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Dynamics of the Australian Superannuation System

The next 20 years: 2015 - 2035

Deloitte Actuaries & Consultants

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Executive summary

In this eighth edition of Deloitte's Dynamics of the Australian Superannuation System, we have modelled the components of the industry, projected their growth, and commented on the market dynamics, demographic shifts, longevity and adequacy of the current system.

We have also developed some recommendations for options for Australia to meet current and future shortfalls. Our research highlights some significant changes in these areas including the fact that improved longevity means the proportion of retirees to working Australians has almost doubled in the past 60 years. While there are currently four and a half workers for each retiree in Australia, it is projected that by 2050 this will have dropped to just two and a third workers for each retiree. This means that managing the issues of adequacy and longevity have never been more important.

We propose some ameliorating views for consideration including:

- Underpinning the Superannuation Guarantee (SG) with effective concessions and incentives for voluntary contributions which could include both concessional contribution caps based on joint incomes and lifetime contribution caps
- Increasing the Superannuation Guarantee to 12% as quickly as possible
- A bipartisan superannuation policy by the Federal Government in accordance with the Murray Financial System Inquiry
- Government incentives via the taxation system to encourage retirees to draw-down their superannuation as annuities, account-based pensions or other types of products which provide a stable income during retirement
- Supporting continuing advancements in education and advice.

These proposals are underpinned by our research, which continues to look at what the statistics mean and draws on the collective knowledge of the superannuation and financial services industry across a wide range of professionals at Deloitte. Our report is based on the Super Model which was built and is managed by Deloitte Actuaries & Consultants, and is soundly based on a combination of data collected by the Australian Bureau of Statistics (ABS), the Australian Prudential Regulation Authority (APRA), the Association of Superannuation Funds of Australia (ASFA) and other public organisations and associations, together with research conducted by Deloitte.

The dynamic nature of the Super Model, which calculates the future market for superannuation assets, in aggregate, and within segments, is based on projected inflows to and outputs from the system and enables sensitivity tests to be done using different rates for important variables. These variables include the Superannuation Guarantee contribution rate, levels of voluntary contributions, administration and investment costs, rates of exercise of Fund Choice by individuals, pension take up rates, investment returns, inflation and salary growth and taxation on super.

We trust you will find this report useful and thought provoking and along with the team, key authors and contributors, we look forward to discussing it, the industry, your own requirements and some of the proposals we put forward with you.

Managing the issues of adequacy and longevity have never been more important

Section one: Market overview

Projected total superannuation assets

Despite ongoing volatility in investment markets, the Australian superannuation industry has continued to grow in the past few years, with total superannuation assets rising from $1.6 trillion at 30 June 2013 to $2 trillion as at 30 June 2015.

The base projections from the Deloitte super model show that total superannuation assets in Australia will increase steadily to $9.5 trillion by 2035 *(See Figure 1 Projected superannuation assets)*. These projections reflect the legislated increases in the Superannuation Guarantee (SG) rate from 9.5% to 12% by July 2025, with the next increase (to 10%) scheduled to occur from 1 July 2021.

Caveat: There is an important caveat to the projected 375% growth to $9.5 trillion in superannuation assets by 2035. Given the current low interest rate environment and volatile super fund returns there are material sequencing risks for retirees. This double whammy has forced many retirees to draw down greater proportions of their retirement savings to deal with the fact that their annual earnings have not been adequate to sustain their living needs and minimum drawdown requirements.

As a result the growth in post-retirement assets to date has been materially lower than previously projected.

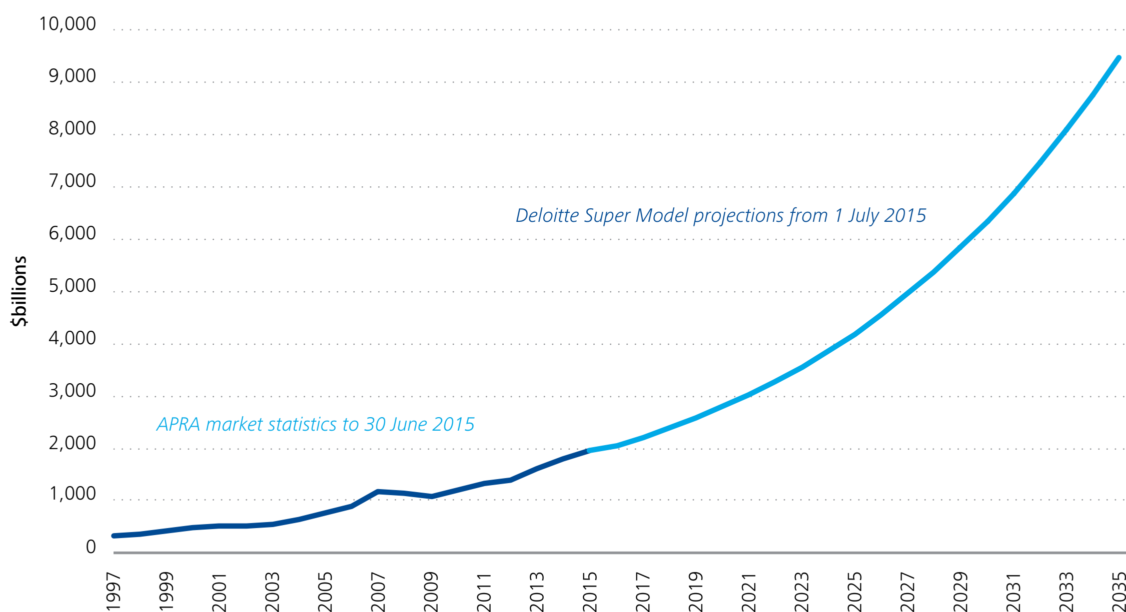
If this was to continue, then the projected asset growth to $9.5 trillion by 2035 would also be lower, and commensurately, the call on government for the aged pension would be greater.

Adequacy: There has been a lot of debate recently regarding the adequacy of incomes for retiring Australians, and there is the potential for changes to policy settings such as contribution caps, drawdown conditions, and tax concessions as a result. Nevertheless, emerging superannuation benefits for most Australians at retirement will not be sufficient to provide them with a reasonable standard of living without continued reliance on at least a partial age pension.

What this means: To manage this reality Australians will need to work longer and delay their retirement even from the new age pension eligibility age of 67 years. These changes will continue to gain traction as proposed changes to the eligibility age for the age pension transition to the new level.

In this research, it is assumed that many individuals will reduce their rate of voluntary contributions as the SG rate increases. However, the modelling has not allowed for any other changes in member behaviour which may result from the SG increase.

Figure 1: Projected superannuation assets *(All amounts are in future nominal dollars).*



Source: APRA and Deloitte Actuaries & Consultants, 2015

Superannuation in the economy

To better understand the superannuation industry in the context of the Australian economy, Figure 2 shows the relationship between total superannuation assets and Gross Domestic Product (GDP) over the last decade and as we project into the future. The results demonstrate that:

- The super asset pool, as a multiple of GDP, has only regained its pre-GFC levels in the past couple of years
- There are significant annual variations in the relationship between total superannuation assets and GDP. This is due to the fluctuations in actual investment returns for super assets year on year, and
- There is a long-term trend of growth in superannuation assets relative to GDP.

As well as growing in terms of total assets, superannuation funds are also growing their share of total financial system assets, aided by increases in the level of compulsory Superannuation Guarantee contributions.

What this means: This increased share of total assets has led to superannuation funds facing higher expectations for their investment activities, which has led in turn to a greater scrutiny of comparative returns and investment costs. One result of this increased expectation is that some funds have moved some elements of asset management in-house and/or expanded the range of their investments beyond the traditional asset classes into alternative assets.

