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31 January 2013

Mr Bill Brummitt
Budget Policy Division
Department of the Treasury

Dear Mr Brummitt

Policy Options for Increasing Life Event Savings – 2013-14 Budget Priorities

Abacus – Australian Mutuals is pleased to table the attached *Policy options for increasing life event savings* paper on behalf of the Friendly Societies of Australia (FSA).

Friendly societies are financial institutions that help safeguard individual wellbeing. Through the insurance bond framework, they have a long history of enabling individuals to save in readiness for these future 'life events', upholding the age-old adage: *saving for a rainy day*.

Friendly societies help Australians become financially independent through the provision of investment bonds, scholarship plans, funeral bonds, aged care facilities as well as retirement and insurance products.

Abacus is the industry association for Australia's $83 billion mutual banking sector, comprising 87 credit unions, seven mutual banks and seven mutual building societies, and through an agreement with the FSA, represents Australia's 10 APRA-regulated friendly societies.

Both Abacus and the FSA support measures that increase national savings, particularly among low and middle income earners. Abacus has prepared a separate submission on behalf of the mutual banking sector which, among other things, calls on government to correct inequities in the taxation of savings with Authorised Deposit Taking Institutions.

This paper sets out the friendly society industry's short and long term policy priorities for consideration as part of the 2013-14 Federal Budget and beyond. If implemented, these measures will substantially improve medium to long term financial and social adequacy for Australian families across all income groups.

A centerpiece of our life event savings policy platform is a proposed reduction in the tax rate applying to friendly society benefit funds and life insurance savings from 30 per cent to 20 per cent. This would be partially offset by welfare savings in specific areas that the respective increase in private expenditure would be applied too – namely, retirement, health and education.

The other headline proposal is a government co-contributions scheme for education savings, a significant reform that we believe is necessary to achieve the education targets set down under the 'Bradley' review of higher education and more recently, the governments Asian Century White Paper.

By introducing such a scheme, government will significantly increase the opportunities available to future generations through an increase in post-secondary education participation.

One short term, yet important issue that requires immediate attention is Proposal 5 - restoring a tax-free threshold to earnings paid to minors under scholarship plans, which are currently taxed at punitive rates as high as 66%.

A notional threshold previously applied up until 1 July 2011, however was inadvertently removed when the government introduced changes to the Low Income Tax Offset. Abacus calls on the Federal Government to restore a new threshold as a priority.

The policy options paper we are submitting for the forthcoming Federal Budget builds on existing research conducted in August 2011 by the Australian Centre for Financial Studies. In November 2012, Abacus asked the ACFS to cost the two chief policy options proposed in this paper. A copy of the research and the costings are included with this submission.

We encourage government to respond to the proposals contained in this paper. Please contact Luke Lawler, Senior Manager, Public Affairs

Yours sincerely

Mark Degotardi
Head of Public Affairs

Friendly Societies of Australia

Policy Options for increasing life event savings

1. Executive Summary

In August 2011, the Australian Centre for Financial Studies (ACFS) released a research report *Private saving: the role of life event products*[1] commissioned on behalf of the Friendly Societies of Australia[2].

The ACFS examined a number of savings mechanisms available to individual Australians and assessed their merits against the need to increase their current levels of discretionary savings for pre and post-retirement life events.

The research showed that individuals face a number of challenges over their lifetime, such as financing education, housing, health and retirement, for which many are unprepared.

The report noted that the financial challenges these life events create can be met, in part, through an adequate, sustainable savings pool or in other cases, government support. Conversely, a shortfall in these areas will directly impact the range of opportunities available to an individual over their lifetime.

The report concluded that the insurance bond framework, offered by Australian friendly societies, is the best mechanism to prevent medium-term savings shortfalls. However there is a disincentive for low to middle income earners to use these products.

Friendly Societies of Australia, as the body representing friendly societies, has developed policy options to address this disincentive, drawing on the report's recommendations alongside the industry's existing policy priorities.

While there is merit in all of the recommendations made in the ACFS 2011 paper, we believe that the policy options in this paper will be sufficient in extending the appeal of insurance bonds to a wider section of the community and in turn, encourage sustainable savings patterns that build medium-term financial adequacy.

The two centrepieces of this policy platform are:

1. A reduction in the life insurance fund tax rate applied to friendly societies from 30 per cent to 20 per cent.
2. The introduction of an education savings government co-contribution scheme to help stimulate this form of saving.

Our proposed reduction in the fund tax rate will address the disincentive identified by the ACFS by improving the relativity of personal tax rates to that levied within a fund. This recommendation is consistent with that suggested in the ACFS report.

The FSA also believes there is a case for a government co-contribution scheme that stimulates education saving within the community. Despite active marketing of scholarship plans by the friendly society industry, this form of saving remains low.

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[1] Australian Centre for Financial Studies, Private Saving: The Role of Lifecycle Event Products (August 2011)

[2] *Abacus – Australian Mutuals and the Friendly Societies of Australia were joint sponsors of the research. Abacus represents the interests of around 100 mutual banking institutions in Australia and 10 APRA-regulated friendly societies, on behalf of the FSA*

By illustration, in 2010-11, Australians personally spent around $36 billion on education[3] but only a fraction of that ($270 million[4] or .008 per cent) was met through structured education savings plan.

This paper sets out those policy options identified by the industry as reform priorities and is structured in the following way:

- Section 2 provides a summary of the policy options proposed;
- Section 3 explains the nature and function of friendly societies and life event products;
- Section 4 sets out the case in brief for reforming the taxation of insurance bonds;
- Section 5 tables detailed policy options that are designed to widen the appeal of these products to individuals across all levels of society; and
- Appendices I-III provides further supporting information.

These options should be considered in the context of the following long-term industry vision.

Our 2020 vision

Friendly societies are APRA-regulated[5] mutual and non-mutual financial services companies that provide savings and investment products in the form of bonds and scholarship plans.

The friendly societies' vision is to ensure:

- Australians have adequate savings to fund known life events such as the cost of a child's education, tertiary qualifications or a deposit for a first home;
- Australians have adequate savings to help them through difficult times; the cost of health or aged care, or the sudden expense of a funeral; and
- Australians are in better financial and social wellbeing through increased financial literacy and individual self-reliance.

To help achieve this vision, Australian friendly societies commit to:

- Providing low-fee products that represent good value, are easily understood, meet an express customer need and are inclusive to all levels of society;
- Maintaining exceptionally high standards for customers, centred around honesty, integrity and ease of access;
- Educating Australians about the benefits of medium term savings and the means by which they can safeguard their financial and social wellbeing; and
- Upholding core friendly society principles of mutual self-help, support and cooperation.

[3] *ABS*
[4] *Total earnings paid to scholarship plan beneficiaries, 2010*
[5] *There are a number of fraternal societies and friendly society pharmacies that are outside the scope of this paper.*

2. Summary of Policy Options in this paper

'Insurance bonds' primarily take three forms – investment bonds, used for a range of life events, funeral bonds to cover unexpected funeral expenses and scholarship plans, specifically designed for education saving.

They are medium to long-term savings/investment products that function as a form of 'self insurance' against specific known and unknown financial challenges.

Friendly societies are the main issuer of investment bonds (alongside mainstream life insurance companies) and the sole issuer of scholarship plans and funeral bonds in the Australian market today.

The recommendations in this paper focus on investment bonds and scholarship plans.

Outcome A: Improving financial adequacy (page 9)

Treasury should review the taxation of investment bonds and introduce incentives that encourage their use in medium-term savings.

Policy Options:

1. Set the life insurance fund tax rate to 20 per cent, from its current rate of 30 per cent, as a primary incentive measure.
2. Review the design of certain rules within the investment bond framework, such as the 125% contribution limit and the 10-year holding period, to ensure these products remain flexible and keep pace with changing circumstances.
3. Retain the core features of the investment bond framework – its 'tax paid' structure and life insurance characteristics – which will ensure they remain attractive to individuals.

Outcome B: Increasing education opportunities (page 12)

Government should accelerate a program of encouraging education saving within the community.

Policy Options:

1. Introduce a fixed period, capped education savings government co-contribution scheme designed to stimulate this form of saving and build a healthy pool of funds over a relatively short period of time.
2. Restore an appropriate tax-free threshold to scholarship plan income earned by minors, which are currently taxed at punitive rates as high as 66%.

Outcome C: Eliminating inefficient, indirect state taxes (Appendix II)

All Australian governments should refocus their efforts on the elimination of stamp duties.

Policy Options:

State governments should:

1. Immediately abolish all stamp duty on any form of savings by individuals – including those from insurance bonds - to remove inconsistency across Australian states and territories and between savings products.
2. Commit to the abolition of stamp duty on life insurance policies over three years.

3. Friendly societies and life event products

Friendly societies are one of only five industries prudentially regulated by APRA[6]. Like life insurers and superannuation funds, friendly societies offer products and services that focus on specific life events.

Friendly societies offer products that allow individuals to undertake a discretionary, targeted savings strategy focusing on life events over a range of time horizons.

Investment bonds

Mainstream investment bonds

Investment bonds are multi-purpose life event savings vehicles that are used to prepare for a wide range of life events, such as funding education costs, house deposits, and health and aged-care costs.

They also have a number of strategy-based applications, such as pre-emptive intergenerational wealth transfer and estate planning through the ability to nominate beneficiaries. On death, the balance of the bond is paid tax-free directly to the beneficiary rather than to the estate, avoiding potential disputes and claims from third parties.

Investment bonds are similar in form to a managed fund, except they are 'tax paid', in that earnings within the fund are taxed at the rate of 30 per cent, and non-distributing, with after-tax returns reinvested within the fund.

They can be capital guaranteed (investing in cash and other conservative investments) or unit linked (where investors' funds are pooled together in order to provide individuals with access to investment opportunities that may not otherwise be available to them).

Investment bonds have features that shape their longer-term, savings-based nature, most notably a 10-year holding period, where accumulated capital and earnings are accessible tax-free after ten years. A 125% contribution rule allows for ongoing contributions into the fund over the life of the bond.

Funeral investment bonds

Funeral bonds are also tax paid, capital guaranteed investment bonds but without specified limits on contribution amounts (other than for means testing for pensions) and holding periods, with the amount of the bond paid only on death of the bond holder.

All funds are paid either to the Estate or a Funeral Director (via assignment) and tax is payable by the recipient on earnings, less a 'termination bonus' that equates to the tax paid by the fund.

Scholarship plans

Scholarship plans are a variant of an investment bond but with a specific tax treatment under the Income Tax Assessment Act 1997[7]. They are specific-purpose life event savings vehicles used to fund the education expenses of children across all levels of schooling – from primary through to secondary - or adults pursuing tertiary or skills-based qualifications and carry all of the benefits of investment bonds.

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[6] *APRA regulates Authorised Deposit-taking Institutions, superannuation funds, general insurers, life insurers and friendly societies*

[7] *Income Tax Assessment Act 1997 subsection 995-1(1)*

Under tax law, scholarship plans can only be established by a friendly society regulated under the Life Insurance Act. As the fund is designed specifically for education, it fulfils the requirements of a 'scholarship plan' under the ITAA. This allows the fund to receive concessional tax treatment, in the form of a rebate on the 30 per cent tax paid at the fund level, which in turns optimises the child's scholarship benefit.

Both the Tax Office and individual friendly societies have established protection mechanisms that maintain tax integrity and prevent abuse of the products:

- where plan earnings are not used for legitimate education expenses (defined in the ITAA), the 30% fund tax rate applies; and
- friendly societies incorporate their own caps on allowable contributions to prevent unreasonable use, which are determined by the society in line with the level of education a particular product is intended to fund.

Scholarship plans have a tax treatment more equitable for people on lower incomes and are more popular among this demographic. A 2008 study undertaken by the largest issuer of education savings plans in Australia, Australian Scholarships Group, showed that:

- only 2.3% of new members had a household income of over $100,000; and
- 68.7% of new members had a household income between $52,500 and $78,800.

4. Policy case for insurance bonds in medium-term financial adequacy

In its August 2011 research, the ACFS observed that:

> *Households face a range of possible life events, such as education, health, housing and retirement, which can require significant expenditures for which they are often inadequately prepared by way of saving or insurance.*

The ACFS suggests that government tax policy can also be structured to influence both savings and the design of financial products to assist people in providing for their own pre-retirement welfare.

At a policy level, the ACFS research noted:

> *Insurance bonds are a good example of a 'partnership model' in which individuals accumulate savings to meet expenditures and where some government contribution is involved via the tax concessions provided.*
>
> *It is also possible for that contribution to be achieved by government matching or co-contributions. However, at the current tax rate applied to friendly societies, the attractiveness of these products to low income individuals as a wealth accumulation vehicle is reduced.*

The ACFS research pointed to the insurance bond framework as a long-standing, simple, low-advice mechanism that has the potential to increase household savings and financial wellbeing.

However, the ACFS also made the following observation:

> *The Henry Review (2009) highlighted the lack of neutrality in the tax treatment of various savings products. With the dominance of the superannuation system in public policy, incentives to encourage individuals to be financially self-reliant and plan for the future through non-superannuation vehicles have gradually dissipated.*

The Henry Review, in its report to Government in December 2009 explains the impact of the tax and transfer system in this and other areas, arguing that:

> *"Living standards are also undermined by tax settings that discourage people from making choices that would yield greater lifetime wellbeing"*[8]
>
> "*There* [under the tax and transfer system] *would be clear incentives for people to improve their lifetime opportunities through workforce participation, investing in education or saving".*[9]

The ACFS research drew a key conclusion:

> *To enhance the use of this investment vehicle, and also to counterbalance the preferential tax treatment given to a range of other investment strategies, there is merit in considering changes to the current tax and legislative treatment of friendly societies and insurance bonds.*

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[8] *Australia's Future Tax System*, Part One, p24
[9] *Australia's Future Tax System*, Part One, p26

Friendly Societies of Australia

The FSA commends the ACFS findings. The insurance bond framework is a well-developed, mature mechanism that with only modest changes, will:

1. Strengthen the medium term financial adequacy of a wider group of people than the current financial services framework provides for.
2. Increase the range of social and economic opportunities available to Australians through a growing and sustainable savings pool.

Friendly Societies of Australia

5. Policy Options for encouraging medium-term discretionary savings

The following policy options should be considered if we are to help Australians position themselves to meet life's major financial challenges.

These options firmly uphold the central principles within Treasury's *Wellbeing Framework*, which shapes much of economic and social policy in Australia. Treasury defines 'wellbeing' by a person's substantive freedom to lead a life they have reason to value[10].

The FSA contends that inadequate discretionary savings among Australians is a major challenge - both now and in the future - to securing the economic and social wellbeing of individuals and communities.

The FSA believes there should be no tax disincentives for low and middle income earners to utilise medium-term savings vehicles. The fund tax rate for insurance bonds should maintain or improve relativity to personal tax rates for these two income groups and government should seeks ways to encourage higher savings for key areas such as education.

Outcome A: Improving financial adequacy using investment bonds

Investment in the insurance bond framework (in real terms) has declined significantly, primarily due to a combination of increases to the tax rate applying to fund earnings[11] and concurrent changes in aged-pension means testing rules and personal income tax rates.

This has served to gradually move insurance bonds out of reach of those they were traditionally designed to serve – lower income earners or those with limited financial resources.

The current taxation rate of 30 percent, coupled with a design framework that prevents the pass through of CGT discounts available under other investment classes, has entrenched this situation.

For a middle income earner on a tax rate of 32.5%, there is very little to be gained by saving using an insurance bond. For people on the low incomes, there is no direct financial benefit due to the relatively high fund tax rate.

Treasury should review the merits of investment bonds as a medium-term mechanism for improving financial adequacy and social wellbeing

The FSA proposes that specific focus be given to:

- introducing tax incentives that stimulate medium-term discretionary savings among low to middle income earners, taking into account the relativity of the current fund tax rate to personal income tax rates; and
- reviewing other aspects of the investment bond tax framework that increase flexibility while preventing tax leakage.

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[10] *Treasury's Wellbeing Framework*
[11] *Zero to 20 per cent in 1983 then 30 per cent in 1988*

Friendly Societies of Australia

Proposal 1: The life insurance fund tax rate should be lowered to 20 per cent, from its current rate of 30 per cent, as a primary incentive measure[12].

Estimated cost to revenue[13]: $95 million per annum, in two parts:

1. *$70 million each year based on the existing pool of insurance bonds.*
2. *A further $25 million per annum based on an estimated increase in take up.*

Timetable: Consider as part of the 2014-2015 Federal Budget, with implementation on 1 July 2015

A 20 per cent tax rate lies sufficiently below the main marginal tax rate of most Australians (32.5%) and above the superannuation rate of 15%. It will widen the attractiveness of insurance bonds to virtually everyone above a minimum wage.

Australia's superannuation system is now maturing and with a staged increase in the super guarantee to 12% by 2019, more Australians will enjoy an adequate income during retirement.

Investment bonds offer a platform for financial adequacy outside retirement however at the current tax rate of 30 per cent, lack the universal appeal needed to ensure they are a sustainable option.

The timing for such a measure is ideal. In the emerging 'fee for advice' landscape, investment bonds represent a low cost option because they are simple to understand and administer compared to more traditional managed funds.

In today's economic climate, Australians are focused more on saving, creating an opportunity to support products that direct these savings to a medium term strategy-based pathway, rather than riskier wealth-based mechanisms that have performed poorly in recent years.

It's important that the final shape of the tax framework preserves the benefits and attractiveness of insurance bonds to all Australians, regardless of their income, while ensuring the tax concessions available to any particular group does not move these products ahead of superannuation.

Therefore, while the FSA does not support the exclusion of high income earners from this proposal, there may be scope for corrective measures that balances tax equity across all income groups.

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[12] This can be achieved through a simple amendment to life insurance fund tax rate specified in Section 23A of the Income Tax Rates Act (1986) cth

[13] In September 2012, the FSA asked the Australian Centre for Financial Studies to cost the effects of changing the tax treatment of life event products. Appendix III contains a summary of their methodology and findings.

Friendly Societies of Australia

Proposal 2: Review the design of certain rules within the investment bond framework, such as the 125% contribution limit and the 10-year holding period, to ensure these products remain flexible and keep pace with changing circumstances.

Estimated cost to revenue: Revenue neutral

Timetable: Consider as part of the 2014-2015 Federal Budget with implementation on 1 July 2015

Under this rule, an investor can contribute a maximum of 125 per cent of what they contributed the year before. Exceeding this amount triggers a 'restart' to the 10-year minimum holding period. While the restriction limits the amount an investor can increase their contribution by each year, it also acts as a defacto minimum in that if an investor misses a year, no further contributions can be made without a restart.

This is a worthwhile tax integrity measure that also serves to encourage a sustained annual savings discipline but a review of its functionality in the current investment climate may be warranted.

For example, there is no 'grace period' available to an investor if they are late with a contribution in a given year, even if this is one day. An investor that misses a contribution in an investment year is unable to make further contributions for the remaining term of the bond.

This rule may also unfairly impact investors experiencing temporary financial hardship that leads to them missing a contribution year.

The ACFS report considered these issues and recommended that:

> *The current annual contribution cap of 125 per cent of the previous year's total contribution should be reviewed against an alternative annual cap expressed as a proportion (declining over time) of total accumulated contributions to date – to cover situations of a contribution gap or lower contribution in some years.*

The FSA sees merit in this approach, however the tax integrity of the framework must be maintained. The 125 per cent rule encourages regular, ongoing savings into the bond at an early stage and ensures those funds remain invested for its term.

The 10-year holding rule that applies to investment bonds is an important feature that ensures funds are invested for medium to long-term goals. However some individuals, particularly those with a higher degree of financial sensitivity, may see this as a deterrent.

The ACFS report notes that the 10-year period may create difficulties for those contemplating saving for shorter term goals.

The FSA believes there may be scope for a modest reduction in the term – no earlier than seven years – if this widens the appeal of this product without compromising its valuable role as a medium term savings product.

Proposal 3: Retain other features of the investment bond framework – its 'tax paid' structure and life insurance characteristics – which will ensure they remain attractive to individuals.

Investment bonds contain key features that are a mark of their simplicity in tax administration and compliance and effectiveness in wealth distribution.

The inherent simplicity of investment bonds also reduces the need for extensive financial advice, making them ideal for lower income earners, the benefits of which are highlighted in the ACFS research:

> *The growth of the financial advice industry…in an increasingly complex financial world…has brought with it…problems of conflicts of interest, suitability of advice, and levels of fees. For many individuals, financial advice is an unaffordable luxury.*[14]

The 'tax paid' nature of friendly society benefit funds makes them easy to understand and carry minimal tax administration or accounting requirements. Because there are no tax implications for investors prior to the withdrawal of funds, there are no obligations to include changes in their investment value in annual tax returns.

Specific tax allowances that allow for tax-free early withdrawal due to death, disability or illness upholds their core life insurance principles and must be retained. The ability to nominate a beneficiary means these bonds can be used strategically as a tool for the efficient intergenerational distribution of wealth or the notional transfer of 'welfare benefits'.

