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Adequacy and the Australian Superannuation System

A Deloitte Point of View 2014

June 2014

Executive Summary
We must do better for retiring Australians

Funding retirement in Australia is a three-tiered system that is predicated on the compulsory superannuation guarantee system, introduced in 1992, as well as the public pension and voluntary private savings.

In this paper we focus on the Australian superannuation system, a huge national investment that, despite its international acknowledgements, is still not providing those Australians who rely on the Superannuation Guarantee (SG) with sufficient funds to retire comfortably.

In 2013 Deloitte released its biennial '*Dynamics of Superannuation*' projections, which showed that the Australian system continues to grow and is predicted to reach close to $8 trillion in 20 years' time. Despite this growth, its accumulated funds will still fall far short of providing a comfortable retirement for most retirees. In fact, the problem is getting bigger as Australia's aged population dramatically increases, and significant numbers of Australians live to what has been historically considered extreme old age.

Moreover, the system in its current form devolves all substantive risks onto individual members. Retiring members, especially those with relatively small superannuation balances, are particularly vulnerable to the impact of short-term downturns in investment markets – dramatically highlighted by the GFC.

As we consider this in more detail, we identify issues within the system that inhibit Australia's much vaunted and internationally recognised compulsory savings system from achieving its most basic objective: To satisfactorily provide a reasonable standard of living in retirement for an ageing Australian population.

The 2014 Federal Budget – proposed changes

To manage some of these issues, the 2014 Federal Budget has proposed increasing the eligibility age of the Government pension to 70 years by 2035 for all Australians. This is an understandable change and one foreshadowed in Deloitte's 2013 Dynamics of Superannuation paper. The previous Labor government had proposed age 67 by 2023.

At the same time, it was announced that the SG will also go to 9.5% from 1 July 2014, but would then be frozen until 30 June 2018. At this time, it will increase by 0. 5% each year until it reaches 12% in 1 July 2022 – a year later than originally proposed. Although this means it will take longer for people to build up their super (the Labor government had flagged 2019 as the 12% SG date), the long term impact on superannuation savings individually is expected to be quite limited.

Despite these changes Australia still needs to better address adequacy in retirement. Unless people work longer their superannuation accumulation will be inadequate. The *Dynamics of Superannuation* research shows that even in 20 years' time, at least 75% of retirees will still receive all or part of the age pension under current eligibility. Much more must be done.

What is needed?

A **comfortable retirement** depends on:

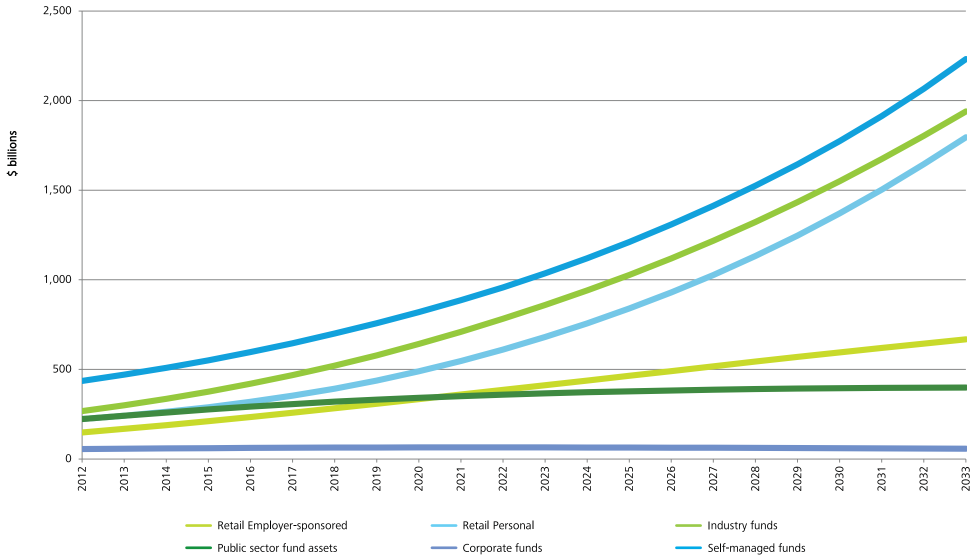
- The accumulation of sufficient funds to last throughout an increasingly long retirement by means of a combination of contributions and investment income.
- Access to appropriate investment products so as to protect members from unacceptable risk and to conserve capital during retirement.
- Better informed Australians able to understand and make good decisions about the financial challenges that retirement poses in the 21st century.

What can be done?

- **Government** can adjust policy settings so that the system:
  - Operates much more efficiently and fairly for the majority of Australians.
  - Prioritises the very long term nature of superannuation over short term budgetary considerations.
  - Increases direct competition among funds for members thereby improving benefits for members.
  - Becomes more efficient and more focused on delivering to member needs both before and during retirement.
  - Better integrates superannuation savings with the aged pension.
- **Superannuation funds** can be much more innovative in:
  - Educating members so individuals can extract maximum value from the system as early as possible.
  - Offering retiring members products that recognise, and better reflect, their individual and differing circumstances.
  - Directly helping members manage investment, inflation, timing, and longevity risks that the system has imposed on individuals.

This will involve building custom investment options geared to risk mitigation and management that is supported by an effective pre-retirement program of education, assistance and advice that triages members into suitable product offerings for their benefit.

Table 1: Superannuation assets by market segment 2012-2033



Source: Deloitte Actuaries & Consultants, 2013

- Members must accept the reality that given that superannuation contributions, even at 12 percent, are not enough, they need to:
  - Take more ownership, and be more involved in their own retirement planning
  - Seek help to make informed decisions regarding:
    - How much to contribute
    - The amount of insurance they should have
    - How their superannuation savings should be invested
    - When they should retire from the workforce and the form of benefit they should take.
  - Revisit these decisions as personal circumstances alter, particularly when they have more disposable income in the later part of their careers.

The 2014 Financial Systems Inquiry

Given that Australians aged over 55 now account for two-thirds of all financial planning clients, as well as four out of every five dollars under advice, the quality of financial advice given to this group likely to garner significant focus in the Murray Financial Systems Inquiry. This will be compounded in years to come by the aging population and generational wealth differences, with the Australian Bureau of Statistics calculating that the number of retirees and pre-retirees is set to grow from 6.2 million to 7.9 million over the next 10 years. Therefore, the economic importance of this group will continue to increase.

Regulating advice, and regulation in general – whether it is the amount of capital financial institutions are required to hold under the global Basel III rules, or the overlap of the ATO, APRA and ASIC; or whether current tax regulations encourage investors in distorting their super saving allocations – will all come under the remit of Murray's Inquiry. And with 270 submissions to inform the preliminary report we can be assured it will be a comprehensive review with some game-changing recommendations.

The bottom line

We simply cannot sit back and let the future take care of itself. Immediate and coordinated action is needed from government, superannuation funds and the industry to innovate to meet member needs. In addition individuals must stand up, be involved, and be better informed to be able to take on personal responsibility for their own retirement.

