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The Australian approach to choice in superannuation/pensions

Professor Hazel Bateman (UNSW Sydney, CEPAR)

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Outline

- Australian retirement income arrangements in brief
- Choice architecture
- What do people do?
- Strengths and weaknesses of Australian arrangements
- Current policy initiatives

Australian retirement income arrangements in brief

Australia's approach to retirement income provision

1. **Age Pension** (safety net)

2. **Compulsory superannuation - superannuation guarantee** (income replacement)

3. **Voluntary retirement savings - superannuation and other** (additional income)

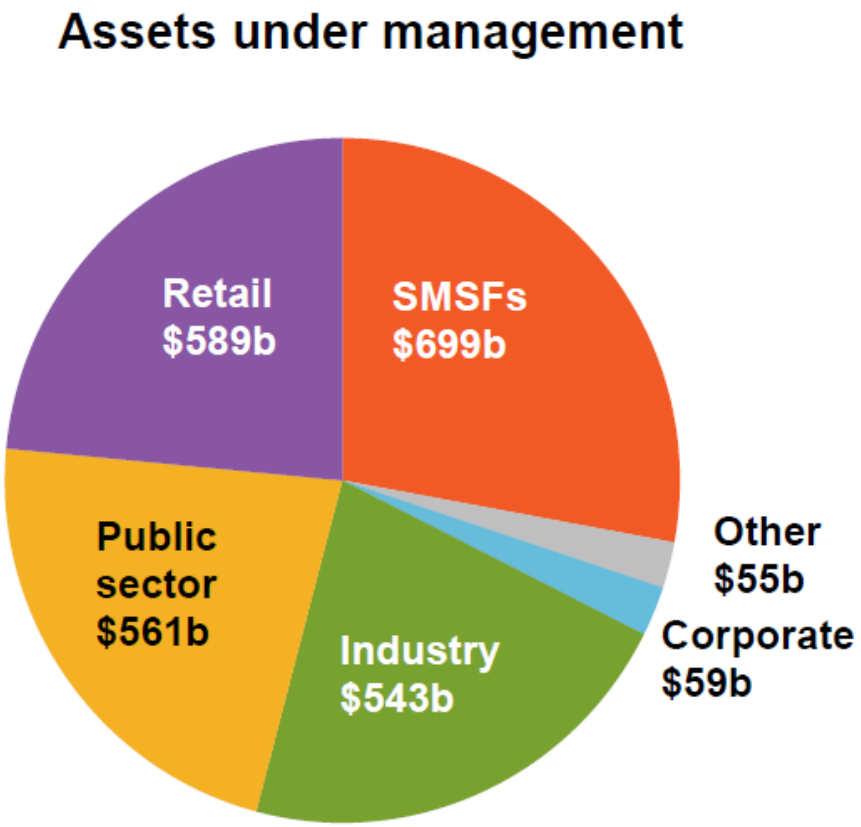
Australia's approach to retirement income provision

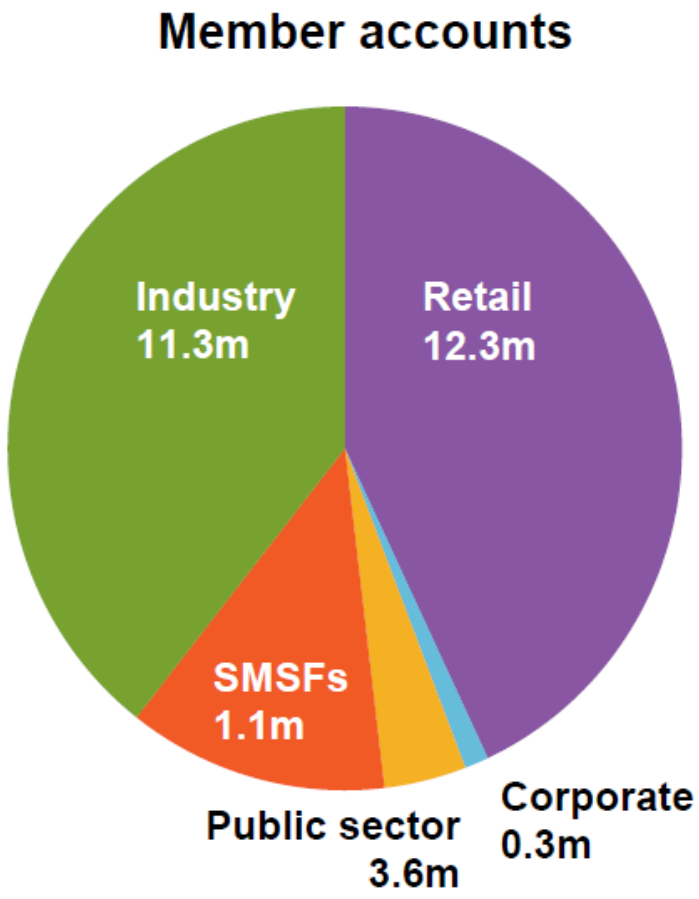
1. **Age Pension**
   - General revenue funded, single →27.7% male av. earnings, indexed to greater of wages and prices, not taxed, from age 66 (increasing to 67), proposal to increase to 70 withdrawn
   - Means tested (income/assets) → excludes richest 20-25%
2. **Compulsory superannuation (superannuation guarantee)**
   - DC, compulsory 9.5% (incr to 12%) of income paid by employer into a superannuation/pension fund (introduced in 1992 at 3-4%)
   - Access at age 60 (work test) or 65 (no work test), 95% employees covered
   - Replaced quasi-mandatory award super (1986), previously voluntary
3. **Voluntary retirement savings (superannuation and other)**
   - Tax incentives to supplement superannuation guarantee, housing

Superannuation: other key features

- Assets: $A2.6 trill, 140% GDP
- Members: 14.8 million
- Number of 'regulated' superannuation/pension funds:
  - consolidation from > 5,000 to approx 230
- Types of superannuation/pension funds:
  - Not-for-profit (corporate, public sector, industry)
  - Retail (owned by financial institutions)
  - Self managed (SMSF) (4 or less member trustees)
- Number of investment options: average of 16 for not-for-profit funds, often hundreds for retail funds

Assets and members by superannuation fund type





Source: APRA Superannuation Statistics (2018)

Choice architecture

Australia: superannuation – choice architecture

- Whether to participate?

