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AUSTRALIA'S PENSION SYSTEM: NO REFORM CAN REPLACE FINANCIAL LITERACY

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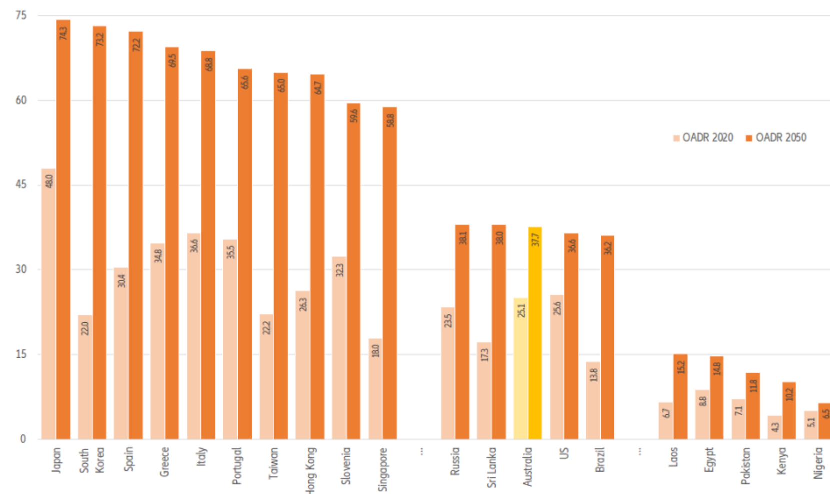
Demographic change poses a formidable challenge for Australia: Despite only a modest increase in the old-age dependency ratio, the number of people aged 65 and older will almost double from 4.1mn today to 7.5mn within the next 30 years. Countries are going to be hit in varying degrees by demographic change, not only in terms of the increase of the shares of older people in their populations but also with respect to the pace of change. According to pre-Covid-19 population projections, Australia's old-age dependency ratio was expected to increase rather moderately from around 25% today to roughly 38% in 2050. Many Asian countries, notably Japan but also South Korea, Taiwan and Singapore, where the old-age dependency ratio is expected to treble within this time span, and some European countries such as Spain and Italy, will have to cope with old-age dependency ratios almost twice as high by mid-century. However, even this modest increase implies that the number of people aged 65 and older in Australia will almost double from 4.1mn today to 7.4mn within the next 30 years (See Figure 1).

While the Covid-19 pandemic has caused more than 4.1mn premature deaths until July 2021 worldwide[1], wiping away the life expectancy gains of decades and leading to record-low numbers of births in many countries in 2020, there were no observed effects in the total birth and death statistics in Australia and no reversal of exisiting trends. However, net overseas migration plunged from 247,600 in 2019 to a mere 3,300 in 2020, resulting in a comparatively low +0.5% population increase[2]. If net immigration stays subdued for the time being, Covid-19 could accelerate the aging of the Australian society.

[1] See John Hopkins University & Medicine, Coronavirus resource center, https://coronavirus.jhu.edu/map.html (accessed 21.07.2021).
[2] The number of births declined further to 294,400 and the number of deaths declined to 161,400. See Australian Bureau of Statistics (2021): Population change in 2020, released on 17 June 2021, https://www.abs.gov.au/articles/population-change-2020 (accessed 21.07.2021). According to the latest available life tables, the average life expectancy of a newborn boy was 80.9 years and that a girl 85.0 years. See Australian Institute of Health and Welfare (2021): Deaths in Australia web report, released on 25. June 2021, https://www.aihw.gov.au/reports/life-expectancy-death/deaths-in-australia/contents/summary (accessed 23.07.2021).

Figure 1: Old-age dependency ratios* in selected countries, in percentage



**population aged 65 and older as percentage of population aged between 15 and 64.*
Source: UN Population Division, World Population Prospects 2019.