The Journey

Government knows that Australia's ageing population and increases in life expectancy represent a financial burden beyond the resources of Government alone. Australian retirees will need to rely more and more on their own retirement savings.

This was the genesis for decisions taken more than 25 years ago when Australian superannuation was recast into the industry as we now know it. Compulsory super obliges Australians to save for retirement and in the process shifts some responsibility for delivering an acceptable standard of living in retirement from the central government to the individual. From relatively small beginnings, superannuation has grown to an asset pool in excess of $1.8 trillion (as of December 2013) held on behalf of Australians and is on its way to almost $8 trillion over the next 20 years.

What was true in 1992 is even more relevant today. The Australian population is ageing faster than ever. Over the next 20 years the number of Australians aged 75 and above will more than double. We will also live longer than ever before with life expectancy at age 65 increasing by one year, every 10 years. Each of us will need to save more for our superannuation so that it can last longer than previously predicted.

It appears that, 25 years on from the introduction of SG, we are still well short of meeting the needs of retiring Australians.

Today's Reality

Have no doubt, superannuation balances for the overwhelming majority of Australians retiring in the next few years will be nowhere near sufficient to provide even a modest retirement lifestyle - let alone a comfortable one.

The Australian Superannuation Funds Association (ASFA) publishes useful benchmarks on the amount of income that Australians would require to enjoy a modest or comfortable lifestyle in retirement. In the following table we have estimated the amount of superannuation benefit that would be needed at age 65 to provide that income.

Table 2: Amounts needed at age 65 (2014 dollars)

	Males	Females
Modest lifestyle	$340,000	$370,000
Comfortable lifestyle	$610,000	$680,000

Source: Deloitte Actuaries & Consultants

Poorer Australians will need more still

Although these numbers may seem large, they need to be put into context. The modest lifestyle amounts will only deliver an income of about $450 per week for single retirees, and more than 80% of this is earmarked for essentials, including food, utilities, clothing, transport, health, and home maintenance. In consequence little is left for leisure.

The comfortable lifestyle is set at $813 per week. Even this is not a lot. Only just over a quarter of these funds are available for leisure. It certainly does not allow for an extravagant or luxurious lifestyle. The fact that ASFA income standards presume that the retiree owns his or her home outright and is in good health, is also often overlooked.

Those with a mortgage, or in rental accommodation, will need more savings still. And those in poor health will certainly need to use their savings to meet rising health costs.

Yet, these same people are often likely to be those with even less super than average.

Actual shortfall and gender differential

The superannuation savings of most retiring Australians, male or female, are only a fraction of the amounts needed to meet the ASFA standards. And females, who often spend more time out of the workforce and have greater life expectancy, are even further behind. Table 3 draws on numbers from the APRA statistics. These are averages – many Australians have even less super.

Table 3: Average account balances (June 2013)

	Males	Females
Age: 60-65	$114,000	$94,000
Age: 66+	$151,000	$133,000

Source: APRA

An explanation often used to explain why emerging benefits are so low is that the system is still immature. Those retiring now have not had the benefit of the full Superannuation Guarantee over an entire working lifetime – and so reason assumes things will get better. The reality is much more complex.

Inadequate benefits are a long term reality

In *Dynamics of the Australian Superannuation System: 2013 -- 2033*, Deloitte analysed elements of growth in the system and emerging benefits for individuals. Deloitte projections revealed that the retirement benefits for the next 20 years will continue to fall well short of the amount needed to wholly support most Australians into their old age.

The sobering conclusion is that even with the planned increase in superannuation guarantee contributions to 12%, most Australians retiring as far into the future as 2033 will find their super to be materially short of providing a comfortable lifestyle. For many a 'modest' lifestyle will still be aspirational.

Retiring Australians are especially vulnerable to short term factors

A sustainable superannuation system must do more to protect members from the impact of events that, while of short duration, can permanently damage their retirement in the long term. Despite the fact that both Government and industry professionals extol the strength of the Australian superannuation system and how well it compares with those in other developed economies, recent history – the Global Financial Crisis – demonstrates that the 'odd hiccup' in equity returns can lead to a lot of long lasting individual pain. Sadly this falls heaviest on those least able to cope with it – people retiring with relatively small balances that they rely on to survive.

The GFC hurt retirees

The GFC dealt a triple body blow to retirees as accumulated benefits reduced, low interest rates also reduced income from capital protected assets, and there was a steady increase in the cost of living.

The years immediately following the GFC were also not kind to investors. And they were especially tough for those retiring. Markets were predominantly flat, often negative. Only in the last year or two have superannuation fund returns rebounded into double-digits – in line with markets.

Low interest rates may be a windfall for those paying off their mortgages, but they dramatically hit the wallets of pensioners and retirees. In this climate, even moderate inflation, within the RBA target range, causes pain and hardship as retirees draw on dwindling savings to meet day to day expenses.

For the super system as a whole, increases in total benefit payments and a definite slowing in the growth of post-retirement assets, has meant that retirees are drawing down their diminishing superannuation balances faster.

To compound matters, the Government has decided to reduce concessional contribution limits, which has particularly impacted those aged 50 and over. This has meant it is even more difficult for those close to retirement to claw back reductions to their super balances.

Despite this, the superannuation industry as a $1.8 trillion whole, can legitimately state that the GFC storm has been weathered. The system, at least in aggregate, is back on its long-term path of steady growth. Headlines suggest economic conditions have generally improved, although economists give no guarantees.

But this ignores the plight of those Australians who, sometimes involuntarily, retired over the past few years, or who are now approaching retirement. They face the reality of not just an inadequate superannuation benefit, but also a benefit that is much less than they had expected just a few years earlier.

APRA stats confirm the pain

APRA statistics show the 'average' superannuation balance of super fund members at various ages each year. We need to be careful how we interpret them, given there are many multiple balances, and reporting is not always 100% accurate. Nevertheless they paint a picture of how the system is changing at an individual member level.

In table 4 we show numbers of those approaching age 65 and of those continuing in the super system at older ages.

Table 4: Average Super account balance

30 June	60 - 65 female	60 - 65 male	66+ female	66+ male
2013	94,000	114,000	133,000	151,000
2012	88,000	*103,000*	120,000	134,000
2011	86,000	102,000	116,000	130,000
2010	76,000	88,000	110,000	120,000
2009	72,000	84,000	97,000	110,000
2008	77,000	89,000	102,000	114,000
2007	81,000	*98,000*	103,000	121,000
Increase: 2007-2012	**8.6%**	**5.1%**	**16.5%**	**10.7%**
CPI increase: 2007-2012	**14.5%**			

Source: APRA

In 2007 the average balance for males aged 60 to 65 was $98,000, well below the amount needed to finance even a modest lifestyle in retirement. Fast forward five years, those now aged 60 to 65 have spent an extra five years in the system contributing 9% each year. For someone on a wage of $50,000 this would mean an extra $20,000 in contributions. Those retiring in 2012 were, on average, getting much less in real terms than those retiring five years earlier – despite the extra contributions.