[14] *Private saving: the role of Life Event Products, page 6*

Friendly Societies of Australia

6. Policy options that increase education opportunities

Successive governments have placed education at the forefront of long-term economic prosperity. Most recently, the federal government, in its *Australia in the Asian Century* White Paper (October 2012), noted that:

> *...as a nation we must do even more to develop the capabilities that will help Australia succeed. Our greatest responsibility is to invest in our people through skills and education to drive Australia's productivity performance and ensure that all Australians can participate and contribute.*

In this new 'Asian Century' strategy, the government has flagged skills and education as one of the five 'pillars of productivity' on which Australia's future standing in the region will be built.

Importantly, there are already targets for increased skills and participation in place, established in 2009 following the 'Bradley' review of higher education. Two notable measures are:

1. 40 per cent of all 25-34 year olds should hold a bachelor qualification or higher by 2025.
2. 20 per cent of all undergraduate enrolments coming from people with lower socioeconomic backgrounds by 2020[15].

The new school funding model proposed under the Gonksi review, and accepted by the government, is timely in that it has the potential to increase the quality of our education institutions and in turn, our nation's talent.

The next big policy question is what mechanisms can be applied to increase overall participation rates among those groups with the least capacity to do so while maximising the level of education achieved among those that do?

To help meet its stated education targets, government should accelerate a program of education savings within the community

> ***Proposal 4: Introduce a fixed period, capped education savings co-contribution scheme targeting post-secondary education.***
>
> *Estimated cost to revenue: $6.3 million initially, climbing incrementally to just over $100 million per annum over 10 years[16].*
>
> *Timetable: Consider as part of the 2013/14 Federal Budget with a commencement date of 1 July 2015*

The objective of this proposal is to both focus public attention on the benefits of education savings and provide a 'stimulus' that increases household savings activity.

The scheme would be available to all households that make contributions to a scholarship plan[17] issued by a friendly society and would adopt the basic characteristics of a contribution amount, a cap and eligibility rules.

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[15] *Transforming Australia's Higher Education System, 2009, page 12.* *http://www.deewr.gov.au/Department/Publications/Documents/TransformingAusHigherED.pdf*
[16] *Costing was conducted by the Australian Centre for Financial Studies in November 2012 and is set out in detail in Appendix III*
[17] *As defined under the Income Tax Assessment Act 1997 s 995-1(1)*

Government could use the existing opportunities presented by its current education reform program to actively promote the scheme. For example, the scheme could be promoted alongside the annual Schoolkids Bonus.[18]

The Schoolkids Bonus is designed to help parents with the cost of schooling in primary and secondary years while the education savings co-contribution scheme proposed in this paper is targeted at helping fund post-secondary education, making both schemes highly complementary.

There is also a case for linking these two schemes, where parents can opt to receive one, or both part-payments of the Schoolkids Bonus as a payment into a scholarship plan rather than cash, noting that the availability of the bonus should remain with lower income earners.

Whichever the approach, a much larger pool of 'public-private' education funding could emerge within a relatively short period of time. This will help address lower education participation rates, particularly among low and middle income households, and widen the range of education pathways available to a young adult when their plan matures.

Table 1
Benefit to a student where parents save $10 per week towards their child's education:

Scenario A: Benefits under a co-contribution scheme	
Age of student	18 years
Personal contributions made	$9,360 over 18 years
Government matching contributions	$2,500 over five years
Interest earnings	$8,349 accrued
Savings balance	**$19,606**

Scenario B: Benefits under a co-contribution scheme with full Schoolkids Bonus reinvested	
Age of student	18 years
Personal & gov co-contributions made	$11,860 over 18 years (5 via co-cont)
Schoolkids Bonus reinvested (7x pr + 6x sec)	$7,790 over 13 years
Interest earnings	$11,112 accrued
Savings balance	**$30,762**

Methodology:
$10 personal contribution made every week for life of plan. Government co-contribution of $500 per year for first five years, paid in arrears. Interest earnings of 5%. Tax rebate already added back (neutral tax-free outcome)

A scholarship plan owner (usually a parent, grandparent or another sponsor) could participate in the scheme on a child-by-child basis over a fixed, five year period that commences within the first two years after the birth of a child, with government matching, dollar-for-dollar, annual contributions up to a maximum of $500 per year.

The scheme should specifically target post-secondary education, be that tertiary study, TAFE or other forms of skills and vocational training. This can be achieved by preserving the co-contribution made by government (both the capital and income component) until the time the student beneficiary reaches a minimum school leaving age of 17.

There should be no restrictions on withdrawing personal contributions made by the plan owner earlier. Scholarship plans are designed to fund education expenses across all levels of schooling and this flexibility must be maintained.

[18] *Announced as part of the 20120-13 Federal Budget and replaces the Education Tax Refund*

Friendly Societies of Australia

However, creating a 'lock-in' period of a proportion of these savings over a child's entire schooling life will allow sufficient time for the amount of the co-contribution to generate a sufficient amount of earnings.

The integrity of the scheme would be maintained via the existing ATO-defined 'sole purpose test', which removes the existing concessional tax treatment on earnings if they are not used for legitimate education expenditure.[19]

There are other considerations that would need to be discussed with industry as part of a consultation process, such as entry and exit rules (particularly around any unused contribution amounts), timing and eligibility.

The FSA reiterates that the existing tax regime specifically established for scholarship plans back in 2003 is well-placed to address any major tax integrity concerns and facilitate a relatively easy design and implementation phase of the scheme.

A case for increasing Australia's personal education savings rate

There are several compelling reasons to introduce incentive-based measures that encourage education saving. A family that builds a sustainable pool of education funds can increase their financial adequacy and in turn:

- provide a child with a higher level of education, such as a tertiary degree, that may otherwise have been unaffordable;
- unlock new education pathways, such as TAFE study or vocational education and training;
- increase a child's level of education support, such as tutoring and coaching or exam preparation; and
- relieve financial pressure by using savings to cover ancillary education costs (such as uniforms, travel or textbooks) or simply smoothing the impact of education costs over time.

These are significant benefits at an individual level, with flow on collective benefits for Australian society. A large pool of national education savings could potentially:

- boost Australia's long-term education capacity;
- increase workplace productivity and participation rates; and
- widen employment opportunities and subsequent earnings capacity.

Such outcomes support the first of the federal government's twenty-five national objectives for its Asian Century strategy[20]:

> Skills and Education: *All Australians will have the opportunity to acquire the skills and education they need to participate fully in a strong economy and a fairer society.*

One pathway of relevance to friendly society products is:

> *Increase participation among groups currently under-represented in the workforce, including through education and training, child care, paid parental leave, employment services and assistance for older Australians, so that more Australians can benefit from the Asian Century.*

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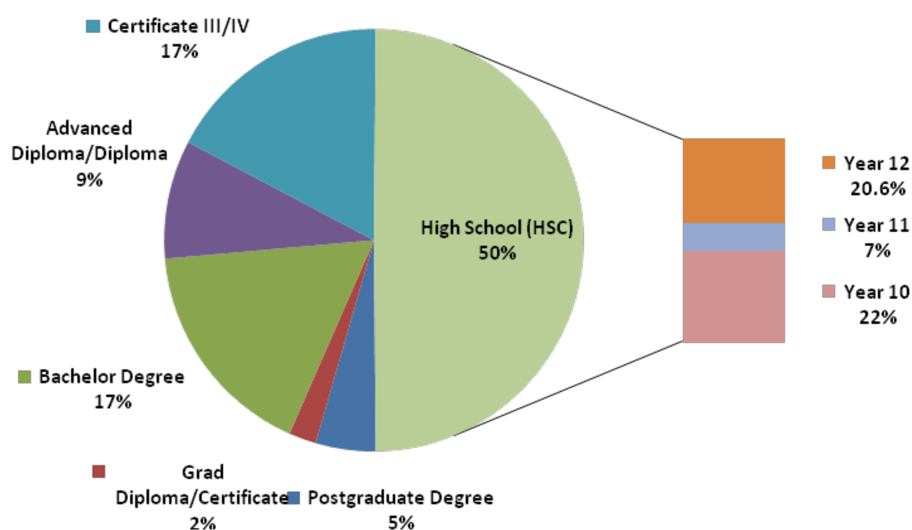
[19] Under tax law, if the earnings under these plans are not used for legitimate education expenses, then the 30% tax paid at a fund level applies to these earnings and is assessed in the hands of the parent investor, not the child. Where the investor is on a higher tax bracket than 30%, further tax is payable.
[20] http://asiancentury.dpmc.gov.au/white-paper Page 10

The FSA believes that participation rates are a function of access, which is driven by affordability and means. A national program of education savings could mitigate, or even overcome affordability problems and make a wide range of education pathways available to more people, regardless of their socio economic backgrounds and beyond what government welfare support can currently sustain.

Illustrating the size of this challenge, 2011 ABS Census data reveals that half the Australian population had not yet achieved education qualifications beyond high school and 17% held a bachelor qualification.

Chart 1: Highest level of education attained among Australians 2011



Currently, the friendly society industry manages over $1.6 billion in education savings on behalf of 190,000 students up to tertiary age. Depending on the level of schooling, students can have, on average, $9,000-$14,000 in funds to put towards an education.

These are healthy numbers in real terms however when viewed against the wider population, the current pool of funds equates to around $230 for every child and young adult in Australia between the age of 0-24 years, providing an insight into how small Australia's education savings rate is in relative terms.

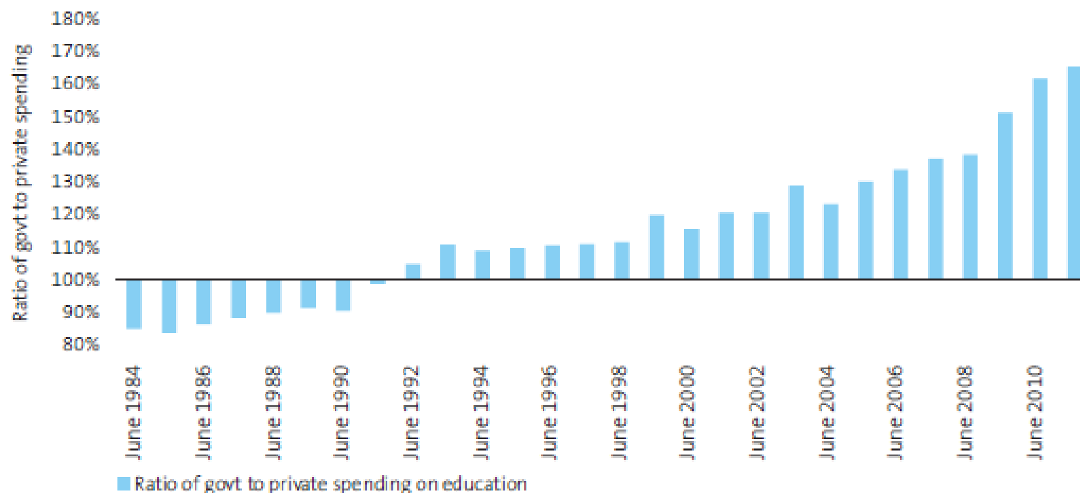
In the latest AMP.NATSEM Income and Wealth Report: *Smarter Australians*, which explores education and innovation in Australia, education was found to be among the top 15 expenditure items for Australian families and in the last six years, average family spending on preschool and primary school education had risen by 79 per cent and spending on secondary education increased even more at 101 per cent.[21]

The same report (graph below) showed that the ratio of government to private expenditure on education had increased substantially between 1984 and 2011. In 1991, Australians spent the same amount on their education as government; now, government expenditure is 65% higher than private expenditure (2011) and rising each year.

[21] http://www.natsem.canberra.edu.au/storage/AMP.NATSEM%2032%20Income%20and%20Wealth%20Report%20-%20Smart%20Australians.pdf

Friendly Societies of Australia

Figure 2 Ratio of government to private expenditure on education, 1984–2010



Source: AMP.NATSEM Income and Wealth Report issue 32 October 2012

If incentive-based reforms are successful in encouraging a higher rate of private, discretionary savings to fund education expenses, it is reasonable to expect a commensurate easing in household financial pressure and a gradual fall in reliance on government support for education.

Government co-contribution schemes are driven by these principles and have been used as a 'stimulus' in a number of areas of national concern, including health, retirement and housing, however one is yet to be considered for education.

The success of the superannuation co-contribution scheme indicates that Australians may respond to similar scheme for education. Over the three years from 2008-2011, 1.35 million Australians on low to middle incomes utilised the super co-contribution scheme, a significant reaction given the long-term nature of retirement savings.

Education savings are medium-term, discretionary savings vehicles. This means that people using these vehicles realise the benefits of their investment earlier than superannuation, have active control over their savings and therefore have a greater level of personal involvement.

The FSA believes this will have a significant influence on the success of an education co-contribution scheme, perhaps even greater than that seen with superannuation (in relative terms).

For any targeted savings incentives to be successful, a major obstacle to the growth of education savings in Australia must first be removed

> ***Proposal 5: Restore an appropriate tax-free threshold to earnings paid to minors under scholarship plans, which are currently taxed at punitive rates as high as 66%.***
>
> *Estimated cost to revenue: Nil for existing and future plans. The FSA proposes a threshold equal to the notional amount that was already available prior to the 2011/12 financial year.*
>
> *Timetable: Immediate, 1 July 2013*

Friendly Societies of Australia

The lack of any meaningful tax-free threshold and the high rate of tax on income earned by minors from scholarship plans is an unintended consequence that stemmed from the removal of the low income tax offset from non-work income earned by minors in 2001.

While the original policy behind this measure was sound (it would prevent high income earners from accessing the tax offset via the transfer of income to a child), it triggered a major jump in a minor's tax rate on any income[22] they withdrew from a scholarship plan.

On 1 July 2011, the tax rate increased from 0% to 66% for earnings between $416 and $1,307, and from 0% to 45% for earnings above that. This was due to a decrease in a child's notional tax-free threshold from $3,333 to $416.

This has a significant impact on existing beneficiaries. At the time of the change, nearly 60,000 Australian children under the age of 18 had in place a family-sponsored scholarship plan accumulating education savings on their behalf.

These plans were established by families on the understanding that the government's concessional tax treatment would remain, only to later find that the final earnings payment would be much lower should they decide to withdraw.

Industry evidence over 1 July 2011-30 June 2012 points to a concerning combination of a spike in plan closures and substantially slower product take up. One fund of around 6,500 members saw 600 investors withdraw completely in the first 12 months after the changes and 33 per cent less in new members over the same period.

There are only two friendly societies that offer scholarship plans in Australia. A third had just commenced offering these plans three months prior to the changes but has now closed this product line.

The FSA believes that the future of scholarship plans in the under 18 year old market is under a cloud – the specific tax benefits introduced by government years ago have been all but reversed.

This is a very unfortunate outcome for thousands of Australian families. Scholarship plans are unique – they are the only dedicated education savings vehicle in the market today and by law[23], can only be offered by a friendly society. Their tax integrity has never been in question being upheld through a sole purpose test that removes any taxation concessions if earnings are not used for their intended education purposes.

With the low income tax offset all but removed, government should announce a new tax-free threshold for these vehicles as a priority, set at $3,333 (the same as originally applied) and **indexed annually** in line with the CPI for education.

We believe the cost to revenue from this change would be negligible. The flow on impact of the LITO changes on education earnings was never foreseen and it is unlikely that the small revenue gain from an increased tax rate applicable to these plans was measured.

Therefore, the FSA believes there are no further revenue implications under this proposal.

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[22] *Where assessable in the hands of a student who is a minor (under Division 6AA rules) and not in the hands of a sponsoring adult Tax Laws Amendments (2011 Measures No 4) Bill 2011, Explanatory Memorandum, ch 2.*
[23] *Section 995.1 of the Income Tax Assessment Act 1997 defines a scholarship plan as a life insurance policy issued by a friendly society for the sole purpose of providing benefits to help in the education of nominated beneficiaries*

8. Conclusion

This paper presents a number of targeted policy measures that if adopted, will improve the financial and social wellbeing of individual Australians.

The FSA believes government should recognise the benefits an increase in medium-term savings could deliver to society and introduce measures that encourage people to utilise specific mechanisms best-suited to the task.

We believe the insurance bond framework is such a mechanism and can deliver significant benefits across a number of levels.

Financially, insurance bonds can:

- help increase overall national savings by encouraging a savings culture;
- boost private household wealth through a reduction in debt reliance and the smoothing expenditure on key life events over time; and
- increase financial literacy levels across a wide age group due to the planned, intergenerational, discretionary nature of the product.

Socially, insurance bonds can:

- increase the employment opportunities available to Australians by facilitating access to a higher standard of education;
- reduce reliance on government and social welfare by encouraging personal responsibility; and
- act as an efficient vehicle for intergenerational wealth transfer that doesn't become entangled in inheritance or personal bankruptcy issues[24].

We encourage government to respond to the recommendations tabled in this paper.

[24] Page 21 of the ACFS report points out that nomination of a beneficiary other than the investor enables intergenerational transfers directed at a specific purpose, and is not subject to intervention by other claimants on the estate of a deceased investor or in the event of bankruptcy

Friendly Societies of Australia

Appendix I – a short history of friendly societies in Australia

Friendly Societies were established in 1830 by ordinary Australians who, in response to a common need, formed mutual organisations to provide medical and other welfare-based services they lacked. They did so by establishing a collective vehicle by which people could pool their savings and share risk, and subsequently call upon the society in times of need.

Friendly societies boast a proud tradition in the development of financial welfare services commonly provided by governments today and arguably were a precursor to the modern welfare state[25], gave rise to private health insurance and were pioneers of the modern day financial services industry[26].

Friendly societies have traditionally encouraged and supported self-help in society, having been founded on the concepts of thrift, savings and the pooling or sharing of risks within a community.

Before World War One, around half of Australia's population had some form of an association with a friendly society. After World War II, society membership began to decline as social conditions, influenced by rapid economic growth, an abundance of work and the provision of government benefits, improved.

However, friendly societies evolved to focus on areas that were either under-served or received no form of welfare support.

In terms of asset size, the sector reached its peak in the early 1990s with assets of over $9 billion, however increases to the tax rate applied to funds under management and changes to pensioner means testing rules, alongside the introduction of concessional tax treatment for superannuation, saw friendly societies fall out of favour with the average Australian and financial planners.

Australian friendly societies today

Friendly societies are financial institutions that help safeguard individual wellbeing. Through the insurance bond framework, they have a long history of enabling individuals to save in readiness for these future 'life events', upholding the age-old adage: *saving for a rainy day*.

170 years since they first emerged in Australia, friendly societies still help some 1.5 million Australians become financially independent and plan for life events through the provision of investment bonds, scholarship plans, funeral bonds, aged care facilities as well as retirement and insurance products.

There are 10 active APRA-regulated friendly societies (with 14 registered but not trading), custodians for nearly $6 billion in funds under management on behalf of over 800,000 Australians.

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[25] Australian Centre for Financial Studies, *Private Saving: The Role of Lifecycle Event Products*, page 18
[26] The ABS in its Year Book Australia 2012, supports the notion that private health insurance was born from the friendly society movement in the 1840's.
http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/1301.0Main+Features2372012

Friendly Societies of Australia

Not all friendly societies offer financial services. Some provide aged care, health and pharmaceutical services, while a small number are fraternal societies engaged in social and community activities. It is estimated that a further 700,000 people are members of these societies. The Australian Bureau of Statistics, in its annual Year Book Australia, featured friendly societies as part of a wider examination of financial cooperatives in Australia[27].

Friendly societies play a small but important role in society. They are all about helping people to help themselves and bring choice and competition to customers and aid diversity in the wider market, which is vital to a healthy and stable financial services sector.

The prudent and responsible self-help savings culture pioneered by friendly societies preceded the state-sponsored social welfare that commenced early in the 20th century and has proven a worthwhile alternative since.

While this hallmark continues today, friendly societies have also shown they are innovative and responsive to change. Many societies have introduced expansive investment menus and the modern insurance bond operates like a 'mini master fund' in a tax paid environment.

The industry is also diverse, with institutions either specialising in specific products (such as Australian Scholarships Group, the largest provider of education savings plans in Australia) or running a highly diversified business (such as Australian Unity, which spans national healthcare, financial services, retirement living and even mutual banking).

Friendly societies also stand alongside life and general insurance companies, banks and superannuation funds as the most intensively supervised and regulated institutions in the Australian financial services industry.

All friendly societies are Australian Financial Services Licensees regulated by the Australian Securities and Investments Commission (ASIC) under the *Corporations Act 2001*. Societies offering financial products are also prudentially regulated by the Australian Prudential Regulation Authority (APRA) to the same, strict prudential standards as large life insurance companies under the *Life Insurance Act 1995*.

From 1 January 2013, life companies, including friendly societies will move towards a new, more risk-sensitive capital regime that is more closely aligned with general insurance standards.

This potentially makes them safer for investors compared to mainstream collective or managed investment vehicles not regulated by APRA, as their prudential regulation mandates that they hold adequate capital reserves to meet investor obligations.

[27] http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/1301.0Main+Features2722012

Friendly Societies of Australia

Appendix II: Friendly society industry view on the removal of inefficient indirect state taxes

The FSA believes that all governments should commit to the elimination of inefficient, indirect state taxes, starting with stamp duty on insurance bonds.

While stamp duty does not apply to savings in most investment products – such as superannuation, banking products, managed unit trust products, listed securities and unlisted securities (abolition being applied progressively), medium to long-term savings in life insurance products do attract stamp duty in every state except South Australia and Western Australia, and then only to the extent of the investment component.

In stamp duty terms, the continuing application of duty to insurance bonds is an anomaly that leads to a substantial competitive disadvantage.

