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Dynamics of the Australian Superannuation System
The next 20 years to 2043

Deloitte Actuaries & Consultants
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Australia’s total superannuation assets are projected to more than triple to over $11 trillion in 2043 from $3.2 trillion today.

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EXECUTIVE SUMMARY

In this eleventh edition of *Deloitte's Dynamics of the Australian Superannuation System - the next 20 years to 2043,* we model the components of the superannuation industry in Australia, project their growth, and comment on the market dynamics, demographic shifts, longevity and retirement incomes, and the possible asset allocation impact in respect of the Australian sharemarket.

Growth and more growth

Total superannuation assets have grown to $3.2 trillion as at 30 June 2023, and are projected to more than triple over the next 20 years. Since 2019, superannuation assets had remained relatively constant as a result of the uncertainty of the COVID-19 pandemic followed by an emerging high inflationary environment. This result indicates a recovery from this period with increased contributions and positive investment returns increasing the size of the market. However, some funds continue to experience significant outflows.

Consolidation and industry rationalisation

For many years, we have predicted ongoing consolidation within the superannuation industry. Fund rationalisation has sped up in recent years and we can expect up to 12 mega-funds (each with assets under management exceeding $100 billion) within the coming years – with 8 already at this size.

We expect to see further consolidation in the superannuation system, both:

- **At a fund level** – with significant merger activity underway and likely to continue as the industry rationalises around improving member outcomes and best financial interests of members; and
- **At an account level** – account consolidation has been continuing at pace, driven by funds encouraging members to consolidate their superannuation arrangements, the ATO working to proactively match Unclaimed Super Monies to active accounts as well as leveraging the MyGov portal to help individuals identify their multiple super accounts, and the account stapling measures under *Your Future, Your Super* which have applied since November 2021.

Retirement incomes

Each generation is building larger real superannuation balances than earlier generations, underpinned by longer periods of their working lives covered by the compulsory Superannuation Guarantee (SG) system and higher SG rates than in the past. The maturing of the superannuation system will greatly increase the importance of the retirement segment of the market. The Retirement Income Covenant came into effect on 1 July 2022 and now requires every superannuation trustee to formulate, review regularly and give effect to a retirement income strategy for their members approaching or in retirement, balancing three objectives: maximising expected retirement income, managing expected risks, and flexible access to monies.

This provides real opportunities as well as challenges for the industry to innovate and develop retirement products to enable retirees to manage the dual risks of longevity and investments, while still being simple and easy to understand. The joint APRA/ASIC thematic review found that, although trustees have improved their offerings in retirement, critical gaps in metrics and data are still present amongst most trustees, preventing their performance of an in-depth analysis of members' income needs in retirement as well as the ability to implement and track their retirement income strategy. To assist, the government and regulators have committed to recognising and overcoming any existing barriers preventing the provision of retirement advice, as trustees work to better understand their members' retirement needs and develop products which support them.

Adequacy and longevity

It is common knowledge that the 'old age dependency' ratio in Australia is projected to 'worsen' over the next 20 years and on to 2050, which represents that an increasing proportion of the population will be retired. Managing the issues of adequacy and longevity continue to be important for individuals and for Australia as a whole. In their recently released corporate plans, improving retirement outcomes remains a key part of the agendas for both APRA and ASIC as regulators over the coming years.

Treasury has released a consultation paper in which it seeks to gather views on potential policy reforms addressed at the retirement phase of superannuation. The consultation is focused on gathering feedback around three key areas: supporting members to navigate retirement income, supporting funds to deliver better retirement income strategies, and making lifetime income products more accessible.

We consider the impact on retirement incomes as a proportion of final salary for individuals entering the workforce today. This reflects comparisons if their superannuation benefits are based on the current 11% SG rate, or an increased rate of 12% (being the ultimate maximum level per current legislation) and using different life expectancy ages. Our projections show that an increased contribution rate throughout an individual's working life and the length of time spent in retirement have a material impact on the final retirement income that an individual can expect to receive.

Immediate focus

In the next few years, superannuation funds will be focused on ongoing merger activity, improving operational efficiencies and strengthening retirement strategies and product solutions. As the industry matures and more people retire, major super funds are expected to establish retirement solutions as a separate business segment, focused on specialised administration, financial advice, and product structures tailored to members' retirement needs.

Nevertheless, we can expect to see:

- Further incremental development of retirement products.
- The integration of account-based and lifetime income stream products.
- The development of much more sophisticated member segmentation analysis with enhanced data gathering.
- The development of more affordable and accessible advisory services facilitated by technology and embracing changes arising from the Quality of Advice Review which will allow super funds to expand the advice services they can provide to members.
- Ongoing development of the legislative and regulatory framework, with continued industry consultation.

The dynamics of the retirement income system will continue to shift over the coming decades.

We trust you will find this report useful and thought provoking and we look forward to discussing it with you as you consider the superannuation industry, your own needs and objectives, member outcomes, retirement strategies and product solutions, and the implications of our projections. We are available to present our findings and strategic perspective to executive teams and Boards.

If you would like to obtain more detailed information on the market projections set out in this report to inform your business planning, we would be happy to discuss how we can support you.

Methodology

The Dynamics of Super Report is based on the SPROUT Super Model which has been developed by the Deloitte Actuaries & Consultants team. It references a combination of data collected by the Australian Bureau of Statistics (ABS), the Australian Prudential Regulation Authority (APRA), the Association of Superannuation Funds of Australia (ASFA) and other public organisations and associations, together with research conducted by Deloitte.

The dynamic nature of the SPROUT Model, which calculates the future market for superannuation assets, in aggregate, and within segments, is based on projected inflows and outputs from the system and enables sensitivity tests to be done using different rates for important variables.

These variables include the Superannuation Guarantee contribution rate, levels of voluntary contributions, administration and investment costs, rates of exercise of fund choice by individuals, income stream take up rates, investment returns, inflation and salary growth, taxation on super, consolidation of superannuation accounts, estimated impacts of account stapling under *Your Future, Your Super* legislation, and latest migration targets.

MARKET OVERVIEW

Projected total superannuation assets

Total superannuation assets have grown to $3.2 trillion as at 30 June 2023. Since 2019, superannuation assets had remained relatively constant as a result of the uncertainty of the COVID-19 pandemic followed by an emerging high inflationary environment. This result indicates a recovery from this period with increased contributions and positive investment returns increasing the size of the market.

The base projections from the Deloitte super projections model show that total net superannuation assets in Australia will continue to increase to $11.2 trillion by 2043 (See Figure 1 *Projected superannuation assets*). These projections also reflect the legislated increases in the Superannuation Guarantee (SG) rate from 11% at July 2023 to 12% by July 2025, with increases of 0.5% at each 1 July in the intervening period.

Over the financial year to 2022, superannuation funds delivered negative nominal returns as a result of increased interest rates and inflation. With the market recovering from these challenging market conditions over the following year, we have seen the total value of superannuation assets grow to $3.2 trillion as at 30 June 2023, an increase from $3.0 trillion as at 30 June 2022.

Average balances at retirement are increasing, driven both by strong investment returns and by members having received superannuation contributions for increasing proportions of their working lives (noting that the SG was introduced from 1992, and non compulsory Award arrangements applied prior to that). Post-retirement assets are also expected to grow as Baby Boomers move into retirement closely followed by Generation X. As a result of this we expect continuing strong growth in post-retirement assets over the next 20 years despite retired members drawing down their accumulated superannuation savings over time.

However, given that there are no maximum constraints on the pace at which members can draw down their benefits in retirement, if retirees draw down too quickly (e.g. to meet their needs in a low return environment), then the projected asset growth would slow, and commensurately, the call on the government for the aged pension would be greater.