The 2013 rebound came too late for many

Throughout 2013 equity market values increased substantially with fund returns well above 10%. Returns in 2014 may also be very good. Historically this is the cycle – see Table 4. Bull markets succeed bear and vice versa. Over the long term, returns tend to average out.

However for those people who retired after the GFC their superannuation benefits were simply too small for a long-term view. They had to draw down their benefits to live. They could not wait for the recovery to come. When it did, it was too late.

These events are not 'one-offs'

Brushing aside the GFC as a 'once-in-a-lifetime' event and suggesting we should not read too much into its impact on the relatively small numbers who retired at the wrong time is incorrect. The reality is different. In the mid-70s, super funds experienced negative returns. A $100,000 invested on 1 January 1972 would have reduced by 30% over the following 34 months. In the same period inflation was 37%. For those retiring at the end of 1974 the purchasing power of their superannuation savings would have halved in just three years.

The bottom line

If we leave the system in its current form then members need to contribute more – much more. Deloitte calculations suggest each person needs to put an extra 5.5%-7.5% of salary into superannuation each and every year of their working lifetime. Even then we need the industry to innovate and help members to better manage the many risks that they are being asked to bear.

Coordinated effort from government and the industry is essential.

The contradiction embedded in Australian superannuation

Over the past 20 years, the superannuation system has passed on the impact of most key risks to individuals. Yet this has been done without simultaneously arming members with the essential knowledge to understand these risks or product offerings to enable them to properly and easily manage those risks. In fact, as an industry, we have encouraged members to not get involved.

Risk has been steadily passed to individuals

The days of the defined benefit funds, when investment and inflation risk were essentially pooled and borne by the sponsoring employer, have gone. Changing work patterns, accounting standards, and much more volatile markets have meant that defined benefits have been wound back and replaced by more flexible defined contribution plans where inflation and investment risk directly impact individual members.

Australia has continued to almost universally provide lump sum benefits and consequently individual members also bear longevity risk. Fewer Australians now qualify for a superannuation financed lifetime pension than in 1990. Individuals also wear the consequences of retiring at the 'wrong time' – an example of what the industry terms sequencing risk.

The once popular practice of smoothing investment returns over three to five years has been discouraged to the point where it is now rare. This is not a bad thing, but unless those members approaching retirement actively invest to protect their accrued entitlements, it does expose retirees to falling benefits and a reduction in retirement living standards. With most members investing in defaults, this means funds should introduce products that more actively manage risk at an individual level. However most do not.

Australians are still not obliged to be involved in their super

The super industry is vocal in bemoaning the lack of engagement of most Australians in their superannuation. To be fair, we know that the industry does spend a lot of money and time trying to communicate with members -- albeit with disappointing results.

Much of the material members receive is complex, driven by compliance with complex regulation, and ends up unread.

Yet fundamentally, the Australian system has – at least partly – designed this regrettable lack of involvement into its DNA. The system is predicated on a sequence of decisions taken by institutions on behalf of individuals on the assumption they are either unable or unwilling to make their own decisions.

Currently there is nothing in the system that obliges Australians to take personal ownership of their superannuation and so get the most out of what is on offer.

- When joining the workforce or changing jobs, most of employees are offered membership of the 'default fund' selected by the employer or nominated under an award.
- On joining any fund, superannuants' contributions will be put into the 'default investment option' along with the money held for more than 50% of other Australians.
- Most funds offer a basic level of life and disability insurance cover that employees automatically sign up for, unless they opt out.
- The Government has made contribution to superannuation compulsory – 9.5% of Ordinary Times Earnings from 1 July 2014. The employer pays the levy directly into the fund on the employee's behalf, and then invests it usually in an option also not chosen by the employee. Employees know that super is 'looked after automatically', and many take little or no further interest.

Trustees put much thought into 'default' arrangements but it is often based on the 'greater good', or typical member, with an investment strategy appropriate to the long term as well as the needs of the majority. Generally they are not bad. But, it will be coincidental if the arrangements actually deliver what each individual needs or wants. This is especially true as a member approaches and enters retirement with inadequate benefits and exposed to risks that can be devastating.

The bottom line

As it stands Australia's superannuation system will deliver inadequate retirement benefits into the foreseeable future. But the issues to be addressed extend well beyond this single, albeit important, matter.

The system exposes individuals to fundamental risks without arming them with the knowledge or ability to make informed decisions. In fact, the safety nets in the system allow Australians to remain disengaged throughout much of their working life. Funds do not necessarily provide their members with the range of products to manage those risks. This is especially concerning when members are close to retirement.

Continuing the status quo will mean that Australians retiring now, and into the foreseeable future, will need to draw on the aged pension to meet part, perhaps most, of their needs in retirement.

Many barriers to retirement adequacy

Many factors act to frustrate the ability of individual Australians to accumulate sufficient assets through their working lifetime to provide them a comfortable lifestyle in retirement. Those mentioned here are not exhaustive but they do point towards the actions required from both government and the superannuation industry.

Many Australians lose their jobs/retire when they can least afford it

Employment in the 21st century is conditional on both the individual being able to do their job well, and the capacity of the employer to continually adjust to a rapidly changing world. Unemployment can occur, even for very good employees, and may do so when an individual is at their most vulnerable. It can also last for a long time.

In addition, we do not save for retirement when we are out of work. The facts are that many Australians will spend time out of the workforce and returning to the workforce gets tougher as you get older. Many Australians do not choose when to retire. If this occurs at the wrong time – as in the wake of the GFC – the retirees can find themselves in desperate straits.

Of the obstacles that stand between each Australian and a comfortable retirement, many are simply the vagaries of life, however some are more directly related to the structure of the superannuation system.

1. Periods of unemployment, redundancy and forced premature retirement are facts of life for many.
2. Women who spend time out of the work-force raising children do not receive contributions for this work.
3. As we live longer than ever before, with costs that can rise dramatically in advanced old age, we need larger retirement benefits.
4. We also need super funds to develop products that are more attuned to the needs of retirees and which better allow older Australians to manage and conserve their superannuation.
5. A lump sum superannuation system is not efficient, especially when we have no idea how long the lump sum is needed to last. Those that live to an advanced age run out of money while residual assets for those dying young often fall out of the system.
6. Australians do not contribute enough to super, even with current tax incentives (and tax limitations for older workers). The current contribution limits focus on each year and pay no regard to total contributions paid into the system or the level of benefit accumulated vis-à-vis what is reasonable.
7. Most Australians are not involved in their super. They have little idea of the challenge they will ultimately face. Traditional advice models have bypassed the majority of Australians and for those who have received advice it has often been too late.
8. A fixation by both employees and employers with age 65 as a universal retirement date.
9. A bias towards youth among employers as evidenced by the difficulty that over 50s have in re-entering the workforce.

Women are further disadvantaged

Women can spend long periods out of the workforce raising families which puts them even further behind. Superannuation contributions rank far down the list of priorities and consequently women retire with far less in their account than males and yet they live longer and so need to accumulate even more than otherwise identical males.

