Summary and briefing points on recent Grattan Institute reports on superannuation tax concessions and fund costs

Confidential Report

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About ASFA
ASFA is a non-profit, non-politically aligned national organisation that is the peak policy and research body for the superannuation sector. Our mandate is to develop and advocate for policy in the best long-term interest of fund members. Our members – which include corporate, public sector, industry and retail superannuation funds, plus self-managed superannuation funds and small APRA funds through its service provider members – represent more than 90 per cent of the 12 million Australians with superannuation.

ASFA welcomes the conversations on the equity and sustainability of the superannuation system, however is keen to ensure that the debate is based on fact and correct assumptions. With that in mind, ASFA has been working with the Grattan Institute to address some of the issues it has identified with the numbers and calculations that the Institute has produced.

Superannuation tax concessions

The Grattan Institute released a report on 27 November 2013 called *Balancing budgets: tough choices we need*: http://grattan.edu.au/publications/reports/post/balancing-budgets-tough-choices-we-need/

Main claims and recommendations of the report

The report claims that the package of changes proposed would add about $37 billion a year to Australian Government budgets and help to tackle Australia's growing Federal Budget crisis.

More specifically, the package proposed by Grattan Institute would broaden the GST to include fresh food and private spending on health and education, raise the age of access to superannuation and the Age Pension, remove the exemption of owner-occupied housing from the Age Pension assets test, and limit tax concessions on superannuation deposits.

Commentary on the report by ASFA

There are a number of areas where ASFA does not agree with the Grattan Institute. These are stated below.

1. Tax calculations overstate the amount of tax payable

- The report claims that a person aged 59 earning $100,000 a year pays a total of $42,000 in income tax on their salary and on the investment earnings of $35,000 in their super fund (on a balance of $500,000). However, tax on $100,000 salary is $26,447 (including the Medicare levy) and tax on superannuation earnings is only $2,800 or so if the super is in a balanced fund with imputation credits and capital gains.

2. Turning 60 does not lead to a tax saving. The tax saving is driven by transition to retirement arrangements

- The claim that the tax suddenly reduces to $18,000 when a person turns 60 seems to be based, reading the earlier Grattan Institute report, on the assumption that the person moves to a transition to retirement (TTR) pension. However, if a person contributed the maximum possible in concessional contributions, that would change $25,750 in wages to $25,750 in contributions taxed at 15 per cent, rather than 38.5 per cent. This represents a tax saving of $6,050. The tax on investment earnings in the fund also stops, so the total tax savings would be $8,850.
- So, in ASFA's view, the tax would decrease from $29,247 to $20,397, not $42,000 to $18,000 when a person transitions to retirement at age 60.
- ASFA has worked with the Grattan Institute on these issues and the Institute is updating its report with revised figures. The revised figures indicate a drop in total tax paid from $28,000 to $18,000, which is significantly different from the original claim of a fall from $42,000 to $18,000. This is represented in the table below.

	Grattan Institute Figures	Revised Grattan figures	ASFA figures
59 year old person	$42,000	$28,000	$29,247
60 year old person on TTR	$18,000	$18,000	$20,397
Total tax decrease	$24,000	$10,000	$8,850

3. The Medicare levy should be taken into account

- The Grattan Institute numbers continue to differ from the ASFA calculation as they do not take the Medicare levy into account. Additionally, they use different assumptions about investment earnings and investment tax rates but these do not have a material impact on the difference between the two scenarios; the impact is mostly on the absolute amounts of tax.