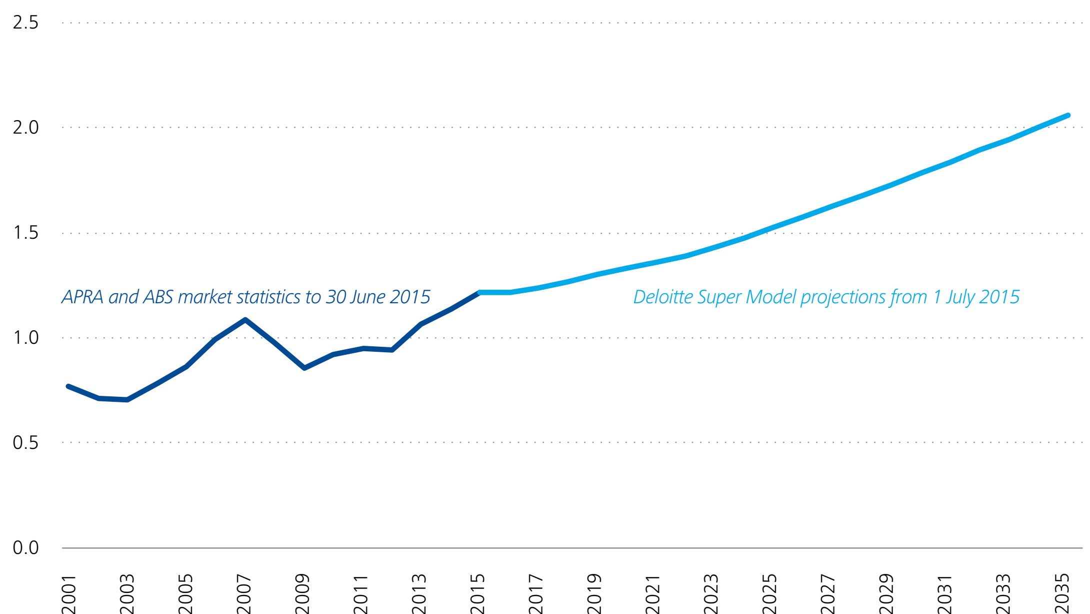
Dynamics of the superannuation industry

Figure 3 (over page) looks at the cash flows into and out of the superannuation system.

Benefit payments have continued to reach higher levels in recent years. This is partly due to individuals aged 60 and over being able to withdraw their superannuation benefits tax-free since July 2007. This appears to be affecting members' benefit-taking behaviours; in particular influencing the level of lump sum benefits taken, as well as the rate of account-based pension drawdowns (noting that there is no maximum limit).

Given that this trend has continued consistently for the past eight years, beyond the period immediately following the Global Financial Crisis, it can no longer be regarded as a short-term aberration.

Figure 2: Superannuation assets/nominal GDP at 30 June



Source: APRA and Deloitte Actuaries & Consultants, 2015

What this means: We expect the drawdown trend to continue to evolve over the coming years, subject to any changes in regulations or tax rules, such as those recommended by the Financial System Inquiry, which may encourage or discourage different behaviours from retirees. The projected cash flows illustrated below reflect this expectation.

Members are still paying significant additional contributions into their superannuation in the years approaching retirement, and hence the level of contributions remains strong year-on-year. As a result we anticipate that sizeable voluntary contributions will continue into the future, with some reduction in future voluntary contribution rates to offset, at least partially, the increase in compulsory Superannuation Guarantee contributions rate to 12%.

Investment returns

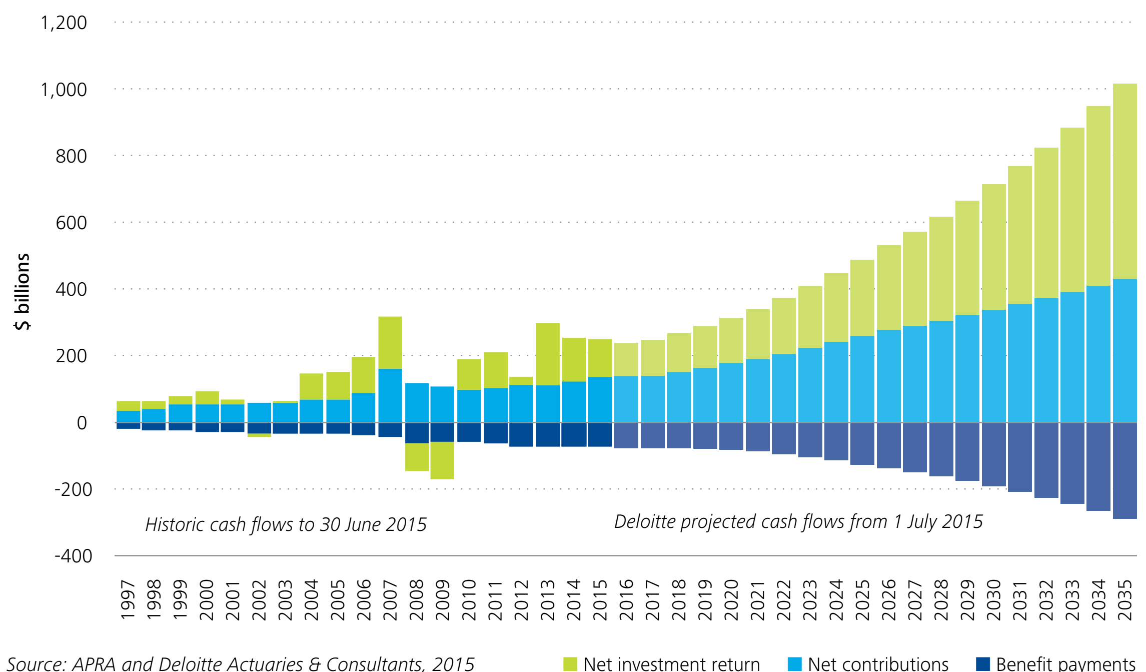
Investment returns on superannuation assets remain a significant contributor to the growth of the superannuation industry. In the past three years there has been a return to the trend for net investment income to at least equal total net superannuation contributions.

The strategic asset allocation for each superannuation member's assets, whether a MySuper default option, or an investment portfolio chosen by the member, has the greatest impact on the member's final benefit; greater in fact than the selection of individual managers within each asset sector.

What this means: It is important that members do not invest too conservatively in the early to middle years of their working lives, so they can maximise the impact of investment returns compounding up to and into retirement. Given that superannuation is preserved for retirement, these members will be able to withstand the short-term volatility inherent in growth-oriented portfolios and achieve a higher long-term average return overall.

As total superannuation assets continue to grow larger, relative to the size of the Australian economy, this will increase pressure on the investment capacity of funds and will drive increased investments in alternative assets and across all asset classes in overseas markets.

Figure 3: Cash flow sources and uses



Source: APRA and Deloitte Actuaries & Consultants, 2015

Advice
Funds are continuing to offer limited advice and robo-advice to their membership at growing rates. Given that the two levers - contribution rates and investment strategy - that will have the greatest effect on ultimate superannuation balance at retirement are in a member's control, the earlier a member seeks appropriate advice on making the most of their superannuation, the bigger the impact on their final retirement outcomes.

Each generation is accruing larger superannuation balances than before. Therefore getting timely advice becomes even more important to maximise their final retirement position. Funds must focus on boosting member engagement with their super.

Australian superannuation – a genuine post-retirement market

Given recent concern over the demographic challenges presented by an ageing population, our modelling looked at the total superannuation assets split between pre-retirement and post-retirement.