Table 5: ASFA retirement standards and lump sums required at age 65

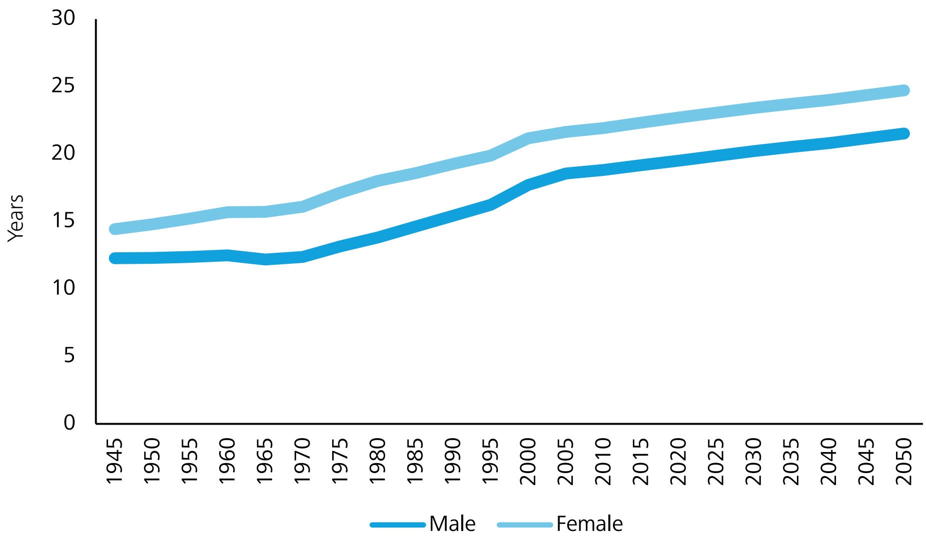
	Modest lifestyle in retirement		Comfortable lifestyle in retirement	
	Male Age 65	Female Age 65	Male Age 65	Female Age 65
ASFA Standard Income pa	$23,283	$23,283	$42,254	$42,254
Required lump sum at retirement*	$340,000	$370,000	$610,000	$680,000

** Rounded to the nearest $10,000*

Australians are living longer than ever

The average time in retirement has increased by more than 50% since 1947. Table 6 demonstrates the point.

Table 6: Residual life expectancy at age 65

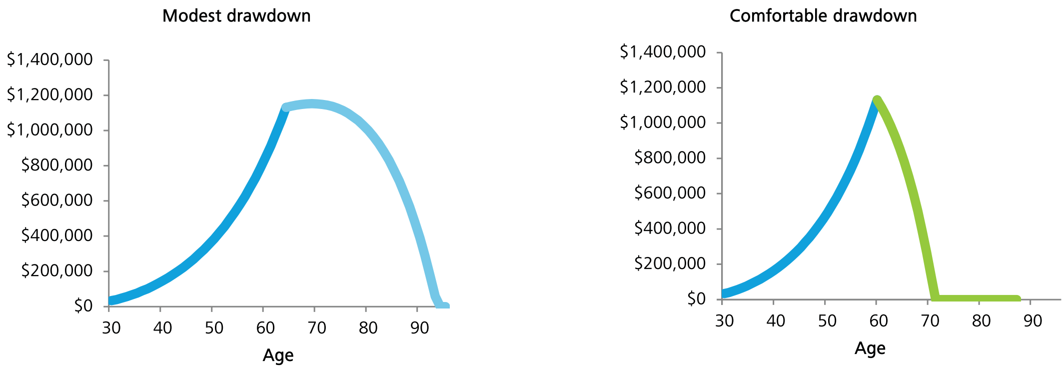


Source: Australian Life Tables – actual and projections

It is continuing to increase. We need more superannuation because it has to last much longer. Similarly, the cost of the aged pension is getting greater and greater.

In our 2013 *Dynamics of the Australian Superannuation System* report we showed that projected benefits from superannuation for a person retiring at age 65 in 2048 would not be enough to provide a comfortable lifestyle throughout retirement. In fact superannuation will run out for most Australians.

Table 7: Projected account balances



Source: Deloitte Actuaries & Consultants, 2014

Rising cost of living at very advanced ages

Health and aged care costs increase rapidly as we enter advanced old age. These costs can rapidly eat into remaining savings resulting in a large, rapidly increasing, burden on the public purse as Australians outlive their savings.

Lump sum benefits result in 'leakage' out of the system

Australia differs from many other countries in making very little use of lifetime and reversionary annuities. Lump sums do not generate guaranteed income throughout a retirement of uncertain length. On early death after retirement, any residual benefit remaining passes to dependants or to the estate.

At the same time we have a means tested social security safety net expressed as a lifetime pension. Delivering lump sum benefits out of the superannuation system encourages Australians to dispose of their lump sum in a way that will increase their ability to access the aged pension.

As it stands, the aged pension and superannuation as part of an overall 'retirement system' have become very difficult to integrate efficiently creating a greater cost for genuine retirement provision than necessary.

If the superannuation system produced a lump sum sufficient to generate a comfortable income for each person over their expected lifetime, we would need much more than $7.6 trillion in total assets in 2033.

Because each person has their own lump sum account we know that the superannuation for those that live a long time, and more than average, will run out. The flip side is that some will die younger than expected and will not use all of their superannuation – but the system as it stands, cannot access this left over to help pay for those that live longer than average.

We calculate that between 10% and 15% of the total pool held at retirement could leave the system in this way.

Australians do not contribute enough to superannuation

Australians need to contribute more to super. The Superannuation Guarantee contribution will still be insufficient when it increases to 12% of salary.

Deloitte calculates that males should contribute an extra 5.5% and females 7. 5% of salary, in addition to the 12% each and every year both sexes need to contribute through their working life in order to self-finance a comfortable retirement.

We know that many industry people would like to see the Superannuation Guarantee increase to the original 15% posited by the system's architect former Prime Minister and Treasurer Paul Keating – so well beyond the currently legislated maximum of 12%. In some respects this is easier than 'encouraging' individuals to voluntarily save, but it does also potentially increase the cost of employment.

Contribution caps make the problem worse

We all understand the need to place some limit on the contributions that attract a tax deduction. But the limits need to make sense.

There have been many different regimes for limiting tax-deductible superannuation contributions in the past which have created uncertainty, inequity and discouraged retirement savings. Australians have tried to navigate multiple Reasonable Benefit Limits, specific contribution limits with some dependence on age, surcharges, and – most recently – on/off again indexation of the limits.

The limits are now assessed year by year, with no scope for claw back to compensate for periods out of the workforce, or for different lifecycle stages.

There is limited and inadequate scope to top up super in the years approaching retirement to finance a comfortable lifestyle.

In the current system, if you fall behind, then you are left behind.

The usual course is that Australians have their SG contribution paid into a default fund, invested in the default option, with the basic levels of death and Total and Permanent Disablement (TPD) cover. Extra personal contributions are paid by a minority of fund members.

As people approach retirement and come to face with the grim financial reality that it represents, their ability to contribute and to make up for the lack of past contributions is effectively hamstrung by the annual limits imposed by the Federal Government. It therefore makes sense to recognise this and recast legislated contribution limits in a way that reflects the reality for most Australians.

