are problematic and will lead to superannuation fund members making bad decisions regarding their superannuation arrangements. In the long term this could lead to lost credibility and may produce lower retirement benefits that would potentially increase Government expenditure through a greater reliance on the age pension for retirees.

We would therefore like Treasury to clearly state a series of disclosure principles along the lines of those set out above. This will enable the disclosure regime established by APRA and ASIC to be assessed against Government policy in this area.

We would expect this to lead to modifications to the current proposals for:

- dashboards, PDS's and other material intended to assist members and prospective members to understand and compare funds on a sound basis; and
- statistics to be published by APRA and others to help all parties to understand and compare on a sound basis the performance of superannuation funds.

Please let us know if you would appreciate any further information about comparing fees and costs, the two League Tables or the Way Forward proposal.

Yours sincerely,

**Andrew Boal**

Convenor

Actuaries Institute Superannuation Practice Committee

cc Tim Goodland  
Insurance and Superannuation Unit  
Financial System and Services Division  
The Treasury  
Langton Crescent,  
Parkes ACT 2600

## Standardised Disclosure of Fees and Costs - the Way Forward

[Updated November 2009]

The first version of this note was published in the August 2003 edition of *Actuary Australia*, the monthly magazine of the Institute of Actuaries of Australia. To take into account refinements suggested by various industry participants an updated version was published in the May 2004 edition of that magazine and another was included in our April 2007 submission to the Parliamentary Joint Committee on Corporations and Financial Services. For this November 2009 update we have incorporated some changes resulting from the work of the Institute of Actuaries Benefit Projections Working Group (of which Colin Grenfell and Ray Stevens are members) for its submissions to ASIC on benefit projections.

To help consumers compare different superannuation plans and products requires some standardisation in the way that fees, charges and costs are disclosed in Product Disclosure Statements (or PDS's). In fact, the same can be said of any product with an investment component, such as a managed fund or a life office or friendly society investment-linked policy or bond.

Just over ten years ago, Colin Grenfell wrote an article “KFS Disclosure - no easy matter” which was published by the Association of Superannuation Funds of Australia (ASFA) in the December 1998/January 1999 edition of SuperFunds. The article summarised the then public views on fee disclosure as expressed by the Liberal-National Coalition, the Labor Party, the Australian Securities and Investments Commission (ASIC), the Industry Funds Forum and others.

The article also noted that the Institute of Actuaries of Australia recommended that:

- (1) Investment performance should be reported net of tax and investment transaction costs and net of all investment costs.
- (2) Key Features Statements should include a brief description of all fees and charges.
- (3) In addition there should be some form of analysis of the impact of fees and charges which should focus on all non-investment fees and charges.
- (4) The impact of these fees and charges should be shown net of employer subsidies but should include any costs in excess of fees and charges which impact on members' benefits.

**The authors of this note believe that these four recommendations reflect sound principles that remain valid today.**

The authors note that the Institute's principles include the need to show separately the effect of investment fees and costs and of non-investment (or broadly administration) fees and costs. The authors consider this split is essential for a sound comparison of funds. The split also facilitates member investment choices. It is noted that the Report commissioned by ASIC from Professor Ian Ramsay, released in September 2002, recommended that investment and administration fees should be separated. Investment fees and costs would be defined consistent with Corporations Regulation 7.9.01 which refers to “... relating to the management of investment of fund assets”.

In our previous work we have referred to non-investment fees and costs as “administration” fees and costs. The early material issued by the Cooper Review seems to have expressed a preference to call these non-investment fees and costs “superannuation” fees and costs rather than “administration” fees and costs. This is an innovative and very appropriate proposal which we support provided the new terminology is mandatory and clearly specified in regulatory guidance and/or legislation. We have therefore amended the terminology in this update to allow for this preference.

The August 2003 and May 2004 articles explain the background and relevant events since 1998. A further article in August 2005 expands on recommendations (1) and (3) above.

### What happens next?

**We suggest that the way forward should include the following three level fee and cost disclosure framework:**

#### **1. At a glance**

This component of the framework would summarise the existence of various fees and costs using standardised terminology, order of contents and grouping. For example;

INVESTMENT		SUPERANNUATION	
Ongoing fees	<i>Yes</i>	Initial fees	<i>No</i>
Ongoing extra costs	<i>Yes</i>	Ongoing fees	<i>Yes</i>
Switching fees	<i>Yes</i>	Ongoing extra costs	<i>Yes</i>
Buy-sell spread	<i>Yes</i>	Benefit fees	<i>Yes</i>
		Exit fees or penalties	<i>No</i>

<b>OTHER</b>	Any other fees or costs?	<i>No</i>
	Are any dollar fees indexed	<i>Yes</i>
	Are fee rates expected to increase in the next 5 years?	<i>No</i>
	Are some tax deductions withheld?	<i>No</i>

#### **2. Brief description**

This component would be similar to the brief descriptions of fees and charges used in Member Booklets and some PDS's, but there would be a few important constraints. For example;

- Must include brief descriptions of how each of the above "*Yes*" responses is calculated and charged.



- Must start a new paragraph for each fee or cost.
- Must be in the same order as the first component and use the same grouping.
- Must briefly describe the services provided.
- Must use standard terminology similar in style and depth to the requirements of Corporations Amendment Regulations 2005 (No. 1) but, primarily as a consequence of the separation of fees and costs into “investment” and “superannuation” components, without the unnecessary and confusing terms “management costs” and “other management costs”.

### 3. Impact of fees and costs

This third and final component would replace the current Corporations Regulations “example of annual fees and costs”. Like the current example it would exclude service fees. It would have two distinct parts, one for Investment fees and costs and one for Superannuation fees and costs. For example;

#### INVESTMENT

For each investment option, list:

- the ongoing net of tax fees and extra costs as a single annual dollar amount per \$10,000 of average assets (eg. if fees were .44% net of tax and the only other investment costs were Consultant's fees of .09% net of tax, then list \$53 per annum for this option), and
- the buy-sell spread (if any) and state whether this margin is paid to the fund manager or left in the fund for the benefit of other members.

#### SUPERANNUATION

A standardised superannuation fees and costs projection (similar to that now required in the United Kingdom) for at least two levels of contributions. This is probably the most important part of the framework.

This part includes the following five columns for initial annual contributions of \$5,000 and \$10,000 respectively:

- |   |                            |
|---|----------------------------|
| (1) At end of years   | 2, 5, 10, 20 and 40        |
| (2) Total paid in to date   | 3 or 4 significant figures |
| (3) Account balance without fees and costs deducted                 | 3 or 4 significant figures |
| (4) Effect of fees and costs to date                                | 2 or 3 significant figures |
| (5) Account balance with fees and costs deducted<br>[ = (3) - (4) ] | 3 or 4 significant figures |

The Institute of Actuaries of Australia's 6 November 2008 response to ASIC Consultation paper 101 suggested, in its answer to Question 4 in Section B5 (page 30 of the response), how the two contribution levels in 3. above should be determined from time-to-time. The Institute suggested that they should be based on the future SG rate (and any soft compulsion rate of member contributions) applied to say 75% and 150% of an average weekly earnings figure (annualized) with the resultant annual contributions rounded to the nearest \$1,000 and \$2,000 respectively. For example, if average weekly earnings were \$1,300 and the SG rate were 9%, then:

- Lower standard contribution =  $\$1,300 \times 0.75 \times 52 \times 9\% = \$4,563 = \$5,000$
- Higher standard contribution =  $\$1,300 \times 1.50 \times 52 \times 9\% = \$9,126 = \$10,000$

### Sample Product Disclosure Statements

Two sample Product Disclosure Statements, which reflect the principles that we consider should apply to fee and cost disclosure, have been prepared and can be supplied if required. One sample is for a hypothetical Retail superannuation fund and the other is for a hypothetical Industry plan named "ZIS". (They have not been updated to reflect legislative or taxation changes since 2004.)

The next page is an extract from the latter PDS to illustrate the third component of our recommended framework.

This extract has been updated to amend the terminology for non-investment fees and costs from "administration" fees and costs to "superannuation" fees and costs and to use initial contributions of \$5,000 and \$10,000 as determined above.

We consider that if our proposal is adopted, the Australian Government Actuary should be given the responsibility of setting and monitoring the superannuation fee and cost projection basis.

