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By email: Simon.Harrington@nestcorporation.org.uk

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Dear Simon

QSUPER RESPONSE: The future of retirement
A consultation on investing for NEST's members in a new regulatory landscape

We are pleased to attach a response to the NEST consultation paper that was issued in November last year. Our organisations have established a working relationship that we are keen to build on and we trust that this response will contribute to that.

We would be happy to provide further information and details on any of the matters contained herein, as well as any other matters of interest. We are comfortable to share our experiences and development with NEST and will follow your progress and initiatives with interest.

Yours sincerely

Brad Holzberger
Chief Investment Officer

INTRODUCTION

Superannuation in Australia

Australia has a relatively unique retirement system. In 1992 a compulsory occupational pension system was introduced with a contribution rate, known now as the Superannuation Guarantee (SG) was originally set at 3% of the employee's salary and this has gradually increased to the current minimum obligation of 9.5% (since 1 July 2014; previous amount had been 9% since 2002). The SG rate is set to further increase to 12% by 2025, although it has progression has been halted by the current Australian Government. There are currently a small number of closed Defined Benefit (DB) funds in operation, although they are generally not open to new members and are predominately public service and corporate schemes. Therefore, the majority of superannuants in Australia are in Defined Contribution (DC) schemes.

Whilst members now enjoy relatively generous contribution rates, only those fund members that have been working and contributing within the superannuation system since 2002 will have been fully exposed to these higher employer contribution amounts. Many expert bodies argue that even this amount, whilst a lot higher than it has been historically, is not sufficient for people to attain an adequate retirement. Putting that aside, however, this means that older people have not existed in a *mature* superannuation system for all of their contributing time; many for only a short period of time. This fact alone means that many people will struggle to fund a reasonable retirement.

QSuper Limited

QSuper is one of Australia's largest superannuation funds, responsible for approximately 540,000 members, amounting to funds under management of $84 billion. QSuper is the superannuation fund primarily for Queensland government employees and is currently mandated to receive their superannuation contributions into the fund. All Queensland government employees must be QSuper members and make contributions (employer and/or employee contributions) to their account.

Up until 2000, the default offering for the fund was a Defined Benefit scheme but this was closed to new members in November 2008. Since then an accumulation account (a defined contribution-type arrangement) was introduced as the default offering for new members. At this time, DB members had a once-off option to move to an accumulation account should they choose to (and are still able to); prior to the DB fund closing to new members, new accumulation members had a once off option to move over to a DB account. After this, they had to remain in either that DB or DC plan. At the same time, contribution rates for Queensland Government employees (excluding some subgroups of members, e.g., police) were structured as follows (noting that 9.5% below corresponds to the *current* SG rate):

Member Pays	Employer Pays	Total
0.00%	9.50%	9.50%
2.00%	9.75%	11.75%
3.00%	10.75%	13.75%
4.00%	11.75%	15.75%
5.00%	12.75%	17.75%

The default position for new members joining the fund is that should they not elect an amount they want to contribute, they will be defaulted to paying 5% member contributions so that total amount they receive into their superannuation account will be 17.75% of their superannuable salary. As such, the large majority (approximately 90%) of accumulation members are making contributions of this size.

Relative to the majority of the rest of the working population of Australia, QSuper government-employed members receive very generous contribution rates and would be expected to have higher overall balances at retirement, especially if they remain or have remained in the superannuation system for a long period of time.

For note, QSuper is also open to spouses of current QSuper members. In addition to this, members that have left employment with the Queensland Government are able to remain with the fund and earn only investment returns on their account, or if that do not close their account and go and work elsewhere, they are able to have their new employer contributions (at the current SG rate only) deposited into their old QSuper account.

The defined benefit component of the QSuper fund is not a traditional defined benefit pension. The formula is a service-based defined *lump sum* benefit at retirement. This means that retiring DB member face exactly the same challenges as members retiring from the DC section of the fund. In fact, it could be argued that the retiring DB members' challenges are far greater, as they have never had to consider or had exposure to individual member investment decisions.

In post-retirement or approaching retirement

In Australia, once a person reaches something known as preservation age (currently age 55 for people born before 1 July 1960, and increasing to age 60 for people born on or after 1 July 1964), they can start accessing their superannuation money, subject to having met a condition of release. This condition of release is normally that they have retired or stopped working. At this point, a person has three possible choices:

1. Members can take all of their money out but could incur some tax liability if they are aged under 60 (the first $185,000 of the taxable component is tax-free);

2. Members can open an account-based pension (ABP) by transferring money from an accumulation account[1]. However, once they do this, a minimum drawdown condition, dependent on a person's age, must be met (see Table below for details).

Age	Percentage
55 - 64	4%
65 - 74	5%
75 - 79	6%
80 - 84	7%
85 - 89	9%
90 - 94	11%
95+	14%

The regular payment taken from an ABP can be either a minimum amount or a nominated amount, and these are reset on 1 July each year, as well as selecting a frequency of payment. This can be fortnightly, monthly, quarterly, half-yearly or annually.

Lump sum withdrawals are also allowed with little or no restrictions on the amount or frequency of these withdrawals (the only QSuper rule is that the minimum withdrawal size is $1000). Furthermore, once in an allocated pension investment earnings are tax free, compared to 15% whilst money remains in an accumulation account.

[1] DB members can also open an ABP but their multiple will be affected.

3. Members can remain in the accumulation account and withdraw their money as they choose or need to. The benefit of this is that members are not forced to take a particular amount out of their superannuation account. The main drawback being the tax treatment on investment earnings.

QSuper has had an account-based pension product since 1996. In recent years, the increase in the ABP membership is approximately 1,000 per year, although the demographics of QSuper, and of Australia in general would likely see this increase vastly in coming years.

In the response below, in addressing the consultation questions below, where relevant we will comment and document on various member behaviours and analysis that we have observed from our own members and research that we have undertaken.

CONSULTATION QUESTIONS

1. How will the trend for changing retirement patterns and provision affect what:

a. members need, and

b. employers want, from DC schemes in the future?

2. How will the trends identified in this chapter evolve and what does this mean for DC design?

3. What conclusions should be drawn from the evidence presented on spending, housing wealth and debt for the needs of future NEST members in retirement? What other data on consumption and wealth should we be taking into account?

We will seek to address parts of questions 1 – 3 altogether, presenting evidence that we have gathered over the last 3 years on QSuper members. Whilst the members of our fund may have a different history of superannuation savings than NEST members will have, the needs and desires of members in retirement would not be expected to differ greatly.

With regard to DC design and conclusions drawn from the evidence presented, we believe that the in the short term, information garnered should inform and validate product and strategy development in this space but not be too specific such that all solutions depend on this information.

Over the last three years, QSuper has carried out a rather comprehensive analysis of its membership where data was available. A large body of this work considered member behaviour in the lead up to and whilst in retirement.

QSuper is also in a rather unique position of owning a financial planning entity, QInvest, which is primarily available to QSuper members only. Consequently, we have been able to obtain information on members' desires and needs in retirement as well as assets and liabilities outside of superannuation savings. This data is somewhat limited as only a small proportion of our membership will access QInvest; however at this point in time, this still allows guidance and validation in some aspects of modelling and decision making.

This section is split into two parts.

1. Financial Planning Analysis via QInvest;
2. Withdrawal Behaviour in Retirement, split into:
    a. Member behaviour whilst in pension phase; and
    b. General withdrawal activity.

1. FINANCIAL PLANNING ANALYSIS

As noted above, QInvest is the financial planning entity of QSuper. Given this relationship we have been able to obtain detailed information on QSuper members who had attended a QInvest interview for either specific or comprehensive advice where approximately 95% of people attending interviews are aged 50 or older.

When people attend a QInvest interview, they are asked to fill out a Lifestyle Questionnaire (LQ). This covers a range of topics including basic demographic information, various household assets and liabilities (recorded against client, joint and/or partner) and a risk profile metric. Since 2008, information on a person's desired age of retirement (unless already retired) and their desired income in retirement was also recorded.