- Which superannuation fund?
- Which investment option(s)?
- How much to contribute?

- How much life and TPD insurance?

- When to retire?
- Which benefit(s) to take?

Australia: superannuation – choice architecture

- Whether to participate? MANDATORY (employees) + TAX INCENTIVES (self-employed)
- Which superannuation fund? CHOICE or **MySuper** DEFAULT
- Which investment option(s)? CHOICE or **MySuper** DEFAULT
- How much to contribute? MANDATORY minimum contribution, TAX INCENTIVES to contribute more
- How much life and TPD insurance? DEFAULT participation and coverage, OPT OUT
- When to retire? CHOICE (access age, tax, Age Pension age)
- Which benefit(s) to take? CHOICE – lump sum, phased withdrawal (account-based pension, annuity), proposed **CIPR** superannuation/pension fund recommendation

MySuper: regulated default for superannuation/pension fund and investment option

- A superannuation fund/investment option default if no fund choice is made
- Since 2013, regulated low cost, transparent, single investment strategy - 'balanced fund' or 'lifecycle fund'
  - 2018 average MySuper asset allocation: 27% defensive assets - cash (8%), fixed interest (19%); 73% growth assets - Australian equities (40%), international equities (25%), property (3%), other (5%)
- Selected by employers, generally via industrial relations arrangements
- Must present key information on a single page 'product dashboard'
- Over 100 MySuper products

CIPR (comprehensive income product for retirement) – proposed retirement benefit recommendation

- Recommended by 2014 Financial System Inquiry, to commence July 2020
- A CIPR is a retirement income product that must provide:
  - Broadly constant expected income
  - Income for life
  - Some access to capital

  (eg, account-based pension + 15-20% as longevity insurance product such as deferred annuity)
- Under *draft legislation*, superannuation funds must offer a CIPR to retirees
  - Exception if terminal illness or < $A50K account balance
  - Can offer up 3 CIPRs → offer determined by account balance, can be reversionary
  - Retiree must consent prior to commencement; or choose alternative product under advice

Policy initiatives to complement choice architecture

Mandatory information provision

- Regulated information disclosure
  - Financial product disclosure statement (PDS) → choosing a fund, choosing an investment option
  - Single page 'dashboard' → choosing a MySuper 'default'
- Annual member statements
  - Periodic reporting, benefit projections voluntary (few do)
- Proposed enhanced disclosure for CIPRs + benefit projections to facilitate engagement

Tax incentives

- voluntary contributions
- min retirement income drawdown (account-based pensions)

Regulatory framework for financial advice

Financial literacy initiatives

Superannuation/pension fund support for member decisions

- Informative websites
- Fact sheets/videos
- Member service centres – phone, email, face-to-face
- Seminars/webinars
- Interactive calculators
- Access to member accounts (online, Apps)
- Financial Advice license

- Voluntarily include benefit projections on annual member statements (subject to regulator guidance)

Choices – what do people do?

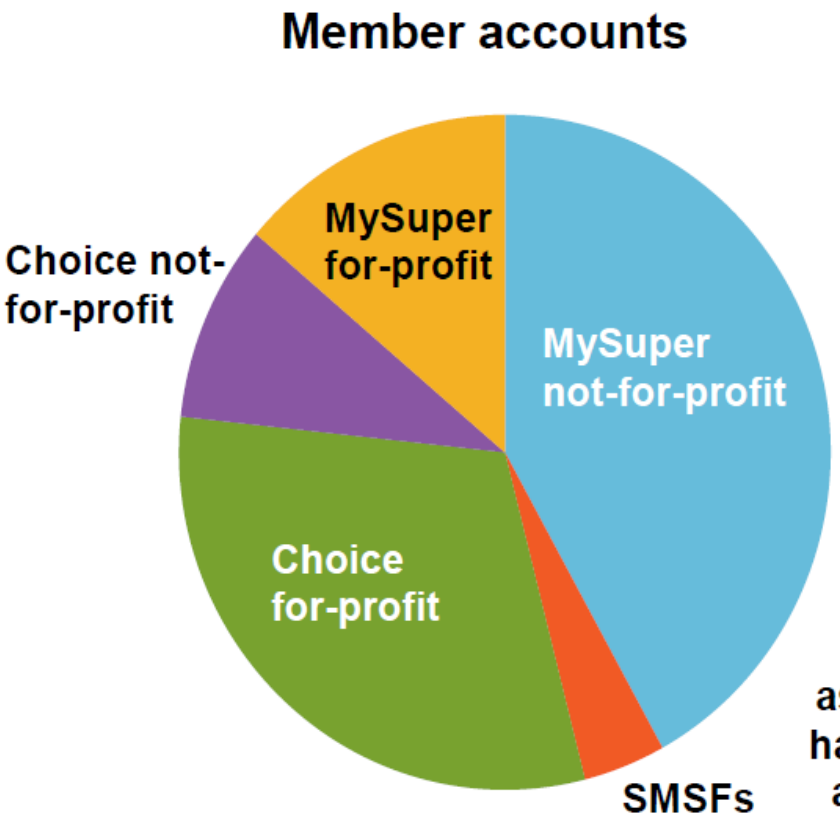
Choice and defaults – what do people do?