### **We draw to your attention the following three important features of "Table 5":**

- The first three columns would be common to all funds (when making a comparison of two or more funds, this feature gives the reader confidence that they are comparing "like with like").
- The fourth and fifth columns are unique to each fund since they depend directly on each fund's superannuation fees and costs.
- The fourth column shows that after 2 year's the effect of fees and costs (for ZIS) for a \$10,000 initial annual contribution is **115%** of that for a \$5,000 initial annual contribution but after 40 year's the effect of fees and costs for a \$10,000 initial annual contribution is **191%** of that for a \$5,000 initial annual contribution (this large relative difference demonstrates why with any comparator it is essential to have results for both short and long durations and for at least two contribution levels).

**Colin Grenfell and Ray Stevens**

[extract only]

**Table 4: ZIS Annual INVESTMENT Fees and Costs Summary per \$10,000 account balance in each investment option**

	<u>Option A</u>	<u>Option B</u>	<u>Option C</u>
Ongoing (and Extra)	\$161	\$140	\$124
Buy-sell spread	Nil	Nil	Nil

### Assumptions on which the following fee table is based

The table below uses the standard assumptions about account balance, contributions and investment returns that all funds must use to show the impact of their superannuation fees and costs. These assumptions are as follows:

- Account balance at start: nil.
- Initial Annual Employer contributions of \$5,000 or \$10,000 (before tax).
- Contributions payable mid-year (or say weekly) and increasing by 4.5% each year.
- Member contributions: nil.
- Net annual investment return of 7% (net of tax and net of investment fees and costs).
- Dollar fees increase by 3% each year.
- Results in “today’s dollars” (ie deflated using a salary increase assumption of 4.5% each year).
- No allowance for any tax payable on benefits.

**Table 5: Effect of ZIS SUPERANNUATION Fees and Costs**

If withdrawn	Total Paid in to date	Account Balance without fees and costs deducted	Effect of fees and costs to date *	Account Balance with fees and costs deducted *
<b><u>Initial Annual Contribution \$5,000</u></b>				
after 2 years	\$ 10,000	\$ 8,700	\$ 130	\$ 8,570
after 5 years	\$ 25,000	\$ 22,560	\$ 420	\$ 22,140
after 10 years	\$ 50,000	\$ 47,940	\$ 1,260	\$ 46,680
after 20 years	\$100,000	\$108,700	\$ 4,700	\$104,000
after 40 years	\$200,000	\$283,000	\$22,500	\$260,500
<b><u>Initial Annual Contribution \$10,000</u></b>				
after 2 years	\$ 20,000	\$ 17,400	\$ 150	\$ 17,250
after 5 years	\$ 50,000	\$ 45,120	\$ 610	\$ 44,510
after 10 years	\$100,000	\$ 95,880	\$ 2,080	\$ 93,800
after 20 years	\$200,000	\$217,400	\$ 8,500	\$208,900
after 40 years	\$400,000	\$566,000	\$43,000	\$523,000

\* The fees and costs include all fees and costs, except investment fees and costs and insurance charges. They include the benefit payment fee. For ZIS there are no other surrender penalties or exit fees and ZIS does not pay any commissions.

The last line of Table 5 (for an annual contribution of \$10,000) shows that over a 40 year period the effect of the total deductions could amount to \$43,000 (in today’s dollars). Putting it another way, this would have the same effect as bringing investment returns down from 7% a year to 6.63% a year.



8 October 2015

Louise Lilley  
(Acting Manager)  
Insurance and Superannuation Unit  
Financial System and Services Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600

Dear Louise,

## Product Dashboards

We refer our meeting with Treasury representatives on 24 September 2015.

From the feedback we received from Treasury, we understand that the legislation and regulations relating to Choice dashboards has been drafted and may be released shortly.

As explained at the meeting, the Actuaries Institute believes the current MySuper dashboard can and should be significantly improved. Our previous submissions have included detailed explanations of why we believe that the current MySuper metrics are inappropriate particularly if they were applied to the Choice dashboard. We are concerned that superannuation fund members will potentially be misled and eventually accumulate lower final retirement benefits if the current MySuper dashboard metrics were applied to the Choice dashboard.

We are certain that the government would be concerned if a superannuation fund member relied on the Choice dashboard to select their fund and this subsequently proved to be misleading. This would be particularly of concern if the member subsequently became aware that the government had known that the metrics in the Choice dashboard were potentially misleading for some superannuation fund members.

In our submission of 18 August 2015 we provided suggested MySuper and Choice dashboards that included the changes that we feel are required.

The key changes suggested were:

1. Return Target as defined by APRA to be replaced by the trustee's SIS Investment Return Objective.

This would provide superannuation fund members with a statement of the investment return the trustees are actually seeking to achieve with their investment strategy. It would also reduce confusion amongst members and reduce the costs they would have to bear.

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2. Net Investment Return and not APRA's Net Return reported on the dashboard.

This would provide superannuation members with a statement of the actual investment return the member would have achieved in the past. It would provide the appropriate investment return to compare with the SIS Investment Return Objective specified by the trustees.

3. A long term risk measure introduced and the risk labels removed.

This would provide superannuation fund members with long term investment horizons (i.e. most members) with a statement of the investment risks that they would be exposed to. It would also remove risk labels that are potentially misleading for most superannuation fund members.

4. A breakdown table of fees and costs for two example members.

This would provide superannuation fund members with a statement of the cost of each of the separate services that a superannuation fund provides. It also shows that these costs can have very different impacts for members with different account balances.

We note that if our suggested metrics are used for both Choice and MySuper dashboards then the "Superannuation Legislation Amendment (MySuper Measures) Regulation 2013" and APRA's "Reporting Standard SRS 700.0 Product Dashboard" will need to be changed to reflect our recommended approach.

At the meeting on 24 September Treasury indicated the importance of ensuring that dashboards were easily understood. We offered to produce simplified versions of the proposed MySuper and Choice dashboards which would achieve this.

The revised examples of a MySuper and a Choice Dashboard are attached. In these examples we have limited the dashboard to one page, reduced the amount of text by the use of simple tables and taken advantage of the fact the dashboard is web-based by introducing hyperlinks to provide members with easy access to additional information and explanations.



In summary, these two simplified examples demonstrate how it is possible for the Government to:

- Replace the current misleading dashboard with a technically sound alternative
- Remove the need for trustees to determine a 'target' which is causing confusion by adding complex inconsistencies between dashboards and PDS's
- Avoid increases in costs due to duplication in regulatory requirements
- Have the same form of dashboard for both MySuper and Choice products
- Enable consumers to compare the investment performance of different products
- Discard misunderstood risk labels
- Recognise most superannuation members have long not short term objectives
- Provide fees and cost examples which disclose dollar and 'asset-based' impacts
- Cease 'total fees' only disclosure and resultant market distortion
- Rectify the dashboard chart which has failed ASIC consumer-testing
- Add a colour-coded table which clearly compares returns against objectives
- Simplify fees and returns by removing unnecessary and confusing jargon.

Please note that we have now based the long term risk metric on CPI although we still believe that there are good technical reasons why this metric should be based on AWOTE (as we have previously proposed). However, we accept that CPI is an index that most superannuation fund members would currently be more familiar with than AWOTE. Therefore, for the sake of expediency and in pursuit of simplicity and better superannuation fund member engagement, we have restructured the long term risk metric to use CPI. We would still like Treasury to consider moving this metric to an AWOTE basis over time but we appreciate that further discussions and industry engagement may be needed for such a change to take place. We recommend that the Government make at least some reference to this as part of its response to the November 2013 Consultation submissions.

With regard to the long term risk metric, we would also point out that we carried out a significant amount of analysis to determine the margin over AWOTE that was required to provide meaningful differentiation between investment products with different levels of growth assets. Given the need to provide a simplified dashboard quickly, we have not been able to carry out the same analysis to determine the appropriate margin over CPI. Therefore, the margin included in our examples **is for illustration purposes only**. Although we believe that it is a reasonable estimate of the margin that will be required, if Treasury wish to use a long term risk metric consistent with our proposal, we will need some additional time to carry out the appropriate analysis so we can recommend the margin that should be used.

You will also notice that the Investment Return Objective quoted in the attached example MySuper dashboard is now also based on CPI rather than AWOTE. This reflects current practice where growth-orientated MySuper products often base their Investment Return Objectives on CPI plus a margin. We would be happy to discuss our views on the use of CPI versus AWOTE in various circumstances with you at an appropriate future time.



Please let us know if you would appreciate any further information about this matter.

