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Introduction

This paper has been prepared to accompany the inaugural edition of How Australia Saves 2017, Vanguard’s first deep dive data analytical exploration of member behaviours in a large Australian superannuation fund.1

The paper provides further depth of information on various aspects of the Australian superannuation (private pension) system, beyond the essentials that are summarised in How Australia Saves 2017. This includes an outline of the underlying demographic drivers, policy settings, regulation and segmentation of the superannuation system, and some commentary on how these compare with other major developed economy retirement savings systems.

A precursor to an in-depth understanding of any retirement income system is to reflect on the macro settings from a public policy and economic perspective. Our discussion therefore starts at that level, before moving on to the specifics of the Australian superannuation system’s rules, regulation and industry structure.

Where relevant, the paper reflects regulatory changes and new tax rates and thresholds that have taken effect since 30 June 2016, which was the completion date of the data in the first How Australia Saves report. These changes include an extensive package of reforms to the superannuation system that was announced in the May 2016 Federal Budget and subsequently legislated (after some further refinements) in November 2016, with an implementation date in most cases of 1 July 2017.

While these reforms have not formally commenced at the date of publication, they are expected to influence many superannuation members’ savings behaviour, both in anticipation of their introduction and subsequently. They will therefore be an important focus of analysis in future editions of How Australia Saves.

The paper concludes with a discussion of expected future developments in the system as it evolves towards a focus on provision of retirement incomes, as well as accumulation of savings leading up to retirement.

Through all of these sections, our Key Superannuation Milestones graphic on pages 8 to 9 summarises the major highlights.

1 Available on Vanguard’s Australian website at www.vanguard.com.au/howaustraliasaves
The global retirement savings challenge

In developed economies worldwide, a range of macro-economic forces are combining to force a fundamental reassessment of the settings for securing meaningful income for retirees. These include:

- An inexorable demographic trend to an ageing population, driven by declining fertility rates, medical and public health advances, and continued improvements in life expectancy;
- Transformation of the nature of work and the drivers of productivity in the modern economy, through continued technological disruption and changing workforce participation patterns;
- A subdued outlook for global economic growth and investment market returns for the foreseeable future, relative to expectations set in previous economic cycles.

At stake in this transition are a number of threshold questions about the values and priorities that underpin the social contract between governments, citizens and other stakeholders in pension systems. Among them:

- To what extent should income for retirees be funded from general taxation revenue, as opposed to self-provision?
- Should public support be pre-funded, or paid out of recurrent revenue?
- What is the right balance between incentives to save for the future and facilitating current consumption?
- How can the system ensure equitable treatment between different generations?
- Should financial risks in the system be borne primarily by governments, by employers, or individuals?
- What level of retirement income (either in absolute terms, or as a replacement of pre-retirement income) should the system aim to achieve?
- Can individuals be realistically expected to make their own retirement income decisions, or do they need advice and guidance?
- To what extent should regulatory agencies or fiduciaries determine key retirement settings or defaults on behalf of their citizens?

Policy responses

In most economies, the answers to questions like these have been distilled – either directly or implicitly – into one variant or another of the “Three Pillars” framework posited by a landmark report by the World Bank in the 1990s, and subsequently adapted for the Organisation for Economic Cooperation and Development (OECD) for developed economies specifically.\(^2\)

In broad terms, the three pillars are:

Pillar 1: A universal, taxpayer-funded component aimed at poverty-alleviation (at a minimum) and equitable targeting/re-distribution, e.g. through means-testing.

Pillar 2: A pre-funded private savings component, usually employment-based.

Pillar 3: Tax-incentivised voluntary savings for retirement, within the pension/superannuation system, outside it, or a combination.

While various configurations of this framework can be observed in different developed countries, some common trends have emerged – most notably:

- A mounting fiscal burden of public pension systems in the face of the intractable demographic changes noted earlier. This trend is leading to a tightening of eligibility rules for access to publicly funded pension benefits in most OECD economies (e.g. increasing the access age from a common norm of age 65 to 67 or higher), along with a range of policy measures to increase labour force participation rates of older workers.

\(^2\) World Bank, *Averting the Old Age Crisis* (Oxford University Press, 1994). The World Bank has more recently evolved this model into a more extensive “Five Pillar” framework incorporating additional inputs such as social insurance schemes and non-financial aspects (such as family support) – see The World Bank Pension Reform Primer – Conceptual Framework (2007). However the original 3 pillar framework is cited here as it remains the most common framework referred to in pension system literature and public policy discussions. In markets like Australia which have relatively high rates of home ownership, housing wealth is also often cited as a “fourth pillar” of the retirement income system.
• An increasing reliance on funded, occupationally based arrangements to deliver outcomes that go beyond mere poverty alleviation or subsistence in retirement. These private retirement savings systems have in turn evolved significantly, including in their degree of coverage of the working population, participation rules (mandatory, opt-in or auto-enrolment) and underlying benefit design.

• A seismic shift away from defined benefit (DB) occupational pension schemes, in which participants’ benefits are underwritten by employers, to defined contribution (DC) schemes. DC schemes offer a high degree of investment choice, design transparency and flexibility, but make the individual participants largely responsible for their own selection decisions. This exposes participants more directly to the underlying investment, longevity and other risks of the system.

• A wide variety of approaches to promote additional retirement savings beyond the public and occupationally based systems. These include taxation incentives for voluntary contributions above mandated or default levels, and mechanisms for retirees to supplement retirement income by accessing other sources of stored value, such as housing equity.

Looking ahead, additional challenges are emerging, affecting all pension systems globally. These stem not only from continued shifts in demographic forces, but also from likely structural changes in the nature of work as a driver of economic growth and productivity, and the likely persistence of a low-growth, low-interest rate investment environment for the foreseeable future.3

**Spotlight on Australia**

One economy that exemplifies all of these trends – and has developed some particularly noteworthy approaches to addressing them – is that of Australia.

With a population of 24.3 million and a GDP of US$1.34 trillion, Australia is the world’s 13th largest economy, representing approximately 2% of the global economy by GDP value.4

As a relatively affluent, urban and diverse society, Australia has been well-placed to tackle post-World War II demographic trends at least partly through measures outside the direct realm of retirement income policy. For example, Australia’s relatively high net migration numbers have to a significant degree counteracted the decline in fertility rates experienced over the past generation, and contributed more to productivity improvements than would have been achieved through natural population growth alone.5

Nevertheless, the demographic drivers of population ageing are still very much in evidence. A detailed assessment of these demographic drivers and their long-term implications for public policy, known as the Inter-Generational Report (IGR), is published once every five years by the Australian Treasury. The most recent IGR was published in March 2015 and contains detailed projections for the 40-year period to 2055. Among its headline projections are that Australia:

• Enjoys one of the world’s longest life expectancies at birth (currently 91.5 years for males and 93.6 years for females and projected to rise to 95.1 and 96.6 years respectively by the year 2055).

• Is set to experience a doubling of the number of people over the age of 65 within the next 40 years, with the fastest growing segment being in the over-85 year-old age group.