- Whether to participate? Mandatory (employees) + 70% self-employed
- Choice of superannuation fund? < 9% (most job change)
- Choice of investment option(s)? < 1/3 ever changed, 6-9% pa
- Choice of extra contributions? < 25% voluntary contributions

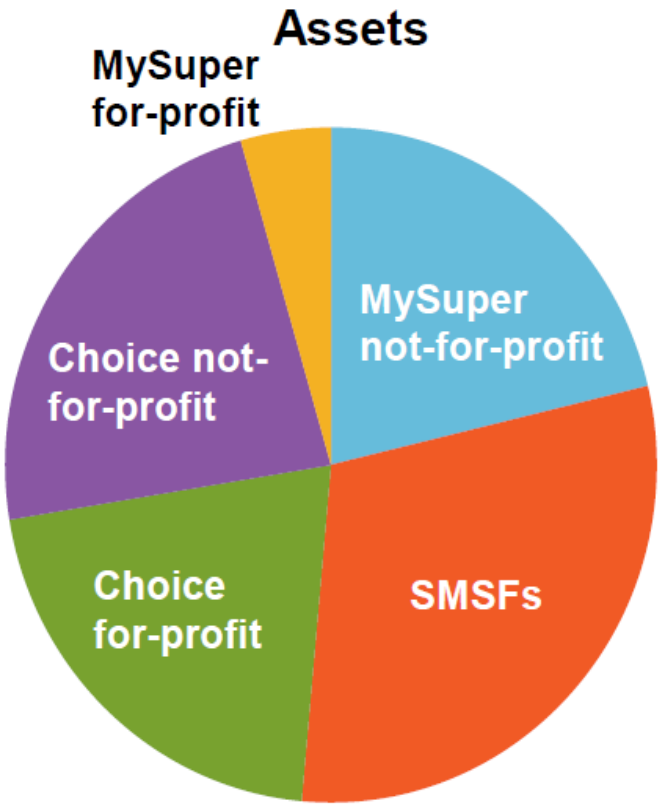
- Choice of life & TPD insurance? Most stay with default

- Choice of retirement age? Average retirement age: (retired in past 5 years), men – 64; women - 62
- Benefit choice? Most non-annuitized products, small lump sums

What do people do? Choose superannuation/pension fund or MySuper default

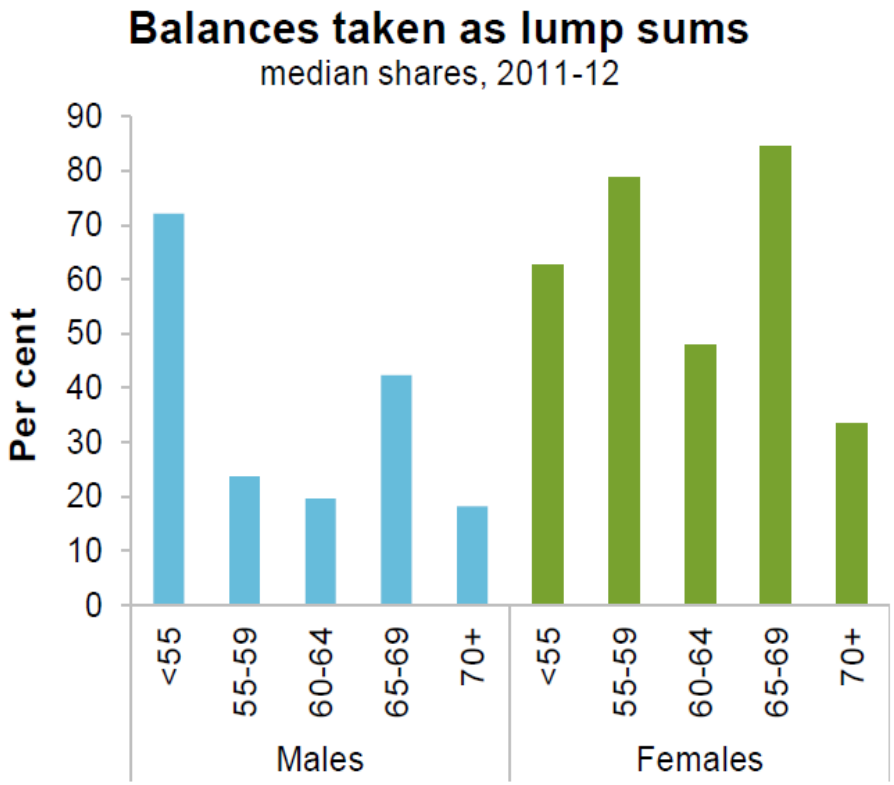


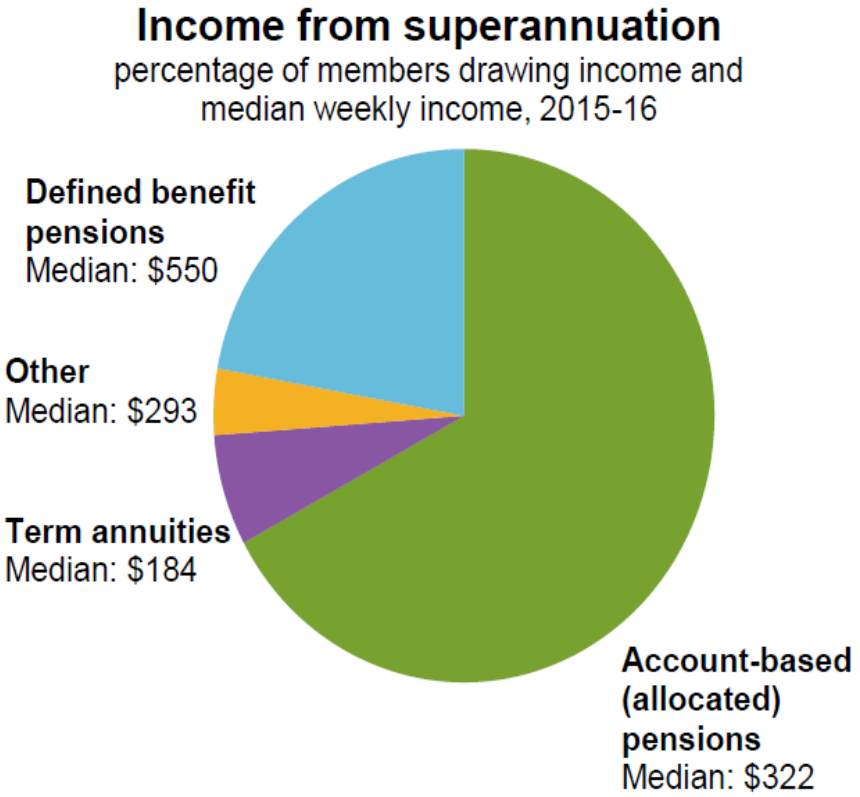
A quarter of assets - but over half of accounts - are in MySuper



