19 June 2013

Mr Michael Wellham
Treasury
Attention: Charter Group
Langton Crescent
Parkes ACT 2600

Email: supercharter@treasury.gov.au

Dear Mr Wellham

Re. Charter of Superannuation Adequacy and Sustainability and Council of Superannuation Custodians

The Financial Planning Association of Australia (FPA) welcomes the opportunity to provide feedback on the proposed Superannuation Charter and Council of Custodians.

The FPA's submission has been guided by the belief that the superannuation system should aim to assist people to fund their own retirement, to reduce the reliance on social security benefits and create a more sustainable and fair system for all Australians.

The FPA would welcome the opportunity to discuss this further. If you have any questions, please contact me on 02 9220 4505 or dante.degori@fpa.asn.au.

Yours faithfully

Dante De Gori
General Manager Policy and Conduct
Financial Planning Association of Australia[1]

[1] The Financial Planning Association (FPA) represents more than 10,000 members and affiliates of whom 7,500 are practising financial planners and 5,500 CFP professionals. The FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- We banned commissions and conflicted remuneration on investments and superannuation for our members in 2009 – years ahead of FOFA.
- We have an independent conduct review panel, Chaired by Professor Dimity Kingsford Smith, dealing with investigations and complaints against our members for breaches of our professional rules.
- The first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices. This is being exported to 24 member countries and the 132,000 CFP practitioners that make up the FPSB globally.
- We have built a curriculum with 17 Australian Universities for degrees in financial planning. As at the 1st July 2013 all new members of the FPA will be required to hold, as a minimum, an approved undergraduate degree.
- CFP certification is the pre-eminent certification in financial planning globally. The educational requirements and standards to attain CFP standing are equal to other professional bodies, eg CPA Australia.
- We are recognised as a professional body by the Tax Practitioners Board

Charter of Superannuation Adequacy and Sustainability

1. A proposed Charter

In principle, the FPA supports the concept of a Charter that provides a strategic vision for the superannuation system to guide the development of public policy in superannuation into the future.

Recommendation

The FPA recommends a Charter of Superannuation Adequacy and Sustainability should be a policy document only and not enshrined in legislation

2. Principles

The FPA recommends additional principles should be included in the Charter.

Additional principles

The superannuation guarantee system will reach maturity in 2037. By this time the make up of Australia's population will look considerably different to today, with the proportion of people aged 65 or over reaching 25 per cent, nearly double that of today, and the number of working age people to support those aged 65 and over decreasing from 5 per cent to only 2.4 per cent. In addition, around 75 per cent of retirees will still be in receipt of some amount of age pension.[2] There is a need to address the issues of retirement adequacy and longevity risk for generations growing up under different superannuation and tax systems.

Recommendation

The FPA recommends the principle of flexibility is needed to respond to changing demographic needs and capabilities to enable people to retire on an adequate income without the compulsory extension of working life.

The FPA agrees with the widely held view that Australia's superannuation system is overly complicated. As stated by a senior Treasury official, "people now need to get highly sophisticated advice just to interact with the system"[3]. Such complexity has resulted in increasing costs of system administration and compliance, reduced competition in service delivery, difficulty for providers to develop innovative products, and a significant reduction in consumer understanding and confidence in the system.

[2] Treasury projections, Intergenerational Report 2007.
[3] David Parker, Executive Director Revenue Group, The Treasury, *Super Policy Forum*, 19 February 2009

Recommendation

To overcome the issues created by the complexity of the system, the FPA recommends a Charter used to guide the development of superannuation public policy must include the following principles:

- Accessibility – A principle of accessibility is needed to ensure the efficiency, approachability, acceptance, trust and useability of the system for consumers, government and providers, is not significantly hindered by the complexity of the superannuation system. Access to superannuation for all Australians is also necessary for a sustainable, fair system.

- Efficiency - A principle of efficiency should consider the adequacy of the coverage of the superannuation system; the ability of the system and providers to respond to consumers needs during all stages of superannuation; ensure legislative requirements do not result in inefficient operations that drive up costs to consumers; and reduce consumer confusion about superannuation. A principle of efficiency would also support the accessibility of the system for consumers, government and providers.