Yours sincerely,

Andrew Boal  
Convenor  
Actuaries Institute Superannuation Practice Committee

**cc**     **Maan Beydoun**  
Senior Specialist, Investment Managers and Superannuation  
Australian Securities & Investments Commission

**Helen Rowell**  
APRA Member  
Australian Prudential Regulation Authority

**Pauline Vamos**  
Chief Executive Officer  
Association of Superannuation Funds of Australia



# ABC Super Dashboard

## Balanced Option (MySuper)

An explanation of the terms used in the Dashboard can be found at this link, [Explanation of Terms](#).

### Investment Return

(Average for 10 years to 30 June 2015)

Investment Return Objective	CPI + 4% pa	<b>6.6% pa</b>
Actual Investment Return	CPI + 4.7% pa	<b>7.3% pa</b>

### Investment Risk

Short-term volatility	Chance of a negative investment return in any given year	<b>4 in 20</b>
Long-term growth	Chance of investment return lower than CPI + 4.5% pa over 20 years	<b>5 in 20</b>

### Statement of fees and other costs (per annum)

	Member with a \$10,000 account balance	Member with a \$50,000 account balance
Administration	<b>\$98</b>	<b>\$178</b>
Advice	<b>\$0</b>	<b>\$0</b>
Investment	<b>\$57</b>	<b>\$285</b>
Total	<b>\$155</b>	<b>\$463</b>

### Average Investment Returns Compared with Objective (% per annum)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Investment Return Objective for 10 years to 30 June (% pa)	6.6	6.7	7.1	7.2	7.2	6.9	6.7	6.7	6.8	6.6
10 year average Investment Return to 30 June (% pa)	10.0	10.1	8.6	6.0	5.7	6.1	6.4	7.6	7.6	7.3

### Investment Returns over the last 10 years (% per annum)



## Explanation of terms

### Investment Return

The **Investment Return** is the net investment return achieved over a period after investment taxes and investment fees and costs.

The **Investment Return Objective** is the objective that the Trustee of the Fund has set for the MySuper option over the medium to long term. The investments held by the Trustee are selected to achieve this objective. Future returns are not guaranteed, so this is only an objective and therefore may not be achieved.

The **Actual Investment Return** is the actual compound average Investment Return achieved over the 10 year period to 30 June 2015.

**CPI** is the Consumer Price Index, reported by the Australian Bureau of Statistics.

### Investment Risk

**Short-term volatility** indicates how likely it is that the value of your investments will fall over any given year.

**Long-term growth** indicates how likely it is that your investments will not grow sufficiently faster than CPI over the longer term, which could mean you won't have enough income in retirement. The 4.5% margin over CPI is a standard margin set for all Australian superannuation funds to measure the long-term growth investment risk.

**CPI** is the Consumer Price Index, reported by the Australian Bureau of Statistics.

### Statement of fees and other costs (per annum)

The fees and costs on the Dashboard assume that the member is fully invested in the MySuper Option.

#### Administration

ABC Super charges a flat fee of \$1.50 each week. The fee is charged directly to a member's account.

Further administration costs have been deducted from investment earnings. For the year ending 30 June 2014 this cost was 0.2% of the value of fund assets.

#### Investment

The investment fees and costs for the MySuper Option were 0.57% for 2014/15.

This includes investment management, custodian and asset consultant fees, including performance fees. The amount quoted in the Dashboard is calculated looking back at 30 June each year (using the average value of all assets in the investment option over the year to 30 June). These may change from year to year. For the last three years performance fees have been 0.13% (2012/13), 0.07% (2013/14) and 0.05% (2014/15) of the value of assets for the MySuper option. The 2014/15 fee has been included in the investment fees and costs shown on the Dashboard.

#### Advice

There is no charge for general advice that is provided to members. Advice that takes into account your personal circumstances is negotiated between you and your adviser. This can include advice on your investment options, insurance cover, contributions to super and retirement pension options and can be deducted from your super account or paid directly to your adviser. The cost of advice on non-super matters can't be deducted from your account.

### Average Investment Returns Compared with Objective (% per annum)

The **Investment Return Objective for 10 years to 30 June (% pa)** is the compound average [Investment Return Objective](#) over 10 year periods to 30 June each year.

The **10 year average Investment Return to 30 June (% pa)** is the compound average [Investment Return](#) actually achieved over 10 year periods to 30 June each year.

It is useful to compare the actual average investment return achieved over 10 year periods with the average Investment Return Objective for the same period. This will provide a guide as to how well a fund is progressing towards satisfying its Investment Return Objective. Green shading indicates that this guide to the objective was met.

### Investment Returns over the last 10 years (% per annum)

The **1 year return** is the [Investment Return](#) for each year to 30 June for each of the last 10 years for the MySuper option.

The **10 year average return** is the compound average Investment Return actually achieved over 10 year periods to 30 June each year.

# ABC Super Dashboard

## Australian Shares Option

An explanation of the terms used in the Dashboard can be found at this link, [Explanation of Terms](#).

### Investment Return

(Average for 10 years to 30 June 2015)

Investment Return Objective	S&P/ASX 300 Accumulation Index (Adjusted for tax)	<b>6.9% pa</b>
Actual Investment Return	S&P/ASX 300 Accumulation Index (Adjusted for tax) + 0.7%	<b>7.6% pa</b>

### Investment Risk

Short-term volatility	Chance of a negative investment return in any given year	<b>6 in 20</b>
Long-term growth	Chance of investment return lower than CPI + 4.5% pa over 20 years	<b>3 in 20</b>

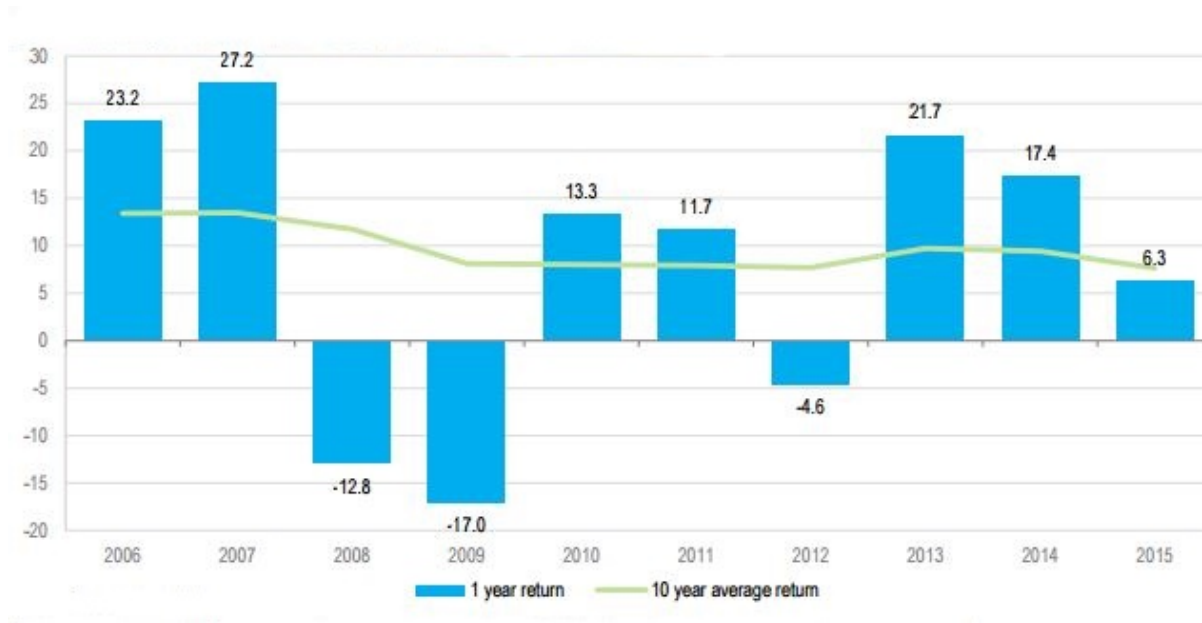
### Statement of fees and other costs (per annum)

	Member with a \$10,000 account balance	Member with a \$50,000 account balance
Administration	<b>\$98</b>	<b>\$178</b>
Advice	<b>\$0</b>	<b>\$0</b>
Investment	<b>\$31</b>	<b>\$155</b>
Total	<b>\$129</b>	<b>\$333</b>

### Average Investment Returns Compared with Objective (% per annum)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Investment Return Objective for 10 years to 30 June (% pa)	12.8	13.0	11.2	7.1	7.0	7.2	6.9	9.3	8.9	6.9
10 year average Investment Return to 30 June (% pa)	13.4	13.5	11.7	8.1	8.0	7.9	7.7	9.7	9.4	7.6

### Investment Returns over the last 10 years (% per annum)



## Explanation of terms

### Investment Return

The **Investment Return** is the net investment return achieved over a period after investment taxes and investment fees and costs.

