SPEECH

Speaker	Brad Cooper, chief executive, BT Financial Group
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CHECK AGAINST DELIVERY

Thanks very much for the introduction Stephen.

Good afternoon and thank you everyone for being here today.

So, SUPERANNUATION!

For a subject that most people spend their lives avoiding, it has certainly dominated recent media headlines.

I must say, it's encouraging to see that superannuation is now worth arguing about. Ten years ago, I doubt such speculation would have made the front pages. The retirement income system is now a matter of public interest, and that's a good thing.

Now we have to ensure that any uncertainty generated by this discussion is outweighed by the benefits that flow from it.

Uncertainty is the enemy of long-term savings.

I believe that if the discussions of a few weeks ago made anything clear to all sides of politics, it was that super should not be up for grabs.

If we look at the retirement system in 20 to 40 year windows, how many governments will come and go? How many elections? How many budgets with forward estimates?

By 2033, in twenty years time, Australia will have more than 27 million people. More than one-quarter of the working-age population at that time will be over the age of 65. The compounding fiscal impacts and challenges of a shrinking workforce and an ageing population are mathematical facts.

If the retired population can financially support themselves, they will spend and contribute to the economy. If they cannot, the economy – held up by a shrinking proportion of the population – will need to support them.

These choices are stark, but they are the reality that - as a country - we need to confront and discuss.

All of us in this room will be thinking of just one thing when we come to retire. Do we have enough money? And not just – do we have enough? But – do we have enough to LIVE, rather than simply exist?

As we prepare for the day that we stop work, we want to know and trust the framework, we want to know that the rules we relied on are still operating.

Ladies and gentlemen, today I want to discuss where the superannuation system is heading and what we can do about it. I want to look at three things:

1. the importance of getting stable policy settings that determine the shape of our economy in 20 short years;
2. the importance of Australians taking ownership of their money;
   and
3. the operation of our broader financial system in
   20 years time, when there is $7 trillion in superannuation. How will the system work? Where will the funds be invested?

Glimpse of the future

In just over 20 years the first people to benefit from the compulsory super system all their working lives, will be retiring.

Many of us will remember the beginning of compulsory super just over 20 years ago. Is another 20 years really so far away – a time when most of us in this room will be in retirement?

Well, think back 20 years to 1993.

Jurassic Park was our blockbuster movie.

Bill Clinton was sworn in as the American President.

I was a regional manager, working on something called ‘Project 2000’ which was about branch reengineering – Y2K was yet to hit us.   It was important stuff, but the year 2000 didn’t seem imminent.

In 1993 the superannuation guarantee had just started. And here we are already, a superannuation system with just under $1.5 trillion in assets.

While the superannuation system will have $7 trillion in 2033, not every Australian will have what they need. Our superannuation system is one of the largest private pension systems in the world relative to GDP but it will be a failure for many.

How is this possible? And if we know it now, why are we not looking to correct it?

The economy

Let’s look at the Australian economy in 20 years time.

Australia will be one of the wealthiest per capita countries in the world with a population of almost 30 million. Sydney will have five-and-a-half million residents.

We’ll be more urban than today – 9 out of 10 Australians will live in cities, putting greater pressure on public infrastructure.

More than 40 per cent of our power needs will come from renewables[1] and our economy will be integrated with Asia, which – as an economic region – will be the largest on earth, larger even than the G7[2].

Average weekly earnings will be slightly under $3000 per week – more than twice what it is today.[3]

The economy will have expanded but economic growth will have slowed: from 3.3 per cent in the Nineties and Two Thousands, to 2.7 per cent over the following two decades.

And you can't outrun demographics – Australia in 2033 will be labouring under an ageing population.

There'll be just over three working people for every retired person – as opposed to the five we have now.[4]

Life expectancy will be longer.