Assets included in the questionnaire are: annuities, antiques, artwork, bank accounts, boats, franchises, goodwill, holiday home, home (and then home and contents), insurance bonds, inventory, jewellery, managed funds, motor vehicles, pension, plant and machinery, rental properties, shares, superannuation and term deposits. Liabilities included in the questionnaire are: home, car, investment, education and personal loans, investment property debt, credit cards, lines of credit and overdrafts.

The analysis presented here is in two parts:

- a rather comprehensive analysis of QSuper interviews carried out between 1996 and 2012; and
- a more recent analysis on members since 1 January 2013.

When initial analysis was carried, privacy rules meant that we were not able to match QSuper data on members that we held in our systems against the QInvest data. These rules have since been relaxed and we were then able to incorporate additional information held on our members. Rather than going back and matching the original data to our membership, in order to keep the future analysis current and more relevant, we restricted the later analysis to only those interviews that took place from 1 January 2013.

Furthermore, over time questions on the LQ and how the data was stored has changed and therefore, we were able to address additional aspects of member behaviour in or approaching retirement, as well as what members assets/liabilities are outside of superannuation, through both sets of analysis separately.

Pre 2012 analysis:

We received data on 16,389 QSuper members that had attended a QInvest interview during this time. Of these, there were 11,528 members for which we had superannuation assets (accumulation and/or pension monies) recorded. Of these members, the average superannuation balance was $421,000 (median of $364,000). The distribution of superannuation balance was, as expected, skewed to the right, however, 90% of members interviewed had a balance greater than $96,000 and 75% had a balance greater than $192,000, suggesting that not all members attending QInvest interviews necessarily had a high balance[2].

Of the 16,389 members, 11,349 held assets external to superannuation in both clients, jointly or in a partner's name. The remaining 5,040 members had assets recorded in their name only. This represents almost one third of the sample of members, although it was not possible to state with confidence that these were single people and marital status was not explicitly captured in this data.

[2] It is often assumed that the higher net worth members are those that seek financial advice.

Going forward, except for descriptions specifically involving superannuation assets, any assets and/or liabilities refer to total household assets.

Shown in Table 1 is a summary of the more common assets and liabilities of these members with the main points summarised below.

- The majority of members (14,893) owned their own home (average value of $507,919) but 4,901 had loans outstanding on their residence (average value of $144,260).
- Almost 14,000 members had money in their bank accounts; the average amount was almost $49,299 but the median was only $15,247.
- Other than cars, the other most common assets were shares, rental properties, term deposits and managed funds. The average (median) value of each of these were: $67,124 ($15,740); $555,250 ($400,000); $80,937 ($40,000); $79,636 ($41,000), respectively.
- After a home loan, the next most common liability was an investment loan with around 15% of members having a loan of this type to the value of $228,441 on average (median of $150,000).

Also shown in Table 1 is information regarding desired income (excluding lump sums) in retirement and current desired income (therefore, what they need now). These are calculated from a budget plan in the lifestyle questionnaire where the median values of each of these are $34,000 and $37,934, respectively. The average desired age of retirement (and also the median) of these members was 62.

Analysis broken down by Superannuation Balance

The following analysis considers various aspects of the LQ for those members who had a superannuation value recorded against their name and splits this balance into intervals to approximately represent low to high balance groups. The balances considered are greater than $1m, between $500,000 and $1m, $300,000 and $500,000, $100,000 and $300,000 and less than $100,000.

The outcome of the risk profiling section of the lifestyle questionnaire is shown in Table 2. Approximately half of members profiled are considered as desiring moderate levels of risk and the distribution around this outcome is reasonably symmetric. The distribution of risk preference is similar, irrespective of superannuation account balance.

Table 3 shows the desired retirement age for members split by superannuation balance. For those people who had smaller balances, the average desired age was 63, which is marginally higher than for those with higher balances. This suggests, perhaps counterintuitively, that desired retirement age is not terribly influenced by superannuation account balance.

A person's net position has been calculated and from this the value of house and superannuation assets has been subtracted to allow an analysis of net assets outside of their main assets. These results are shown in Table 4 with the main points summarised below:

- As expected, those members with a higher superannuation balance did have a larger net position (median of $590,140) which decreases as superannuation balance decreases to around $222,290 for the lowest balance group.
- The smaller balance groups (less than $300,000) made up almost half of the overall sample.
- Desired income in retirement reduces as superannuation balance declines ($44,500 for the largest balance group to $30,000 for the smallest balance group). These numbers were surprisingly small and imply that QSuper members only require a modest lifestyle in retirement, irrespective of account balance.

- Interestingly, desired income now (which was calculated using the budget planner as part of the lifestyle questionnaire) decreased with balance, although not as markedly, but was then higher for the lowest balance group.

As a result, we cautiously note the following conclusions:

1. The majority of members owned their own home with a small proportion of them still having debt on this asset.
2. Other than a members home and superannuation monies, many of them had assets outside of superannuation that was not insignificant (most commonly, shares, term deposits and rental properties). This was across the board, irrespective of superannuation balance.
3. The desired income in retirement was modest, irrespective of account balance ranging from $44,500 for those people with large superannuation balances to $30,000 for those with much smaller superannuation balances.
4. The desired retirement age of members was 62, on average. Given that members appeared to have assets outside of super, this would indicate that for a period of time after retirement, members did not feel that they would need to access Centrelink (social security) immediately.

Table 1. Summary of assets, liabilities and desired income.

	ASSETS									LIABILITIES		OTHER	
	Home	Bank Accounts	Annuity	Managed Funds	Motor Vehicle	Rental Property	Shares	Term Deposits	Investment Loan	Investment Property Mortgage	Home Loan	Desired Income Now	Desired Income in Retirement
Count	14893	13886	189	2832	15046	4052	6955	3602	2365	602	4901	3357	3006
Average	$ 507,919	$ 49,299	$ 218,158	$ 79,636	$ 22,614	$ 555,250	$ 67,124	$ 80,937	$ 228,441	$ 308,962	$ 144,260	$ 41,179	$ 31,777
Median	$ 450,000	$ 15,247	$ 136,950	$ 41,000	$ 18,000	$ 400,000	$ 15,740	$ 40,000	$ 150,000	$ 225,000	$ 108,496	$ 37,934	$ 34,000

Table 2. Risk profile outcome split by superannuation assets.

Risk Profile Outcome	Total Sample		Super Assets: 1m and greater		Super Assets: 500k to 1m		Super Assets: 300k to 500k		Super Assets: 100k to 300k		Super Assets: less than 100k	
Conservative	754	6.14%	15	3.22%	171	5.03%	148	6.32%	301	7.69%	69	5.81%
Moderately Conservative	2660	21.66%	72	15.45%	643	18.90%	514	21.95%	977	24.96%	260	21.89%
Moderate	6538	53.25%	270	57.94%	1960	57.61%	1270	54.23%	1935	49.44%	566	47.64%
Moderately Aggressive	2083	16.97%	102	21.89%	581	17.08%	377	16.10%	625	15.97%	234	19.70%
Aggressive	243	1.98%	7	1.50%	47	1.38%	33	1.41%	76	1.94%	59	4.97%
Total	**12278**	**100.00%**	**466**	**100.00%**	**3402**	**100.00%**	**2342**	**100.00%**	**3914**	**100.00%**	**1188**	**100.00%**

Table 3. Desired retirement age separated by superannuation balance

	Desired Retirement Age				
	1m and greater	500k to 1m	300k to 500k	100k to 300k	less than 100k
Count	321	2,450	1,675	2,851	881
Average	62	61	62	63	63

Table 4. Summary of assets and liabilities, including net asset position split by a person's superannuation balance.