Source: APRA superannuation statistics (2018)

What do people do? Benefits





Sources: ABS (*Household Income and Wealth, Australia 2015-16*, Cat. no. 6253.0); PC (2015a, p. 85).

Strengths and weaknesses

Australia's approach to choice - strengths

High coverage

- Delivered by mandatory participation and minimum contribution rate (employees) and tax concessions (self-employed)

Allocation to growth assets

- Despite some poorly performing default MySuper funds, members benefit from emphasis on growth assets in default asset allocation

'Stick to default' strategy most likely to deliver adequate outcome in accumulation

- However, undeveloped choice architecture in decumulation → inadequate take-up of longevity insurance

Australia's approach to choice - weaknesses

Mandatory participation excludes self-employed

- Although 70% voluntarily covered

Allocation to MySuper default

- Possible allocation to poor performing fund
- Multiple accounts

Default MySuper (and choice segment)

- Lack of competition & high relative fees/costs

Default (opt-out) insurance

- Lack of awareness, some inappropriate insurance coverage

Undeveloped retirement benefit choice policy

- Continued (precautionary) saving in retirement
- Product menu recently expanded to include deferred annuities, variable annuities, group self-annuitization products
- New choice architecture for benefits - *in progress*

Australia's approach to choice - weaknesses

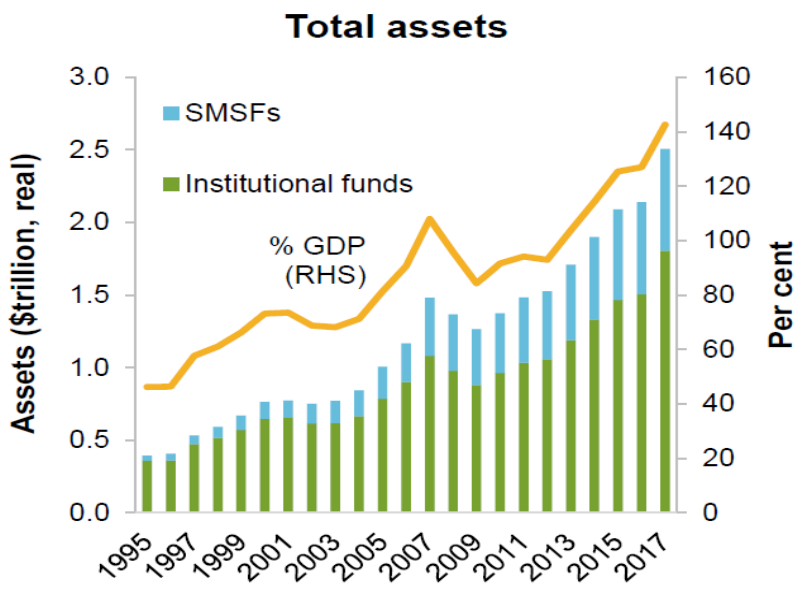
Complementary policies could work better

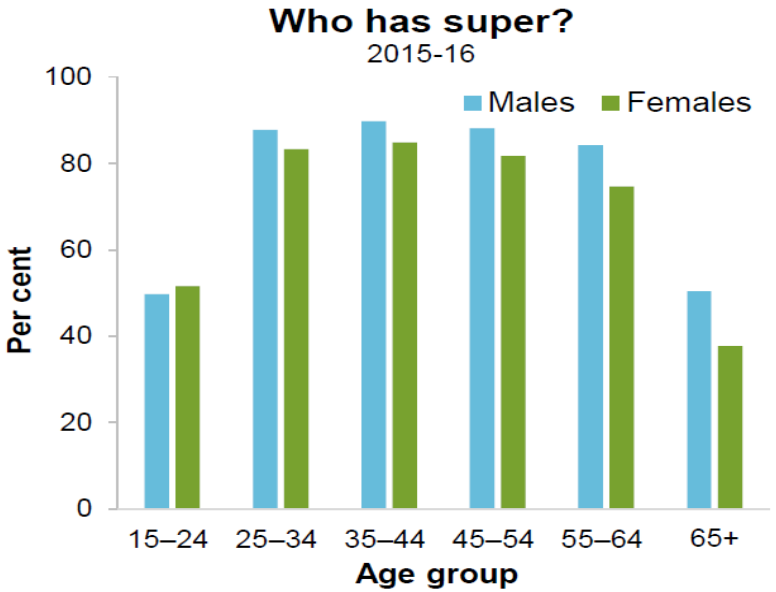
- Financial product disclosure not effective
- Poor knowledge of system & products, poor financial literacy
- Low trust in financial advisers, need more focus on 'guidance'

