29 January 2021

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

Email prebudgetsubs@treasury.gov.au

Dear Sir/Madam

Pre-Budget submission (2021-2022)

The Actuaries Institute ("the Institute") is the professional body for Actuaries in Australia. It educates members and supports ongoing professional development. The Institute is also active in contributing to public policy debates where its members have relevant expertise.

The Institute provides commentary on public policy issues where there is uncertainty of future financial outcomes. We strive to act in the public interest and our contributions to public policy issues are guided by the principles of transparency, a 'level playing field' and good regulation (proportional and the most appropriate regulatory tool/s).

This submission notes a few areas where our members have expertise and insights. The Institute encourages Treasury to consider, as part of its pre-budget deliberations, some of our views in the areas of retirement incomes, natural disaster resilience, intergenerational equity and the rise of the 'gig' economy.

Retirement incomes

Actuaries have a long tradition of participating in the retirement incomes system and contributing to public policy, including, for example, in the Institute's extensive submission to the Retirement Income Review.

As the Government considers the report of the Retirement Income Review, the Institute encourages it to:

- Legislate, in accordance with the suggestions of the Review, to provide an overall objective for the Retirement Income system which takes into account the key elements of Adequacy, Equity, Sustainability, and Cohesion.
- Consider establishing a task force to consider ways to simplify regulatory requirements throughout the superannuation system. An example could be introducing a merged asset and income test, where some portion of the home is allowed for in the test.
- Review areas where retirees need additional support. An example is to increase rental assistance to provide greater retirement income adequacy for those in need.
- Work through the complex interactions involved in setting the ultimate SG level and seek community support for the pathway to it. The most appropriate superannuation contribution rate is likely to be in the range of 9.5% -12% to ensure most Australians live in dignity in retirement.

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- However, the complex and difficult question which needs to be addressed is the level at which compulsory SG contributions should be set. Some of the complex interactions that will need to be considered include the government's overall objective for the compulsory SG system, its interaction with the Age Pension, rental assistance and other forms of welfare that support older Australians, as well as whether other assets such as the home could or should be used to provide some income in retirement.
- In determining the level adequacy sought from a compulsory SG system, consideration needs to be given to matters such as the assumptions used in relation to retirement income indexation (e.g. to keep pace with a measure of inflation or wages growth), broken work patterns and involuntary early retirements.
- Further, we note that a higher rate of SG will reduce future Age Pension costs and give more income to retirees throughout the whole of retirement, including helping them deal with improving longevity and potential aged care needs.
- Enable the provision of appropriate financial advice for all Australians at an affordable price.
- Early finalisation of the requirements for the Retirement Income Covenant such that funds can confidently develop retirement income products ahead of the legislated start in 2022.
- Oblige trustees to develop default retirement products, and to consider providing longevity protection along with unbiased information that outlines the relative benefits of such protection.

Climate Change and Natural Disaster Resilience

The Institute continues to have a strong interest in climate change and the potential impacts on the financial services sector as indicated in its updated Climate Change Public Policy Statement released in September 2020. The Statement outlined the Institute's positions on the Paris Agreement, resilience, adaptation, and how the profession can positively contribute to the public policy debates over how to best develop cost-effective responses to climate change.

As indicated by the Australian Actuaries Climate Index, for example, there is a clear trend that across much of Australia temperatures are warming, extreme dry conditions are becoming more frequent and average sea levels are rising, relative to the longer-term historical averages and occurrences. These clearly observed trends will disrupt Australian lives, property, and economic livelihoods, yet with proper planning and measured action adverse consequences can be minimised and new opportunities realised.

The Institute commends the work of the Royal Commission into National Natural Disaster Arrangements and the Government's response. As articulated in the Institute's submission to the Royal Commission and previous pre-budget and other submissions, there are significant benefits to gained from a greater emphasis of funding being pre-disaster (including through timely and effective mitigation and adaptation investments informed by detailed and nationally consistent data) rather than post-disaster. We look forward to the Commonwealth's support for this being reflected in the Budget.

Both the final reports of the Royal Commission into National Natural Disaster Arrangements and the Australian Competition and Consumer Commission's (ACCC) Northern Australia Insurance Inquiry note the importance of reconsidering building codes as part of improving Australia's resilience. The Institute strongly encourages reconsideration of the Australian Building Codes

Board's remit to explicitly include consideration of proportionate and cost-effective protection of property over the expected lifetime of the building. This requires that likely future conditions which may affect structures over their design lifetimes be explicitly considered.

As also identified by the ACCC report, affordability of insurance is a challenge for some communities. With the likelihood of a longer-term overall increase in climate-related risks (including changes in which regions are most affected) and the multidecadal nature of some mitigation and adaptation investments, affordability is expected to persist as a challenge for some time. As noted in the Institute's Research Paper, *Property Insurance Affordability: Challenges and Potential Solutions*, there are a range of solutions involving multiple stakeholders, including government, that can be considered. The Institute encourages the Government to consider these options and the principles put forward in that paper as it responds to the ACCC's report and provides any necessary funding.

