

# ACTU Submission in Response to the Financial System Inquiry Interim Report

## INTRODUCTION

The Australian Council of Trade Unions represents nearly 2 million working Australians and their families. Many more have their pay and conditions of employment shaped by the work of our affiliates.

The ACTU welcomes the Financial System Inquiry and its Interim Report. It contains a thoughtful and balanced discussion of many issues of importance to the future growth and stability of our financial system. Unions have a strong interest in the structure, performance and regulation of this system. This is for a number of reasons.

Firstly, the financial services industry in Australia employs nearly 400,000 people. As a major employer the industry has a responsibility to the wider community to provide forms of employment and remuneration that are fair, skill-enhancing and which actively encourage staff to provide products and services that are in the best interests of the millions of businesses and individuals they serve. However, significant parts of the financial industry are regarded with suspicion by the Australian public, in large part because their experience is of institutions who promise much but too often deliver inappropriate and expensive products while imposing fees, charges and commissions that lack transparency and obvious justification.<sup>1</sup>

Central to this behaviour is how the industry employs, rewards and incentivises its employees. Across the industry the take-home pay of many employees is closely tied to sales-outcomes, not just in financial planning but also across retail banking and insurance. This generates powerful incentives for inappropriate and sometimes unlawful conduct that disadvantages particular consumers while undermining public confidence in the system as a whole.

Matters of pay and incentives are not only relevant to the problems of recruitment and retention faced by some public regulators such as ASIC and APRA. They are pertinent to the whole financial services industry and the practices these arrangements are intended to promote. We therefore endorse the concerns and recommendations made by the Financial Services Union in its submission to your Inquiry earlier this year. We hope the Inquiry will engage with and comment on these issues in its Final Report to government.

Secondly, workers and unions have an interest in a financial system that efficiently allocates capital for the purposes of building a successful, innovative and sustainable economy that generates the jobs, incomes and skills we need as a nation. In theory, banking acts as an intermediary between savers and borrowers. In practice, in a context where much credit creation and lending has been deregulated, there are few practical limits on the quantity of credit money that banks can create and their use of that money to help fuel speculative bubbles in property, global commodities and new technologies.<sup>2</sup>

This context provides ample incentives and opportunities to use capital for means other than long-term capital formation and building strategically important infrastructures. It also helps to magnify the information asymmetries and principal-agent problems that have become pervasive

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<sup>1</sup> Choice (2011) *Better Banking*, Choice, NSW.

<sup>2</sup> New Economics Foundation (2012) *Where Does Money Come From?* NEF, London.

throughout the global financial system, helping to keep levels of costs and systemic risk higher than they should be in a growing and increasingly integrated system.

It is therefore incumbent on governments and regulators to act against these trends and impose a public-interest orientation on the financial industry when and where it insists on acting otherwise. This may, in certain contexts, involve increasing competitive pressures. It may also require increasing government direction and control. The precise mix will vary according to the products, markets and institutions involved. But the public policy aim must be clear and consistent: to radically reduce the inefficiencies and costs of the financial system to the benefit of increasing investment in the industries and jobs of the future.<sup>3</sup>

Thirdly, for over 30 years unions have played a leading role in campaigning for better retirement incomes for working people. Without that campaigning in the 1970s and 1980s there would be no Superannuation Guarantee and many workers in Australia today would not have their own superannuation account containing savings that will help them live a more comfortable life in retirement. Without unions Australia would not have some of the largest, best performing and well-run not-for-profit superannuation funds in the world.

Most of these funds are governed by boards of directors that comprise equal or majority numbers of employer and employee representatives. Most employee representatives are union members nominated by their union to help ensure funds are operated in the best interests of fund members. Unions therefore have extensive knowledge and direct experience of many of the issues raised by the chapters in the Inquiry's Interim Report that discuss superannuation and retirement incomes.

In this submission we will focus on a number of these superannuation and retirement-related issues. Please note that there is an Appendix to this submission relevant to the issue of default funds. A number of other bodies and funds associated with the not-for-profit sector will be making their own submissions in response to the Interim Report. They will deal with some issues that we do not discuss here. We are happy to comment further on any aspect of the content of this submission on request or any other issues the Inquiry may wish to raise and explore further.