• Is seeing higher demands on its public health and welfare systems through a decline in the working age population from 7.3 workers per retiree in 1975, to 4.5 workers per retiree in 2015, and projected to decline further to 2.7 workers per retiree by 2055.6

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6 It should be noted that the life expectancy ages quoted in the first dot point were calculated by the IGR on a “cohort” basis, which (unlike the ‘period’ approach used in some statistical surveys) takes into account further projected life expectancy improvements during the lifetime of people born today. The cohort approach yields higher life expectancies than the period approach (in the order of 10.8 years for males and 8.8 years for females according to the IGR for those born in the year 2015). For further explanation see http://www.treasury.gov.au/PublicationsAndMedia/Publications/2015/2015-Intergenerational-Report (Appendix C, p. 107).
Further amplifying these projections, Figure 1 illustrates the projected changes in the age structure of Australia’s population between 2011 and 2061 as estimated by the Australian Bureau of Statistics. As can be seen, the proportions of both men and women aged 65 and over are projected to increase significantly over this 50-year period, largely at the expense of those age cohorts generally considered to be of “working age” (i.e. those aged 15 to 64).

In comparative terms, this data shows that the ageing population challenge is not as dire in Australia as it is in many other developed economies. However, in absolute terms it remains a very significant factor in the design and sustainability of the country’s retirement income system. In particular, it helps place into context the emergence of Australia’s rapidly growing occupational superannuation system over the past three decades.

In the following two-page timeline, we illustrate key milestones in the evolution of Australia’s modern superannuation system from its infancy in the 1980s to the present, and projected forward to 2025, a time horizon over which many policy settings in place today will be implemented. We then outline in more detail the policy settings of the broader Australian retirement savings system, before turning to describe in more detail the dimensions, industry structure and regulation of the superannuation industry specifically. The paper concludes with some commentary on current key themes and expected future developments.

Together, these provide an essential backdrop to the detailed analysis of member transaction behaviours that is the key focus of the How Australia Saves report.

Figure 1. Australia’s population – age distribution in 2011 and 2061

**Figure 1.** Australia’s population – age distribution in 2011 and 2061

<table>
<thead>
<tr>
<th>Age group (years)</th>
<th>2011</th>
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Source: Australian Bureau of Statistics 3222.0
Population Projections Australia 2012 (base) to 2061

**Figure 2.** International comparisons – population aged 65 and over, 2010 and 2030

**Figure 2** is projected over a shorter time period, but illustrates Australia’s expected population ageing experience relative to other advanced economies, between 2010 and 2030.

A note on superannuation rates and thresholds

Most of the tax rates, dollar thresholds and other variables that apply to Australia’s superannuation system change over time – for example, due to periodic indexation increases, or to regulatory changes.

Some rates and thresholds also differ depending on individual circumstances. For example, different age pension rates and means test thresholds apply depending on marital status and home ownership. Or, in the pre-retirement phase, some members are subject to different tax treatments depending on their length of tenure in the system, income, or account balance.

In this report, we cite rates and thresholds that were applicable at the date of publication (June 2017). In some cases we also foreshadow known changes in rates and thresholds that are due to take effect in the future, including a number significant changes that commence on 1 July 2017.

In each case, this is to show the effect of a policy in general terms, not to address every possible scenario that might apply to an individual superannuation fund member or retiree.

The following online public resources are recommended for readers who require more detailed information about specific rates and thresholds applicable in individual circumstances or points in time:


Individuals should obtain personal financial advice about the rates and thresholds applicable to their own circumstances.
### Key superannuation milestones

#### Australian PMs and Treasurers

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#### Major events

- **1996**: Superannuation Guarantee (SG) introduced
- **1997**: Superannuation Guarantee (SG) commenced
- **1998**: Superannuation Guarantee (SG) increased to 3%
- **1999**: Superannuation Guarantee (SG) increased to 5%
- **2000**: Superannuation Guarantee (SG) increased to 6%
- **2001**: Superannuation Guarantee (SG) increased to 7%
- **2002**: Superannuation Guarantee (SG) increased to 8%

#### Industry milestones

- **1996**: Insurance & Superannuation Commission (ISC) established as industry regulator
- **1997**: Superannuation Guarantee (SG) introduced in some industries as an industrial arbitration measure
- **1998**: Superannuation Guarantee (SG) introduced
- **1999**: Superannuation Guarantee (SG) increased to 3%
- **2000**: Superannuation Guarantee (SG) increased to 5%
- **2001**: Superannuation Guarantee (SG) increased to 6%
- **2002**: Superannuation Guarantee (SG) increased to 7%
- **2003**: Superannuation Guarantee (SG) increased to 8%

#### SG contribution rate

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#### Industry growth

- **Super FUM**: $350bn
- **Super as % of GDP (RHS)**: 9%
- **Millions**: 2017
- **Billions**: 2025

#### Australia’s population

- **Australia’s population**: 16,047,026
- **Total number of superannuation accounts**: 24,309,330

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1. In the first 3 years of the SG, a higher contribution rate applied to employers with payrolls above $1 million per annum.

2. Source: Australian Bureau of Statistics, Australian Demographic Statistics Sep 2016 (ABS catalogue 3101.0) for 1986-2016 data; Population Projections 2012 (base) to 2101 (Medium series), ABS catalogue 3222.0 for 2017-2025 projections

3. Source: Rice Warner
Policy settings – Australia’s retirement system

First tier

A taxpayer-funded age pension:

- Universally available, subject to means testing and residency requirements
- Accessible from age 65.5 (from 1 July 2017), gradually increasing to age 67 by the year 2023.

Australia’s national taxpayer-funded age pension has existed since the very early years of the nation’s Federation, commencing in July 1909.8

In its modern form, the age pension is a critical part of the nation’s social welfare infrastructure, with a maximum rate set according to an indexation formula that equates to approximately 28% of male average full-time earnings, adjusted twice yearly in March and September. At June 2017, this amounts to a maximum payment of $888.30 per fortnight (approximately $23,100 p.a.) for an eligible single homeowner. For eligible couples who own their own home, the maximum rate is $1,339.20 per fortnight (approximately $34,820 p.a.).9

The minimum age pension access age is currently 65 for both men and women, but in common with many other countries this is being increased gradually to age 67 between 2017 and 2023, with the first incremental increase (to age 65.5) applicable from 1 July 2017. Further increases to age 70 have been foreshadowed by the Australian Government for some time after 2023, but have not been legislated to date.

Age pension eligibility is subject to means tests on both assets and income. While most superannuation balances and other financial and non-financial assets are included under the assets test, the family home (and up to two hectares of land on the same title) is excluded.

The means tests are structured such that age pension eligibility tapers down once certain income and/or asset thresholds are exceeded. To illustrate their effect, in the case of a single pensioner who owns their own home (at June 2017):

- The maximum assets that can be owned or fortnightly income received while retaining eligibility for the full age pension are $250,000 and $164 per fortnight respectively.

- After that, pension eligibility tapers down at a rate of $3 per $1000 of assets and $0.50 per dollar of income, until reaching an upper threshold of either $546,250 in assets, or $1,940.60 of income per fortnight, beyond which the individual is no longer eligible for any pension payment.

- Higher dollar thresholds apply for retiree couples, non-homeowner singles and couples, and couples separated by illness.

- Across the system, the effect of these dual means tests is that around 30 percent of Australians of pension age receive no age pension entitlement, unless they deplete their private savings below the relevant thresholds later in life.10

- With a growing and ageing population, the absolute number of Australian retirees depending on the age pension for at least part of their retirement income is expected to increase for the foreseeable future, notwithstanding the continued growth of the second and third tier superannuation systems. Consequently, public outlays to support the age pension are not expected to decline significantly over coming years, if at all, as a proportion of overall government expenditure, even as the stock of wealth in private superannuation savings grows.11

- From an investor behaviour perspective, strategies to maximise the age pension and ancillary public benefits (e.g. concessional health and travel benefits) through the management of private retirement savings and drawdowns are key drivers of superannuation member

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8 Major superannuation and retirement income changes in Australia: a chronology (Parliamentary Library of Australia, March 2014). Prior to the 1908 Commonwealth legislation, predecessor taxpayer-funded pension schemes had been established in the Colonies of New South Wales and Victoria in 1900, and in the State of Queensland in 1908.