In 2033, men who reach 65 will live to 91 and women to 93.[5] So, people born after 1968 will have to consider how to support themselves for around 30 years after retirement. [6]

These people are already with us. They're sitting next to you right now. They are 45 or younger now.

Ageing populations require greater spending on social services while a proportionately shrinking cohort of younger people has to pay for the spending.

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[1] Siemens 'Picture the Future: Australia 2030' page 13
[2] Wayne Swan, Treasurer, Address to Market leaders Summit June 2010
[3] 6302.0 – ABS Average Weekly Earnings, Australia, Nov 2012
[4] Intergenerational Report 2010, Treasury
[5] Nathan Bonarius – Rice Warner research for BTFG
[6] Actuaries Institute, 'Australia's Longevity Tsunami', August 2012. page 6

This will have many effects, as the Intergenerational Report states:

- It will reduce government revenues as a percentage of GDP
- It will increase government spending, especially in health
- It will slow economic growth as more people retire and the birth rate stays low.

Economic growth slows with an ageing population but even as growth slows, governments still have to spend on ageing Australians.

Clearly, when retirees are one quarter of the working population in the 2030s, the extent to which they can fund themselves is crucial to our economic welfare.

And in terms of social policy, we can not have such a large number Australians just existing – we need them spending on restaurants, retail, entertainment and travel, and all the other discretionary spending that stimulates an economy.

When life expectancies are up to 30 years in retirement, subsistence living cannot be the goal, and neither is it in the economic interest.

The economy – retirees

And what of retirees in 20 years? There will be around five million of them and money in superannuation accounts will be more than 160 per cent of GDP, compared to the 100 per cent of GDP today.

They will be an important cohort and they'll have a different outlook to their predecessors: where retirement was once seen as the end of something, now it is the start of doing what you couldn't do in your working life.[7]

The amounts in super will be huge. However, we should be careful of large numbers and averages.

[7] NATSEM page 3

Let me illustrate.

During our most recent debate on the taxation of superannuation, we defined wealthy at one end and low income earners at the other. So who was in the middle? Was it you?

The average salary in this country is just over $72,400 but not many people earn this amount. Only 4 per cent of tax payers earn between $69,000 and $74,000. In fact, 75 per cent of employed Australians earn less than the average.

So while a $7 trillion pool of savings in the 2030s may look big, and retirees overall expect to pursue leisure activities, there's going to be many stories within these figures.

A Senate committee in 2002 found that retirees needed to replace 65 per cent of their pre-retirement income to live comfortably. Paul Keating said superannuation should aim to replace 70 per cent of an individual's pre-retirement income, when in retirement.

This is the most important number in superannuation – the income replacement rate, which, in my view, should fall somewhere between 65 and 70 per cent.

But the system, as it stands, means many will not achieve this rate.

Consider this: take a 20 year old male who enters the workforce and earns an average salary of $72,000 during his working life. He receives 12 per cent compulsory contributions, makes no voluntary contributions and retires at 65.

If the rate of return is 5 per cent – the figure used recently in Government announcements - he will replace just 51 per cent of his average salary.

So, on the compulsory superannuation payments alone, a person earning the average salary cannot get near the preferred income replacement rate of 70 per cent.

When you look at the adequacy of compulsory super contributions, you realise that even those earning $90,000 a year or $120,000 a year, will also have a large shortfall. They will replace just 45 per cent and 37 per cent respectively.

The only salary that reaches the 70 per cent standard will be the person on $40,000 a year. But that's because the government will top up their super with the age pension. Without a government-age pension, they would replace only 31 per cent.

These common-place scenarios should be ringing alarm bells since one of the reasons for a compulsory private pension system was to ease the burden of future generations paying for a universal age pension. Clearly, the issue is how to get employees to put *more* money into their super so they reach a 70 per cent replacement rate.

So when we talk about the adequacy of the system, I believe we need to stop talking about superannuation in subsistence terms. Subsistence is not a goal – it's a safety net. The goal should be living – not existence.