	Superannuation	Pension	Total Superannuation Assets	Assets - Liabilities (not incl Super and House)	Desired Income Now	Desired Income in Retirement	Home	Bank Accounts	Rental Property	Shares	Term Deposits	Home Loan
Super Assets: > 1m (N = 474)												
Count	465	71	474	474	68	68	455	431	184	289	138	113
Average	$ 1,205,267	$ 819,407	$ 1,305,121	$ 929,590	$ 48,113	$ 41,971	$ 711,959	$ 97,312	$ 1,052,712	$ 165,519	$ 149,139	$ 202,485
Median	$ 1,130,910	$ 745,213	$ 1,166,749	$ 590,140	$ 44,500	$ 44,500	$ 600,000	$ 40,000	$ 595,000	$ 60,000	$ 92,500	$ 140,000
Super Assets: 500k - 1m (N = 3444)												
Count	3354	404	3444	3444	324	324	3297	2957	941	1701	795	954
Average	$ 640,261	$ 468,175	$ 678,449	$ 472,712	$ 43,675	$ 35,233	$ 571,358	$ 57,305	$ 598,429	$ 81,353	$ 89,772	$ 149,423
Median	$ 639,489	$ 506,803	$ 652,222	$ 309,620	$ 40,000	$ 36,500	$ 500,000	$ 20,167	$ 450,000	$ 20,550	$ 50,000	$ 109,000
Super Assets: 300k - 500k (N = 2384)												
Count	2273	339	2384	2384	187	187	2226	2063	605	1027	545	717
Average	$ 383,030	$ 319,282	$ 410,597	$ 390,364	$ 43,619	$ 32,263	$ 548,910	$ 48,976	$ 563,266	$ 55,425	$ 76,129	$ 145,883
Median	$ 400,415	$ 355,059	$ 409,399	$ 249,868	$ 40,000	$ 35,000	$ 500,000	$ 17,000	$ 400,000	$ 15,700	$ 40,000	$ 112,000
Super Assets: 100k - 300k (N = 3995)												
Count	3807	440	3995	3995	240	240	3636	3423	873	1553	832	1289
Average	$ 203,025	$ 176,709	$ 212,933	$ 339,018	$ 37,656	$ 26,995	$ 508,294	$ 46,715	$ 539,186	$ 46,819	$ 83,265	$ 152,870
Median	$ 203,537	$ 169,412	$ 210,974	$ 215,256	$ 35,000	$ 30,000	$ 450,000	$ 15,000	$ 420,000	$ 11,800	$ 40,000	$ 119,000
Super Assets: < 100k (N = 1231)												
Count	1191	67	1231	1231	50	50	1011	1038	278	399	213	435
Average	$ 54,284	$ 58,743	$ 55,717	$ 351,371	$ 41,021	$ 26,748	$ 501,787	$ 61,480	$ 523,479	$ 46,616	$ 93,492	$ 181,113
Median	$ 57,478	$ 62,019	$ 59,115	$ 222,290	$ 35,988	$ 30,000	$ 450,000	$ 12,000	$ 400,000	$ 10,869	$ 40,000	$ 164,000

1 January 2013 onwards

Since 1 January 2013, 5,225 QInvest interviews have been captured. Extra information collected in the latest LQ included marital status, members needs and desires in retirement (for example, travel or health, how much they expect to need, as well as whether this is a high, medium or low priority) and some information captured on various health questions (for example, smoking status).

Out of the 5,225 members considered, 3,865 (74%) were married at the time of their interview (this included defacto status) and 1350 members (26%) who were single (including widowed and divorced members)[3]. Figure 1 shows the proportion of married and single members by age, where we see that the percentages are relatively stable, irrespective of age.

Figure 1: Marital status (proportion) by age

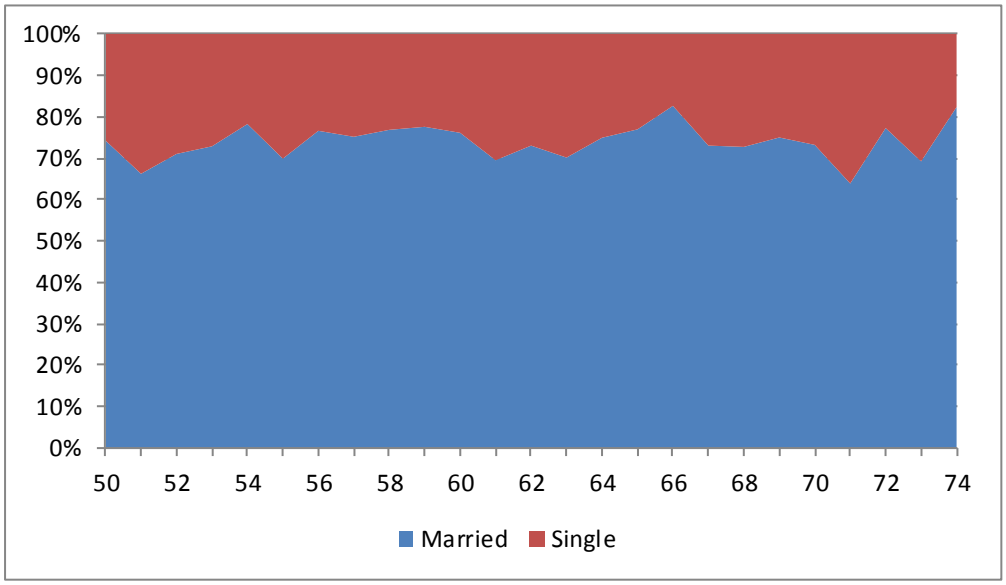


Table 5 below summarises the employment status, split by marital status for members aged 60 and above. Of interest is that there is a definite difference in the employment status for the married members compared to the single members. For example, 40% of married members are retired compared to only 26% of single members. Furthermore, a large percentage of those single members appear to be working part-time (20%) and full-time (44%) compared to respective figures (13% and 37%) for the married members.

[3] 10 were excluded here due to no status being recorded.

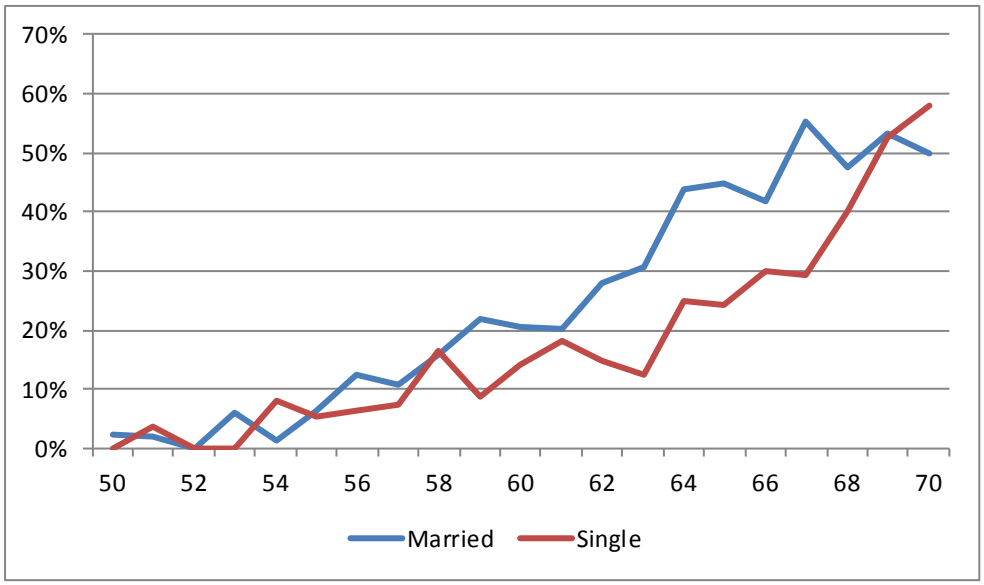
Table 5: Summaries of Employment Status and Marital Status for Members aged 60+

Counts	Full-Time	Part-Time	Casual	Retired	Redundant	Unemployed	Home Duties	Total
Married	645	232	85	706	59	18	10	1,755
Single	283	129	20	166	20	18	2	638
Total	**928**	**361**	**105**	**872**	**79**	**36**	**12**	**2,393**

Percent	Full-Time	Part-Time	Casual	Retired	Redundant	Unemployed	Home Duties	Total
Married	37%	13%	5%	40%	3%	1%	1%	100%
Single	44%	20%	3%	26%	3%	3%	0%	100%

If we examine the retirement proportion of members by marital status for the different ages (shown in Figure 2), we observe that there are a smaller percentage of single members (from around the age of 60) compared to married members that are retired. This gap widens for a number of years until it closes around age 70. This suggests that single people are more likely to continue to work for longer, whether this be for need, or by choice. We also observe in our data (although summaries are not shown here) that 68% of the female clients have an older partner and 73% of the male clients have a younger partner. It is not uncommon that married people will retire at the same time, which could explain the gap below where a higher proportion of married people are retiring at the age of the younger partner.

