Industry Funds Forum Inc.

SUBMISSION 22

House of representatives Standing Committee on Economics, Finance and Public Administration
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22 July 2005

The Committee Secretary
Standing Committee of Economics, Finance and Public Administration
Department of the House of Representatives
Parliament House
CANBERRA ACT 2600

Dear Ms Forbes,

INQUIRY INTO IMPROVING THE SUPERANNUATION SAVINGS OF PEOPLE UNDER AGE 40

The Industry Funds Forum (IFF) represents the interests of 25 major industry superannuation funds, their members and employers. These funds have more than 7 million member accounts with over $55 billion in assets, and more than 300,000 participating employers.

IFF fund members cover employees across Australia from all industries and professions, with a large portion of the active membership of these funds, members under the age of 40. Included in this membership are two large national industry superannuation funds, both of which have an exceptionally high portion of membership under age 40:

- ***REST*** covering mainly retail, fast foods, pharmacies, hair and beauty with over 1.4 million members and $8.5 billion in funds under management, and *83% of members under age 40*;
- ***HOSTPLUS*** covering mainly hospitality, tourism, recreation and leisure with over 650,000 members and $3.7 billion in assets under management, and *77% of members under age 40*.

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Given the size and coverage of the IFF membership, the IFF is well placed to contribute to this important debate on adequacy and consumer understanding and interest in superannuation.

The IFF would be pleased to discuss this submission or provide further information as required by the Committee in order to assist it with its deliberations around Improving the Superannuation Savings of People Under Age 40.

Yours sincerely,

IAN SILK
Convenor
Industry Funds Forum

THE INDUSTRY FUNDS FORUM

SUBMISSION TO

HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON ECONOMICS, FINANCE AND PUBLIC ADMINISTRATION

INQUIRY INTO IMPROVING THE SUPERANNUATION SAVINGS OF PEOPLE UNDER THE AGE OF 40

July 2005

CREATING A STRATEGY FRAMEWORK

A strategic framework approach provides a basis for improving our understanding of people under age 40 and for analysing findings within the Terms of Reference of the Inquiry. This helps to make recommendations for changes as part of a strategy directed at improving superannuation for people under the age of 40.

This submission is has 5 parts:

1. **Terms of Reference**

2. **Profile of Generations X and Y**: scanning those aged under 40 was undertaken in order to assess the psychographic and behavioural characteristics that serve to illustrate the general attitudes and beliefs of this cohort.

3. **Super Context**: identifying how characteristics of this cohort have manifested in a superannuation context. This is necessary if we are to better understand how barriers and/or disincentives to contribute can be overcome, and how we can influence the behaviour and attitude of people under age 40.

4. **Analysis**: using this understanding to analyse superannuation and develop strategies that will appeal to this group.

5. **Strategic Direction**: recommendations for changes and for positioning superannuation as an important consideration for people under age 40, by building relevance and through appropriate education and awareness building strategies.

1. TERMS OF REFERENCE

To enquire into improving the superannuation savings of people under age 40 with particular reference to:

- barriers and/or disincentives to contribute to superannuation;
- current incentives in place to encourage voluntary superannuation contributions; and
- improving their awareness of the importance of saving early for their retirement.

2. PROFILE OF GENERATIONS X AND Y

This submission includes extracts from research conducted by IFF member, HOSTPLUS (Attachment 1). This research seeks to better understand the demographic characteristics of the under 40 age group, known as Generations X and Y, recognising that this very large group covers people of different stages in their life cycle, with different interests and responsibilities.

Of these two generations almost 60% have never married, only 44% are in full time employment and 19.3% in part time employment, with almost 32% not in the workforce, mostly students and unemployed [1].

Most demographers suggest that the life expectancy of these generations will increase beyond the current life expectancy of 76 years for males and 82 years for females. Technology, genetics and medical science may also increase the average life expectancy of these generations, and those to come.