3. Benchmarks for measuring superannuation adequacy

The concept of adequacy of retirement incomes presents complications, as the way the concept is used by Government in setting policy direction and legislation is likely to differ from the way it will be perceived and used by consumers planning their retirement goals. The FPA supports the concept for the development of an "adequate retirement income" but notes that one system is unlikely to suit all Australians and Government should be mindful about the way the concept is used to educate consumers.

The FPA suggests that the issues of longevity and a lifetime view of the retirement system are essential when identifying a potential benchmark of adequacy. There is also a need for flexibility in a retirement income measure to match the different spending needs and patterns in the different phases of retirement.

Factors that affect the adequacy of the system to fund Australians' retirement include:

- participation in the workforce, including continuing participation beyond "retirement";
- investment returns throughout the funding period and retirement;
- expenses during the funding period;
- level of debt at retirement;
- duration of retirement;
- the cost of living in retirement; and
- access to social security concessions and benefits.

Consumer expectations and adequacy

The experience of FPA members is that clients plan to achieve a dollar level of income in retirement and do not think in concepts of a percentage of pre-retirement income. Clients think in dollar terms and match this to expenditure requirements.

In a utopian sense, 'adequacy' can be measured against the capacity of an amount of capital to provide a standard of living commensurate with a retiree's expectations or goals. However, people preparing to retire are somewhat surprised that, what is a comparatively large lump sum of money, results in a decline in their income when compared to their pre-retirement salary/wages.

With this in mind, planning retirement income targets generally use two broad methodologies:

- Project the estimated level of savings at retirement using current balances and savings patterns and determine the level of income that can be sustained from this savings level over an estimated period of time. This sets a benchmark to either adjust the level of savings to achieve a higher savings target or to reduce expectations for expenditure in retirement; or

- Project retirement expenditure patterns (using benchmarks such as the Australian Superannuation Fund Association (ASFA)/Westpac retirement survey or the consumer's own detailed budget) to set a savings target to achieve this income.

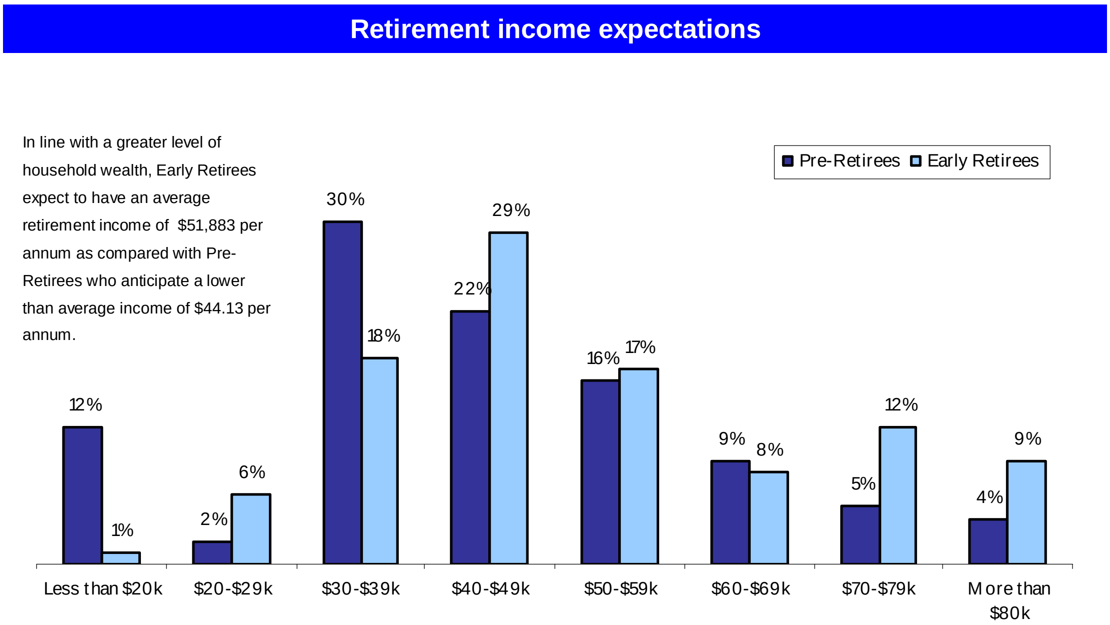
For most people, these calculations also factor in eligibility for the age pension to supplement savings.

Longevity is a major risk in this planning process and can be exacerbated if consumers have unrealistic expectations of expenditure needs or life expectancies.

