SPEECH BY BRIAN BENARI
Managing Director and Chief Executive Officer, Challenger Limited

AB&F Randstad Leaders Lecture
Sydney: 19 May 2016

You're living longer… how's Australia going to pay for it?

Introduction

Welcome and thank you AB&F for the invitation to speak. Today I will explore a topic which is relevant to us all … longevity and retirement.

I will start by looking at the demographic wave of an ageing population that is breaking across Australia.

Then I will discuss the successes and, some of the shortcomings of our current pension system … and how the government began to transform it in this month's Federal Budget.

Finally, I will look at the role that corporate Australia can play in helping employees deal with longevity and retirement.

But before that I want all of you to think about 3 personal questions. Firstly, how long will I live? … Secondly, when will I retire? … Thirdly, how will I pay for my retirement? …

I'm also going to look at another big question. The good news is we are all likely to live longer and be retired longer. The question is: how is Australia going to pay for it?

How long will we live?

At Challenger our purpose as a company is to provide Australians with financial security for retirement.

That means we are mostly focused on the retirement spending phase of superannuation, whereas the bulk of the industry concentrates on accumulation – the savings phase - as people try to accumulate a nest egg.

Until recently, being focused on retirement income has been a fairly unusual place to be.

That's now changing and its being driven by a number of major themes.

Every day about 700 Australians turn 65.

And, with Australia only five years into a 20-year Baby Boomer retirement cycle, it is a trend that has a long way to run.
The number of people aged over 65 will double to 7 million over the next 40 years.

And those new retirees will live longer than previous generations.

Greater longevity dramatically changes the proportion of retirees to working Australians, which impacts the sustainability of our system.

60 years ago there were about 8 people in the working age population for each and every retiree. Today it's about 4 ½ and, in 40 years' time, it is expected to be just 2 1/3 workers per retiree.

This is creating a massive and unprecedented fiscal challenge.

It's a worldwide phenomenon but even more critical to Australia as we have among the longest life expectancies.

The average Australian born today is expected to live to 85 for women and 80 for men, according to the World Health Organisation.

That puts us near the top of the world rankings – fourth for women, with Japan at number one - and sixth for men, where top of the rankings is … and there would be a prize for guessing this … the tiny European state of San Marino.

If you were one of the 148 boys lucky enough to be born in San Marino last year, then well done to you!

However, if you have already made it through many of the trials of life to age 65, your age cohort life expectancy is even higher.

In Australia, with future mortality improvements, it's an average 90 for women and 87 for men. Of course, nobody is average. Half of us will live longer, some much longer.

There's a 9 per cent chance that one partner in a couple retiring today will live to be 100 years of age.

All up, there are about 5,000 centenarians alive in Australia today. In 40 years' time, there's expected to be 8 times that number.

So, what is driving this increased life expectancy?

The two biggest drivers of mortality improvement over the last century have been:

- The widespread use of antibiotics and vaccinations since the second world war; and,
- In the 1980s and 90s, advances in treatment of cardio-vascular disease.

Now I'm sure you will know people in their 50s, 60s or 70s who have had heart stents put in – a great example of how longevity is being materially extended.

It's hard keeping up with the rate at which lifespans have increased and that's one of the reasons why most Australians underestimate their own lifespan - by around 7 years.

This has consequences when it comes to retirement planning and making sure your money lasts as long as you do.

Because, of course, there's a serious side to the longevity issue.

While a long life is a blessing, it seems inevitable that future retirees will need to save harder, work longer and be more financially self-reliant than they ever expected.

Our retirement system is incomplete

The Commonwealth Age Pension was introduced in 1909. Try and guess what the average life expectancy was back then? … 56.

And guess what percentage of the population made it beyond 65 and became entitled to the Age Pension? … 4 per cent.

Nowadays at 65, most people can look forward to another 20 or 30 years.

This is a huge fiscal challenge, exacerbated by the Baby Boomer retirement cycle.

To address this looming fiscal issue, in 1992 we saw the creation of the modern super system. However, a fundamental, less apparent shift also occurred.

This was the shift from a defined benefit system, where you receive a regular pension income, to a defined contribution world, where you contribute regularly to your savings pot but your pension depends on how your investments perform.

That is, you have assumed new risks.

In 1982 my father retired from the public service with a defined benefit pension of 75 per cent of final average salary, linked to inflation. That was normal at the time and saw employers stump up the money to meet that income stream.

Now individuals are required to put money in via the super system.

So we've all got used to looking at our super balances rather than thinking about the pension income it could create.

I call this the wealth effect. While many people look at their super balance statements and feel wealthier over time, the reality is they are shouldering far more risk than their defined benefit predecessors.

Today, market risk, longevity risk and inflation risk, all conspire to place greater volatility on your personal balance sheet.

