

Response to
'Superannuation: Assessing Competitiveness and
Efficiency'

Julian D Gribble

Cary Helenius

for

Australian Government
Productivity Commission

13 July 2018

THIS PAGE HAS BEEN INTENTIONALLY LEFT BLANK

Australian Government
Productivity Commission
4 National Circuit Barton ACT 2600

13 July 2018

Via e-mail: super@pc.gov.au

Response to Productivity Commission Paper Stage 3: 'Superannuation: Assessing Competitiveness and Efficiency'

Dear Sir/Madam

Thank you for the opportunity to make a submission and comments on the Stage 3 Paper "Superannuation: Assessing Competitiveness and Efficiency".

1 Overview

We will limit our comments to focussing on the issue of:

Costs, fees and net returns

With particular regard to:

whether the system is minimising costs and fees (including, but not limited to exit fees) for given returns

and

whether tailoring of costs and fees for different member segments would be appropriate.

In particular, we focus on the post-retirement phase of superannuation which we project to be of the order of \$3.7 trillion by 2040. This is over 40% of the projected \$8.6 trillion in the entire superannuation system at that time. In particular we focus on the rapidly growing elderly segment of retirees, those aged over 80. We estimate they will then represent about \$700 billion of funds, or almost 20% of the total post-retirement super funds. Both these proportions are projected to continue to increase further post 2040.

We believe the discussion about 'efficiency' is important but is a multi-faceted one. Clearly an important dimension is direct cost efficiency. However, there are other dimensions that also have

a systemic financial impact as their management reflects the extent to which retirees utilise their funds. We believe this leads to an increased focus on services, as we discuss below. Therefore, efficiency should be managed from an overall perspective, optimising the impact over all its dimensions. Focusing on the two dimensions of costs and returns, may produce a sub-optimal overall outcome from both the superannuation system's and the retiree's perspective.

The cost efficiency versus returns focus is more appropriate in the wealth accumulation phase of superannuation, as the funds are in an accumulation mode and cannot be accessed. However, it should be noted that the retirement phase is about 'wealth management and utilisation' more so than 'wealth accumulation'.

We believe there is a third dimension that needs to be overlaid, particularly for the decumulation phase, which is the appropriate level of service, versus costs and returns. For example, many elderly retirees may lose the capacity to use technology-based services as cognitive skills and physical dexterity decline. So, while these services may directly be considered to be financially cost efficient and low cost, they will become inefficient and ineffective for the utilisation of retirement funds by older retirees. That is, the overall efficiency of the system will be diminished.

The service element is key to make the decumulation phase of retirement efficient as superannuation members progress from the active phase of retirement into the passive, and frail phases. The declining capacity of superannuation members will become an increasing problem as the superannuation system matures and the membership ages. We believe this will require a human interface as part of the service offering of superannuation funds in the retirement phase.

By its nature, the cost of wages and employing individuals to service ageing retiree needs will add costs to the system, but these costs will be far outweighed by the efficient use and deployment of retiree funds to benefit the retiree in later life.

As increasing proportions of retirees suffer mental capacity declines as they age, through either Mild Cognitive Impairment, or through onset and progression of dementia, a significant component of the retired population will need a higher level of service to manage and utilise their diminishing superannuation balances. Our research suggests that in the over 80s segment the prevalence of individuals with either Mild Cognitive Impairment or dementia is substantial and is likely to represent more than 50% of these retirees.

The utilisation, and preservation, of these retirement funds are both critical to the efficiency of outcomes from the superannuation system. The utilisation of funds requires that retirement funds are put to appropriate use to improve the retirees' quality of life. If the only criteria are based on funds being efficiently invested in low cost, high return investments, they will serve no purpose for the retiree, who cannot access and utilise these funds when most needed and will result in a substantial inefficiency within the retirement system.

We have made separate submissions into the Comprehensive Products for Retirement process and highlighted the need for retirement services to be integrated with the superannuation system.

2 Paper

In June 2018 we presented a paper at the International Congress of Actuaries in Berlin, titled "Retirement - the new frontier of the over 80's market". The paper focusses on holistically considering the suite of issues that need to be addressed in designing retirement products for the over age 80's segment of the population. In particular, we focus on the utilisation of funds for retirees with declining physical and mental capacity. The management of these issues directly impacts the efficiency debate. We would be pleased to provide a copy of the presentation and supporting paper, or discuss our findings, if this is of interest to you.