- ***Post-retirement pension assets*** represent a significant and growing pool of assets in their own right. The tax-free status of investment earnings on assets backing pensions is a major factor encouraging this growth
- ***Generational change:*** Each subsequent generation is building larger real superannuation balances, underpinned by longer periods of higher rates of compulsory Superannuation Guarantee contributions. As final balances grow, increasingly higher proportions of members will take their benefits as an income stream by gradually drawing down their balance over time – although many will continue to bear the risk of outliving their savings due to continuing improvements in mortality.

What this means: For many members retiring in the next decade, the level of their final superannuation benefit will be a relatively small proportion of their final salary. These members will still need significant support from the 'safety net' of the age pension provided by the Australian Government.

Looking to the near future: As Baby Boomers retire, and Generation X approaches and enters retirement, there will be significant growth in post-retirement assets. However, it appears that there will also be significant leakage from the superannuation sector. We anticipate a considerable proportion of benefits will continue to be withdrawn as lump sums, either at retirement or as ad-hoc withdrawals from account-based pension accounts. This is rather than using the benefit to provide a regular income stream over an individual's remaining lifetime.

Sequencing risk: The intentions, and ultimately, actions of members in choosing how they will take their superannuation benefits have major implications for asset allocation. In post-retirement, members are generally less able to withstand the impact of negative returns, and they are exposed to sequencing risk around the timing of withdrawing their benefit. Likewise, as pre-retirement members reach the final years of their working lives, they will also be less prepared to accept negative returns and will need to avoid the risk of a sudden drop in their savings as they enter retirement.

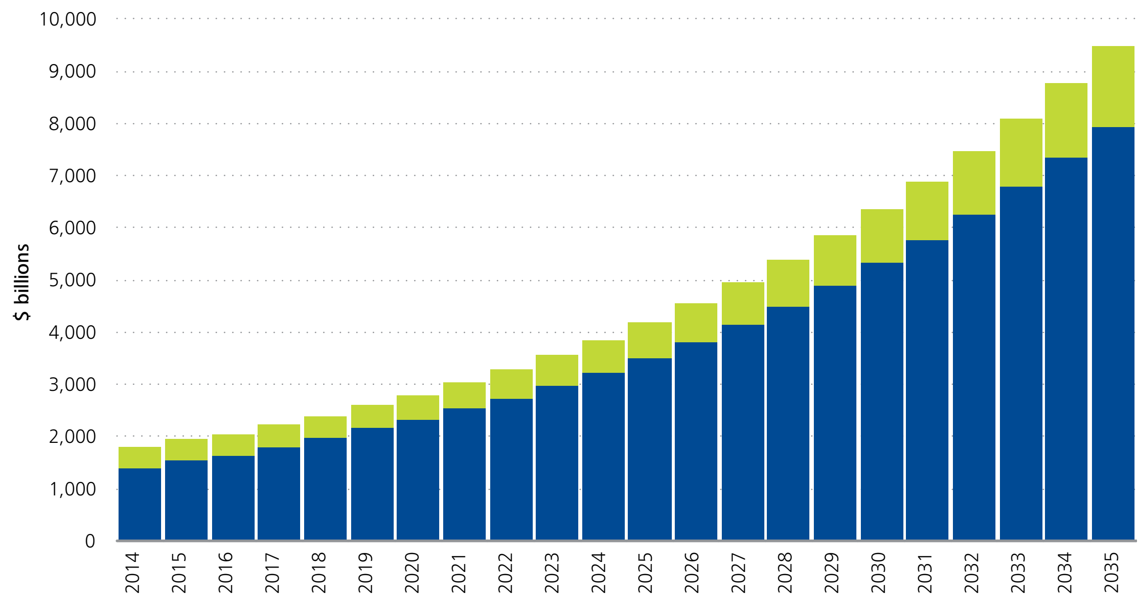
What this means: Consequently we expect members both in retirement, and on the cusp of retirement, to place greater importance on capital and income protection than younger members with decades remaining to retirement.

The increase in the prevalence of lifecycle designs in MySuper offerings i.e. those with asset allocation more heavily weighted to growth assets at younger ages, and gradually becoming more conservative as the individual ages over time, is a way of funds helping members to reduce sequencing risk in an automated manner.

Groups: There is no 'one size fits all' approach that applies to individuals of any generation. In fact individuals will generally be in one of the following groups when they retire:

i. ***Small balances:*** Those with relatively small superannuation balances i.e. less than $75,000.
    - These individuals will deplete their superannuation quickly after retirement, and then need to fall back on the 'age pension' safety-net, or will draw just a small income from their superannuation in order to supplement the age pension throughout retirement.

Figure 4: Projected superannuation assets (2014 to 2035)



Source: APRA and Deloitte Actuaries & Consultants, 2015

ii. ***Reasonable balances:*** Those with reasonable levels of superannuation and other savings, but with total balances that will not be adequate to support them over the entire period of their remaining life.

- This group is likely to also receive additional support through the age pension
- These individuals will be spending all of their investment earnings each year, supplemented by drawing down their capital more quickly than would be appropriate if it were to last for the rest of their lives.

iii. ***Significant balances:*** Those with significant superannuation and other assets, who will have enough savings to support themselves independently throughout their retirement.

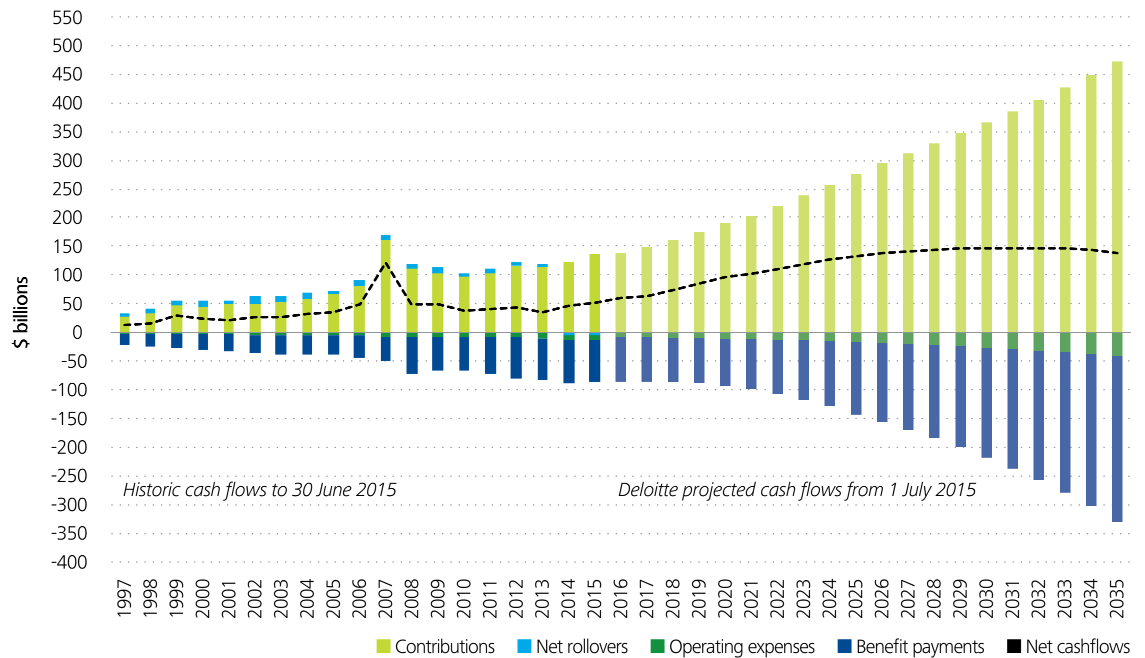
- A large part of their retirement income will be their investment income with potentially little or no need to use their capital each year
- As life expectancies continue to increase, individuals will need to make their superannuation last even longer and so will retain more of their balances in growth-oriented investments, particularly in their early retirement years.