Figure 2: Proportion of retirees by marital status and age



Finally, shown below in Figures 3 and 4 is the net asset position of QInvest interviewees split by marital status. It would appear that married people have more assets than singles. Of interest is that the average percentage of assets in the client's name (for the married clients) is 71% compared to 29% in the partner's name. This confirms expectations that often one person in a relationship has more assets than the other.

Figure 3: Net assets (incl. super): Married

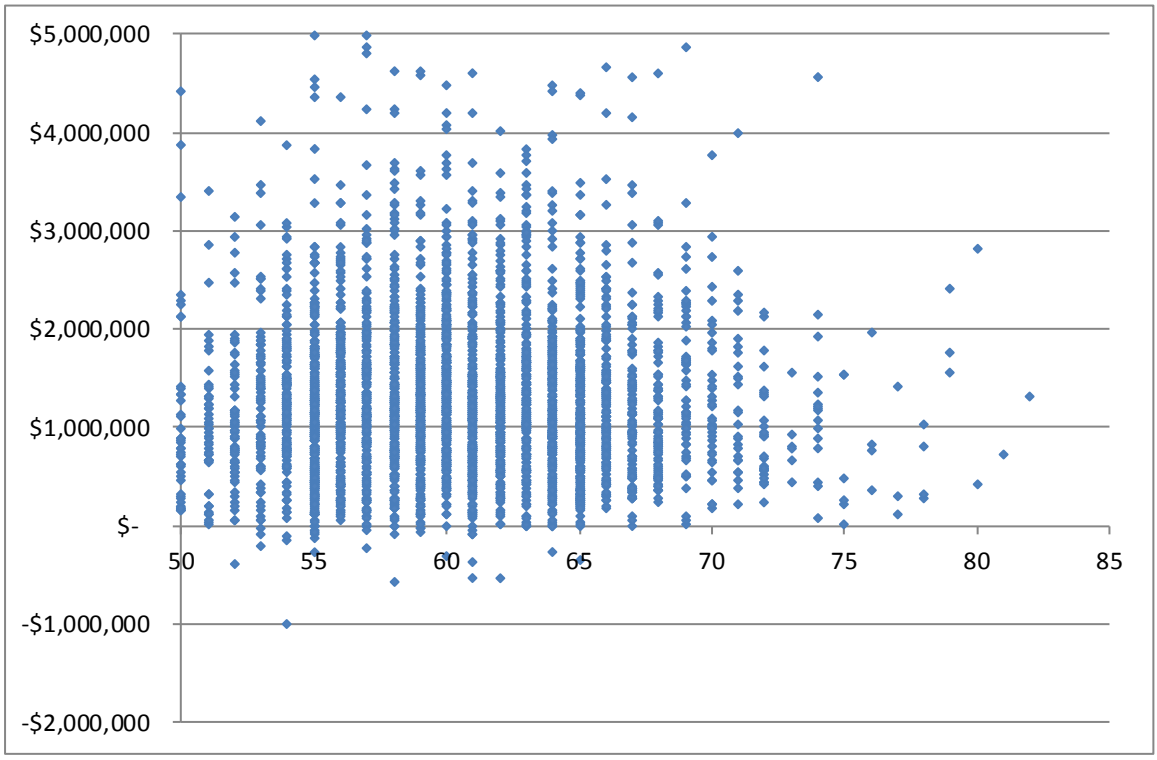
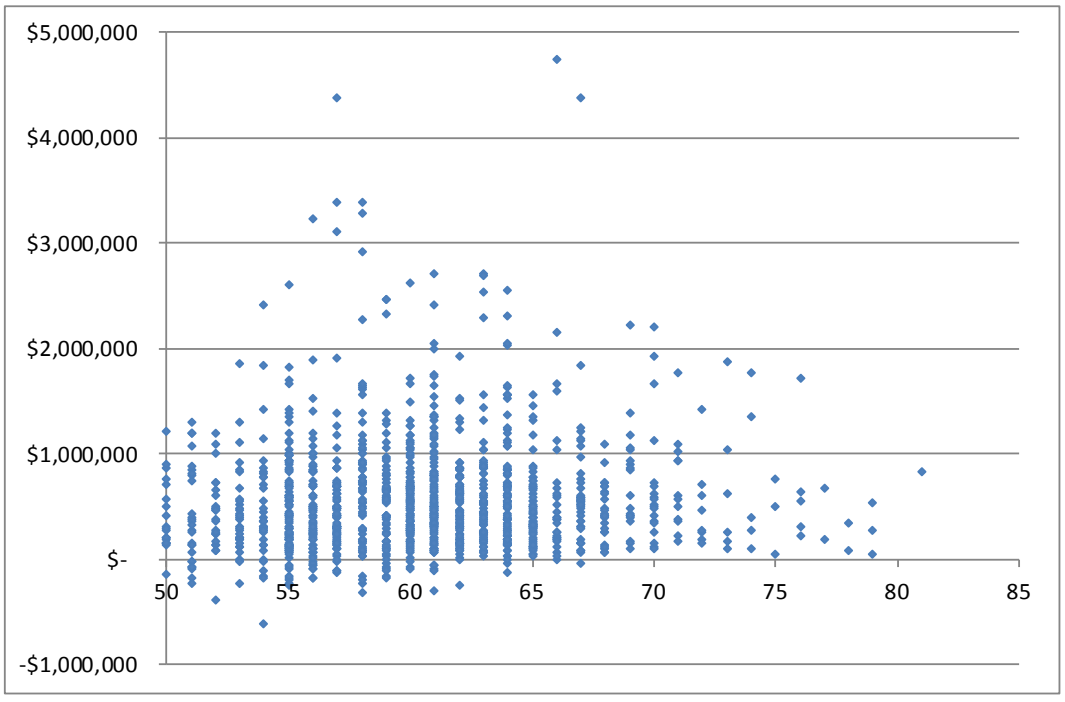


Figure 4: Net assets (incl. super): Single



The final section of the Lifestyle Questionnaire that we now have data on is future expenses (needs or desires) of members and whether they consider these to be high, medium or low priority. Possible needs included travel, paying off debt, purchasing a new house, caravan or boat, health care costs and children's education expenses.

Table 6 provides a high level summary of the responses for the most common answers. The high priority needs or desires are travel, home renovations, replacement of their car and to repay debt. Travel and replacing a car also feature highly as a medium term priority where if we combine these they account for 56% of the interviewees with a high or medium desire to travel (needing approximately $15k) and 44% with a high or medium desire to replace their car (needing approximately $30k).

Note that interviewees could list more than one future expense (although it can only be categorised as either high, medium, low or not specified). Interestingly, future payment of a child's wedding was a relatively common response.