9 Full details of current rates, supplements and means test thresholds see https://www.humanservices.gov.au/customer/services/centrelink/age-pension. Figures quoted include the fortnightly pension supplement and energy supplement that are paid on top of the core age pension calculation, and are current at June 2017 (based on March 2017 indexation increases).

10 For further details see The Adequacy of the Age Pension in Australia – an Assessment of pensioner living standards (Benevolent Society/Per Capita, September 2016).

11 The Inter-Generational Report 2015 projected that public outlays on age and service pensions would decrease from 2.9% of GDP in 2014-15 to 2.7% in 2054-55 assuming both a tightening of means testing and an increase of the age pension access age to 70 by 2035. The former of these two measures has now been implemented but the latter has not been as yet, with the access age presently only formally scheduled to rise from 65 to 67 by the year 2023 under current policy settings.
decision-making, both during retirement and in the years leading up to it. It is therefore critical to understand the role of the age pension as a driver of product design, member behaviour and financial planning strategies in other parts of the system.

So in a nutshell, Australia’s age pension system is, and will remain, an integral part of the country’s retirement income system, providing an annuity-like safety net underpinning the long-term savings and consumption needs of most Australian retirees.

Second tier
A universal occupational defined contribution superannuation system:

• Funded by mandatory contributions by employers (currently at 9.5% of salaries)

• Accessible from age 60 (or earlier for those born before 1 July 1964).

The cornerstone of Australia’s private retirement income system is its mandatory occupational defined contribution system, known as the Superannuation Guarantee (SG).

A precursor to the SG was the introduction of industry-wide employer superannuation contributions in some industries in the 1980s, as an industrial award entitlement in lieu of salary increases. Prior to that, occupational superannuation coverage had largely been confined to the public sector and management-level schemes in some larger companies, with no common framework for contribution rates, vesting entitlements or portability of benefits between different employers.12

The SG was first introduced as a near-universal employee entitlement in 1992 with a contribution rate of 3% of salaries, or 4% for employers with payrolls above $1 million per annum. The contribution rate has been gradually increasing over the past 20 years to its current level of 9.5%, and with further increments is scheduled to reach 12% of salaries by the year 2025.

The SG contribution regime applies to all employed Australians aged 18 and over, and earning at least $450 per month from a given employer.13 The maximum salary at which mandated contributions must be paid is indexed annually and currently stands at $206,480 p.a. (for the 2016/17 fiscal year), a threshold that equates to approximately 2.5 times average annual earnings. SG contributions are required to be paid at least quarterly, but usually they are paid in line with the employer’s regular monthly or fortnightly payroll cycle.

Self-employed individuals, who comprise approximately 10% of Australia’s working population, as well as those who are unemployed, are not covered by the SG system. However, individuals in these categories can access broadly equivalent tax concessions by claiming a tax deduction on non-concessional contributions made from their after-tax earnings or other income.14

Upon commencement of a new job, an employee may nominate a superannuation fund of their own choice to receive their SG contributions, and may also specify their preferred portfolio investment strategy. However, it is more likely that the new employee will automatically be enrolled in a default fund selected by their employer, and in the default investment strategy.15 The latter is known as "MySuper", an option which has a diversified investment strategy and is required to meet certain regulatory standards concerning fee and performance disclosure, and to providing a default level of death, disability and/or income protection insurance cover on an opt-out basis.

While most superannuation funds offer a wide range of investment choices, switching opportunities and additional insurance cover, the majority of newly joining members do not make active selection decisions and are simply placed in the MySuper option.

Default settings and member inertia are therefore important elements of the Australian system, especially during the early accumulation phase. But, over the course of their working lives and into retirement, Australian superannuation fund members have a wide range of choices and incentives for additional discretionary transactions available to them, over and above the mandated SG contributions and default product selections.

These pathways, and their influence on members’ transaction behaviour, are a primary focus of the analysis in Vanguard’s How Australia Saves research report.

12 For a detailed examination of the “pre-history” of the modern superannuation system and its origins in industrial relations campaigns of the 1970s and 1980s, see Bernard Mees & Cathy Bridgen, Workers Capital – Industry funds and the fight for universal superannuation in Australia (Allen & Unwin, 2017), Chapters 1-4.
13 These minimum criteria for SG eligibility have not changed since the commencement of the SG regime in 1992. A recent study by Industry Super Australia highlighted a significant level of employer non-compliance with the required contribution rules, to the tune of up to $5.6 billion in the 2013-14 fiscal year. At the time of writing this issue was the subject of a Senate Committee report, one of the recommendations of which was to consider abolition of the $450 per month minimum SG eligibility threshold – Australian Senate, Standing Committee on Economics, Superbad – Wage Theft and non-compliance of the Superannuation Guarantee (May 2017).
14 In 2012-13 an estimated 25% of self-employed individuals made contributions on this basis (source: ASFA, Super and the Self-Employed, 2016).
15 In many but not all cases the employer’s selection of a default fund is limited to those specified in an industrial award or Enterprise Bargaining Agreement.
Third tier

Tax incentives for additional voluntary contributions, over and above the mandated employer contributions, including:

- For salary earners, the opportunity to make additional pre-tax contributions in lieu of take-home pay. These are generally described as concessional or salary sacrifice contributions. In the fiscal year ending 30 June 2017 the maximum concessional contribution cap is $30,000 for individuals aged under 49, and $35,000 for those aged 49 and over.
- For self-employed individuals and small business owners, the ability to make tax-deductible contributions and in some cases transfer the proceeds from the sale of a business into a superannuation fund without incurring a capital gains tax liability.
- For all members, the ability to contribute from after-tax earnings, or from sales/transfers of other investments such as shares or property. These are called non-concessional or after-tax contributions. In the fiscal year ending 30 June 2017, the maximum non-concessional contribution cap is $180,000, with those under the age of 65 being able to use "bring forward" provisions to contribute up to $540,000 in a single year.

There is also a range of policy measures aimed at increasing the superannuation balances of specific targeted groups, including:

- A government co-contribution where those on lower incomes are eligible for a matching contribution of up to $500 per year for non-concessional contributions. The eligible low-income range is between $36,021 and $51,021 for the 2016-17 fiscal year, and between $36,813 and $51,813 for 2017-18.
- A Low Income Superannuation Contribution (LISC) scheme, designed to compensate employees on low incomes for tax paid on their mandatory employer SG contributions, which might otherwise exceed the rate paid on take-home pay.  
- Facilities for individuals to split their employer contributions and/or make additional after-tax contributions on behalf of their spouses, to optimise savings at an overall household level.

Tax settings

The discretionary contribution options described above are largely driven by incentives embedded in the taxation structure of the Australian superannuation system. Key elements of these incentives are that:

SG and salary sacrifice contributions and all investment earnings are taxed at a concessional rate of 15% during the accumulation phase. This compares to a top marginal income tax rate of at least 47% including the 2% Medicare levy (or 49% while the temporary deficit repair levy of 2% of income over $180,000 remains in place).  

