Insights

Defined Contribution

October 2019

Global Retirement Reality Report

Australia Snapshot

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From our 2019 Global Retirement Reality Report (GR3), we have summarised country-specific findings from plan sponsors. Here we explore Australian employers' evolving perspectives on retirement and outline three key system needs.

Since the middle of the last century, globalization has led to a gradual blurring of national and cultural distinctives. Large parts of the world's population are equally well versed in everything from pizza to smart phones to reality TV. However, there are plenty of areas where big national differences still exist, not least in national retirement systems. If you don't believe me, just try and explain franking credits or means testing for the Age Pension to someone outside our sunburnt country.

Key Findings

1 **Simplicity Is the Ultimate Sophistication** According to employers, simplicity and ease of use for employees was the top priority when choosing a retirement plan provider. By keeping plans simple, employees are more likely to engage.

2 **The Power of Advice Is Global** Over 60% of both Australian and global employers we spoke to thought their employees placed a high value on access to advice. Employers understand the value of advice when trying to navigate the complexity of the Australian taxation and age pension requirements.

3 **ESG Makes a Difference** Both employers and employees believe it is important to incorporate Environmental, Social and Governance (ESG) investing options in a plan menu. Funds with a clear ESG proposition will start with an advantage over their competitors.

Survey Methodology

The 2019 Global Retirement Reality Report analyses how defined contribution (DC) plan sponsors across the globe are thinking about retirement.

In the first half of 2019, State Street Global Advisors commissioned YouGov to conduct interviews across five countries representing a range of retirement systems. We interviewed 195 DC plan sponsors.

Region	Number Surveyed
Australia	41
Ireland	30
Netherlands	37
United Kingdom	45
United States	42

The report follows on from our 2018 report that looked at retirement happiness through the eyes of the saver. As expected we saw some notable differences within the Australian sample; however there were also some surprisingly strong similarities.

Our Australian sample covered a range of plan sponsors present in the market:

Corporate	32%
Public	29%
Retail	27%
Other	27%

The Biggest Difference

You may have already spotted a big difference in the previous section. The global report was designed around "plan sponsors". It's a phrase that makes a lot less sense in Australia than it did a couple of decades ago. Go back to the late 1990s and Australia had over 4,000 corporate funds, i.e. superannuation funds provided by the employer for their employees only. By 2004 that number had dropped to a little over 1,000 and by June last year that number had dropped to just 24.[1] It is true that employers provide contributions into a superannuation fund for their employees, but they have little, if any, control over fund design, investment choices and so on.

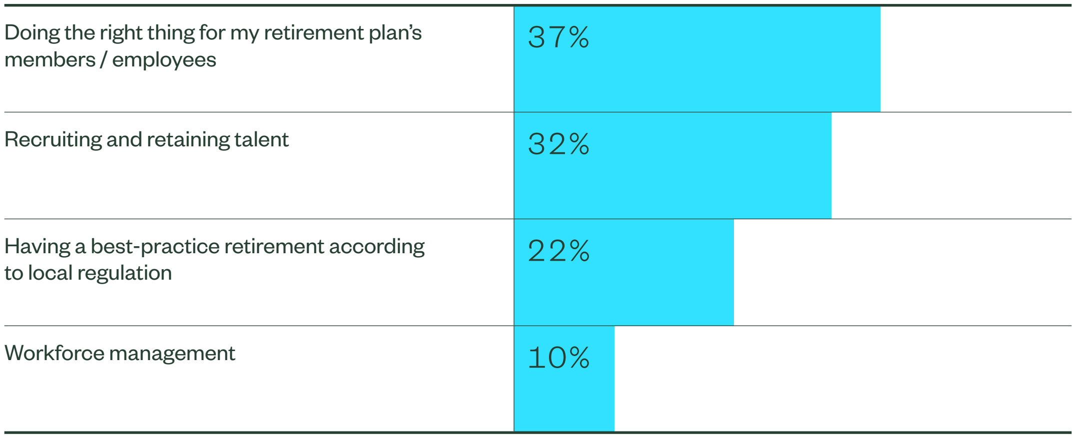
When we asked questions of "plan sponsors" in other parts of the world, we were generally speaking to individuals who had both oversight of the plan and worked for the employer. In Australia, we were generally speaking to the HR department of the employer — in other words we weren't speaking to someone who had control over fund design or investment options.

A Surprising Similarity

Given the virtual elimination of the employer sponsored funds, you might think Australian employers have no more reason to be interested in your retirement prospects than they do your mortgage. In practice, you may be surprised to learn that employers actually do care about their workforce's retirement prospects. When asked to rank what was most important to their organisation with regards to their retirement plan, *doing the right thing for employees* was ranked first by over a third of employers.

Please rank the following in terms of importance to you and your organisation.

Figure 1
Doing the Right Thing by Employees Takes Top Rank



Source: State Street Global Retirement Reality Report 2019. n=41.