The majority of employees planning to retire in the next 10 –20 years will spend between 25 and 35 years in retirement, and for many, this period will equal or almost equal, the number of years they will have spent in the paid workforce. For part time workers and many women taking time out to bear and raise children, the number of full time equivalent years in the paid workforce could be less than the number of years they will spend in retirement.

While most funds have a significant majority of members under age 40, the value of the account balances of this age cohort would be generally much less than for older age cohorts, reflecting their low earnings and period in the paid workforce, and also their lack of interest in investing for their retirement.

Our research has split this larger group of members under age 40 into two segments on the presumption that the stage of life and the priorities of each may be vastly different. The research demonstrates that this group cannot be viewed as a homogeneous collective as they are very different in their views across a range of issues, including superannuation. These findings will need to be factored into any strategy to improve the appeal of superannuation for people under age 40.

Footnote: 1) Source BS 1998-99 Household Expenditure Survey

3. SUPER CONTEXT

The HOSTPLUS findings have been further examined, by age cohort, in a superannuation context, in order to understand the barriers and/or disincentives to contribute to superannuation.

This work also allows us to examine current incentives and their relevance to each of these groups.

AGE COHORT 18-25

University/TAFE student, graduate, career starter

Barriers:

- Lack of income flow makes it difficult to make voluntary contributions. Many in this group are part-time employees, usually on low rates of pay and often earning less than $450 in a calendar month, excluding them from receiving superannuation entitlements under the Superannuation Guarantee Legislation (SG).

- People in this age group tend to be more sensitive to rights and justice issues. As such, large degrees of cynicism surrounding the demise of corporate institutions and unethical investing prompts questions of security; making them less likely to consider voluntary contributions. This mistrust and often confusion, is further exacerbated with the constant changes to the rules that applying to superannuation.

- Other saving/spending priorities. Most think that retirement is too far off for them to worry about now. Saving for an overseas holiday or a car are more important priorities than saving for retirement.

- Many in this age bracket are setting life goals which often change and for this reason prefer a more flexible savings vehicle.

- Poor savings mentality – many regularly use credit to sustain their current lifestyle.

- Perception that the SG of 9% will be sufficient for retirement. Most are likely to have given little thought to their needs in retirement and their savings ability during their working life.

- With zero population growth most are from small families, and many expect to inherit, but this may not be the case if their parents and childless relatives spend their accumulated capital, much of which is accumulated in the value of their home, to support themselves in retirement.

- The very notion of superannuation is at odds with this group's pleasure principle, 'live for today'.

- Superannuation is seen as something only worthy of consideration when they start working in the 'real world', not as a lower paid employee working in casual, part-time or entry levels jobs.

Attitude:

You want me to part with my hard-earned cash, that I have little of, and invest it in something I don't understand and that I can't touch for 40 years? Why?"

AGE COHORT 26-40

First home buyer, ambitious, career seekerBarriers:

- Security is a high priority for this group, which includes first home buyers and people starting out or raising a family. Generally they aim to pay off mortgages as soon as possible, as this is a non-deductible expense. This is usually a priority over saving for retirement and preservation is seen as a barrier rather than a benefit.

- Current market conditions are conducive to encouraging saving for retirement, as compared to periods of poor or negative market performance. The majority of first homebuyers or people aspiring to be first home buyers, are focussed on savings for their home purchase.

  Others in this group are likely to be saving for education and family related expenses, whilst some with higher disposable incomes or moving up the promotion/earning curve are likely to be seeking tax effective savings, including superannuation. The performance of the housing sector and the security of home ownership, are effective incentives for investing further in capital-gains-tax-free home ownership, particularly for this upwardly mobile group.

- Many young people mistakenly do not regard superannuation as an investment in the same way as they do not see themselves as having 'purchased' the investment. Voluntary contributions, before and after tax, would help to overcome this perception and barrier to saving for retirement.

- Some superannuation funds are seen as being managed and controlled by faceless people. Some 'wealth creators' may want to take a more active role in making some of the decisions about their super. They could make use of the new Choice of Funds regime to do this, whilst others will be more interested in their investment portfolio and use Member Investment Choice. One of the barriers to engaging members in their superannuation decisions and taking more interest and ownership, is the need for simple information and sometimes what is now regarded as advice.