With its strong capital-funded superannuation fund, Australia's pension system is rated as one of the best prepared for demographic change worldwide. However, savers' behavior during the Covid-19 crisis underlines the need for more financial education and literacy to avoid old-age poverty without overburdening already strained state budgets and future younger generations. According to our proprietary Allianz Pensions Indicator (API) (see box), Australia's pension system ranks among the top 10 due to its strong capital-funded, compulsory superannuation system. So far, this has made it better able to cushion the impact of demographic change than the pension systems of many other industrialized countries.

Box: Allianz Pension Indicator (API)
In order to get a structured overview of the preparedness of pension systems around the world, we developed the Allianz Pension Indicator. The API is based on three pillars, taking into account more than 30 parameters that are rated on a scale from 1 to 7, with 1 being the best and 7 the worst grade. By adding up all weighted subtotals, the API assigns each country a grade between 1 and 7, thus providing a comprehensive view of the sustainability and adequacy of the pension system of a respective country compared to other countries. In the first pillar we take into account the overall living standards, governments' financial leeway and demographic change, as the starting points of the 75 countries that are included in our analysis are by no means similar. Our list ranges from high-income countries such as Australia to low-income countries such as Nigeria. In the second pillar we analyse the sustainability of pensions systems, i.e. how they react to demographic change. And in the third pillar we rate the adequacy of pension systems, questioning whether they can provide an adequate standard of living in old age[3].

However, a look at the overall ratings blurs the picture. Even the top 10 have at best upper midfield ratings, with the overall results ranging between 2.6 in Sweden and 3.1 in New Zealand, implying there is still room for improvement in all countries. Of course, there is no one-size-fits-all pension system. In the case of Australia, the adjustment of the retirement

[3] For a more detailed description of the Allianz Pension Indicator, see Allianz Pension Report: Asia special 2021.

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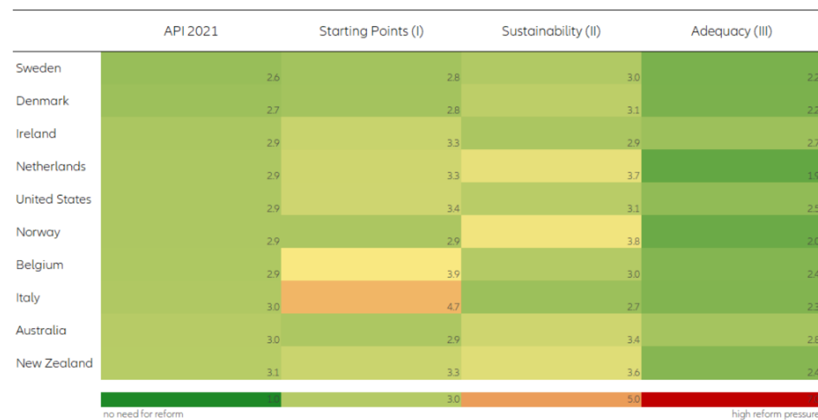
age in line with increases of further life expectancy could help to make the system even more sustainable. With respect to the pension system's adequacy, it was the average gross benefit ratio of the public pension, which is mediocre by international comparison, that dampened the result. (see Figure 2).

Figure 2: Australia in the top 10 of the Allianz Pension Indicator



	API 2021	Starting Points (I)	Sustainability (II)	Adequacy (III)
Sweden	2.6	2.8	3.0	2.2
Denmark	2.7	2.8	3.1	2.2
Ireland	2.9	3.3	2.9	2.7
Netherlands	2.9	3.3	3.7	1.9
United States	2.9	3.4	3.1	2.5
Norway	2.9	2.9	3.8	2.0
Belgium	2.9	3.9	3.0	2.4
Italy	3.0	4.7	2.7	2.3
Australia	3.0	2.9	3.4	2.8
New Zealand	3.1	3.3	3.6	2.4

1.0 3.0 5.0 7.0
no need for reform — high reform pressure

Source: Allianz Research.