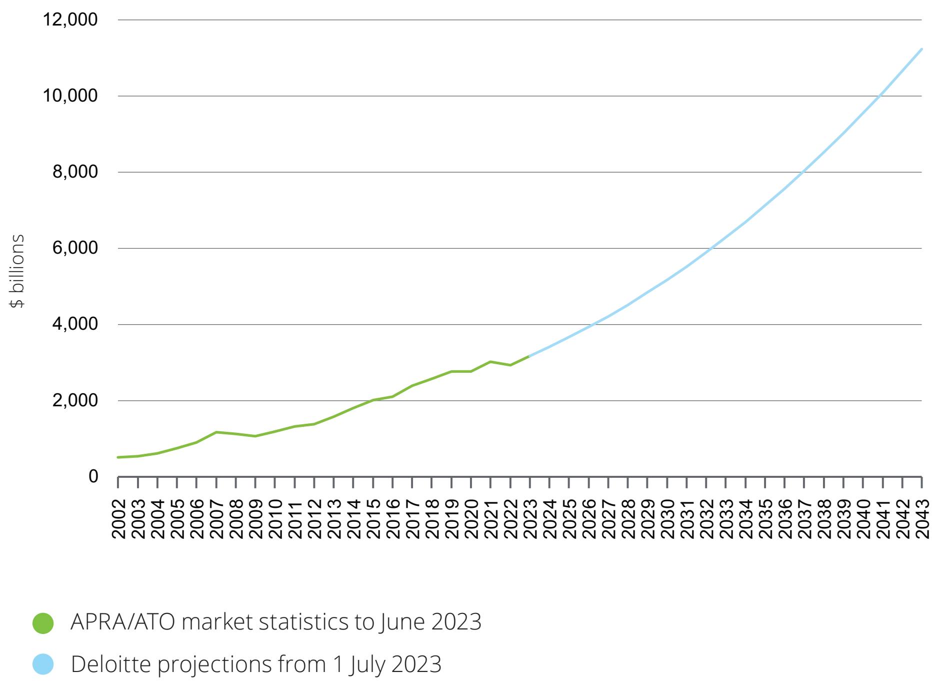
The thematic review of superannuation trustees' progress implementing the Retirement Income Covenant was published by APRA and ASIC in mid-2023. One key element of this review was the need to improve trustees' ability to perform an in-depth analysis of members' income needs in retirement as well as implement and track the effectiveness of their retirement income strategy. To assist, the government and regulators have committed to identifying and addressing any existing barriers preventing the provision of fit-for-purpose retirement advice and products.

In our modelling for the *Dynamics of Superannuation* research, we have continued to assume that many individuals will reduce their rate of voluntary contributions as the SG rate increases. However, the modelling has not allowed for any other changes in member behaviour which may result from the SG increase.

Superannuation in the economy

To better understand the superannuation industry in the context of the Australian economy, Figure 2 shows the relationship between total superannuation assets and Australia's Gross Domestic Product (GDP) over the last two decades, and as we project into the future.

Figure 1: Projected superannuation assets (All amounts are in future nominal dollars)



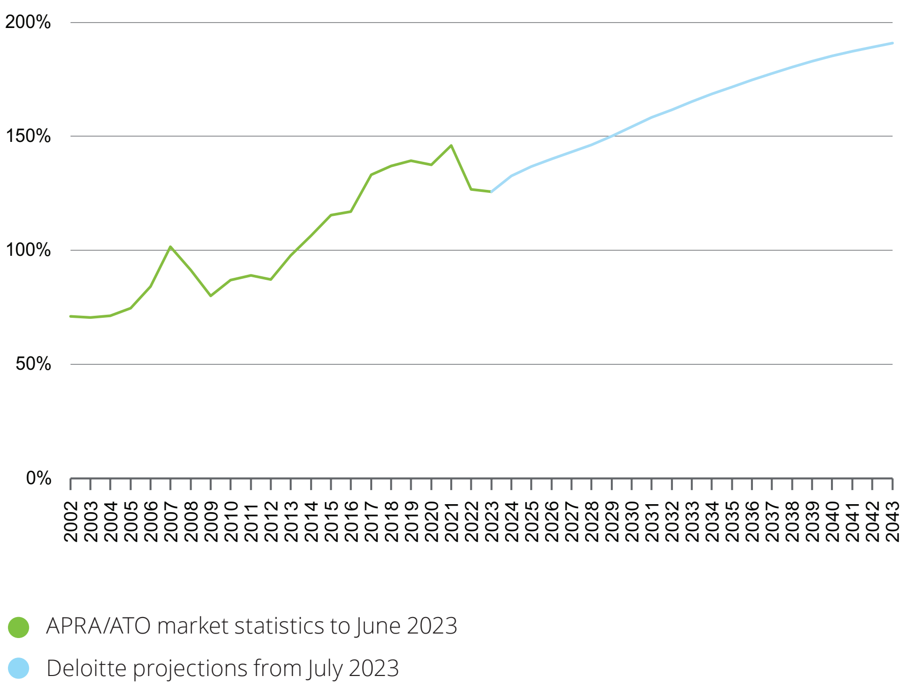
Source: APRA, ATO and Deloitte Actuaries & Consultants, 2023

The results demonstrate that:

- Superannuation assets having stayed relatively constant over the past few years as a result of the uncertainty of the COVID-19 pandemic followed by an emerging high inflationary environment, resulting in a relative reduction in the relative size of the superannuation asset pool compared to GDP (as illustrated in Figure 2).
- The percentile relationship between total superannuation assets and GDP is sensitive to the fluctuations in actual investment returns for super assets year on year but, overall, there is a clear increasing trend over time.
- There is a long-term trend of growth in superannuation assets relative to GDP, although the rate of growth has slowed in recent years. We estimate that the trend will pick up again over the coming years, although growth rates will remain lower than in the past as the Superannuation Guarantee rate reaches its legislated maximum of 12%.

As well as growing in terms of total assets, superannuation funds are also growing their share of total financial system assets, aided by increases in the level of compulsory Superannuation Guarantee contributions and strong real returns being delivered in recent years, despite (or in spite of) economic uncertainties amid global conflicts.

Figure 2: Superannuation assets as a proportion of nominal GDP at 30 June



Source: APRA, ATO and Deloitte Actuaries & Consultants, 2023

This means

The increased share of total assets has meant superannuation funds face higher expectations for their investment activities, which in turn has led to greater scrutiny of comparative returns and peer-relative performance metrics.

Application of the APRA Heatmaps to both MySuper and Trustee-Directed Products, and the public naming of funds that underperform the set performance benchmarks, has added a new imperative to fund Trustees when considering their fund's investment strategy. Growing super funds are diversifying their portfolios by moving into private market assets such as real estate, private equity, and infrastructure (e.g., toll roads and airports). Also, super funds are increasingly favouring passive investments for their core investment strategies due to cost-effectiveness and regulatory changes.

Dynamics of the superannuation industry

Contributions

Many members continue to pay significant additional contributions into their superannuation in the years approaching retirement. Accordingly the level of contributions remains strong year-on-year. As a result we anticipate that sizeable voluntary contributions will continue into the future, although there may be some reduction in future voluntary contribution rates due to the contribution caps and to offset, at least partially, the increase in the compulsory SG contribution rate to 12%.

It is encouraging to see the SG rate increase to 11% from 1 July 2023, and being almost certain to increase to 12% by 1 July 2025. This increased rate of minimum contributions will support Australians to build up their super balances before retirement, particularly to boost balances at retirement for those Australians who withdrew a total of $36.4 billion from their superannuation accounts under COVID-19 Early Release of Super measures only a few years ago.

Investment returns

Investment returns on superannuation assets remain a significant contributor to the growth of the superannuation industry. Over the financial year to 2022, many superannuation funds delivered negative nominal returns as a result of the increases in interest rates, and the high inflationary environment which has continued into 2023. Over the 2023 financial year, the general trend for net investment income has recovered and is expected to exceed total net superannuation contributions.