Lifetime contribution caps are more rational, much fairer, and relate more closely to the amount of super an individual will accumulate.

Australians do not receive financial advice … until too late

Financial advice has historically been a 'face to face' labour-intensive costly service. Planners therefore have targeted those with the capacity to pay, generally those with the larger benefits or assets, as well as those approaching retirement.

However things are changing.

Super funds are now much more active in offering advice. The concepts of limited and intra-fund advice hold out the prospect of more cost effective advice for many more Australians considering the level of contributions, appropriate investment options, amount of insurance, etc. But it is still too little.

Adviser groups, including those operated within superannuation funds are also being innovative. Advice in Australia is being 'digitally disrupted' as new ways are being developed to deliver advice to Australians in almost real time and at minimal incremental cost.

Where is your next worker coming from?

Only a relatively few Australians will be able to retire before 65 with enough set aside to provide for an adequate retirement. The reality is that most will require work and these people are a valuable resource for the country and for businesses that decide to make use of it.

Yet job participation after age 55 falls markedly, and most Australians will have retired by age 65.

There is a clear case of opportunity meeting need with benefit for individuals and for Australia.

The first in Deloitte's 'Building the Lucky Country' series – Where's your next worker? highlighted that the problem for Australia in the future won't be a lack of jobs, it will be a lack of workers. We will desperately need to find extra workers if we are to fuel economic growth. By 2050 one in five Australians will be over 65, compared to just one in seven in 2010.

There is limited scope to increase workforce participation among those aged 15-54 as it is already high. However those aged 55-70 represent a huge pool of untapped talent.

What Government can do

The ageing of the population represents a massive future economic time bomb. Government cannot rely on future generations of working Australians to finance even a modest retirement lifestyle for baby boomers and younger generations. The SG contribution ensures some super for most people but it is insufficient. Current working Australians must somehow save more for their own retirement so as to reduce the burden on future generations.

Current policy settings, both within super directly and more broadly, will not do it. They are not enough.

Government policy settings can assist the super system to deliver better retirement benefits and encourage individual Australians to better plan for their own individual retirement, or they can frustrate that aim and condemn Australian reliance on the aged pension into the foreseeable future.

1. Where practical, encourage, but not force, Australians to work beyond 65 and employers to employ older Australians including those of pension age
2. Encourage higher contributions into super. Be serious about this:
   a. Look at lifetime limits rather than year to year
   b. Be realistic in setting the limits and ensure that they are indexed. You need a lot to retire on an adequate income
   c. Do not chop/change and so destroy trust in super.
3. Make it simple and easy for members to access independent advice
4. Facilitate access to deferred and lifetime annuities. This will not happen on a wide scale without Government action. It makes sense in a number of important ways:
   a. It will enable better integration with the social security safety net
   b. It removes a major inefficiency in the current system that sees major outflows from the super system
   c. It is far and away the best way to address longevity risk.

   There is a case for Government to go further and move to a genuine income-based system
5. Gradually de-emphasise those features of the system that allow, and indeed encourage so many Australians to passively sit by and allow others to make decisions on their behalf in the belief that their super will take care of itself. This must be done in tandem with:
   a. Providing people with the tools and the information to make good decisions. It can begin in Schools and be supported by the superannuation industry; and
   b. Prudential regulation of the industry that protects individuals from abuse: much like the MySuper legislation that provides a framework of allowed and disallowed practices.

Encourage and facilitate people working beyond age 65

The mathematics is clear. If people can work longer and save for their retirement, they will enjoy a better standard of living once they stop work. This reality lies at the source of the decision to increase aged pension eligibility to 70.

There are two prerequisites for this to happen:

1. Australians need to want to continue to work, and be physically able to work. This will not always be the case.
2. There needs to be jobs. This is an issue in three parts:
   i. Economic growth will generate jobs for many, including the over 55s, although many may well require reskilling, and will build demand for experienced workers.
   ii. Employers need to better value the benefits of retaining skilled, experienced people in their workforce.
   iii. Many occupations require physical capabilities that we lose with age, so assisting people to remain productively employed through retraining, reskilling, and redeployment is an excellent investment for Government.

The Government should continue to allow access to retirement income earlier than age 65 in appropriate circumstances. We also argue that current rules which allow access to superannuation from age 55/60 should continue for those using this aspect of the current system. Any retrospective change would have serious adverse impact for many Australians. We appeal to the financial self-interest of Government. There is a clear, and obvious, financial gain for the Commonwealth and the States and Territories in having older Australians in employment for longer.

Perhaps this gain can be shared in a way that produces jobs. Government has started the move to kick start a rethink by Australian employers of how they could benefit from tapping into what is ultimately a large and talented resource with its $5k incentive to employ Australians over 55 years of age. In some respects this would simply bring forward what will inevitably be imposed by Australia's ageing demographic.

Allow and encourage Australians to contribute more to superannuation

Government can encourage those with the capacity to save for retirement to make additional voluntary contributions into superannuation.

Tax incentives already exist but are not adequately used. Government should reassess the way in which it limits contributions into superannuation. These limits are intended to regulate/limit the amount of tax concessions claimed. While these limits have changed many times, they are essentially a limit that resets each and every year. As such they are superficially generous, as the overwhelming majority of Australians will contribute much less than these limits permit across their entire working lifetime. The annual limits directly penalise the unemployed, and women who spend time out of the workforce.

The Government needs to introduce a lifetime limit that enables individuals to 'catch up' in the later part of their working lives.

Make it simpler to access independent advice

This is not a commentary on the FOFA reforms. Rather, quality independent financial advice is of huge value to those who receive it. As a nation we want – and need – Australians to be involved in planning for and taking responsibility for the financial needs of their own retirement. They should get the most out of the superannuation system and capitalise on the best options and alternatives available. For many, the advice needed is scaled limited assistance with specific issues facing them, and not a comprehensive financial plan, which they cannot afford. This is something that the industry is now coming to grips with.

While advice should be provided within a protective regulatory framework we need to facilitate, and definitely minimise red tape which can be both a barrier and a cost ultimately borne by those obtaining the advice. We should focus on the quality of advice, its fiduciary obligations, and genuine protection against substantive risk.

Digital channels also offer innovative ways to provide intra-fund and limited advice at a very low incremental cost. Government should applaud the initiatives already under way across the industry and under the auspices of the Financial Systems Inquiry, and sympathetically review any identified impediments to increasing the number of people receiving quality independent advice.

Facilitate lifetime and deferred pensions

Longevity risk is underestimated by almost all Australians. It is difficult to manage individually in a lump sum system. The solution seems obvious, and it is one that has been adopted in many countries around the world – genuine lifetime pensions.

Our calculations have highlighted how lifetime pensions can reduce leakage out of the superannuation system, and at the same time, assist individuals to manage longevity risk.

The best way to manage longevity risk is through pooling a very large number of people and in providing them with lifetime pensions.

However this is not as simple as it sounds.

People cannot just enter or exit a pension pool at will. If this happened, very ill people would cash out, so that we would be left with only long-lived individuals in the pool. Eventually the money would run out. Long before that the pool would become insolvent–unable to meet its obligations. We need a genuine representative group, together with rules for joining and leaving that are designed to protect the financial stability of the pool.