Attitude:

I know it's important to save for my retirement if I'm going to have enough, but I need this money now to meet mortgage, education and family expenses. Anyway they keep changing the rules, making something already hard to understand, even harder. I need some advice about how to sort out my priorities and start a savings plan, but I don't trust people who are paid commissions.

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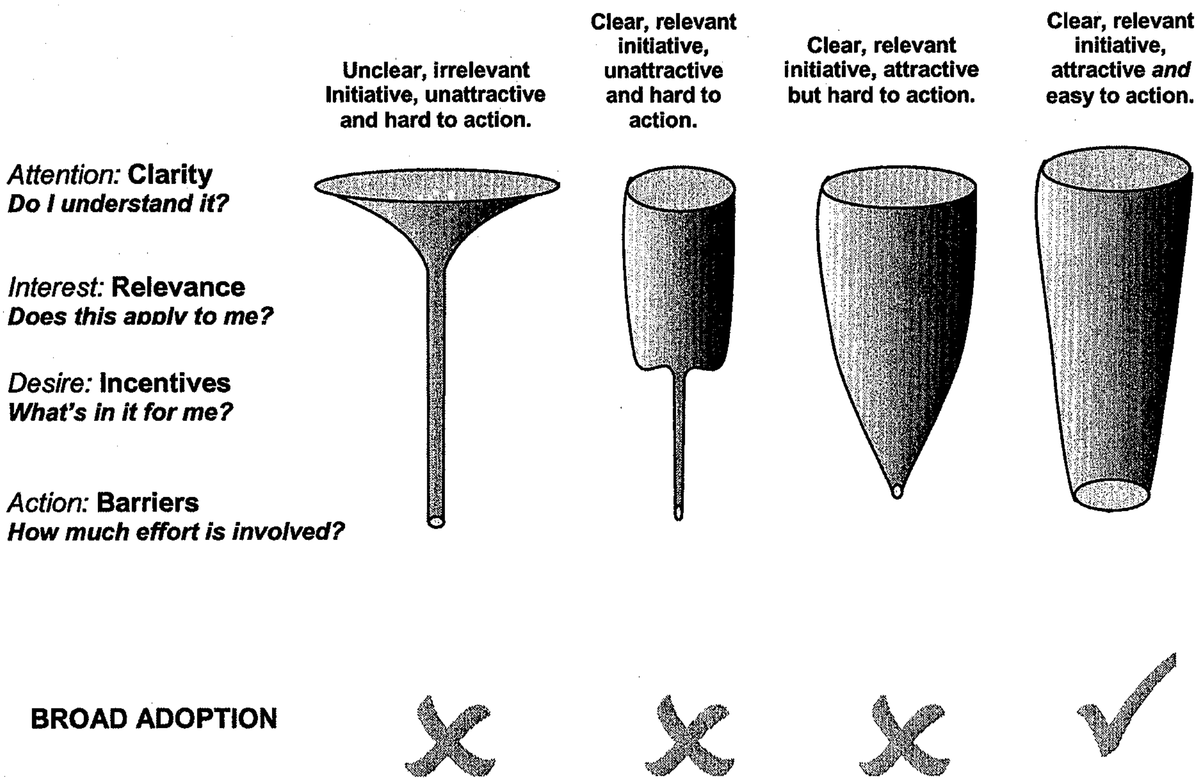
4. ANALYSIS

A person entering the workforce or an early entrant is unlikely to contribute to their superannuation, unless it is compulsory. Incentives are unlikely to work for this group, even though the Contribution Matching Scheme may be very attractive, it is likely to appeal to the parents of this younger group, who may contribute on their behalf. Yet this group has the most to gain from the longer-term benefit of compound interest on contributions made early in their working lives.

The home-maker with family interests and security in mind or the 'wealth accumulator', is much more likely to be enticed by incentives such as reduced contributions tax, contribution matching schemes and rebates.