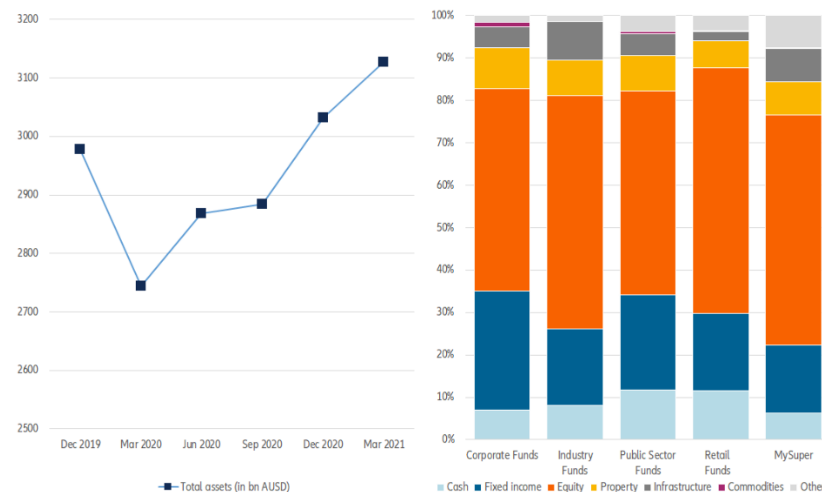
Against the backdrop of an entrenched low-yield environment and more volatile equity markets, the main challenge, however, lies in the capital-funded pillar, given its importance in the Australian pension system. The Australian government has therefore adopted several reforms to strengthen this pillar and make the superannuation system more efficient. Among them are the reduction of the number of unintended multiple accounts by allowing employees to move their funds when choosing a new employer[4] to help to avoid unnecessary fees that reduce savings. The reforms also mandate annual performance tests for superannuation products, which will help savers to become more engaged and choose the funds that promise the highest yields. If a product fails the performance test for two consecutive years, the members have to be informed and the trustee is prohibited from accepting new beneficiaries into that product[5]. Furthermore, the qualification requirements for financial advisors have been increased to ensure high-quality advice for consumers. New advisors need at least a bachelor's degree and must complete a professional year during which they must pass a formal exam before they can become financial advisors. Active advisors must also pass the exam and have until the end of 2025 to acquire a bachelor's degree.[6]

These reforms are reasonable but may have some drawbacks, too – as the Covid-19 crisis showed. There are estimates that between 3% and 4% of retirement savings were moved into cash during the pandemic.[7] But those fund members who decided to shift their assets into cash, alarmed by the

[4] 27% of all Australians have more than one superannuation fund account, see Australian Government (2020): Your Future, your Super. Reforms to make your Super work harder for you, published 20 October 2020, https://treasury.gov.au/sites/default/files/2020-10/p2020-super_0.pdf (accessed 20.07.2021)
[5] see Australian Government (2020): Your Future, your Super. Reforms to make your Super work harder for you, published 20 October 2020, https://treasury.gov.au/sites/default/files/2020-10/p2020-super_0.pdf (accessed 20.07.2021)
[6] See Collet, John (2021): Rapid decline in financial adviser numbers sees fees rise, in: The Sydney Morning Herald, online edition, released 17 July 2021, 10.00pm, https://www.smh.com.au/money/planning-and-budgeting/rapid-decline-in-financial-adviser-numbers-sees-fees-rise-20210714-p589ng.html (accessed 21.07.2021).
[7] See Grieve, Charlotte (2021): Harsh lesson for those who turned super to cash during Covid-19 crash, in: The Sydney Morning Herald, online edition, released 22 June 2021, 10.00pm, https://www.smh.com.au/money/super-and-retirement/harsh-lesson-for-those-who-turned-super-to-cash-during-covid-19-crash-20210621-p582rb.html (accessed 21.07.2021).

stock market downturn at the start of the crisis, locked in their losses and are now deprived of making up for them in the course of the strong equity market recovery. In fact, superannuation funds increased by +13.9% within 12 months, reaching AUSD3.1trn at the end of March 2021, which corresponds to EUR2.0trn. These developments hint at the possibility that short-term annual assessements of single funds might in the end not be as beneficial as intended. Given the increased volatility of markets, performance flucutations can be temporary and short-term in nature. The accumuluation of pension assets, in contrast, is a long-term investment, where losses can be offset over time, especially when savers are still a long way from retirement (see Figure 3).