There is a strong financial case for the Government to act to mandate retirement benefits being taken as pensions. However, it would be a big decision to take and one that might involve short-term political pain. Nevertheless there is a certain inevitability about it, given Australia's demographic future.

Changes that encouraged genuine pension benefits, together with encouraging people to purchase deferred pensions that focus on guaranteeing income in advanced old age, would have a number of advantages.

They would:

- Do much to address longevity risk.
- Lead to an even larger superannuation asset pool, generating still greater investment income and constituting an even greater sovereign asset for Australia as a whole.
- Make it much easier to properly integrate the aged pension with superannuation so that the 'incentives' to manipulate and manufacture entitlement are removed.

As a first step the Government should consult with the industry.

Foster greater member involvement:

We know that Government alone cannot provide all Australians with an adequate income throughout their entire retirement. It would cost too much. Individuals need to save for themselves. They need to understand the many risks their comfortable retirement is exposed to, and to manage those risks. And the younger they start the better.

In 2022 we will reach the point where 12 cents of every dollar of salary will be paid into superannuation. So it is critical that we strive for individuals to make a decision on super, to get involved, and to stay involved. Young Australians will need to make substantial voluntary contributions to super and the sooner they can reasonably commence the better, as they will likely have to remain in work into their late 60s and even into their 70s.

What can be done?

Education: start early and keep it coming

There are few greater financial challenges facing Australians (young and old) than that of setting aside sufficient savings to survive (if not live comfortably) in a retirement that might begin at age 40, 50 or more years and last another 40. To empower people to act, we need to arm them with the knowledge to get the most out of their superannuation. That done, we need to strongly encourage individuals to act.

This could begin at school. With imagination and purpose there are a number of ways in which Government, the industry and schools could partner to prepare Australians to make their own informed financial decisions as they embark on their adult lives. This should continue into the workforce with a healthy and continuing interest in savings, and be maintained so that we can make good decisions, reflecting our own needs, as and when necessary.

This is where the industry can improve and Government has the power to assist.

Currently much of the information that super funds provide for members is quite poor, not easily digested, understood, or able to be turned into action by members. Part of the problem lies with Government qualification, caveats, and technicalities, around a fund's websites, PDSs, and almost every communication between the fund and its members that makes it so much more difficult for members to sift, analyse, and translate information into decision making.

Simplification would empower members.

Increase competition for members: fine-tune the default fund system

There is much to admire in the arrangements that successive Governments have put in place. The framework of a number of default (now, MySuper) funds prudentially vetted and thus deemed to be eligible vehicles for those Australians who have not made any decision has definite merit. Such funds have effectively passed tests applied by the Government and the regulator to ensure that the members who join them are looked after.

However, we should not ignore some important side effects.

1. The nature of competition for members is indirect. The current system is more than just a protection for disengaged members. Through one of a number of mechanisms it identifies the specific MySuper product, or a select few products, that can be the default fund for any specific individual.

   For many superannuation funds the key business imperative is to capture default fund status under awards or via employers. Much effort is focused on this because if default fund status is won then membership and asset growth almost automatically follows.

   Established default funds are in a powerful position and it is up to them to continue to drive change and meet the competition now happening from other industry funds and the retail sector.

2. It is easy for a member to 'opt out' of any involvement in super.

   Choice of fund, investment option, and level of insured benefits are all predetermined and put in place. A member can advance on 'autopilot' through to ultimate retirement or until such time that they choose to personally intervene and make a decision for themselves.

   This is not desirable. It is not something we should encourage.

   On changing employment the member may well find themselves in a tug of war between their existing default fund and the default fund at their new workplace. This results in a form of limited competition with the existing fund going to some lengths so that it is 'easy' for a member to continue membership at the new employer, and the new default fund benefiting from the member doing absolutely nothing and joining a second fund by 'default' and, after joining the new default fund sends a form suggesting they rollover their benefits from other funds into a single account.

   This is one reason why we have multiple, inactive superannuation accounts held in the name of millions of Australians, and why there is so much effort by both government and superannuation funds to consolidate accounts.

The concept of default arrangements remains important while so many Australians are so unwilling or ill prepared to make decisions on their own behalf. However, the current system restricts competition and creates incentives for some to maintain the 'status quo'.

Government should:

- Consider ways to broaden competition between funds, and have that competition more focused on member benefits. Greater competition will of itself improve the delivery of information to members and improve decision-making capability. The result may be a phased process aiming to steadily increase the ability for any MySuper fund to be the default.
- Create an environment where more and more Australians are both willing and prepared to make informed decisions about their super:
  - Regulate to allow simpler and easily understood information to get to members from funds.
  - Recognise that millions of Australians do not see print as their medium of choice.
  - Oblige the industry to use all the tools at its disposal and to engineer processes that have the explicit aim of increasing member decision-making. Make increased decision-making a KPI for the industry, and for funds.

And of course build member decision-making capability where education is a key plank.

What superannuation funds can do: a framework for action

The superannuation fund of today was purpose-built around a default, which typically has 70% exposure to the growth asset classes on the understanding that this is likely to produce a higher long-term investment return albeit at a certain level of investment risk. This is simple enough, and reflects the focus of most funds to assist members to accumulate assets.

Issues surrounding members in, and approaching, retirement are still relatively novel for institutional funds. This reflects two important facts:

1. Many Australians retire with a small amount and benefits are used in the short term to pay off debt etc and do not stay in the system.
2. Post-retirement assets are still relatively small. Even the largest superannuation funds with millions of members only have a few thousand pensioners.

Two things need to happen if a fund member is to have a financially comfortable retirement.

1. Members need to accumulate sufficient assets before retirement.
2. They need to be able to invest their retirement benefit to best effect for their personal circumstances as they move into old age.

Funds can do a lot.
Prepare members for retirement early; the earlier the better

Funds bemoan the lack of involvement from their membership. However in reality some funds have done little to encourage members to get involved. Others have tried, but been ineffective. Some that have tried hard would be disappointed in the result.

Push websites are not the answer. Building a website, populating it with calculators and information is often both complex and convoluted and rarely user friendly.

Simple eight step framework for funds to become relevant and valued by retirees

1. Begin educating retirees well before they retire. Push educational advice and insist on participation. Be creative and diverse in scoping and directing your efforts.
2. Have investment options tailored for retirees.
3. Recognise that retirees constitute a multi-segmented population. Provide products that meet the different needs and objectives of each.
4. View and manage risk from the perspective of members, and their capacity to bear it. Deploy well-tried asset liability matching techniques, and use synthetics to innovate and deliver value to what is generally a risk-averse population.
5. Encompass exposure to investment, inflation, longevity and liquidity risk within the products offered.
6. Combine an efficient, clean and fraud protected payments system within the post retirement offering.
7. Learn from the success of SMSFs and provide, on a user pays and as far as is practicable, access to SMSF type features including:
   a. Directed investment
   b. Family unit benefits
   c. Death benefits as pensions to dependents.
8. Use purchasing power to deliver added value benefits to retirees, for example, in health and aged care.