Investment earnings after age 60 are tax-free, provided that the member has satisfied a “condition of release”, generally retirement, and their drawdowns are taken as lump sums or from eligible retirement income stream products.

In the taxonomy sometimes used to compare the taxation structures of retirement savings systems around the world, these features make Australia’s system a “ttE” system. This taxonomy refers to the taxation status of the three main phases of the retirement account – contributions, investment earnings and benefit payments – with the lower case character signifying when the taxation rate is levied at a concessional rate compared to other taxable inputs such as incomes and capital gains.

So, Australia’s “ttE” system means that tax is levied at concessional rates on both the contributions and earnings phases leading up to retirement, while drawdowns in the retirement phase are generally exempt from tax, provided that they are held in eligible retirement income stream products. This approach stands in significant contrast to the “EET” approach that applies in many other developed market pension systems including the US, UK, the Netherlands and Canada.

These taxation incentives are a major driver of transaction behaviours within the Australian system, particularly among more affluent and older superannuation fund members. However, as their unconstrained use by wealthier individuals can lead to distributional inequities and adverse impacts on public revenues, they have also come into focus in various policy adjustments to the system over recent years. These adjustments include a wide-ranging set of regulatory changes taking effect from 1 July 2017, which include:

---

16 The LISC is being renamed as the Low Income Superannuation Tax Offset (LISTO) from 1 July 2017, but has the same underlying intent of providing a matching government contribution of up to $500 to concessional contributions made by or for individuals with adjusted taxable incomes of up to $37,000 per annum – for full details see https://www.ato.gov.au/Rates/Key-superannuation-rates-and-thresholds.

17 Since 2012-13, an additional 15% tax known as Division 293 tax has also applied to reduce the degree of tax concessions enjoyed by high income earners with respect to their concessional contributions. From its establishment in 2012 until 30 June 2017, the threshold for Division 293 tax was income greater than $300,000 per year. This threshold is being reduced to $250,000 from 1 July 2017.

18 The taxation characteristics of the Australian system and comparisons with other major pension markets are detailed in a 2013 report by Mercer, Tax and Superannuation – Benchmarking Australia against the world’s best retirement savings systems. Some modelling of the effect of different tax configurations on the advantages of saving through pensions relative to other benchmark savings vehicles was undertaken by the OECD in Chapter 2 of its most recent (2016) Pensions Outlook report.
• Introduction of an upper limit of $1.6 million on the value of superannuation savings that can be transferred to a tax-exempt retirement account;

• A reduction in the concessional contribution cap to $25,000 regardless of age;

• A reduction in the non-concessional contribution cap to $100,000 per annum, or $300,000 broadly every three years under the “bring forward” provision.

• A reduction in the threshold at which an additional 15% tax (Division 293 tax) on concessional contributions is levied, from annual income of $300,000 to $250,000.

• Extension of the 15% tax on investment earnings to Transition to Retirement pensions, whereas previously this form of income stream enjoyed an earnings tax exemption.19

Headline industry dimensions and growth data

As a result of its well-established second and third tier systems, Australia today has one of the world’s largest and fastest growing private pension (superannuation) systems, with over $2.1 trillion in total assets at 30 June 2016, and very high coverage of the adult working population of some 12 million people.20 This makes Australia’s the world’s fourth-largest private pension savings pool in terms of total assets, and amongst the largest in terms of size relative to the domestic economy, at approximately 126% of GDP (in $US terms). The Australian system has also been growing at among the fastest rates of any developed economy pension system, with a compound annual growth rate of 7.9% p.a. (in local currency terms) for the 10 years to the end of 2016.21

Estimates of future industry growth vary widely depending on the assumptions concerning investment returns, demographics, regulatory and behavioural aspects. One detailed projection suggests that the total industry will almost double to reach $4.2 trillion (in 2016 dollar terms) by the year 2031, equating to 171% of projected GDP.22

Still a maturing system

Despite its size and rapid growth to date, the Australian superannuation system is yet to reach full maturity. Older members of the workforce have only had the benefit of mandated employer contributions since the early 1990s, and for most of this period at low contribution rates, as it has taken more than 20 years for the rate of contributions to rise to 9.5% of salaries.

The system will not reach maturity until at least the mid-2030s, when those at the point of retirement will have spent their entire working lives accumulating compulsory superannuation savings (and around another 25 years after that for an entire working life of contributions to have been at the maximum proposed level of 12%, assuming continuity of current policy settings.

Reflecting these trends, the transition of the superannuation system into a broader lifetime pension system has only really begun in earnest in recent years, with the movement into retirement of the initial cohort of the post-World War II “baby boomer” generation.

With the wave of baby boomer members moving into retirement, post-retirement assets are projected to increase from approximately $661 billion in 2016 to $1.4 trillion in 2030 (in nominal dollar terms). Retirement income account numbers are also expected to grow from around 2.0 million to 4.1 million over the same period.23

19 The majority of these reforms were introduced in the May 2016 Federal Budget and, following some further refinements and industry consultation, passed by Parliament in November 2016. Details are at http://www.treasury.gov.au/Policy-Topics/SuperannuationAndRetirement/Superannuation-Reforms.
20 Source: Australian Prudential Regulatory Authority (APRA) Quarterly Superannuation Performance (September 2016).
21 Source: Willis Towers Watson Global Pension Assets Study 2017. The other countries in the comparison group were the US, UK, Japan, Canada, the Netherlands and Switzerland. These countries, together with Australia, accounted for 92% of total assets across 22 major pension markets included in this study.
With the maturing of the system and increasing superannuation balances from both compulsory and voluntary superannuation savings, the proportion of retirement income drawn from superannuation will increase, and consequently retirees’ dependence on the age pension is expected to fall, as Figure 3 shows:

As a result of these changing dynamics, a significant focus of current public policy and product development attention is being directed towards more effective delivery of post-retirement income streams and protection against longevity risks, on top of the traditional focus of the Australian system on accumulation of assets up to the point of retirement.

Figure 3. Average retirement income at age pension qualifying age

Single pensioner (excluding non-super assets), in 2014 dollars

<table>
<thead>
<tr>
<th></th>
<th>1992</th>
<th>2014</th>
<th>2019</th>
<th>2024</th>
<th>2029</th>
</tr>
</thead>
<tbody>
<tr>
<td>Superannuation</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
<td>$0</td>
</tr>
<tr>
<td>Age Pension</td>
<td>$50,000</td>
<td>$50,000</td>
<td>$50,000</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
</tbody>
</table>


Net replacement rates vs. OECD average – a work in progress

One of the metrics commonly used by researchers to measure and compare pension systems globally is the net replacement rate. This metric expresses the outcomes delivered by the country’s retirement savings system (including both publicly funded and mandatory occupational components) as a proportion of pre-retirement incomes.

According to a recent analysis from the OECD, the Australian retirement income system in 2014 delivered a net replacement rate of around 58% for men and 53% for women at average net earnings. The equivalent figures for individuals on 0.5x average earnings were 89% and 85%, while for individuals on 2x average earnings they were 45% and 40%.²⁴

On the surface, these figures suggest that the outcomes delivered by the Australian system today are quite modest when compared with an OECD average replacement rate for a mature pension system of 63% of pre-retirement income for average earners.²⁵

However, the figures also show that Australia’s first tier system is comparatively well targeted to lower-income segments of the population (meeting its core “safety net” function), and is arguably more fiscally sustainable than other systems that promise more generous headline benefits that may prove unaffordable in the future.²⁶

Over coming years, as shown in Figure 3, the maturing second and third tier systems will gradually reduce the degree of Australian retirees’ dependency on the age pension, as the proportion of retirement incomes attributable to mandated employer contributions and tax-preferred voluntary contributions increases.