An Unsurprising Similarity

The Australian retirement system is, by global standards, a pretty healthy system.

Figure 2
Australia vs. Global Pension Systems

Selected Countries	Mercer Global Pension Rating	Coverage Ratio (% or Working-Age Population)	Assets (% of GDP)
Australia	B	76	124
Ireland	B	47	41
Netherlands	A	88	180
United Kingdom	C+	43	95
United States	C	41	135

Source: Mercer, *Melbourne Mercer Global Pension Index,* 2018, Australian Centre for Financial Studies, Melbourne; OECD, Pensions at a Glance 2017: *OECD and G20 Indicators,* OECD Publishing, Paris, pp 151 & 155.

Yet, in our previous retirement survey[2] only one in five people in the Australian workforce had a sense of optimism or happiness about their financial situation in retirement.

We believe this lack of member confidence in retirement outcomes has less to do with the overall adequacy of the system, and more to do with its complexity. The integration of the Age Pension with superannuation, especially the notorious twin-headed asset and incomes test, is the primary source of complexity. The prevalence of multiple accounts hasn't improved things in the past either. The Productivity Commission in Australia highlighted the problem of members paying unnecessary fees and insurance premiums across multiple accounts stating, *"It (multiple accounts) is an avoidable system failure that has hurt members since the inception of compulsory super".*[3] However, it is gratifying to see some steps in the right direction through recently passed legislation[4] that allows the Australian Taxation Office to consolidate inactive low-balance accounts on behalf of individuals.

Which leads to an unsurprising similarity between Australian and global "plan sponsors" in our survey this year. Australian employers have low expected replacement ratios for their employees approaching retirement and that reflects a global pattern.

Figure 3
Employer and Employee Expected Retirement Income Replacement Ratios Are Often at Odds

More Aligned ⟵⟶ Less Aligned

	Australia	Ireland	Netherlands	United Kingdom	United States
2019 GR3 Plan Sponsor Survey (n=195) Plan sponsor estimate of replacement ratio for employees retiring in next 5 years	34%	28%	33%	27%	23%
2018 GR3 Participants Survey (n=2,463) Expected replacement ratio from participants approaching retirement	47%	46%	14%	46%	57%
OECD Pensions at a Glance 2017 Net replacement ratios for average earners	43%	77%	101%	62%	87%

Notes: OECD replacement ratio includes DC, Defined Benefit (DB) and social security benefits.

Source: Mercer, *Melbourne Mercer Global Pension Index*, 2018, Australian Centre for Financial Studies, Melbourne; OECD, Pensions at a Glance 2017: *OECD and G20 Indicators*, OECD Publishing, Paris, pp 151 & 155.

In fact, the ability of Australian employers to assess the retirement outcomes for their workforce is clearly impaired. Not only is there the problem of Age Pension and superannuation integration, or the problem of multiple superannuation accounts, there is also the problem of investments or assets outside the superannuation system.

It turns out this is a global problem faced by employers and we have seen similar concerns arising in other markets.

When asked, "What are the main gaps in your current retirement plan provider or offering?", respondents said:

> **"People have a lack of knowledge generally and more specifically, don't know how to move their pension plot from one provider to another."**
>
> —UK employer, Finance Officer, Media and Communications Industry

> **"The lack of communication between employee and pension provider."**
>
> —Netherlands employer, Human Resources, Financial Services Industry

Results

Looking through employer responses, we were left with three system needs.

1

Simplicity Is the Ultimate Sophistication

In the early days of superannuation, when your plan was linked to your employer, the plan was promoted as part of a suite of benefits for new employees. The superannuation industry now operates independently of any individual employer and that has led to fierce competition for members. And much of that fierce competition has focused on investment performance and fees.

So, given that employers in Australia actually care about retirement outcomes for their employees, you would think their *primary* focus would be on the investment returns and fees associated with the funds being used by their employees. Not so. Mathematically, both are critical to generating solid retirement outcomes. However, the best mathematical calculations in the world are useless if members don't understand enough to engage.

What we witnessed in our survey was a strong local and global focus on simplicity and ease of use over and above investment returns or fees.

When you think about selecting a provider for your retirement plan, what are you key goals / objectives?

Figure 4
Employers Rank Retirement Plan Intuitiveness and Ease as Top Priorities

	Global ex Australia	Australia
Making sure it is easy for employees to use and understand	29%	37%
Making sure that the plan is easy for the employer to implement, maintain and monitor	29%	27%
Minimising cost and / or fees charged	17%	22%
Ensuring that the plan offers an appropirate range of investment options	18%	14%
Member communication and engagement (availability of webportal, app, website, service desk)	7%	0%

Source: State Street Global Retirement Reality Report 2019. n=189.