What this means: These groups face very different investment and life challenges and will require different responses from the superannuation industry to assist them. This provides real opportunities as well as challenges for the industry to innovate and develop products and solutions which will enable retirees to manage the retirement risks of longevity and investment risk, and obtain reliable advice at a reasonable cost.

The changes in eligibility for the age pension, with the age pension age increasing to 67 by 2023, will also have an impact. Where people retire before the new age pension eligibility age of 67 years, they may need to draw down their superannuation more quickly during this early part of their retirement up to age 67.

This in turn will mean they will have a lower remaining superannuation balance at pension age and will be likely to be more heavily reliant on the age pension in the later years of retirement. It is therefore important to consider the interaction between the age pension eligibility age, and superannuation preservation age to ensure that the overall outcomes of the Australian retirement system are not undermined. We note this specific issue has been considered by both Treasury and the Productivity Commission (most recently in the Superannuation Policy for Post-Retirement report).

Figure 5: Projected net cashflows



Source: APRA and Deloitte Actuaries & Consultants, 2015

The impact of a compulsory superannuation system

Australia's compulsory superannuation system means that funds can anticipate strong cash inflows provided they retain members. In most funds, the demographics are dominated by those still some way from retirement, so they can anticipate continuing positive net cash flows.

Figure 5 shows historic cash flows to 30 June 2015 and our projected cash flows thereafter.

An important outcome of this projection is the expectation that net cashflows will remain positive throughout the 20 year projection period. Add investment returns to this and we can see why the assets of the industry continue to grow.

However, we do project a plateauing of net cashflows from around 2030, and possibly the hint of a drop at the tail end of the projection period.

It will be interesting to see how changing behaviours toward taking retirement benefits as income streams, particularly if default Comprehensive Income Products for Retirement (CIPRs) are introduced as recommended by the Financial System Inquiry and agreed by the Government, may alter this expectation over the next few years.

We project a plateauing of net cashflows from around 2030, and possibly the hint of a drop at the tail end of the projection period

Section two: Components of the market

Sectors

Restructuring and consolidating in the industry continues unabated. Ultimately the industry is dominated by:

- Self-Managed Superannuation Funds (SMSFs)
- The retail giants, predominantly the large banks and life insurers, and
- Industry funds.

Choice of Fund has been in force for more than a decade - introduced in July 2005 - and has reinforced the decoupling of super from an individual's specific terms of employment. More members are retaining their existing superannuation funds when changing employers.

Also, some funds and financial services providers are proactively encouraging and assisting members to consolidate their superannuation arrangements, which are bolstering the continuing consolidations.

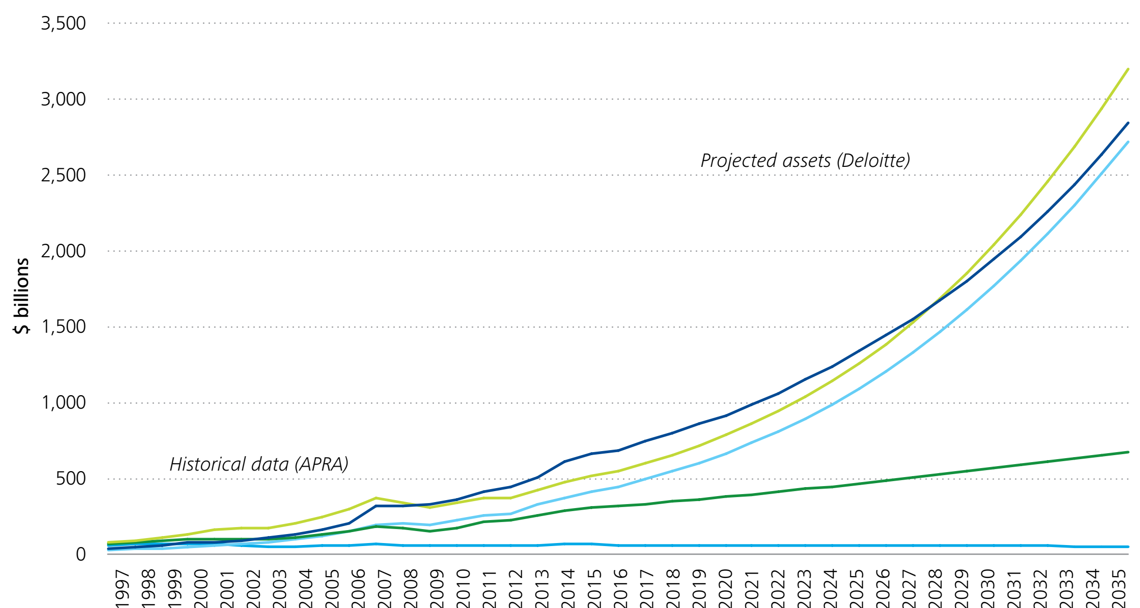
Market share by major segments

Figure 6 shows the movement of total assets in each segment from 1997 to 2015 compiled from APRA data and the Deloitte Super Model projected movement from 2015 to 2035.

Some highlights from these projections include:

1. ***Growth:*** Industry funds and retail funds are expected to grow significantly over the next 20 years with similar rates of overall growth, and slightly above the rate of growth of SMSFs. (See Figure 6).
2. ***Retail largest overall:*** Our projections indicate that the total retail fund sector (that is a combination of retail employer sponsored and retail personal) will take over from SMSFs as the largest market segment in 2028 and reach $3 trillion in assets in 2034.
3. ***SMSFs – post retirement bulge:*** However SMSFs are still expected to be the largest sector by far in the post-retirement superannuation market, reaching $900 billion in 2035, and eclipsing the retail segment in 2018. (See Figure 9)

Figure 6: Superannuation assets by market segment (APRA classification)



Source: APRA and Deloitte Actuaries & Consultants, 2015

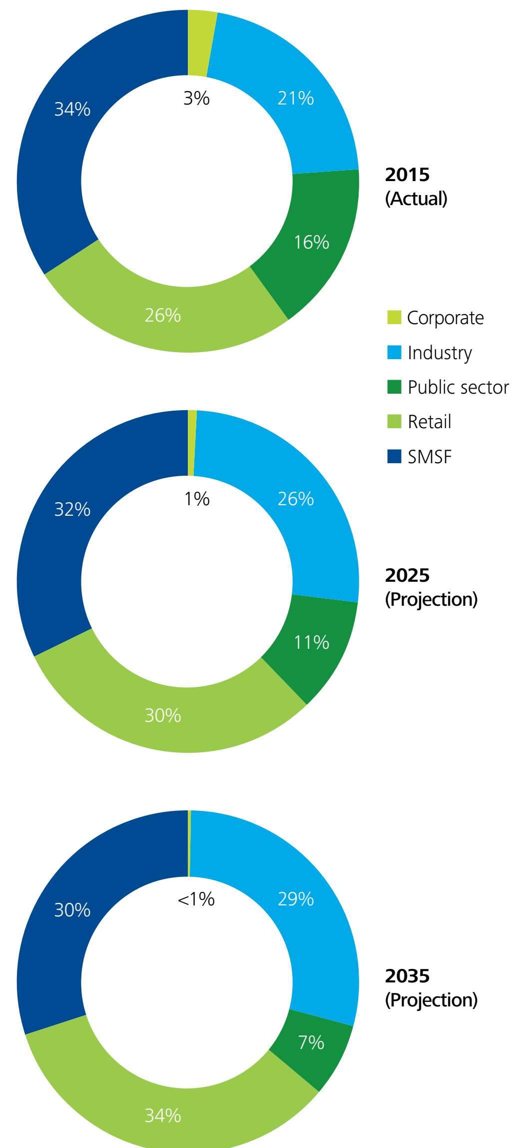
4. ***Industry and retail funds:*** It is not yet clear how successful industry funds and the large wealth management businesses will be in curtailing the rapid growth in post-retirement assets for SMSFs. There is considerable scope for funds to capitalise on the opportunity to develop new initiatives to capture a greater share of that market, such as providing members with more individual flexibility. Those that do this well will be most successful in retaining and growing their market share.
5. ***Public sector:*** Public sector funds are expected to continue to grow at a reasonable rate over the period, while the corporate segment will continue to slowly decline.