Four key drivers for improving the attractiveness of superannuation for people under age 40:



CURRENT INCENTIVES AND THEIR ATTRACTIVENESS

AGE COHORT 18-25

University/TAFE student, graduate, career starter

Government Co-Contribution – This appears to have been quite successful for those that can afford to contribute or those with a spouse or parents who can afford to contribute on their behalf. Many receiving this benefit appear not to be very low-income earners who were the target group for this benefit. Those at the higher end of the earning base for this benefit are more likely to able to afford to contribute.

Deductions and tax rebates on contributions – While attractive in theory, these are mainly out of reach of most of this age group. With people marrying later and staying at home longer, spouse contributions are not very attractive or accessible for most in this group.

Choice of fund – While still in its infancy, choice has significantly raised all consumers' consciousnesses of superannuation.. Looking at a traditional advertising concept, it has effectively created attention and involvement but it remains to be seen whether it will result in desire and action to make an active choice and to participate through voluntary savings.

Insurance – Insurance is seen as a very attractive and valuable 'available now' benefit from superannuation. However many single young people see themselves as invincible with no need for a financial safety net. Generally they have no dependants and 'they know what they are doing' so they are unlikely to injured or need insurance.

With a relatively low income to debt ratio and the trend to live at home longer, the cost of excessive insurance could serve them better by compounding in their superannuation account for 40 to 45 years.

AGE COHORT 26-40

First home buyer, ambitious, career seeker

Salary sacrifice – While many took advantage of this benefit for both compulsory contributions and personal contributions, the effectiveness of salary-sacrificed contributions was greatly diminished with the introduction of the surcharge. Recent changes to reduce this tax are expected to increase the interest in the attractiveness of salary sacrificed contributions – both compulsory and voluntary.

As these contributions are treated as employer contributions for tax purposes, members using this method of contribution need to be protected by ensuring that these contributions are paid monthly in the same way as after tax member voluntary contributions.

Deductions and tax rebates on contributions – Although the base deduction has been increased, this may not be sufficient to attract self employed to make voluntary contributions. Most self employed see their business as their quasi-superannuation, but many under age 40 are likely to use the proceeds from any sale for home purchase or to meet other expenditure, even though there is an incentive for those who invest the proceeds of the sale into superannuation.

Government co-contribution, deductions and rebates on contributions, choice of fund and insurance are also relevant to this group, with slightly higher degrees of success based on their higher income (although this does not necessarily translate into higher disposable income) and the resultant changes from progressing from one life stage to another (stable relationship, greater financial responsibilities to protect and provide, etc.).

5. STRATEGIC DIRECTION

5.1 Education, Communication and Guidance

In the Longer Term

5.1.1 To engage people in superannuation, particularly young people, they need to be exposed to early education to educe a superannuation mindset that will enable an easier transition to a financial relationship, at the appropriate time.

This needs to be done without sponsored products and without trade-offs such as relationship opportunities, branding and advertising for those engaged in selling products and services. This needs to be paid for by Government as an investment cost.

There needs to be a focus on awareness, education and non-financial involvements during the foundation years whilst still at school. This will lead to confidence, comfort and, over time, establish improved financial literacy.

A better informed person is more likely to respond to calls to action to contribute to superannuation, although this may be limited if the appropriate incentives are not in place.

Able to be addressed in the Short Term

5.1.2 There is a great need to simplify documentation, process and language when communicating with existing and potential members, particularly younger people. This is seen as a major obstacle that needs to be overcome if superannuation is to be more attractive to people under the age of 40.

5.1.3 Another priority is to enable superannuation funds to provide information and guidance to members and potential members without fear of licensing implications. Most people under the age of 40 are looking for some simple guidance about the various aspects of their superannuation such as the level of insurance they need, the investment choice strategy most suitable for them, the level of contributions to be made and the best way to make these contributions – before or after tax. This guidance usually need to be given with some consideration of the person's financial circumstances and ability. The lack of clarity surrounding the possible limitations under the Sole Purpose Test, makes it very difficult for funds to provide members with appropriate and necessary guidance on these relatively uncomplicated issues without either the member or the fund incurring significant costs because of the need to use licensed advisors who are usually external to their organisations.