The **Investment Return Objective** is the objective that the Trustee of the Fund has set for the Australian Shares Option over the medium to long term. The investments held by the Trustee are selected to achieve this objective. Future returns are not guaranteed, so this is only an objective and therefore may not be achieved.

The **S&P/ASX 300 Accumulation Index (Adjusted for Tax)** is a benchmark that measures the investment return that an investment in the shares of the top largest 300 Australian companies (weighted by the market value of all the shares in each company) would have achieved allowing for the dividends that are paid by these companies and the tax that a superannuation fund would pay.

The **Actual Investment Return** is the actual compound average Investment Return achieved over the 10 year period to 30 June 2015.

### Investment Risk

**Short-term volatility** indicates how likely it is that the value of your investments will fall over any given year.

**Long-term growth** indicates how likely it is that your investments will not grow sufficiently faster than CPI over the longer term, which could mean you won't have enough income in retirement. The 4.5% margin over CPI is a standard margin set for all Australian superannuation funds to measure the long-term growth investment risk.

**CPI** is the Consumer Price Index, reported by the Australian Bureau of Statistics.

### Statement of fees and other costs (per annum)

The fees and costs on the Dashboard assume that the member is fully invested in the Australian Shares Option.

#### Administration

ABC Super charges a flat fee of \$1.50 each week. The fee is charged directly to a member's account.

Further administration costs have been deducted from investment earnings. For the year ending 30 June 2015 this cost was 0.2% of the value of fund assets.

#### Investment

The investment fees and costs for the Australian Shares Option were 0.31% for 2014/15.

This includes investment management, custodian and asset consultant fees, including performance fees. The amount quoted in the Dashboard is calculated looking back at 30 June each year (using the average value of all assets in the investment option over the year to 30 June). These may change from year to year. For the last three years performance fees have been 0.01% (2012/13), 0.00% (2013/14) and 0.01% (2014/15) of the value of assets for the Australian Shares Option. The 2014/15 fee has been included in the investment fees and costs shown on the Dashboard.

#### Advice

There is no charge for general advice that is provided to members. Advice that takes into account your personal circumstances is negotiated between you and your adviser. This can include advice on your investment options, insurance cover, contributions to super and retirement pension options and can be deducted from your super account or paid directly to your adviser. The cost of advice on non-super matters can't be deducted from your account.

### Average Investment Returns Compared with Objective (% per annum)

The **Investment Return Objective for 10 years to 30 June (% pa)** is the compound average [Investment Return Objective](#) over 10 year periods to 30 June each year.

The **10 year average Investment Return to 30 June (% pa)** is the compound average [Investment Return](#) actually achieved over 10 year periods to 30 June each year.

It is useful to compare the actual average investment return achieved over 10 year periods with the average Investment Return Objective for the same period. This will provide a guide as to how well a fund is progressing towards satisfying its Investment Return Objective. Green shading indicates that this guide to the objective was met.

### Investment Returns over the last 10 years (% per annum)

The **1 year return** is the [Investment Return](#) for each year to 30 June for each of the last 10 years for the Australian Shares Option.

The **10 year average return** is the compound average Investment Return actually achieved over 10 year periods to 30 June each year.

28 January 2016

Division Head  
Retirement Income Policy Division  
The Treasury  
Langton Crescent  
Parkes ACT 2600

Email: [superannuationtransparency@treasury.gov.au](mailto:superannuationtransparency@treasury.gov.au)

Dear Sir

## Product Dashboard Comparison Metric

The purpose of this submission is to provide feedback on the Treasury's Product Dashboard Comparison Metric, as outlined in the Consultation Paper released in December 2015. We have framed most of our comments as answers in response to the Focus Questions in the Consultation Paper.

### Background

Whether a comparison metric will be effective clearly depends on whether the Dashboard item which is to be compared is itself appropriate. This presents us with a problem because we believe that some important changes are required to ensure that the current MySuper and the proposed Choice Dashboard items do not mislead consumers. The reasons for this view have recently been explained in the following letters to Treasury and in recent meetings with Treasury, ASIC and APRA representatives:

- |                  |  |
|------------------|--|
| 18 August 2015   | Listed the main changes and additions required to the current Dashboard, and the reasons, and attached examples for a MySuper and a Choice Dashboard.  |
| 8 October 2015   | Summarised the key changes suggested, the benefits for consumers, the Government and the superannuation industry and attached two revised and simplified examples.   |
| 11 December 2015 | Refined and explained the Long Term Risk Metric and examined the Dashboards of four MySuper funds against information from PDS's and websites of the sample funds, to show how inappropriate the current MySuper Dashboard structure is for Choice products. |
| 17 December 2015 | Expressed our grave concern that the above proposals have not been addressed or reflected in the Government's December 2015 Product Dashboard Consultation Paper and related exposure draft regulations, and attached further revised Dashboard examples.    |

Our comments below therefore assume that the key aspects of our proposals above are reflected in the next round of Dashboard regulations. Should this not eventuate then we believe that the proposed comparison metrics will be ineffective.



## Terminology

In our answers to the Focus Questions we have used the following terminology:

- **"Composite options"** for those Choice options that are the typical diversified three or four options called "Aggressive" / "High Growth"; "Balanced" / "Growth"; "Stable" / "Moderately Conservative"; "Conservative" etc.. A Composite option will comprise a number of different asset classes with the proportion of each asset class being dependent on the risk profile of the option. The Composite option will include both growth and defensive asset classes.
- **"Prime sector options"** for single asset class Choice options. Prime sector options typically have only one asset class. However, Prime sector options include options that have two or more growth asset classes (e.g. International Shares (unhedged) and International Shares (hedged)) or two more defensive asset classes (e.g. Australian and International Fixed Interest investments).

We acknowledge that some options may not clearly be either Prime or Composite (e.g. a "100% Growth" option with a small allowance for cash for liquidity) so that further refinement may be required if different requirements were to be applied based on the classification of an option as Prime or Composite (as we suggest later in this submission).

## Focus questions

### **1. Would the inclusion of comparison metrics on the Product Dashboard provide easily understandable and valuable information for consumers? What are the pros and cons of such a comparison?**

The current Product Dashboard shows some key metrics for a particular fund but gives no comparative information. Many members will not go to the trouble of comparing two Product Dashboards from different funds. A comparative metric should alert a person to whether or not a fund's particular metric is significantly different to the comparable metrics from other funds. If it is, then the person should be advised to investigate why this differential exists. Whether the metrics will provide easily understandable and valuable information will depend on how they are presented.

Consumer testing indicates that most people have difficulty understanding most of the metrics included on the Dashboard. The inclusion of a comparative metric introduces the risk that a person will rely only on the comparative metric in choosing a fund without further investigation. A person may choose a fund with higher than average investment returns or lower than average fees and costs without understanding the reasons why this is the case. This might lead to poor decisions. For example, if lower than average fees and costs are due to a lesser level of service (such as no call-centre or limited on-line services) or a lower quality of service (such as frequent errors or delays) then a decision to choose a fund with apparently lower fees and costs might subsequently be regretted.

We believe that the inclusion of comparison metrics will work best for MySuper Dashboards and might be workable for Composite options, but will be difficult or impossible for Prime sector options. MySuper products tend to be more generic – the portfolios are mostly balanced or thereabouts so comparison metrics might be useful (though lifecycle options are problematic and are becoming more prevalent). However Choice products vary over the whole spectrum. We would expect that consumers who were utilising the Dashboard metrics would want to compare the MySuper options with the Composite options, but we doubt whether this would be workable. If the consumer wanted to investigate the Prime sector



options we would expect that they would be more financially competent and would be prepared to examine the details in the PDS relevant to each option.

## **2. Would a comparison metric be easy or difficult for superannuation funds to implement? Why?**

For MySuper products we do not believe it will be overly difficult for superannuation funds to implement comparison metrics such as those proposed in the Consultation Paper (and amended as based on our proposals). There will be some additional costs in redesigning the Dashboard to include this information, but this should not be excessive and could be done at the same time as other proposed changes to the Dashboard. The cost of annually updating this data should be minimal, as long as APRA annually provides the comparative data on a timely basis. Funds should not be required to change this comparison data more regularly than annually, so they can update the comparative information at the same time as they update their returns to the latest 30 June.