Individuals face market risk in getting the right investment outcomes and they've also taken on longevity risk - ensuring their super lasts throughout their lifetime.

Understandably, people are beginning to wake up to this, especially in the current low interest rate environment, which is very topical in today's news.

A recent survey of over-50s conducted by National Seniors Australia, shows that only 45 per cent were confident their superannuation savings would last the distance.

Most people respond in a fairly commonsense way to that kind of uncertainty.

Three-quarters of older Australians expect to cut back their spending.

Quite often they are more frugal than they need to be and live less comfortably than their savings should allow, because of the fear of running out of money.

Academic research shows this self-enforced frugality leads to situations in later stages of retirement where retirees are running down their spending at the cost of a materially diminished lifestyle.

Many seniors are responding to uncertainty by preparing to work longer, or returning to the workforce. The age at which Australians intend to retire is actually increasing.

A report out earlier this year from the Australian Bureau of Statistics showed the majority of over- 45 year olds intend to retire between 65 and 69 years of age, with one in four men intending to work past 70.

There are a number of reasons for this and, there are certainly social benefits from working but the main reason cited by ABS is financial security.

This highlights weaknesses in Australia's retirement system.

Our superannuation system currently stands at $2 trillion – bigger than Australia's GDP, and it is underpinned by an Age Pension safety net that costs about $44 billion a year.

The average super balance at retirement is now substantial - $377,000 for a 65-year old man and $215,000 for a woman. I will come back to that inequality later.

Our super system is internationally recognised as a leader in generating savings in the run up to retirement, or the accumulation phase.

But it ranks lower when it comes to retirement itself because there has been no structured system for converting those savings into sustainable income for life.

The emphasis on the accumulation phase of superannuation has led to heavy reliance on investing in growth assets, predominantly equities and property.

About 48 per cent of super fund asset allocation is to equities, the second highest in the OECD.

Conversely, we have the lowest allocation to fixed income of any pension system in the first world, according to Willis Towers Watson.

Australia's super system is about 9 per cent invested in fixed income versus an average for the leading OECD countries of around 50 per cent.

Let me be clear, growth assets make a lot of sense in accumulation but it's a different story when it comes to retirement where safe and sustainable income streams need to be the priority.

The point I'm making is of the need for a better balanced system in retirement.

Our retirement system is essentially incomplete. It's like a half built Sydney Harbour Bridge and doesn't deliver you safely where you need to go - a more secure, more sustainable retirement.

Building a superannuation system that's fit for purpose

This month's Federal Budget marked a sea change in Australia's approach to retirement and cleared the way for three major reforms. I will talk about each of these.

One of the key pillars and something that has been overlooked in much of the budget discussion is the government's confirmation that the objective of superannuation is "to provide income in retirement to substitute or supplement the Age Pension."

This objective is based on a recommendation from the Financial System Inquiry.

It is a critical reform.

Its 24 years since the superannuation guarantee was introduced and setting the objective of super is timely and a sign of the maturing of the superannuation system.

Indeed it is a recognition that things have to change.

Making clear that the purpose of super is for income in retirement provides a framework to tackle the financial challenges of our ageing population.

It provides direction and clarity for policymakers, for industry participants like super funds, and for all of us as individuals.

In practical terms, it says that the purpose of super is not to create huge savings pools but it is to create income streams that would supplement or substitute the age pension.

You can look at changes to super in the budget, including the $1.6 million transfer balance cap, and see that they are consistent with this newly articulated purpose of super.

Equally important in the budget is the second reform that will allow for a broader range of retirement income products.

Among these products will be deferred lifetime annuities which are, effectively, insurance.

Retirees would purchase them, probably through a number of regular premiums while they are still working, with annuity income starting to pay from an agreed age in the future. Perhaps, average life expectancy.

In this way, a key uncertainty in retirement planning is removed.

What deferred lifetime annuities do is give certainty about how long your other savings have to last. Once you get to that age, the income stream from the annuity can kick in. Retirees will have greater confidence to spend their savings and enjoy a better standard of living in their retirement.

One of the problems with longevity risk is that while averages work fine across a whole population, it is idiosyncratic, meaning that it is specific to you only.

Your lifespan is the single greatest unknown factor in retirement planning. In fact, only about 5 per cent of people actually live to their projected life expectancy; the rest live longer and shorter.

Most people build their retirement plans on average life expectancy. But, by definition, there's a 50 per cent chance of you living beyond that.

This is an asymmetric risk. If you die early the risk doesn't matter – you leave money to your kids. If you die later, it does matter – you run out of money.

While we all routinely insure against risks in our everyday life with relatively low probabilities – we insure our cars and our homes – many of us don't insure ourselves against a risk that has a much higher chance of happening. That is, the risk of outliving our savings. Deferred lifetime annuities will help us do just that.