We need to see more relevant and personalised information and assistance from the fund to an individual member. The answer is not just a benefit statement, nor a web page, or a campaign driven mail out, but material that strikes at the heart of the issues facing the individual member, and assists them to take the next step; to prepare for the critical decisions they face, and to then easily implement the decisions they make.

In fairness to funds, we recognise that for some, the ability to interact with individual members in a way that is personally relevant is constrained by the administration platform and the lack of cost-effective access to reliable and sufficient member data.

Even so, we know that it is possible to quickly overcome these limitations at a low unit cost. Funds can develop enriched, flat and granular member data engines that are adept at developing analytic insights that empower trustees to both inform members, and dramatically improve member engagement.

While this is still in its infancy in Australia we see signs that Trustees are prepared to invest in building these capabilities so that they can be more relevant to individual member needs and circumstances. Funds are increasingly prepared to offer advice to members.

All of this combines self-interest with noble purpose. The initiatives we see do promote member involvement and decisions. However, they are also seen as important member retention strategies. Many funds are concerned at levels of turnover when members change jobs, and at retirement when many transfer balances elsewhere, often to a SMSF.

Pre-retirement investment options

Nevertheless we know that many fund members, and especially young members, will leave it to their fund to make decisions for them. To this end it is very important that while default and MySuper options remain so central to the system, that they be designed with the noble purpose of maximising retirement outcomes.

This is one area where most of the main super funds have done very well for a long time. In Australia the better funds have default portfolios weighted towards the growth asset classes because these are expected to produce higher long term returns given that the investment horizon for most members is long.

Traditionally this involved about 70-75% of total assets being invested in equities and property. As the industry grew, extra weight was given to international assets and to other classes such as infrastructure, hedge funds, and private equity both domestically and overseas, and on and off market.

Design products that meet needs of retirees

Members approaching retirement are often quite short term investors. We need to meet their needs. Here the institutional funds have been less successful. Current arrangements in most funds fall well short of what is needed by retirees.

We still see superannuation funds offering the same investment options to retirees as to other members. Moreover, some of these funds still do not offer separate tax-exempt options to pensioners. There is almost no acknowledgement of the differing needs of retirees.

No wonder SMSFs are so popular!

Institutional funds need to do much more to be more relevant to retirees. They need to develop an offer that addresses the different needs of retirees and especially members' very different capacity to absorb risk. If funds do not act then we will continue to observe rapid growth in SMSFs as the vehicle of choice for retirees.

Glide paths and tax exempt portfolios make sense

Some funds have taken initial steps to meet what Trustees see as the generic needs of retirees.

Trustees, perhaps prompted by StrongerSuper, are clearly thinking about this. Some of the new glide path type options introduced have increased exposure to more volatile growth assets at younger ages to well above the traditional 70%. As members approach retirement age the asset allocation changes. Far less goes to growth.

A much more conservative approach follows.

Beyond retirement age, and as the member ages, the asset allocation glides to an increasingly conservative base.

The reducing exposure to the more volatile growth assets is intended to reflect both a shorter investment horizon and a lower investment risk appetite among older members and retirees.

In addition there is a big difference in the tax treatment of pre and post retirement assets. This difference must manifest in the very core of the way portfolios are constructed. Funds that use the same portfolio but declare different unit prices to reflect differing tax treatments are taking a far too superficial approach to tax.

We are now also seeing some specially constructed tax-free portfolios. It is about time. If a fund does not do this then we should not be surprised if retirees continue their exodus to SMSFs or to funds that do. Regulation makes clear the importance of the net of tax return in the hands of the member. It is a competitive necessity in the longer term.

But even then it is only a first step – much more needs to be done.

Those approaching and in retirement are a multi-segmented population

While each individual member is different they do tend to share some general characteristics.

In retirement or as members approach retirement:

- Appetite for risk varies but is generally less than at younger ages.
- The impact of various risks can be very different:
  - Investment risk can have a very short term focus
  - Inflation can impact in crippling ways
- There is a greater need for immediate income.
- Liquidity risk is very personal, but generally greater.
- As members enter advanced old age certain costs increase rapidly. Circumstances change, and health-related costs can soar.
- Access to health and other insurance would be valuable.
- The fund payments system must be simple, convenient, flexible, robust and fraud resistant.

Beyond this, it is much harder to characterise the investment needs of post retirees.

Funds need to segment their population to effectively assist retirees into the appropriate product for them. Individual needs can vary dramatically. A member with AUD$3 million at retirement will want different products to someone with only enough funds to last a few years.

Even then personal circumstances lead different people down different paths.

A single post retirement product or investment option will not meet the needs of different retirees. Funds require a number of options and a means to match each member to the one that is best suited for that individual.

Institutional funds have a long way to go.

Look at cost, return and risks from member perspectives

Part of the problem is that trustees and superannuation fund management do not always look at cost, return and risks (including but not restricted to investment risk) from the perspective of members.

As we examine the PDSs issued by superannuation funds for pension members we notice there is often little if any difference between the pre and post retirement default options.

In some, the two portfolios are identical with a:

- Limited number of tax exempt options
- Lack of explicit evidence of how the different tax positions of members (pre and post retirement) flow through to portfolio construction
- Little reference to the greater liquidity risk present in a portfolio where members are regularly drawing down their account
- Dearth of examples where trustees, working with their advisers, have sought to construct portfolios that explicitly recognise the range of risks that, magnified, strike directly at the savings of those in retirement.
  These include:
  - Tax
  - Investment Risk
  - Liquidity
  - Inflation

This last point attests to a lack of innovation in Australian superannuation. We know from both international and domestic cases that more can be done.

- For many years, the sponsors of Defined Benefit funds, both in Australia and globally, have carefully constructed investment portfolios that sought to lock in returns at a level while protecting accruing liabilities against a fall in asset values.
- The judicious use of derivatives and synthetics can provide members with the ability to participate in growth markets, both to improve long term returns and as an inflation hedge, while limiting exposure to market falls. Of course this comes at a cost – but for many retirees that cost is well worth the protection offered!

There are isolated examples of these skills in Australia mainly in products offered by the major financial institutions. The market instruments available in Australia and internationally offer superannuation funds much greater capabilities to balance risk and return, and to construct portfolios to more precisely meet individual needs – both pre and post retirement.

The reasons this hasn't happened more include:

- The competitive imperative has not been sufficient. Funds with default status are guaranteed to grow, and face limited competition. It is easy to stick with simple, easily constructed investment portfolios
- A 'herd mentality'. Australian funds tend to follow each other.

- Derivatives, options, and other instruments need careful management and a deep understanding of risk. Exposures must be closely monitored and controlled. We detect a lack of understanding at trustee level.

Portfolios constructed in these ways can involve higher costs: sometimes much higher costs as the price of building downside protection. Industry funds, pre MySuper, have competed vigorously on being low cost providers. Moving into what is essentially uncharted waters for them could confuse their sales message.