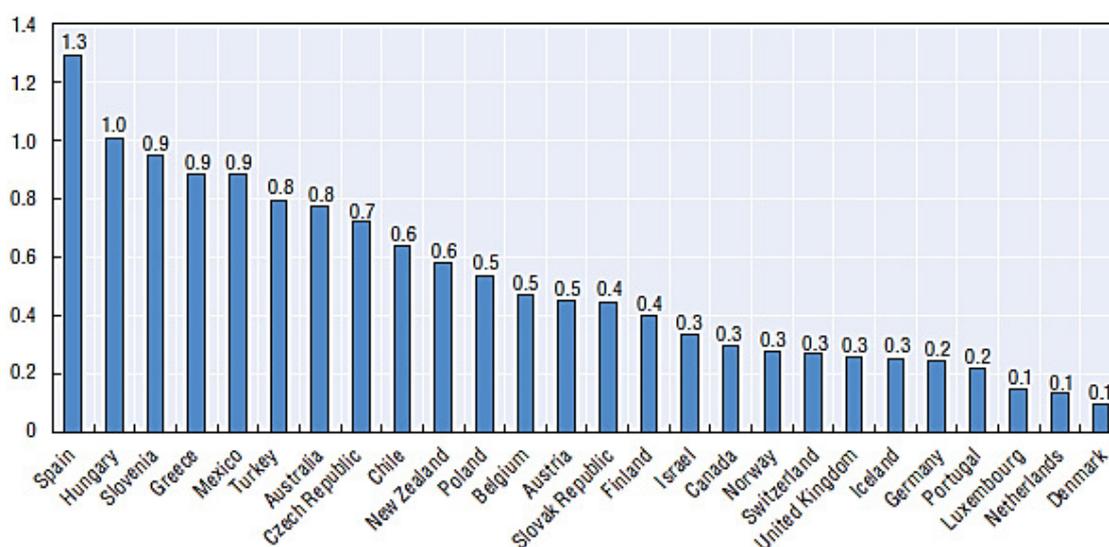
## **REDUCING THE COSTS OF SUPERANNUATION**

We welcome the Interim Report's focus on superannuation operating costs and fees. They matter because they act as a drain on members' retirement savings. While some level of costs and fees are unavoidable of course, the Interim Report is right to suggest that they are too high by international standards and should come down. Figure 1 (below) confirms that measured in terms of their share of total investments, the operating expenses of Australian funds are more than double those of countries such as Canada and the United Kingdom, and eight times higher than the Netherlands and Denmark.

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<sup>3</sup> An important discussion of the role of the Australian financial system in long-term capital formation, and some of the inefficiencies it presently displays, is offered by Industry Super Australia (2014) *Financing Australia's Growth: Submission to the Financial System Inquiry*, ISA, Melbourne.

**Figure 1: Pension funds' operating expenses as a share of total investments in selected OECD countries, 2011 (percentage of total investment)**



Source: OECD Global Pension Statistics

Following the Cooper Review of superannuation in 2010 the previous government took some important steps to help bring costs and fees down. SuperStream should eventually act to reduce the costs generated by the manual processing of money transfers and data by requiring the standardised electronic transmission of much financial and member data. The greater transparency and competitive pressures intended by the MySuper reforms may result in lower costs and fees at some future point. However, the extent to which MySuper delivers such savings will be heavily dependent on employer engagement with published MySuper cost and performance data and their willingness to change behaviour accordingly. Reflecting on this in the context of its review of the role of the Modern Awards system in selecting default funds, the Productivity Commission rejected the idea that employers should be allowed to choose any MySuper product they wished.

Their reasoning is relevant to why MySuper may not create the outcomes government hoped for:

'The Commission considers that, while the MySuper legislation seeks to provide information that will better enable superannuation products to be compared, employers are not best placed to make this comparison from the expected full suite of products that will be available in the medium term. This is due to the inherent principle-agent issues that exist between employers and employees, and the stated lack of interest and expertise on the part of many employers when it comes to choosing a default product, particularly from a large number of available products. Therefore, the Commission currently does not support [employers choosing any MySuper product].'<sup>4</sup>

<sup>4</sup> Productivity Commission (2012) *Default Superannuation Funds in Modern Awards Inquiry Report*, pp. 191-2.

We agree with the Productivity Commission on this point. More generally, we are sceptical of arguments that in the field of superannuation greater competition, facilitated by more employer and member choice, is likely to generate sufficient and sustained pressure to reduce costs and fees over the short and medium term. There are two main reasons for this: the nature of the market for superannuation, and the profit-orientation of retail super funds.