The reality of consumer experience is that pre-retirees tend to underestimate the cost of retirement. Benchmarks like the ASFA/Westpac figures tend to play an important role in the education of consumers as they can assist to provide a realistic view of retirement expenditure to achieve certain lifestyles. Research highlights that income expectations of pre-retirees tend to be underestimated compared to the expectations of those who have retired and face the reality of expenditure needs on a daily basis[4].

[4] Asteron/Stellar market research on client expectations and longevity, 2006

Graph 2: Retirement income expectations – pre-retirees versus early retirees



Source: Asteron/Stellar market research on client expectations and longevity, 2006.

Note: For this research pre-retirees are defined as being within five years of planned retirement while early retirees are defined as being within the first five years of retirement.

Individual plans for adequate levels of savings are set in pre-retirement years as clients decide on how much current expenditure to forgo to create retirement income but if they underestimate their retirement needs, the longevity risk is exacerbated. Often consumers also misunderstand the changing needs they will face as they progress through retirement and the impact this can have on expenditure, particularly with regards to health and aged care.

Phases of retirement

The ageing of the population and longer periods in retirement will lead to greater recognition of the structure of retirement and the life stage transitions during this period. Retirement has been segregated into three phases, each of which has different needs and expenditure requirements:

1. Active phase – retirees are likely to be more active early in retirement and are inclined to continue with their existing lifestyle, including more leisure and travel time, during this active phase.

2. Passive phase – this phase starts to see increased expenditure on health costs.

3. Frail or high dependency phase – later in retirement a retiree's restricted mobility means expenditure on leisure is increasingly replaced by higher expenditure on health and aged care.

Increasing health and aged care costs change expenditure patterns in retirement and create the need for a steady or even increasing income (rather than a decreasing one).

Recommendation

The FPA recommends that a benchmark for adequacy must accommodate the special needs of these different phases.

Issues of aged care and adequacy

Traditionally many people have taken the view that retirement income needs decrease as a client ages. In many cases, this meant that clients were willing to spend savings in early years of retirement and rely on the age pension at older ages. It has been suggested that to adequately fund retirement, a typical couple would need to reduce expenditure by around 40 per cent upon retirement and then further reduce this by 0.5 per cent per year thereafter[5].

This traditional view is being challenged by the current issues facing an ageing population. Increasing health and aged care costs as a person progresses through retirement may lead to an increase in retirement expenditure in later years and significantly impacts on adequacy.

The impact of aged care can be difficult to quantify. Not all retirees will need to move into aged care accommodation, but most will require progressively greater levels of support as they age. The expenses and impact on their retirement income will depend on the level of support from a spouse, family and friends, ongoing suitability of their family home to meet their needs, location and associated property expenses or care availability, personal health and mobility, and level of savings.

In fact, it could be argued that later in life, the need is higher for capital than income to access and pay for health and aged care. Yet the decision to spend capital in early years of retirement and rely on income from the aged pension later in life runs counter to this need.

Adequacy of income is therefore important at older ages when a person needs greater care to allow choice and dignity in how they are treated. It also allows greater access to the relevant services.

Policy benchmarks for adequacy

The FPA supports the development of benchmarks for the adequacy of retirement incomes to assist Government to determine policies around access to the age pension and levels of support as well as the development of policies to create incentives for Australians to accumulate adequate retirement incomes.

It is the FPA's view that adequacy benchmarks should focus on the concepts of retirement expenditure, with consideration to increasing health costs, aged care needs and longevity. Assumptions for the benchmark must include flexibility for the diverse financial positions of retirees (for example, entering retirement with debt and varying lifestyles) and the different expenditure requirements in the three phases of retirement. A one-size-fits-all approach would deliver insufficient outcomes for Australians.

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5 Centre for pensions and superannuation, UNSW, *Superannuation Guarantee / Adequacy and Retirement: Longevity and economic impacts*, 2007.

The government's discussion paper suggests the use of a replacement rate and states that:

> *A commonly expressed aspiration for adequacy is for a superannuation balance large enough to provide an income stream (including capital drawdown) of around 70 per cent of pre-retirement income over a 25-30 year period.*

A significant part of the debate surrounding longevity arises from the differing approaches to adequacy benchmarks as well as the level of income required.