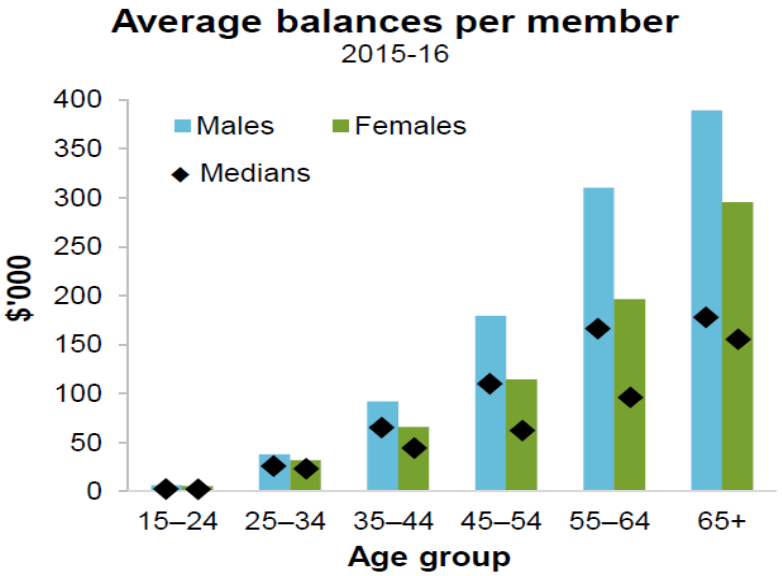
Complexity and member (dis)engagement

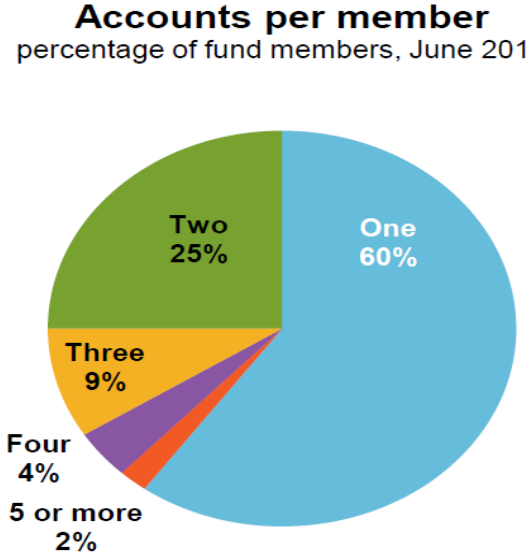
- Active engagement low (change funds, investment options, extra contributions, pay for financial advice)
- Passive engagement higher (contact fund, use online calculators, access member online)

Strengths (coverage) and weaknesses (multiple accounts)