This presents a significant timing issue - funds will not be able to update their dashboards until after APRA can provide the comparative information for the prior year to 30 June. The issue of funds being required to compare their current year fees with the range and average for the prior year also merits some consideration.

For Choice products, we suggest that the comparison metrics should initially only be considered for Composite options (with comparisons limited to 'similar' Composite options, not to MySuper options). Then, perhaps at a later date consideration could be given to Prime sector options.

## **3. How should MySuper products be compared to each other?**

The six metrics that could, subject to our answers to other questions, be compared between funds are the following:

- Investment objectives
- Average 10-year 'net investment return'
- Short term risk metric
- Long term risk metric
- Investment fees and costs
- Administration and advice fees and costs

As suggested at the Melbourne Roundtable meeting in January, if investment objectives (rather than return targets) are used in the Dashboard, it would seem desirable for APRA to provide more detailed guidance as to how investment objectives should be determined. One aspect of this guidance would be the probability that the objective would be met.

In this context it should be recognised that our suggested comparison of the investment objective with the actual ten-year net investment return should provide some pressure on trustees to develop more realistic investment objectives. If their investment objective is too high the bulk of actual returns will be lower than the objective. Consumers will see this as a negative. If the investment objective is too low, then, even though the bulk of actual returns may exceed the objective, consumers will question whether this will continue to occur in the future and may select funds that have higher investment objectives.





We recommend that 'net investment return' (i.e. the return net of investment fees and costs and tax) is used to compare fund performance as this measure is generally independent of account balance. This is not the case for 'net return', the performance net of all fees and costs assuming a balance of \$50,000, which is not relevant for members with a different balance. We also believe performance comparisons are best done by deducting only the fees and costs paid to obtain that performance (i.e. investment fees and costs) and not deducting fees and costs that provide other unrelated services such as administration, advice and other member services. We note that consumer testing has indicated that many people might ignore this metric as they believe the \$50,000 balance is not relevant to their circumstances. The inclusion of a metric that is (generally) independent of the level of a person's account balance should be seen as being relevant to all.

Investment fees and costs should be compared separately to administration fees and costs as these two types of fees and costs provide very different types of services to members. Investment fees and costs cover the cost of investing members' funds to provide an appropriate return on their investments whereas administration fees and costs typically cover the costs of administration services and a wide range of member services such as education, targeted campaigns, scaled advice and the fund's online services. The level and quality of these services vary markedly between funds. Therefore, administration and advice fees and costs should be compared separately to investment fees and costs so members can easily compare the level of administration and advice fees costs with other funds. Where these costs are significantly different to other funds fees and costs, the member will be alerted to investigate the reason for this difference.

#### **4. How should choice investment options be compared to MySuper products?**

Choice investment options are difficult to compare to MySuper products. Many Choice options are invested very differently to MySuper options (eg. Choice options will include Prime sector options) and may have very different return objectives. A comparison with Prime sector options will be even more difficult. Consumer testing indicates consumers would also find the inclusion of Prime sector options confusing and difficult to understand.

We note that the inclusion of Prime sector options would require APRA to specify how Prime sector options should be grouped for reporting purposes to ensure that the comparative results represented the results of options that were similar. This would in itself be quite difficult as APRA have highlighted the near impossibility of getting agreement on something as fundamental as whether some assets are defensive or growth assets.

A comparison of Prime sector options with other Prime sector options might be possible. It would require the classification of Prime sector options into a range of similar options (eg. Australian shares, international shares, hedge funds, etc.). It should be kept in mind that Prime sector options are not really 'products' because members tend to use a combination of them rather than seeing them as an alternative to MySuper.



**5. Is a range the most appropriate comparison? Does it provide sufficient information to consumers about how their investment option is performing compared to others? If so, what range would be the most suitable?**

If the purpose of the Dashboard is to allow a member to compare specific metrics across funds, the range covering two-thirds of products is appropriate. This range will exclude any funds that have extreme metrics.

**6. What other comparison metric could be suitable? How would this be measured and displayed?**

It is important that the average of the metrics of all funds also be shown. Whilst helpful, the range by itself does not provide any indication of the distribution of results within that range. Another useful metric would be the median as 50% of results lie below the median and 50% lie above the median. We are however concerned that consumers might not understand this term. In most cases the median and average are close to each other and therefore the median (the more appropriate metric) could be replaced by the average (the more easily understood metric) without a significant loss of accuracy.

**7. Would a comparison metric be suitable for the risk, return, return target and fee metrics on the dashboard? If not, why not?**

Yes, but subject to the qualifications in our answers to other Focus Questions, and provided the key aspects of our four letters to Treasury are reflected in the next round of Dashboard regulations.

**8. If a comparison range is to be used, do you prefer a line of text, a diagram comparison or would you propose an alternate model? Why? Describe the alternate model you would propose.**

The feedback from ASIC's consumer testing is that diagrams are generally more easily understood than a line of text. A diagrammatic comparison, as proposed in the Consultation paper, would probably work better than descriptive text.

**9. If a diagram comparison is preferred, how would the information be presented? What text would be necessary to complement the diagram?**

The presentation at the bottom of page 2 of the Consultation paper seems appropriate, however:

- (a) the comparison should be based on the six items in our answer to 3. above,
- (b) the current data label 'This product's total fees and others costs' should simply be an abbreviated name of the fund, and
- (c) the diagram should be presented in such a way that it requires little if any explanatory text.



10. Are there any issues with using the available APRA data to make these comparisons? Issues could include technical issues. For example:

- Is it a problem that not all superannuation funds have the same reporting date?
- What would happen if the comparison were made as at a June reporting date, but an investment option's metrics were updated after this date?

Some funds have reporting dates other than 30 June but this should not be a problem as long as performance is always shown to 30 June. This is the currently the case for returns shown on the MySuper Dashboard, which are all to 30 June.

APRA's data currently has some inconsistencies but given it is only being used to calculate ranges and averages, the data inconsistencies for some funds should not significantly affect the comparison metrics. We also expect the quality of APRA's data will improve as funds get used to providing APRA with the prescribed data and understand more clearly what is required. We are also confident that the data quality will significantly improve when our simplification proposals are implemented.

During the year, funds may need to change the fees and costs they show on the Dashboard to reflect current fee and cost levels, but they should not need to change the fee and cost comparison metrics which should only change once every 12 months. The best time to issue the new comparison metrics would probably (but see our answer to question 2 above) be a month after 30 June when the June returns are being determined and the Dashboard updated.

Yours sincerely,

Andrew Boal  
Convenor of the Actuaries Institute Superannuation Practice Committee

**cc**     **Maan Beydoun**  
Senior Specialist, Investment Managers and Superannuation  
Australian Securities & Investments Commission

**Helen Rowell**  
Deputy Chair, APRA  
Australian Prudential Regulation Authority

**Pauline Vamos**  
Chief Executive Officer  
Association of Superannuation Funds of Australia

1 March 2016

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Dear Louise and Jenny,

## Indirect Costs and Product Dashboards

The purpose of this letter is twofold. Firstly we wish to clarify and explain our views about superannuation fund "Indirect costs", and secondly we have attached revised versions of the two example dashboards that we produced late last year.

### Indirect Costs

We refer to our previous submissions of 18 August 2015, 8 October 2015, 11 December 2015 and 17 December 2015 relating to Product Dashboards. Page 2 of our 18 August 2015 letter listed the eight main changes we are seeking for Product Dashboards. One of the recommendations was:

- "Provide a table of fees and costs showing how these are split between administration, advice and investment. The reason for this proposal was set out in our February 2014 submission, and relates to the fact that Investment fees need to be assessed separately by members against the return they might expect based on the fund's specific investment strategy.

The exposure draft regulations issued in December 2015 included a revision to subregulation 7.9.07N(2) that proposed a **"Statement of fees and other costs"** showing:

Investment fees	[ ] % of \$50,000
PLUS administration	\$( )
and advice fees	
PLUS indirect costs	[ ] % of \$50,000

Although this presentation shows the split between investment fees and administration/advice fees it does not separate the investment and administration/advice components of indirect costs. It also mixes percentages and dollars in one table which would be very confusing to members.

