Submission to Financial System Inquiry
by SuperEd Pty Ltd
August 26, 2014

We welcome the focus on Retirement Incomes in the Interim Report and focus our observations and recommendations on that area.

In our view, the overriding purpose of the superannuation system is to assure Australians have an adequate income throughout their retirement.

Yet, as the Interim Report argues, the decumulation phase of the system is largely underdeveloped, a result of both government and industry's attention over the last two decades being focused on establishing the system. It is now high time to address the drawdown phase with resolve and innovative thinking.

The Australian approach to retirement funding places an extraordinary responsibility on citizens to provide financial resources to fund their own retirement – placing as much reliance on personal decisions and actions as any other country among the major developed economies. Our dependence on defined contribution plans means that members must face the substantial dual challenges of uncertain longevity and uncertain investment markets. These are awesome challenges presenting wide ranges of potential outcomes, which many financial professionals find daunting let alone our largely untutored citizenry.

SuperEd[1] makes the following observation and recommendations:

1. **Reframe required contributions**
   It is not unreasonable, in the absence of other messages, for individuals to assume that if the Government says we must save 9.5% that would be sufficient to fund their retirement.

   While the Superannuation Guarantee Charge (SGC) at 9.5% of salary is an excellent start to a retirement nest egg, it (or even the planned future rate of 12%) is insufficient by itself to provide an adequate retirement income for most people, as measured by a replacement ratio (i.e. income in retirement compared to the level prior to retirement) or the ASFA Retirement Standards[2].

[1] SuperEd is a company dedicated to providing affordable online retirement incomes advice to provide superannuation members with better retirement outcomes.
[2] Deloitte Actuaries and Consultants (2013), 'Dynamics of the Australian Superannuation System: The Next 20 Years: 2013–2033', September, pp26-29.

Yet, we well know from behavioural finance research that individuals' expectations are strongly influenced by "framing."

Government and industry should confront the illusion we create through our otherwise laudatory superannuation guarantee charge. We need to encourage further savings and so must get out the message that 9.5% (really 8.1% after contributions tax) generally is not by itself sufficient, not even with the Age Pension.

No one it seems wants to have this "hard conversation." Government, industry and trustees have a responsibility to do so.

2. **Refocus on sustainable retirement income**

A superannuation account balance statement means very little to members about the income they might expect from superannuation. After all, how many people can calculate the sustainable retirement income based on their current balance? A focus on investment balance also has the undesirable effect of drawing attention to short-term market volatility, often leading to suboptimal investment behaviours.

We believe it is entirely appropriate that superannuation funds, whose express purpose is to provide retirement income, should provide high quality retirement income forecasts.

These forecasts should be provided as a range of stochastic outcomes reflecting the uncertainty of the investment situation members face. And they should factor in the potential availability of the Age Pension. Overseas evidence[3] shows that members provided with a retirement income forecast are much more likely to increase contributions in order to have a higher retirement income.

3. **Bring longevity risk into focus**

The chance of living much longer than average lifespans places a huge burden on individuals to maintain a sustainable income stream, without inordinately under-spending (as many retirees acting conservatively tend to do). The standard deviation of lifespans around the mean age of death of 83 is 8.4 years.[4] Consequently the range of longevity outcomes creates as

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[3] How Do Retirement Income Projections Affect Saving Behavior? By Gopi Shah Goda, Stanford University, 2014

4 Your money or your life: what's more certain? by Jeremy Cooper on May 30, 2014 in Cuffelinks

much uncertainty for individuals as does investment uncertainty.

Government and the super industry should therefore encourage the understanding of longevity and its associated uncertainty.

It would also seem very helpful to have mechanisms for individuals to become less reliant on their own savings/investments as they reach advanced ages. As a social policy issue, there is an argument, for providing greater assurance about levels of income at elder ages. This could be accomplished through:

a. Private means – e.g. by encouraging deferred lifetime annuities or group risk sharing arrangements;
b. Public means -- providing either higher pension payments to those over 85 or 90, or providing an even higher assurance as to coverage of medical and aged care expenses.