1. The market for superannuation products is defined by a number of features that inhibit competitive dynamics, and these are unlikely to change soon. These features include:

- a) Market participation is mandated by statute: the *Superannuation Guarantee (Administration) Act 1992*. This mandate now applies to nearly all employed people in Australia. While most involuntary market participants are then free to choose which superannuation funds their contributions are made to, very few actually do so. Only around 3 per cent of fund members switch funds each year. Around half of those who switch only do so because they move to a different employer. Over 90 per cent of fund members do not take the opportunity to switch between investment options.<sup>5</sup>
- b) There is significant information asymmetry between most fund members and superannuation professionals. To millions of Australians superannuation appears complex, opaque and shrouded in impenetrable jargon. The proliferation of products and investment options in recent years, far from encouraging engagement and empowering consumers, has often served to reinforce the image of an industry beyond the understanding of many ordinary people. ‘Choice overload’ in the context of limited financial literacy tends to reinforce consumer passivity and inertia. For many, the time and costs involved in acquiring sufficient knowledge to make informed decisions about how the compulsory contributions they must make should be managed and invested by others are too great.<sup>6</sup>
- c) Multiple conflicts of interest. For many financial institutions our superannuation system is primarily an opportunity to accumulate private profit. The existence of a large number of customers who are compelled to participate in a market they often do not understand and are unable to influence has provided financial institutions with many opportunities to apply a raft of fees, charges and commissions at the expense of member benefits. This is evidenced by the fact that while retail funds on average underperform relative to industry funds in terms of net returns to members, they nevertheless charge significantly higher fees.<sup>7</sup>

2. The profit-orientation of retail funds. The Interim Report discusses the Australian superannuation industry in general terms. However, when it comes to understanding the cost, fee and performance dynamics of the system it is important to make distinctions between those funds that operate primarily in the interests of fund members, and those who sell superannuation and related products primarily as a source of profit for parent corporations and

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<sup>5</sup> Industry Super Network (2009) *Competition in the Superannuation Market*.

<sup>6</sup> Fear, J. and G. Pace (2008) *Choosing Not To Choose: making superannuation work by default*, The Australia Institute, Discussion Paper 103.

<sup>7</sup> Bryan, D. et al (2009) *Agents With Too Many Principles? An Analysis of Occupational Superannuation Fund Governance in Australia*, Workplace Research Centre, University of Sydney.

shareholders. This is important because if competition is unlikely to drive down costs and fees, then regulation and policy must instead target the specific drivers of those costs and fees. And those drivers vary according to the business model adopted by particular trustees.

In 2008 APRA undertook a study of the performance of the main groups of superannuation funds in Australia with the aim of identifying the reasons for any significant differences.<sup>8</sup> Super funds were grouped into four categories: corporate, public sector, industry, and retail. The performance of funds was then analysed by reference to the four possible explanations for differences in their net returns: asset allocation, investment performance relative to asset allocation benchmarks, expenses (including fees), and taxes.

The study concluded that there were very few statistically significant differences in returns between corporate, public sector and industry funds. For the purposes of their research APRA grouped these funds together as 'not for profits'. However, the analysis found there were significant differences in the performance of retail funds compared to the not for profits. In short, retail funds significantly underperformed relative to the other fund types. After analysing the potential causes of this performance differential the study reached the following conclusion:

'The evidence indicates that part of the net retail underperformance is due to embedded fees that are already incorporated by the investment vehicles used by these funds at the gross return level, rather than poor investment manager skill. Retail fund expenses, explicit and embedded, lower the net earnings of the retail sector relative to the not-for-profit sector.' (p. 3)

In short, retail funds perform less well because their costs are higher. In many cases their costs are higher because they utilise expensive investment vehicles that are solely or mainly provided by the parent corporate bodies that own the retail funds. They utilise those vehicles because retail superannuation funds are first and foremost a source of profit for the parent body. For reasons outlined above, competition based on clear and consistent fee and performance data, to the extent it is available, is largely ineffective. The retail funds and the corporate entities into which they are vertically integrated therefore have very little incentive to lower costs and therefore very little incentive to improve performance.