At the Industry Roundtable discussions held in Melbourne and Sydney in mid January 2016, representatives of the Actuaries Institute explained that **indirect costs** should be:

- (a) split between investment and administration/advice,
- (b) combined with investment fees and administration/advice fees, and
- (c) referred to as "other costs" in headings (as has been the situation for some years).

At both meetings these proposals appeared to be well accepted by ASIC and APRA representatives and by the other stakeholders. For the following reasons we believe that these changes are important:

- (1) investment services are paid for by both investment fees and investment costs and cover the costs of investing members' funds to provide an appropriate return on their investments,
- (2) administration/advice services are paid for by administration fees, administration costs and advice fees and cover **very different services from (1) above**, for example, the costs of contribution and benefit processing, member records and a wide range of member services such as education, targeted campaigns, scaled advice and a fund's online services,
- (3) **administration/advice fees and costs** (and the services they provide) should be compared separately from **investment fees and costs** (and the services they provide) - where either measure of fees and costs is significantly different from other funds, the member will be alerted to investigate the reason for these differences.
- (4) the separation of investment and administration/advice fees and costs is far more important than the separation of fees from indirect costs - many consumers will be unnecessarily confused if the superannuation industry retains the past focus on operational/mechanical differences between fees and costs.
- (5) the main problem with the past strong distinction between fees and costs, is that different funds treat fees and costs quite differently and the separation implies a false level of accuracy - very similar costs (and even very similar deduction of those costs from members' accounts) are variously treated as fees and/or costs by different funds.
- (6) the main difference between a fee and cost is that the fee is known in advance whereas a cost is usually known after the period and is based on cost recovery - these subtleties are of little or no interest to members and should usually not enter into comparisons between funds, products or services.
- (7) the statement of fees and other costs must be as kept as simple as possible - unnecessary and confusing jargon (such as "indirect costs", "indirect cost ratios" and "ICR costs") should be removed - but we recommend that the two words "other costs" should be retained in headings to make it clear that they are included.
- (8) separately showing both fees and costs for investment and administration/ advice would result in too many numbers and Dashboards would become unworkable for members.
- (9) there should be no double counting - fees and other costs should only be counted once - "other costs" should comprise any impost which impacts on a member's benefits which is not a fee, tax, or insurance premium.



The main purpose of the Dashboard is to allow members to compare funds and the different practices of what is shown as a fee and what is shown as a cost should not be allowed to confuse members as they try to compare funds. For such a purpose, we believe the fees and costs for administration/advice and the fees and costs for investment are what members need to compare between funds, products and services.

### **Product Dashboards**

The updated copies of the two example Dashboards we enclosed with our submission of 17 December 2015 included a **"Statement of fees and other costs"** based on account balances of \$10,000 and \$50,000. These also combined "Administration and Advice" in the fees and costs table consistent with the Superannuation Transparency proposals. This was a useful simplification. It results in a fee and cost table containing just three lines (i.e. "Administration and Advice", "Investment" and "Total") for each balance.

At the Industry Roundtable discussions held in mid January 2016, it was suggested that the fee and cost table could usefully be expanded by adding fees and costs for an account balance of \$250,000. We believe that this idea has merit because it shows the full impact of fees and costs over a much wider range of account balances. Because of the removal of the "Indirect cost" line (based on our recommendations) and the combining of "Administration and Advice", it can also now be achieved without over-complicating the table.

We have therefore updated our two example Dashboards to include a **"Statement of fees and other costs"** based on account balances of \$10,000, \$50,000 and \$250,000. The revised examples are enclosed for your consideration.

We are currently exploring ways of replacing the three-by-two "Investment Risk" table on each example with two graphics – one for illustrating short-term investment risk and the other for illustrating long-term investment risk. Replacing the table with two graphics improves the visual presentation and we believe it will help improve consumer understanding of the two investment risks. We are currently developing this and will forward it to you as soon as possible.

Please do not hesitate to contact myself or the Chief Executive Officer of the Actuaries Institute, David Bell to discuss any aspect of this letter.

Yours sincerely,

Andrew Boal

**Convenor, Superannuation Practice Committee**

**cc Maan Beydoun**  
Senior Specialist, Investment Managers and Superannuation, ASIC

**Helen Rowell**  
APRA Deputy Chair, APRA

**Pauline Vamos**  
Chief Executive Officer, ASFA

# ABC Super Dashboard

## Australian Shares Option

An explanation of the terms used in the Dashboard can be found at this link, [Explanation of Terms.](#)

### Investment Return

(Average for 10 years to 30 June 2015)

Investment Return Objective	S&P/ASX 300 Accumulation Index (Adjusted for tax)	<b>6.9% pa</b>
Actual Investment Return	S&P/ASX 300 Accumulation Index (Adjusted for tax) + 0.7%	<b>7.6% pa</b>

### Investment Risk

Short-term volatility	Chance of a negative investment return in any given year	<b>6 in 20</b>
Long-term growth	Chance of investment return lower than CPI + 4% pa over 20 years	<b>3 in 20</b>

### Statement of fees and other costs (per annum)

	\$10,000 account balance	\$50,000 account balance	\$250,000 account balance
Administration and Advice	<b>\$98</b>	<b>\$178</b>	<b>\$578</b>
Investment	<b>\$31</b>	<b>\$155</b>	<b>\$775</b>
Total	<b>\$129</b>	<b>\$333</b>	<b>\$1,353</b>

### Average Investment Returns compared with Objective (% per annum)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Investment Return Objective for 10 years to 30 June (% pa)	12.8	13.0	11.2	7.1	7.0	7.2	6.9	9.3	8.9	6.9
10 year average Investment Return to 30 June (% pa)	13.4	13.5	11.7	8.1	8.0	7.9	7.7	9.7	9.4	7.6

### Investment Returns over the last 10 years (% per annum)





## Explanation of terms

### Investment Return

The **Investment Return** is the net investment return achieved over a period after investment taxes and investment fees and costs.

The **Investment Return Objective** is the objective that the Trustee of the Fund has set for the Australian Shares Option over the medium to long term. The investments held by the Trustee are selected to achieve this objective. Future returns are not guaranteed, so this is only an objective and therefore may not be achieved.

The **S&P/ASX 300 Accumulation Index (Adjusted for Tax)** is a benchmark that measures the investment return that an investment in the shares of the top largest 300 Australian companies (weighted by the market value of all the shares in each company) would have achieved allowing for the dividends that are paid by these companies and the tax that a superannuation fund would pay.

The **Actual Investment Return** is the actual compound average Investment Return achieved over the 10 year period to 30 June 2015.

### Investment Risk

**Short-term volatility** indicates how likely it is that the value of your investments will fall over any given year.

**Long-term growth** indicates how likely it is that your investments will not grow sufficiently faster than CPI over the longer term, which could mean you won't have enough income in retirement. The 4% margin over CPI is a standard margin set for all Australian superannuation funds to measure the long-term growth investment risk.

**CPI** is the Consumer Price Index, reported by the Australian Bureau of Statistics.

### Statement of fees and other costs (per annum)

The fees and costs on the Dashboard assume that the member is fully invested in the Australian Shares Option.

#### Administration

ABC Super charges a flat fee of \$1.50 each week. The fee is charged directly to a member's account.

Further administration costs have been deducted from investment earnings. For the year ending 30 June 2015 this cost was 0.2% of the value of fund assets.

#### Advice

There is no charge for general advice that is provided to members. Advice that takes into account your personal circumstances is negotiated between you and your adviser. This can include advice on your investment options, insurance cover, contributions to super and retirement pension options and can be deducted from your super account or paid directly to your adviser. The cost of advice on non-super matters can't be deducted from your account.

#### Investment

The investment fees and costs for the Australian Shares Option were 0.31% for 2014/15.

This includes investment management, custodian and asset consultant fees, including performance fees. The amount quoted in the Dashboard is calculated looking back at 30 June each year (using the average value of all assets in the investment option over the year to 30 June). These may change from year to year. For the last three years performance fees have been 0.01% (2012/13), 0.00% (2013/14) and 0.01% (2014/15) of the value of assets for the Australian Shares Option. The 2014/15 fee has been included in the investment fees and costs shown on the Dashboard.

### Average Investment Returns Compared with Objective (% per annum)

The **Investment Return Objective for 10 years to 30 June (% pa)** is the compound average [Investment Return Objective](#) over 10 year periods to 30 June each year.

The **10 year average Investment Return to 30 June (% pa)** is the compound average [Investment Return](#) actually achieved over 10 year periods to 30 June each year.