This should lead to a system that, when fully mature, will deliver replacement rates that meet or exceed the OECD benchmark for retirees at median income levels and below, with ample opportunity for higher earners to achieve similar replacement rates through discretionary tax-preferred (third tier) contributions above the mandated levels.²⁷

²⁴ OECD Pensions at a Glance 2015 – OECD and G20 Indicators (March 2016) p. 210. The difference between male and female figures is driven by different pre-retirement workforce participation patterns, income levels and superannuation contributions. There is no difference in actual age pension payments on the basis of gender.
²⁶ An additional factor is that Australian’s high rate of retiree home ownership (around 80%) means that relatively fewer retirees need to factor high accommodation costs into their retirement spending plans (noting also that the capital value of owner-occupied housing is exempted from the age pension means test).
²⁷ Committee for Sustainable Retirement Incomes, Pursuing Adequate Retirement Incomes for All (October 2016).
Superannuation industry dynamics

**Unique structural characteristics**
The particular dynamics and history of Australia’s superannuation system have resulted in it having several structural characteristics that distinguish it in important ways from other major world pension markets.

These characteristics are often cited as a bellwether of future developments in other nations, as policy-makers explore options to transfer increasingly unaffordable pension liabilities from government and corporate balance sheets to individuals.

**Defined contribution (DC) orientation**
First, Australia’s is the most “DC-centric” of any of the world’s developed market pension systems, with approximately 87% of total assets in DC schemes. Just 13% of assets are in defined benefit (DB) schemes, with the majority of these now being closed to new members. This compares with a DC:DB split of around 60:40 in the next-most DC-focused system, the US, and to other markets where DC schemes still account for a minority of total system assets (18% in the UK, down to just 5% in the Netherlands and Canada, and 4% in Japan). (Figure 4).

**Multiple dimensions of member choice**
A related development has been that the Australian superannuation system, notwithstanding the fact that it is mandatory, has evolved further down the path of offering individual consumer choices than many other major pension markets.

These choices include not just a variety of investment options within whichever employer-sponsored fund they join – a common feature of DC plans everywhere – but also the option to switch or split their superannuation between different funds, and even the ability to establish a self-managed superannuation fund (SMSF).

**Product and service extensions**
In tandem with this industry evolution, many superannuation funds have expanded beyond their origins as single-employer, government or industry sector-level entities to become more broadly based financial institutions, expanding their offerings and competing against each other to retain existing members and attract new members.

These dynamics have played out in numerous ways including development of enhanced financial education and advice services, consumer brand-building and media promotion, commercial sponsorships, fund mergers, new product development, and strategies to attract and retain members in retirement as well as during their accumulation phase.

These commercial drivers have significantly expanded the commercial operations, cost base and resources of many superannuation funds, beyond their original core purpose of managing member contributions delivering net investment returns and paying benefits to retirees.

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**Figure 4.** DB/DC asset split: 2017

<table>
<thead>
<tr>
<th>Country</th>
<th>DB</th>
<th>DC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>13%</td>
<td>87%</td>
</tr>
<tr>
<td>United States</td>
<td>40%</td>
<td>60%</td>
</tr>
<tr>
<td>UK</td>
<td>82%</td>
<td>18%</td>
</tr>
<tr>
<td>Netherlands</td>
<td>94%</td>
<td>6%</td>
</tr>
<tr>
<td>Canada</td>
<td>95%</td>
<td>5%</td>
</tr>
<tr>
<td>Japan</td>
<td>96%</td>
<td>4%</td>
</tr>
</tbody>
</table>

Source: Towers Watson Global Pension Assets Study 2017, p. 34
Key market segments

The key segments and membership numbers of the Australian superannuation industry as at 30 June 2016 are shown in Figure 5.

As can be seen, the dominant segments in terms of number of member accounts are the Retail and Industry fund segments, which operate on a multi-employer basis and between them represent over 83% of total superannuation accounts and around half of total system assets.

Retail funds are typically operated by wealth management subsidiaries of large “for-profit” financial institutions such as banks or life insurance companies. These funds are generally characterised by offering extensive investment platforms comprising investment products manufactured by external asset managers as well as by in-house investment teams.

Industry funds, by contrast, are non-profit entities that were originally set up under industrial relations agreements to accept mandated contributions for workers in particular industries. Most Industry funds are owned and controlled jointly by trade unions and employer representative bodies of the particular industry concerned. They generally have very significant membership bases, with a current average of around 275,000 member accounts per fund, and the largest Industry fund having in excess of 2 million members.

Retail and Industry fund segments compete with each other (and increasingly with other entities in their own segments) for new employers and members. From a competitive perspective:

- Industry funds are generally favoured by their non-profit motivation, and affinity with the particular industry sector(s) in which they operate. These funds are also often favoured by default fund arrangements specified in industrial relations agreements, making them the most common destination for newly joining members in industries that operate on a collective bargaining basis, such as the healthcare, construction, hospitality and retail sectors.28

- Retail funds’ advantage is generally that they can leverage the distribution, systems and capital strength of their parent entities (often banks), and offer a wide range of options on their investment platforms to attract and retain superannuation business. Retail funds also compete with Industry funds for employer default fund business that has not been specified in industrial agreements, with offerings that have become increasingly price-competitive with those of non-profit providers over recent years.29

Public Sector funds include those provided to employees of all three levels of government in Australia (federal, state and local). These funds are also multi-employer in nature, in that they typically cover a range of entities and offer portability of benefits between them for members who change jobs within the same arm of public administration. In some cases, this includes active and/or legacy defined benefit entitlements.

Figure 5. Australian superannuation industry – key market segments

<table>
<thead>
<tr>
<th>Type of Fund</th>
<th>Total Assets ($billion)</th>
<th>No. of Funds</th>
<th>No. of Member Accounts ('000)</th>
<th>Primary Regulator(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail</td>
<td>545.3</td>
<td>135</td>
<td>12,978</td>
<td></td>
</tr>
<tr>
<td>Not-for-Profit</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>466.4</td>
<td>41</td>
<td>11,118</td>
<td></td>
</tr>
<tr>
<td>Public Sector</td>
<td>356.1</td>
<td>38</td>
<td>3,533</td>
<td></td>
</tr>
<tr>
<td>Corporate</td>
<td>54.6</td>
<td>30</td>
<td>341</td>
<td></td>
</tr>
<tr>
<td>Self-Managed Super Funds</td>
<td>623.7</td>
<td>579,291</td>
<td>1,092</td>
<td></td>
</tr>
<tr>
<td>(SMSFs) and other small funds*</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>2,099.5**</td>
<td>579,579</td>
<td>29,061</td>
<td></td>
</tr>
</tbody>
</table>

*Other small funds includes Small APRA Funds (SAFs) and single-member approved deposit funds.
** Total assets include $53.3 billion of life office statutory funds that do not reconcile directly to the main industry segments.

Source: APRA Superannuation Bulletin June 2016 (issued 1 February 2017)

28 In 2016 the Productivity Commission was tasked by the Federal Government to examine alternative models for a formal competitive process for allocating default fund members to products. A draft report was released in March 2017, and the final report is scheduled to be released in August 2017.

29 Rice Warner Superannuation Fees Analysis 2016.
Public Sector funds include a small number of very large funds that have been in operation since well before the introduction of mandatory SG contributions, when public sector employees were among the only ones to enjoy workplace superannuation benefits.