These issues can be more easily addressed in the short term with the assistance of Government and the Regulator. Simplifying communication and providing guidance of the nature proposed will help address other issues also such as increasing the relevance of superannuation and reducing the barrier to action.

5.2 Improving the Net Benefit to Members

5.2.1 <u>Reducing the Contributions Tax for People on Low Incomes</u>

Reducing the tax on contributions would obviously be a great assistance for those on low incomes, and this group would include many people under age 40. This coupled with the magic of compound interest would make a dramatic difference to the longer-term national savings.

It is proposed that this reduction be by way of a providing a tax credit of 15% on employer superannuation contributions for those with taxable incomes up to $28,000 scaling back to zero for those with taxable incomes above $58,000. The estimated cost of this very significant incentive for those that need it most, would be $1.667 billion, after allowing for some increases in income since 2002/03), which represents about 43% of the total contributions tax. This cost is of the same order as the cost of reducing the superannuation fund tax rate for all fund income (contributions and investment) from 15% to 10%. However the proposed reduction in contributions tax is targeted at people on low incomes, many of whom would be under age 40.

It is proposed that this rebate would be by way of credit to the taxpayer's superannuation fund, based on 9% of their earnings from wages and salaries, as per the individual's income tax return. This would avoid the expense of another unpopular 'surcharge style' administrative cost. The scheme would operate in the same way as the current Federal Government's Co-Contribution arrangement.

Enclosed as **Attachment 2** is a costing for the proposed scheme, generously prepared by David Knox of Mercer.

5.2.2 Removing the Inequalities in the Superannuation Guarantee

Remove the $450 monthly earning threshold as this is impacting on people under the age of 40, many of whom are women and others engaged in part time or casual work.

There is also a need to look at ways of addressing the gap in contributions for people out of the paid workforce on family leave, mostly women.

5.2.3 Full Co-Contribution

Increase the $28,000 threshold for people able to receive the full co-contribution over time. This will assist many people under age 40 to maximise their benefits.

5.2.4 Ban Commissions on Compulsory Superannuation

Ban the payment of commissions on compulsory superannuation contributions, in particular those paid under the Superannuation Guarantee. There is significant loss of benefit as a result on commission paid on superannuation.

This will help increase confidence, remove conflict of interest on the part of advisers or others selling superannuation products, and reduce the cost, increase earnings, resulting in an improving the end benefit.

5.2.5 Promote Superannuation as an Investment

Promote superannuation as a financial investment to people under the age of 40, in their future lifestyle and security.

Encourage mortgage and loan providers to include voluntary contributions as a measure of assessing a person's ability and preparedness to save. This would need to be looked at in the context of their overall earnings and disposable income, otherwise a hard worker and saver on a low income with high necessary outgoings will be penalised.

5.2.6 Member Protection Costs

Member protection costs are generally carried by those funds with large numbers of small accounts. These are mainly with a large proportion of members with broken work patterns such as young people working part time, women and occupations with frequent gaps in employment such as building and construction workers.

These costs in the case of REST can be very significant and they vary from $8 to $13 million per annum depending on the investment market performance and the resulting crediting rates.

If these costs were more evenly spread across the industry, younger members would not be prejudiced by having to bear higher administrative costs which include member protection costs.

It is proposed that a levy be struck to cover these costs and a pool be established, not dissimilar to the pool funded by the Financial Sectors Levy to protect members in the case of defaults. Under this proposal every fund would be levied on the basic of funds under management or some other appropriate measure, and the proceeds would be used to meet the cost of member protection. Fund could deduct their cost of member protection (after audit sign off) from their contribution, the would result in a more equitable sharing of costs across all funds and superannuation providers.

5.2.7 Lost Super

The campaign to reunite people with their lost superannuation was highly successful. This campaign should be ongoing and a relaunch to help it to gain momentum and raise the awareness of the community about the need to stay in touch with their superannuation.