Assumptions:

- These projections assume no changes in the current legislative environment applying to superannuation
- However, given the significant debate in the market and government around the level of tax concessions and product structures for superannuation, particularly in relation to post-retirement products as recommended by the Financial System Inquiry and agreed by the Government, change is likely
- Nevertheless, as any future changes are still speculative, we have not taken any potential changes into account for the purposes of this report.

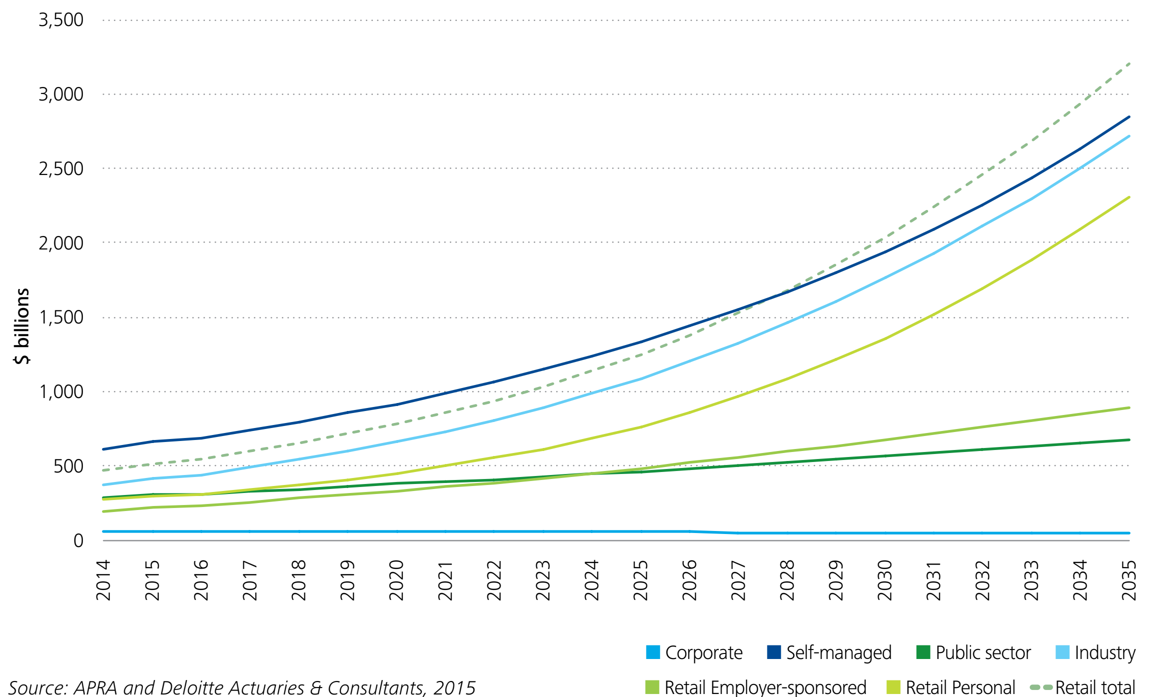
Figure 8 shows the projection when splitting Retail into 'employer-sponsored' and 'personal superannuation funds'. The distinction between Retail Employer and Retail Personal has become more blurred over the past few years following the introduction of MySuper products and other competitive forces in the market. We expect this trend to continue.

Figure 7: Proportion of Superannuation assets by market segment (APRA classification)



The distinction between Retail Employer and Retail Personal has become more blurred over the past few years. We expect this trend to continue.

Figure 8: Superannuation assets by market segment (Deloitte classification)



Source: APRA and Deloitte Actuaries & Consultants, 2015

Pre and post-retirement assets

Figure 9 shows that industry funds will become the largest pre-retirement sector by around 2025. Retail Personal will also continue to grow strongly, reflecting the power of the banks and their distribution networks, and if remaining on the current trajectory will become the second largest pre-retirement sector around 2033. SMSFs continue to remain popular although their growth is expected to be less strong for pre-retirement assets than post-retirement assets.

Figure 10 shows that SMSFs dominate the post-retirement space, offering greater control over superannuation and the ability to harness the greater flexibility of family-based accounts for those members with larger account balances in particular.

It is common practice for people to create their own SMSF on retirement or earlier, particularly when leaving employment with a large benefit entitlement from their existing superannuation fund (e.g. their current corporate plan or public sector plan). There are a number of factors that suggest this will continue, including the tax benefits available within an SMSF structure for those transitioning from pre-retirement to post-retirement.

We note that there is nothing standing in the way of other funds offering these same tax advantages to their members, other than the ability of their systems and processes to make this work.

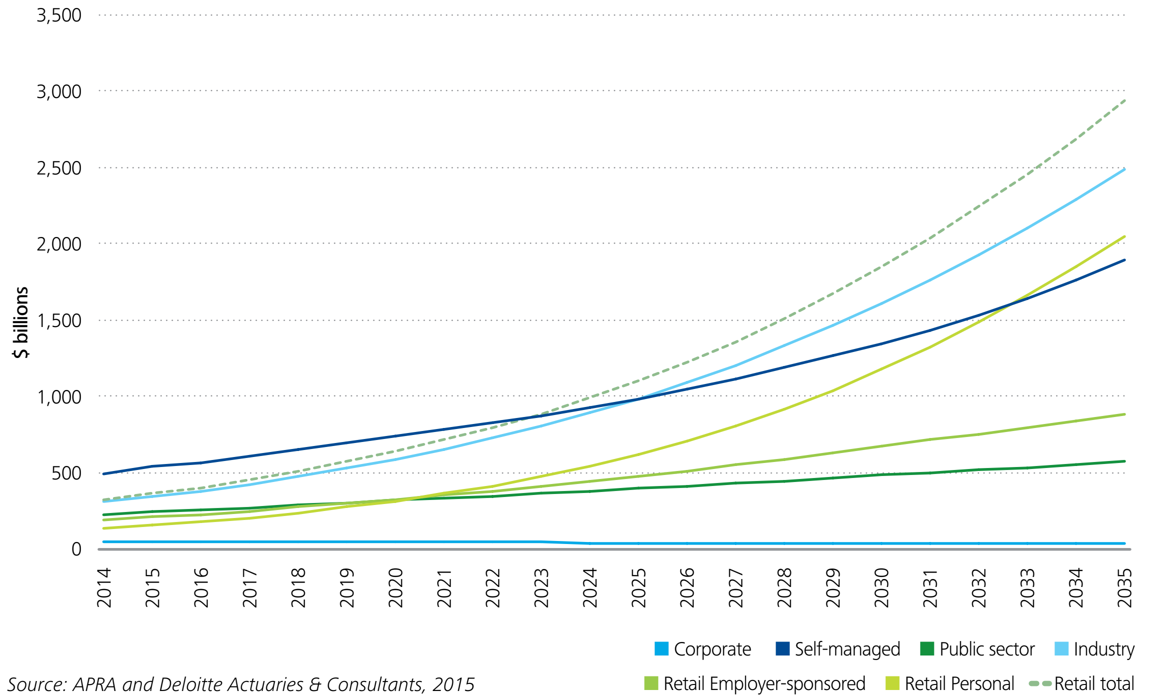
Other key points regarding post-retirement include:

The significant proportion of benefits which are taken as a lump sum has a dampening effect on the level of post-retirement assets. Other than in the SMSF sector, growth in post-retirement assets will be relatively modest over the next 10 years due to the:

1. Rate of drawdowns from post-retirement accounts (regular pension payments plus additional ad-hoc amounts) remaining a relatively high proportion of account balances each year
2. Fairly low proportions of retirement benefits being converted into post-retirement income streams.

