DREW·WALK & CO

25 November 2016

Mr Mark Fitt
Committee Secretary
Senate Economics Legislation Committee

Dear Mr Fitt,

Re: *Inquiry into the Superannuation (Objective) Bill 2016 [Provisions]*

Thank you for the opportunity to make a submission to the Senate Economics Legislation Committee on this most important issue.

We would argue that the Australian superannuation system is well-regarded globally, with periodic reminders about how we compare to our peers (for instance, the strong rankings provided by the Melbourne Mercer Global Pension Index). While such indexes admittedly provide relative ratings, they at least suggest that the Australian system is reasonably well-designed and run.

We make the following points to contextualise the "objective of superannuation":

- *Pension finance is about more than just returns* – While the financial literature doesn't always acknowledge it, wealth is a function of more than returns. Therefore, fiduciaries have a range of levers at their disposal. For example, how might fiduciaries improve plan design to "nudge" members to increase contributions in order to improve their retirement outcomes?
- *Plan design is more than "to retirement"* – Increasingly superannuation funds are taking a whole-of-life approach to plan design, and consciously seeking to retain members after retirement. Research indicates that improved plan design in the post-retirement phase can dramatically improve retirement outcomes for members.
- *Retirement adequacy is more than wealth at retirement* – While having a healthy stock of wealth at retirement is a good thing, product innovation and high-quality advice is necessary to ensure that this wealth lasts for the remainder of the retiree's life.

We have argued for some time that there has been too much emphasis on measures of retirement adequacy that are based on terminal wealth (the metaphorical "pot-of-gold" at retirement) and not about the sustainability (or otherwise) of retirement income.

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The benefit of framing superannuation outcomes in terminal wealth terms is that it is easy to operationalise and enables analysis of retirement outcomes using a range of evaluation criteria. More importantly, the terminal portfolio balance represents the single most important objective that superannuation members aim to achieve immediately prior to retirement.

Our research supports the use of two alternative, but related, measures of retirement adequacy.

The first measure is the income replacement rate (RR). The RR provides a target that is expressed as the annuity equivalent value of retirement wealth as a fraction of a person's salary in the final year of employment. This measure is popular in the literature because it is very likely that people's post-retirement expectations are closely linked to their pre-retirement income. An income replacement rate of 65%-75% is commonly assumed for Australian workers and is comparable to international rates.

Second is the retirement wealth ratio (RWR), which is a useful measure of adequacy because it frames the retirement target as the ratio of terminal wealth to final annual salary. These benchmarks are accessible to the individual because they relate their retirement savings to their standard of living.

The attached ("Attachment 1") outlines a selection of our key research papers as they relate to several of the issues raised in our submission.

Please do not hesitate to contact us if you would like to discuss this matter further.

Yours sincerely,

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Attachment 1

Retirement risk zone

- Basu, A, Doran B, and Drew, M 2012, *Sequencing Risk: A Key Challenge to Sustainable Retirement Incomes*, Finsia (Financial Services Institute of Australasia), Sydney. https://www.finsia.com/docs/default-source/Retirement-Risk-Zone/sequencing-risk-a-key-challenge-to-creating-sustainable-retirement-income.pdf?sfvrsn=2

- Drew, M, and Walk, A 2014, *How Safe are Safe Withdrawal Rates in Retirement? An Australian Perspective*, Finsia (Financial Services Institute of Australasia), Sydney. https://www.finsia.com/docs/default-source/Retirement-Risk-Zone/how-safe-are-safe-withdrawal-rates-in-retirement-an-australian-perspective.pdf?sfvrsn=2

- Drew, M, Walk A and West J 2015, The Role of Asset Allocation in Navigating the Retirement Risk Zone, Finsia (Financial Services Institute of Australasia), Sydney. https://www.finsia.com/docs/default-source/industry-reports-retirement-risk-zone/the-role-of-asset-allocation-in-navigating-the-retirement-risk-zone.pdf?sfvrsn=4

Outcome-oriented retirement objectives (RR and RWR)

- Basu, A and Drew, M 2009, 'Portfolio Size and Lifecycle Asset Allocation in Pension Funds', *Journal of Portfolio Management*, vol. 35, no. 3, pp. 61-72. http://www.iijournals.com/doi/abs/10.3905/JPM.2009.35.3.061

- Basu, A, Byrne, A and Drew, M 2011, 'Dynamic lifecycle strategies for target date retirement funds', *Journal of Portfolio Management*, vol. 37, no. 2, pp. 83-96. http://www.iijournals.com/doi/abs/10.3905/jpm.2011.37.2.083

- Drew, M, Stoltz, P, Walk, A and West, J 2014, 'Retirement Adequacy through Higher Contributions: Is This the Only Way? *Journal of Retirement*, vol. 1, no.4, pp. 1-18. http://www.iijournals.com/doi/abs/10.3905/jor.2014.1.4.057?journalCode=jor

Framing superannuation objectives

- Drew, M, Walk A and West J 2016, 'Withdrawal capacity in the face of expected and unexpected health and aged-care expenses during retirement.' *Journal of Retirement*, vol. 3, no. 3, pp. 77-94. http://www.iijournals.com/doi/abs/10.3905/jor.2016.3.3.077

- Bianchi, R, Drew, M, Evans, M and Walk, A 2014, 'The Two Faces of Investment Performance and Risk', *JASSA: The Finsia Journal of Applied Finance*, no. 1, pp. 6-12. https://www.finsia.com/docs/default-source/jassa-new/jassa-2014/jassa-2014-issue-1/jassa_1_2014_the-two-faces-of-investment-performance-and-risk.pdf?sfvrsn=10

- Bianchi, R, Drew, M and Walk, A 2013, 'The Time Diversification Puzzle: Why Trustees Should Care', *JASSA The Finsia Journal of Applied Finance*, no 1. pp. 51-55. https://www.finsia.com/docs/default-source/jassa-new/jassa-2013/jassa-2013-issue-1/the-time-diversification-puzzle-why-trustees-should-care.pdf?sfvrsn=5