This is unfortunate. While costs of purpose built portfolios, especially if they involve synthetics, can be higher, this is not to say that they are expensive. It all depends on the relative importance placed on risk, downside protection versus return *by the member*.

It is those in, or approaching, retirement are generally the most risk conscious of all members. They still represent a relatively small proportion of institutional fund assets. Attention has not yet fully focused on products that meet their needs.

An efficient and safe payment system

Superannuation administration in Australia is struggling to catch up with the move to more member centric product design and the increasing demand for flexibility and choice by members. Digital technology has upped the ante and placed pressure on established players and aged platforms.

And it is only going to get tougher. It is one thing for superannuation systems to collect and invest contributions through a member's working lifetime. It is a very different thing to administer a regime of semi-regular payments to those same members in retirement. Funds can also struggle to simultaneously manage dynamic asset allocation vis-à-vis the need to maintain liquidity to meet variable demand for payments.

Poor quality member data compounds the dangers.

Huge amounts of money are involved. The temptations for fraud, as well as the risk of costly error, are compounded. Tight and comprehensive controls are absolutely essential, but they must not inhibit efficiency, convenience, and simplicity.

The banks with their many years of experience have the edge here. It makes sense for all sections of the industry to capture this experience if they can.

Learn from the success of SMSFs

Our research shows that SMSFs are increasingly becoming the vehicle of choice for Australian retirees who have large benefits and want to retain assets within the superannuation system. This has led a number of funds to try and copy some of the features of SMSFs.

Direct investments

Most obvious is the introduction of a facility that allows members the ability to invest directly in Australian shares, and term deposits. Some funds are considering how this flexibility might be extended into other asset classes. In this way funds seek to replicate greater member control and flexibility.

However is this enough?

More can and should be done

People set up an SMSF for all sorts of reasons. Control and flexibility are two, albeit important, ones.

In future we will likely see more SMSF type features in large super funds. Three make good sense, and can be introduced with relative ease.

1. ***Added value for the family unit***

   Many SMSFs are essentially family funds. They aggregate benefits of the family within a coherent total investment strategy and provide for the seamless transition of benefits (sic assets) in the event of death. Death benefits are often expressed in a form that allows retention of the full benefit value within the SMSF.

   Many of Australia's largest funds, and some that are smaller, are well positioned to develop family product offerings. If a fund can deliver added extra value to a family, it opens up a new channel.

2. ***Access to first rate comprehensive advice***

   Advice given in respect of the SMSF takes into account broader family finances, estate planning and tax effectiveness. Advice of this nature is not inexpensive, but those setting up such an SMSFs are prepared to pay for quality assistance, on top of the costs associated with running the plan.

   Advice is becoming core business for funds. It is therefore quite simple for funds to package family products with access to, or in conjunction with, top notch advice.

3. ***Greater choice in structuring portfolios to meet individual need.***
   An actively run SMSF has heavy involvement from the members and active management of assets (within the constraints set at law) to meet needs and objectives as they continuously adjust to changing circumstances. Many funds do not have the range of investment options in place to replicate this.

Non super benefits during retirement

An ageing population living ever longer paints a picture of a superannuation fund maintaining a relationship with a retiree well into their 80s and 90s, considerably after the final superannuation contribution. What form will that relationship take?

In a purely strict case it will be to look after the member's investment and to administer payments to them. Periodically the fund is required to communicate with the member. If this is all then it will be a relatively barren relationship. It might fulfil core functions, but it makes sense for the fund to be proactive and to adjust member services to, and as, that member's needs and circumstances change over time. This is what trustees should be doing in order to better meet the superannuation needs of members.

We know there are issues including the sole purpose test for super, and the fact that some fund sponsors have interests in other organisations that sell services, so conflicts of interest exist, and need to be managed.

However, super funds can be thought of as huge affinity groups. The market leverage that this represents has potential value. If that value can be realised to benefit members then it makes sense to do so.

Health, aged care, and other financial services might appear to be the most logical, but there is no conceptual reason to limit the potential suite of services or products offered.

Superannuation funds are in a very powerful position: the larger the fund, the more powerful it is. The fund can use its purchasing power, or the value represented by the sheer number of its members, to deliver an almost limitless range of added value benefits and services to its members.

Individual Australians must take ownership

We need to actively encourage Australians to make decisions about their retirement at a sufficiently young age so that it will make a difference to their retirement. The alternative is just not acceptable. The cost to the nation will be far too high both socially and financially. Consider the triple whammy impact on retirees over the past few years of inadequate super, the GFC and low interest rates.

Conclusion
Reasonable retirement outcomes demand concerted action

The Australian superannuation industry is a long way from being able to deliver retirement incomes that will offer retiring Australians a modest, let alone a comfortable, income throughout their retirement.

Significant change needs to happen if the industry is to get anywhere close to achieving this central goal. And we cannot leave it to just one part of the industry: If the Australian superannuation industry is to achieve its potential then we need Government, superannuation funds, and individual Australians to work together and positively transform the system in ways that focus on where we have to end up.

Even then risks will abound. The Australian system in its current form devolves almost all significant investment, inflation and longevity risk onto individuals. At the same time we know that most Australians are disengaged from their superannuation, and do not get involved in managing their own provision for retirement until it is far too late. The irony is that the system itself encourages this by selecting a fund if you do not choose one; selecting a default investment option if you do not choose one; providing base levels of death and disability benefit if you do choose them.

The challenge is for superannuation funds to develop and promote products that help individual fund members, and especially those approaching retirement to manage these risks and to compel members into active involvement and informed decision-making at an early age.

To date this has not happened. Poor member engagement is a fact of life across the industry.

Australian super funds need to become more sophisticated and learn from the successful financial services institutions that are listening to the customer, embracing competition, and considering new ways of personalising their services and offerings to meet the ever-changing demands of the Australian population.

Contacts

Russell Mason
Superannuation Partner
Actuaries & Consultants
Tel: +61 2 9322 5347
rmason@deloitte.com.au

Stephen Huppert
Superannuation Partner
Actuaries & Consultants
Tel: +61 3 9671 7778
sthuppert@deloitte.com.au

Diane Somerville
Superannuation Director
Actuaries & Consultants
Tel: +61 2 9322 7636
dsomerville@deloitte.com.au

Caroline Bennet
National Lead Partner
Actuaries & Consultants
Tel: +61 3 9671 6572
cbennet@deloitte.com.au

Wayne Walker
Special Superannuation Adviser
Actuaries & Consultants
Mob: +61 419 390 436
wawalker@deloitte.com.au

Ben Facer
Superannuation Principal
Actuaries & Consultants
Tel: +61 2 9322 3493
bfacer@deloitte.com.au

Peter Larsen
Superannuation Principal
Actuaries & Consultants
Tel: +61 3 9671 6929
plarsen@deloitte.com.au

Neil Brown
Deloitte National Industry Leader
Wealth Management
Tel. +61 3 9671 7154
nbrown@deloitte.com.au

Authors

Actuaries & Consultants

Contact:

Louise Denver
Director Corporate Affairs &
Communications
Mob: +61 414 889 857
ldenver@deloitte.com.au

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