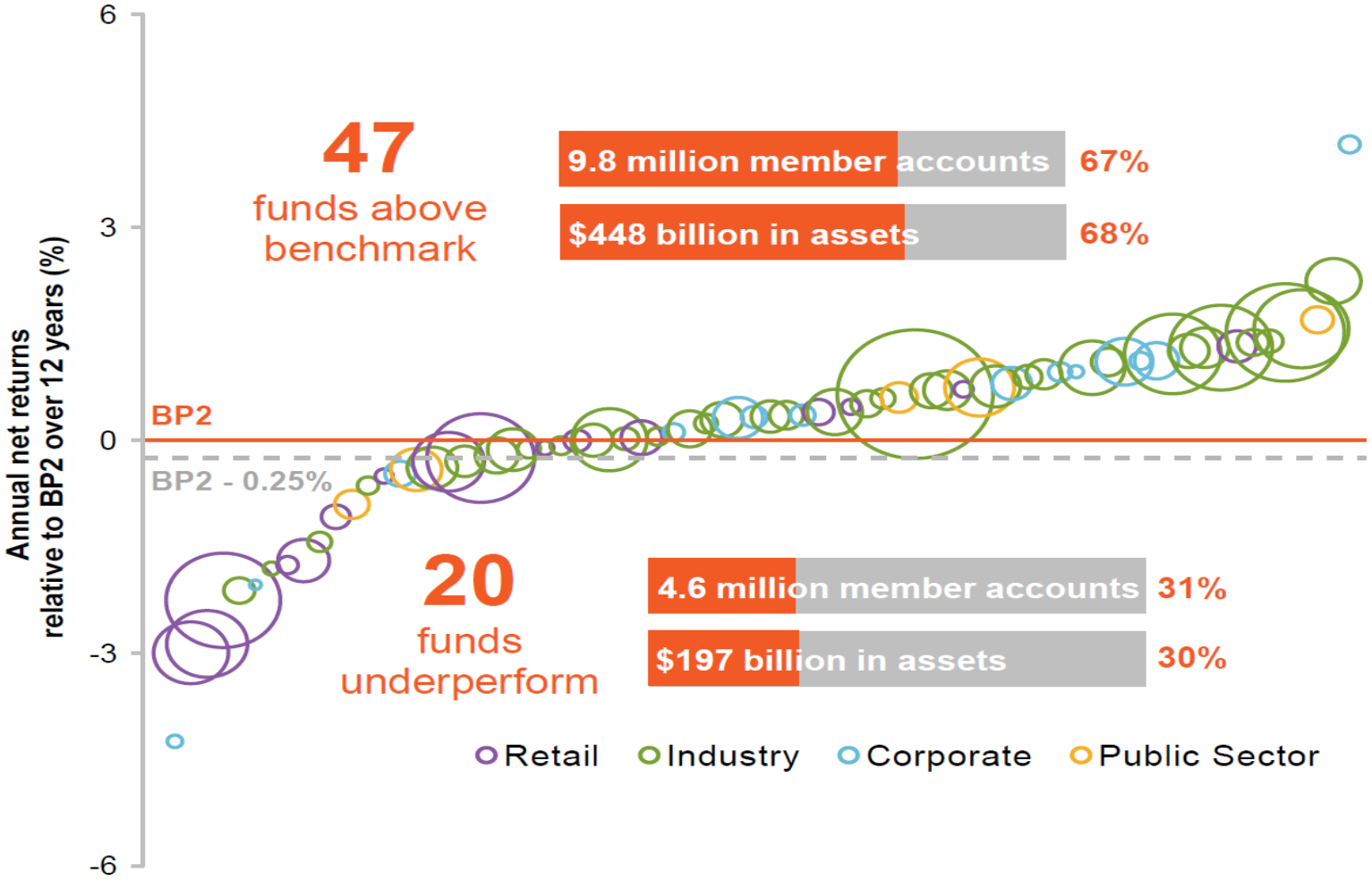






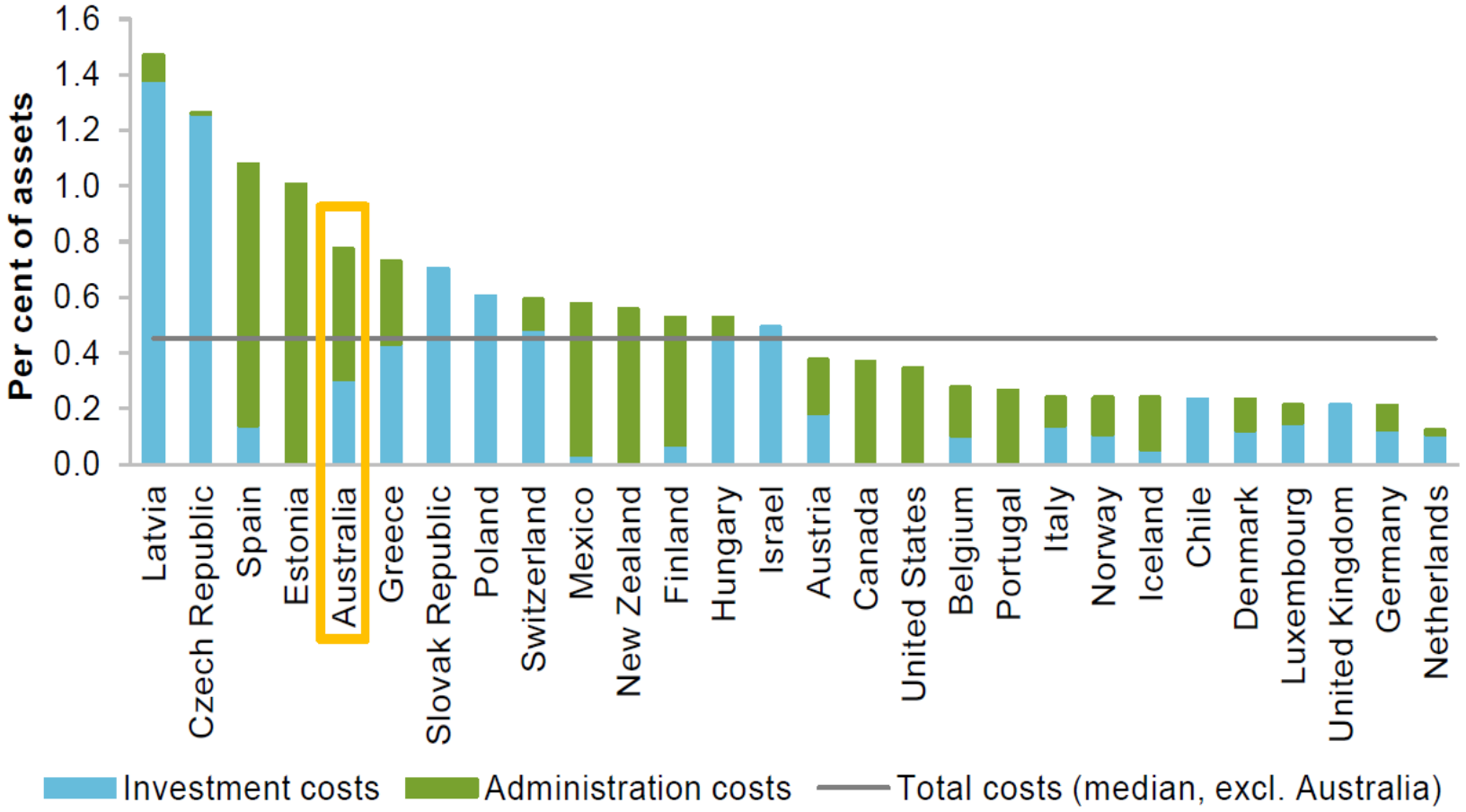


Weaknesses (allocation to low performing MySuper)



