AustralianSuper

5/08/2024

Australian Securities and Investments Commission
Level 5, 100 Market Street
Sydney NSW 2000

Via email: super.enquiries@asic.gov.au

Dear ASIC,

ASIC Consultation - Proposed update to superannuation forecasts relief instrument

AustralianSuper welcomes the opportunity to provide feedback on ASIC's proposal to update the default wage inflation assumption in *ASIC (Superannuation Calculators and Retirement Estimates) Instrument 2022/603* and Regulatory Guide 276 Superannuation forecasts: Calculators and retirement estimates (RG 276) and on the transitional arrangements.

AustralianSuper is Australia's largest superannuation fund and is run only to benefit members. AustralianSuper manages over $335 billion of member assets on behalf of over 3.4 million members.[1] Our purpose is to help members achieve their best financial position in retirement.

Superannuation projection calculators are an important tool to help members prepare for retirement and help members engage with their superannuation. We know from our research that goal setting and planning, as well as financial factors, are key drivers of retirement confidence and a successful retirement outcome. Calculators can help members understand the impact of the steps they can take now to secure a better standard of living in retirement. It is therefore crucial that assumptions underpinning superannuation calculators, and therefore the results that they produce, are credible, consistent and reliable.

We are concerned that assumptions set out in RG 276, including with ASIC's proposed change, are inconsistent with the Government's proposed objective of super, which includes delivering income for a dignified retirement.[2] This is because a person who uses a superannuation calculator that relies on these assumptions to plan for their retirement may not ultimately enjoy the standard of living that the calculator leads them to expect.

Summary of our position

Calculators forecast a members' projected balance at retirement and retirement income in today's dollars. To do this, they need to incorporate assumptions about inflation, which are set out in RG 276. Currently, ASIC's RG 276 states that "*by default, trustees and other providers must assume an inflation rate of 4% p.a. in the accumulation phase (wage inflation) and 2.5% p.a. in the retirement phase (consumer price inflation) in working out the value of the user's retirement benefit in today's dollars*".[3]

AustralianSuper supports the proposed change in the inflation rate in the accumulation phase from 4% to 3.7% p.a. (although we consider that the 3.5% p.a. long term wage growth figure used by Treasury in the budget papers would be a more consistent figure to use, and one that should be less subject to change over short terms).

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[1] As at 31 March 2024.

[2] The Government's proposed Objective of Superannuation is 'to preserve savings to deliver income for a dignified retirement, alongside government support in an equitable and sustainable way': see section 5, Superannuation (Objective) Bill 2023.

[3] RG 276.170, note 2.

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However, we do not support retaining a 2.5% p.a. (CPI-based) inflation rate in the retirement phase. This is because:

- A better measure of increases in retirement living costs is wage inflation (at 3.5% p.a.). Retirees expect to enjoy their part of increases in living standards across the Australian community and a wage inflation measure better reflects this than CPI.
- The assumed inflation rate should be the same between the accumulation and retirement phases. This is because retirees should expect to enjoy the benefits of productivity growth both when they are working and in retirement.
- The CPI-based rate creates anomalies when Age Pension income is shown in calculators, suggesting that the Age Pension grows in real terms.

Living expenses in retirement

Under ASIC's proposal, calculators provided by superannuation trustees will assume an inflation rate of 3.7% p.a. in the accumulation phase (wage inflation) but the 2.5% p.a. assumption in the retirement phase (consumer price inflation) will continue. For someone who is currently employed and is planning their retirement, this will mean that calculators will assume that:

- the member's salary will increase at 3.7% p.a. and the resulting future account balances discounted to today's dollars at 3.7% p.a. (in the accumulation phase),
- once the person retires, the discount rate suddenly changes to 2.5% p.a., implying that the person's income needs will only increase at CPI (rather than wages) once they have retired.

In our view, the 2.5% p.a. inflation assumption in retirement (based on CPI) understates the needs of retirees. This means that the RG results in calculators and forecasts understating members' expenses in retirement. We are concerned that this assumption sets up a situation where members will discover, at retirement, that they are not able to afford the retirement that the 2.5% inflation rate assumption rate had given them the impression they would have.