Instead retail funds often utilise headline fee figures to misleadingly suggest that because their products are cheaper than others in terms of the monthly or annual fees members are charged they therefore represent a 'good deal' or 'value for money'. However, what ultimately matters for retirees is not the level of fee they pay, but the net return to their account once all fees, charges and commissions have been deducted. In terms of net returns to members retail funds have consistently underperformed all the other main types of super fund, as APRA data routinely demonstrates (see Table 1 below).

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<sup>8</sup> APRA (2008) 'Investment Performance, Asset Allocation and Expenses of Large Superannuation Funds', *APRA Insight*, issue 3.

**Table 1: Rate of return by fund classification over 1, 5, 10 and 15 years (%)**

	1yr	5yr	10yr	15yr
All entities	13.70	3.50	6.00	4.80
Corporate	12.30	4.40	6.50	5.30
Industry	14.40	3.80	6.70	5.30
Public Sector	14.20	4.00	7.00	5.90
Retail	13.10	2.90	4.90	3.70

Source: APRA (2014) *Annual Superannuation Bulletin*

APRA's analysis of annual rates of return over a 10 year period show that 96 per cent of the 50 top performing funds are from the not-for-profit sector. Of the 50 lowest performing funds, 80 per cent are for-profit funds.

There is a common misperception outside the superannuation industry that because all funds (with the exception of public sector funds) operate under the same principles of trust law and the covenants prescribed by Section 52(2) of the *Superannuation Industry (Supervision) Act 1993* and Regulations, that the nature the fiduciary relationship between fund trustees and their members is effectively the same regardless of fund-type. This is not the case. The very large exposure of retail funds to related-party assets has significant implications for how the relationship operates in practice. Drawing on original research into the various structures and practices of retail and non-retail trustees in Australia, an APRA paper made the following important observations:

'Whilst company boards and trustee boards of retail pension funds are distinct entities, their historical origins and their typical compositions with significant numbers of overlapping executive directors make the distinction more theoretical than real, particularly in many cases where the shareholders are related entities or a parent company. In practice, the conflicts are 'resolved' by the retail trustees treating fund members like clients or consumers in a pension product, thus possibly diluting the notion of trusteeship in favour of the notion of product manager. *Unlike non-retail trustees who negotiate the best possible terms for investment management services for their funds, retail trustees who often have investment managers as executive directors on their boards have impaired incentive to negotiate best terms for investment management services.*'<sup>9</sup>

The importance for how funds are governed for costs and performance has been underlined by recent research undertaken by researchers at Macquarie University for The McKell Institute. After reviewing APRA and Rainmaker performance data and modelling outcomes for different initial investment scenarios under for-profit and not-for-profit governance structures, the research concluded:

'...the available evidence does show a clear causal relationship between not-for-profit representative governance funds, and higher levels of returns for members...Both raw

<sup>9</sup> Wilson, S. (2008) *Superannuation Fund Governance: an interpretation*, APRA, Sydney, p. 12 (emphasis added)

and risk-adjusted research supports the proposition that the two governance models produce significantly different performance outcomes.’<sup>10</sup>

The source of these performance differences lay in the very different incentives and agency costs generated by funds where directors and management must make a profit for a party other than the membership, and those associated with funds whose sole concern is to maximise returns for members.

In sum, there are many drivers of costs and fees across the Australian superannuation system. Some of these are being dealt with by initiatives such as SuperStream. However, some are ‘structural’ in the sense that they are not driven by relative differences in scale, skill or efficiency: they are embedded in the for-profit business model. Public policy should therefore focus on attempting to change the structure of incentives within that model.

At present superannuation funds are not required to regularly review their existing contracts with material service providers in areas such as investment for the purposes of being able to demonstrate to APRA that such contracts are in the best interests of members (defined in terms of long-term net returns). One potential policy option would be to require that all funds do so, perhaps at least once every 3 to 5 years.

## COMPETITION AND DEFAULT FUNDS

The Interim Report discusses a number of potential policy options that may reduce costs. Here we want to focus on the suggestion that creating a new single national fund for default contributions, the management of which would be auctioned on the basis of fees, may push fees down.