In 2020 the Institute published an Information Note to assist actuaries, and suitable for other stakeholders, understand the full range of potential effects of climate change and how the risks can be managed. While 'physical risk' (the first-order risks from weather-related events) is well appreciated and researched, 'transition risk' (the financial risks arising from a transition to a low-carbon economy) is less well appreciated yet can have significant consequences (e.g. assets becoming unexpectedly 'stranded'). 'Liability risk' (e.g. that Directors or trustees may be held responsible for failing to mitigate against the physical and/or transition risks of climate change on their organisation) Is also becoming an area of growing importance to deeply understand if that risk is to be efficiently managed. The Institute encourages the Government to consider these risks, including as it prepares its Statement of Risks in the Budget.

Intergenerational Equity

Many topics that the Institute takes public policy interest in have intergenerational implications. For this reason, the Institute commissioned the construction of the Australian Actuaries Intergenerational Equity Index as part of a green paper launched in August 2020. It found that the gap in wealth and wellbeing between older and younger Australians is wider now than it has been for at least two decades. The index itself is a composite of many different indicators related to intergenerational fairness, with the increasing gap attributable to trends in economic, housing and environmental indicators.

On the **economic** indicators, the research found that recent asset price appreciation has disproportionally advantaged older Australians, with an 87% increase in net wealth for the 65-74 age group compared to a 20% increase (off a much lower base) for those aged 25-34. Much of government expenditure is targeted at services that go to older Australians, such as pensions, health and aged care, and this spending has skewed further to older Australians over time. And increasing net debt is commonly recognised as a cost passed onto future generations.

On the **housing** front, where much of the asset price inflation has disproportionately advantaged older Australians, home ownership has dropped precipitously for younger Australians; the rate for those aged 25-34 has slid from 51% to 37% in 17 years, compared to relatively little change for those aged 56-74. High house prices have made market entry more difficult. Since housing is an important store of wealth and is often a key to a comfortable retirement (poverty rates are higher for age pensioners who do not own property), this trend is a concern and highlights the importance of understanding any linkages between higher savings levels in other assets such as superannuation and lower levels of home ownership[1], as

[1] Noting that other factors, such as those on the supply side, are also important.

well as the merit of increasing rental assistance and other targeted welfare benefits to non-home owners.

The **environmental** indicators reflect adverse trends in temperature, rainfall and biodiversity; such long-term trends are important when considering the world that today's young people will inherit. While Australia cannot singlehandedly avoid global climate change, it can implement a carbon emissions reduction strategy that meets global commitments and provides investment certainty for business. Doing so will help reduce the most severe of the physical, transition and liability risks noted in the previous section.

Some of the indicators show positive trends (for example, significant reductions in crime which disproportionately affects younger people), however the overall findings suggest that intergenerational tensions are growing and should be considered in policy settings. This need is further heightened during the COVID-19 pandemic, where many intergenerational effects have been accentuated. Increases in unemployment are greatest for younger Australians, and there is past evidence of long-term labour market scarring for those who enter the labour market during a recession. This, combined with increased government debt, means that while the direct health impacts of COVID-19 fall more heavily on older Australians, the young shoulder much of the economic burden.

While the green paper does not provide detailed policy recommendations, it does point to existing policy thinking around each of the domains in the intergenerational equity index, many of which address intergenerational concerns. This includes existing Institute work on retirement incomes, climate change adaptation and mitigation, and private health insurance. We appreciate some of these issues may be better explored in the forthcoming Intergenerational Report.

Rise of the gig economy

Research published in 2020 by the Institute, *The Rise of the Gig Economy and its Impact on the Australian Workforce*, indicates the gig economy is growing fast and brings both opportunities and risks to the broader economy and its workers. Using non-traditional data sources, the Institute estimates that since 2015 the gig economy for platform intermediated food delivery and private transport has grown 9-fold to capture $6.3 billion in annual consumer spending, and to involve as many as 250,000 workers.

A granular understanding of the gig economy workforce population is necessary to understand the opportunities and risks. These will, for example, be very different for a younger gig worker remaining in this model of employment for an extended period as their main source of income, compared with an older worker using it to supplement more traditional employee income. Their superannuation, life insurance and health insurance needs will differ significantly. Specific areas where implications for policy should be considered include compulsory superannuation coverage and the flow on impacts to future age pension costs, as well as the potential for under-insurance and the financial risks this imposes on gig economy workers. We note these implications may be different for gig workers and more traditional self-employed workers who are also seeking to build up financial capital in their business as a form of savings. This distinction further highlights the value in obtaining a more granular understanding of the gig workforce and its subsets.

Traditional labour data are limited in their ability to identify gig economy workers and cannot provide such a granular characterisation. The Institute encourages the Government to improve the data available to understand this segment of the labour market. The Business Longitudinal Analysis Data Environment (BLADE, Department of Industry, 2017) and the Multi-Agency Data

Integration Project (MADIP, ABS) are statistical resources that may assist. Alternatively, augmenting design of traditional labour market and household-based surveys to directly measure the size and composition of the gig economy workforce, such as the Household, Income and Labour Dynamics in Australia (HILDA), may assist.

Should you wish to discuss any aspect of this submission or make arrangements for a meeting with Institute representatives please contact Elayne Grace, Chief Executive Officer of the Actuaries Institute, elayne.grace@actuaries.asn.au or phone (02) 9239 6100.

Yours sincerely

Jefferson Gibbs
President