A better measure of increases in retirement living costs is wage inflation. We think that an appropriate figure is 3.5% p.a. This represents long-term CPI of 2.5% plus 1% reflecting productivity gains which are experienced as living standards improve. Retirees expect to enjoy their part of increases in living standards across the Australian community and a wage inflation measure better reflects this than CPI.

This point is supported by the fact that:

- the Government's proposed Objective of Superannuation includes the objective of 'delivering income for a dignified retirement'. A dignified retirement 'denotes a standard of financial security and wellbeing in retirement *which allows the person to participate economically and socially in their community*' (emphasis added). [4]
- the rules for calculating six-monthly Age Pension increases are based on the view that a wage inflation measure is necessary to account for increases in costs of living for retirees: Age Pension payment rates are benchmarked to Male Total Average Weekly Earnings.[5]

[4] See paragraph 1.30, Explanatory Memorandum to the Superannuation (Objective) Bill 2023.

[5] The Age Pension is indexed every six months to the higher of CPI and the Pensioner and Beneficiary Living Cost Index and then benchmarked to a percentage of Male Total Average Weekly Earnings (MTAWE), which means it cannot fall behind increases in wages as measured by MTAWE. The Harmer Review endorsed a two-part approach over an approach that relied solely on a price index like CPI: "*Benchmarking pensions relative to community standards should be the primary indexation factor, with indexation for changes in prices acting as a safety net over periods where price change would otherwise reduce the real value of the pension*": Pension Review Report, 27 February 2009, Dr Jeff Harmer, Department of Families, Housing, Community Services and Indigenous Affairs, page 54.

Age Pension in calculators

Not using a wage inflation measure in the retirement phase leads to confusing outputs when calculators project Government Age Pension income. This is because:

- total income (from superannuation drawdowns and the Age Pension combined) is assumed to increase in line with CPI (assumed at 2.5% p.a.),
- income from the Age Pension component is assumed to increase in line with wages growth (currently 4% p.a. but proposed to be 3.7% p.a.), and
- all future income is then expressed in "today's dollars" by discounting at CPI (2.5% p.a.).[6]

This means that calculators show the Age Pension growing in real terms. Under ASIC's proposed guidance this will be growth at the real rate of 1.2% p.a. (3.7% p.a. - 2.5% p.a.). This suggests to calculator users that, each year, the Age Pension will grow faster than their income needs grow. We believe this is at odds with the experience of pensioners.

A graphical example of this anomaly is shown in the **Appendix**.

It is also unclear why wage inflation is an appropriate increase assumption for the Age Pension, but not for total retirement income. For the user, income is income, regardless of whether it is received before or after retirement, and whether it is through superannuation or the Age Pension. A consistent application of assumptions is required to present users with a clear and consistent projection of their retirement needs.

Conclusion

The changes recommended in this submission would better provide members with greater confidence about what their retirement will look like and steps they can take now to secure a better standard of living in retirement.

If you have any questions about this submission or would like to arrange a discussion, please contact AustralianSuper's Fund Actuary, Jeff Warner, at **jwarner@australiansuper.com**.

Yours sincerely

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[6] RG 276.170 note 2 states that "we think it is reasonable to assume for the retirement phase that Age Pension rates will increase by 4% and to deflate the result by 2.5% to work out the value in today's dollars".

Appendix – Graphical example of retirement income projections

The following sets out an example to illustrate the distortion created by the adoption of a CPI-based inflation of 2.5% p.a. in the retirement phase. The example uses AustralianSuper's online calculator – the Super Projection Calculator – updated to use the revised wage inflation assumption of 3.7% p.a.

The relevant inputs for this example are as follows:

Chart 1: User inputs

Get started | About you | Your super | What's next?