The Report cites the example of Chile in this respect. As part of a series of significant structural reforms of the Chilean pension system in 2008 a competitive bidding process was introduced under which all new pension contributors are automatically enrolled for two years in the AFP (the private sector pension fund) which offered the lowest management charges in the most recent bidding round. This reform was intended to deliver a number of outcomes. Firstly, in 2008 there were only five AFPs in Chile. The bidding process hoped to encourage the formation of new AFPs on the basis that they would potentially gain access to a large number of members without incurring marketing costs – a key driver of high fees in the Chilean system. In 2012 the number of AFPs had risen to six.<sup>11</sup>

Secondly, it was hoped the bidding process would bring costs down. As the Interim Report notes, the costs charged by successful bidders has fallen by 65 per cent. However, fees charged by other AFPs have not fallen by the same degree. A balanced assessment of this reform would need to consider whether net returns have improved proportionate to the changes in fees during the pre and post reform periods. We are not aware of research that specifically considers this issue.

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<sup>10</sup> McKell Institute (2014) *The Success of Representative Governance on Superannuation Boards*, Sydney, p. 37.

<sup>11</sup> Shelton, A.M. (2012) *Chile’s Pension System*, CRS Report for Congress, p. 8.

However, there are some important differences between the retirement systems in Chile and Australia that make the Chilean reform experience less relevant than it may appear.

Firstly, there are over 200 Registered Superannuation Entities in Australia many of whom operate on a not-for-profit basis and are already concerned to bring costs down to the benefit of members. This provides an existing basis for reform that did not exist in Chile prior to 2008. Therefore, we do not need to start with a 'blank sheet of paper' when it comes to determining where a more efficient and beneficial superannuation system may come from.

Secondly, Australia has a system for allocating the majority of default contributions to funds that best represent the long-term interests of members. As the Interim Report notes, the role of the Modern Awards system in selecting funds for default members is under review by the present government. The Fair Work Commission (FWC) is currently in the process of implementing a new selection process that was legislated by the previous government. This government's stated view is that there should be more competition in the 'market' for default superannuation.

The ACTU strongly supports the system being implemented by the FWC and does not agree that the notion of 'competition' is by itself appropriate to how default superannuation operates. Nor do we accept that the absence of competition is detrimental to most disengaged members who have their fund chosen for them via the system of Modern Awards.

In February this year we made a detailed submission to the government making clear why the present system is in the best interests of default members and why the reform options floated by the government were misconceived and potentially very damaging to millions of disengaged fund members. We have included a copy of that submission as an Appendix to this document. Pages 16 to 24 of the Appendix discuss issues relevant to default fund selection.

If the Inquiry Panel is minded to consider proposing reforms to how default superannuation is regulated in Australia we hope you will engage with the arguments in that submission. Given the central role that unions currently play in selecting many workplace default funds we would welcome the opportunity to discuss these issues further with the Panel before any final recommendations are made to government.

## **THE TRUST STRUCTURE OF SUPERANNUATION GOVERNANCE**

In the context of potential options for helping to reduce costs the Interim Report states:

'Trust law forms the basis for the governance of superannuation. The Inquiry seeks views on whether the trust-structure is best placed to meet the needs of all members in a cost-effective manner.' (p. 2-107)

The Report does not offer any evidence that trust-based governance imposes costs disproportionate to the risks and costs that may be incurred by an alternative system of

governance. Nor does the Report suggest what such an alternative could be. In the absence of supporting detail or potential alternatives it is difficult to engage with what the Panel's direction of thinking may be.

In a number of other countries, such as the UK, the main alternative to trust-based schemes are those based on individual contracts between employees and providers. Advocates of contract-based schemes argue they are potentially more beneficial to individual account holders because they eliminate some of the costs associated with trust-based schemes that can act to reduce retirement balances. These costs often include those associated with the appointment and training of trustees, the holding of formal meetings and record maintenance, compliance with trust law, risk assessments and reporting, and regulatory levies.

There are obvious risks associated with contract-based schemes. Governance beyond that embedded in the contract offered by the provider is voluntary and therefore highly uneven in terms of its quality and coverage. In the absence of a fiduciary relationship the success of such schemes as a reliable source of adequate retirement incomes is likely to be highly dependent on the knowledge, skill and engagement of the individuals who contract into them. They are arguably best suited to people who work as pension professionals, an important but somewhat unrepresentative section of the broader population. We therefore agree with this view expressed by the British Trades Union Congress:

'It is not implausible to suggest that contract-based defined contribution pensions are so far removed from the collective risk-sharing nature of a true pension, that they are not pensions at all, but individual savings accounts...The absence of trustees means that the saver is assumed to be an active consumer making informed decisions in a well-functioning market, but in a complex investment chain involving employers, advisers, insurance companies and (internal and external) asset managers, the saver is the only person in this chain who exercises virtually no influence over any key decisions. In contract-based provision, almost none of the conditions for a market to function properly exist.'<sup>12</sup>

It is not surprising that the increasing use of contract arrangements in the UK in recent years has not been generated by demand from individual workers, but rather by employers who wish to further minimise their involvement in pension provision for their employees.