Table 6: Summary of Future Expenses by Priority

PRIORITY	FUTURE EXPENSE	NO. OF MEMBERS	AVERAGE AMOUNT DESIRED ($)	% OF INTERVIEWEES
High	Travel	1352	17,434	26%
	Renovations	781	41,128	15%
	Replace Car	761	32,735	15%
	Repay Debt	744	174,249	14%
	Property Purchase Costs	162	326,958	3%
	Wedding	145	17,259	3%
Medium	Travel	1565	15,565	30%
	Replace Car	1511	28,730	29%
	Renovations	818	25,423	16%
	Repay Debt	148	168,570	3%
	Wedding	106	18,462	2%
Low	Children's Education	780	27,942	15%
	Caravan or Boat Purchase	297	18,200	6%
	Family Needs	267	10,903	5%
Not Specified	Travel	483	12,985	9%
	Replace Car	441	27,546	8%
	Renovations	391	20,777	7%
	Wedding	115	13,248	2%

2. WITHDRAWAL BEHAVIOUR IN RETIREMENT

Before proceeding, we note the following regarding the rules around withdrawing money from superannuation past a certain age. Irrespective of whether your money is held in an account based pension or remains in an accumulation account:

- Between preservation age and age 60, income stream and lump sum withdrawals are taxed at your marginal tax rate[4].
- After age 60, income stream and lump sum withdrawals are tax-free;

The main difference for members in either a pension or an accumulation account is the treatment of the investment earnings. In a pension account, investment earnings are tax-free compared to in an accumulation account.

[4] It is not quite as clear cut as this due to slightly more complex rules of superannuation but the point is that there is a tax penalty for withdrawing money at these ages.

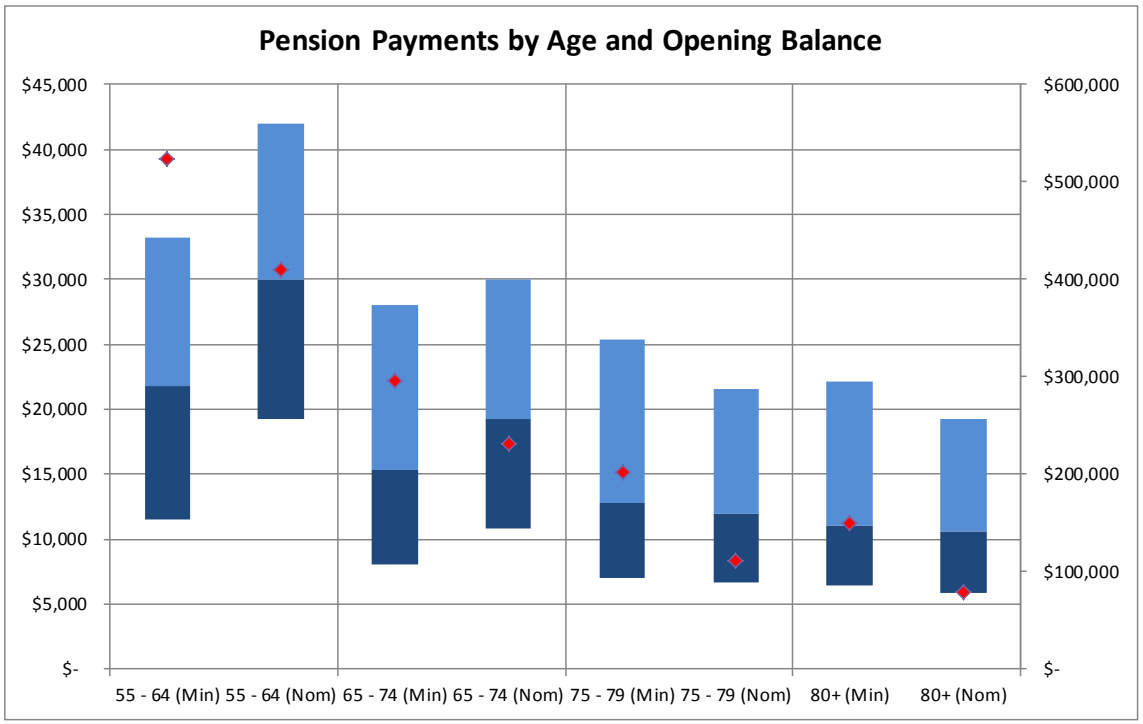
a. Member behaviour whilst in pension phase

Below we analyse the drawdown behaviour of our income account members over the previous financial year (2013-14), excluding members who have taken out a transition to retirement[5] pension as they could distort the results below. As such, the charts and summaries correspond to approximately 25,000 QSuper members.

When looking at the behaviour of our members over the last financial year (2013-14), we observe the following:

Regular Payments

Figure 5: Distribution of pension payments by type and age



Shown in Figure 5 above is the distribution of the regular drawdown payments members take split by age category and whether they opted to take the minimum amount or a nominated amount. The lower, middle and top bars represent the 25th, 50th, and 75th percentiles, respectively. On the secondary axis is the median opening balance (as at 1 July 2013) of those corresponding members. Overall, of the 25,000 members examined, 45% chose to take the minimum payment amount with the remaining 55% opting to take a nominated amount.

In the younger age groups, we observe that those members choosing a nominated payment amount are drawing a higher median amount relative to those taking a minimum amount. It is possible that for those members who needed to draw an amount different to the minimum allowed, they did not feel that the minimum is not enough to live on and need to draw more.

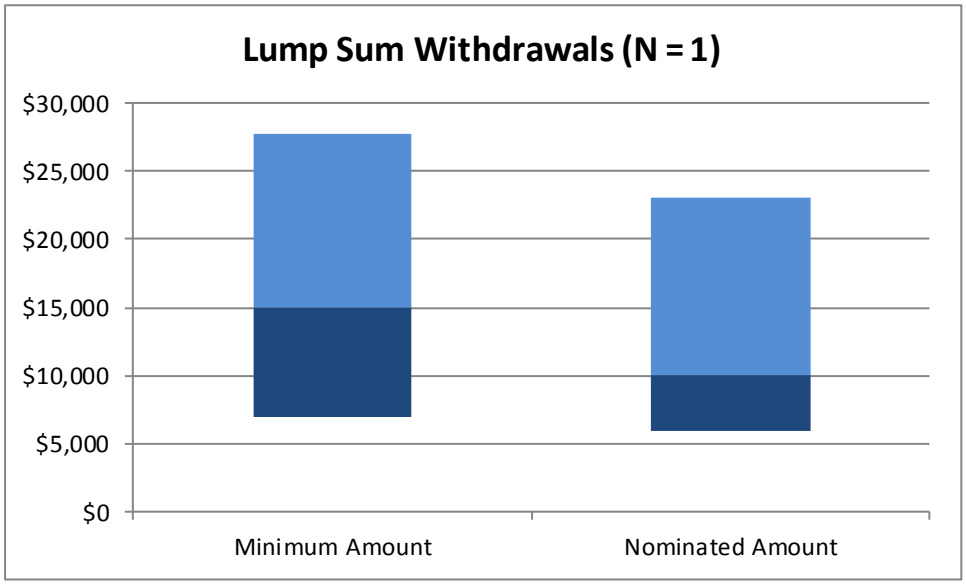
[5] A transition to retirement pension enables Australians of preservation age to access their super in the form of a pension without retiring or satisfying an additional condition of release and were introduced to help Australians who wanted to transition to retirement via part-time work.

On average, this group of members also have smaller balances, as depicted by the opening balance shown on the right axis. This trend however stops as people turn 75 and older, but these members are more likely dominated by having smaller balances, and consequently more reliance on Centrelink.

Lump Sum Withdrawals

If we observe the same members, we note that a further 6,089 members also took as an extra payment, at least one lump sum withdrawal. Almost 60% of these members took only one withdrawal, a further 23% took two withdrawals, 9% took 3 withdrawals and the remaining 8% took 4 or more withdrawals. Shown in Figure 6 below is the distribution of these withdrawals (25th, 50th and 75th percentiles shown, respectively) where only one was taken over the year, and split by those members who have elected to take either a minimum amount or a nominated amount.