2

The Power of Advice Is Global

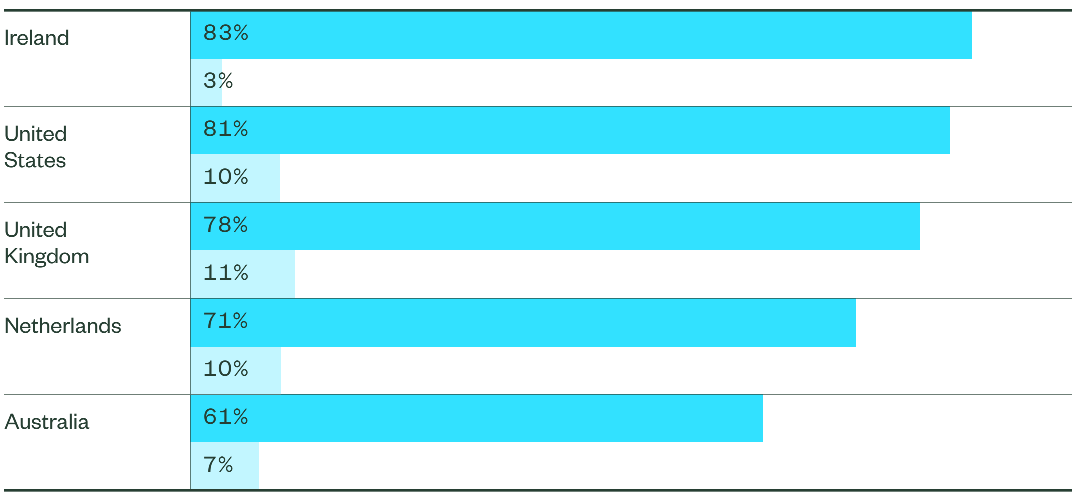
Retirement is a uniquely personal experience, and it is notoriously difficult to find a reliable "one size fits all". The Australian superannuation industry has struggled with the question of advice for many years. How should advice be delivered? Who pays for it and what is a reasonable cost? What constitutes general as opposed to full scale advice?

We found in our survey that employers are as aware of this problem as anyone else. Over 60% of the Australian employers we spoke to thought their employees placed a high value on access to advice. But Australia is not alone on this issue. As more of the global pensions industry moves from older defined benefit to defined contribution designs, the questions the Australian industry has faced over advice have become global questions.

How much do you think that employees/ members value the Ability to Access Advice in a retirement plan?

Figure 5
Employers Agree on the Importance of Access to Retirement Planning Advice

Important
Not Important



Source: State Street Global Retirement Reality Report 2019. n=189.

3

ESG Makes a Difference

For some industry participants, ESG considerations are at best a distraction, and at worst a detractor to returns. Sometimes the industry misses the wood for the trees. A more pointed question is to ask whether the industry can continue to operate with absolutely no regard for the environmental or social consequences of its investment decisions, or whether the industry bears no responsibility for the governance of the companies it selects for portfolios. At State Street Global Advisors, we believe that firms that adhere to environmental efficiency, social awareness and the highest governance standards are well-positioned to withstand emerging risks and capitalise on new opportunities.

When we asked fund members in Australia about ESG last year 47% responded it was important that their investments incorporated companies with ethical values.[5] We found much the same when we interviewed employers this year with six in ten (61%) believing it is important to incorporate ESG in their plan's investments.

As battles for employer default fund status are waged over the coming years, we believe that funds with a clear ESG proposition for both employers and prospective members will start with an advantage over their competitors.

Conclusion

The last few years have seen huge disruptions to the financial services sector in Australia. However, these disruptions haven't occurred in a domestic vacuum; a number of the broad themes that have emerged in Australia are truly global in scope. As world pension systems increasingly move toward defined contribution designs, themes like system complexity, the role of financial advice and ESG are coming to the fore.

Employers care about these themes partly because employee receptivity is so high. Our 2018 GR3 survey shows Australian retirees' top advice to today's savers is to engage pension planning earlier (71% of respondents), followed by saving earlier (69% of respondents).[6] Advice allows savers' to forge their own paths, and the sooner they begin upon the journey, the more rewarding the experience. Employers have the opportunity to guide them to the start.

Endnotes

1 Australian Prudential Regulation Authority (APRA), *Annual Superannuation Bulletin,* June 2018 (Reissued 3 July 2019), Table 3, (https://apra.gov.au), accessed 6 August 2019.

2 State Street Global Advisors, *Global Retirement Reality Report 2018: Australia Snapshot,* July 2018, p.6.

3 Productivity Commission 2018, *Superannuation: Assessing Efficiency and Competitiveness,* Report no. 91, 21 December 2018, p.16.

4 Treasury Laws Amendment (Protecting Your Superannuation Package) Act 2019.

5 State Street Global Advisors, *Global Retirement Reality Report 2018: The Happiness Formula,* October 2018, p. 19.

6 State Street Global Advisors, *Global Retirement Reality Report 2018: Australian Snapshot,* October 2018, p. 10.

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