In Australia the government has mandated that nearly every employee makes contributions to an appropriate superannuation fund. Most of these funds are operated as private corporate entities. In a context where the large majority of workers do not actively engage with their super, but are obliged to make contributions to privately operated superannuation funds, it is that vital there is a system of governance that owes a duty of care to them and their long-term financial interests. Not every single fund member requires this care. But evidence of low levels of financial literacy and members deciding to move between funds suggests many do.

The ACTU is therefore a strong supporter of the trust-based system of superannuation governance. It has a proven record of providing diligent, prudent and resilient governance during periods of global economic stability and crisis. We are not aware of any evidence that the costs

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<sup>12</sup> Trades Union Congress (2010) *Third Time Lucky: Building a Progressive Pensions Consensus*, TUC, London, p. 29.

associated with trust-based governance outweigh the risks and costs that a different system may entail.

We therefore recommend that the Review Panel make clear its support for the existing system of trust-based superannuation governance in its final report to government.

## STABILITY OF SUPERANNUATION POLICY SETTINGS

The Interim Report observes that ‘Superannuation policy settings lack stability, which adds to costs and reduces long-term confidence and trust in the system’ (p. 2-118).

We agree. In recent years the superannuation system has been the subject of numerous reviews, consultations and legislative changes. Some of these were necessary. But the pace and intensity of change has imposed costs on members and has helped to reinforce the public impression of super as endlessly complex and beyond the understanding of those who do not work within the industry. This reinforces disengagement and undermines confidence.

After an intensive period of review and change following the Cooper Review the present government has initiated a new round of consultations that have generated further uncertainty and costs.

For a mix of commercial and political reasons superannuation has become an area of public policy subject to partisan politics, sectional interests and special pleading. We therefore need to establish a broad community and policy consensus about what superannuation is for and what constitutes appropriate and legitimate reform. Only then may parts of the industry and policymakers begin to take a long-term and considered view of the system that avoids making change for reasons other than what is in the best interests of fund members.

The previous government began this process in 2013 by proposing to establish a Council of Superannuation Custodians which would then monitor a Charter of Superannuation Adequacy and Sustainability. Future policy proposals would then be assessed against this Charter with the aim of ensuring they were consistent with key principles such as adequacy, sustainability and fairness. A report on implementing these proposals was presented to the government in June 2013.<sup>13</sup>

Unfortunately the present government abandoned these proposals shortly after being elected last year.

The ACTU was a strong supporter of the Custodians and Charter initiative. It had the potential to help bring much needed stability and transparency to superannuation policy. We believe the present Inquiry should examine the initiative and recommend to government that it reinstate the implementation of the proposals that were being actioned until September last year.

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<sup>13</sup> Charter Group (2013) *A Super Charter: Fewer Changes, Better Outcomes*, Commonwealth, Canberra.

## RETIREMENT INCOME FRAMEWORK

The Interim Report states that our retirement income system is currently ill-prepared to help future retirees manage longevity risk in ways that respond to individual expectations, needs and circumstances. It is suggested that a major weakness of our system is that longevity risk is largely borne by the publically funded Age Pension. The Report offers three policy options for consideration:

- a) Strong incentives for income stream products and, where appropriate, disincentives for lump sums (using the tax and social security systems);
- b) Default transition to longevity protected retirement products;
- c) Compulsory purchase of a longevity protected retirement product.

The ACTU supports action to increase the income choices available to more workers when they come to retire. But first it is important to make clear the financial realities that millions of workers will face in retirement. Our superannuation system will improve the quality of life for most workers when they stop working. But for many that improvement will be relatively modest, reflecting life-times of low wages and low rates of super contributions. This is particularly true for female workers, many of whom are concentrated in occupations where low pay is endemic, and many of whom work part-time and spend periods outside the labour force because they care for children and other relatives.