The strategic asset allocation adopted by each superannuation member, whether that is implemented through a MySuper default option, or an investment portfolio chosen by the member, continues to have the greatest impact on the member's final benefit; greater in fact than the selection of individual managers within each asset sector.

Ongoing regulatory change

Change is not foreign to the Australian superannuation system and there have been many refinements since the Superannuation Guarantee system started in 1992. Key legislative items which are shaping the industry include:

- Your Future, Your Super (YFYS) reforms, which aim to:
  - 'Staple' new members to a fund for life (unless they exercise Choice).
  - Place restrictions on trustee expenditure to ensure it is in the best financial interests of members and place the evidentiary burden of proof on trustees.
  - Measure the investment performance of MySuper products against peers and show this on a new ATO comparison website (which commenced on 1 July 2021).
  - Measure the investment performance of default products initially and, from July 2022, most other products where trustees select and control the asset allocation (Trustee Directed Products).
- Retirement Income Covenant came into effect on 1 July 2022 and now requires every superannuation trustee to formulate, review regularly and give effect to a retirement income strategy for their members approaching or in retirement.

  The strategy must address how the trustee will assist those beneficiaries to achieve and balance the following three retirement objectives:
  - To maximise expected retirement income over the period of retirement;
  - To manage expected risks to the sustainability and stability of retirement income over the period of retirement; and
  - To have flexible access to expected monies over the period of retirement.
- Prudential Standard CPS 230 – Operational Risk Management, to come into effect from 1 July 2025:
  - APRA aims to formalise in CPS 230 the operational risk management requirements for super funds
  - Entities must appropriately manage operational risks, sustain critical operations during disruptions and address risks from service providers
  - Effective management of risks related to service providers is mandated, including comprehensive policy, formal agreements, and robust monitoring
- The Quality of Advice Review report was published in 2023 and contains recommendations to enable the provision of high quality accessible and affordable financial advice. The government accepted most of the recommendations in principle

This means

Given the long-term nature of superannuation, which is preserved for retirement, it is important that members do not invest too conservatively in the early to middle years of their working lives, so they can maximise the impact of investment returns compounding over the long term, up to and into retirement.

Members should be able to withstand the short-term volatility inherent in growth-oriented portfolios and achieve a higher long-term average return overall. This factor is taken into account by trustees in setting their MySuper portfolios and should also be considered by members making an investment choice.

It is important that members do not over-react to short-term market falls, which may result in crystallising losses and possibly missing the upside of a subsequent recovery. This is particularly the case in the current economic environment where cash investments are only just now increasing back above general inflation, after a period of negative real returns due to high inflation seen over the past couple of years.

and provided a final response to the Quality of Advice Review on 7 December 2023, as part of the Delivering Better Financial Outcomes package. A period of consultation is expected in 2024, with expectation of having draft legislation tabled before the end of the year.

- On 28 February 2023, the Government announced a new tax, Division 296 – Better targeted superannuation concessions, intended to reduce the superannuation tax concessions available to individuals whose total superannuation balance exceeds $3 million.

Australian superannuation – financing members' retirements

We have modelled the value of superannuation assets held, split between the pre-retirement and post-retirement phases of the system. This is especially pertinent given the application of the Retirement Income Covenant and increasing concern over the demographic challenges presented by an ageing population.

Figure 3 illustrates the projected assets in accumulation (pre-retirement) and pension (post-retirement) phase. Post-retirement assets include tax-exempt balances (that is, assets supporting retirement phase pensions) as well as concessionally taxed balances such as transition to retirement pensions and balances in excess of a member's Transfer Balance Cap.

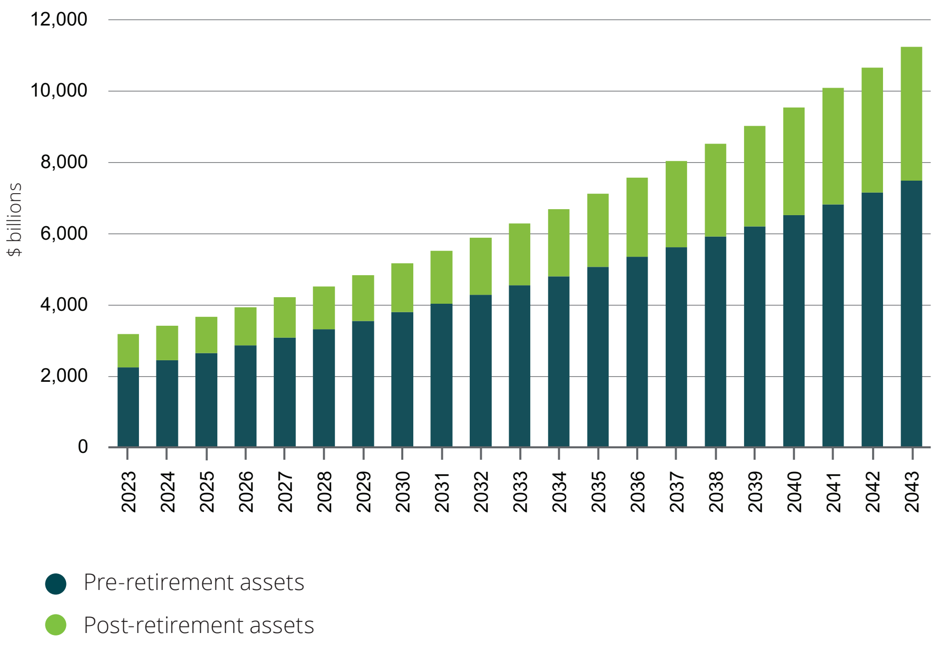
Post-retirement pension assets – represent a significant and growing pool of assets in their own right. The tax-free status of investment earnings on assets backing pensions (up to relevant caps) continues to be a major factor encouraging this growth.

Recent growth in post-retirement assets has been further supported by the temporary reductions in minimum annual payments for account-based pensions and market-linked pensions over the 4 financial years ending June 2023. From 1 July 2023 the minimum annual drawdown reverted to the standard age-based rates. That means future pension drawdowns from post-retirement assets will be higher as many retirees will need to withdraw higher amounts from their pension accounts in order to satisfy those minimums.

Generational change – each subsequent generation is building larger real superannuation balances, underpinned by longer periods of their working lives covered by the compulsory SG system and higher SG rates than in the past. As final balances grow, increasingly higher proportions of members will take their benefits as an income stream by gradually drawing down their balance over time – although the desire to avoid outliving their savings, coupled with concerns about healthcare and aged care costs, drives many Australians to err on the side of caution when choosing their super drawdowns.

Looking to the near future: As Baby Boomers move into retirement, closely followed by Generation X, there will be significant growth in post-retirement assets. However, it appears that there will also be sizeable leakage from the superannuation sector. We anticipate a considerable proportion of benefits will continue to be withdrawn as lump sums, either at retirement, or as ad-hoc withdrawals from account-based pension accounts, rather than using superannuation balances to provide a regular income stream over an individual's remaining lifetime.

Figure 3: Projected superannuation assets (2023 to 2043)



Source: Deloitte Actuaries & Consultants, 2023

This means

Retiring members will need more guidance and/or advice to help them manage drawing down their retirement savings over time. They will need to manage the conflicting elements of not drawing down too quickly and risk outliving their savings due to increasing longevity, and at the same time not drawing down too slowly so a significant proportion of their superannuation remains when they do eventually pass away and so have lived more frugally than was necessary.

The Government's introduction of the Retirement Income Covenant aims to improve member outcomes in retirement by encouraging trustees to focus on and implement strategies for members in retirement or approaching that stage. One of the difficulties facing funds is the lack of complete information they hold on their existing members, whether in accumulation or in pension phase. Trustees will need to develop a plan to address the data gaps in order to construct better segmented cohorts of members.