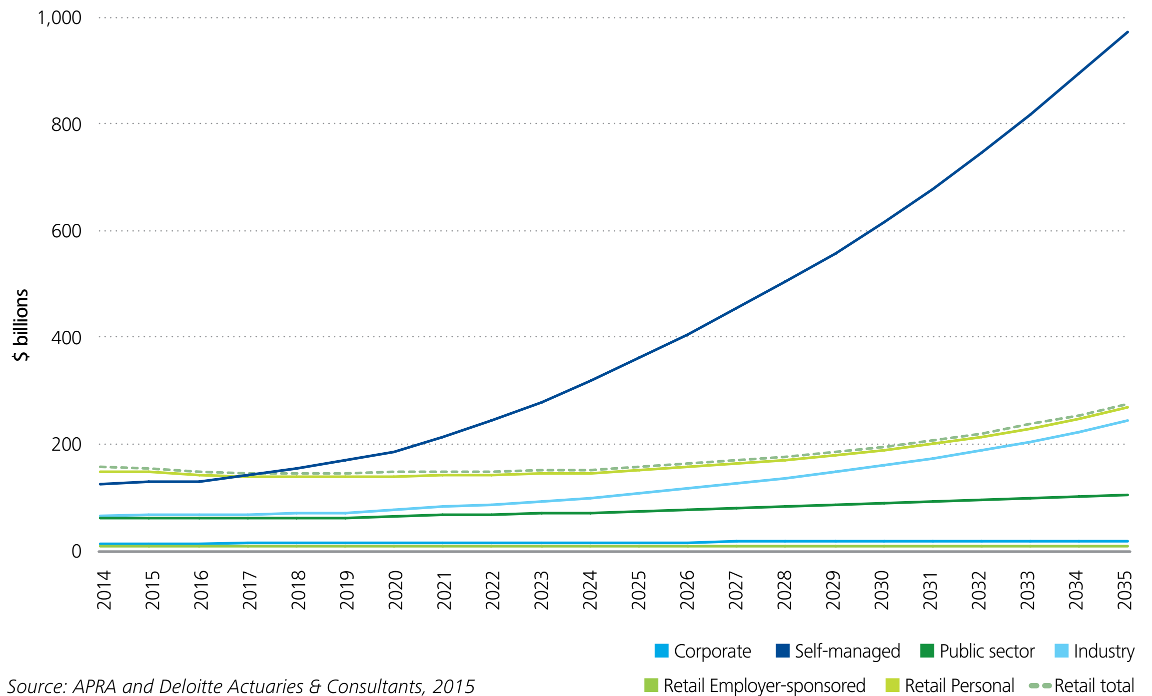
Figure 11 shows the projected growth rates by market segment over the next 10 and 20 years that are reflected in the previous charts, compared with the historical growth rates for the preceding 10 years.

Figure 9: Pre-retirement assets by market segment



Source: APRA and Deloitte Actuaries & Consultants, 2015

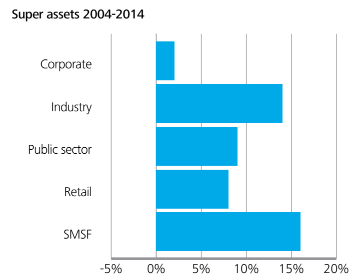
Figure 10: Post-retirement assets by market segment



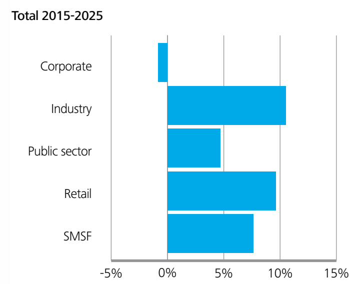
Source: APRA and Deloitte Actuaries & Consultants, 2015

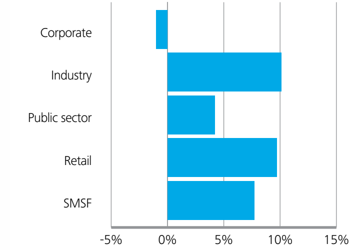
Figure 11: Projected growth rates by market segment - compound annual growth rates (CAGR)

Historical 2004 - 2014

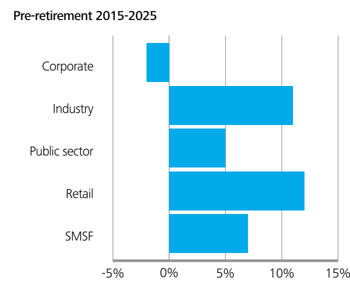


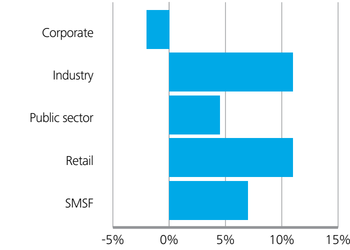
Projected: total assets



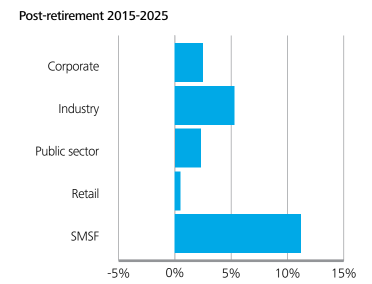


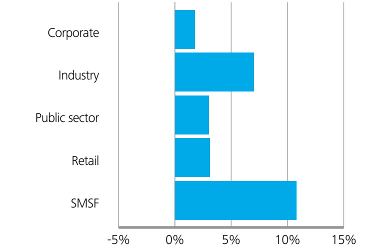
Projected: pre-retirement assets





Projected: post retirement assets





Source: APRA and Deloitte Actuaries & Consultants, 2015

Section three: The shift in population demographics

Improved longevity means the proportion of retirees to working Australians has almost doubled in the past 60 years.

According to the OECD statistics, in Australia in 1960 there was one retiree to every seven working Australians. There were universal pensions, irrespective of incomes and assets, superannuation coverage of less than 20% of the workforce, and a booming primary industry that had Australia 'riding on the sheep's back'.

Fast forward to 2015 and there are a very different set of circumstances. There is one retiree aged 65 or older for every four to five working Australians. Government pensions are not universal, although approximately 75% of retirees at age 65 qualify for at least a part pension, and the overwhelming majority of the workforce receives superannuation.