Duty applies to insurance bonds issued by friendly societies due to their classification as a 'life insurance policy' however most bonds issued today are unit-linked investment policies. The main 'competing' vehicle to these products are traditional share investments and managed funds, which have been exempt from stamp duty in every state for nearly a decade.

Tax reform is the fifth priority in the federal government's twenty-five national objectives for its Asian Century strategy[28] and has the following stated aim:

> *Australia's tax and transfer system will be efficient and fair, encouraging continued investment in the capital base and greater participation in the workforce, while delivering sustainable revenues to support economic growth by meeting public and social needs.*

Stamp duties are highlighted as a priority reform pathway:

> *Facilitate State and Territory-led tax reform, to phase out their inefficient taxes and make better use of their efficient tax bases.*

The FSA strongly supports this position.

State governments should immediately abolish all stamp duty on any form of savings by individuals – including life event savings, whether on premiums or on assignments, to remove fiscal inconsistency across Australian states and territories – and between savings products.

They should also commit to the abolition of stamp duty on life insurance policies over three years.

The argument for abolition of stamp duty on life event savings should also be considered in the context of the compliance costs (for both the revenue authorities and industry) in proportion to the quantum of duty collected in this area.

[28] http://asiancentury.dpmc.gov.au/white-paper *Page 12*

Friendly Societies of Australia

Appendix III – ACFS analysis of budgetary costs for headline policy proposals

The following pages contained edited summaries of the following two reports prepared by the Australian Centre for Financial Studies in November and December 2012:

1. Changing the tax treatment of life event products: costing the effects.
2. An education savings co-contribution scheme: estimating the budgetary cost.

These reports provide a guide to the potential costs of the two chief measures proposed in this paper.

AUSTRALIAN CENTRE FOR FINANCIAL STUDIES

Abacus
Australian Mutuals

Changing the Tax Treatment of Life Event Products:

Costing the Effects

26th October, 2012

An independent report prepared for Abacus by the Australian Centre for Financial Studies. Principal authors are Professor Kevin Davis (Research Director) and Mr Martin Jenkinson (Research Officer).

3. The Effect of a Tax Rate Change

The first calculation is to determine what will happen to tax revenue if the tax rate on friendly societies is reduced to 20 per cent. One consequence may be that the portfolio allocation of the societies shifts away from fixed interest to equities and within equities towards higher dividend yield/ lower capital gain stocks. In this case however, we assume initially that portfolio composition will not change as this will be driven by investors changing menu selections rather than by individual societies.

The difference between the corporate tax rate of 30 per cent and the proposed 20 per cent rate for insurance bonds complicates the tax calculation, which we explain in the context of Scenario 1. Taxation of interest income at 20 per cent rate is now 0.2 x $1 = $0.20. Franked dividend cash income of $3.75 will lead to a tax rebate of 0.375/0.7 = -$0.5357 (calculated by grossing up the cash dividend by $1/(1-t_c)$ and noting that tax payable is $3.75(t_p - t_c) / (1-t_c)$.[5] Capital gains taxation will be 0.2 x 3.75 =$ 0.75. Thus total tax paid is now 0.2 - 0.5357 + 0.75 = total tax of $0.41, on a pre-tax income of $8.5 which corresponds to an effective tax rate of 4.87 per cent. (Note that for a superannuation fund with the same portfolio, and with a tax rate of 15 per cent and only 2/3 of long term capital gains taxable the effective tax rate would be negative). The corresponding tax break-down after the reduction in the insurance bond tax rate for the alternative scenarios is provided in the table below.

Tax Payments (at tax rate of 20 per cent)						
	Interest	Franked Dividends	Unfranked Dividends	Capital Gains	Total Tax	Tax Rate
Scenario 1	0.2	-0.54	0	0.75	0.41	4.87%
Scenario 2	0.2	-0.43	0	0.9	0.67	7.90%
Scenario 3	0.2	-0.29	0.25	0.75	0.91	10.71%
Scenario 4	0.2	-0.29	0.2	0.9	1.01	11.93%

Using the total asset portfolio size of friendly societies of around $5.7 billion (greater than net policy liabilities due to capital and reserves), total pre-tax income using the assumed rates of return above would be 0.085*5.7 billion = $484.5 million p.a. Total tax revenue based on the

[5] Where t_p is the tax rate of the friendly society and t_c is the corporate tax rate.

statutory tax rate of 30 per cent giving an effective tax rate of 16.8 per cent would be $81.2 million. Changing the statutory tax rate to 20 per cent, giving rise to an effective tax rate of 4.87 per cent, would reduce tax revenue to $23.6 million.[6]

Total Asset Portfolio Size of Friendly Societies	5.7	Billion
Total Return of Friendly Societies	0.485	Billion

Tax Revenue Change: (assuming pre-tax rate of return of 8.5% on portfolio of $5.7 billion)			
	Tax Revenue at 30 per cent tax rate	Tax Revenue at 20 per cent tax rate	Tax Reduction $mill
Scenario 1	81.225 Million	23.614 Million	57.611
Scenario 2	94.050 Million	38.271 Million	55.779
Scenario 3	102.6 Million	51.87 Million	50.73
Scenario 4	111.150 Million	57.814 Million	53.336

A ball-park estimate of the cost to the budget, assuming no change in portfolio composition or change in scale of the sector of reducing the statutory tax rate from 30 to 20 per cent is thus $50-60 million p.a.

There is a minor caveat to the results above arising from the particular characteristics on education bonds. In the case of education bonds, withdrawals lead to investors recouping the tax paid on earnings within the fund, with that amount included with the earnings amount in the recipient's assessable income. Changing the tax rate from 30 to 20 per cent would mean that the gross amount received would be relatively unchanged, but would include a higher earnings component and less recoupment of tax. Thus lower tax inflows from earnings of the fund would be offset by lower tax outflows when the education bond is redeemed, suggesting that the main effect is a change in the timing of tax flows rather than a change in aggregate. Thus while a reduction in the tax rate would have initial consequences for budget revenue as

[6] In the case of education bonds, withdrawals lead to investors recouping the tax paid on earnings within the fund, with that amount included with the earnings amount in the recipient's assessable income. Changing the tax rate from 30 to 20 per cent would mean that the gross amount received would be relatively unchanged, but would include a higher earnings component and less recoupment of tax. Thus lower tax inflows from earnings of the fund would be offset by lower tax outflows when the education bond is redeemed, suggesting that the main effect is a change in the timing of tax flows rather than a change in aggregate.

outlined above, this would be largely offset at a later time when the bonds mature, withdrawals are made, and lower reimbursements of tax are required.

The consequences of a reduced tax rate in the case of education bonds appears to be primarily a reduction in current tax revenue which will be offset by a reduced reimbursement of tax when bonds are redeemed. In a long run steady state, when the tax change has been in effect for some time, these effects should tend to net out, implying no significant change in tax revenue.

AUSTRALIAN CENTRE FOR FINANCIAL STUDIES

Abacus Australian Mutuals

An Education Bond Co-contribution Scheme:

Estimating the Budgetary Cost

12th December, 2012

An independent report prepared for Abacus by the Australian Centre for Financial Studies. Principal authors are Professor Kevin Davis (Research Director) and Mr Martin Jenkinson (Research Officer).

1. The Education Bond Co-contribution Scheme

It has been proposed that the Federal Government should consider introducing a co-contribution scheme whereby Australians who invest funds in an Education Scholarship plan would receive a capped government co-contribution. The objective is to encourage private saving for provision of education needs of children, and recognises the rationale for financial incentives to encourage such forward planning.

The proposal involves the Government providing matching funding of up to $500 p.a., for a period of five years, for contributions made by a family (or relatives) on behalf of children under seven years of age. The version of the scheme presented in this report is based on the scheme being available to all households however the scheme could also include eligibility requirements based on parental income.[1] Co-contributions would be paid by the government one year in arrears.

The budgetary costs are of two types. One is the direct co-contribution amounts. The second is the extent of tax concessions arising from the taxation rate applied to earnings of the fund. This aspect is complicated by two factors. First, it is necessary to estimate the additional budgetary cost arising from the extent to which fund balances are higher than they would otherwise be in the absence of the scheme. (Some households may have made contributions in the absence of the scheme). The second complication is that the "tax cost" depends upon the size of fund balances and the difference between the tax rate applied to earnings in the fund and that which would have been applied if the household had held assets personally. As explained in the box below, this calculation is complicated.

Estimating the Tax Cost

Consider an individual who saves and contributes $500, If instead they had not participated but invested that amount on personal account, the tax on earnings would be t_p.r (500), where r is the earnings rate and t_p is the personal tax rate. If they participate, the tax payable will be t_f.r (1000), where t_f is the fund tax rate and the fund balance of $1,000 reflects the additional government co-contribution. (It is assumed for simplicity that the earnings rate is the same in both cases). However, the nature of scheme eligibility is such that participants would have personal marginal tax rates of 30 per cent or less (and generally less). Assume for simplicity that the average t_p is 20 per cent (and it could be substantially less, particularly once concessional tax treatment of capital gains is taken into account). Then if the fund tax rate t_f is 30 per cent, and assuming a return on assets of 6 per cent, the government will receive tax revenue of 0.3 x 0.06 x $1000 = $18. In the alternative case where the individual held $500 on personal account, the tax revenue would be 0.2 x 0.06 x $500 = $6.

There is thus some recoupment of the government's co-contribution amount because of the higher tax rate applied to earnings. However, because the tax paid within the fund is reimbursed to the scheme participant when funds are withdrawn and used for eligible education purposes, this is primarily a bringing forward of tax revenues. In the example above, the $18 tax revenue would be offset at a later date by reimbursement of this amount (as taxable income) to the beneficiary. The overall tax effect will depend on the marginal tax rate of the beneficiary.

[1] An eligibility requirement would limit the scheme to children whose parents are classified as low to middle income. Low income could be defined as personal income of less than $37,000, while middle income could be defined as income of less than $80,000.

Because of these considerable complications, and in the absence of sufficient information about future tax rates applicable to beneficiaries, we think it appropriate to assume that the tax effects net out to zero.

Two further complications also need to be noted. First, the calculation above assumes that the effect of the scheme is primarily a reallocation of asset holdings, such that the differential tax rate is the main effect. However, if the scheme induces extra saving and investment by individuals, the tax receipts from investment earnings in the alternative case would be zero. Second, some participants in the scheme may have also contributed funds in the absence of the scheme, in which case the only tax effect is the tax revenue on fund earnings on the co-contribution amount (which are ultimately reimbursed). These further complications also suggest that, in the absence of more detailed information, it is appropriate to ignore the tax effects.

2. Basis for Assumptions

To estimate the direct co-contribution amounts, we make the following assumptions. First, we take the number of births in 2011 from ABS data as our benchmark and project births for subsequent years by assuming a growth rate of 1.25%.

Table 1 Total Number of Births 2006-2011

	2006	2007	2008	2009	2010	2011
Births	265,949	285,213	296,621	295,738	297,903	301,617
Birth Growth Rates		7.24%	4.00%	-0.30%	0.73%	1.25%

Source: Australian Bureau of Statistics, CAT: 3301.0 - Births, Australia, 2011

It is assumed that the scheme starts in 2013. We assume that 40% of births are to low-income families,40% to middle income families and 20% to high income families. This is based on the average age of child bearing adults and the average income of those age brackets. These proportions would appear to be reasonable given that the figures provided in Tables 2 and 3 show that almost all babies are born to mothers aged below 40 and accounting for the upward bias of using mean rather than median values for average annual incomes.

Table 2 Births, Nuptiality and age of mother, Australia–2011

24	17.48%
25	21.76%
26	26.70%
27	32.38%
28	38.70%
29	45.38%
30	52.11%
31	59.02%
32	65.52%
33	71.57%
34	77.11%
35	82.11%

36	86.50%
37	90.16%
38	93.17%
39	95.55%
40	97.24%

Source: ABS, CAT 3301.0 - 2011 Births, Australia, 2011

Table 3 Average Annual Income by Age Bracket

20–24	$36,868
25–29	$52,260
30–34	$62,192
35–39	$63,544

Source: ABS, CAT 6310.0 - Employee Earnings, Benefits and Trade Union Membership, Australia, August 2011

We then assume that 11% of low-income eligible families and 15% of middle income families decide to participate. These figures are based on the percentage of eligible low and middle income earners (as defined by the income brackets stated above) who participated in the superannuation co-contribution scheme. Due to high income earners not being eligible for the superannuation co-contribution scheme there is no such precedent on which to derive the proportion of high income earners who are likely to use the scheme. However, due to the modest take up of scholarship plans amongst high income earners we have assumed that 15 per cent of high income earners would utilise this scheme. We also assume that the initial year of participation in the scheme is spread equally over the three years following birth.

Table 4 Superannuation Co-contributors

	2010
Total low income superannuation co-contributors	367,616
Total middle income superannuation co-contributors	661,200

Source: Derived from ATO, Super co-contributions reports for 1 July 2010 to 30 June 2011

Table 5 Total Low and Middle Income Earners 2010

	2010
Total Low Income Earners	3,255,100.0
Total Middle Income Earners	4,336,800.0

Source: Australian Bureau of Statistics, CAT: 6306.0 - Employee Earnings and Hours, Australia, May 2010

Percentage of low-income earners utilising superannuation co-contribution	11.29%
Percentage of middle-income earners utilising superannuation co-contribution	15.25%
Proportion of High Income Families that Utilise Scheme	15.25%

When determining the average contribution of scheme participants, two scenarios are presented. The first assumes an average contribution of $350 for all income brackets[2]. The second, and perhaps more realistic scenario, is that marginal contributors to the scheme do so solely because of the co-contribution incentive and therefore middle income and high income earners contribute the full $500 each year while lower income earners contribute $350 annually. The table below provides a list of other macro-assumptions that were used when determining the budgetary costs and marginal increase in savings that are expected to be generated as a result of the scheme. The rate of return on education bonds used for calculations is an after-tax real return of 4% which is consistent with the target returns on balanced account options in many large superannuation funds.[3] A key assumption that is made when calculating the overall pool of funds generated through the scheme is that no withdrawals are made from the balances of account holders by the year 2022. This is a reasonable assumption given that the sole purpose test for the co-contribution states the funds are to be used only for secondary education onward, implying that a child must be around 13 years old before withdrawals begin.

Number of Total Births (2013)	309,205
Growth in Births	1.25%
Education Bonds Real After Tax Rate of Return	4.00%

3. Budgetary Costs and Increases in Education Savings: Scenario 1

The premise for scenario 1 is that both low and middle income earners have a maximum government co-contribution of $500. However, in a similar fashion to the take up of the superannuation co-contribution scheme, the average annual contribution utilises only 70% of this amount.[4] A summary of the assumptions used are listed in the tables below.

Table 6 Assumptions for low-income Australians

Proportion of Births to Low Income Families	40.00%
Maximum Government Contribution	500
Average Annual Contribution per-family (Annual)	350
Proportion of Low Income Families that Utilise Scheme	11%

Table 7 Assumptions for middle-income Australians

Proportion of Births to Middle Income Families	40.00%
Maximum Government Contribution	500
Average Contribution per-family (Annual)	350
Proportion of Middle Income Families that Utilise Scheme	15%

[2] This is calculated as 70% of the maximum contribution, a ratio that coincides with the average co-contribution of superannuation co-contributors across 2009 and 2010 (ATO, 2011)
[3] For example, Australian Super targets CPI + 4% on their balanced investment option. http://www.australiansuper.com/investments-and-performance/super-investment-choices/premixed-investment-choice/balanced.aspx
[4] It is also assumed that individuals will continue to contribute to their education bond investment account beyond the initial five years in which they are eligible for the co-contribution

Table 8 Assumptions for high-income Australians

Proportion of Births to High Income Families	20.00%
Maximum Government Contribution	500
Average Contribution per-family (Annual)	350
Proportion of High Income Families that Utilise Scheme	15%

Based on the figures above, the total budgetary cost for government is expected to begin at $5 million dollars in 2014 (remembering that co-contributions are made one year in arrears) to reach a steady state of around $75 million dollars by 2020.[5] Note that the annual government cost equals the private contribution of the prior year for the first five years but stabilizes thereafter, while the private contributions continue to grow. The increase in education savings balances directly attributable to the scheme is expected to increase annual private contributions into education savings products by around $140 million per annum (in constant dollar terms) by 2022. A complete working of this is provided in Appendix 1.

Table 9 Effects of Co-Contributions scheme (Scenario 1)

Years	Annual Budgetary Cost for Government	Cumulative Cost for Government	Annual Private Contributions	Total Balance in Education Savings Products
2013	$0	$0	$4,911,789	$5,108,261
2014	$4,911,789	$4,911,789	$14,796,765	$25,809,487
2015	$14,796,765	$19,708,554	$29,717,091	$72,931,946
2016	$29,717,091	$49,425,645	$44,823,922	$152,339,499
2017	$44,823,922	$94,249,568	$60,119,589	$264,657,053
2018	$60,119,589	$154,369,156	$75,606,451	$410,304,836
2019	$70,694,662	$225,063,818	$91,286,899	$584,591,570
2020	$76,490,134	$301,553,952	$107,163,352	$782,562,665
2021	$77,446,261	$379,000,213	$123,238,261	$999,193,412
2022	$78,414,339	$457,414,552	$139,514,107	$1,234,504,226

4. Budgetary Costs and Increases in Education Savings: Scenario 2

In this section we consider the effects of changing particular assumptions underlying the estimates. Specifically we assume that high-income and middle income earners participating in the co-contribution education bond scheme do so with the intention of utilising the maximum $500 co-contribution amount, rather than the 75% figure used in the previous scenario. Low-income earners continue to have an average annual contribution of $350.

[5] The budgetary cost will continue to grow slightly from this figure due to the assumed continued growth in birth rates.

Table 10 Assumptions for low-income Australians

Proportion of Births to Low Income Families	40.00%
Maximum Government Contribution	500
Average Annual Contribution per-family (Annual)	350
Proportion of Low Income Families that Utilise Scheme	11%

Table 11 Assumptions for middle-income Australians

Proportion of Births to Middle Income Families	40.00%
Maximum Government Contribution	500
Average Contribution per-family (Annual)	500
Proportion of Middle Income Families that Utilise Scheme	15%

Table 12 Assumptions for high-income Australians

Proportion of Births to High Income Families	20.00%
Maximum Government Contribution	500
Average Contribution per-family (Annual)	500
Proportion of High Income Families that Utilise Scheme	15%

It can be seen from Table 13 that the effect of this change is that the total annual budgetary cost incurred by government will reach a steady state of around $100 million dollars an increase of approximately $25 million from the figure projected in Scenario 1. The change in assumptions also means that the amount of annual private contributions will increase to approximately $180 million by 2022, leading to a total balance in education savings products of around $1.6 billion.

Table 13 Effects of Co-contribution scheme (Scenario 2)

Years	Annual Budgetary Cost for Government	Cumulative Cost for Government	Annual Private Contributions	Total Balance in Education Savings Products
2013	$0	$0	$6,343,821	$6,597,574
2014	$6,343,821	$6,343,821	$19,110,760	$33,334,241
2015	$19,110,760	$25,454,581	$38,381,107	$94,195,250
2016	$38,381,107	$63,835,688	$57,892,334	$196,754,069
2017	$57,892,334	$121,728,022	$77,647,450	$341,817,797
2018	$77,647,450	$199,375,472	$97,649,506	$529,929,181
2019	$91,305,685	$290,681,157	$117,901,587	$755,029,199
2020	$98,790,827	$389,471,985	$138,406,820	$1,010,718,753
2021	$100,025,712	$489,497,697	$159,168,367	$1,290,508,178
2022	$101,276,034	$590,773,731	$180,189,435	$1,594,423,842

A ball-park estimate of the steady state direct budgetary cost of the proposed co-contribution scheme is between $80 - $100 million p.a. Based on the same assumptions the scheme is likely to result in an increased pool of education savings of between $1.2 and $1.6 billion dollars by 2022.

August 2011

Private Saving:
The Role of
Life Event Products

Produced by

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Executive Summary

Households face a range of possible life events, such as education, health, housing, retirement, which can require significant expenditures for which they are often inadequately prepared by way of saving or insurance. This lack of preparation may reflect behavioral biases, inadequate information, or in the case of lower income earners, inadequate financial resources. Governments have taken a variety of actions to counteract these influences such as taxation incentives, government grants or expenditures, and compulsion. The most obvious is the promotion of superannuation as a preparation for retirement.

There has been less attention paid to how government policy can best be designed for assisting individuals in preparing for other life events. Indeed, the tax incentives given for superannuation may have impeded the development and growth of other financial products well suited for non-retirement life event preparation. In particular, the strong emphasis on superannuation tax-incentives has been at the expense of incentives for some existing well-established life cycle savings products currently offered by Australian Friendly Societies. These products have the potential to raise private savings levels and assist individuals to prepare for life cycle events without the need for complex and on-going financial advice.

In this paper, we examine the role of a particular type of financial product in meeting these objectives. That product is the "Insurance Bond", and variants upon that structure (such as "Education Bonds"), offered to the public by Friendly Societies.