Figure 6: Distribution of additional lump sum withdrawals by amount-type drawn

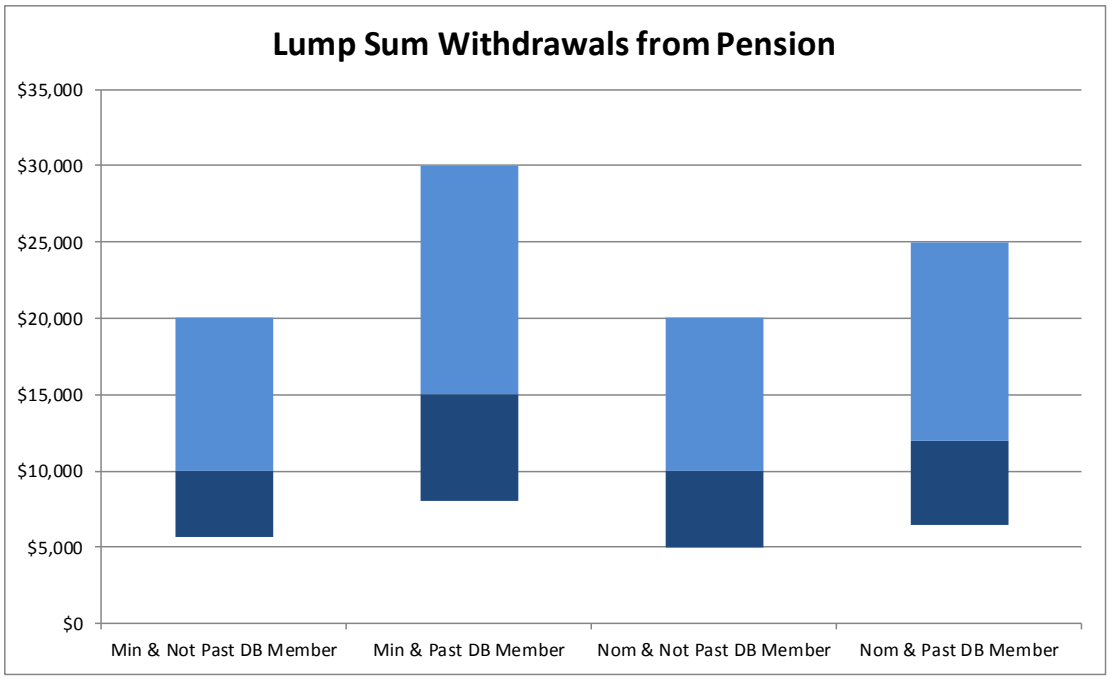


It is unclear at this stage, if the reason for those members who are currently taking one-off lump sum withdrawals are in need of extra money to subsist on or whether they are taking one-off lump sums to fund more discretionary expenses, such as travel, or purchasing a new car. Future work will consider observation of these members longitudinally to see if these are indeed one-off withdrawals or ongoing.

It would seem that those members withdrawing the minimum amount are taking larger one-off payments than those taking regular nominated payments. It is also of note that of the members taking one lump sum withdrawal over this period, 59% (41%) of them are those taking a nominated (minimum) amount. When looking at the raw data, values of $1k, $2k, etc., are commonly observed, suggesting that people are taking small lump sums to potentially cover small costs, such as bills, that their income stream payments are not covering.

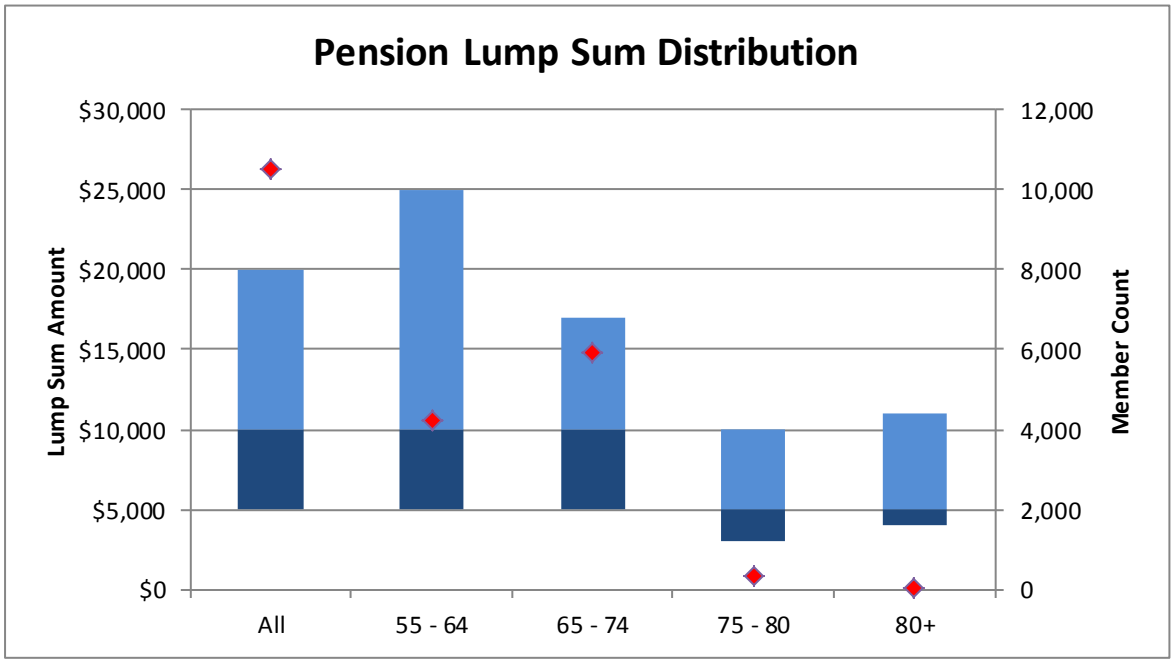
Given the legacy of QSuper's DB membership, where DB members have on average larger balances, these summaries can be somewhat distorted. When you break down both the regular payments and lump sum withdrawals by previous DB membership, we see that these members, are able to (and on average do) take larger income streams in retirement as well as larger lump sums, perhaps to be used on luxury item purchases, as mentioned above.

Figure 7: Distribution of additional lump sum withdrawals by amount-type drawn and past DB membership



Finally, if we look at the pension lump sum distribution by age, shown below in Figure 8, we observe some further trends. The median amount withdrawn for members between the ages of 55 – 74 is $10,000, with the 25th percentile being $5,000. There is a higher proportion of members in the 55 – 64 age group taking larger lump sums (up to $25,000) where this is likely to be newly-retired members withdrawing money for various items of consumption – repaying debt, going on holiday, etc. These amounts do dwindle as people age, where for those people older than 75, their balances will have been largely drawn down and therefore lump sum withdrawals will naturally be smaller, with the median around $5,000. Recall also that the older members have not been in the superannuation system for all of their working life and would have smaller balances when they retired.

Figure 8: Distribution of additional lump sum withdrawals by age



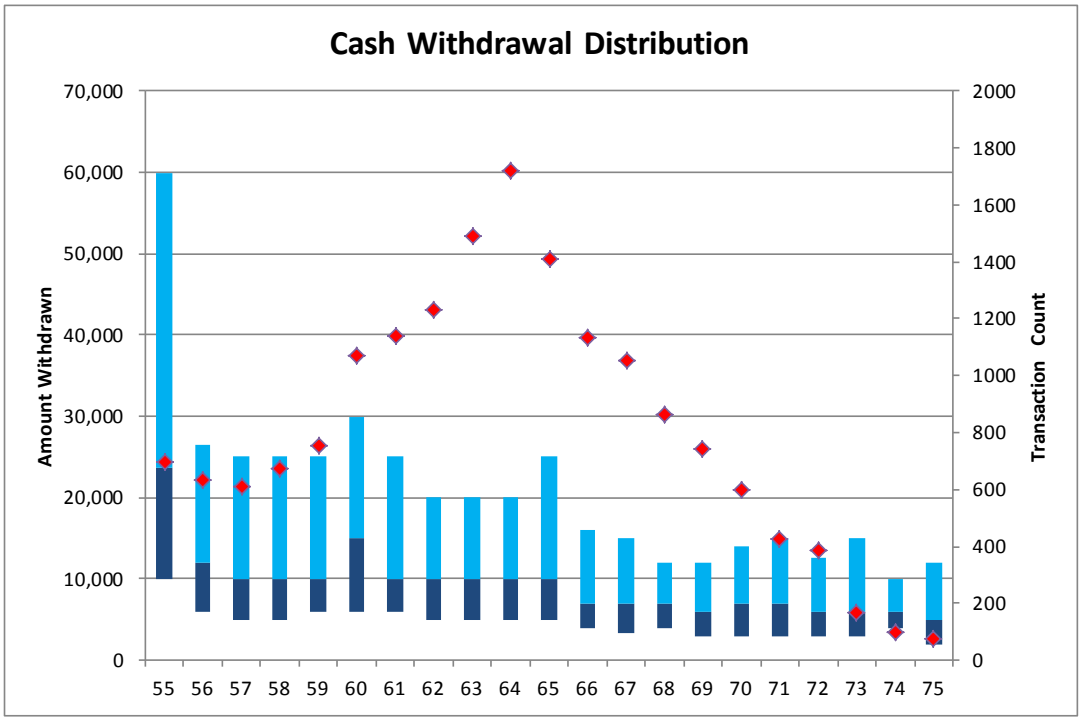
Lastly, over the last year, the opening income account balance has been approximately $455,000, where the average opening balance for males and females is $510,000 and $400,000, respectively. This is a widely accepted fact that women will retire with less superannuation savings than men due to time out of the workforce.