In mid-2023 APRA and ASIC completed and published their joint thematic review of superannuation trustees' progress implementing the Retirement Income Covenant, examining how trustees understood member needs, offered assistance and executed strategy. The review concluded that, although trustees have expanded their assistance and support offerings for members in or approaching retirement, critical gaps in metrics and data are still present amongst most trustees, preventing their performance of an in-depth analysis of members' income needs in retirement as well as the ability to implement and track the effectiveness of their retirement income strategy. To assist, the government and regulators have committed to identifying and addressing any existing barriers preventing the provision of fit for purpose retirement advice and products, with two current government consultations aimed at addressing these points: the consultations associated with the Delivering Better Financial Outcomes package and the Retirement Phase of Superannuation consultation.

Sequencing risk: The intentions, and ultimately, actions of members in choosing how they will take their superannuation benefits have major implications for asset allocation.

In post-retirement, members are generally less able to withstand the impact of negative returns and are more exposed to sequencing risk around the timing of withdrawing their benefit. Likewise, as pre-retirement members reach the final years of their working lives, they will also be less prepared to accept negative returns and will seek to reduce the risk of a sudden material drop in their savings as they enter retirement.

The increase in the use of lifecycle types of asset allocations in MySuper offerings (that is, those more heavily weighted to growth assets at younger ages, and gradually becoming more conservative as the individual ages over time) is in response to this trend. Likewise, there is an increased application by super funds of lifecycle investment designs which continue through retirement, not just up to the point of retirement.

Product cohorts: There is no 'one size fits all' approach that applies to individuals of any generation. Individuals will generally be in one of the following groups when they retire:

- **Small balances:** Those with relatively small superannuation balances
  - These individuals will often deplete their superannuation quickly after retirement and will depend on the 'age pension' safety-net to support their income needs in retirement.
- **Moderate balances:** Those with reasonable levels of superannuation and other savings, but with total balances that will not be adequate to support them over the entire period of their remaining life.
  - This group is likely to also receive additional support through the age pension.
  - These individuals will likely spend all of their investment earnings each year, supplemented by drawing down their capital more quickly than would be appropriate if it was intended to make it last for the rest of their lives.

This means

We expect both post-retirement members, and members on the cusp of retirement, to place greater importance on capital and income protection than younger members with decades remaining to retirement.

On the other hand, these members must also balance the risk of underperformance if they move too quickly to a conservative investment allocation, given the period in retirement may extend more than 20 years beyond their retirement date.

- **Significant balances:** Those with significant superannuation and other assets, who will have enough savings to support themselves independently throughout their retirement.
  - A large part of their retirement income will be their investment income with potentially little or no need to use their capital each year.
  - Unless they mismanage their money (such as wilful overspending or poor investment decisions), they will be self-sufficient and will not require any support from the age pension.

Where people retire before the age pension eligibility age, they may need to draw down their superannuation more quickly during this early part of their retirement until they become eligible for the age pension. In turn this means they will have a lower remaining superannuation balance at age pension age and will be likely to be more heavily reliant on the age pension as they grow older.

It is therefore important to consider the interaction between the age pension eligibility age, and superannuation preservation age, to ensure that the overall outcomes of the Australian retirement system are not undermined.

A holistic approach that integrates superannuation, the Age Pension, and home equity release (with options ranging from reverse mortgages, the government's Home Equity Access Scheme and downsizing to a smaller property) can provide retirees with enhanced financial security during retirement. We expect to see increased use of tailored strategies incorporating these elements over the coming years.

This means

Understanding the unique needs and behaviours of different superannuation cohorts is crucial for tailoring effective retirement strategies and ensuring financial well-being throughout their retirement phase. Each of the above groups face very different investment and life challenges and will require different responses to assist them.

As part of meeting obligations related to member outcomes assessments, trustees must conduct relevant cohort analysis. Trustees are expected to consider similar analysis for the purpose of developing and maintaining a retirement income strategy as required under the retirement income covenant legislation.

This provides real opportunities as well as challenges for the industry to innovate and develop retirement products that align with retirees' motivations, fears, and preferences, while still being simple and easy to understand. As approximately 3.6 million Australians transition from accumulation to retirement in the next decade, innovative and tailored solutions will become imperative.

COMPONENTS OF THE MARKET

Merger activity, which we have been monitoring and commenting on for years, has now reached the stage that it has delivered a markedly different competitive landscape than we were contemplating even only a couple of years ago, and we expect strong merger activity to continue over the next few years. This has resulted in the development of much larger funds and even mega-funds (with assets under management exceeding $100 billion) dominating the superannuation space. APRA, as the regulator, continues to encourage smaller funds to explore mergers with larger players, applying varying levels of pressure.

In addition, account consolidation has been continuing at pace. This process has been driven by a range of market and legislative forces, including:

- Funds and financial services providers are proactively encouraging members to consolidate their superannuation arrangements
- The ATO is actively working to provide information through the MyGov portal, for individuals to see if they have multiple super accounts, and it supports them to trigger a consolidation of those accounts into the account of their choice
- Reporting of Unclaimed Super Monies to the ATO including inactive low-balance accounts, small or insoluble lost member accounts and trustee voluntary payments, which the ATO is proactively matching to active superannuation accounts for the individual taxpayers where possible.

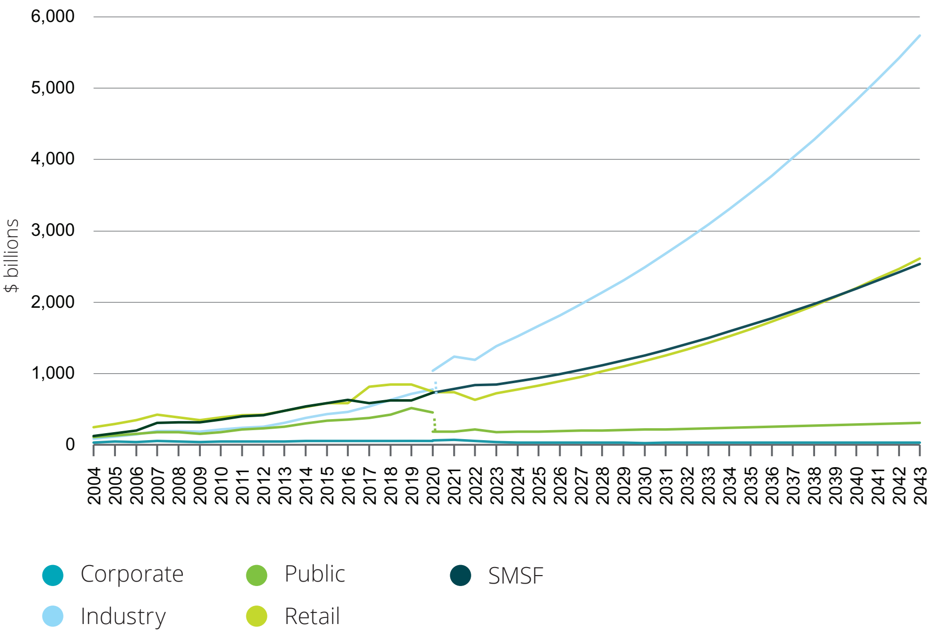
The '**Stapling**' measures under the *Your Future, Your Super* legislation, introduced in November 2021, have been acting as an additional driver in this area. Individuals who start a new job, but do not nominate a fund when starting with their new employer (including opting-in to join the employer's default fund or any other fund of their choice), will now have their contributions directed to their stapled fund as advised by the ATO. There are subtleties and complexities to this process, but this is the primary consequence.

Market share by major segments

Australia's compulsory superannuation system means that overall superannuation assets have continued to grow recently, both in respect of contribution inflows exceeding benefit outflows, as well as robust investment returns. However, increased switching activity, including the impacts of the *Your Future, Your Super* reforms and Stapling, have resulted in some funds experiencing significant outflows.

Figure 4 shows the movement of total assets in each segment from 2004 to 2023 compiled from APRA and ATO data and the Deloitte SPROUT Model's projected movement from 2023 to 2043.