We conclude that:

- The insurance bond framework has significant benefits as a mechanism for promoting saving for life events. These include:
    - i. Product simplicity and consequent minimal financial advice needs;
    - ii. Application to targeted event-oriented products that can help overcome behavioral biases;
    - iii. Tax concessions, or government co-contributions, can be provided effectively and without complexity; and,
    - iv. Prudential regulation of providers by APRA provides comfort to investors that promises will be met. A range of investment options made available to investors provides (much like (accumulation) superannuation accounts) scope for tailoring risk taking to individual preferences, and the long-term nature of

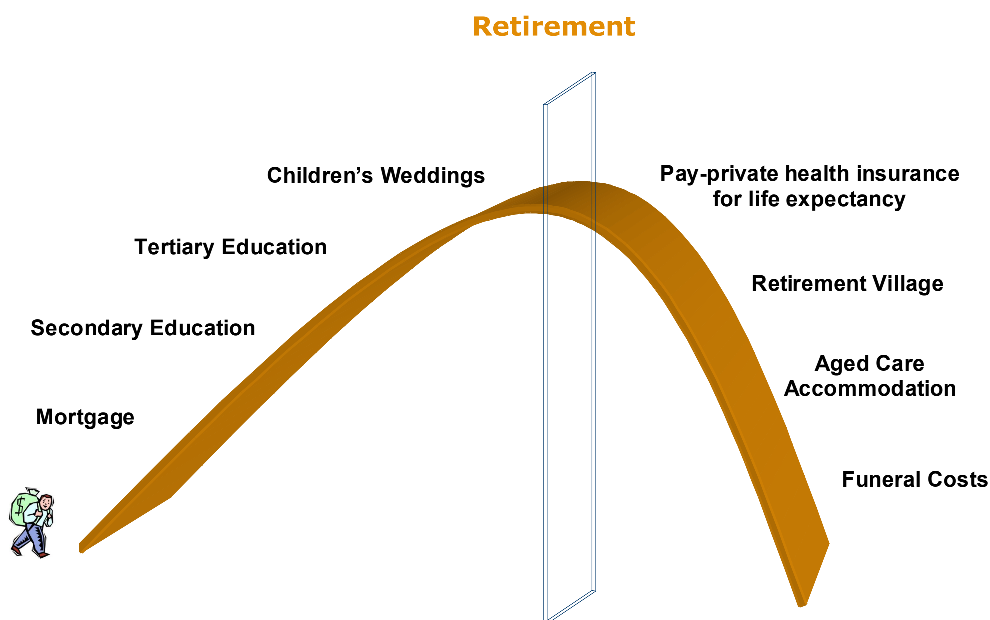
the contract enables risk reduction benefits from "time diversification".

- Use of the insurance bond framework by Government for delivery of targeted social benefits fits with an "asset accumulation" approach to social welfare which:
  i. Encourages personal responsibility, and
  ii. Can assist in the development of financial literacy.
- The insurance bond framework has other advantages for individuals:
  i. As a vehicle for targeted intergenerational transfers, which do not get entangled in inheritance or personal bankruptcy issues; and
  ii. As a form of investment which does not involve any personal tax consequences or reporting requirements during the life of the investment.
- The promotion of life cycle event products such as insurance bonds has the potential to increase household savings and financial wellbeing.
- On the basis of international evidence it appears that Australian policy makers have failed to appreciate the opportunity that life event savings schemes offer, such as for education and medical savings in the USA, and, as a consequence, such products receive far less favorable tax treatment in Australia.
- To increase usage and social benefits from insurance bond products, and to reduce current tax and legislative distortions vis a vis superannuation, it is recommended that:
  i. A reduction in the current tax rate of 30 per cent applied to earnings within insurance bond funds should be considered to provide a lower and targeted savings-incentive tax rate for policy-holder funds;
  ii. A reduction in the current 10 year holding period required for tax-paid/tax-free payouts should be considered for specific types of targeted savings; and,
  iii. The current annual contribution cap of 125 per cent of the previous year's total contribution should be reviewed against an alternative annual cap expressed as a proportion (declining over time) of total accumulated contributions to date – to cover situations of a contribution gap or lower contribution in some years.

1. Introduction

Everyone's life experiences are different, with different consequences for their financial position throughout life. But there are common trends and events which enable a benchmark profile of saving and investment needs throughout the lifecycle to be established – which, in turn, enables analysis of how financial products and government policies might best be designed to deal with the "known and unknown" unknowns which affect us all. Those unknowns include such things as timing and/or occurrence of events such as sickness, unemployment, marriage, divorce, dependant-related expenses (such as marriage and post-compulsory education), retirement, and death (at least the timing thereof). Figure 1 provides an illustration of some of these possible events.

FIGURE 1: Potential Life Events



Source: Ross Higgins, Austock 2011

As Figure 1 also illustrates, there are many such potential events requiring substantial outlays at different stages of the life-cycle, and these are augmented by discretionary lump sum outlays on capital items or investments.

This paper focuses upon how financial products might be designed, and how government policies might be fashioned, to assist individuals in planning for and dealing with such life events which involve significant expenditures. Such policies would also ensure that individuals are less expectant of Government income or

lump sum support. It identifies specific life-cycle events warranting attention, provides an overview of financial products currently available (and issuers thereof), examines how regulatory and tax policy affects the design and use of such products, and provides recommendations for policy.

Underpinning the paper is the perspective that government regulatory and tax policies should, at least, not impede the development and take-up of financial products which help individuals and families to prepare financially for life cycle events. But also relevant is the view that an "asset accumulation" approach to welfare policy is worth exploring further. Using tax/transfer policies and grants to encourage individuals to accumulate financial assets can lead to greater private responsibility for dealing with possible life cycle events, rather than reliance upon government welfare. Government long-run budgetary outcomes may be improved, and increased responsibility and familiarity with financial products may help enhance financial literacy. More generally, targeted tax concessions for particular forms of saving may increase aggregate saving, although studies of how subsidized savings schemes affect total savings tend to generate conflicting results[1] .

Another consideration underpinning the paper is the recognition that many individuals have difficulty understanding the suitability of financial products and in planning household finances over the life-cycle. The growth of the financial advice industry reflects the growth of these problems in an increasingly complex financial world. It has brought with it, however, problems of conflicts of interest, suitability of advice, and levels of fees. For many individuals, financial advice is an unaffordable luxury. Simple financial products designed to deal with significant life events, and which can be explained simply to individuals, offer an advantage in that they can be achieved through low-cost, one-off advice associated with that product, rather than requiring expensive, on-going, relationship advice.

[1] Poterba *et al (1996)* found that subsidization of savings in the form retirement savings accounts in the USA and Canada led to increased aggregate saving, but other studies have found conflicting results. See Japelli and Pistaferri (2003) for a review.

1.1. Saving, Investment and Life Events

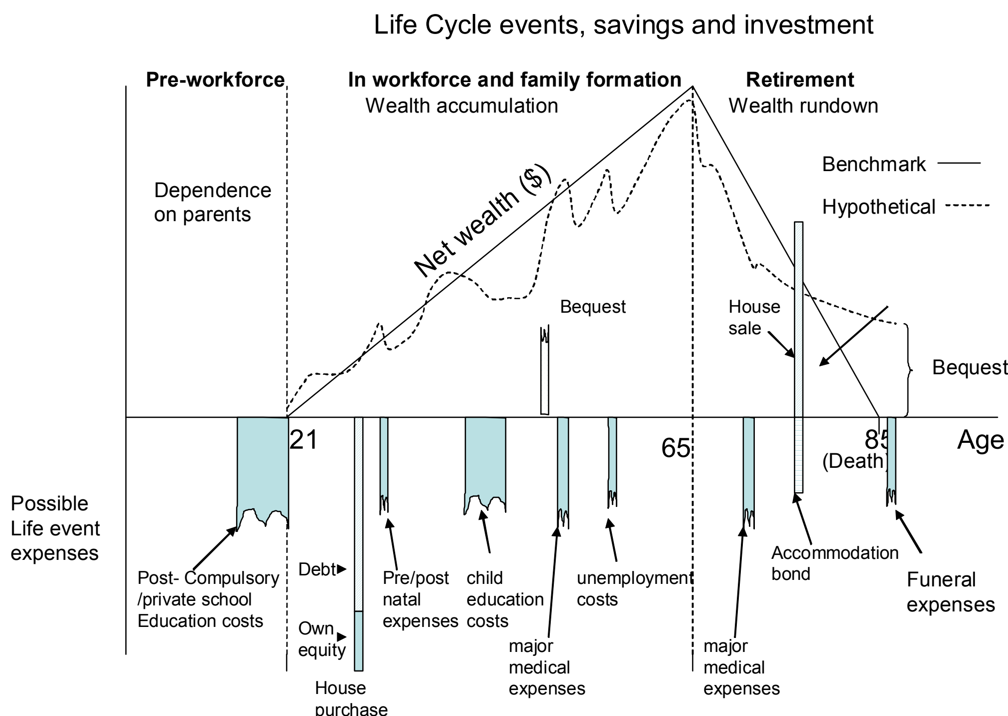
Although all life-cycle experiences are unique, an often used benchmark for analysis is a scenario in which an individual is assumed to enter the workforce at the end of schooling (at an age of around 20) works full time for around 45 years, and retires with a remaining life expectancy of around 20 years. Over the working life wealth is accumulated (in the form of financial assets and property) and during retirement consumption is financed by running down of assets – perhaps with a bequest motive in mind. In practice, a more appropriate benchmark model involves incorporating household formation sometime after workforce participation commences, with the household subsequently involving dependants (and associated expenses), and potential dissolution of the household via separation/divorce or death of one of the partners.

That benchmark model obviously abstracts from a multitude of complications (such as spells of unemployment or sickness, receipt of bequests etc), and needs further elaboration to deal with cross-sectional differences in lifetime earning capacity and parental wealth and financial support etc.[2] But it does serve as a useful benchmark to identify the consequences of major life-cycle events for household finances and financial product needs. Foremost among these are bad health, higher education, disability, retirement, frailty and intergenerational wealth transfer.

Figure 2 provides an illustration of how the standard life-cycle perspective on wealth accumulation and rundown is affected by life-cycle events. Various potential expenses affect actual wealth accumulation, and can be dealt with through insurance, pre-saving, or wealth run-down (or reliance on government benefits). Assets accumulated will also have differing characteristics affecting ability to run them down to meet expenses or for use as collateral for borrowings. Superannuation cannot (generally) be accessed until the preservation age is reached, home equity may be accessible via mortgage re-draw facilities or through reverse mortgages. Government asset or income tests for various social security benefits (such as the old-age pension) can create inducements for particular forms of asset structuring and expenditure patterns, in order to access those benefits. Desire to achieve effective tax planning, intergenerational wealth transfer, and allocation or control of assets within a family context, can also lead to the use of particular legal structures (such as family/discretionary trusts) for asset ownership to achieve those objectives.

[2] Besley and Meghir (1998) analyze the effects of tax preference of some assets within this framework.

FIGURE 2: Life cycle events, savings and investment



Source: K Davis, ACFS 2011

Of course, for many low-income or disadvantaged individuals and households, wealth accumulation is a limited prospect, placing them at particular risk in dealing with both post-retirement living expenses and possible pre-retirement life-cycle event costs. Government policies recognize the resulting personal and social costs, and ameliorate them to some degree by way of subsidizing particular types of expenditures (health, education etc.) and through provision of social security benefits (unemployment, disability and old age pensions etc.).

Those policies can induce *moral hazard*, when government safety nets induce individuals not to take personal responsibility for financial preparation for life-cycle events. Consequently it is often desirable to find some form of risk-expenditure sharing between government and individual which provides an ultimate safety net but induces private saving or insurance for dealing with those potential events.

Some life-cycle events also involve discretionary expenditures – such as those on post-compulsory or private education expenditures for children.

Where these are seen as having social value, or where parents underestimate the private value accruing to their children, government policies involving subsidization of such expenses may be warranted, but again involve potential for *moral hazard*. Consequently, policies which encourage private savings for such expenditures, by attracting tax concessions or government funding, are generally preferable.

Life-cycle financial planning also requires individuals to be cognizant of the longer-term consequences of current savings and investment strategies for their own welfare. Arguably many are not, and government policies may involve compulsion or incentives to induce changes in savings behavior thought to be more compatible with private best interest. Compulsory superannuation is an example, although that also is motivated by moral hazard arguments – specifically as an attempt to increase private savings for retirement rather than reliance on government support through the age pension.

Another fundamental consideration is the role of financial advice on an individual's savings and financial investment decisions. This is particularly relevant in the context of financial plan prepared by financial advisers – directed to the retirement life-cycle event – and often being oblivious to the plethora of other events on life's journey.

In rendering professional financial planning advice, planners should be factoring in to their client financial plans savings directed at life events, other than just retirement. There is widespread and elementary financial planning oversight in not recognising and using long term tax-paid investments (such as insurance bonds) for these purposes.

Since the global financial crisis investors have also naturally shied away from financial planning advice directed to investment outcomes (and superannuation), and there is an emerging shift for financial advisers to focus a lot more on "strategy-based" financial planning. As we discuss later, Insurance Bonds are tailor made for this changed focus, because they are inherently about meeting long–dated "strategy-based" objectives.

As this brief overview of life-cycle savings and investment suggests, there are a number of areas in which there are opportunities for financial products (insurance, savings/investment) to assist individuals in meeting life-cycle events, and where there may be a case for some form of government support. In some cases, optimal solutions may lie primarily in the realm of insurance (eg medical and unemployment insurance) while for others (eg education, retirement, funeral expenses) the solutions are more likely to involve savings products.

It is, in principle, possible for households to meet large outlays for life-cycle events by borrowing at the time the event happens and making subsequent repayments, rather than from accumulated savings and investments. In practice, that approach is likely to be more costly and disruptive to optimal life-cycle wealth accumulation. Moreover, it is simply not available to those with inadequate assets or potential income to meet criteria imposed by lenders – thus limiting ability to appropriately deal with those events.

The optimal design of such products requires understanding of how individuals approach saving, investment, and risk management decisions, and how they respond to various incentives and features of product design. That is discussed in the following section and important implications for financial product design drawn out.

1.2. Behavioral Finance, Savings and Investment

One approach towards analyzing individual savings and investment behavior is to view individuals as rational, anticipating that life-cycle events may happen, and planning their finances to deal with the possible consequences. To implement such plans, financial products are required which can enable such risk management, or wealth accumulation to "self-insure". An alternative approach, based around behavioral finance, is to note that individuals and families do not behave like the rational beings in economics textbooks, and that products which assist them to deal with "non-rational" behavior regarding the possibility of such life-cycle events are of significant social and private value.

Behavioral finance, drawing on research in psychology, posits that there are a number of characteristics of individual behavior which prevent individuals from behaving like the rational *homo-economicus* of textbook theory.[3] This

[3] In their survey of behavioral finance, Barberis and Thaler (2003) distinguish between formation of individual beliefs (which determine the "information" which underpins the process of decision-making) and the nature of decision making. Inconsistencies in behavior and decision making and choices which do not maximize individual welfare have been demonstrated repeatedly. A number of alternative approaches to analyzing individual decision making have emerged. One is the concept of *Satisficing* behavior, in which decisions are made which reflect information processing skills and "bounded rationality". *Prospect Theory* is an alternative description of decision making behavior under uncertainty in which individuals evaluate prospects in terms of gains or losses relative to their perceived current situation (rather than in absolute terms). Also relevant is *ambiguity*

has significant implications for attitudes towards financial products and services and for the optimal design of financial products. For example, there is substantial evidence to show that individuals allocated to a "default" option will tend to stay with that option rather than switch to available alternatives.

It also has important implications for policy, implying a policy approach of "nudging" individuals to make better financial decisions by appropriate settings of tax/transfer arrangements, information provision, and setting of default options.

The most relevant issue as regards life cycle event products is the existence of cognitive biases in behavior. Ritter (2003) provides a concise overview, covering the following issues.

- *Heuristics (rules of thumb)*. Faced with potentially complex choices, individuals often follow some rule of thumb – which they may have developed based on past experiences, but which may lead to biases if circumstances have changed. Some studies have shown that faced with an allocation decision across N categories, investors tend towards a rule of thumb of allocation 1/N to each category, regardless of the size of N or differences in the characteristics of those categories.
- *Overconfidence*. There is widespread evidence, across a range of activities, that individuals are generally overconfident about their ability, and that males exhibit this trait more than do females. This may lead to insufficient diversification of investments, underestimation of risks, and a tendency to undertake trading too often.
- *Mental accounting*. Individuals appear to act as though they divide decision-making into separate compartments, reflected in maintaining separate psychological accounts for funding different types of expenditure.
- *Framing.* Individuals react differently depending on the way in which a choice situation is described or "framed". Ritter (2003) suggests that one example of this can be found in investors overestimating real returns on debt in an inflationary period because financial accounts record nominal interest but not the decline in the real capital. If framing affects how individuals perceive their current situation, then according to Prospect Theory it can influence decisions.

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aversion, whereby individuals do not like dealing with situations in which they are unable to accurately assess the probabilities of particular events occurring.

- *Representativeness.* Individuals put too much weight on recent experiences in forming judgments about the future.
- *Anchoring*. Individuals tend to evaluate options relative to their current position.
- *Disposition effect*. Individuals are unwilling to realize losses but willing to realize gains.

What do these behavioral biases imply for the design of retail financial products?

- Individuals tend to treat cash flows differently from changes in capital value, even where those cash flows involve return of capital, and are more willing to consume out of cash flows perceived to be income. This suggests that financial products which involve automatic reinvestment of income (in the form of interest or dividends) are more likely to lead to greater accumulation than those which distribute such income.
- Because individuals have concerns about their self control, commitments to long term savings plans can be attractive. This suggests a place for financial products which involve a target long term accumulation amount with disincentives to withdraw funds or not make predetermined contributions.
- The use of "mental accounts" implies that financial products which have a sole purpose can be attractive, even if they involve sacrificing flexibility. Individuals may treat savings for such a special purpose differently to other savings and be less inclined to reduce other savings, thus increasing total saving.
- Individuals dislike dealing with situations in which there is substantial ambiguity about the timing and probability of events. Consequently products which resolve this uncertainty will be attractive, such as a wealth accumulation scheme targeted at meeting some possible event expenditure, but where there is sufficient flexibility for accumulated funds to be made available for other purposes should the event not occur.

2. Life Event Products in Australia

Life event products fall into a somewhat unique category of investment / savings products. While they generally have some characteristics of *collective investments* (in which investor funds are pooled and investment returns distributed *pro rata*) they are distinguished by the linkage of the timing and/or amount of returns to individual investor circumstances. This may be via some insurance component, or lifecycle event trigger (commencement of education, retirement etc). They are also distinguished by their long-term contractual savings/investment nature, involving incentives to lock-in funds until the maturity date or occurrence of a specified event. That long term nature (and insurance features) give rise to a case for prudential regulation of the providers of such products. And while most modern products involve the investor bearing the investment risk, capital guaranteed products are possible which require maintenance of higher capital reserves and lower expected returns and accumulation.

It is also important to note that the legal structure involved can have substantial tax or control implications. For example:

- Where an investment product is structured as an insurance product with a designated beneficiary, the payment of proceeds is not subject to challenge as part of an estate.
- A particular investment structure may provide the individuals controlling that investment with discretion in the allocation of earnings to particular individuals, which may also have tax planning benefits.

In Australia, institutions such as superannuation funds, insurance companies and friendly societies all offer products to assist individuals in saving for the future and manage lifecycle risks. Each type of institution and set of products, however, operates in a different environment with regard to tax-incentives and control, thereby creating an unlevel playing field and in some cases a disincentive for individuals wishing to plan for their own future, thereby imposing a consequent potential for greater reliance on the State.

2.1. Superannuation funds

The most common form of life event products in Australia, are superannuation accounts, whose growth has been promoted by government compulsion and taxation incentives. At June 2010, there was $1,225 billion in superannuation, split between main types of funds: corporate, industry, public sector and retail funds.

Compulsory superannuation for employees (not covered by corporate or public sector schemes) began in the early 1990s. Employees had no choice between industry funds until legislation was introduced in 2004, and many industry funds have since become public offer and also offer a range of investment options to members. Few workers have exercised their freedom of choice of fund. Less than 10 per cent of workers have actively chosen a fund and switching rates are as low as 2 to 4 per cent annually.

Superannuation has also been encouraged by substantial tax incentives, which have varied over time. Currently contributions can be made (up to specified limits) from pre-tax earnings (as well as post-tax earnings), superannuation funds earnings are taxed at a concessional rate (15 per cent, with long term capital gains taxed at 10 per cent), and withdrawals after a specified age (currently 60) are tax-free. Access to accumulated funds before retirement is, however, generally not possible.

As well as providing a vehicle for accumulating funds for retirement, superannuation funds also provide life insurance, and accumulated funds will also become available to dependants upon death of the member. While beneficiaries can be nominated, ultimately the trustees of the fund determine how funds will be allocated.

Around 85% of working age Australians have a superannuation account, providing a broad-based coverage which allows individuals to prepare for their retirement. Despite this widespread coverage, however, Treasury modeling indicates that by 2047, when the superannuation system is fully mature, the proportion of people receiving an age pension will not change, although the proportion on a full pension will decrease. Consequently, the onus remains on individuals wishing to enjoy wellbeing in retirement to make additional financial provision for later life to assist with escalating expenses of accommodation and health care (Finsia 2010).

2.2. Insurance Companies

Australia has over 140 insurance companies which provide financial protection to individuals and businesses to manage the risk of damage or loss from a wide variety of events. Insurance is most typically classified as general, life and health insurance.