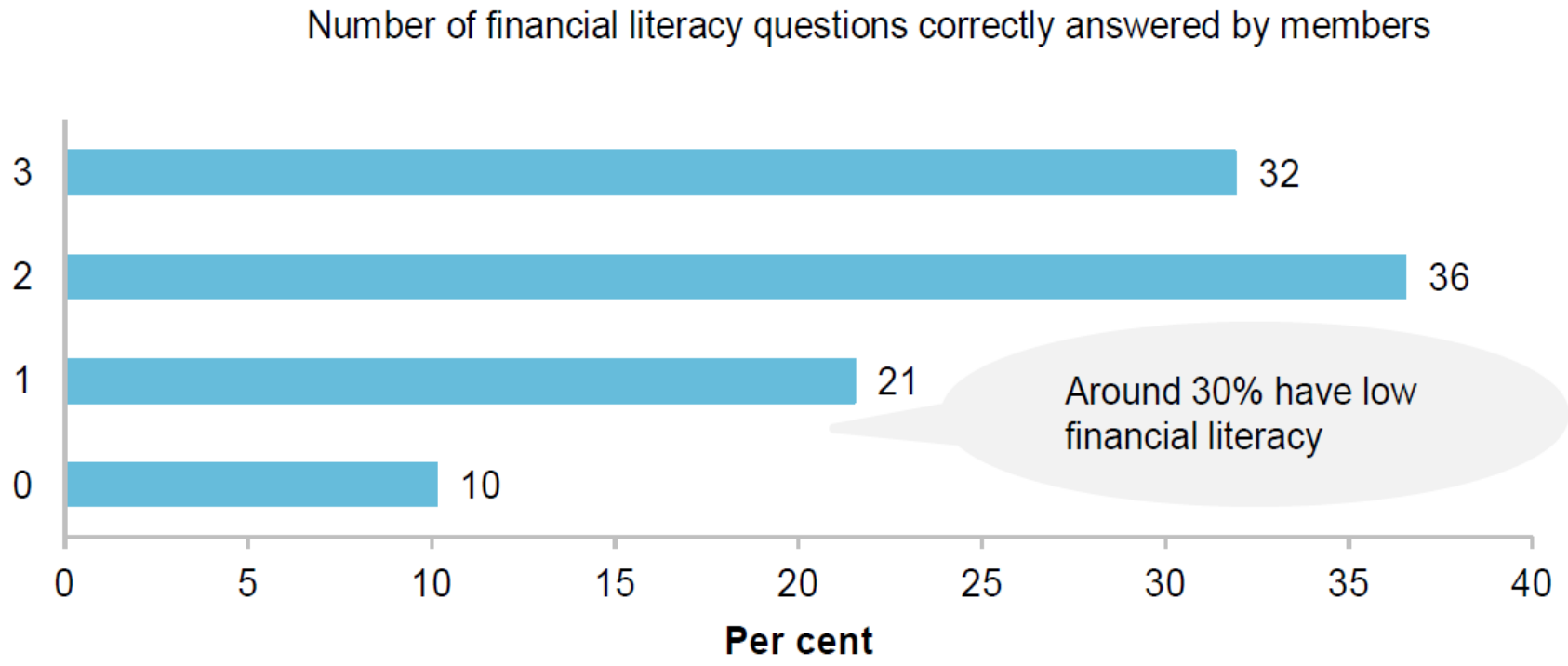
Source: Productivity Commission Draft Report (2018)

Weakness – high costs (as % assets under management) above OECD average



Source: OECD (2017)

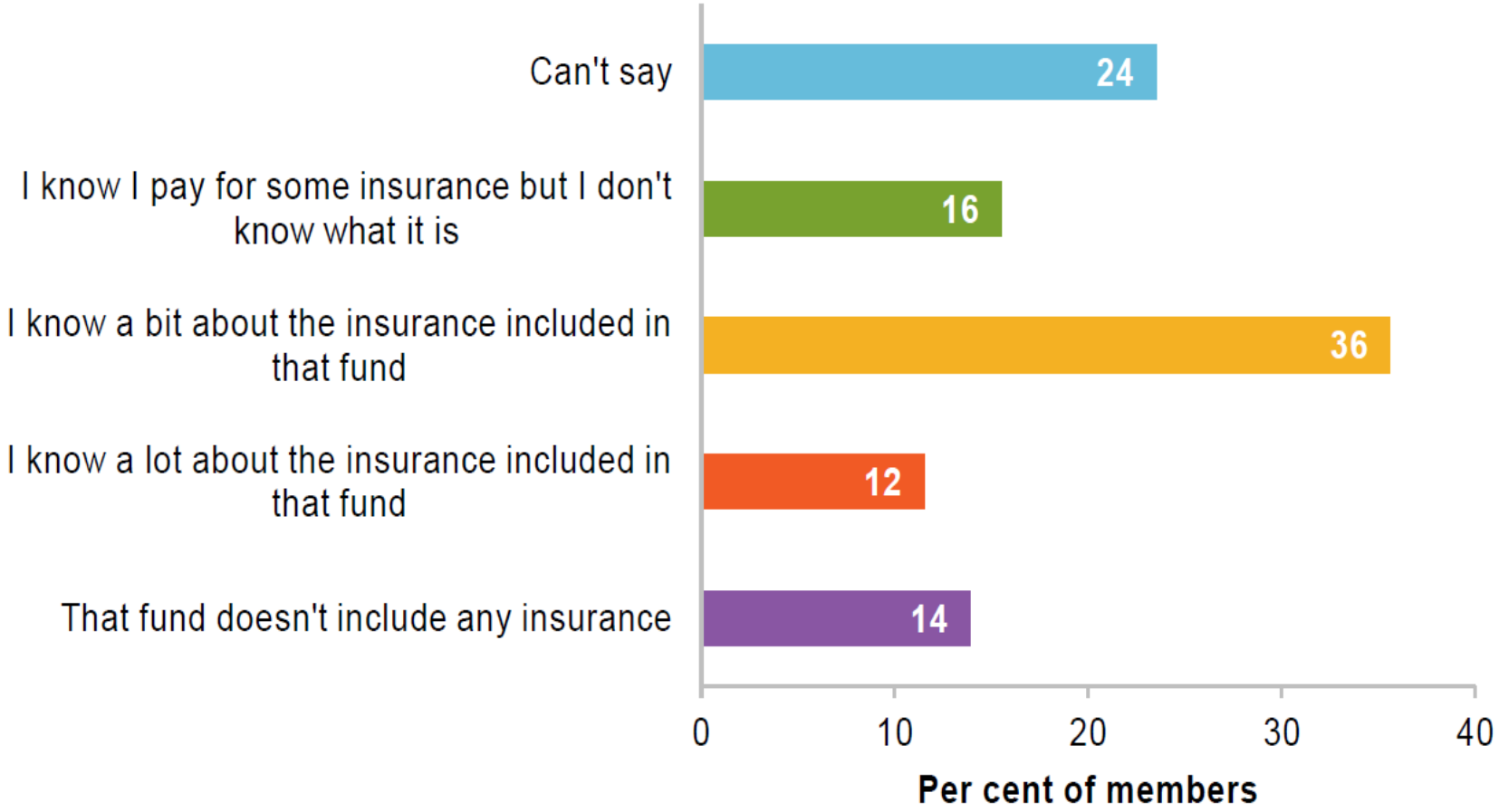
Weakness – moderate levels of financial literacy