Figure 4: Superannuation assets by market segment (APRA classification)



Source: APRA, ATO and Deloitte Actuaries & Consultants, 2023

Figure 4 shows a disconnect in the lines for Industry funds and Public Sector funds, due to a reclassification (in 2020) of some large funds as Industry funds that were previously regarded as Public Sector funds. These funds, such as QSuper (now part of Australian Retirement Trust) and Aware Super (previously First State Super), are (or were) public offer funds open to anyone, not just public sector employees but also private sector employees, and therefore the breakdown between the public and private sectors has become increasingly blurred. In practice, these funds are operationally more like Industry funds irrespective of how they first came into being.

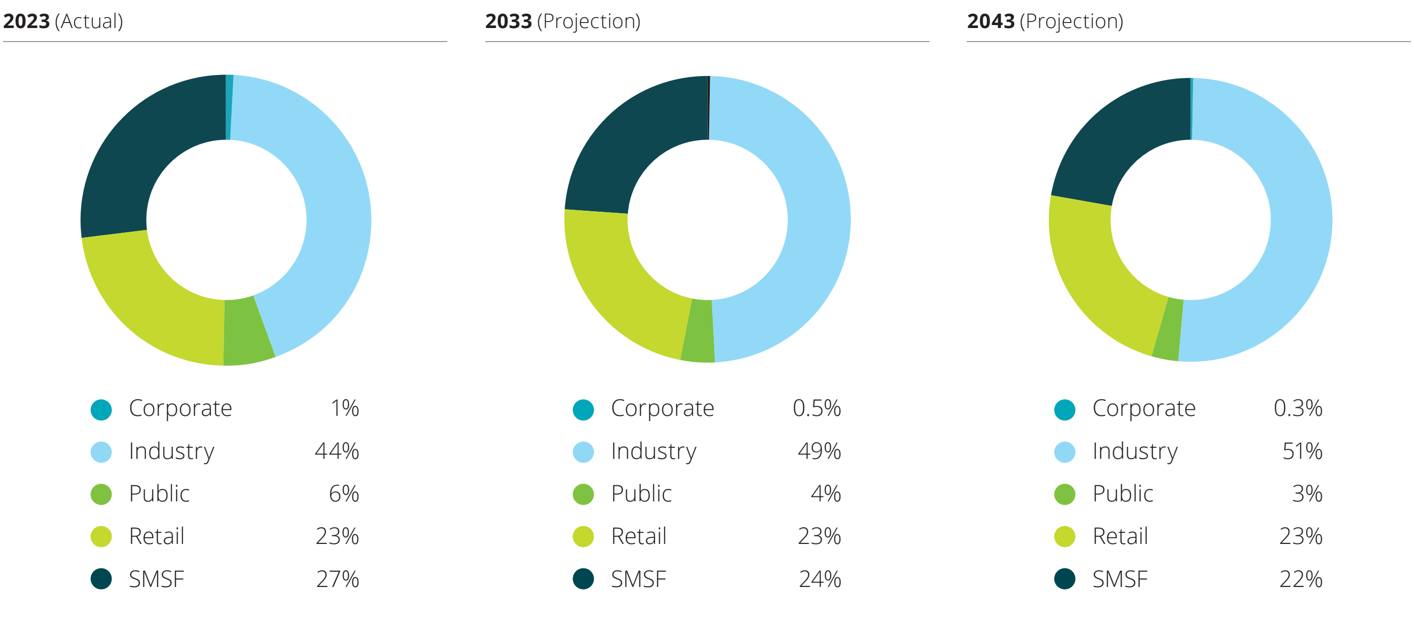
Some highlights from these projections include:

- **Growth:** Each of the dominant fund sectors (Industry, Retail and SMSFs) are expected to grow significantly over the next 20 years. Within this set, Industry funds are expected to grow at a rate above competitors due to strong current positioning and lower fees on average.
- **Industry funds:** Fund mergers are increasingly commonplace in the superannuation environment and are acting to shift the market structure. Mergers of funds with different backgrounds are increasing the market share of the Industry fund segment.
- **Retail funds:** Following the Hayne Royal Commission, Retail funds have responded with changes intended to improve their business operations. This has seen many product closures, remediation exercises, product simplification and investment in member services. Into the future we expect growth in the Retail segment by virtue of their existing scale, wealthier demographic base and ability to spend capital to develop new products which retain members up to and through retirement.
- **SMSFs:** SMSFs remain a preferred vehicle for investing the assets of wealthy Australians due to their tax benefits and provision of additional control. Despite these benefits remaining, we expect that SMSFs will decline in market share in the next two decades due to their older demographic transitioning to retirement and commencing material drawdowns of their assets.
- **Other funds:** We expect that the remaining Public Sector funds will continue to grow, albeit at a diminished pace over the coming years. Also, we expect that the Corporate sector will continue to slowly decline, due to many not being public offer funds and therefore only available to restricted groups of people, as well as the constraints of the Stapling legislation.

Assumptions:

These projections assume no changes in the current legislative environment applying to superannuation. We note that given the significant debate in the market and within government around the level of tax concessions and product structures for superannuation, and numerous reviews (Financial Services Inquiry, Productivity Commission Inquiry into Competitiveness and Efficiency of Australia's superannuation system, Hayne Royal Commission, and the Retirement Income System Review), further change is possible. Nevertheless, as any future changes are still hypothetical and unpredictable, we have not taken any potential changes into account for the purposes of this report.

Figure 5: Proportion of Superannuation assets by market segment



Source: Deloitte Actuaries & Consultants, 2023

Pre- and post-retirement assets

Figure 6 shows that Industry funds are now the largest pre-retirement sector and this position will gradually strengthen into the future. We expect that the Stapling measures under the Your Future, Your Super package will favour Industry funds as most young people joining the workforce for the first time are likely to join an employer whose default super arrangement is an Industry fund under the Awards system.

Retail funds will also continue to grow, but their growth rates are not expected to be as strong, reflecting the gradual remediation of issues raised by the Hayne Royal Commission and progressively winning back the trust of consumers, whilst addressing impacts from APRA heatmap and underperformance reporting. SMSFs continue to remain popular, although their growth is expected to be less strong for pre-retirement assets than post-retirement assets.

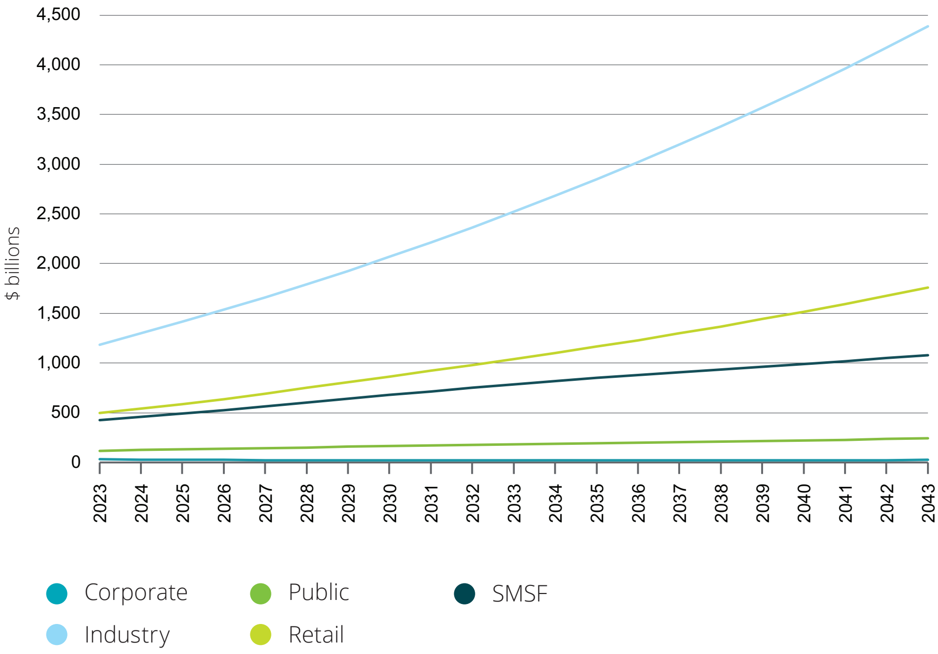
Figure 7 shows that industry funds and SMSFs will be the dominant sectors in the post-retirement space. Industry funds will benefit from the 'stapling' of superannuation accounts, and individuals being more likely to be industry fund members at the point of retirement and therefore continuing to remain in that fund post-retirement. Because of their older demographic, the SMSF sector already has a significant proportion of its assets supporting pensions in payment, but will grow less strongly due to their high cash outflows.