General insurance includes fire and industrial special risk (ISR) insurance, household/house owner insurance, motor vehicle insurance (domestic, CTP and commercial), professional indemnity insurance and public and product liability insurance. General insurers pool risk and derive revenue from insurance premiums and the investment of premium reserves in bonds,

stocks and other assets. The vast majority of general insurance premiums are derived from the renewal of policies that relate to existing risk. The remaining premiums relate to an increase in risk exposure or a change in pricing conditions.

Australians have a history of underinsuring their exposure to property risks. In 2005 a survey conducted nationally by the Australian Securities & Investments Commission (ASIC) investigated the extent of non-insurance. Approximately 200,000 or one in six small businesses and 1.8 million or one in five home owners were found not to have insured their properties, while 70% of tenants failed to insure contents. Further, around 30% of properties were insured for significantly less than their replacement value (Ralston 2009).

Historically, life insurance companies provided life event type products through insurance products. Endowment policies involved regular premium payments which led to payment at a specified age (or upon earlier death) of the sum assured plus bonuses credited to the policy from investment earnings. Because the payment profile was relatively constant over time, early payments (after selling commissions to agents were paid) were partly pre-payments of the insurance premiums required at older ages, making these a form of savings vehicle.

For several reasons, such products have virtually vanished. One reason is the generally poor rates of return on products reflecting high distribution costs due to a substantial part of early year's premiums being absorbed by commission costs and also the growth of superannuation and the insurance/savings component involved therein.

Indeed, the growth of superannuation and the compulsory offering of life insurance in superannuation as specified by the SIS Act, has and will continue to have, significant effects on the take-up of life insurance in Australia. The provision of life, total and permanent disability (TPD), and income protection insurance cover through superannuation funds has become big business, involving changes in product designs, accessibility for consumers, distribution channels, and the nature of industry competition. It has also brought many non-insured workers into the insurance market – albeit often unknowingly

At the same time, however, it can be argued that the packaging of life (and TPD) insurance within super, rather than as explicit separate products, and past restrictions on super funds providing financial advice may have contributed to less awareness of the extent of coverage and availability of additional insurance coverage within super. This has led to a tendency to underinsure for a number of reasons. First, the minimum

default level of insurance in super tends to be quite low and is determined as a dollar amount (premiums or coverage) often inversely linked to the age of the member. Second, with an ageing membership, the average default amount of coverage is likely to decline because of that linkage (ACFS 2010).

Private health insurance is a critical and integral plank of the Australian health system. While the Medicare system ensures free universal access to hospital treatment and subsidised out-of-hospital medical treatment, around 44.6 percent of the Australian population also has private health insurance. There are currently 35 private health insurance companies, with the top 10 companies accounting for over 70 percent of the market (PWC 2011). Government policies play a significant role in shaping private health insurance in Australia, influencing its cost through the mandated approval of rate rises and the tax rules. Tax incentives such as a private health insurance rebate and a higher Medicare levy surcharge for those who do not take out health insurance provide a carrot and stick approach to ensuring that the public share the cost of health care provision.

Health insurance premiums are generally paid on an annual basis, but with an ageing population and increasing health costs, the need to provide longer-term health insurance cover to, or encourage saving to meet additional expenses for, both employed and retired citizens will only increase.

2.3. Friendly societies

Friendly Societies have operated in Australia since the mid 1800s, originating as mutual organizations providing insurance and savings type products for groups of individuals.[4] Originally established as mutual self-help organizations enabling individuals to save and insure against such life cycle events as such as sickness, accident, education, funerals, retirement accommodation etc., Friendly Societies were, in some sense a precursor to the modern, government provided, welfare state. Their role has declined with the growth in public welfare. Notably, the friendly society approach to enabling individuals to meet contingencies was primarily by asset accumulation and insurance.[5] Before World War 1, around half of Australia's population had some association with Friendly Societies. In terms of asset size, the sector

[4] Information about UK friendly societies and their history and products can be found at http://www.friendlysocieties.co.uk/

[5] Green and Cromwell (1984) provide a history of Australia's Friendly Societies and emphasize the importance of their medical and hospital funds and operation of pharmacies etc. at that time. They also note the role of provision of holiday accommodation for members, and aged care facilities

reached its peak in the early 1990s when the then favorable tax treatment of insurance bonds saw the sector reach around $10 billion of assets. O'Brien (1997) presents figures indicating membership in 1996 of around 1.27 million, with most assets being associated with flexible assurance products (such as insurance bonds).

At January 2011 there were 15 registered friendly societies, with a substantial decline in numbers having occurred over time from mergers. (There were over 25 friendly societies supplying data to the ABS in 2003). Some of those remaining have also demutualised and either become companies listed on the stock exchange (eg IOOF and Centuria Life) or acquired by other organizations (eg. Manchester Unity Australia).

Friendly societies primarily offer investment products to members (although some also offer health insurance and other related products). Contributions by members into an investment product are pooled into a "fund" and those monies invested in accordance with the product's requirements. The principal investment product offered is an *Insurance Bond* (described in more detail below). Such products have some of the characteristics of collective investments (such as unit trusts), in that the ultimate return to investors depends upon the performance of the fund's investments and are expressed in frequently updated unit prices (ie they are "unit-linked").

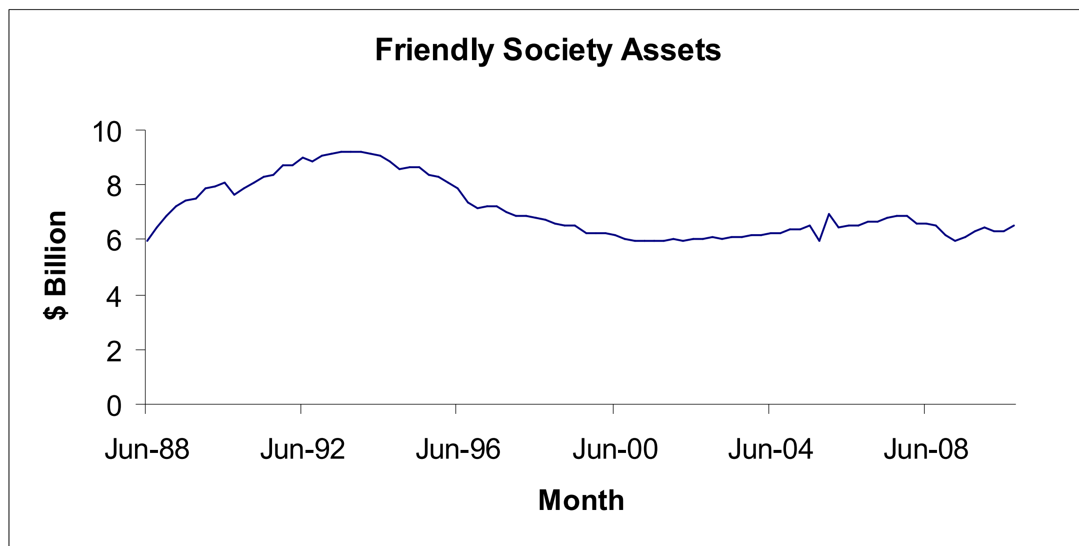
However, unlike typical collective investments Friendly Societies are subject to prudential requirements laid down by APRA (Australian Prudential Regulation Authority) designed to ensure that amounts promised to investors will be paid. But whereas once, insurance bonds were often "capital guaranteed"[6] by the Friendly Society, modern products generally involve the investor choosing an investment option and bearing the investment risk. Such unit linked products are now the main type of offered investment vehicle, but unlike many other collective investments where adverse short term performance can lead to withdrawals, the incentives for longer term investment provide the opportunity for "time-diversification" which reduces the longer term volatility of returns. Friendly Societies are required to have capital reserves adequate to ensure ongoing management of the funds they offer.

The sector has not grown in size over the past twenty years as Figure 3 illustrates, although the stagnation of total assets disguises ongoing new take-up of friendly society products, because of the maturing of older products. Taxation changes over time partly explain that, with tax treatment

[6] McGing and Polic (1997, p27) note that capital guaranteed products "are the predominant area of friendly society investment business"

of friendly societies having worsened their competitive position – both generally and specifically relative to superannuation.

FIGURE 3: Friendly Society Growth



Source: Reserve Bank of Australia Bulletin, various

Friendly Societies are taxed under special provisions of the Tax Act, such that a tax rate of 30 per cent applies to earnings, regardless of whether they are composed of income (dividends, interest) or capital gains. Franking credits can be used to reduce the effective rate of tax below 30 per cent. Unrealised changes in the value of member/policy holder investments in the fund are not subject to taxation at the individual level.

There have been substantial changes in the tax treatment of Friendly Societies over time, which are shown in Table 1.

TABLE 1: Taxation of Friendly Societies

Period	Tax Rate (Life insurance and corporate funds)	Comment	Tax Rate (Complying superannuation and deferred annuity funds)	Tax Rate (Immediate annuity and superannuation pension funds)
Until 1982-83	Zero		Zero	Zero
1983-84 to 1987-88	20%		Zero	Zero
1988-89 to 1993-94	30%		15%	Zero
1994-95 to 2000-01	33%		15%	Zero
2001-02 onwards	30%		15%	Zero
2013-14	29%	proposed in 2010 Budget		
2014-15 onwards	28%	proposed in 2010 Budget		

Source: A Compendium of some important financial planning reference rates and tables, Australian Friendly Societies Association, March 2011.

The zero and lower tax rates prevailing prior to the late 1980s, reflecting their status as mutual, not for profit and self-help organizations, led to rapid growth in take-up of the "insurance bond" product till the late 1980s.

While the current rate of taxation is 30 per cent, it is possible for Friendly Societies to reduce the effective rate of taxation by investments in shares paying franked dividends. Depending on the extent to which investment returns take the form of franked dividends versus capital gains (or unfranked dividends), the tax rate in the fund can be reduced significantly.

3. Life Event Products - Insurance Bonds, Related Products, and Alternatives

3.1 The Generic Insurance Bond[7]

As noted earlier, insurance bonds (and other related products built upon the same structure) are essentially a form of managed fund, but which have particular insurance and capital guarantee features, as well as other special features reflecting special taxation treatment.

They are a long-term savings and wealth accumulation vehicle providing investors with the ability to make one-off or ongoing contributions into a fund with accumulated capital and earnings accessible on a tax-free basis 10 years (or longer) after the initial contribution, or at any time in certain defined events[8]. Because of their insurance characteristic, a 'life insured' person is nominated, who may the investor or someone else. Accumulated funds can also be accessed before the 10 year period ends (with loss of some tax benefits) or are paid out (without loss of tax benefits) on death of the nominated policy-holder.

This relatively simple structure is distorted by certain anomalies in the tax treatment of insurance bonds, as outlined below:

- Income earned within the bond fund is taxed at the life insurance fund rate (currently 30 per cent), but
- No distinction is made between the revenue income (eg. interest and dividends) and capital gains (viz. realized capital gains). Thus, the fund does not gain the benefit of the concessional capital gains tax discount available to individual investors, which exempts 50% of capital gains on investments held directly or indirectly via collective investment vehicles for more than one year (a corresponding 1/3 exemption applies for superannuation funds).

On the other hand:

- Like other investments, the fund is able to use franking credits received to reduce the effective income tax rate.
- There are no tax implications for investors in the fund prior to withdrawal of funds. Investors do not need to include changes in the value of their investment (or fund earnings) in their individual tax

[7] For more discussion and examples of the flexibility of the investment structure see Higgins (2006, 2009) and Rubin (2005)

[8] Defined events include bond maturity due to death, disability or serious illness of the nominated 'life insured' or unforeseen serious financial difficulties of the bond investor.

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returns. (The value of the investment may, however, be relevant for the assets test for the old age pension or other government benefits).

- Withdrawal of funds from the fund after 10 years of initial investment is tax free in the hands of the investor (policy holder/ beneficiary). Withdrawal before 8 years means that the earnings component of the distribution (ie not including contributions of capital) is taxable in full at the investor' marginal tax rate, but is subject to a 30 per cent tax rebate to offset the impact of tax paid in the fund. Withdrawals between 8 and 10 years receive some concessional treatment (2/3 taxed for year 9 and 1/3 taxed for year 10).[9]
- Investors are allowed to contribute additional amounts of up to 125 per cent of the previous year's contribution each year without affecting the initial investment date (thereby keeping the original 10-year period intact). This also means that should no additional contribution be made in any one year, any further contributions would cause a deemed recommencement of the initial investment date (although investors could avoid that trigger by investing in a new insurance bond commencing at that date).

This tax treatment means that investors on marginal tax rates above 30 per cent receive tax benefits from use of these products because of a greater compounding effect which is not offset by subsequent taxation. Thus, for example, a $100 investment which earns 10 per cent p.a. before tax generates $196.72 after 10 years in the insurance bond structure with a tax rate of 30 per cent, compared to a cumulated value of $170.81 if taxed at an investor's top marginal tax rate of 45 per cent.[10]

This higher return is achieved at a cost to liquidity (early access to the funds leads to loss of tax benefits)[11] and segregation of the investment from other investments. However, the 30% tax rebate associated with early withdrawal can be used to offset tax on other forms of income,.

Despite the relatively complex tax treatment within the fund, the insurance bond remains a simple product whose structure can be easily explained to investors. In essence, an initial investment is made for 10 years, which can be supplemented by subsequent investments for the same maturity, with bonuses, based on the after-tax return on funds invested, added to the invested balance and available tax free after 10 years. Because the Friendly

[9] This provision is contained in section 26AH of Income Tax Assessment Act 1936.
[10] The comparison is based on Amount = $\$100(r(1-t))^{10}$ where r is 10 per cent and t is either 0.3 or 0.45.
[11] Not all of the tax benefit is lost, because the tax rebate of 30 per cent does not take into account the effect of compounding based on after tax rate of return of 70 per cent of the pre tax return rather than 55 per cent.

Society pays tax (currently at 30 per cent) on investment returns, there are no on-going tax implications for the investor prior to redemption (and none at all, if that is after 10 years or when withdrawn in the case of defined events).

As well as the simplicity of the product structure, the investment bond has a number of other merits as a life event savings product:

- A "target date" accumulation product, with provision of insurance and flexibility but tax disincentives for earlier access.
- Nomination of a beneficiary other than the investor enables intergenerational transfers directed at a specific purpose, and is not subject to intervention by other claimants on the estate of a deceased investor or in the event of bankruptcy (if the nominated 'life insured' were the investor or the investor's spouse).
- Minimal on-going administrative/accounting requirements for the investor, who does not need to include fund earnings on the investment in a personal tax return.
- Managed investment of funds by the APRA-regulated Friendly Society aimed at achieving highest possible returns consistent with prudential management and ability to meet policy-holder liabilities.

Within the context of financial planning, Insurance bonds are a way to build into client financial plans the accumulation of "Tax-Free" lump sums for major "life-event" objectives. These include education financing, children's endowments (e.g. for home deposits); succession funding, sinking fund strategies, health contingency funds, and in many estate planning applications.

Other strategy-based applications for insurance bonds include:

- sinking fund strategies – accumulating Tax-Free lump sums for early mortgage payout, discharging geared investments and for meeting margin calls;
- for other "life-event" contingencies, such as endowments, health contingencies and retirement accommodation, or perhaps paying up health insurance from a certain age;
- building an investment nest-egg to draw-down over a future period as a tax-effective and flexible income stream;
- provisioning for a child or a loved one with a physical or intellectual disability; and
- as dedicated funds to meet costs of financially maintaining children, such as in circumstances of a divorce.

3.2 Education Savings Plans

One variant upon the generic insurance bond structure is an Education Bond or Scholarship Plan which involves slightly different (and more complex) tax treatment of distributions from the Bond. These tax differences reflect a recognition by Government that household saving to meet educational expenses of dependents warrant a degree of government support and encouragement.

In a number of countries, education savings plans are supported by Governments as a way of encouraging specific purpose saving and increasing access to post compulsory education, particularly for lower income families. In Australia, the situation is somewhat different, with post compulsory education subsidized by the Government and deferral of fees possible through the HECS or HELP programs on an admission quota basis. No up-front payment of fees is required (but is an option), with students incurring a future tax liability (indexed to the rate of inflation) with repayments occurring only when income exceeds average weekly earnings through an increase in the individual's tax of 1 per cent. While there is some discount provided for up-front payment of fees, it is generally advantageous (in a Net Present Value sense) to defer payment. Consequently, to the extent the deferred payment option is taken up, one view may be that there is less rationale for government supported education savings plans to facilitate access to higher education by lower income families. However, with an increasing trend towards fee-based courses involving costs beyond those covered by HECS or HELP another view is that long-term education savings plans are even more relevant.

In any event many parents (and grandparents) see it as their responsibility to finance such education for their children (and grandchildren), providing a role for savings plans targeted at meeting likely fees, or covering living expenses and other associated education costs of students. Moreover, a preference among some parents to use private schools, and incur higher fees, rather than public schools (albeit with lower fees but increasing other costs) also provides a rationale for such schemes.

Under Australian tax legislation, scholarship (or education) plans can be established by a friendly society, as a variant on the standard insurance bond structure, which have certain tax benefits. In essence, friendly societies are able to establish a scheme (fund) which accepts contributions from parents (or others) to finance education expenses of the nominated student beneficiary. Funds in individual accounts are pooled in a benefit fund for investment purposes. In some cases, a variety of investment choices are

provided. The fund may operate a capital account (comprising plan contributions) and an income account (comprising fund earnings), and fund earnings on current scholarship plans offered are taxed at the friendly society's life insurance rate – currently 30 per cent. Amounts paid out from the income account for education expenses include recoupment of prior tax paid – for example, a balance (after tax) of $70 in the income account grosses-up to a total payment of $100. The income component of payments made to (or for the benefit of) students (which may include education-related living expenses) are treated as part of assessable income of the student, with the student's tax rate sometimes being lower than that of the plan contributor. However, in the case of a student under age 18 (who may be in primary or secondary school), Australia's punitive tax regime for minors can result in the student's tax rate being equal to or higher than that of the plan contributor.

The tax treatment of scholarship plans enables investment income earnings of education benefits to be essentially diverted to lower income students, but who personal tax rate may be low (if aged 18 and above) or high (if aged under 18). By applying on-going tax on fund earnings, tax deferral and "pre-tax compounding" of interest are prevented, although for high marginal tax rate investors, the fund tax rate of 30 per cent may give some advantages. Amounts in the contributions account can be withdrawn at any time without tax implications. As on-going earnings are taxed in the fund, plan contributors and students do not need to include its earnings in their tax returns. If amounts in the earnings account are withdrawn for non-education reasons (which, for example, can be done if the contributions account has been completely withdrawn), the income component of withdrawn amounts revert to being assessable in the plan contributor's hands - and the standard tax rules applying to insurance bonds apply.

As with all managed investments, there can be various fees and charges. These include contributions fees (of perhaps up to 4 per cent on amounts contributed) and annual management fees.

While scholarship plans have the behavioral benefit of a "defined purpose" saving scheme, with the current tax treatment of Friendly Societies, the tax advantages (of tax deferral and income diversion) may only be readily apparent for higher income families. Subject to due consideration being given to the anti-avoidance provisions, other alternatives with tax-preferred treatment may also be available to higher income families. These include:

- establishment of family trusts (enabling tax effective allocation of investment income among family members);

- establishment of a discretionary trust which invests solely in a tax-preferred insurance bond;
- salary packaging of school fees (although higher effective FBT rates may have made this alternative tax disadvantageous);
- additional contributions into superannuation by family members (grandparents) who will have reached the preservation age (and have retired) when funds are required; and
- mortgage pre-payments under loan structures which enable redraw facilities (to reduce loan interest payments made out of post-tax income).

3.3 Funeral bonds

Funeral bonds involve the investor making contribution(s) into a managed fund run by a friendly society and which pays out on the death of the investor (or partner). The funds may be paid to the estate (or surviving partner) to meet funeral expenses. The fund may invest in a specified range of assets and an income amount (bonus) is allocated to the investor's account out of fund earnings (after tax) – generally at the end of each year. No tax is payable by the investor on these amounts as they accrue and are taxed in the fund (for currently-offered funeral bonds). Upon death – and in the case of a funeral bond that continues to be held by the investor, accumulated earnings (including a recoupment of prior taxes paid by the fund) are paid to (or as directed by) the trustee of the estate and this amount is taxable to the estate.

In the case of a funeral bond where a funeral director becomes entitled to proceeds on death (as a result of the investor entering into a prepaid funeral plan and conferring such entitlement as consideration), no amount is received by the estate – nor is the estate subject to tax on the proceeds.

The principal distinction between this and a generic insurance bond is that the accumulated value can only be received upon the death of the contributor. It also differs from a separate "funeral plan" which typically takes the form of an insurance policy requiring either a one-off contribution or regular contributions as purchase payment for a defined benefit amount upon death.

An effective limit is imposed on contributions as follows:

- For income tax purposes, the total amount contributed must be commensurate with the reasonable cost of funding a person's future funeral expenses. Tax law's definition of a 'funeral policy' has a sole purpose test, which relates to this principle.