This campaign was largely funded by a small section of the industry who are already very active in this area of reuniting people with their lost superannuation.

This campaign needs greater Government sponsorship if it is to be successful and ongoing and it needs to involved the whole industry.

The campaign should be broadened to encourage by way of incentive if necessary, all superannuation providers to participate and contribute.

5.2.8 Monthly Contributions

The Superannuation Guarantee Legislation should be changed to require employers to make contributions monthly instead of quarterly.

Most business expenses and charges are paid monthly, so this should not be an unreasonable burden on employers. Payment of these contributions at monthly intervals would help protect members should their employer experience financial difficulties and greatly add to earnings over the person's working life. This would be of particular advantage to people under the age of 40.

5.2.9 Unpaid Contributions

IFF is concerned about the loss of superannuation earnings and sometimes benefits for people, where an employer fails to pay contributions or fails to pay contributions on time. The ATO says it is pursuing employers who fail to pay but clearly the resources allocated to this important task and well less than those required to make a real impact on his task. It is our understanding that the ATO intends to audit 100,000 employers in the coming year, this as a proportion of the total employer group is a very small number.

This is of particular important to young members, as many are not interested enough in their superannuation to check if contributions have been paid. This means for many of those involved in such defaults, they will not be picked up at all and by the time it is realised or if by chance the ATO audits the employer it may well be too late as the defaulting employer may not be able to be found or their financial situation may be such that they cannot pay the superannuation as other debts are ranked ahead in bankruptcy.

Where an employer pays late and is not picked up by the ATO the members loose the interest and the benefits of compound interest for a period, on the late contribution.

ATTACHMENT 1

HOSTPLUS: MEMBER FINDINGS

18-25 yrs	26-40 yrs
Reckless Full-on Unpredictable Danger Spiritual Lose Relaxed Integrated	Luxury Acquisitive Exotic travel Planning and choice Marriage and kids or not Balance Eating out Diet First tyre on waist

Summary
Integrated vs Compartment
Imbalance vs Balance

18-25 yrs	26-40 yrs
Belonging Sub culture On line Virtual SMS Smaller groups Sex Couples	New friends Cause related groups Selective Activity based Work is friends Tighter circle Quality Home based Part of group/member

Summary
Distant vs Involved
Spontaneous vs Deliberate
Undefined vs Nurtured

Source: **HOSTPLUS** member research, December 2002; Team analysis; extrapolated to age 40

ATTACHMENT 1

HOSTPLUS MEMBER FINDINGS

[redacted]

18-25 yrs	26-40 yrs
Part time	Career
Necessity	Working harder
Aspirational	Career crisis
First real job	Work is fun/friends
Transition	Service based
Self discovery	Growing responsibilities
Own money	Fulfillment focus
Feeling adult	Change savvy
Daunting	Building networks
Means to an end	Planning transition
Stressful	Further study
Responsible	
Career	
Disloyal and fickle	
Let down	
Unemployed	

Summary
Catalyst for life choices now/just income
vs
Aspirational/status building

[redacted]

18-25 yrs	26-40 yrs
Pervert	Niche
Nike	WRX
Hoyts	Virgin
Independent labels	Premium foods
Gucci	IKEA
Borders / Amazon	Freedom
Surf brands	Mobiles
STA travel	Mooks
Smirnoff	
Tooheys	
Virgin	
Sony	
Mooks	
Royals	

Summary
Of now vs Established
Badging vs Quality
Label vs Look

Source: **HOSTPLUS** member research, DEC 2002; Team analysis; extrapolated to age 40

ATTACHMENT 1

HOSTPLUS: MEMBER FINDINGS

[redacted]

18-25 yrs	26-40 yrs
Dude	Intellectual
Tribal	Independent
Rhyming slang	Finance
SMS	More mature
English	Gossip
Cool	Experience
USA	Technology (SMS, email)
Code	Career
	Future
	Talking about experiences