Many industry funds are also improving their investment propositions for members, incorporating options which provide access to:

- A selection of diversified multi-asset class investment options (TDPs).
- Asset class building blocks which allow a member to construct a well-diversified portfolio that reflects their risk tolerance and appetite for various asset class exposures.
- Low-cost (or passive) options for the major asset classes to allow members to address concerns on investment cost and implement a strategy which is consistent with their views on active management.
- Tailored Environmental, Social and/or Governance (ESG) investment profiles delivered through either a specifically tailored option, or through an investment framework with overarching ideals.
- Member Direct Options which allow members to directly invest in large ASX-listed company shares, ETFs and managed funds, giving members greater control in selecting their investments in superannuation, if desired.

The low fees and strong investment performance of industry funds, combined with strong inflows, will result in a growth rate of approximately 10% per annum for industry fund post-retirement assets, compared to 6.8% for retail funds and 6.4% for SMSFs.

Figure 6: Pre-retirement assets by market segment



Source: Deloitte Actuaries & Consultants, 2023

Other key points regarding post-retirement include:

The significant proportion of benefits which are taken as a lump sum has a dampening effect on the level of post-retirement assets. Apart from industry funds, growth in post-retirement assets will be relatively modest over the next 10 years due to the:

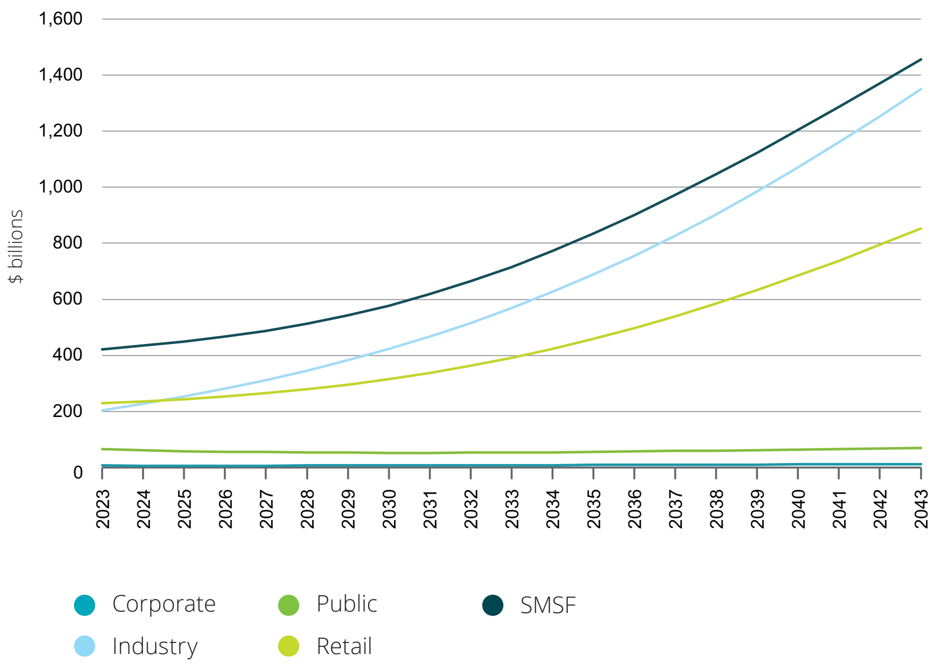
- Rate of drawdowns from post-retirement accounts (regular pension payments plus additional ad-hoc withdrawals) remaining a relatively high proportion of account balances each year.
- No minimums on the proportions of retirement benefits to be converted into post-retirement income streams, and lack of widespread guidance and advice to members to assist them in making such a decision.
- Contributions limits restricting the rate of growth in superannuation balances up to the date of retirement.

The regulation of financial advice remains a challenge in the current environment. Under current regulations, only wealthier Australians tend to be prepared to pay the fees required to access advice. To ensure advice is accessible and affordable for more Australians, it has been acknowledged by the industry and government alike that changes to the current settings are required.

In mid-2023 APRA and ASIC completed and published their thematic review of superannuation trustees' progress implementing the Retirement Income Covenant, examining how trustees understood member needs, offered assistance and executed strategy. The review concluded that, although trustees have improved their offerings in retirement, critical gaps in metrics and data are still present amongst most trustees, preventing their performance of an in-depth analysis of members' income needs in retirement as well as the ability to implement and track their retirement income strategy.

The major impediment funds face in the complexity and expense of financial advice is currently under active review and will hopefully be resolved in the medium term. The Government has recently announced plans to expand the provision of advice and guidance by superannuation funds through its Delivering Better Financial Outcomes package.

Figure 7: Post-retirement assets by market segment



Source: Deloitte Actuaries & Consultants, 2023

INVESTING SUPER ASSETS

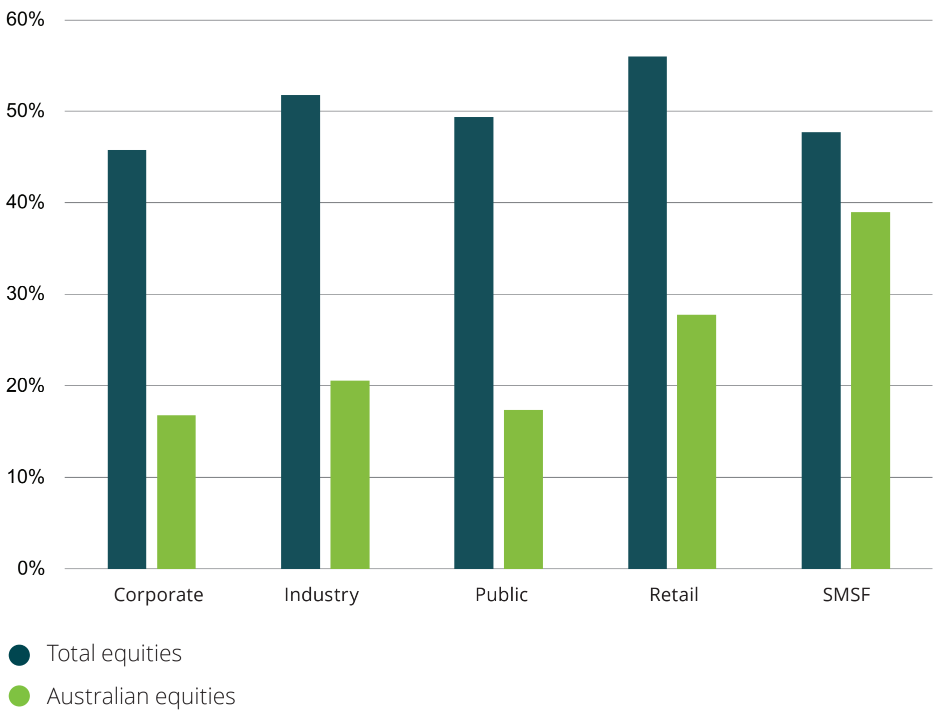
Across superannuation funds in Australia, about two-thirds of assets are invested in 'growth' type of assets – equities, property and growth alternative investments. The high allocation to growth assets recognises that the Australian superannuation system is predominantly comprised of account balances tied to investment returns earned on the underlying assets, both during accumulation phase and also throughout the pension drawdown period during the retirement phase and based on a long investment time horizon spanning many decades.