It is useful to compare the actual average investment return achieved over 10 year periods with the average Investment Return Objective for the same period. This will provide a guide as to how well a fund is progressing towards satisfying its Investment Return Objective. Green shading indicates that this guide to the objective was met.

### Investment Returns over the last 10 years (% per annum)

The **1 year return** is the [Investment Return](#) for each year to 30 June for each of the last 10 years for the Australian Shares Option.

The **10 year average return** is the compound average Investment Return actually achieved over 10 year periods to 30 June each year.

# ABC Super Dashboard

## Balanced Option (MySuper)

An explanation of the terms used in the Dashboard can be found at this link, [Explanation of Terms](#).

### Investment Return

(Average for 10 years to 30 June 2015)

Investment Return Objective	CPI + 4% pa	<b>6.6% pa</b>
Actual Investment Return	CPI + 4.7% pa	<b>7.3% pa</b>

### Investment Risk

Short-term volatility	Chance of a negative investment return in any given year	<b>4 in 20</b>
Long-term growth	Chance of investment return lower than CPI + 4% pa over 20 years	<b>5 in 20</b>

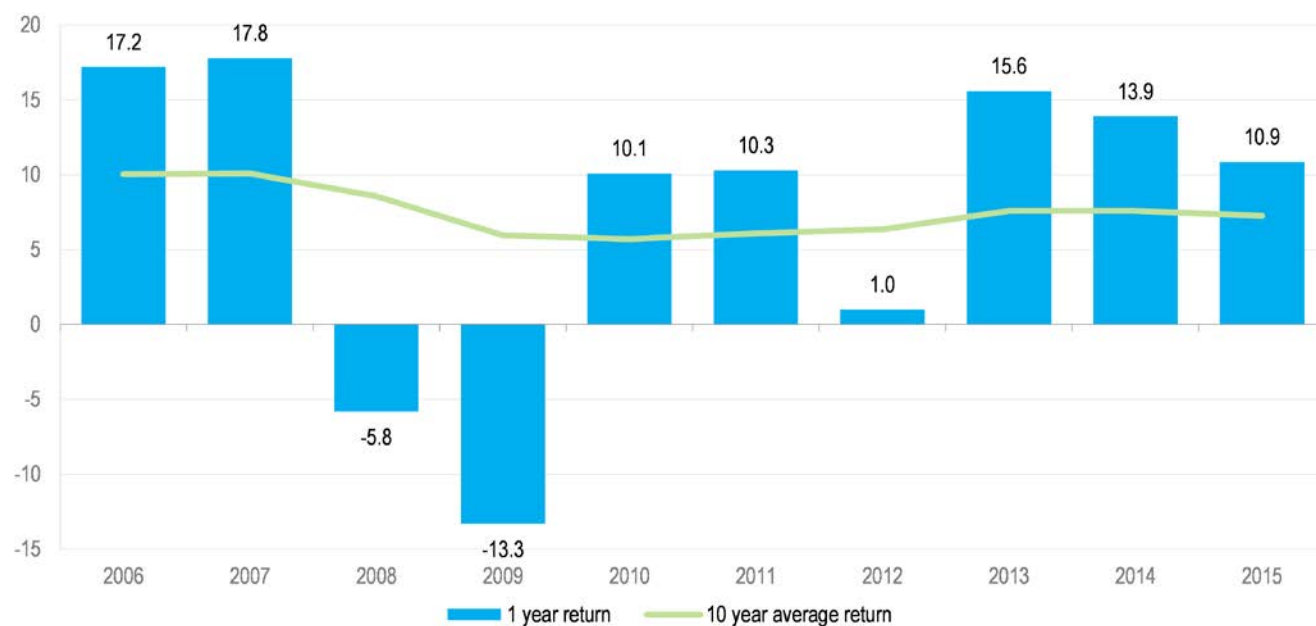
### Statement of fees and other costs (per annum)

	\$10,000 account balance	\$50,000 account balance	\$250,000 account balance
Administration and Advice	<b>\$98</b>	<b>\$178</b>	<b>\$578</b>
Investment	<b>\$57</b>	<b>\$285</b>	<b>\$1,425</b>
Total	<b>\$155</b>	<b>\$463</b>	<b>\$2,003</b>

### Average Investment Returns compared with Objective (% per annum)

	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Investment Return Objective for 10 years to 30 June (% pa)	6.6	6.7	7.1	7.2	7.2	6.9	6.7	6.7	6.8	6.6
10 year average Investment Return to 30 June (% pa)	10.0	10.1	8.6	6.0	5.7	6.1	6.4	7.6	7.6	7.3

### Investment Returns over the last 10 years (% per annum)



## Explanation of terms

### Investment Return

The **Investment Return** is the net investment return achieved over a period after investment taxes and investment fees and costs.

The **Investment Return Objective** is the objective that the Trustee of the Fund has set for the MySuper option over the medium to long term. The investments held by the Trustee are selected to achieve this objective. Future returns are not guaranteed, so this is only an objective and therefore may not be achieved.

The **Actual Investment Return** is the actual compound average Investment Return achieved over the 10 year period to 30 June 2015.

**CPI** is the Consumer Price Index, reported by the Australian Bureau of Statistics.

### Investment Risk

**Short-term volatility** indicates how likely it is that the value of your investments will fall over any given year.

**Long-term growth** indicates how likely it is that your investments will not grow sufficiently faster than CPI over the longer term, which could mean you won't have enough income in retirement. The 4% margin over CPI is a standard margin set for all Australian superannuation funds to measure the long-term growth investment risk.

**CPI** is the Consumer Price Index, reported by the Australian Bureau of Statistics.

### Statement of fees and other costs (per annum)

The fees and costs on the Dashboard assume that the member is fully invested in the MySuper Option.

#### Administration

ABC Super charges a flat fee of \$1.50 each week. The fee is charged directly to a member's account.

Further administration costs have been deducted from investment earnings. For the year ending 30 June 2014 this cost was 0.2% of the value of fund assets.

#### Advice

There is no charge for general advice that is provided to members. Advice that takes into account your personal circumstances is negotiated between you and your adviser. This can include advice on your investment options, insurance cover, contributions to super and retirement pension options and can be deducted from your super account or paid directly to your adviser. The cost of advice on non-super matters can't be deducted from your account.

#### Investment

The investment fees and costs for the MySuper Option were 0.57% for 2014/15.

This includes investment management, custodian and asset consultant fees, including performance fees. The amount quoted in the Dashboard is calculated looking back at 30 June each year (using the average value of all assets in the investment option over the year to 30 June). These may change from year to year. For the last three years performance fees have been 0.13% (2012/13), 0.07% (2013/14) and 0.05% (2014/15) of the value of assets for the MySuper option. The 2014/15 fee has been included in the investment fees and costs shown on the Dashboard.

### Average Investment Returns Compared with Objective (% per annum)

The **Investment Return Objective for 10 years to 30 June (% pa)** is the compound average [Investment Return Objective](#) over 10 year periods to 30 June each year.

The **10 year average Investment Return to 30 June (% pa)** is the compound average [Investment Return](#) actually achieved over 10 year periods to 30 June each year.

It is useful to compare the actual average investment return achieved over 10 year periods with the average Investment Return Objective for the same period. This will provide a guide as to how well a fund is progressing towards satisfying its Investment Return Objective. Green shading indicates that this guide to the objective was met.

### Investment Returns over the last 10 years (% per annum)

The **1 year return** is the [Investment Return](#) for each year to 30 June for each of the last 10 years for the MySuper option.

The **10 year average return** is the compound average Investment Return actually achieved over 10 year periods to 30 June each year.

6 April 2016

Ms Jennifer Wilkinson  
Division Head  
Retirement Income Policy Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [superannuationobjective@treasury.gov.au](mailto:superannuationobjective@treasury.gov.au)

## **Subject: Objective of Superannuation**

In response to the Discussion Paper released by the Government on 9 March 2016, the Actuaries Institute is pleased to provide this feedback on the issues raised in the paper in relation to the objective of superannuation.

### **Objectives for the whole retirement system**

One of the recommendations of the Financial System Inquiry (FSI) last year was to set a clear objective for the superannuation system to provide income in retirement. However, the Institute would go further than that. We believe that it would be helpful if the Government developed objectives for the whole retirement system, as well as complementary objectives for each pillar or component of the system. This would include objectives for the Age Pension and the compulsory Superannuation Guarantee (SG), as well as for additional savings both inside and outside the superannuation system that are tax advantaged and can be used for retirement (including housing wealth).