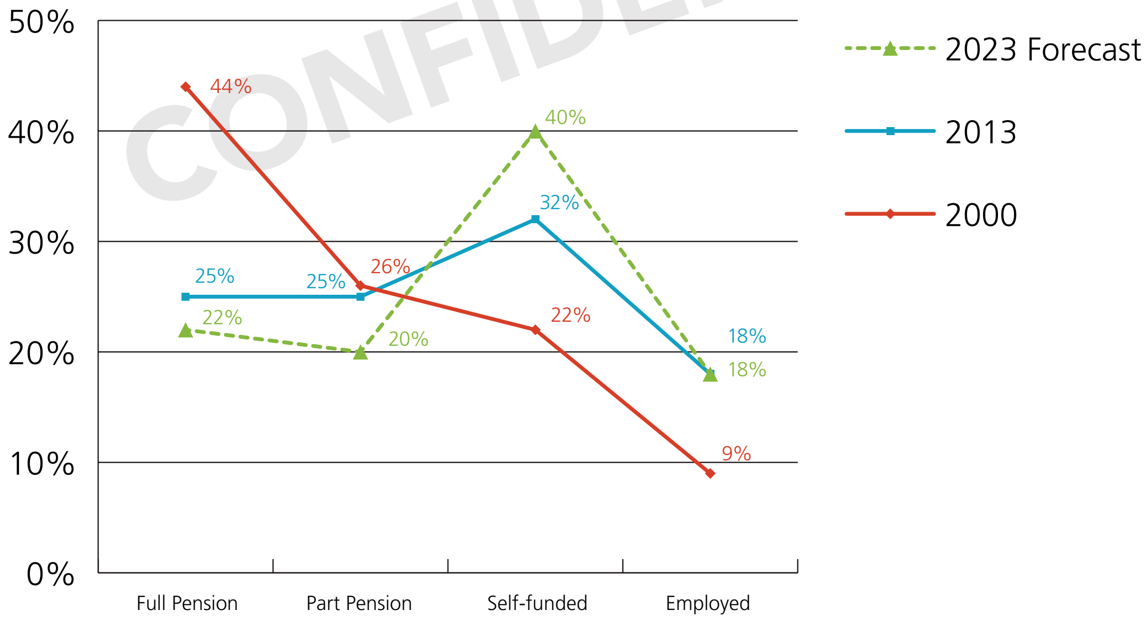
4. Grattan Institute revenue gain estimates are overstated

- Ending TTRs would lead to $300 million plus in extra revenue, not billions, as there are not that many people with incomes and balances sufficient to get the large tax savings described in the Grattan Institute analysis. Additionally, the saving per person is grossly overstated in their calculation, as shown above.
- The Grattan Institute also claims that paying 15 per cent on investment earnings in the retirement phase would generate around $3 billion in revenue. This estimate is on the high side as it does seem to allow for the effective rate of tax being much lower than 15 per cent in the accumulation stage due to things such as imputation credits. Many low income retirees also would take their money out of super as they would pay very little tax after various offsets and rebates in the general personal tax system.

There are inequities in the system but the Institute should be clearer in what they are addressing. If TTR arrangements are the problem, then they should be addressed. If people have built up balances larger than needed for genuine retirement purposes, then the tax treatment of those balances should be addressed. Limiting future concessional contributions to $10,000 a year simply impacts Generation X and younger generations, rather than those who built up big balances before the current contribution caps came into force.

The Institute claims, incorrectly, that increased superannuation balances have had no real impact on the Age Pension bill. While it might be true that about four in five persons aged over 65 qualify for the Age Pension, not much different to five or ten years ago, the proportion on a part Age Pension, as opposed to full Age Pension, is higher. More importantly, the proportion of those who have recently turned 65 not receiving the Age Pension or only receiving a small Age Pension payment has increased markedly. In 2000 43.7 per cent of those aged 65 were on the full Age Pension but this dropped to 25.3 per cent in 2013. It would be unrealistic to expect that the Superannuation Guarantee system will, in the short term, lead to those currently aged 85 or more being less dependent on the Age Pension.

Chart 1: Retirees at age 65



Source: Department of Social Services and ASFA Research Centre.

Chart 2: Retirees at age 75

Source: Department of Social Services and ASFA Research Centre.

Fund costs and fees

The Grattan Institute released a report on 27 April 2014 called *Super sting: how to stop Australians paying too much for superannuation*: http://grattan.edu.au/publications/reports/post/super-sting-how-to-stop-australians-paying-too-much-for-superannuation/

Main claims and recommendations of the report

The report claims that the cost of superannuation is too high because the system wrongly assumes that choice in the market will drive enough account holders to choose low-price funds, thereby forcing others to lower their fees. The report argues that this approach has not worked in Australia or anywhere in the world, that superannuation is inherently opaque and most people do not make an informed choice, instead paying into a default fund, chosen by their employer.