In particular, there is a high percentage of assets invested in equities, of which a significant proportion are domestic (Australian) equities. This is illustrated in Figure 8.

Australian shares remain attractive to superannuation funds for many reasons including:

- The dividend imputation system in Australia means that superannuation funds effectively receive refunds of excess franking credits on franked dividends, boosting overall investment returns.
- Many Australians hold Australian shares directly as a result of past privatisations and demutualisations, and as a result they are comfortable and familiar with these investments and their growth potential.
- The investment horizon for superannuation investments is long, spanning more than 40 years between starting work and retirement, and extending into the retirement phase.
- More conservative investments such as bonds and cash have struggled to achieve a return much more than keeping up with inflation, with cash failing to even achieve this most recently amid inflation peaks hitting levels not seen since 1990 (but fortunately now starting to fall).

Figure 8: Allocation to equities



Source: Deloitte Actuaries & Consultants, 2023

Currently the total investment by superannuation funds in Australian shares (including allocations within managed funds and Pooled Superannuation Trusts) comprises about 34% of the total market capitalisation of the Australian Stock Exchange (ASX).

If we assume that superannuation funds seek to retain the same percentage allocation to Australian shares, we have estimated that the proportion of the ASX market capitalisation represented by superannuation funds would steadily increase, potentially to more than 50% eventually. This is illustrated in Figure 9.

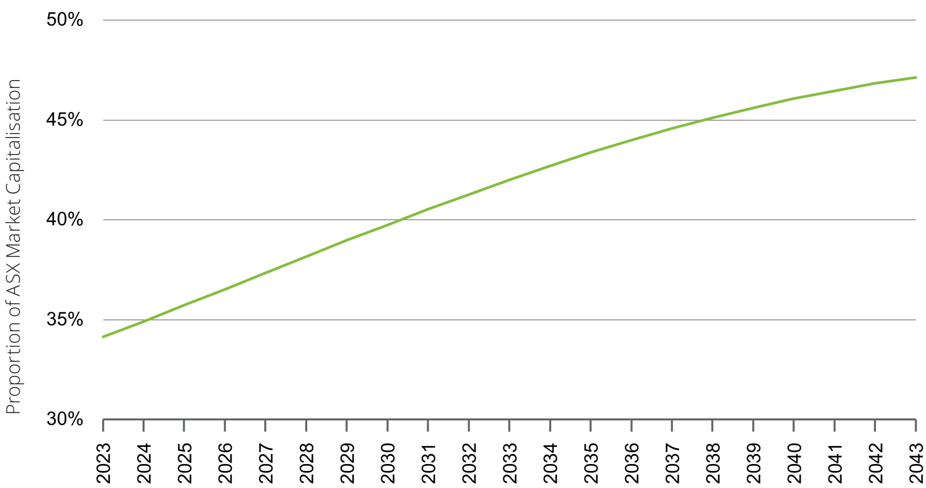
This means

Superannuation funds would own a large and increasing proportion of the Australian Stock Exchange holdings over time if they continue to hold a similar allocation of assets to Australian shares as they hold now. While super funds need to navigate concentration risks, the tax advantages of dividend imputation for Australian shares are compelling in delivering strong after-tax returns to members. However, a key issue will be whether there will be enough capacity in the ASX to support this level of demand from superannuation funds, and any consequential impacts on assessment against APRA's super product heatmaps.

- Will superannuation funds seek to increase their exposure to overseas investment markets over time to further diversify their exposures?
- Will funds utilise passive or active investments and/or investment managers to fulfill their allocations to equity markets?
- Will super funds grow their proportionate exposures to alternative assets such as private equity, infrastructure and unlisted property as they grow in size, which might result in lower growth in allocations to ASX-listed shares?
- Will growth in the ASX maintain a similar pace to recent history? Will growth slow or speed up, and how would this affect the strategic asset allocations of super funds?
- Will superannuation funds seek representation on the boards of public companies in which they will hold significant investments?

We have also seen superannuation funds enter into joint ventures and consortiums to make large acquisitions and investments. For example, a consortium of super funds (plus several Australian and international investment and infrastructure funds) successfully acquired Sydney Airport in early 2022, achieving regulatory approvals and completing one of the largest corporate takeovers in Australian history.

Figure 9: Proportion of ASX market capitalisation represented by superannuation funds



Source: Deloitte Actuaries & Consultants, 2023

LONGEVITY AND RETIREMENT INCOMES

In its green paper on 'Options for an Improved and Integrated System of Retirement' published in 2019, the Actuaries Institute noted that the proportion of retirees who are expected to receive the Age Pension as income support will reduce over time, through a combination of higher accumulated superannuation balances, increases in the age pension eligibility age, and tightened means testing rules.

The Actuaries Institute has also issued a number of papers over the past few years, in a series called 'The Dialogue', which aim to stimulate discussion on retirement, including:

- Developing the Retirement Income Framework
- A Framework to 'Maximise' Retirement Incomes
- Retirement Matters

The most recent paper, 'Retirement Matters', noted that the key retirement challenge for many people is longevity, which can make them worry about running out of money and live more frugally than necessary. The paper advocates for expanding Australia's three pillars of retirement funding (age pension, superannuation, and voluntary savings) to better promote additional income sources for retirees, such as earnings from part-time work or accessing income from housing equity. It also proposes that Australians would benefit from a Help, Guidance and Advice framework for both the transition to retirement and into retirement from full-time work, building on the Quality of Advice Review recommendations.

According to the Australian Bureau of Statistics (ABS), the government age pension remains the main source of income for most retirees, but more people are retiring with superannuation as a source of income (although the increase was higher for men than for women). Superannuation is the largest source of retirement income for 35% of men but less than 20% of women. Over a third of retired women, but only about 7% of retired men, relied on their partner's income to meet their living costs in retirement.

Over the past 20 years, the proportion of older Australians in receipt of a full age pension has been falling, while the proportion receiving a partial age pension has remained fairly stable. This means that the proportion not receiving any age pension has been increasing.

These trends will continue. In the 2023 Intergenerational Report, Treasury estimated that, over the next 20 years, those who don't qualify for an age pension (the so-called self-funded retirees) will increase from 29% to 34% of retirees, whereas those on a full age pension will fall from 44% to 35% of retirees, with the proportion receiving a partial age pension increasing slightly from 28% to 32%.

This means

There are a number of factors that affect retirement decisions including health status, involuntary redundancy and accumulated savings. Access to superannuation from an earlier date than the Age Pension eligibility age recognises that superannuation is a form of deferred earnings for individuals. Therefore, it is important that those who need to retire early are able to access it to support themselves, as an alternative to accessing other government income support, and to lessen the burden on taxpayers (at least in the short term).

The Productivity Commission previously found that almost half of men and around one-third of women who retire between the ages of 60 and 64 did so involuntarily. The Retirement Income System Review noted that increasing the superannuation preservation age or the age pension eligibility age would adversely affect a significant number of involuntary retirees who are more likely to be people with lower wealth.

A key driver of this will be that the accumulated superannuation savings are becoming more substantial for individuals at retirement. However, a continuing uncertainty is whether those retirement savings will be sufficient to meet an individual's needs for their full (unknown) period of their retirement - or whether they will need to fall back on the age pension in the later years of retirement, due to a combination of living longer and/or drawing down their monies too quickly (given the lack of maximum drawdown restrictions and lack of guidance/advice).

Because individuals do not know how long they will live, they face longevity risk in the sense that they may outlive their superannuation savings. On the other hand, the alternative is that they are too conservative in drawing down their account balance, so experiencing a lower income in retirement than necessary and ultimately leaving money unspent when they pass away.