b. General withdrawal activity

From the age of 55 (current preservation age), where a member has met a condition of release (e.g., stopped working and no longer contributing), they can withdraw money from their superannuation account. A number of QSuper members (approximately 12,0000) for which this criteria matches do engage in this activity.

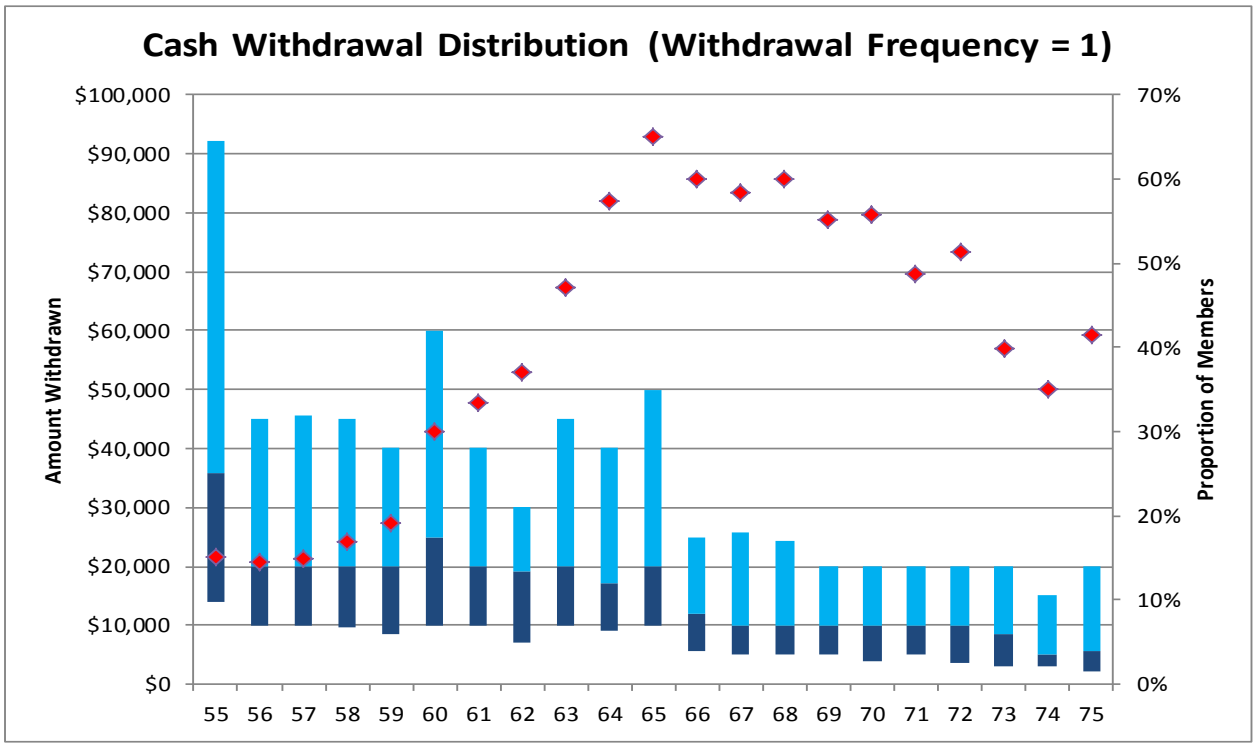
Figure 9 below shows the size (25th, 50th, 75th percentiles, respectively) of each cash withdrawal for members over a one-year period by age, with the count of transactions on the secondary axis. First noting the number of transactions, there is an obvious peak at age 64 where this has gradually climbed, more so through ages 60 – 64 and then starts to decline from age 65 onwards. We also note the size of these transactions where through to age 65, the median is around $5,000 irrespective of age. There is a peak for ages 55 (that we also observed for members in an ABP) and 60; at age 55, most likely due to newly retired members getting access to their money and at age 60, when withdrawals become tax-free and possibly an incentive to take more now that they can.

Figure 9: Distribution of cash lump sum withdrawals by age from an Accumulation account



In Figure 10, we isolate those members taking only one cash withdrawal in the previous year which makes up 58% of those members making any cash withdrawals, we see that the 25th percentile and median amounts increase to around $10,000 and $20,000, respectively, for ages 56 through to 65. Again the amounts taken in later years are less, but likely due to depleted balances and a need for caution on behalf of the member. On the secondary axis on the same chart, we observe the proportion of members for each age; this peaks at age 65 where we see that over 60% of all retired 65 year olds (still in the accumulation account) are taking one lump sum. This gradually decreases over time down to around 35 – 40% at age 75 but is still reasonably high through the late 60s.

Figure 10: Distribution of single cash lump sum withdrawals per year by age from an Accumulation account



4. Given the heterogeneity of likely spending patterns in retirement, is it possible to reflect these in the design of retirement solutions?

There will be variability in spending patterns. For this reason we strongly advocate that our members seek advice which can take both their assets and liabilities into account and match them with an investment risk preference. However a sizeable proportion of our members continue to follow default strategies for a range of motivations. Therefore we consider average spending patterns can serve three useful purposes:

- As the best measure of the liabilities on which to construct default post-retirement strategies for members who, despite our advocacy, still wish to allow the Trustee to set investment strategy for them.
- As a way for the Trustee to signal to members who make their own choices a baseline strategy which they can use to compare and contrast with their own (advised) decisions.
- As the basis for strategy development by the Fund which enables the Trustees and management to make real decisions about asset/liability interactions. This reinforces an ALM culture and way of thinking across the organisation as a springboard for properly considering the full post-retirement problem facing members.

5. Taking into account current retirement decisions, what people say they want and what the evidence says about behavioural biases, how are savers likely to act under the new freedoms?

We can make no assertions about this. In Australia these freedoms have been the only path available to retirees in a DC environment. While we do not have comprehensive data it is fair to say that members on the whole appear to act reasonably rationally. They react to external influences.

For example during the GFC there was a rapid adjustment when members were offered temporary relief from minimum drawdown requirements in account based pensions. While some of this may have been irrational fear of short term market volatility it was probably more about them wishing to moderate consumption temporarily as a way of managing long term risk.

Based on experience and observation of member behaviour when faced with wide choice we tend to construct strategies on the basis that members will be reasonably rational and conservative. They are also remarkably willing to follow default paths of course but these are constructed to be rational and conservative so in some ways it is not surprising.

6. What member behavioural risks do providers need to manage?

We are most concerned to advise and act to prevent members moving to extremes of strategies. We do not think they are advantaged by being too conservative or too aggressive. We acknowledge the risk of underspending early in retirement as realistically as overspending. By advocating moderation in consumption plans and investment strategy we feel we are best placed to cater for a baseline for default and choice members.

Another feature which is emerging in our philosophy is that we do not put a high value on bequests. Most of our current members approaching or in retirement will have insufficient funds to support their desired standard of living through an extended retirement even with top ups from social security.