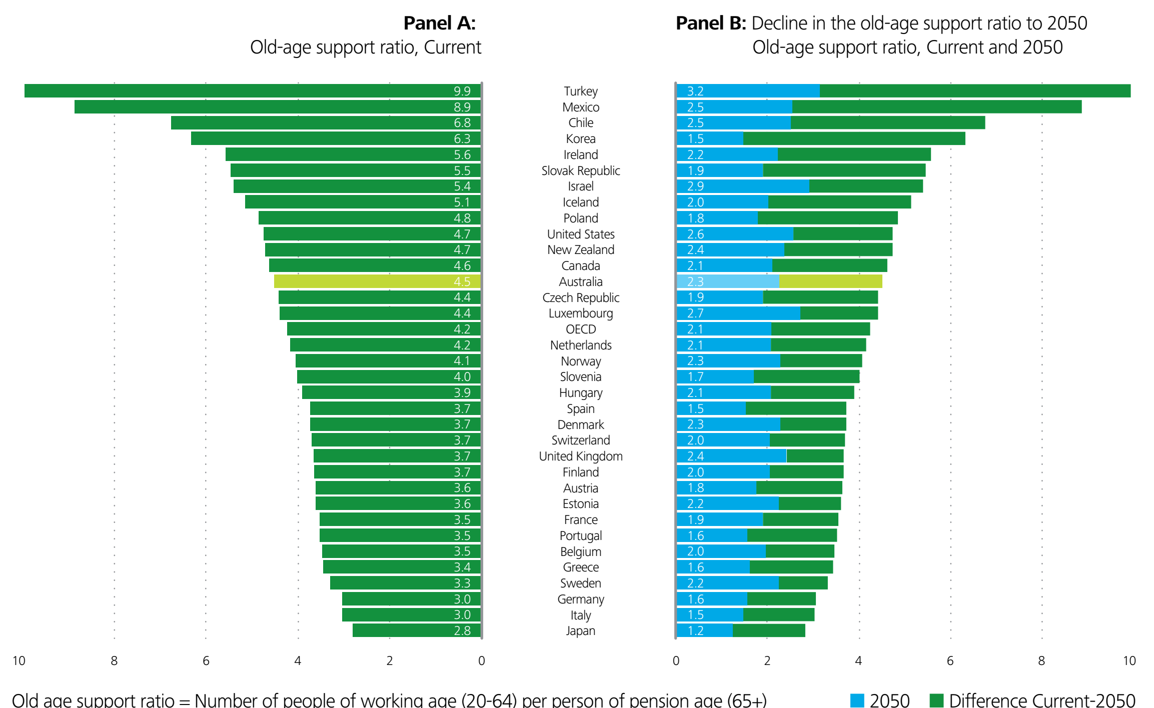
Global longevity: While Australia does have a longevity 'problem', many other developed countries share the same issues, with Japan at a ratio of less than three working Japanese for every retiree and most Western European countries having a lower old age support ratio than Australia. These ratios are expected to worsen in all countries over the period to 2050. (See Figure 12.)

The improvements in longevity show no signs of slowing down

Using current life expectancy tables, a retiree in 2015 will live on average 50% longer than someone who retired in 1947. This is an increase of almost 12 years in just 70 years. Using the Australian Government's Intergenerational report as well as OECD reports it is predicted that by 2050, with improved longevity, our old age support ratio will have increased to one retiree for every two to three working Australians.

What this means: Clearly without a robust and sustainable superannuation system Australians will not be able to maintain their current standard of living if these longevity improvements occur.

Figure 12: Global old age support ratios



Source: OECD and Deloitte Actuaries & Consultants, 2015

The reality is that unless Australians accept to drop their standard of living there are only three choices:

1. ***Work longer*** and defer the age at which the pension becomes an entitlement (which has already been done by gradually increasing the pension eligibility age to 67).
2. ***Increase tax revenue*** from working Australians to fund the Government's age pension, healthcare and other social security commitments.
3. ***Make more Australians self-sufficient*** in retirement.

While the ability to work longer or enter into alternative careers at the end of their mainstream working lives will suit many, this will not suit all retirees, especially those with heavy physical jobs, in poor health or with limited ability to retrain or start a new career. For this cohort, superannuation and the ability to access it is critical if they need to cease work prior to being entitled to apply for the Government pension.

What this means: It is essential, therefore, that current and future Governments place a high priority on a strong universal superannuation system that Australians have confidence in, with more self-funded retirees to lessen the burden on tax payers.

According to Federal Treasury numbers only just over 10% of retirees remain self-funded throughout their period of retirement. This means that almost 60% of those who retire self-funded need to fall back on Government support at some stage during their retirement phase.

Deloitte expects that by 2035 the superannuation system will have total assets of $9.5 trillion and will continue to maintain its position as the fourth largest pension fund system in the world behind the U.S., the UK and Japan. While this is admirable, what will it mean for the sustainability of the superannuation system?

1. ***Required contributions:*** With increased longevity the current target Superannuation Guarantee of 12% will be insufficient. Deloitte has calculated that a 30 year old female needs to contribute 19.5% per annum on average for the balance of her career to achieve the ASFA Comfortable Standard in Retirement. The equivalent male will need to contribute 17.4% per annum.
2. ***Closing the gap:*** Clearly there is a significant gap between compulsory and required contributions which is not being met by additional voluntary contributions by the majority of Australians.

   Without voluntary additional contributions, increased Superannuation Guarantee, or compulsory after tax contributions, many Australians will fall short of their desired lifestyle in retirement.
3. ***Pensions:*** The Government's social security expenditure will not decrease. While fewer Australians will qualify for the full age pension at retirement, the inadequacy of superannuation savings means that the number of self-funded retirees throughout retirement will not increase meaningfully and those on the age pension will stay on the age pension longer.
4. ***Affordability:*** The majority of Australian retirees will receive the age pension. However subsequent generations will not be able to afford it. Increased longevity means that by 2035 more than 20% of the population will be aged 65 plus – i.e. a 30% increase in the current proportion.

Options: What are the available options to ensure Australia's superannuation system is viable and sustainable?

1. ***Compulsory member contributions:*** In addition to the employer funded SG contributions, members could be required to contribute 3% after tax possibly with the option to opt-out.
2. ***The Superannuation Guarantee*** could be increased to 12% as quickly as possible, earlier than the currently planned trajectory.
3. ***A bipartisan superannuation policy*** should be developed by the Federal Government acknowledging the need for a sustainable superannuation system and putting in place a set of broad guidelines which form the basis for consumers to have confidence in the system over the longer term. This would best form part of the articulation of objectives of the superannuation system, as recommended by the Financial System Inquiry and agreed by the Government.
4. The Government could provide ***incentives via the taxation system*** in the draw-down phase to encourage retirees to place their superannuation in annuity, account-based pension or other type of products that aim to provide a stable income throughout retirement.
5. ***A taxation regime*** could be put in place that discourages retirees from treating superannuation as an estate planning and inheritance vehicle. The purpose of superannuation should always be to provide retired Australians with an adequate and comfortable lifestyle at the end of their working lives. This means it should not be a tax advantaged lump sum for their beneficiaries.

Section four: Achieving benefit adequacy

It is widely recognised that Superannuation Guarantee contributions alone are insufficient to produce an adequate retirement income for a typical retiree. When Paul Keating first designed the superannuation system in the early 1990s, he intended compulsory contributions to reach 15% of salary – 12% from employers and 3% from employees.

Society and its constituent retirees have come a long way since the 1990s, with many factors impacting what would constitute an adequate retirement income, and the inputs required to produce this income. Perhaps most importantly, retirees are living longer. As we live longer then, unless we retire later, a higher contribution rate will be required to produce an adequate and sustainable retirement income. To illustrate, consider a typical 30 year old individual today, earning approximately $65,000 p.a. and with a current superannuation balance of $30,000 invested in a typical 70/30 balanced portfolio. In order to produce a retirement income equivalent to the ASFA Comfortable Standard lasting until their life expectancy, this individual would need to contribute at the rate of 17.4%, if they were male, and 19.5% if they were female.