While public sector funds represent a significant proportion of current system assets and member accounts (approximately 17% and 12% respectively), their market share in both of these dimensions is expected to decline in the future as other segments of the industry grow.

Corporate funds are single-employer “in-house” superannuation schemes (including a small number of legacy DB schemes) that are similar in many respects to those seen in other markets such as the US and UK, where employers assume a direct responsibility for provision of pensions for their employees.

The number of single-employer schemes has declined dramatically since the introduction of mandatory SG contributions, Choice of Fund and the Registrable Superannuation Entity (RSE) licensing regime, with most employers electing to outsource their superannuation provision to either a Retail or Industry fund. There were just 30 funds remaining in the Corporate fund category in June 2016, compared to 962 in 2005.30

With ongoing compliance obligations and the dominance of Industry and Retail funds as multi-employer providers, the Corporate fund sector is expected to become practically extinct over coming years. This is a key point of differentiation of the Australian superannuation landscape from other large DC systems such as the US 401(k) system, where pension provision at the individual employer level is still the predominant model.

Nevertheless, employers’ role in selection and/or removal of external providers in Australia is still a critical element of the current system. Hence employers remain a crucial distribution channel for both Industry and Retail funds.

The final segment is the uniquely Australian phenomenon of Self-Managed Superannuation Funds (SMSFs), which have grown exponentially over the past decade or so to become the largest segment of the industry by assets. SMSFs accounted for around 30% of total industry assets, but less than 4% of individual member account numbers, at June 2016.

SMSFs allow greater autonomy in the selection and management of investment portfolios, for those seeking a more self-directed investment solution. They can also do most of the things that collectively oriented funds can do, including accepting ongoing employer and member contributions, receiving rollovers from other superannuation accounts, paying pensions, and providing a vehicle for transferring external assets such as proceeds from the sale of private businesses.

While these motivations will remain strong drivers of SMSF establishment, their rate of growth is expected to plateau in the future. SMSFs are now entrenched as a permanent and influential feature of the Australian superannuation landscape, and lead the industry in the drawdown or pension phase.

Regulation

Key regulatory agencies

Australian superannuation funds (other than SMSFs) are subject to a dual regulatory regime for different aspects of their operations.

Australia’s main prudential regulator, the Australian Prudential Regulation Authority (APRA), oversees funds’ governance, investment management, insurance and outsourcing arrangements, as well as compliance with a range of specific standards around issues such as liquidity, risk management and related party transactions.

APRA has primary responsibility for administering the key legislation governing the superannuation industry, the Superannuation Industry (Supervision) Act 1993 (generally referred to as the "SIS Act" or just "SIS"). The SIS Act sits alongside the foundation document that governs each fund, the trust deed, and includes a number of operating and fiduciary standards that are mandatory for all funds (i.e. cannot be varied or diluted by the trust deed).31

The national securities regulator, the Australian Securities & Investments Commission (ASIC), is responsible for consumer protection aspects of the superannuation system, including disclosure requirements, complaint-handling and licensing for funds and service providers offering personal financial advice. These requirements are contained in the Corporations Act 2001 and associated regulations administered by ASIC.32

Despite this dual regulatory structure, the generic term used to describe funds operating on a bulk-membership basis (whether in the Industry, Corporate or Retail segments) is “APRA-regulated”. This is primarily to distinguish these funds from SMSFs, which are not

31 For a detailed list of legislative instruments relating to superannuation in Australia, see http://www.apra.gov.au/Super/Pages/superannuation-legislation.aspx
32 A list of legislation overseen by ASIC including in relation to superannuation is at http://www.asic.gov.au/about-asic/what-we-do/laws-we-administer/
subject to prudential supervision by APRA and are instead regulated by the Australian Taxation Office (ATO), principally to ensure compliance with relevant taxation and audit requirements.

Public Sector funds are generally exempt from formal APRA supervision and many ASIC requirements, but most of them opt in to broadly equivalent standards under parallel state or commonwealth legislation.

**Fund governance arrangements**

Industry and Corporate funds are required by the SIS Act to have a Board of Trustees comprising an equal number of member and employee representatives. Public Sector funds are also generally governed on this basis, under the relevant legislation within their jurisdiction.

Retail fund trustees typically include executives and/or independent individuals nominated by the parent institution as opposed to direct stakeholder representatives, but are still subject to the same SIS Act fiduciary duties as other employer-sponsored funds to act solely in the interests of fund beneficiaries in their capacity as trustees.

With SMSFs, a key requirement is that each member is required to be a trustee (with a maximum of four trustees per fund), or that a corporate trustee is established with each member as a director. This direct imposition of fiduciary responsibility onto members helps explain why SMSFs do not require the same level of prudential supervision as other market segments, as SMSFs are not managing assets or making decisions that affect third parties.

There is one final regulatory category called Small APRA Funds (SAFs), that (unlike SMSFs) are prudentially supervised and do have trustees who are independent of the members. This segment is very small (comprising just 4,000 member accounts and 0.1% of total superannuation assets at 30 June 2015).

**Scope of operations**

All Retail funds and some Industry funds are offered on an “Extended Public Offer” basis, meaning that they can accept contributions from any Australian worker (or their employer), even where the individual concerned is outside the industry that the fund has traditionally been associated with, and/or a different default fund has been nominated at the individual’s current workplace.

Some other funds are available on a “Limited Public Offer” basis, meaning that they can accept contributions from family members and friends referred directly by incumbent members (but not from the public at large).

Choice architecture

There are two broad dimensions of investment choice available to Australian superannuation fund members.

Choice of fund

The first of these – Choice of Fund – provides the ability for members to select any public offer APRA-regulated fund or SMSF they wish as the destination for their future employer SG contributions.

Upon commencement with an employer, new employees who are eligible for SG contributions must be provided with a Standard Choice Form that gives them the opportunity to nominate a fund of their choice, or confirm that they are happy to have their SG contributions paid into the default fund nominated by their employer.

Employees are in turn obliged to remit SG contributions to whichever superannuation fund has been nominated by the employee, including when they decide to select a fund other than the employer’s default fund. This election can also be made at any time after commencement of employment with regard to future SG contributions, subject to the employer only being obliged to accept a fund choice nomination once every 12 months.

Employees also have the ability to transfer all or part of their accrued balances to any other fund of their choice, even if their ongoing contributions are still being paid into their current employer’s default fund or some other chosen fund. In this instance the transaction is known as a portability transfer as it does not in itself displace or change the destination of future SG contributions.

A new system-wide clearing facility known as SuperStream has recently been introduced to improve the administrative efficiency of this process by setting a number of rules for data format requirements, contribution remittance and deadlines, along with sanctions for non-compliance with these. SuperStream is now the main industry vehicle for account consolidation for members who possess multiple superannuation accounts from different employers, and/or have “lost super” held by the Australian Taxation Office arising from an inability for funds to communicate with them over extended periods.

At present more than 45% of members have more than one superannuation account, but there has been a concerted campaign over recent years to facilitate account consolidation, and this trend is expected to continue with improved payment mechanisms and a greater emphasis on efficiency of the overall system.

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33 Many funds also have some independent directors but under current rules these cannot be sufficiently numerous to displace the equal representation rule between employers and employees. The introduction of a requirement for more independent directors on superannuation boards is under consideration by the current federal government but has not been implemented as at the date of publication.