Preservation age and Age Pension eligibility

From mid-2024 there will be a seven-year gap between the preservation age (which will then be age 60 for everyone in practice - noting that all those born earlier than July 1964 who do have an earlier preservation age will also be aged at least 60 by then) and the Age Pension eligibility age (which is now age 67 for all Australians).

While members of superannuation funds may not be dependent on the age pension when they initially retire (that is, they will effectively be self-funded retirees at that point), as their superannuation balances reduce over time, many retirees will become eligible for a partial age pension in the later stages of their retirement, and possibly eventually receive the full age pension in time if they are lucky to live long enough (or unlucky to run out of superannuation savings).

Managing longevity

The Superannuation (Objective) Bill 2023, which is currently before the Senate Economics Legislation Committee, defines the objective of super as: "to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way." One key element of this is the objective that the system should have effective incentives to smooth consumption and support people in taking personal responsibility for their retirement incomes.

As mentioned earlier, the Retirement Income Covenant came into effect on 1 July 2022 and now requires every superannuation trustee to formulate, review regularly and give effect to a retirement income strategy for their members approaching or in retirement. It also considers how the trustee will assist their members to strike the right balance between maximising their retirement income, managing risks and having flexible access to monies.

In the 2022/23 Budget, the Government announced measures designed to help older Australians with their finances, which included the extension of assets test exemption for principal home sale proceeds from 12 to 24 months, to help pensioners downsize.

The 2023/24 Budget expanded upon those measures, introducing new aged care assessment arrangements to simplify and improve access to aged care services, and 9,500 additional Home Care Packages.

New means testing rules have applied for innovative retirement income streams purchased from 1 July 2019. These rules assess a fixed 60 per cent of all pooled lifetime product payments as income, and 60 per cent of the purchase price of the product as assets until age 84, or a minimum of five years, and then 30 per cent for the rest of the person's life. These rules make innovative income streams attractive to consumers in terms of increasing their total retirement income whilst protecting against longevity risks, particularly for people who are eligible for a part age pension or are just over the threshold for being eligible for a part pension.

Treasury has released a consultation paper in which it seeks to gather views on potential policy reforms addressed at the retirement phase of superannuation. The consultation is focused on gathering feedback around three key areas: supporting members to navigate retirement income, supporting funds to deliver better retirement income strategies, and making lifetime income products more accessible.

In addition, in their recently released corporate plans, improving retirement outcomes remains a key part of the agendas for both APRA and ASIC as regulators over the coming years.

Longevity illustrations

To illustrate the impact of a retiree living to different ages, we have considered a 25 year old entering the workforce with no superannuation savings, based on different contribution levels throughout their working life (the current Superannuation Guarantee rate of 11%, or a higher rate of 12% aligned to the maximum legislated SG rate).

We have modelled the amount that this individual could withdraw from their superannuation balance as a percentage of final pre-tax salary, such that the member receives the same benefit in real terms throughout their remaining life, assuming that they die at four ages specified in Figure 10. It is not the exact amount of replacement percentages which is important, but rather the relativity between the percentages based on different individual life expectancies, or different contribution rates.

This means

It is evident from Figure 10 that higher contributions throughout working life makes a meaningful difference – in the order of 3.5% to 4.5% of final salary (for just a 1% of salary higher contribution) – to the eventual retirement income of individuals, particularly those who are going to live longer than average. As women tend to live longer than men, this also means that women would tend to have a lower replacement rate than men if they were otherwise equal in all other areas (that is, same age, period in the workforce, salary pattern, and accumulated superannuation balance at retirement date).

Figure 10

	Annual Income Drawn as % of Final Salary	
Assumed Age at Death	**11% Contributions**	**12% Contributions**
85	46.5%	51.0%
90	40.5%	44.5%
95	37.0%	40.5%
100	34.0%	37.5%

Source: Deloitte Actuaries & Consultants, 2023

Note: The income replacement percentages depend on the assumptions applied for investment returns and expenses, and are based on simplified assumptions in relation to no time out of the workforce and smooth salary increases.

It is worth noting that the average life expectancy for a 25 year old today, assuming they live to a retirement age of 65, is over age 85 and varies depending on gender and the extent of continuing future mortality improvements - with a quarter of them living beyond age 90 and potentially well into their late 90s.

To consider the likelihood of individuals needing to finance long periods spent in retirement, we have calculated the life expectancy for the average 25 year old today based on the latest Australian Life Tables 2015-2017, both before and after allowing for assumed mortality improvements (as published by the Australian Government Actuary).

This means

Even ignoring any future improvements in mortality, it is more likely than not that individuals entering the workforce today will live beyond age 85. A quarter of them will live beyond age 90. Once future mortality improvements are taken into account, individuals are expected to live beyond age 90 on average, with a quarter living into their late 90s and beyond.

Figure 11

	Males	Females
Half of 25 year olds today who live to age 65 will live beyond age...		
ALT15-17, no improvements	85	88.5
ALT15-17, improvements over long term (125 years)	89	92
ALT15-17, recent improvements (25 years)	92.5	93.5
A quarter of 25 year olds today who live to age 65 will live beyond age...		
ALT15-17, no improvements	91	93.5
ALT15-17, improvements over long term (125 years)	94	96.5
ALT15-17, recent improvements (25 years)	97	97.5

CONCLUSION

In this edition of the *Dynamics of the Australian Superannuation System* we have considered what the industry should expect in the next 20 years regarding:

- The **size** of the superannuation assets
- Changes in **market share** of different sectors
- Shifting **demographics and longevity** in an ageing population
- The **dominance** of superannuation assets relative to GDP and in domestic asset allocations (such as the Australian sharemarket)

Total superannuation assets grew to $3.2 trillion over the year to 30 June 2023, as the markets recovered from the stagnation caused by the COVID-19 pandemic, emerging high inflation and geopolitical uncertainties. We have projected that superannuation assets will more than triple over the next 20 years to over $11 trillion in 2043.

The superannuation industry continues to experience a frenetic pace of change. The Your Future, Your Super initiatives and increased trustee focus on Members' Best Financial Interests and the Retirement Income Covenant will continue to encourage rationalisation within the industry. Many funds have been conducting transformation projects over the past few years in efforts to improve their efficiencies and value to members, as they reduce the range of legacy products they need to manage and simplify their offerings.

For many years, we have predicted ongoing consolidation within the superannuation industry. The pressure on all funds with higher costs and weaker performance to merge has increased and can be seen in the merger activity of recent years. The member outcomes assessment and product heatmaps have given APRA expanded powers in relation to underperforming funds, which has already resulted in some additional industry consolidation.

We expect merger activity and the commensurate reduction in the number of market participants to continue, and we can expect up to 12 mega-funds (each with assets under management exceeding $100 billion) within the coming years – with 8 already at this size. These funds will increase their foreign investments due to their size and the relative size of global opportunities compared to the small Australian market. They will also increase investment in privately-held assets.

In addition, we are seeing an increasing shift from employer-driven superannuation to being focused at the individual level. Initiatives such as account 'stapling' and proactive consolidation of small accounts by the ATO seek to boost further consolidation of accounts which will reduce the drag of unnecessary fees associated with multiple accounts for an individual as well as make it easier for people to keep track of their superannuation.

With the Retirement Income Covenant in place since 1 July 2022, and acknowledging the findings of the joint thematic review by APRA and ASIC, it is clear there is still more to be done to assist members in meeting their retirement income needs. Although trustees have expanded their assistance and support offerings for members in or approaching retirement, one of the key difficulties facing funds is the lack of complete information they hold on their members, and therefore trustees will need to develop a plan to address those data gaps in order to construct better segmented cohorts of members. To this end, the government and regulators have committed to identifying and addressing existing barriers which are preventing the provision of fit-for-purpose retirement advice and products.

Deloitte's team of superannuation partners and specialists look forward to discussing these changes and working with you to consider ways to develop innovative and sustainable retirement products and solutions.

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