- For social security means test purposes – as would be relevant to recipients of (for example) the age pension or veterans service pension, special income and assets test exemption is allowed for up to two 'exempt funeral investments' where total contributions do not exceed a prescribed CPI-indexed limit. That limit is $11,000 for contributions (or top-up contributions) made during the 2010-11 year.[12] If funeral bond proceeds have been conferred to a funeral director (in consideration for acquiring a prepaid funeral plan), there is no contribution limit, as the amount contributed is regarded as immediately expended.

The bond may be *capital guaranteed* by the issuing institution, but this is not a requirement.

3.4 First Home Savers Accounts (FHSA)

Another life event product recently created through Government tax incentives is the FHSA launched in October 2008. This was aimed at providing incentives and assistance for individuals to save and accumulate funds for the purchase of a first home. Use of the scheme was limited, with only 20,000 accounts opened in the first two years, prompting changes to the scheme to be announced in the 2010 budget.

Rather than build upon existing life event product structures such as the insurance bond, the Government implemented the scheme via creation of a new type of savings accounts at banks, credit unions, building societies, life insurance companies (including friendly societies) and superannuation fund trustees. The scheme involved the creation of tax-preferred deposit accounts, designated as being for first home purchase by the account holder, in which interest paid on the account was taxed at a lower rate than for other income, as well as a government co-contribution. The Government contribution is currently set at 17% on the first $5,500 contributed in any financial year. The maximum tax rate on earnings in the account is set at 15 per cent. Contributions can be made by anyone on behalf of the account holder. Withdrawals from the account to purchase a first home are tax free, but could only occur after reaching the 4th financial year (since original contribution) and only where contributions of at least $1,000 have been made in each of at least four financial years. An indexed account balance cap of $80,000 applies to the 2010-11 year (will be $85,000 for the 2011-12 year). Once the

[12] There are also special arrangements for situations in which the funeral bond has been assigned to a funeral parlor as pre-payment for a funeral.

account balance cap is reached, no further personal contributions can be made, even if indexation increases the cap in later years.

A significant disincentive to use of FHSA was the requirement that purchase of a first home by an account holder before the four year maturity meant that accrued funds could not be put towards the house purchase but were required to be paid into a superannuation account. Changes were proposed to the scheme in the 2010 Budget (but as of March 2011 are yet to be enacted) which still do not allow accrued funds to be used for a house purchase prior to the four year maturity, but allow accrued funds to be used to pay down a mortgage on a first home when the four year limit is reached. No further contributions were to be allowed after a first home is purchased.

As noted above, the scheme has not attracted much interest among potential home-owners, nor amongst institutions eligible to supply the product. This can be attributed to complexity of design, administrative costs, and constraints imposed upon withdrawals from the account. No friendly society is currently offering an FHSA product.

An alternative approach could have been to build upon the existing insurance bond structure. For example, a special purpose insurance bond allowing for early redemption of accumulated balances without losing the concessional tax rate treatment if a first home is purchased, and receiving the government co-contribution in those circumstances would have been relatively easy to implement and administer. The option to withdraw early for other purposes (and lose the tax concessions) or at the maturity of the insurance bond, would reduce the "lock in" effect associated with the original or proposed alternative arrangements.

It is emphasized that 'first home' seekers need to have the time flexibility of funding a home purchase when a desired home at the desired price is found. As home prices values are sizable, the 4-year time-constrained FHSA incentive is negated – if 'first home' seekers wish to avail of a perceived bargain price whenever it arises.

3.5 Taxation and Life event products

There is a variety of tax arrangements applied to financial products, and the current situation is a far-from-level playing field. To some extent that is driven by government policy aimed at encouraging particular forms of asset accumulation. The substantial tax concessions involved in superannuation are a clear example, and these are accompanied by various constraints on usage to prevent excessive exploitation of those concessions. Other forms of investment which receive concessional tax treatment are owner-occupied

housing, as well as levered investments in real or financial assets such as investment properties and shares.

To provide a basis for comparison across investment types, it is helpful to think of tax characteristics according to the "3T" framework. This framework is based on noting that concessional tax treatment can occur at three stages of the product life-cycle: (1) on injection of funds, (2) on earnings while funds are within the product, and (3) when funds are withdrawn from the product. A triplet (t_1, t_2, t_3) can thus describe the tax treatment where t_i is tax treatment at stage i. Each t_i can take on one of three values: t_i = 0 for tax exemption; t_i = t for preferential tax treatment; and t_i = T for non-concessional tax treatment. (Preferential tax treatment could also involve government co-contributions, or not including the value of the asset in calculation of the means test for government benefits). Thus, for example, a financial product involving contribution of after tax income, receiving preferential tax treatment of earnings, and subject to zero tax on withdrawal would be represented by (T, t, 0). In practice, things will rarely be this straightforward, with tax treatment possibly conditional on some event or investor characteristic, and with various contribution or withdrawal restrictions imposed.

Nevertheless, it is useful to characterize a range of financial products according to this framework, and this is done in Table 2.

TABLE 2: Taxation Treatment of Alternative Investment Types

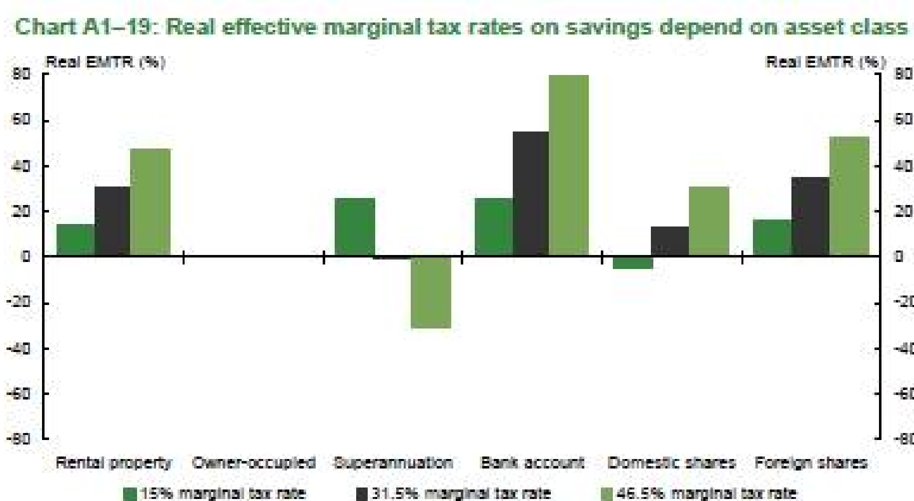
Product	t_1	t_2	t_3	Comment
Savings account	T	T	0	Contributions are from after tax income, earnings are taxed as they accrue, and thus no requirement for taxation on exit when principal is returned.
Shares	T	t	t	Investment is from after tax income, there is concessional treatment of dividend income (imputation) and deferral of tax on capital gains until realization, and then at a concessional rate (if held for more than one year).
Complying Superannuation (funded schemes)	t	t	0	Contributions can be made from pre-tax income, there is a concessional tax rate (15 per cent) on super funds, and no tax payable on withdrawal (past age 60)
Insurance Bond	T	T (<10 years) t (>10 years)	0	Contributions are from after tax income, earnings are subject to 30 per cent rate (beneficial for high income earners), and no tax is payable on withdrawal (after the 10-year period).
Owner Occupied Housing	T	0	0	Purchase out of after tax income (and/or borrowed funds), imputed (self) rental income not taxed, no capital gains tax on sale
Levered Rental Property or Equity investments	T	t	t	Purchase out of after tax income, tax deductibility of loan interest, concessional capital gains tax (if held for at least one year).

Some of these differences in tax treatment are reflected in Chart A1-19 from the Henry Review of Australia's Tax System (Henry, 2009) reproduced below as Figure 4.[13] In particular, the highly favorable tax treatment of superannuation for

[13] This chart involves specific assumptions about inflation and pre-tax rates of return. A zero tax rate as form owner-occupied housing corresponds to an expenditure (consumption) tax (ie

high income earners is apparent. And it should be noted that the tax rate comparisons for rental property and shares do not involve leveraged investments.

FIGURE 4: Relative Taxation of Savings Products



Source: Henry (2009)

Without further information, it is not possible to do a similar calculation to that underlying Chart A1-19 for investment bonds, but a comparison with domestic share investment is possible. Table 3 provides a calculation of the real rate of return on an investment in shares directly by an investor and indirectly via an investment bond. (It is assumed that the nominal rate of return is 6 per cent p.a., half via capital gains and half as unfranked dividends, and that the inflation rate is 2.5 per cent p.a. The share is purchased and held for 10 years in both cases).

Because the Insurance Bond is taxed at the level of the Friendly Society and involves no tax consequences for the investor, its real after tax rate of return is the same for all investors (if amounts are later withdrawn tax-free to the investors). It can be seen that this tax treatment makes the Insurance Bond a higher yielding investment for high (45 per cent) tax rate investors, but not for low (15 per cent) tax rate investors. It is also noticeable, that the denial of concessional capital gains tax treatment means that the Insurance Bond return is slightly less than that available from a direct investment for a 30 per cent tax rate investor.

investment out of after-tax income and no subsequent taxes). Recent changes to superannuation will have caused these estimates to change for low income earners.

TABLE 3: Comparative Returns on Share Investment

Investor	Real After tax rate of return (% p.a.)
Individual share investor on 15 per cent tax rate	2.80
Individual share investor on 30 per cent tax rate	2.18
Individual share investor on 45 per cent tax rate	1.55
Individual investing via Insurance Bond	1.81

Assumptions: 3 per cent unfranked dividend and 3 per cent nominal capital gains p.a., inflation rate of 2.5 per cent p.a. Share held for 10 years. Insurance Bond taxed at 30 per cent on both dividends and realized capital gain.

Combining these results with those of Chart A1-19 of Henry (2009) suggests that, given current tax treatment, there are incentives for low (and medium) tax rate investors to invest directly in shares or levered investment properties in preference to products such as insurance bonds, even though their financial resources and expertise are unlikely to be suited to such investments.

More significantly, it is apparent that the tax treatment of Superannuation is vastly more favorable than that of Insurance Bonds, even though both are long-term savings vehicles. Table 4 provides a comparative analysis of the key characteristics of Superannuation and Insurance Bonds. As this analysis demonstrates, while superannuation has a more favourable tax treatment, Insurance Bonds have benefits in terms of simplicity and flexibility.

TABLE 4: Comparative analysis of Superannuation and Insurance Bonds

Characteristic	Superannuation	Insurance Bond
Taxation	Pre-tax contributions, 15 per cent tax on earnings (10 per cent for capital gains), tax free on exit if over sixty	Post-tax contributions, 30 per cent tax on earnings (including capital gains), tax free on exit if after 10 years or on defined events
Life Insurance	Accumulated sum paid out on death (plus some part of contributions allocated to an insurance policy) – tax status would depend upon type of beneficiary	Accumulated sum paid out on death – tax-free to any beneficiary
Tax Reporting by Investor	Generally not during accumulation mode (provided contributions under allowable cap) reporting required in pension mode	None
Legal Status	Policy or account managed by superannuation fund trustee.	Contract with Friendly Society/Life Office
Control and Access	Limited prior to preservation age (unless hardship or terminally-ill conditions are met)	Unrestricted
Change of Ownership	Not possible	Possible via assignment of policy
Assets Investment	Range	Range
Capital Guaranteed	Can be	Can be
Cash Distributions	None prior to preservation age	None prior to maturity or withdrawal (part-withdrawals permitted)
Use as security for borrowing	Prohibited	Possible
Creditor protection in personal bankruptcy	Yes	Yes (if life insured is investor or investor's spouse)

4. Public policy towards life event financial products

There are a number of dimensions of public policy which are relevant in considering life event financial products. First, is there some form of market failure or imperfection which inhibits the development of financial products which can meet needs and desires of individuals? Second, is there a role for "paternalistic" behavior by government in creating a demand for such products by way of tax-transfer incentives or other means? Third, do government policies inappropriately advantage some financial services and products which meet these needs, but not in a socially optimal way? Fourth, is government support for such products for lower income groups an appropriate way of achieving distributional and equity goals? Fifth, what type of regulation of providers of such products is appropriate?

- *Market Failure Rationale*. There are two main sources of potential market failure in the case of life cycle event products. One is the pervasive effect of imperfect information which can lead to individuals incorrectly assessing the probability and timing of these events and thus the merits of such products. Moreover, the imperfect ability of individuals to discriminate between possible products can create substantial quality related problems such as the "lemons" problem.[14] Policies to enhance financial literacy and entry/product quality restrictions are potential policy measures. The second major source of market failure can arise from the operation of the tax system which may affect demand for investments in / saving through these particular types of products.

- *Paternalism Rationale*. Individuals may under-invest in life cycle event products relative to what is socially optimal for various reasons. One is through behavioral biases or irrationality. A second is that other forms of government financial support are available when such events occur, such that private provision for these eventualities is replaced by public provision. In these circumstances, there may be grounds for government incentives for or mandating of investment in such products. Another reason for government promotion of asset accumulation can be the desire to improve financial literacy – based on the argument that increased familiarity with, and stake in, the financial sector may help encourage interest and learning.

[14] The "lemons" problem introduced to the economics literature by George Akerlof (1970) argues that inability of purchasers to differentiate (*ex ante)* between the quality of products from different suppliers creates incentives for lower quality producers to enter the market, driving down average quality and thus demand and price, and causing higher quality (higher cost) producers to exit in a vicious spiral and potentially collapse of the market.

- *Government Induced Distortions*. Substantively different tax rates apply to different types of savings vehicles in Australia – as pointed out in Figure 4 (Henry 2010) reproduced earlier. Tax incentives exist for saving via way of (levered) investment in property and superannuation. While individuals may be able to access some of the accumulated wealth in those forms of saving to meet life-cycle events, it is not apparent that this is optimal.
- *Redistributional Motives*. Public and political support for redistributional measures is often enhanced if those measures are linked to increased expenditure by the recipients on some products and services thought to have social value. Several authors (see for example Doling and Ronald, 2010) argue that a growing trend in social welfare policy is use of asset based policies in which individuals are induced to assume greater responsibility for their own welfare by investing in financial products to accumulate wealth for future expenditures. Such inducement may be by way of subsidies, tax concessions, grants, and directed at saving for particular expenditures such as housing or education.
- *Regulatory Policies.* Life Cycle event financial products involve significant promises by providers. For this reason providers can be expected to be prudentially regulated.

Funding of Life event expenses

Mayhew, Karlsson et al. (2010) provide a useful taxonomy of possible financing options for life-cycle events in their discussion of the UK Green Paper on Long Term Care. They identify five main options. These are:

- Self funding – where individuals are responsible for meeting expenses.
- Partnership – where some proportion of expenditure required is met by the government and some part by the individual
- Insurance – where (compulsory or voluntary) insurance would provide additional funds to any available from government
- Comprehensive – where mandated contributions (income linked) to a government (or private) scheme are required and expenditures met by the scheme
- Tax funded – where expenditures are met by the Government out of tax revenue.

The preferred financing arrangement will depend upon the type of expenditures being considered, and ideological influences. For example, universal self funding is problematic where predictability of need for the expenditure is low, and where consequences of not being able to meet the expenditure are severe. Also

important is how the quality of service or product for which expenditure is required might be affected by the financing mechanism.

Insurance Bonds are a good example of the partnership approach, in which individuals accumulate savings to meet expenditures and where some government contribution is involved via the tax concessions provided. It is also possible for that contribution to be achieved by government matching or co-contributions. However, at the current tax rate applied to Friendly Societies, the attractiveness of these products to low income individuals as a wealth accumulation vehicle is reduced.

5. Overseas experience

There are a number of international examples of governments supporting life event financial products. These often have distributional objectives, although they are also sometimes targeted at increasing the savings available to families to undertake socially desirable expenditures (such as on post-secondary education), and may have an objective of increasing national saving. Government support may be provided via tax concessions or by way of matching grants. Institutional arrangements and taxation systems differ markedly across countries, such that it is often difficult to make direct comparisons of similar types of schemes. A number of different schemes have also been introduced in some countries and subsequently terminated. In some cases this may be attributable to design flaws, while in others it reflects changes in government and political attitudes.

It is worth noting that the effect of such schemes on increasing savings appears to be greater for low to moderate income households (see e.g. Benjamin, 2003). And, *ceteris paribus*, the larger the proportion of lower income (lower tax rate) individuals who participate, the less will be the average tax revenue forgone (ie tax expenditure) per participant. And because such schemes often have a distributional objective, finding design features which lead to relatively greater take-up by lower income households is an important consideration – especially given their collective potential to boost national savings.The OECD (2007) undertook an analysis of tax preferred savings accounts, including those for education, children, and insurance. All involve some form of tax concession, while some also involve a government contribution or bonus amount (subject to certain conditions being met).

Table 5 (based on Tables 1.1, and 1.2 of OECD, 2007) summarizes the general approach at a national level, using the "three t" approach. Dual entries indicate different tax treatment of different schemes, and "B" indicates a bonus element, where the bonus is in the form of a government co-contribution or matching grants to the scheme. The Table also shows the period for which access to savings is limited in order to obtain the concessional tax treatment.

TABLE 5: International tax treatment of tax preferred savings account products*

Country	Contributions	Earnings	Withdrawals	Access limited for
Belgium	T/t	0	0/t	
Canada	T	0 (B)	T	Until expenses incurred

Denmark	T	0	0	7 years
Germany	T	E/T (B)	0/t	7 or 12 years
Ireland	T	0	0	3 or 5 years[1]
Italy	T/t	0	T	
Netherlands	0	0	0	4 years
Norway	T	T	0	4 years
UK	T	0	0	5 or 10 years or age 18
USA	T/0	0	0	Until expenses incurred

* T indicates fully taxed, t indicates partially taxed, 0 indicates tax exempt, B indicates a bonus element. Data relates to 2005. Blanks indicate that information was not available in an appropriate form.

[1] The limit for Special Savings Accounts is 3 months

Source: OECD(2007, Table 1.1)

Two features stand out in Table 5. First, the time required before funds can be withdrawn without losing tax concessions is generally substantially shorter than for Insurance Bonds in Australia. Second, the taxation rate on earnings is generally lower than the statutory tax rate (and often zero) – again different to the case in Australia. It is also worth noting that in a number of cases government co-contributions or matching grants are used rather than tax concessions.

There are a range of schemes of tax preferred saving in operation internationally targeting child development/asset building, education funding, insurance, home ownership, health plans, as well as non-specific asset accumulation schemes. In the following we review some of those schemes. However, before reviewing these policies, it is worth noting that their implementation on purely financial criteria (availability of a lump sum for some purpose) assumes, perhaps rightly, that financial markets are imperfect in that loans would not be available to meet such lumpy expenditures when they arise. There is also a question as to whether subsidies provided for this specific form of wealth accumulation are offset by reduced saving from other income.[15] Finally, there is the question of what

[15] Japelli and Pistaferri (2003), review the research examining aggregate savings effects from tax concessions on IRA's in the USA (which has been the most intensively studied example). They conclude that there is evidence that tax incentives affect the composition of saving, but the effect on total saving is less clear.

happens to funds in these specific purpose designated accounts should the targeted event not occur.

5.1 Child Development Accounts

One type of approach found in a number of countries is that of Child Development Accounts aimed at encouraging savings and wealth accumulation from a young age. Loke and Sherraden (2009) describe policies existing in Canada, UK, Singapore, Korea and a planned scheme for the USA. Underpinning these strategies is the perspective that asset accumulation provides resources for meeting lumpy costs or for aspirational expenditures, and that the process of wealth accumulation is a "merit activity" which warrants inculcation at an early age.

Table 6 provides information on the types of Child Development Account tax-preferred schemes in a number of countries.

TABLE 6 Tax Preferred Child Accounts

Country	Name	Tax Treatment	Available to	Contribution Limits	
Belgium	Tax preferred deposit accounts	(T, 0, 0)	All	None	If account opened in childs name, withdrawal is restricted
Denmark	Savings Accounts for Children / Grandchildren	(T, 0, 0)	All	Annual and lifetime	
Hong Kong	Child Development Fund	(T/B,T,0/B)	Disadvant-aged Children aged 10-16	Target savings limit	3 year time span for specific purpose
Singapore	Children Development Account (SDCA)	(T/B,T,0)	2nd -4th children aged 0 to 6	Annual limit for government contribution	Use for education, child care etc.
South Korea	Child Development Account	(T/B, T, 0)	All children in welfare system	Monthly limit for government contribution	Available at age 18 for range of uses
UK	Child Trust Fund	(T, 0, 0)	All	Annual limit	Initial government bonus contribution. Matures at age 18

Singapore[16]*: Baby Bonus/Children Development Account (SCDA)*. The Baby Bonus involves a government cash grant at birth deposited into a savings account and a second tier component of the SCDA, where family contributions are matched by the Government up to a cap. The SCDA is

[16] https://www.babybonus.gov.sg/bbss/html/index.html

available only for 2nd to 4th children in a family and operates from ages 0 to 6. Funds can be used for education, child care, medical related expenses etc., and unused amounts transferred into the PSEA upon entering primary school. In 2011, the Government announced the introduction of new Child Development Credits to be payable into SCDA's to all children below 6.

Hong Kong[17]*: Child Development Fund (CDF).* The CDF is aimed at developing savings behavior and personal development planning and targeted at children aged 10-16 from low-income and welfare-dependent families. It involves participation in personal development planning activities involving financial plans run by NGOs who provide matching funding for the targeted savings made, as well as mentoring. At the end of the 3 year program, successful completion leads to a government contribution and accumulated funds can be used for the activity specified in the plan.