Summary
Symbol based/ informal/exclusive
vs
Inclusive, knowledgeable and formal

[redacted]

18-25 yrs	26-40 yrs
Not our parents	SBS
Clan	Interwar, global
Outdoor	Cultural
Tribal	Multi-cultural
Indoor	Spiritual
Student	Mainstream
Personal space	Challenging norms
Alone together	Accept working
Activist / protest	
Naughties	
Drugs	

Summary
Search vs Found
Acquire vs Arrived

Source: HOSTPLUS member research, December 2002; Team analysis; extrapolated to age 40

ATTACHMENT 1

HOSTPLUS: MEMBER FINDINGS

18-25 yrs	26-40 yrs
Future optimists	Controlling
Yeah right!	Financially aware
Put money away for what?	Realise need
Disinterested	Procrastinate
Untrusting	Misunderstood
Skepticism	Liquidity driven
Unsophisticated users	Other priorities
Not my choice	Performance high on agenda
Internet banking	Use resources well
Untouchable money	Ambitious
Confusing	Non super investors
Ill defined	Wealth = physical assets
Avoid	
Expensive	
Today!	

Summary

Despondent, uninterested, unconvinced

vs

Appreciation, not a priority, visible assets

Source: HOSTPLUS member research, December 2002; Team analysis; extrapolated to age 40

Estimated Cost of providing tax credit from the 15% contributions tax for low income earners **ATTACHMENT 2**

Taxable income	# of tax payers	Average taxable income	Salary or wages	Assumed 9% SG contribution	Assumed rate of tax credit	Tax credit
Less than $6,001	32,257	$3,327	49,792,426	$4,481,318	15.0%	$672,198
$6,001-$10,000	335,246	$8,687	2,084,703,933	$187,623,354	15.0%	$28,143,503
$10,001-$15,000	731,087	$12,514	6,517,218,770	$586,549,689	15.0%	$87,982,453
$15,001-$20,000	804,419	$17,614	10,634,527,249	$957,107,452	15.0%	$143,566,118
$20,001-$25,000	907,995	$22,499	15,531,293,672	$1,397,816,430	15.0%	$209,672,465
$25,001-$30,000	927,100	$27,509	21,096,353,187	$1,898,671,787	15.0%	$284,800,768
$30,001-$35,000	871,725	$32,458	24,397,763,353	$2,195,798,702	12.8%	$280,427,277
$35,001-$40,000	766,149	$37,443	25,191,425,592	$2,267,228,303	10.3%	$233,037,917
$40,001-$50,000	1,237,339	$44,861	48,382,266,317	$4,354,403,969	6.6%	$286,055,374
$50,001-$60,000	796,699	$54,643	38,411,996,204	$3,457,079,658	1.7%	$58,025,381
$60,001-$80,000	678,249	$68,073	39,576,045,746	$3,561,844,117	0.0%	$0
$80,001-$100,000	240,947	$88,544	17,112,186,346	$1,540,096,771	0.0%	$0
$100,001-$200,000	240,249	$130,933	21,130,819,188	$1,901,773,727	0.0%	$0
$200,001-$500,000	54,828	$284,976	7,499,642,152	$674,967,794	0.0%	$0
$500,001-$1,000,000	7,684	$664,263	1,590,108,083	$143,109,727	0.0%	$0
$1,000,001 or more	2,273	$1,989,952	1,053,743,473	$94,836,913	0.0%	$0
Nontaxable	2,029,620	$7,263	4,087,574,720	$367,881,725	15.0%	$55,182,259
Total	**10,663,866**		**$284,347,460,411**	**$25,591,271,437**		**$1,667,565,712**

Source for taxable income and number of taxpayers: Taxation Statistics 2002-03

Check on reasonableness:

Gross taxable employer contributions to superannuation funds in 2002-03:	$31,913,093,908
Transfers of taxable contributions in 2002-03:	$7,067,138,809
Net taxable contributions	$24,845,955,099

Therefore the above estimate of approximately $25 billion of employer contributions is reasonable.