To shift most super balances towards a healthy income replacement rate, we need to acknowledge the importance of voluntary contributions in our system.

Superannuation has moved on from the discussion of its role in the social wage. It now needs to be a system that compels and encourages people to retire on 65 to 70 per cent of their average earnings.

A future economy will of course rely on public sector spending, mining and other industries. But we will need the retirees of the future contributing with private consumption and their own savings – the economy will depend on it.

Policy

In 1992, Keating legislated compulsory superannuation that would include all workers by having the employer contribute a percentage of the worker's wages into super.

The main aim of the Superannuation Guarantee was to replace the government's age pension with self funded retirees, and to ensure all employees could access the system.

As Paul Keating has said: "The whole point of superannuation is producing an actuarial income in retirement, and when that goes, the rationale for it goes."

The argument for the Guarantee was bolstered by the consequences of an ageing population and the cost to the future tax payer of an overburdened age pension system.

Superannuation would share the burden of retirement income between the individual and the government. It would forsake tax revenue on deferred income now, to reduce reliance on the age pension later.

Keating essentially said that all retirements have to be funded – you either pay for it now, by letting people save; or you pay for it later, with taxes.

There were three pillars of the new system:

- an age pension, which would act as a safety net
- a superannuation guarantee, paid by employers starting at 3 per cent of wages
- and voluntary contributions, which attracted tax concessions as an incentive.

The Inter-generational report shows that in the longer-term the proportion of the population which is fully self-funding in retirement remains static at about 20%. Shouldn't we be more aspirational than this? I believe we should aim for a system where the majority are self-funded in retirement.

In this superannuation system, we need people to top up above their compulsory super, as they can, to give them enough retirement savings to live well. Tax concessions have been used to do this and we know that small changes affect long-term savings.

When speculation was rife regarding changes to super recently, we looked at some scenarios with the actuaries, Rice Warner.

What if today we increased the tax on super income from 15 per cent to 20 per cent?

By 2042 we'd have $335 billion LESS in super than if we left it the way it is.

What if we increased the contribution tax on superannuation from 15 to 20 per cent?

In 2042 we'd have about $345 billion LESS in funds in the super system.

What's the impact of increasing the tax concessional contribution from $25,000 to $35,000, for everybody? It potentially puts an extra $330 billion in the system over 30 years.

The point is this: the tax treatment of super has a large impact. And anything taken out of superannuation *now*, will have to be paid back later.

The more than six million retirees will be there in 30 years, we know who they are: it's anyone aged 35 and older.

They should be making voluntary contributions to top up their compulsory super, and it will be far more efficient to give them the incentives to do this now, than to make generations of the future pay for their age pension.

We have to redefine what we want from the superannuation system. When we've done that, we need bi-partisan support and to only refine the system with the long term in mind.

The temptation to cut today, and kick the burden into the future, is too great.

People need a system they can commit to and engage with.

This brings me to an important aspect of this discussion: member engagement.

Engagement

We use this word engagement in our industry but what we really mean is, do Australians feel involved? Do they feel they're in control? Do they have influence?

Super has been operating for more than 20 years but most of the action has been played out between Canberra and the financial services organisations in Sydney and Melbourne.

The unions and employer groups have been active participants too.

It has been a steep curve and we have all worked hard to get this system into its present shape.

But that leaves ordinary Australians – whose engagement with superannuation is very poor.

Our research at BT shows that 37 per cent of Australians don't look at their superannuation balances and 33 per cent of members who elected the 'default' option, do not know who is managing their savings.

In the Future Tax System review in 2009, Treasury secretary Ken Henry observed that the lack of member engagement in super was not just worrying – it affected the coherence and the adequacy of the actual system.[8]

Just to illustrate this picture of disengagement, there is
$17 billion worth of forgotten and lost superannuation funds sitting in three and a half million super accounts. That's almost $5,000 in each account. When you accidentally leave $100 in an ATM, do you run back and grab it? Of course you do!