The difference between these required contribution rates is quite stark, and stems from two key factors. Firstly, our projections assume that a female withdraws from the workforce for a period in order to raise children. While we recognise that this will not always be the case, it serves to illustrate the added difficulty of those with broken work patterns in generating an adequate retirement income. Secondly, as females live longer on average, their retirement benefits will typically need to last longer and hence need to be larger.

There are numerous reasons why individuals may find it challenging to build an adequate retirement benefit, including for example:

- Broken work patterns, whether this be for illness, raising children, caring for family, unable to find work etc
- Financial commitments in younger years, for example mortgage payments or costs of raising children, which diminish the ability to make voluntary contributions to super
- A successful career progression, meaning that lower contributions in early years are insufficient for a higher living standard gained closer to retirement
- Potentially poor investment experience, especially closer to or during retirement.

So, if the rate of Superannuation Guarantee (SG) is insufficient in isolation to generate an adequate retirement income, should contributions be increased? And if so, in what form – SG or member contributions, compulsory or voluntary? While clearly higher contributions will lead to higher benefits and hence improved adequacy, there are also a number of potential drawbacks, including:

- High contributions will place an additional burden on lower paid workers, who can ill-afford the lower take home salary and who receive very little in the way of tax concessions from superannuation presently
- Further challenges for younger individuals in meeting other financial commitments, such as mortgage repayments
- Removal of the flexibility for individuals to choose to save in forms other than superannuation
- The potential for generation of a benefit in excess of needs in some circumstances, and hence which may be more beneficial taken as salary.

While we believe that the rate of SG should be increased to the planned maximum of 12% as soon as possible, it is our view that contributions should not be increased further on a compulsory basis. Rather, the superannuation system should be underpinned by effective concessions and incentives to voluntary contributions, and supported by continued advancements in education and advice.

One of the key inhibitors to generating an adequate retirement income is the current inflexibility of the concessional and non-concessional contribution limits. On the surface, the contribution limits (currently $30,000 per year for concessional contributions of individuals under age 50, and $180,000 per year for non-concessional contributions) appear to be more than sufficient to generate an adequate retirement income. However in reality some of these challenges mean that most individuals are simply unable to fully utilise the limits throughout most of their working life. When major financial commitments like mortgages and raising children are no longer factors, the limits are insufficient for the individual to catch up.

We believe that there are fundamental changes to the manner in which contribution caps are structured which will result in much greater flexibility for individuals to use more of the caps to generate an adequate retirement income. In particular, Deloitte recommends the following structural improvements:

1. ***Lifetime contribution caps***
   We believe that individuals should be able to make voluntary contributions to superannuation, concessional or non-concessional, at a time which best suits their financial circumstances, and recognises that the pattern of contributions will necessarily differ between individuals. Importantly, the level of the lifetime cap should be based upon achieving a defined goal for the superannuation system. For instance the lifetime cap for concessional contributions could be based on a level which is likely to produce a retirement income that is consistent with the ASFA 'Comfortable' standard. Our modelling indicates that a lifetime cap of $580,000, with most voluntary contributions made after age 45, would be sufficient to produce such a retirement income from age 65 to the 75th percentile of life expectancy, assuming a typical default investment fund and normal investment outcomes.

   Consideration should be given to a level of tax concessions, particularly on concessional contributions, which is considered reasonable.

2. ***Concessional contribution caps based on joint incomes***
   Under the current system if an individual is out of the workforce for a period of time, they are able to make non-concessional contributions but are unable to make concessional contributions as these are based on either Superannuation Guarantee payments by the employer or salary sacrifice contributions made out of taxable income. Particularly in cases such as maternity or paternity leave, it seems reasonable that the partner should be able to make tax deductible or concessional contributions on behalf of his or her spouse up to an equitable limit.

Our modelling indicates a lifetime cap of $580,000 would be sufficient to produce an ASFA 'Comfortable' retirement income from age 65 to life expectancy for 75% of people

Conclusion

In this edition of the Dynamics of Superannuation 2015 we have considered what the industry should expect in the next 20 years around:

- The ***size*** of the superannuation assets
- ***Sectoral growth***
- ***Adequacy***, including inadequate superannuation for our retiring long living ***female population*** and others with ***broken work patterns***
- The disruption of our ***ageing*** population and its ***significant impacts***.

Our findings all highlight the need for industry and government to consider how best to deal with these shifts.

Deloitte believes that inherent in the answers are decisions around:

- ***Revenue*** – what to do to increase revenue streams
- ***Strategy*** – the agility to respond to market forces, competition, and generational shifts
- ***Costs*** – how to gain the necessary efficiencies and ensure the system remains effective and sustainable.

Given the need to replenish revenues, refresh strategy, and recalibrate costs, there are a number of proposed actions that industry and government can consider including:

- ***Developing innovative products*** to meet customer needs:
  - Retail funds seeking reach, relationships and revenues, and meeting the SMSF onslaught and competition from industry funds, could leverage the inherent advantages of their sophisticated marketing techniques, branding and advances in social business
  - Industry funds could continue to give fund members the ability to invest directly in shares, deposits and fixed term assets, and should improve their access to and use of data sources which can be used to develop personalised product and service offerings for default and choice members
- ***Increasing education*** and emphasizing the value of ***after-tax returns*** from superannuation products relative to other investment vehicles
- ***Introducing new investment options*** to target the income needs of retirees including:
  - Considering innovative approaches to making income streams and annuities an attractive proposition to retirees
- ***Investing two to five years more*** in employment and the accumulation phase of the system
- ***Boosting the population*** and the size of the asset pool through:
  - Migration and increased working life
  - Immigration (at working ages) is relevant as it keeps the dependency ratios down
    - NB the population projections assume mid-level immigration without which things would be worse.

These are just some of the levers that business and government can pull to help manage the shifting dynamics of superannuation over the next twenty years.

Deloitte's team of superannuation partners and directors look forward to discussing these changes and working with you to consider ways to develop appropriate and sustainable solutions.

Contact the Authors:

Russell Mason
Partner

Tel: +61 2 9322 5347
rmason@deloitte.com.au

Ben Facer
Partner

Tel: +61 2 9322 3493
bfacer@deloitte.com.au

Stephen Huppert
Partner

Tel: +61 3 9671 7778
sthuppert@deloitte.com.au

Louise Denver
Director (Editor)

Tel: +61 414 889 857
ldenver@deloitte.com.au

Diane Somerville
Principal

Tel: +61 2 9322 7636
dsomerville@deloitte.com.au

Other contacts:

Neil Brown
Partner

Tel: +61 3 9671 7154
nbrown@deloitte.com.au

Frances Borg
Partner

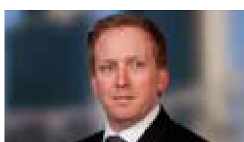
Tel: +61 2 9322 7202
fborg@deloitte.com.au

James Oliver
Partner

Tel: +61 3 9671 7969
joliver@deloitte.com.au

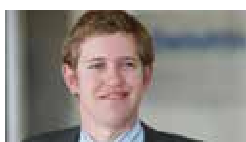
Wayne Walker
Retired Partner

Tel: +61 3 9671 6916
wawalker@deloitte.com.au



David Rodgers
Partner

Tel: +61 7 3308 7453
drodgers@deloitte.com.au



Dave Salmon
Partner

Tel: +61 2 6263 7110
dsalmon@deloitte.com.au

Caroline Bennet
Partner

Tel: +61 3 9671 6572
cbennet@deloitte.com.au

Fiona O'Keefe
Partner

Tel: +61 3 9671 7317
fiokeefe@deloitte.com.au

www.deloitte.com.au

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