4. Improve access to high quality advice

The Financial System Inquiry has rightly considered the nature and quality of financial advice available to Australians. Given the complexity and uncertainty (investment, longevity (and regulatory) risks) associated with self-provisioning for retirement, we encourage innovation in financial advice to ensure more Australians have access to advice to help them assure adequate retirement incomes. Traditional approaches to advice have been too broad and too expensive to meet the needs of most Australians.

Given the challenges and complexity of our superannuation system and tax code, we simply must broaden the access to advice for Australians.

Broadening access to advice will require embracing modern technology and limited purpose advice approaches. New technology creates the opportunity for advice to be personalized at low cost and to be delivered on an ongoing, as opposed to one-time, basis. The focus of regulation should be more on providing satisfactory outcomes for members than on regulating product sales.

We observe that innovation is occurring in this sphere at a rapid pace in overseas markets but has been slow to develop in Australia. We encourage the superannuation industry to take action to provide advice to a much greater proportion of its membership and ASIC to work collaboratively with the industry to encourage the development of new cost-effective, high quality models for advice provision.

5. **Encourage deferred retirement**
The Australian Government should consider ways to encourage people to address savings shortfalls by working longer, as has been mooted in the Federal Government's 2015 budget proposals.

Increasing the pension age is inevitable as lifespans rise. However, we also need to recognise that individual circumstances vary dramatically and a sizeable group of people face involuntary retirement at an age younger than the pension age. And for others the definition of retirement is changing with many preferring to work in some capacity, or on a part-time basis, as long as they can.

Several things could be done to address the differences in the population. One approach would be to adopt a tiered approach to benefits payment. That is, individuals could be entitled to a lower rate of pension benefits if they retire early and a higher rate if they draw on the pension at a later age. This approach is utilised in Social Security payments in the US. (In the US Social Security System, an individual may draw on Social Security payments from age 62. However, those payments are only paid at a maximum level if the participant waits until age 70. This clearly provides an incentive to work longer and delay drawing the government benefits.)

6. **Shift from lump sum to income streams**
The Australian Government should reconsider our lump-sum retirement superannuation system and encourage the greater use of pension streams. Again, as the purpose of superannuation is to provide retirement incomes, we should move away from a lump-sum mentality as balances grow and encourage individuals to take the money out gradually. The policy intention would be to encourage self-funding of retirement and reduce the immediate pull on the public purse through the age pension.

This could be achieved through a variety of mechanisms. For example by limiting super funds' pension phase tax-free status to retirement income streams; establishing a maximum tax-free lump-sum withdrawal amount at a modest level and requiring amounts above this to be drawn via income streams et cetera.

7. **Attend to cognitive decline**
The Financial System Inquiry and our industry must acknowledge the presence of, and difficulties arising from, cognitive decline in our elder

populations.[5] The financial services industry must develop a broad-ranging capability to provide "Geriatric Financial Services." We need to recognise such factors as: a relative inability to adapt to rapid technology change in financial services, the potential loss of decision-making quality with respect to financial decisions and particularly investment decisions, the challenge of dealing with government compliance in financial services (such as in tax compliance and self-managed super funds), and the vulnerability of the elderly to scams and financial fraudsters. These are profound issues and we were concerned that they were not broached in the Financial System Inquiry Interim Report, as they clearly loom on the horizon for our ageing population.

In conclusion, we support the Inquiry's focus on further development of the retirement drawdown phase of the superannuation system. We would of course be happy to elaborate on any points as requested by the Committee or the Secretariat.

Sincerely,

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Co-Founders
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[5] There is a growing academic literature on the impacts of cognitive decline on financial decision-making. A good starting point is: Investigating the Impact of Cognitive Decline on the Quality of Financial Decision-Making in Older Adults: The Case of Self-Managed Super Funds (2013) by Joanne Earl, Paul Gerrans, Anthony Asher and Julia Woodside.