34 APRA Annual Superannuation Bulletin 30 June 2015 (reissued August 2016) p. 7. A typical scenario for establishment of a small APRA Fund is when one or more of the trustees of an SMSF becomes incapacitated or dies, and the remaining trustees/beneficiaries wish to maintain the fund as an independent entity without needing to transfer assets back into a large scale APRA-regulated fund.
MySuper
Since 2013, all APRA-regulated funds seeking to be nominated as default providers have been required to offer a “MySuper” product as the default for members who do not make an active investment selection.

The MySuper designation applies to simple, relatively low-cost investment products that can be easily compared across different providers, based on standardised public disclosures on metrics such as fees and charges, investment objectives, risks and performance relative to relevant industry benchmarks over standardised timeframes.

Further requirements include that the MySuper product:

• Has a diversified portfolio that the trustee decides is suitable in the absence of a direct investment choice by the member.

• Offers a standard level of life and total and permanent disability (TPD) insurance cover, with members being able to opt out or apply to purchase additional insurance cover at their own election.

At 30 June 2016, there were 115 MySuper products registered across the Australian superannuation system, ranging in size from $2.1 million to $69.2 billion. Total assets of all MySuper products were $474 billion, or approximately 36% of the total APRA-regulated market.36

The majority of MySuper products have a single diversified portfolio covering all members, with strategic allocations to growth assets such as shares and property generally in the vicinity of 60-75%.

A smaller proportion (around one-third) of all MySuper options are offered on a lifecycle or target-date basis, with exposures to more risky assets reducing as members move between age segments over time.37 Many of these options have only two or three phases of in-built asset allocation changes; more tailored target retirement date “glidepath” designs remain relatively uncommon in Australia at this stage.

By 1 July 2017, providers of MySuper products will be required to transfer all members who were in previous default options into their registered MySuper product. This measure is designed to ensure that the majority of defaulting members enjoy the benefits of the enhanced disclosure, pricing and comparability aspects of the new regulatory regime, and are not left in more expensive or legacy default products.

Broader choice architecture
Beyond the MySuper regime, most funds offer a wide range of “Choice” options for members who wish to make their own investment selections.

Choice options generally include a range of target-risk oriented diversified portfolios (usually labelled Growth, Balanced, Conservative, etc.), as well as discrete options in major asset classes such as Australian and international equities, fixed interest, cash, and listed property. In some cases, funds have expanded their choice options to permit selection of particular investment managers, and even to the selection of individual securities such as ASX-listed shares, ETFs and term deposits.

Depending on the particular fund’s rules and procedures, members can generally allocate their portfolios across multiple Choice options, switch between them at any time, and provide different portfolio allocations for future contributions. Members can also elect to retain accounts in multiple funds if they so desire (for example, leaving a balance in one fund to take advantage of higher group insurance benefits, while allocating ongoing contributions to a different APRA fund or SMSF).

These facilities – together with the ability for members to select between different funds and even to opt out of a collective environment altogether and set up a fund of their own – give the Australian superannuation system a very diverse character for those members who elect to move outside the default MySuper framework.

Nevertheless, the MySuper default option generally remains the destination for the majority of contributions in most APRA-regulated funds, especially among younger members who are generally less engaged with their retirement savings than those closer to retirement.

36 APRA Quarterly MySuper Statistics June 2016
37 Ibid.
Accessing superannuation benefits

Preservation age

Since 1999, all superannuation contributions (including discretionary after-tax contributions and rollovers as well as employer SG and salary sacrifice contributions) have been required to be retained in the superannuation system until the member reaches “preservation age”, subject only to some very limited exceptions for situations of extreme financial hardship, permanent incapacity or terminal illness.38

Preservation age has historically been age 55 (for all Australians born prior to 1 January 1960), but is now in the process of being gradually increased between 2015 and 2024, such that the standard preservation age will be 60 years of age for Australians born on or after 1 July 1964. (Figure 6).

<table>
<thead>
<tr>
<th>Date of birth</th>
<th>Preservation age</th>
</tr>
</thead>
<tbody>
<tr>
<td>Before 1 July 1960</td>
<td>55</td>
</tr>
<tr>
<td>From 1 July 1960 until 30 June 1961</td>
<td>56</td>
</tr>
<tr>
<td>From 1 July 1961 until 30 June 1962</td>
<td>57</td>
</tr>
<tr>
<td>From 1 July 1962 until 30 June 1963</td>
<td>58</td>
</tr>
<tr>
<td>From 1 July 1963 until 30 June 1964</td>
<td>59</td>
</tr>
<tr>
<td>On or after 1 July 1964</td>
<td>60</td>
</tr>
</tbody>
</table>

These taxation arrangements provide strong incentives for Australians to treat age 60 as the de facto target age for accessing benefits, even before it becomes the universal minimum preservation age.

It should also be noted, unlike some other pension systems, there is no facility for members to borrow from or drawdown accumulated savings to meet other lifestyle savings or spending needs.39

Transition to retirement (TTR)

The Australian system permits members to partially access superannuation benefits without needing to actually retire, by way of a “Transition to Retirement” (TTR) facility.

This facility, which is not compulsory for funds to offer (though most of the major ones do), allows a member who has reached preservation age to drawdown on superannuation savings while still in the workforce, while at the same time continuing to receive employer SG contributions.

The TTR rules were initially intended to encourage older workers to stay in the workforce on a part-time basis, and supplement any loss of income due to reduced hours with a superannuation benefit. In practice, however, they often came to be used as an effective tax arbitrage by higher-income earners to increase their superannuation account balances without reducing their working hours or their net take-home pay.

The extent of this arbitrage opportunity is now limited by recent regulatory changes, but TTR strategies retain some appeal for members who have reached their preservation age, and consequently remain a significant trigger-point for transaction activity within a fund.

Standard retirement and age thresholds

Apart from the TTR facility, the general threshold for being able to access superannuation benefits is to have reached preservation age and retired. This is formally called the “retirement condition of release”.

A further important factor influencing members’ drawdown behaviour is that (since 2007) superannuation benefits withdrawn from age 60 are tax-free, whether taken as a lump sum or as an income stream (provided that the income stream meets certain requirements, discussed below).

By contrast, benefits accessed between preservation age and age 60 (for the years that those two dates are still different) remain subject to taxes, albeit at lower rates than those applying to incomes for those on higher marginal tax rates.

38 Details of the various rules around “conditions for release” of superannuation benefits are available on the ATO website at https://www.ato.gov.au/Super/Self-managed-super-funds/Paying-benefits/Conditions-of-release/. Note also that certain superannuation benefits that relate to contributions made prior to 1999 (“restricted non-preserved” contributions) can be accessed on a change of employment; while other legacy components (“unrestricted non-preserved” contributions) can be withdrawn at any time. However generally these types of withdrawals are discouraged by tax rules if accessed prior to preservation age, and both of them have been effectively frozen in dollar terms at their 1999 levels so they will eventually wash out of the system.

39 Note however that a new “First Home Super Saver Scheme” was announced by the Federal Government in the May 2017 Federal Budget, providing limited capacity for super fund members to make additional designated contributions to superannuation accounts from 1 July 2017. These separate contributions (limited to $15,000 a year and no more than $30,000 in total) can be withdrawn to help finance the purchase of a first home.
The next major threshold date is age 65, when superannuation benefits can be fully accessed without needing to formally retire from the workforce.