Tell us about yourself so we can estimate your super balance at retirement

Input	Value
Your age	45
Your expected salary	$100,000
Employer contributions	11.5%
Current super balance	$50,000
Gender	MALE / FEMALE

Retirement income results for this example are shown below, where the orange bars represent drawdown from superannuation and the blue bars represent income from the Age Pension.

Chart 2: Retirement income projection

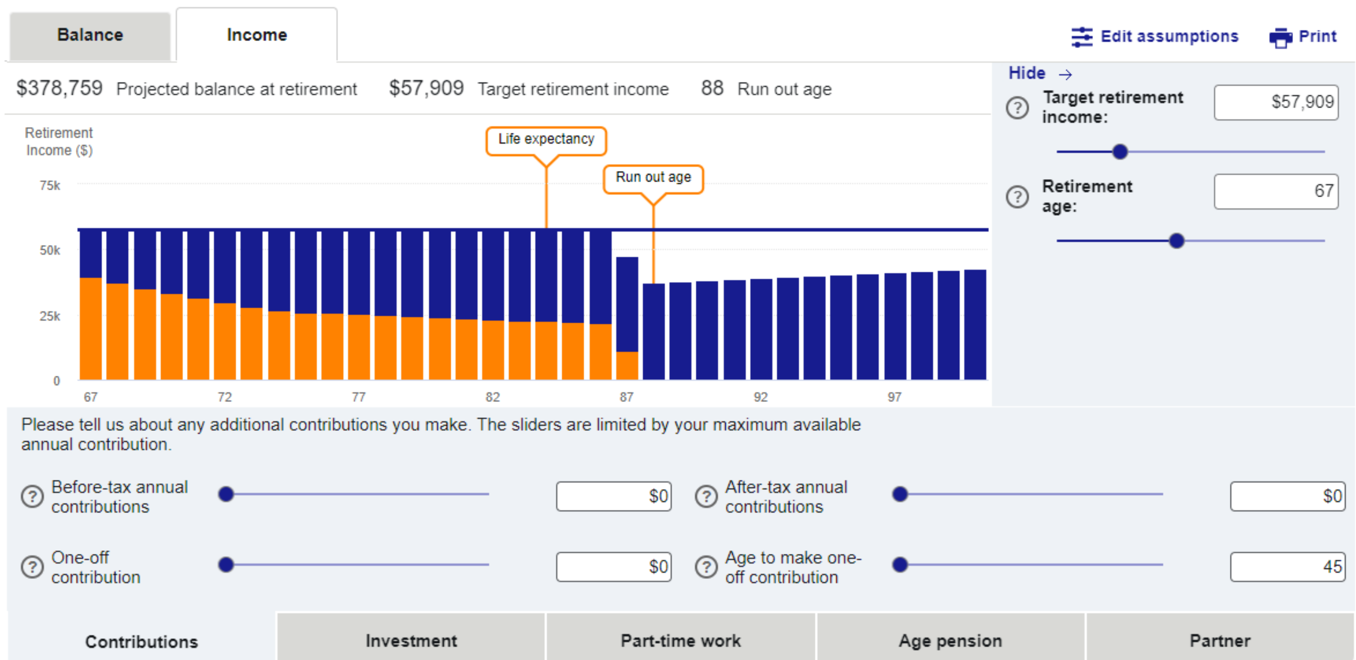

Chart 2 illustrates that:

- total income at the target retirement income level will last until age 86,
- the remaining super balance will be paid out at age 87 (but not at a level to meet the target retirement income level), and
- from age 88 onwards income will be from the Age Pension only.

Prior to age 87, total income increases at 2.5% p.a. and is then discounted into today's dollars at 2.5% p.a., hence resulting in the appearance of level income.

However, from age 88 – where reliance is on the Age Pension only – the impact of increasing the Age Pension at the wage inflation assumption of 3.7% p.a. and then discounting to today's dollars at CPI of 2.5% p.a. gives the appearance of an increasing Age Pension in real terms. This clearly does not reflect reality.

The anomaly would be eliminated by using wage inflation (in this case at 3.7% p.a.) to discount to today's dollars in the retirement phase.