The third and final component of the current reform agenda is something that goes by the fairly clumsy acronym of CIPRs, which stands for Comprehensive Income Products for Retirement.

Again, we have David Murray's Financial System Inquiry to thank for the concept and, for that acronym as well.

While I'm not promising it will be a household word, it's one that we will all hear a lot more of in the years ahead.

The Government is pushing forward with plans for all super funds to facilitate an option for retirees to choose a CIPR.

CIPRS help address those conspiring forces of market risk, longevity risk and inflation risk that I spoke about earlier. They work by combining current superannuation products with lifetime annuities and other longevity risk products.

Together all 3 regulatory reforms I've spoken about will make a fundamental difference to the effectiveness of our superannuation system.

Winners and losers

We already have a very good superannuation system. With the shift of focus towards retirement income, we will have an even better one.

But even with all this in place, it won't be perfect.

There are winners and losers. The losers quite often are women and people from indigenous backgrounds.

Under our current planned superannuation settings full time working Australian men are well on their way to building their super savings. It's a different story for women, the lower paid and those with irregular work patterns.

Women and super is an area that quite rightly has received a lot of attention over the past couple of years.

Last month, a Senate economic committee published a report entitled "A husband is not a retirement plan" looking at the disparity that sees women retire with far lower super balances than men.

For current retirees, women have just over half the super balances of men. Younger women, who will have the benefit of the superannuation guarantee system their whole working life, are expected to have about 30 per cent less than men when they retire.

There are many factors behind this but at the heart of the problem is that super is a by-product of the relationship between the employer and the employee … and women and men tend to have different experiences of work.

Women, on average, are more likely to work in lower paid roles and lower paid fields, they are more likely to work part-time and are more likely to take breaks from paid employment to provide unpaid care for others.

The issue is amplified by a gender pay gap that for similar roles sees women being paid about 18 per cent less than men on average.

So over their lifetimes they will earn significantly less than men.

There's been less publicity about indigenous Australians but there are some similar patterns. Griffith University research shows that their median income is much lower than for non- indigenous Australians.

As a result indigenous Australians will retire with about 27 per cent less savings. Or, put another way, based on the current 9.5 per cent super contribution rate, to retire with the same savings, they would have to work an additional 6 ½ years.

By its nature, superannuation tends to reflect some of the disparities in working life. It's not a cure for them but neither should it amplify them.

Though the super guarantee structure was set up just a generation ago, it was a time when traditional full time working patterns were more prevalent.

As we look forward, it seems highly likely that the proportion of people working part time, coming in and out of the workforce, or working later in life will increase and that will continue to provide challenges for our system.

Looking to the future

I want to finish by stressing the opportunity for corporate Australia to make a difference when it comes to retirement income.

At Challenger, we pay superannuation guarantee payments for employees on parental leave. Our scheme is a little different to most as we will pay this for either partner taking parental leave.

For each individual employee this is a relatively small payment but it can make a big difference.

For a 30 year old woman on the average full-time female salary of $68,000, receiving the superannuation guarantee for two periods of child care during her working life would cost an employer about $11,000.

Invested in super for the 35 years until retirement, that should generate an additional $67,000 in super savings, once compound returns and inflation are taken into account.

That would equate to an uplift of 6 to 7 per cent when it comes to retirement in 2050, or about 20 per cent of the projected retirement gender gap.

So it doesn't solve the problem of retirement inequality but it makes a material difference.

I personally believe that this is something that every company that can afford to do, should do.

There's also an opportunity for companies to engage more with their people around super:

- through education to make sure employees understand the risks and benefits they are assuming in retirement;
- through encouraging people to salary sacrifice and, partially matching their contributions;
- and, where possible, through paying superannuation guarantees during parental leave.

What's the pay-off for companies? It's the ability to attract and retain the best employees.

Today I hope I've helped you answer those questions I posed at the start.

How long will I live? Probably 7 years longer than you think and if you are a 65-year old woman, there's a 50 per cent chance of living beyond 90.

When will I retire? As the penny drops about the risk of increased longevity, people are thinking about retiring later, most between 65 and 69.

How will I pay for my retirement? I hope by taking steps to insure against the high risk of outliving your savings.

And what about that last question. As we all live longer, how's Australia going to pay for it?

There is no silver bullet.

Government has an important role to play in setting the right superannuation policy and we absolutely need to hold them to that task.

But we can't look to government to solve all our super issues.

Corporate Australia can help by addressing some of the inequality in the system and, alongside super funds, helping employees be more engaged in their super outcomes.

The financial services industry has a role to play in developing a wider range of products that help address the changing needs of retirees.

And, at the end of the day, as individuals we all need to be much better informed about how we manage the new risks of retirement.

Thank you.