There is a significant body of research devoted to the worldwide use of replacement rates. Replacement rates are defined as ratios of a person's income or spending power after retirement to that before retirement. The proposition underlying the replacement rate concept is that a person's standard of living in retirement should be a reasonable proportion of his or her standard of living during working life.[6]

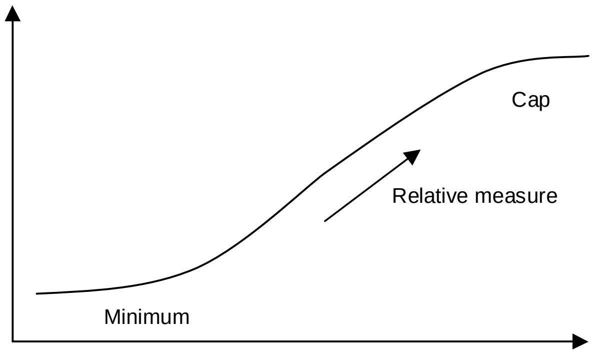
The replacement rate is a relative measure based on previous earnings. The use of this type of measure carries significant risks, particularly for low income earners whose pre-retirement income may have been very low relative to average earnings or in some cases not far above the poverty line. This measure also does not take into account actual retirement costs or an increase in health and aged care costs as a person ages.

In contrast, the budget standard is an absolute measure and lacks the flexibility to cater for the different needs of generational groups and the changing expenditure patterns in the active, passive and high dependency phases of retirement. It also does not sufficiently address different lifestyle expectations.

To cater for consumers' varying retirement expectations, longevity and the phases of retirement, the FPA acknowledges there may be some merit to the wellbeing measure however, we also note this measure is still being developed.

The FPA considers it insufficient to use either the replacement rate or the budget standard as a stand alone measure for retirement adequacy. The FPA suggests a combination of an absolute and a relative measure would be more appropriate. Integrating these measures would allow the budget standard to set a minimum level of adequacy for all Australians which is then overlaid with a replacement rate methodology (up to a potential cap) to assist Australians on medium and higher incomes to maintain a comfortable level of retirement.

[6] George Rothman, *The Adequacy of Australian Retirement Incomes*, 2007



Recommendation

The FPA recommends more information and research on expenditure patterns in retirement, based on consumer experience at different phases of retirement, is required to identify an effective adequacy benchmark.

Adequacy benchmark indexation

In benchmarking adequacy there is a need to determine an appropriate indexation methodology.

Current policy indexes age pension thresholds to the Consumer Price Indexation (CPI). Payment rates are also linked to CPI but with a check to ensure they do not fall behind the relative increases in Average Weekly Ordinary Times Earning (AWOTE).

However, the needs of a retiree are different to the needs of a pre-retiree. Before retirement the focus is on the level of income generated, while in retirement focus shifts to the level of expenditure needed. As such, the FPA suggests a more appropriate indexation measure is the use of a special Retirement Price Index (RPI). For example, weighting the current CPI into an RPI to take into account health and aged care needs, which increase during retirement. The use of an RPI would also assist to insulate against inflation.

As an alternative, if an RPI is not to be used, the FPA believes that the use of AWOTE would be a better indexation methodology than CPI. This is because AWOTE allows a more equal balance of standards of living for both workers and retirees.

Council of Superannuation Custodians

The FPA believes that the establishment of a Charter of Superannuation, as a policy document that guides the development of public policy, should not necessarily dictate the creation of a body to provide advice to government on superannuation policy. The FPA is concerned that a Council of Superannuation Custodian, should it be established, would duplicate the work of existing superannuation advisory bodies and Treasury in the development of superannuation public policy (as noted in the Discussion Paper), and potentially result in confusion for consumers and industry.

Recommendation

Should a Council of Superannuation Custodian be established, the FPA recommends the Council should:

- be able to examine and report on issues on its own initiative;
- have the capacity to recommend policy changes for consideration by the government;
- be structured to ensure representation of all stakeholders that play a vital role in the superannuation system and consumers' interaction with the system, including from:
  - superannuation industry – retail and industry funds or a body that represents both
  - Self Manager Super Funds industry - representing the users of SMSF's (for example the SMSF Owners Alliance)
  - Financial planning profession
  - Consumer bodies
  - Accountancy profession
  - The Regulator, APRA
  - Treasury
- take the form of an advisory panel.

The Council should ensure a level playing field with respect to both product distribution, and compliance requirements of other industry players.