What does poor engagement mean?

- It means having multiple accounts and paying more fees than you need to
- It means workers not topping up with voluntary contributions over and above the superannuation guarantee
- It means low numbers of superannuation members taking financial advice.

Of these three points – the most critical is the second: Without voluntary contributions, the system will fail to be sustainable.

Underpinning low engagement levels is this recurring theme that Australians don't see super as their money until they get close to retirement age.

They see the Super Guarantee as a tax. Then they hit 45, they panic, and start worrying about how engaged they should have been when they were younger.

So we have three classes of superannuation member: engaged and doing something about it; disengaged and worried; and disengaged and completely switched off.

Recently we were preparing a national road show for BT and we recorded some vox pops of people we interviewed in the street. We wanted honest comments about super.

[8] Ken Henry, Australia's Future Tax System: the Retirement Income System 2009, page 4

The lingering memory I have was the massive underestimation of what Australians need to live well in retirement. One of the respondents said she thought $80,000 would be a good super pay out. Not one of the respondents knew their super balance.

I can understand why Australians with careers, families and mortgages might feel they have better things to think about than retirement. And I can understand why someone loses interest when all the contact they have with their super fund consists of one statement each year.

Perhaps the remedy is to spend as much time talking about living in retirement as we talk about building a nest egg? Younger Australians might prefer to discuss superannuation in terms of overseas travel and a nice car, and how much they'll need to fund it. Another way might be to look at what makes Australians so engaged in that other pillar of financial security: their own home.

We might also have to address resentment among people in their thirties, who are forced to accumulate savings for retirement yet they can't get a deposit to buy a house. I would stop short of promoting the idea that you can draw down super to buy a home.

However, it's worth noting that the calculations of what you need to live well in retirement are always more favourable to those who own their home – it is a massive advantage over those who have to rent.

Australians – in the end – need to understand the benefits of topping up their compulsory super; the benefits of advice and reviewing; and the benefits of preparing for retired life rather than simply concentrating on accumulation. And they won't do this unless they're engaged.

Understanding, confidence and stability are cornerstones to building the engagement we need.

Investment

So, let’s look at investment.

If you’re going to build a private pension system to give people sustained income in retirement then you need to ensure that the underlying investments produce reliable yields.

We should start by dispelling the myth that there is an asset class called ‘superannuation’. There is not. Superannuation is a framework of tax arrangements and governance designed to build savings large enough to self-fund retirement.

To serve this goal the funds must have a range of options so that required returns are traded-off against stability. Annual fund performances are important, but the real issue is the risk and return equation for each member. Each member will have different needs and risk appetite, and we must cater for that.

But then there’s investment from the funds’ point of view. The Australian superannuation system grew quickly from a mandated beginning. Australian superannuation is about 50 per cent exposed to listed shares on average, much higher than other comparable retirement schemes.

As the super pool grows it will reduce its exposure to equities for two reasons: Firstly, there won’t be enough quality stocks to invest in. Super funds generally invest in the ASX 200 – which account for about 80 per cent of the ASX’s value. When superannuation has $7 trillion funds under management, super funds will have to find alternatives to the best 200 stocks in the ASX.

Secondly, in the 2030s the focus will shift from accumulation to preservation as more people retire and no longer contribute. This trend will peak in 2040, when the outflows from super – for the first time – are matched by inflows.

It'll be an era of income streams, where retirees use their lump sum to secure a monthly income. The race will be on to invest in long-term, stable assets such as infrastructure, mortgages and bonds – assets that underwrite these income products for decades.

The super pool will still retain exposure to shares, cash and property – but they'll want stability and predictability, and they'll find this in lending to governments and banks.

Some investments will be via bond issues and others will be direct investment into mortgage pools and infrastructure projects.

But there'll have to be a low risk way for super funds to invest in infrastructure. One way is to have long-date inflation bonds issued by governments. Or we could develop a liquid corporate bond market for infrastructure projects.