The three financial literacy questions test knowledge of interest rates, inflation and risk diversification

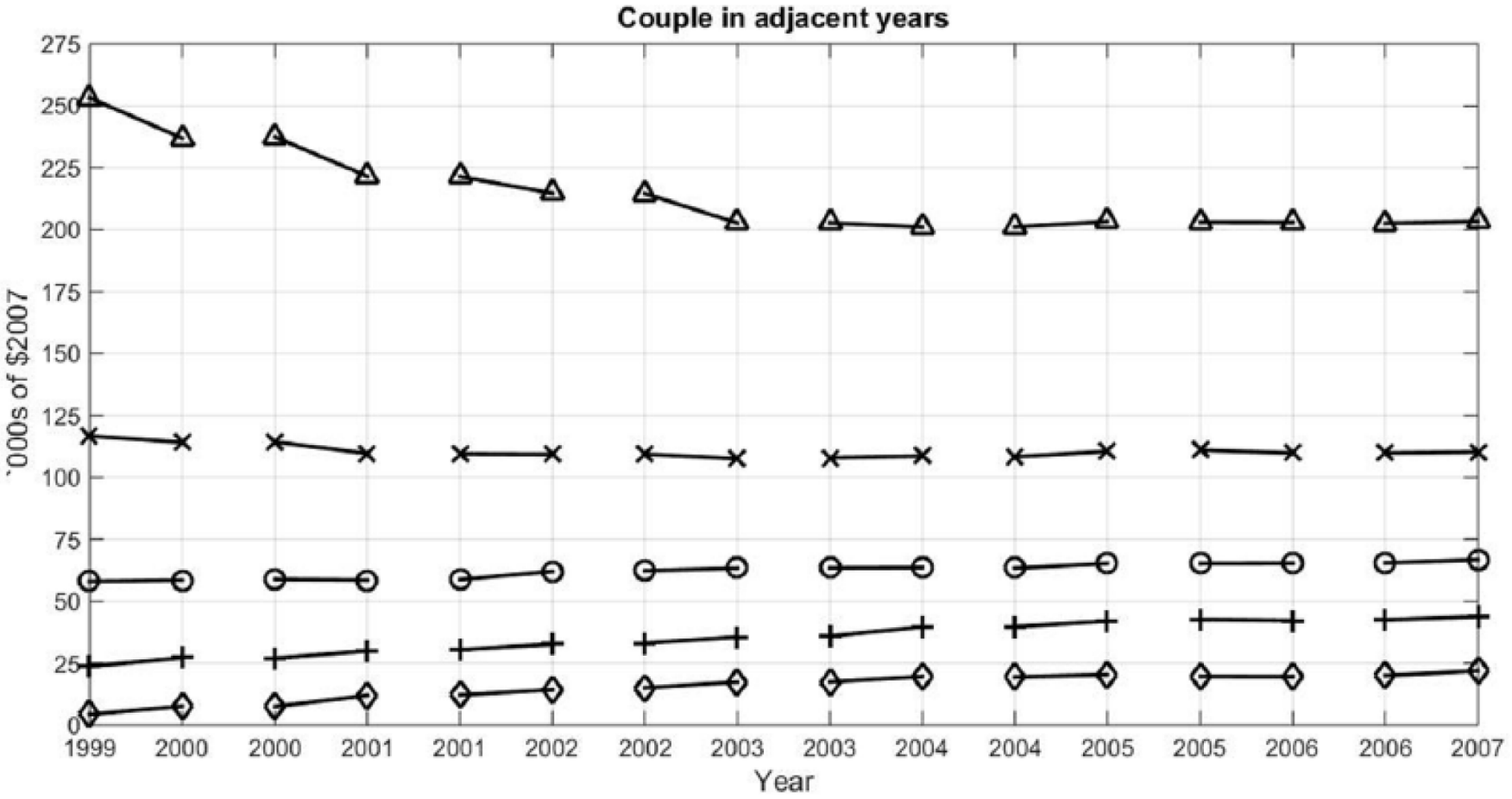
Source: Productivity Commission Draft Report (2018)

Weakness – poor knowledge of system (eg, insurance in super)



Source: Productivity Commission Draft Report (2018)

Weakness – retirees continue to save in retirement



Source: Asher et al. (2017)

Current policy initiatives

Current policy initiatives

- Benefit choice:
  - New products on choice menu
  - In progress → choice framework to involve 'offer' of a CIPR (retirement benefit with longevity and flexibility)

- Process for allocation to MySuper default:
  - Productivity Commission Draft Report: Assessing Efficiency and Competitiveness (May 2018) proposes choice or random assignment to a MySuper default from one of 10 short-listed superannuation funds
  - Recommendation to government not government policy

Productivity Commission draft report: Efficiency and Competitiveness in superannuation

Aims include:

- Facilitate downward pressure on fees
- Address MySuper default 'lottery'
- Address dissipation of account balance by multiple accounts & inappropriate insurance

Proposes NEW default mechanism for fund/investment option

- Remove role of IR and employers from default MySuper decision
- New entrants to labour force asked to choose a MySuper fund from a list of 10
- List of 10 chosen by independent, expert panel every 4 years
- If no choice → randomly assigned to 1 of the 10
- Propose online comparison tools to assist decisions

Draft report released May 2018 for consultation → Final by Nov 18

Questions