UK: Child Trust Fund (CTF). Government contributions are made under the CTF (Child Trust Fund) at birth and age 7, via a voucher (of larger value for low income families) which can only be placed in specified CTF account types. Family contributions, up to an annual cap, into the CTF account are possible, and earnings are tax exempt. The CTF funds can be withdrawn by the child after age 18 for any purpose. The scheme was abolished in December 2010 by the new Conservative Government.

South Korea: Child Development Account (CDA). The CDA[18] was introduced in 2007 with the objectives of improving financial education and asset accumulation by children from disadvantaged backgrounds. Families of children between 0 -17 can make contributions which are matched up to a prescribed limit by the Government, together with limited other contributions. The funds can be accessed at age 18 for education, medical, wedding, business, housing expenses.

Denmark: (Savings Accounts for Children/Grandchildren). These were introduced at the start of the 1980s. There are both maximum annual and total contribution limits which can be made until the beneficiary reaches 21, when funds are available, and the account must be opened before the beneficiary is 14, since a minimum 7 year term is imposed. Earnings are tax free, and the account can be operated by the administering financial institution as a pooled investment scheme.

USA[19]*: KIDS (Kids Investment and Development)* accounts were proposed under the *ASPIRE* Bill introduced in Congress for introduction in 2007 with an initial government contribution (higher for lower income households) on birth.

[17] http://www.cdf.gov.hk/eindex.html
[18] Nam et al (2010)
[19] Cramer (2010)

Private contributions up to an annual cap could be made and, up to a lower annual cap, would attract matching government funds in the case of low income households. Earnings would be tax exempt and no withdrawals allowed until 18 (when funds could be used for education expenses, or (after 25) for homeownership or retirement security).

5.2 Education Schemes

A number of countries operate tax preferred savings schemes for education. Table 7 provides a summary.

TABLE 7: Tax Preferred Education Savings Schemes

Country	Name	Tax Treatment	Available to	Contribution Limits	Comments
Canada	Registered Education savings Plans (RESPs)	(T, 0, t) and bonus	All,Bonus linked to income	Annual and lifetime per beneficiary	Govt bonus payments through Canada Learning Bond and Canada Education Savings Grant
Singapore	SCDA/PSEA	(T/B,T,0)			
USA	ESAs	(T, 0, 0)	All		
	529 (Qualified Tuition) Plans	(T, 0, 0)	All		

Singapore[20]*:* Singapore operates three relevant schemes - *Edusave, the Post-Secondary Education Account (PSEA),* and (as discussed above) the *Baby Bonus/Children Development Account (SCDA)*. The Edusave scheme involves government contributions into an account during compulsory schooling which can be used for particular education expenses, with unused balances transferred on leaving school into the PSEA. Contributions into the PSEA for children between 7 and 18 attract a matching government grant up to a cap. Funds in the PSEA not used by age 30 are transferred to the

[20] See Loke V and M Sherraden (2009)

individual's pension fund (CPF) account. (Baby Bonus /SCDA unused amounts are transferred into the PSEA upon entering primary school).

Canada[21]: The Registered Education Savings Plan (allows parents to contribute (after-tax) funds for post-secondary education into a registered savings account in which taxation of interest is deferred until withdrawal. These RESPs may attract additional Government subsidy through the Canada Education Savings Grant (CESG) or the Canada Learning Bond (CLB) schemes. The CESG involves government providing partially matching funding to parent contributions up to a cap, with the matching proportion linked to family income. The CLB involves a government grant into the RESP for low income families. The tax rate applied is that of the student withdrawing funds (which may be very low or zero) or a mark-up over the parent's tax rate if the child does not undertake an eligible education program.

USA: Education Savings Accounts (ESA) have operated since 1997 and number of states also operate "529" plans. Earnings are tax free if used for post secondary education, and some states allow limited income tax deductions for 529 contributions. If some distributions are not used for education expenses the earnings are taxed at the beneficiary's tax rate (plus a surcharge of 10 per cent). The maximum contribution limit is substantial.

5.3 Life Assurance Tax Incentives

There is generally quite complex treatment of life assurance savings, but some concessional treatment generally applies. Table 8 provides an overview.

[21] http://www.canlearn.ca/eng/saving/resp/index.shtml)

Table 8: Tax treatment of Life protection

Country	Summary	Tax Treatment
United States	Investment income is not taxed but withdrawals and contributions are. Employer-provided group term policies up to $ 50,000 not taxed.	(T/0, 0, T)
Belgium	Taxpayer gets tax credit on premium, Insurance company subject to one-shot tax when assured reaches 60 and assured pay 10 per cent tax on withdrawal	(t,0,t)
Canada	Investment income and withdrawals are tax free if they provide only an insurance, rather than an investment element.	(T,0,0)
United Kingdom	Withdrawals are tax free, but returns are taxed (at 20%). Tax relief on premiums phased out in 1984.	(T,t,0)
	Friendly Society Tax-Exempt Savings Policies (TESPs) – maximum contribution limit imposed	(T,0,0)
Germany	Pre 2005, contributions are tax-deductible subject to a cap; returns are not subject to tax. From 2005, no deductibility of premia, concessional taxation of payouts if minimum age etc. met.	(t,0,0) – pre 2005 (T,0,t) – 2005 on
Italy	Contributions are tax-deductible subject to a cap and a time limit for life insurance products specifically designed to supplement social security pensions; withdrawals are taxed. Asset accumulation policies have non-deductible premiums and concessional (12.5% capital gains tax on withdrawal (no time limit).	(t,0,T) or (T,0,t)
Japan	Contributions are tax-deductible subject to a cap and a time limit; withdrawals are partially tax-exempt.	(0,T,t)
France	Contributions are tax-deductible subject to a cap and a time limit; withdrawals are taxed.	(0,T,T)
Argentina	Contributions are tax-deductible subject to a cap; returns are tax-free.	(0,0,T)
India	Contributions are tax deductible; returns are taxed.	(0,T,T)
Singapore	Contributions are tax-deductible subject to a cap; returns are taxed.	(0,T,T)
Taiwan.	Contributions are tax-deductible subject to a cap; returns are taxed	(0,T,T)

Source: Japelli and Pistaferri (2003), OECD (2007)

5.4 Non Specific purpose Schemes

Table 9 provides information on a number of schemes operating in overseas countries which do not have a specific purpose (such as education of child asset building)[22].

TABLE 9: Tax preferred (non-specific) accounts

Country	Name	Tax Treatment	Available to	Contribution Limits	Comment
Belgium	Tax preferred deposit accounts	(T, 0, 0)	All	Annual limit on interest which gets concessional tax	
Germany	Employee saving bonus (Arbeitnehmersparzulage)	(T, t, 0), saving bonus not taxed	Low/ medium incomes	Limit on contribution matched by bonus	Employer payroll contributions
Ireland	Special term accounts	(T, t, 0)	All	Monthly contribution limit, Annual limit on interest which gets concessional tax	Commence 2002 and replaced a number of prior schemes
Netherlands	Spaarloon	(0, 0, 0)	All	None	Employer payroll contributions
Norway	Aksjesparing med skattefradag	(t, T, 0)	All	None	For equity investments, abolished in 2000
UK	ISAs	(T, 0, 0)	All	Annual contribution limits	No time limit on withdrawals (various prior schemes terminated)

Source: OECD (2007) *Encouraging Savings through Tax-Preferred Accounts* OECD Tax Policy Studies No. 15

[22] Hungerford (2006) provides an outline of a number of proposals considered by the Bush Administration in the USA including lifetime savings accounts (LSAs) and Individual Development Accounts (IDAs).

5.5 Contractual Home Savings Schemes

Schemes to assist the purchase of a first home are found in many countries.[23] Sometimes these take the form of a government grant (such as the First Home Owners Grant in Australia) which is not tied to any prior contractual savings scheme nor income tested. Some nations have adopted mandatory housing savings schemes, while some others allow mandatory pension savings to be used, alternatively, for housing purchase. In some other cases, tax incentives and/or subsidies may be given to savings schemes which are tied to ultimate first house purchase. In some cases, institutions may be established which both accept savings and make housing loans to their members.[24] (In Australia, some forms of building societies (Starr-Bowkett societies) and cooperative housing societies took this form, with varying approaches as to how available loan funds would be allocated amongst members).

Promotion of home ownership is often seen as an objective of social policy in its own right. But viewed over a life cycle perspective, there are other reasons for its promotion. One, based on a behavioral finance perspective, is that individuals will not save sufficiently over their working lives in preparation for retirement. Contractual mortgage repayments associated with home ownership involve a form of forced saving, which is unlikely to occur through voluntary saving by renters. While home ownership in retirement reduces living expenses relative to renting, a second important potential life cycle benefit exists. This is the resulting option to run down equity in the property (by "downsizing" or use of financial products such as equity release or reverse mortgages) providing extra resources for retirement living expenses. In practice, however, this option has been underutilized – and, in some cases, deterred by government policies (such as not including the value of the family home in the pension assets test).

[23] Jappelli and Pistaferri (2003) provide an overview. See also Doling and Ronald (2010)
[24] Ronald (2009) outlines a number of contractual savings schemes for housing found in European and other countries.

6. Potential innovations in Australian life event products

The international experience surveyed above brings out a number of points:

- Tax concessions or government co-contributions are often found in a number of countries aimed at promoting particular types of saving and accumulation of "merit assets"
- There is a mix of approaches towards providing tax concessions (between deductibility of contributions, concessional (zero) taxation of earnings, concessional treatment of withdrawals). There is, perhaps, a slight bias towards non deductibility of contributions and concessional (zero) taxation of earnings and withdrawals.
- The savings and investment programs involved often have an objective of improving financial literacy through "learning by doing"
- Targeted and limited government co-contributions are often used to ensure that benefits flow primarily to lower income or welfare dependent groups
- Specific purpose programs (such as for education) have limits upon the use to which funds can be put without loss of tax benefits or government contributions
- The "lock-up" period for funds varies substantially across scheme and country, but is generally shorter than the ten years applied in Australia.

Drawing on this international experience it is possible to see how the generic and prudentially-regulated insurance bond can be enhanced to help Australian families plan and save flexibly, collectively and on an inter-generational basis for known future financial demands in the areas of health, aged care and funeral expenses. Tax incentives and co-contributions can be structured in such a manner as to increase the self reliance of individuals and reduce the potential demands on public welfare into the future. The potential benefits for improving financial literacy and reduced need for expensive financial advice should also not be underestimated. As well as the insurance bond structure, other products are also potentially available to meet gaps in the market, and Friendly Societies have long had an involvement in the provision of such products and services.

6.1 Family Health Management Fund (FHMF) proposal

The Family Health Management Fund (FHMF) has been proposed as a voluntary savings facility to positively encourage Australian families (grandparents, parents and children) to be proactive in planning for their

chosen levels of health care and independence in ageing years. In essence, the FHMF is a tax-paid, life insurance saving and investment product, designed to build an accumulation that is drawn against a range of eligible expenditures falling under five life-event categories as follows:

- Health Maintenance: This benefit category will assist with the costs of carrying through a health plan, a fitness plan or a wellness plan, including coverage of amounts and items generally outside the scope of Medicare and private health insurance. The health maintenance category will be relevant for all consumers - including those who do not have any, or adequate, private health insurance and who choose to have elements of self-insurance by using a disciplined investment vehicle specifically designed for the purpose. It will also be attractive to those not taking ancillary tables under private health insurance and/or in providing for items not covered under ancillary tables. (e.g. pharmacy, special dietary etc.).
- Private Health Insurance Premium: This benefit category is to build an accumulation to fully or partially "pay-up" private health insurance cover. The peace-of-mind of knowing that one's health insurance can be paid-up for life or a defined term is thought to be most attractive. The FHMF strategy could be to reach a sufficient FHMF investment accumulation to finance a set level of private health insurance coverage for life (or joint lives), or for a selected term. (The required accumulation would be determined by actuarial estimates), from which automated draw-downs against the FHMF to meet premiums would be made. This category will be attractive to those families using private health insurance as part of their family health management strategy or plan.
- Aged Care Accommodation: The FHMF may be used to fully or partially meet the costs of a chosen retirement village, hostel or nursing home, including the funding of accommodation bonds, and self-care residential units.
- Aged Care Services: This category will be designed principally for those choosing a level of independence from the publicly funded support services. It will allow, for example, claims for home care as well as for specific aged residential and services needs. These may include the cost of home modifications, home cleaning and maintenance costs and the costs of selected personal therapy or lifestyle services that will allow the individual (or the family) a wider choice for staying longer at home.
- Funeral: This FMHF category will cover funeral benefits for the family. It will do so by permitting direct payment of funeral and related expenses,

allowing payments to funeral directors for pre-paid funerals, and/or funding funeral investment product subscriptions.

The founding family member (e.g. a parent or grandparent) establishes the plan by a lump sum and/or a regular savings plan. The FHMF then grows over a set minimum accumulation period to a point of benefit maturity, from which time the founder controls access to plan benefits. The FHMF will have options (with control vested in the founder) over the product's investment strategy. This can involve choice between portfolios managed by the friendly society or by external fund managers. On death of the founder, options exist for any Plan balance to vest in the estate of the founder, or to pass to eligible family members, including being used to seed an ongoing FHMF.

6.2 Disability and other insurance

A range of insurance products are available for events which are low probability-high cost events. These include total and permanent disability insurance, trauma insurance, and income protection (salary continuance) insurance. Currently the Productivity Commission is examining the merits of a National Disability Scheme.

Such insurance schemes share a characteristic with savings based life cycle event products that regular (or lump sum) contributions are made and a payment is received should the relevant event happen. Two significant differences exist however. One is that these "pure" insurance products do not provide a return to the individual if the event does not happen. The other is that the payout is substantially greater than the accumulated amount from contributions and earnings.

Historically, products existed in Australia which combined the savings and risk insurance functions. Life Endowment Insurance policies paid out an insured sum on death before a nominated date, or an accrued amount (including bonuses based on investment earnings) should the insured still be alive at that date. Thus, some part of the contribution paid was a form of savings and some part a pure insurance premium. Because the insurance cost increases with age and the contribution amount was constant over time, there was front end loading of the savings component.

6.3 Long Term Care

A significant proportion of elderly individuals will require long term care towards the end of their lives. Currently over 830,000 retirees receive assistance in their home under the Government's Home and Community Care

(HACC) scheme. Government funded Community Aged Care Packages (slightly over half operated by religious and charitable institutions) were used by 53,250 people during 2007–08, and around 7,500 received higher levels of community care assistance. At June 2008 there were 175,472 residential aged care places available in Australia provided by almost 3,000 providers from the religious, charitable, community and for-profit sectors.

As well as the aspects of physical provision of these services and facilities, an important issue concerns the financing arrangements. Mayhew, Karlsson et al. (2010) note several private sector financing instruments which can be used and which may involve pre-purchase (at any time), date (eg retirement) specific purchase, or immediate use purchase:

- *home equity release* (reverse mortgages), whereby accumulated equity in the family residence can be drawn-down.
- *Top up insurance* whereby an insurance policy is taken out which pays out if, and when, long term care is needed. (The insurance may be linked to use of particular long term care facilities)
- *Disability linked annuities* whereby an annuity purchase while healthy includes a step-up (uplift) provision to a higher amount should a disability event necessitating long-term care occur. (Mayhew, Karlsson et al. 2010) note that the negative correlation between longevity and long term care need may be beneficial in risk management by writers of such annuities).
- *Immediate needs annuities* in which an individual entering care purchases an annuity to meet expenses and avoid the possibility of running out of funds for care
- *Accelerated life insurance* in which the policy begins payout if a severe disability occurs, and with such payments reducing the amount payable on death.
- *Long Term Care Bonds* involving regular purchases of zero coupon bonds which promise a payout on death or prior event of disability. Mayhew, Karlsson et al. (2010) suggest adding a lottery prize component to increase attractiveness)

6.4 A Re-Emerging Market for Modern Insurance Bonds

The 1980s and early 1990s were the heyday for insurance bonds, however from the mid 1990's onwards, they lost support of financial planners and retail investors. A major contributor was the increase in the head-line Tax-Paid rate to 30% as was the removal of means-tested pension advantages. The "lost" decade was also impacted by modest

investment performance and antiquated investment structures concentrated on capital guaranteed business.

Friendly societies and the wider Life Industry failed to move insurance bonds with the times by introducing modern multi-optioned investment platforms with switching facilities to higher performing equity and property options.

The insurance bond market today is seeing signs of new life with new entrants and existing issuers re-emerging with updated products and expansive investment menus. The re-kindling interest in insurance bonds is due to product design innovation by combining its long established taxation structure with a modern, investment platform.

The modern insurance bond operates like a mini master fund, and many are structured to give access to a menu of underlying managed funds under the bond's Tax-Paid investment environment. In comparison to single option "capital guaranteed" insurance bonds, this radically changes the Bond's performance capabilities. It is generally left to investors (or their Advisers) to construct their Bond's portfolio mix across the option selections from its menu.

Insurance bonds are generally written as "long-term" "strategy-based" business. As such, investment terms vary considerably. Many bonds are simply structured with 10 year plus terms aligned to the insurance bond taxation framework, which facilitates "Tax-Free" withdrawals after 10 years, or earlier death of the life insured. Longer post 10-year terms are commonly used for certain long-dated financial planning strategies using insurance bonds. For example, when using a bond rather than private trusts (where the rule against perpetuities can apply) or where the bond is used as the investment asset within a private trust. Also, Children's Advancement Bonds are typically 10 to 25 years, estate planning based business may track the client (or other person's) death maturity profile.

7. Regulation of Life Event Products

Life Event products must be consistent with government policies regarding financial products including prudential regulation, disclosure, marketing and distribution of financial products. This section provides an overview of the current (and changing) regulatory framework,

The delivery of financial products and services to individuals is significantly impacted by regulation and the tax system. Much of the regulatory structure and tax arrangements are designed to protect individuals from adverse financial outcomes or to induce particular types of saving and investment behavior. There can, however, be unanticipated effects upon the demand for some financial products and services which warrant a review of arrangements.

For the delivery of life cycle event products, a number of features of Australian financial regulation are relevant.

First is the requirement for suppliers of financial products and services to hold an appropriate Australian Financial Services Licence (AFSL), requiring compliance with licensing requirements.

Second, some institutions will, because of the nature of the products offered, be subject to prudential regulation by the Australian Prudential Regulation Authority (APRA). This regulation varies according to the type of financial institution (banks, other ADIs, life and general insurers, friendly societies, superannuation funds) but generally involves capital and liquidity requirements, supervision, and disclosure requirements. One consequence of regulation by institution type is that similar products offered by different types of institutions may be subject to different regulatory requirements.

Third, financial product offerings are generally required to be made under a prospectus or product disclosure statement made available to potential investors (although ADI deposits and friendly society funeral policies are excluded from this requirement). Complexity of these documents, which are often prepared with an objective of avoidance of potential future liability to inadequate disclosure, can be a significant impediment to retail investor understanding. Recent ASIC initiatives to allow simplified disclosure documents have been motivated by concerns that investors do not read or understand those long and complex documents.[25] ASIC has also recently provided guidance[26] enabling provision of disclosure documents online rather than via hard-copy. It is, however, worth noting that ASIC has increased disclosure requirements for

[25] See, for example, ASIC Regulatory Guide 213 *Facilitating Debt Raising,* May 2010; ASIC Regulatory Guide 168, *Disclosure: Product Disclosure Statements (and other disclosure obligations)*, September 2010

[26] ASIC Regulatory Guide 221 *Facilitating Online Financial Services Disclosure*, December 2010

certain types of financial products through its "if-not-why-not" disclosure requirements which require a financial product provider to explain why particular aspects of their business model or structure differ from guidelines set out by ASIC.

Fourth, financial products are generally "sold" rather than "bought", requiring marketing and involvement of sales agents and/or financial advisers to bring products to the attention of potential customers. Currently, under the Future of Financial Advice (FOFA) reforms announced in April 2010[27], there are plans to ban "conflicted" remuneration structures for advisers (involving volume and commission based payments from product producers) and a "best interests" duty (placing interests of clients first) requirement. Given the links between financial advisers as part of dealer groups using platforms provided by major product providers, the best interests requirement raises a number of issues about determination of products from other suppliers which should be included on an "approved products list" on the platform.

In some cases, requirements for obtaining financial advice (or at least for the provider to advise the purchaser to seek independent advice) before product purchase apply. This is among the proposals included in stage two of the National Consumer Credit Protection reforms for Reverse Mortgage products where it is proposed that individuals are required to obtain both independent financial and legal advice.

One reason for such proposed changes, which is more generally relevant is that financial decisions to purchase particular products can have significant tax or social security implications. For example, the exclusion of the family home from the assets test for the age pension means that the receipt of a lump sum upon entering a reverse mortgage may increase the included asset amount and affect pension eligibility. Similarly, the "deeming" provisions for the income test for pension eligibility (whereby a "deemed" rather than actual rate of return is used in calculating income) may bias preferences among financial investments.

It is also relevant to note that a degree of self-regulation has long applied to certain friendly society products, as briefly outlined below.

TABLE 10: Self Regulation of Friendly Society Products

Insurance bond	In the absence of statutory or prescribed guidelines, the friendly society has its own integrity procedures to deal with tax concessional payouts arising from claimed death, disability, illness or financial hardship events.