We then are advocating a recognition that they should expect to spend most or all of their financial savings during their retirement. This is reasonably palatable to average members who have high rates of home ownership and so often build a simple construct that the family home is their bequest. Even so it is important to get them to see their financial capital as an amortising pool and they have to do more than live on the interest alone. It seems to naturally concern them when capital begins to deplete.

7. Are there other risks and objectives to be taken into account for DC savers approaching and in retirement?

The Consultation Paper lists all the risk we believe are relevant.

8. What works in terms of communicating and getting DC savers to engage with decision making in the approach to retirement? How can we help members make good choices before and during retirement?

We have seen a predictable but observable higher rate of engagement as members approach retirement age and it is increasingly prevalent as account balances rise. In recent years we have significantly changed investment strategies for our default members close to retirement and sent several significant pieces of communication about that to them. It certainly elicited a material response rate (about 20% reacted by choosing a different path to the default). What we do not know is how many would have naturally moved anyway by virtue of approaching retirement. Our guarded conclusion is that we somewhat accelerated an otherwise significant trend.

It is hard to imagine a stronger way to communicate than advise the members that if they do nothing we will significantly change strategy and then actually make the change and inform them it is done. Presumably it will work a lot better than any amount of general advice and commentary.

Having said this, there is a healthy debate within QSuper on whether or not we should oversell the benefit of moving from defaults. While 20% of members close to retirement with significant account balances opted out of the default the rest stayed. It is clearly wrong to assume that 80% simply did not care of know. Many presumably were happy for any number of reasons to follow the default. We have a philosophy of making the default as rational and sensible as we can based on average member characteristics and so we are not concerned if members follow it. Our hope is they follow it for the right reasons and the ones we are concerned about are those that have characteristics far from average but follow the default anyway through confusion or apathy.

9. How can we help mitigate the risks associated with cognitive decline as people get older?

Our only plan to date is to construct sensible defaults which members can follow either explicitly or by choosing to match them. We have no way yet of measuring or responding to cognitive decline.

One strategy which is not yet policy but is being evaluated is reenrolment of choice members. If members have not made an active choice for an extended period (say 5 years) we are considering contacting them to just reconfirm. One of the potential advantages of this would be to remind or jog actions from members who have become less mentally alert or able, or perhaps their care givers who might not even know they have an account at QSuper.

10. What is the role of default strategies in the new regime and the run up to and throughout retirement?

We have addressed this in the question above but to restate we see them providing:

- A best path on average for members who simply wish for whatever reason to follow a default,
- A way for the Trustee to signal to members who make their own choices a baseline strategy which they can use to compare and contrast with their own (advised) decisions.
- To form a basis for building a culture of ALM management in post-retirement among the Trustees and management.

11. Should we consider having more than one default strategy for different types of member, and which variables can be reasonably used to differentiate member needs in the event of no member engagement?

We definitely consider members should be allocated to different defaults based on meaningful characteristics. As an indication we suggest the following is a reasonable list of these:

- Use age as a starting point. Age is a good proxy for:
    - Investment horizons
    - Member risk tolerance around adequacy vs. certainty of income
- But it is important to also include other factors:
    - Drawdown rates
    - Account balance
    - Variable retirement dates and longevity measures
    - Social security entitlements

12. Based on the member evidence presented should the default target retirement age remain the same as state pension age? If not what are the alternatives?

We see that as a sensible basis for developing strategies and can offer no supportable alternative.

13. Based on the evidence presented, should purchasing annuity income be part of retirement planning for DC savers? If so - on average - what age should this purchase happen?

On balance we feel annuities are part of a retirement strategy but cannot provide a singular solution.

It will never be possible to identify one post-retirement strategy which is superior for all members. While product offerings must be kept simple, it may be that a trustee has to offer more than one income and longevity solution and also accept that the form of those solutions differ over time as members enter retirement with higher levels of adequacy.

Setting overall investment strategy

Income certainty, flexibility and longevity risk are examples of several key risks which must be managed and they are best managed collectively. The emphasis is the efficiency and risk of various trade-offs. Members will have to judge for themselves (unless they choose to delegate to the Trustee through defaults).

One of the key differences between annuities and other products and strategies is how they combine with the baseline assets, accessed via a drawdown strategy, which we assume will hold the bulk of the members' assets (default or choice). The fundamental weakness of a drawdown strategy for longevity risk management is that the member does not know what time horizon to base the drawdown strategy on. This can be mitigated a bit in various ways but it is a major issue. Other longevity solutions including annuities offer different advantages in this regard. Several concepts can be used to manage longevity risk in a fundamentally different way:

Distributing income

Some options (including lifetime annuities) operate by adding incremental income to the drawdown strategy across the full retirement period. This mitigates longevity risk by stretching the flexibility inherent in the drawdown further but they will produce gaps in income levels as drawdown assets are exhausted and the time horizon issue for the drawdown is still challenging.

Deferred consumption

Some options (including deferred annuities) operate to provide a separate source of income which is set up to take over from the drawdown at a specific date. This means that the drawdown investment strategy can be set with higher confidence (implying a higher risk setting) because its time horizon is known. There is still no guarantee, as the outcome would still be binary: either the remaining account balance is exhausted prior to the deferred annuity commencing, or there are still assets available.

14. Would iterative purchase, phased annuitisation, or fixed-term annuities be a better way for DC savers to secure incomes?

See above (13)

15. Should deferred annuities be included in the toolkit for DC retirement solutions?

Yes. See above (13)

16. Are there other ways of helping members hedge longevity risk?

Yes see above (13). Other strategies, such as pooling members, can operate to extend the portfolio life expectancy, either when other assets are depleted, or only from a vesting date onwards. These options maintain some flexibility for members over annuities and could be used to supplement or substitute for them.

Overall this may lead to a somewhat higher overall risk setting which is better utilising the long time horizon a member living beyond life expectancy has to adjust to as both an opportunity and threat. Higher investment returns create a bigger pie to smooth across a long horizon. The different designs allow this gain to flow to members and their beneficiaries in different ways but also have different levels of income certainty as well.

Given current retiring members in QSuper have limited adequacy, on average; this will be a material benefit and we favour solutions that provide flexibility along with certainty. Annuities can be a very useful piece of that strategy but not the whole.

We are happy to share ideas on members pooling if it was of interest. These are only just developing within QSuper but we are cautiously confident they will be a part of our long term solutions.

17. Does investing through retirement, as an alternative to immediate annuitisation, have a significant role to play in meeting the retirement needs of DC savers?

Yes. Drawdown strategies from an invested pool are well understood. Flexibility is high and investment policy can be set consistent with the objective and risk tolerance of members. However members are drawing down on capital and will probably exhaust their assets, so sequence risk must be managed. On death or withdrawal, members always get back 100% of any remaining account balance so members will feel ownership.

The disadvantages are that, while investment choice and flexibility in drawdown rates empowers members to plan and react to various risks and challenges, individual expertise and management is required. They can make adjustments over time providing capital access for emergencies but there is very limited longevity risk management. Only potential way to address longevity risk is to invest more aggressively overall to aim for higher expected average long term returns.

The drawdown strategy is very hard because members have to plan around some life expectancy. They can use average life expectancy but that is only 50% certain which is a very low planning threshold. Almost certainly they will need to plan for an extended life and that will mean restricting consumption early in retirement.

These constraints can be mitigated somewhat by using budgeting techniques like bucketing to set up different pools and drawing from them differentially and then matching investment time horizons. It is however very complex and would need ongoing management, even as members faculties and vigour decline later in retirement.

18. If you were designing a default drawdown strategy for NEST members, how would you do it?

We believe such approaches will require innovation and are therefore interested in solutions that address the following issues:

governance – including setting pay-out rules
asset allocation and risk management
flexibility for members
incorporation of insurance for market and longevity risk.

Picked up in answers to questions above.

19. Should NEST consider some form of risk sharing as part of a solution for NEST members in retirement? If yes, what sort and why?

Yes as described in question 16.

20. Would there be benefits in combining a risk sharing approach and pure DC, and if so, what would these be?

Yes as described above.