As noted above, we estimate that over 50% of the over 80's population currently suffers from some level of mild cognitive impairment or dementia, and this is projected to continue.

Separately, almost 40% of those aged over 65 need some form of assistance with everyday activities (almost half of the women and a third of the males). At age 85, more than 80% (eight out of ten people) need assistance compared to less than 30% (three out of ten people) aged 60-69. It is reasonable to conclude that the prevalence of individuals needing assistance with everyday activities exceeds 50% in the over 80's segment of the population, and that the deployment of retirement funds supporting this segment will be critical to fund the assistance required.

These facts have implications for the operation and mechanics of the retirement system to properly cater for the changing nature and requirements of retirees as they age.

3 Projected size of the over 80's segment

Using UN population projections for Australia it is estimated that in 2040 approximately 21% of the population (6.5 million people) will be over age 65, and almost 8% of the total population will be over age 80.

This suggests that at least 37% of the retired population will be aged over 80. The percentage will increase further as the retirement age in the system increases.

Treasury projections suggest the total superannuation funds by the year 2040 will be \$8.6 trillion.

Using Rice Warner data to proportion this number into 'retirement phase' assets, suggests that approximately \$3.7 trillion will be in retirement phase. This is 142% of the current total superannuation system.

Using this data, in 2040, we estimate that the average retirement phase superannuation balance will be approximately \$570,000. We estimate that for those aged 80 and above it will be approximately half this average, due to the decumulation phase drawdowns.

This suggests that in 2040, there will be in the order of \$700 billion dollars in retirement funds controlled by the retirees aged 80 and over, representing 8% of the entire superannuation system, and almost 20% of the retirement phase assets.

If we apply the current health statistics that suggest that 30% will have dementia (at least in the early stages), and that an additional 20% is likely to have various degrees of Mild Cognitive Impairment, which impact memory, and cognitive skills to operate technology, and 'self-serve' methodologies. This suggests that approximately \$350 billion dollars, or greater than 10% of the retirement phase assets, and greater than 4% of the total superannuation system assets will be at significant risk from being underutilised due to a declining lack of capacity from the retiree. These percentages are projected to increase further beyond 2040 as the prevalence of the over 80's segment increases further with mature superannuation balances at retirement.

4 Servicing the elderly retirees

In our paper we also discuss the nature of retirement products in the current superannuation system, which simply target "Mr & Mrs Average" and note that the vast majority of retirees will have circumstances that put them outside this standard stereotype of being healthy, and capable of dealing with financial retirement issues as they move from the active phase of retirement into the passive and frail phases.

We believe this issue can be significantly addressed by tailored, increased levels of service being available for retirees as they age. In particular, there is a need for financial support services to assist older retirees in accessing and utilising the balance of their retirement savings. We acknowledge that this would add costs to the system, and if measured on a pure cost versus investment return basis may appear inefficient. However, we strongly advocate that these servicing costs will produce significant productivity and efficiency benefits from the \$350-700 billion projected retirement phase assets being put to appropriate use to improve the quality of life for aging retirees suffering from decreasing mental and physical capacity.

While these services may not be seen as the lowest cost option for a given level of returns, they will be necessary to optimise the overall efficiency and effectiveness of the management and utilisation of these funds. The inclusion of these services implies the need for third parties to act on behalf of these retirees to implement these services. These financial support services may be provided outside the superannuation system, for example by an independent trustee company, however, if this support is embedded into the superannuation system it will improve systemic efficiency as it reduces the reliance on individual retirees pro-actively and individually taking action to implement these services as they age.

5 Recommendations

We believe it is critical to take a broader perspective of what 'efficiency' means. This needs to go beyond the two-dimensional paradigm of assessing cost versus returns. It needs to take a portfolio approach and include other dimensions, such as services, to get to an optimal overall outcome for the financial system and the effective utilisation of retirees' assets.

We also believe that the tailoring of costs and fees is important and should distinguish between the 'wealth accumulation' of superannuation and the 'wealth management and decumulation' of retirement assets. This also needs to recognise the inevitable transition from active to passive and frail retirement phases.

6 Next steps

We would welcome the opportunity to discuss our views with you. Please let us know if this would be of interest to you.

Yours sincerely,

Cary Helenius, Actuary

Jules Gribble, Actuary