[27] http://futureofadvice.treasury.gov.au/Content/Content.aspx?doc=home.htm

Funeral policy	The friendly society has its own integrity procedures to deal with tax and social security concessional payouts arising from claimed death events, including the examination of relevant documents.
Scholarship (education savings) plan	The friendly society has its own integrity procedures to deal with tax concessional payouts arising from claimed education expenses, including internal guidelines on what constitute acceptable education courses and expenses. Also, in the absence of statutory or prescribed guidelines, some friendly societies have consulted with the ATO on acceptable contribution caps.

8. Policy Options and Conclusion

The recent Henry Review (2009) highlighted the lack of neutrality in the tax treatment of various savings products. With the dominance of the superannuation system in public policy, incentives to encourage individuals to be financially self-reliant and plan for the future through non-superannuation vehicles has gradually dissipated.

Other important issues in current policy discussions are the role of financial literacy and financial advice, as well as the use of the tax/transfer system to deliver welfare benefits and "nudge" individuals into making financial choices better suited to their long term welfare. Several Asian countries appear to have adopted the view that an "asset accumulation" approach to welfare policy, in which individuals are given tax/transfer incentives to accumulate "merit assets" and thus provide (at least partially) for particular life-cycle events has merit.

As this paper has outlined, the simple financial instrument of the Insurance Bond has many benefits which can be effectively utilized to encourage private saving for targeted life cycle events. In contrast to the disconnect experienced by many of the public in relation to their retirement savings though superannuation, the insurance bond allows individuals to tailor a savings regime that is more immediate and personalised, and does not require expensive on-going financial advice. Important events such as ill health, education, funeral costs and long-term care can be provided for in a targeted manner, thus allowing individuals a better quality of life and reducing reliance on public well fare

The Australian Tax Board (2010) (Australian Tax Board 2010) is currently reviewing the taxation of collective investment schemes, although this review excludes Friendly Societies and Insurance Bonds. It argues that a tax flow-through approach has merit, such that the tax consequences for investors would be the same is if held directly. It also argues the view that taxation should be related to the nature of the investments rather than to the particular investment vehicle used.

Currently, Friendly Societies and thus Insurance Bonds are treated quite differently to this, with no flow-through and differential tax treatment of capital gains relative to other investors. Superannuation is also treated quite differently. One consequence of tax-flow-through is that investors may incur tax liabilities without any cash flow currently being received from the collective investment.

To the extent that the Insurance Bond structure is seen as a valuable way of promoting individual saving for life-cycle events and/or for implementing some social welfare policies based around an asset accumulation/private responsibility approach, the current approach involving non-tax-flow through has merit. There

are however a number of characteristics of Insurance Bonds which result from legislation and tax treatment and warrant reconsideration.

8.1 Contribution Limits

Currently, investors are permitted to invest an additional 125 per cent of the previous year's total contribution in any investment year without affecting the date at which funds can be withdrawn tax free. The technical basis for this constraint relates to the 'eligible period' allowed (currently 10 years) after which tax-free withdrawals are allowed. It can perhaps also be rationalized on two integrity principles. One is the effect of encouraging continuing savings and investment into the bond, since a year without contributions precludes subsequent contributions. A second may be an objective of reducing exploitation of the special tax treatment involved. For example, without some contribution constraint, far sighted individuals could commence an insurance bond with a minimal investment and add substantially to it in the later years, thus getting the benefits of reinvestment at a lower tax rate in those years without having funds locked up in the bond for a long period.

The effect of the constraint is to limit total investment in the same bond, relative to the initial contribution amount and date, and to impose significant opportunity costs on individuals who do not contribute further funds in any subsequent year. While that latter effect may induce a more stable investment flow by the individual, the liquidity costs to the individual may be very substantial (if, for example, a spell of unemployment makes contributing difficult).

Information from individual Friendly Societies indicate that a significant proportion of contributors do not make additional contributions in one of the first three years following the initial contribution, and thus are precluded from further contributions – if wishing to maintain the bond's original start date..

An alternative approach (without comprising the integrity principles) would be to limit subsequent contributions to some multiple of aggregate prior contributions, where that multiple declines over time. For example, annual contribution limits relative to aggregate prior contributions of

- 125 per cent in year 2;
- 70 per cent in year 3;
- 50 per cent in year 4;
- 40 per cent in year 5,
- and then declining gradually to 30 per cent in year 10

would, if fully used, give approximately the same year 10 total contribution as if 125 per cent of the previous years contribution had occurred each year. The benefit of such an approach is that it reduces the penalty (inability to make further contributions) if an investor is unable to make contributions in any one particular year.

One potential downside may be that the 125 per cent limit may be easier to explain to investors than a declining schedule of maximum annual contributions relative to total past contributions. However, providing a schedule of maximum total accumulated contributions allowed at each year for each dollar initially invested would seem likely to overcome this problem and easy for the providers of the insurance bond to communicate to investors.

Regardless, it is noted that existing tax law does not actually prohibit making further contributions of any amount and at any time – only, if they breach the 125% further contributions cap, the bond's 'eligible period' start date is deemed to commence at the beginning of the investment year in which the offending contribution is made.

It is also noted that, with an established multi-premium policy, existing tax law accommodates delayed contributions into a bond – if the particular bond required the investor to make a contribution each year (within the 125% cap).

8.2 Headline Tax Rate

As shown earlier, the current statutory tax rate of 30 per cent applied to Friendly Societies (together with its less favorable capital gains tax treatment) means that insurance bonds are not tax effective investments for individuals on low marginal tax rates. Indeed, individuals on a 30 per cent tax rate would find a direct share investment held for 10 years preferable to making that investment through an Insurance Bond. (They would, however, not get the benefits of diversification, professional portfolio management, and avoidance of annual tax accounting regarding the investment that comes with the Insurance Bond).

Because Insurance Bonds are a simple product, requiring minimal financial advice, and suited to accumulation for life-cycle event purposes, it is unfortunate that the tax treatment weakens their appeal to those individuals to whom they may provide the most intrinsic benefits.

This problem could be resolved by reducing the tax rate paid by Friendly Societies to some lower figure, such as 20 per cent – or two-thirds of the prevailing corporate tax rate. While this would increase the tax benefits from

investment in Insurance Bonds for those individuals on higher tax rates (mindful the same argument may apply to superannuation), the social benefits from increased long term saving (additional to superannuation) may justify this. More generally, even at this lower tax rate, Insurance Bonds would still be taxed less favorably than some other investment structures (such as negatively geared investment housing or shares) intensively utilized by wealthy investors. To the extent that the simplicity, lower risk, lower administration costs of the product induced substitution out of those other structures, the net aggregate tax effect would be lower.

An alternative option is to follow the UK model where tax free savings accounts are offered by Friendly Societies and where no tax is paid by the Society on earnings. To prevent excessive tax arbitrage, the maximum contribution p.a. into such accounts is capped. To prevent individuals creating multiple accounts at different institutions, it would be necessary (much like with superannuation contributions) for information (eg a tax file number) to be collected about beneficiaries and provided to the ATO.

Yet another option is to introduce government co-contributions for specific purpose savings products targeted at particular low income groups, which are conditional upon income and subject to caps. This approach has the merits of more explicit targeting of a group of recipients with less spillover of tax benefits to higher income groups. However, non-cumbersome integrity rules may then be needed to ensure withdrawals are appropriately made for the specific purposes.

8.3 Reducing the Term

Much as with other characteristics of Insurance Bonds, the rationale for the 10 year term is shrouded in the mists of history – mindful there was no 'eligible period' for bonds issued prior to 28 August 1982, it was then 4 years for bonds issued until 7 December 1983, and 10 years for bonds issued thereafter. It would seem to reflect a view that the tax concessions involved in the product for some investors are warranted if the product involves long-term savings and investment. While such a trade-off has appeal, the appropriate terms of the trade-off are less obvious. But it would seem appropriate that the length of the terms involved would be greater the more generous are the tax concessions. Interestingly – and by contrast, in September 1999, tax law recognized that a period of 1 year was long enough an investment period to offer a 50% capital gains tax discount to individual investors (or a corresponding 1/3rd discount to superannuation funds).

Compared to the heyday of the Insurance Bond, when the tax rate was zero and the maturity was also ten years, the trade-off is significantly worsened. Consequently, given the current and even with a lower tax rate, there may be a case for reducing the maturity. Also relevant is the disincentive which a 10 year maturity creates, particularly if individuals are contemplating saving for potential life-cycle events which are not that far distant. In this regard, it seems relevant to note that society has generally moved to shorter-term expectations (compared with the early 1980s) – for example: in employment with the same employer, in residing in the same location, in tenure of a marital relationship, etc.

8.4 Conclusion

The Insurance Bond structure is a proven investment vehicle which can be adapted to a variety of special purpose savings needs. It is particularly suited for the provision of government incentives for the accumulation of "merit assets" which aim to meet life-cycle-event financial needs and for which individuals often make inadequate preparation. It thus can assist in implementing "asset accumulation" policies towards social welfare which promote financial literacy and personal responsibility for financial planning without the need for expensive financial advice.

Other potential benefits may flow from enhanced public awareness and use of Insurance Bonds, including increased focus upon the need for personal preparation for and funding of life-cycle events. Long term savings may be increased, potentially reducing the future taxation funding burden. Intergenerational transfers may become better directed towards helping meet important life events.

To enhance the use of this investment vehicle, and also to counterbalance the preferential tax treatment given to a range of other investment strategies, there is merit in considering changes to the current tax and legislative treatment of Friendly Societies and Insurance Bonds. These changes include: reducing the headline tax rate from its current value of 30 per cent; reducing the "lock-up" term from 10 years; simplifying the rules governing contributions subsequent to the initial investment; and in widening the circumstances for tax-free withdrawals.

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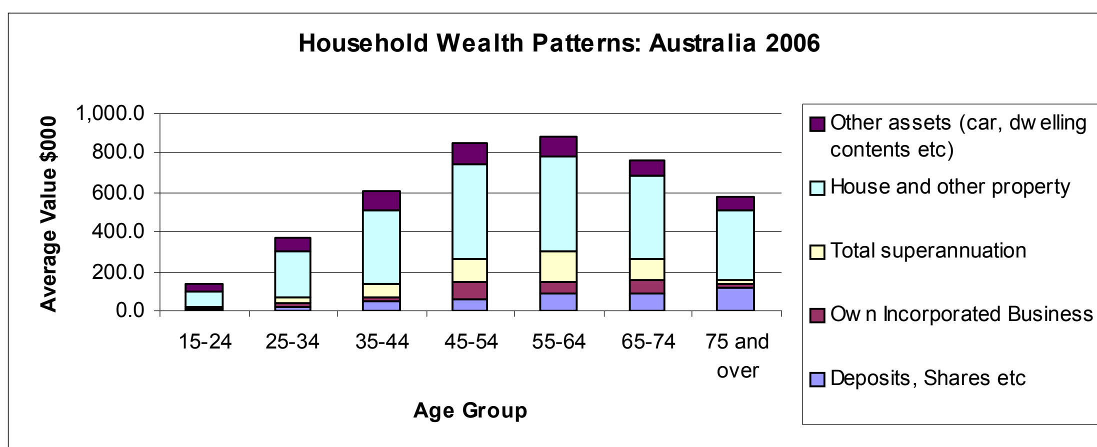
APPENDIX 1: Personal saving and investment choices: Australian experience

While individual financial experiences differ markedly over the lifecycle, Figure A1 illustrates that on average saving and wealth accumulation conform to the lifecycle perspective of wealth accumulation followed by decumulation in retirement. Several features stand out from Figure A1 which have implications for life event financial products.[28] First, most of the wealth accumulation prior to retirement is in the form of housing wealth, and that is not fully run down in retirement. Second, there is, on average, substantial wealth not drawn upon in retirement and left as bequests. While the bequest motive is generally believed to be strong, the concentration of wealth in housing which is not run down in retirement is relevant here.

FIGURE A1: Household Wealth Patterns



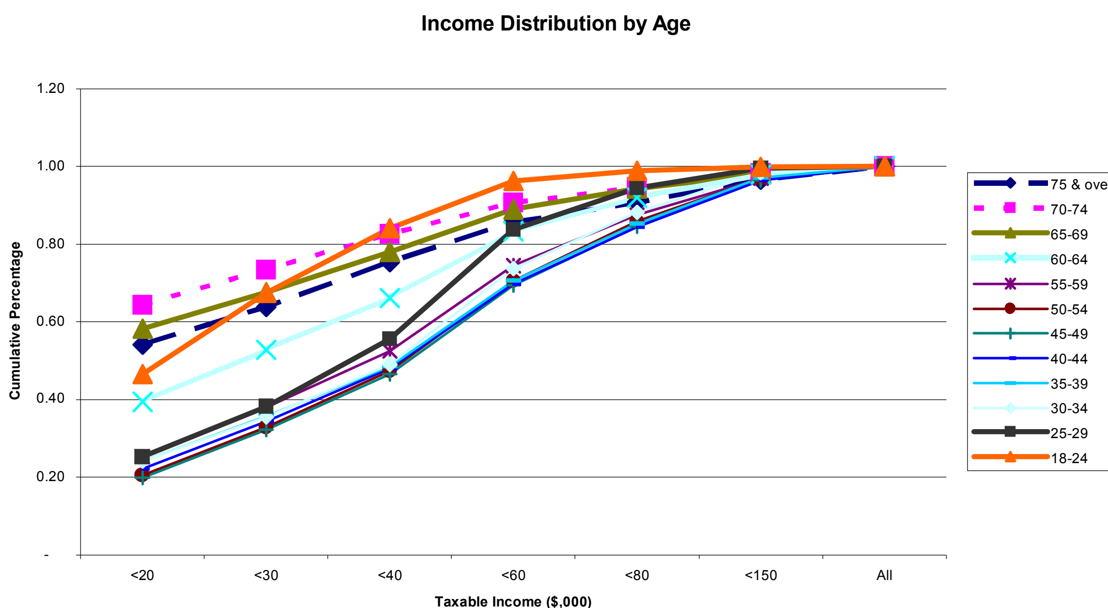
Source: ABS Cat. No. 65540DO001 Household Wealth and Wealth Distribution, Australia, 2005-06

Another general characteristic of the financial lifecycle can be seen in Figure A2 which shows how income levels vary over the life cycle. Income tends to increase with age up to middle age, before declining during retirement. But what is also relevant is the substantial inequality of income at different stages in the lifecycle. For example, approximately 20 per cent of the 40-44 age group had taxable

[28] It should be noted that this cross sectional distribution may not fully reflect the lifecycle pattern of a particular cohort of individuals. For example, the introduction of compulsory superannuation in the 1990s could be expected to lead to higher superannuation balances in later life for currently young individuals, while increasing income levels over time will also affect wealth accumulation.

income of less that $20,000, and approximately 20 per cent were above $80,000 in 2006

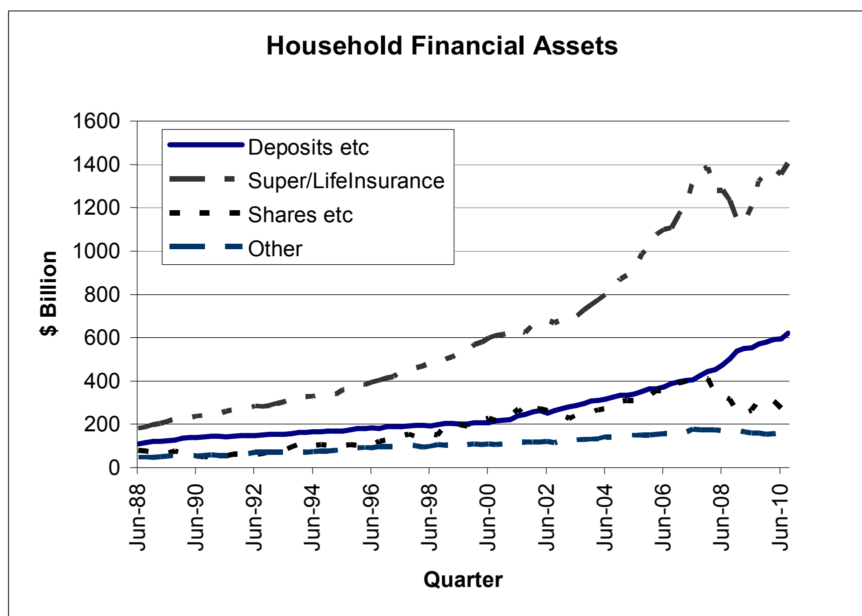
FIGURE A2: Income Distribution by Age



Source: http://www.ato.gov.au/docs/cor00225078_2008PER11.xls

Figure A3 shows the growth of superannuation in the composition of household financial assets over time. This reflects two factors, compulsion and tax benefits.

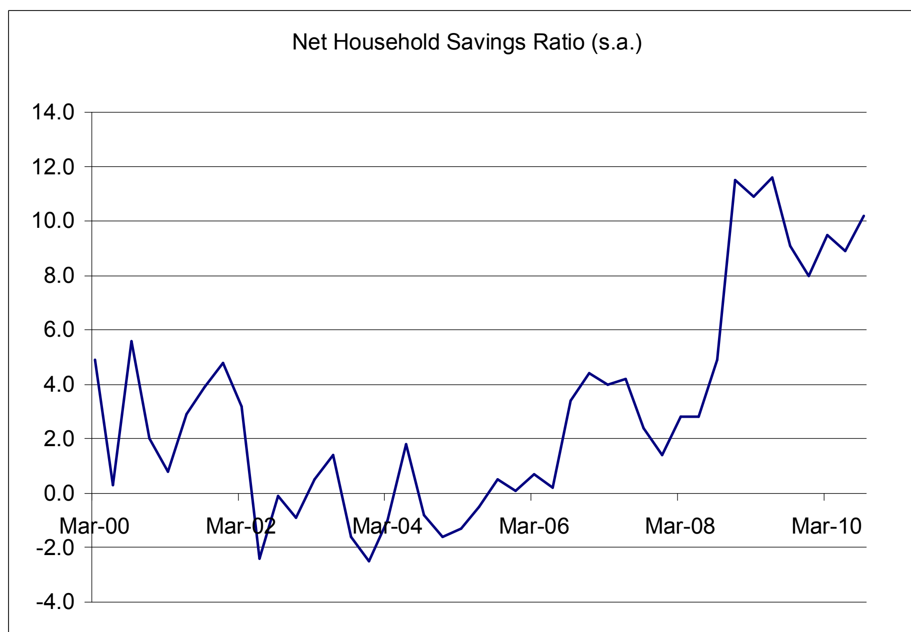
FIGURE A3 : Household Financial Assets



Source: ABS 5232.0

Figure A4 shows that after a long period of very low household savings, there has been a rebound in the savings ratio.

FIGURE A4 ; Household Savings Ratio



Source: ABS 5206.0

APPENDIX 2: Friendly Societies, January 2011.

- Ancient Order of Foresters in Victoria Friendly Society Limited
- Austock Life Limited
- Australian Friendly Society Ltd
- Australian Scholarships Group Friendly Society Limited
- Australian Unity Investment Bonds Limited
- CUA Friendly Society Limited
- Druids Friendly Society Limited
- IOOF Ltd
- KeyInvest Ltd
- Lifeplan Australia Friendly Society Limited
- Newcastle Friendly Society Limited
- NobleOak Life Limited
- Over Fifty Guardian Friendly Society Limited
- Over Fifty Mutual Friendly Society Limited
- Sureplan Friendly Society Ltd

Source: http://www.apra.gov.au/Friendly/FriendlyList.cfm

APPENDIX 3: Education savings Plans 2006

Name	Status	Start date	Regular savings plan?	Minimum investment	Entry fee	Ongoing fee % pa	Invests in...
Aust Unity Education Savings Long Term	Open	31 Jan 01	Yes	$2500	4%	1.95	Australian shares, international shares, cash
Aust Unity Education Savings Medium Term	Open	28 Feb 01	Yes	$2500	4%	1.95	Australian shares, international shares, listed property, Australian bonds, cash
Aust Unity Education Savings Plan Short Term	Open	31 May 01	Yes	$2500	4%	1.95	Australian shares, Australian bonds, cash
CBA Education Savings Plan Balanced	Open	1 Feb 05	Yes	$1000	0	1.75	Australian bonds, Australian shares, international shares, cash
CBA Education Savings Plan Capital Secure Option	Open	1 Feb 05	Yes	$1000	0	1.75	Australian bonds, cash
CBA Education Savings Plan Diversified	Open	1 Jan 06	Yes	$1000	0	1.85	Australian shares, international shares, listed property, Australian bonds, cash
CBA Education Savings Plan High Growth	Open	1 Jan 06	Yes	$1000	0	1.95	Australian shares, international shares
Lifeplan Education Savings Plan	Open	13 Oct 03	Yes	$50	0	1.65	Australian bonds, cash
Over 50's - Education Fund	Closed	6 July 92	No	$500	5%	1.29	Australian bonds, cash
Australian Scholarships Group TEF Plan*	Open	1 Jul 06	Yes	$46 a month	$149	1.25	Australian shares, international shares, fixed interest, property, cash, deposits at call
Australian Scholarships Group SEP Plan*	Open	1 Jul 06	Yes	$65 a month	$89	1.76	Australian shares, international shares, fixed interest, property, cash, deposits at call

Source: Australian Scholarships Group website