Two main changes are proposed. The Institute recommends that the government establish a tender process for the right to run the best-priced default fund for new job starters, and the tax return process should allow taxpayers to match their fund with the low-cost winners of the default tender – and to switch on the spot if they choose.

Commentary on the report by ASFA

- The report is useful and important in that it brings attention to an important issue, that of superannuation fund expenses and fees and their impact on final retirement benefits for Australians.
- It contains considerable factual information and analysis from a variety of sources.
- However, the overall conclusion (that superannuation fees could be cut by 50 per cent) is not well supported by the analysis.

1. **International fund fee levels comparisons do not compare apples with apples**
    - While some other countries have lower pension fund fees, on average, than Australia, typically, in such countries funds have a heavy concentration in interest bearing investments such as government and corporate bonds, rather than a heavy concentration on equities (shares, property, infrastructure, unlisted investments), as is the case in Australia. These portfolios are traditionally significantly less expensive to operate and have lower returns.

- Australia is different to most other countries in its heavy emphasis on defined contribution funds . This means that members can access their money within 30 days and that liquidity requirements must be met, which is costly. It also has costs related to the administration of insurance premiums and benefits, and the provision of financial advice and information that funds in a number of other countries do not provide.
- The report puts to one side or does not mention fees in a number of comparable countries in terms of asset mix and scheme design (such as Mexico and Hong Kong or 401k funds in the USA) where costs and fees are the same or higher than equivalent funds in Australia. Chile is claimed to be a lower fee country, but this is only on modelled results that assume that as balances grow, funds will be able to continue to fund their expenses from unchanged fees on contributions.

2. **Relative investment performance of Australian superannuation funds does not take all factors into account**
   - The Grattan report questions the investment performance of Australian superannuation funds relative to those overseas, but the data they use is for the period 2004 to 2013, which was significantly affected by the global financial crisis. Over longer term periods (20 years or more), real investment returns in Australia have been substantially higher than the period considered by the Grattan report.
   - The report focuses on default fund arrangements and disengaged fund members, but much of the analysis is based on the data for all superannuation funds, including products that are purchased on a choice basis by individuals. Historical choice product fees are influenced by a range of factors, including past practices in regard to the distribution and financial advice costs.
   - The report makes little allowance for differences between funds in the services provided, or when it does, it tends to dismiss enhanced service levels as being less important than final retirement balance.

3. **Fees can be expected to reduce as the introduction of MySuper starts to impact**
   - As the report notes, Stronger Super has not led to any significant fee reductions, or at least not yet. MySuper fees are typically much the same as the default products they replaced, with the exception of retail fund MySuper products that tend to be much lower cost than many of the other retail products previously distributed. SuperStream is yet to deliver costs savings, with upfront levies and regulatory implementation costs required to be paid by funds. However, over time, costs and fees can be expected to reduce for MySuper products.

4. **The way in which competition will supposedly reduce fund costs and fees is unclear**
   - The report puts much faith in the competition process that the Grattan Institute proposes, for a fund to be selected as a default fund as a means of reducing fund fees. However, the report does not clearly specify the costs that would be reduced as the result of such a process. While the report contains a number of charts and tables that suggest that fund fees are much higher than fund costs, this is largely a result of APRA data only identifying a subset of fund costs. Many investment costs included in industry calculations of fund costs are not included in the APRA data.
   - More significant cost reductions would be required to achieve the outcomes that the Grattan report wants to achieve than the relatively minor scaling back of marketing expenses that the report proposes.

ASFA position on competition and on further reduction in costs

- ASFA, of course, supports fund costs and fees being as low as they can be for a specified and required level of services for members and for appropriate investment mixes. Sharpening competitive pressures is desirable but, in itself, will not necessarily lead to much lower fees. More fundamental changes would be needed. If a tender process was poorly managed, it would lead to overly simple products offering bank term-deposit or other fixed- interest based investments becoming the default funds for most Australians, leading to poor net outcomes over the longer term.
- There is already considerable competition in regard to the provision of choice superannuation products in both the accumulation and retirement phases. Competition also exists in regard to selection of default funds by employers.
- Reductions in fund costs and fees are more likely to flow from initiatives such as removing unnecessary red tape and regulatory burdens, and by funds achieving increased scale. Enhancement to the governance of funds will also lead to tougher bargaining and lower fees charged by investment managers to funds.