As noted earlier, 65 is also the age at which eligible Australians can access the age pension (moving to age 65.5 on 1 July 2017 and in further increments to age 67 in 2023). The gap between the preservation age and age pension eligibility means that Australians who retire prior to age 65, and are therefore not yet eligible for the age pension, generally need to self-finance the initial years of their retirement from their own superannuation savings.

Incentives are also provided to encourage older workers to remain in the workforce, a very real possibility with changing labour market dynamics and the improved health of older workers, especially in white collar and service industries. Since 2013, mandated employer SG contributions have had no upper age limit for anyone remaining in “gainful employment”, and members are able to continue to make voluntary additional contributions until they reach 75 years of age provided they satisfy a relatively modest “work test”.40

**Account-based pensions**

The dominant form of retirement income stream product in Australia is known as an *Account-Based Pension* (ABP). ABPs are highly flexible vehicles allowing retirees a similarly broad range of investment strategies as pre-retirement (or “accumulation phase”) accounts, while retaining full access to their capital and concessional taxation treatment, including a full exemption from tax after age 60.

The only major condition for access to these generous taxation incentives is that ABP account-holders are required to make annual withdrawals of at least the following age-based minimums (Figure 7).

**Figure 7.** Account-based pension minimum annual drawdowns

<table>
<thead>
<tr>
<th>Age</th>
<th>&lt;65</th>
<th>66–74</th>
<th>75–79</th>
<th>80–84</th>
<th>85–89</th>
<th>90–94</th>
<th>95+</th>
</tr>
</thead>
<tbody>
<tr>
<td>Minimum drawdown</td>
<td>4%</td>
<td>5%</td>
<td>6%</td>
<td>7%</td>
<td>9%</td>
<td>11%</td>
<td>14%</td>
</tr>
</tbody>
</table>

Note: These rates were reduced by 50% in 2008/09, 09/10 and 10/11 tax years, and by 25% in 2011/12 and 2012/13

The age-based minimum drawdown rules are designed to provide a reasonable level of stability of income (assuming real investment returns in the region of 2-4% p.a.) beyond the average life expectancy of Australian retirees.

On the flipside, ABPs have no maximum annual drawdown requirement,41 meaning that holders of ABPs can choose to withdraw higher proportions of their savings to finance higher spending in retirement and/or meet unanticipated expenses. Retirees using this feature are at risk of exhausting their capital sooner and thereby increasing their reliance on the public age pension.

While this degree of flexibility is sometimes seen as an incentive for retirees to “double dip” between their concessional taxed private savings and the public welfare system, recent research indicates that most ABP holders tend to behave very conservatively, keeping their annual drawdowns as close as possible to the mandatory minimum payment levels.42 The main motivations for this behaviour appear to be a natural anxiety about the risk of outliving one’s savings and the inherent uncertainty of managing complex financial decisions; however for some more affluent retirees the desire to leave a bequest from lifelong savings may also be a factor.

**Other retirement income stream products**

Apart from ABPs, and with some limited exceptions, the only other type of retirement income stream product that qualifies for taxation exemption under the current regulatory framework (pre 1 July 2017) is a traditional lifetime annuity that is indexed to a recognised measure such as wages or inflation growth.43

While products of this type have experienced some renewed interest in volatile market conditions over recent years, they still represent a very small proportion of the total market. In Australia and other markets, annuities have been unpopular from a consumer perspective (especially in times of relatively buoyant market conditions), as they require investors to forego access to their capital in return for the guaranteed income stream.

However, there has recently been an extensive review of the post-retirement product landscape in Australia, focusing in particular on the absence of products that offer protection against longevity risk, apart from the relatively inflexible option of lifetime annuities. This

40 The work test requires members aged between 65 and 74 years old to establish that they have been engaged in gainful employment for at least 40 hours in any 30 day (or less) period during a financial year in which they wish to make a contribution (either concessional or non-concessional). The Federal Government recently announced an intention to remove the work test but has recently deferred this initiative until an indeterminate future date.

41 The exception to this is for Transition to Retirement pensions (i.e. those commenced between preservation age and age 65, without the individual actually retiring), where there is a maximum annual drawdown of 10% of capital permitted.


43 For example, certain legacy defined benefit pensions paid by some public sector and corporate funds.
review was among the major outcomes of the Australian
government’s 2014 Financial System (Murray) Inquiry,
which found that superannuation assets were not being
efficiently converted into retirement incomes due to a
lack of risk pooling and over-reliance on individual
account-based pensions.44

As a result of this review, the rules around eligibility for
concessional taxation treatment in the post-retirement
phase are being expanded to accommodate a much
broader array of approaches to consuming lump sum
benefits over the course of retirement. These changes,
taking effect from 1 July 2017, are expected to see the
development of a range of new retirement income
stream products such as deferred annuities, variable
annuities, collective defined contribution schemes
and longevity risk pooling or “group self-annuitisation”
products.45

In line with a further recommendation of the Financial
System Inquiry, formally agreed to by the government in
October 2015, it is also proposed that superannuation
funds trustees (other than SMSFs) will be able to
develop mass-customised “Comprehensive Income
Products for Retirement” (CIPRs) that blend
characteristics of both account-based and deferred
income stream products.46

The CIPR rules, once implemented, are expected to see
large funds and advisers seeking to blend aspects of
these different product types to suit specific
characteristics of their membership and client-base,
recognising that a “one size fits all” approach is unlikely
to be feasible across a diverse population.

Further, a formal objective for superannuation is currently
being legislated, to “provide income in retirement to
substitute or supplement the age pension.” In line with
this objective retirement policy will increasingly be aimed
at ensuring that a greater proportion of Australians are
self-funding in retirement, thereby reducing dependence
on the age pension.47

Looking ahead, post-retirement product development is
expected to be a fertile ground for innovation in the
superannuation industry as more and more Australians
move into the retirement phase with increasing account
balances. This process will continue to drive the
competitive dynamics of the industry, as the commercial
viability of industry participants will increasingly be
determined by retention of members’ assets from the
accumulation to pension phase, and by the delivery of
successful retirement income stream products.

45 Australian Treasury, Retirement Income Streams Review Final Report (May 2016)
47 On 9 November 2016, the Government introduced the Superannuation (Objective) Bill 2016, which will enshrine the objective of superannuation in legislation. At the time of
writing in May 2017, the Bill has not passed into legislation but may be expected to do so later in 2017. For a detailed analysis of the implications of the new legislatively-
defined objective, see Ralston D, and Feng, J, “Towards a self-funded retirement: will the new objective ensure that superannuation substitutes for the Age Pension?”

22 > Australian Superannuation System Overview
Conclusion

The Australian superannuation system has come a long way since the mandatory Superannuation Guarantee was introduced in the early 1990s. Australia’s super system is now the world’s fourth largest private pension industry, with $2.1 trillion under management at June 2016.

As the super system matures and the population ages, the government is looking to shift the industry’s focus from accumulating capital to generating income, from maximising returns to managing liabilities, and from building wealth to drawing down.

Key changes emanating from the Financial System (Murray) Inquiry and other policy reviews are poised to produce policy outcomes that will transform the retirement product landscape in Australia.

At the date of publication of this report, a further comprehensive review of the efficiency and competitiveness of the whole superannuation system is underway, under the auspices of the Productivity Commission. This review, ambitious in its scope of coverage, is expected to lead to further significant structural reforms to the superannuation system over the remainder of the current decade.48

In future editions of *How Australia Saves* and associated research notes like this one, we aim to follow these reforms and provide a sound evidence-based perspective of the influence they have on member-level behaviours and retirement outcomes.

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