Rice Warner define the 'retirement savings gap' (RSG) as the difference between what workers are likely to have in their final balance and what they are likely to need to receive 62.5 per cent of their pre-retirement earnings. In 2011 they estimated that the RSG was \$836 billion.<sup>14</sup> ASFA define the Gap in terms of the capacity of retirees to sustain a 'modest' or 'comfortable' quality of life after retirement. A 'modest' quality of life is one better than that enabled by the Age Pension, but one in which the retiree is still only able to afford basic activities. A 'comfortable' lifestyle involves being able to afford private health insurance, an occasional holiday and replacing household goods such as a television or fridge.

Table 2 below contains estimates by ASFA of what the final retirement balances for workers today will be, differentiated by wage level and contribution rate. It also shows what is needed to sustain a comfortable or modest retirement standard. These figures assume full home ownership and the stability of Age Pension policy settings as of June 2014.

The ASFA estimates should be interpreted in a context where nearly 50 per cent of workers (5 million) in Australia earn \$50,000 or less per year. Around 36 per cent (3.6 million) earn less than \$37,000.<sup>15</sup>

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<sup>14</sup> Rice Warner (2011) *Retirement Savings Gap at June 2011*, Rice Warner, Sydney.

<sup>15</sup>[http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/FB46BB699848054DCA257CEC001E1B97/\\$File/63100\\_august%202013.pdf](http://www.ausstats.abs.gov.au/ausstats/subscriber.nsf/0/FB46BB699848054DCA257CEC001E1B97/$File/63100_august%202013.pdf)

**Table 2: Retirement Savings Needed to Support a Comfortable or Modest Retirement Standard**

<b>Tax treatment and contribution level</b>	<b>Wage of \$30,000</b>	<b>Wage of \$50,000</b>	<b>Wage of \$100,000</b>
9% contributions and investment earnings taxed at current rates	\$110,000	\$183,000	\$366,000
Lump sum if contributions made at the rate of 12% of salary	\$146,000	\$244,000	\$487,000
Lump sum needed to support comfortable lifestyle for a couple (assumes receipt of part Age Pension)	\$510,000	\$510,000	\$510,000
Lump sum needed to support comfortable lifestyle for a single person (assumes receipt of part Age Pension)	\$430,000	\$430,000	\$430,000

Source: ASFA Retirement Standard June 2014

The future for up to half of all future retired Australians is likely to be ‘modest’ or less. Millions of the lowest paid will be heavily dependent on the Age Pension. In addition, several million may be able to sustain a quality of life just above that enabled by the Pension (assuming full home ownership and reasonable health).

This context is important when it comes to considering new policy settings for the post-retirement phase. For many workers it would be inappropriate for the government to mandate the purchase of (or default them into) a longevity protected retirement product, or to use the tax and social security system to penalise their choice to take a lump sum. Careful consideration needs to be given to designing a system that takes into account the balances that millions of workers will actually retire with and their capacity to independently insure themselves against longevity risk.

The ACTU is therefore a strong supporter of the Age Pension. We do not share the view that is often implicit in much public discussion that the Age Pension is doomed to play an increasingly marginal role in supporting workers in retirement. This assumption often translates into the assertion that the Age Pension is a ‘burden’ to be minimised, so requiring an increasing amount of compulsion when it comes to determining how people organise their post-retirement incomes. For millions of future retirees the Age Pension will be the key determinant of their quality of life. It is therefore vital that its value and availability is maintained for those who will need it most.

In terms of policy options the ACTU supports the following:

- a) Given the future importance of the Age Pension, and the quantum of retirement balances that are likely to make longevity retirement products irrelevant for many, we recommend the Inquiry give consideration to calling for a lifetime annuity that involves retirees purchasing an increase to the Age Pension. Retirees would pay a lump sum to the government in return for a pension indexed to wage growth and determined on an actuarially fair basis. Such a product would benefit from the government’s status as a very low default risk and its related capacity to access capital at relatively low costs.

- b) A review of the legislative and tax framework for annuities with the aim of removing barriers to the development of an annuities market of a size and liquidity that makes them available to more retirees who wish to purchase them. The accompanying regulation of how retirees utilise their final balances should not penalise those below a given balance benchmark who wish to take all or part of their benefits as a lump sum.
- c) The legislative and tax treatment for retirement products must be equal, recognising that many funds offer pension products that members want and which are more appropriate than annuities to their circumstances and needs.

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