### **Superannuation to supplement the Age Pension**

In its final report, the FSI recommended the following primary objective for superannuation:

*To provide income in retirement to substitute or supplement the Age Pension.*

According to the findings of a recent OECD report, Pensions at a Glance 2015, 36% of Australian pensioners are living below the poverty line which the report defined as 50% of median household income. Merely substituting the Age Pension with income from a different source, such as superannuation, will not do much to improve living standards in retirement for many Australians.

Research also shows that, based on the Age Pension means tests that will apply from 1 January 2017, saving a sufficient amount of superannuation to avoid qualifying for any Age Pension payments during the period from age 67 up to life expectancy will be beyond most Australians. Superannuation will therefore act as a supplement to improve their standard of living in retirement.

One of the objectives of superannuation should therefore be:

*To supplement the Age Pension in order to provide a combined level of income that allows Australians to live a dignified retirement.*

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### **Flexibility required due to different retirement needs**

While the focus of tax advantaged retirement savings should be on producing an income in retirement rather than the accumulation of wealth for other purposes, it is understood that the needs of individual retirees will vary significantly and a degree of flexibility will therefore need to be maintained in the retirement system. For example, some savings will be used to pay off debt at retirement, or used for capital improvements or to purchase other items that will be used throughout retirement. Some savings will also be set aside for emergencies such as for large one-off health related costs or to assist family members. Given the variability of individual outcomes in retirement, some savings will also be passed on to future generations on death in some instances.

The Government should consider whether any limits should be placed on how much of a person's superannuation savings can be set aside and used for these purposes. For example, as we suggested in our submission to the Tax White Paper Task Force dated 29 May 2015, consideration should be given to reintroducing maximum withdrawal factors for income streams, which could be set at double the minimum withdrawal factors, to provide a corridor within which payments would be considered to be an income stream. Apart from some limited exceptions (e.g. funding for aged care, financial hardship), any withdrawals in a financial year above the maximum withdrawal amount would be considered to be a lump sum payment and taxed accordingly.

A tax free threshold could be set for the taxable component of lump sum payments, targeted mainly at low income earners, of say \$195,000 (the "low rate cap amount", which is indexed over time). Lump sum payments, above this lifetime threshold (accumulated over time) could be taxed, for example at the rate of 15% plus the Medicare levy.

On death, if there is a Spouse (or other Dependant), they would likely have planned their retirement together and it is therefore reasonable that the partner has the opportunity to rollover (tax free) the death benefit into a super account/income stream in their own name. Payments to non-dependants would be taxed as a lump sum (ie. amounts above \$195,000, except for non-concessional contributions).

Given the retrospective impact of this change to the tax treatment of lump sums, there should be a reasonable transition period provided to allow people to adjust their planning. We also acknowledge that Australians earning much less than the national average may not have the ability to make significant contributions to superannuation without compromising their current basic needs.

### **Fiscal sustainability, adequacy and poverty alleviation**

Another goal should be fiscal sustainability, in other words keeping taxpayer expenditures to a reasonable level. This raises the crucial question of adequacy. What level of retirement income should be targeted?

The Institute's 'For richer, for poorer' White Paper revealed that there is a strong reliance on the Age Pension for half of the population. It comprises 93% of retirement income for those in the bottom 5% income bracket and 44% for 'middle Australia'. Significantly, although those in the top quartile income bracket will achieve a comfortable retirement, many will still qualify for at least a part-Age Pension at some stage during their lifetime. Single women are likely to experience the worst outcomes under the current system.



One suggestion has been to target, say, 65% of a person's after-tax pre-retirement income. However, this would provide very significant levels of retirement income for high income earners and it is questionable whether the cost to the taxpayer of supporting that level of income is warranted.

We believe that a better alternative would be to target a dollar level of retirement income, which is determined after taking into account the after-tax income levels of the majority of working Australians along with any relevant research into retirement living standards. For example, ASFA has suggested that one target could be for the majority of retirees to reach the ASFA Comfortable level (AFSA submission to treasury<sup>6</sup> February 2016). While the merits of the ASFA Comfortable level (or a suitable variation thereof) can be discussed, if we can get at least 50% of Australians up to the ASFA Comfortable level using just their superannuation savings and the Age Pension, then we will certainly be a long way towards achieving a reasonable standard of living retirement for most Australians.

In addition, there should be a target in relation to the proportion of Australian pensioners living below the poverty line (currently 36% according to the OECD). This might mean increasing the Age Pension and/or specifically targeting some pensioner groups (eg. by increasing rental assistance). In our view, it should not be unreasonable for a country like Australia to lead the world in poverty alleviation and a suitable target should be set as part of this process.

For most Australians, the family home is a substantial financial asset, often greater in value than their superannuation savings. In the interest of living a better life in retirement, people should be able to access a certain amount of home equity to top up their superannuation in retirement. Access to home equity could be via a financial instrument (such as a reverse mortgage or equity release scheme) or via a market transaction (such as downsizing to a smaller home). Consideration should be given to maintaining the means test exemption on any home equity released on the sale of (or in respect of) the family home. That amount could go into their superannuation fund in a "protected" account that is not included for the assets test (like the family home was treated). The remaining home equity would still be available for health and aged care.

There should also be a specific target in relation to the fiscal sustainability of the system overall, such as the combined cost to the taxpayer (measured as a percentage of GDP for example) of the Age Pension and superannuation tax concessions.

Whatever the adequacy and other targets, it is important that they are quite specific and measureable, with progress towards the targets assessed on a regular basis, such as in the five-yearly Intergenerational Reports (IGRs). Given the importance of these targets, we encourage the Government and Treasury to undertake further consultation and research before setting them in place, including a suitable level of tax supported superannuation (see section on "equity and fairness").



## **Equity and fairness**

Equity is another core principle that is important for the superannuation system, to ensure that individuals are treated fairly. In our submission to the Tax White Paper Task Force dated 29 May 2015, the Institute made a number of recommendations on how to improve equity in the superannuation system including the retention of the low income superannuation contribution (LISC) and extending the Division 293 tax to individuals with an adjusted taxable income (ATI) of more than the sum of \$180,000 plus an allowance for superannuation contributions, which would provide a tax concession on superannuation contributions of between 15% and 22% for most people.

We also suggested that a lifetime cap be gradually phased in for both concessional and non-concessional contributions. Also, to limit the tax concessions provided on investment earnings on assets supporting a superannuation income stream, we suggested one way would be to limit the amount of any superannuation benefit that can be “crystallised” and then invested in a superannuation income stream that has a 0% tax on investment earnings. For example, a lifetime cap of say \$2.5 million (indexed to wages, such as MTAW) could be applied. Any excess amount could remain in a superannuation account and 15% tax on investment earnings would continue to apply.

## **Sustainability, efficiency and confidence in the system**

The Institute believes that an equitable and sustainable retirement income system that efficiently delivers on its objectives will not need the ongoing tinkering that has been a feature of the superannuation system for decades. Stability in tax and other policy settings will enhance consumer confidence in the system.

The Institute acknowledges that the Productivity Commission released an issues paper on 16 March 2016 to separately develop criteria to assess the efficiency and competitiveness of the superannuation system. We believe that an important role of the superannuation system is to efficiently accumulate sufficient assets to allow each individual retiree to achieve their reasonable retirement goals.

Part of the superannuation system includes the provision of death and disability benefits for members and their beneficiaries. This important role should not be forgotten as many superannuation members “retire” due to disability and many families are afforded financial protection in the event of death. The role (and cost) of such insurance benefits should therefore be considered as part of the objectives for (and efficiency of) the superannuation system.

On 21 July 2014, the Government released a discussion paper as part of a review of retirement income stream regulation. While the results of this review are still not known, it is hoped that the regulatory barriers restricting the availability of relevant and appropriate income stream products in the Australian market (such as deferred lifetime annuities or DLAs) will be removed to provide retirees with the opportunity to better manage their longevity risk and to more efficiently decumulate their retirement savings in a reliable and secure way.





## Conclusion

The Institute acknowledges that flexibility is required in the system to reflect each individual's different retirement income needs and varying capacity to exercise choice. A system that is equitable and sustainable, and allows the majority of Australians to reach an agreed dollar level of retirement income in a reliable and secure way no matter how long they live, could reasonably be judged on track to be a successful retirement income system.

We would be pleased to discuss our submission with you in more detail if required.

Yours sincerely,

Lindsay Smartt  
President