There are also opportunities for direct investment: Infrastructure Australia has identified $219 billion of state government assets that could be sold to super funds and tagged including Snowy Hydro, Sydney Water and the Port of Newcastle. Recently, Port Botany was leased for 99 years to a consortium that included three superannuation funds.

Another opportunity will be investment in venture capital funds, to keep some of our great ideas onshore rather than seeing them developed in other nations. If the Government could provide a framework where these ideas can be reviewed and expanded, allowing proper due diligence from super funds, our country's future could be diversified.

In the 2030s our population will hit 28 million, meaning that regardless of the ageing population we'll still have demand for housing. A number of bankers have remarked that Australian superannuation will be a good alternative to the sometimes-volatile capital markets that currently fund so much of our mortgage market.

Moreover, I have no concerns about the availability of good, safe investments for our super funds: Australia is a sophisticated economy. However, it would be bad policy to compel super funds to invest in government projects or housing markets. Getting super funds into nation-building investments must be via incentives and attractive risk returns, not by compulsion.

Conclusion

We all have a role to play in the superannuation system so it is delivering for Australians.

First: governments have to settle on a super regime that allows for a long-term economic policy framework, rather than responding to budgets and forward estimates. As Ken Henry said in his 2009 review, adjustments to the retirement system affect the work, consumption and savings decisions “made by individuals over the course of their lifetime”.[9] Individuals should be able to make decisions on work, consumption and savings with a degree of certainty.

Second: organisations such as BT Financial Group, who are the caretakers of Australian retirement funds, must acknowledge that the goal is for workers to live in retirement in the way they wish. We have emphasised the accumulation phase, but how many Australians are prepared to live in retirement? Are they advised? Do they understand longevity risk? Ensuring that end-to-end solutions are understood by members is something the fund managers have to do.

And third, the employers. There is a bigger, wider role to be played by employers in this system. The super guarantee payment of 9 to 12 per cent is a cost to employers, but its introduction is gradual and in many cases will be absorbed into regular wage costs. The opportunity is for employers to be clear with employees and help them understand this is their money, part of their wages package and money they need to monitor and protect.

Finally: the engagement of members will be the ultimate key to superannuation, because when they care, they will put much more effort into getting their retirement planning right. They will hold everybody in the system to account, and that’s a good thing.

[9] Henry, Retirement Income 2009, page 10

There are challenges to be addressed such as those with low incomes and low balances. In order for the system to make sense, this end of the spectrum will have to be addressed continually.

Within this broader problem is the specific disadvantage among women: they have more breaks from paid work than men and are often lower paid, so they have smaller superannuation balances.

The gender gap in superannuation may, in part, be addressed by employers. They could, for instance, continue to pay the superannuation guarantee to women during breaks from the workforce, as a way of keeping those employees engaged.

I'm happy to say that Westpac Banking Corporation has had a policy paying super on unpaid parental leave since 2010. Others have since adopted similar schemes.

As we look to the future we also need to keep our eyes on the broader state of the economy and the rising cost of health care, the age pension and age care. Superannuation will take its place in that argument.

A healthy future is reliant on decisions we make now, and that means being able to acknowledge that contemporary politics creates future societies. Having accepted that responsibility, we have to act responsibly – we cannot kick the can down the road.

Regardless of what we think of the financial challenges facing the governments of today, they'll be many times worse in 20 years if we do not create an adequate system of savings. If today's 30 year olds are the government-aged pensioners in 2050, our future economy is in real trouble.

We not only need a framework – as a country we need to understand what our superannuation system, is trying to, and needs to achieve long-term.

Australians and the future economy need that clarity.

I hope my views today are not mistaken for pessimism.

Because, if it’s done properly superannuation doesn’t just support future retirees with savings, it also builds a healthy future economy.

And won’t our children and grandchildren thank us for that.

Thank you.