Figure 3: Total superannuation assets and asset structure*



*March 2021

Source: Australian Prudential Regulation Authority.

The new qualification requirements, too, are a double-edged sword as they forced many advisors to quit or retire. At the same time, the average advice fee increased by +28% within two years, amouting to an average AUSD3,240 (EUR2,050)[8]. The result may be that less members seek advice – and it was especially those members who did not seek advice or could not get advice who locked in their losses by shifting their assets[9]. Adding insult to injury, 32% of consumers have never sought financial advice or do not intend to do so – and most of them are in the lower income bracket, according to the findings of the Financial Services Council. Increasing costs for consultation in the course of rising quality standards will only worsen the situation, given that the average superannuation assets in the lower income quintile were only AUSD69,100, i.e. around EUR43,800, in December 2020 (see Figure 4). In contrast, the 26% of Australians who had sought financial advice in the past were on average male, aged over 65 and belonged to the high-income bracket. Women, on the other hand, were mostly among the 42% of "considerers".[10] Thus, there seems to be a trade-off between the two goals of quality and accessibility of advice: High

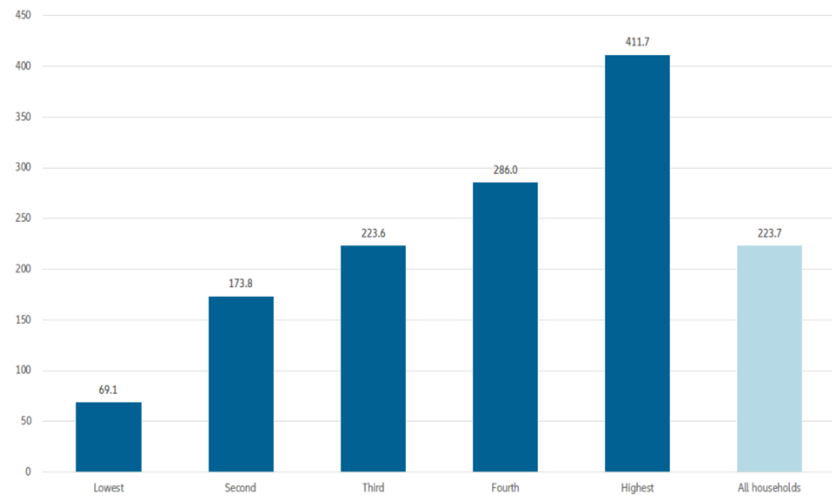
[8] See Financial Services Council (2021): Affordable and Accessible Advice: FSC green paper on financial advice, p. 2, https://fsc.org.au/policy/advice/green-paper (accessed 20.07.2021)

[9] See Grieve, Charlotte (2021): Harsh lesson for those who turned super to cash during Covid-19 crash, in: The Sydney Morning Herald, online edition, released 22 June 2021, 10.00pm, https://www.smh.com.au/money/super-and-retirement/harsh-lesson-for-those-who-turned-super-to-cash-during-covid-19-crash-20210621-p582rb.html (accessed 21.07.2021).

[10] See Financial Services Council (2021): Affordable and Accessible Advice: FSC green paper on financial advice, p. 2, https://fsc.org.au/policy/advice/green-paper (accessed 20.07.2021), p.4.

qualification requirements could make investment advice for the less well-off unachievable.

Figure 4: Mean value of superannuation funds, by quintile (in 1000 AUSD)



Source: Australian Bureau of Statistics.

There is no easy way out of this dilemma. While the Australian pension systems is well positioned to cope with an ever more challenging demographic environment, it puts a rather high burden on individuals to make the right decisions for their future well-being. Detailed regulations can alleviate this burden only up to a point – and might cause their own problems as the examples have shown. A better solution is to start much earlier: In order to empower savers to make educated financial decisions, there is an increasing need for strong financial literacy and thus financial education.

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