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SUBMISSION 64

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16 January 2006

Ms Bev Forbes
Committee Secretary
Standing Committee on Economics,
Finance and Public Administration
Parliament House
Canberra ACT 2600

House of representatives Standing Committee on Economics, Finance and Public Administration
Submission No: 64
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Dear Ms Forbes,

Improving Superannuation – under age 40

Thank you for the opportunity for us to provide a submission for your inquiry into Savings for the Under 40's. We appreciate that you called for submissions some months ago, but we have been undertaking work for IFSA on the Superannuation Savings Gap and have hot been in a position to respond until the completion of that work. We have covered a number of important items and would be pleased to meet with you or any members of your committee to discuss these in more detail.

I also enclose a professional Paper prepared by two of our actuaries in 2004. Some of this is now out-of-date (eg. comments on superannuation surcharge) but it does highlight many of the anomalies in the superannuation system.

Yours sincerely

[signature]

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Submission to the House of Representatives Standing Committee on Economics, Finance and Public Administration on its Inquiry into Improving Superannuation Savings of People under age 40

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Table of Contents

1. Overview

1.1. Goals of this Inquiry

The Inquiry has the goal of encouraging superannuation savings for these younger Australians. Clearly simplification of the superannuation regime and better communication with members are needed as people won't save more unless they are convinced it is in their own interests to do so.

We consider that the Inquiry also serves the useful purpose of reviewing progress with our three-pillar retirement system. We assume that the basic structure will remain as it appears to be universally supported by government and most stake-holders – and regarded internationally as a good structure. Nonetheless, there are many areas which could be improved and our submission comments specifically on the following matters:

- Simplification of superannuation;
- Retirement income products;
- Integration with social security pensions;
- Taxation;
- Encouraging additional contributions ;
- Role of insurance;
- Role of education and financial advice; and
- Particular difficulties facing women.

One of the advantages of reviewing public policy for this group is the time available to implement any changes successfully. Improvements made today can make a real difference to the retirement living standards of this generation. In the interests of simplicity, some changes could be applied to the whole superannuation system whereas others would be more difficult to apply to older members. Hence, some of our recommendations are universal whereas others should be limited to those under 40.

In addition, the Inquiry can also review the issues of inter-generational equity which were highlighted in Treasury's Inter-Generational Report issued as part of the 2002 Budget papers.

1.2. Structure of Retirement

Twenty years ago, only 40% of the Australian workforce belonged to a superannuation fund and many were members of generous defined benefit schemes. However, many Australians above age 40 today had no superannuation for some of their career. Those joining an industry fund in the mid 1980's, would have received an employer contribution of only 3% of salary until 1992. At that time, the Superannuation Guarantee (SG) system was introduced and is now nominally set at 9% of salary, but this equates to 7.65% after tax within the fund (which is 15% of the employer contributions). Hence, many older Australians have inadequate superannuation savings and not much time left to address the situation.

The position for younger Australians is better. According to APRA, in April 2005, 90% of all Australian employees are now members of superannuation funds. Most of those under age 40 have had employer support since they joined the workforce (even if SG contributions have been at low levels for some years), and those under 21 will enjoy at least 9% SG support throughout their career. This near universal coverage means that all Australians have become more aware of superannuation.

Despite the improved financial preparation for retirement of young Australians, this generation will still be substantially dependent on government Age Pensions. Treasury's RIM model analysis was used to prepare the Inter-generational Report as part of the May 2002 Budget papers. Its analysis showed that by 2042, when many of those under age 40 today will have retired, Australia will have approximately 10 million retirees aged over 65 and 55% of their income will still be from Government funded pensions. Clearly, current retirement policies will not be effective in making the majority of Australians self-sufficient in retirement.

1.3. People under 40

The population under age 40 spans two generations of Australians and it is a diverse heterogeneous group. It is true that most of this group are in the process of building assets often through accumulating debt such as mortgages and they are in the family formation years. Of course, the timing fluctuates according to the different circumstances of these people. As a large number of people have significant and immediate commitments, such as saving or paying off a home, raising a family or even beginning their own business, most of this generation gives long-term savings a low priority.

While their individual circumstances vary widely, this group does have many characteristics that differentiate them from older Australians:

- Most of this cohort will have a full career where their employers will make compulsory superannuation contributions at 9% of their salaries;
- Throughout their working lives, they will be wealthier (on average) than their parents and many will inherit their parents' estates shortly before their own retirement;
- The cohort is more intelligent than their parents and should be healthier, so long as continued attention is paid to negative trends such as obesity;
- On average, they will live longer than previous generations of Australians and this will impact on the timing of their retirement and the savings they will need to accumulate;
- Most will belong to accumulation funds and, unlike defined benefit funds, this means that members bear all the key risks including:
  - Picking a suitable fund (which will usually be an industry fund or master trust as most employers no longer manage their own superannuation fund);
  - Determining how much insurance they need from time to time;
  - Selecting an appropriate investment strategy;
  - Determining the level of contributions to make each year to ensure an adequate accumulation at retirement;
  - Planning the timing of retirement given uncertain longevity in retirement, unknown costs (particularly health and aged care) which will be incurred in retirement, and the general lack of suitable retirement products; and

- Over the next few years, most young Australians will select a superannuation fund which they will keep throughout their working life and into retirement. Some people entering the workforce today will stay in their fund for a considerable length of time.

Almost all young Australians will need assistance to work their way through these issues. Most cannot or will not pay for financial advice while they are young, so they will rely on their superannuation fund to steer them through a complicated landscape. Some will take informal advice around the family barbeque or office canteen, so their decisions will not always be made on sound principles.

For many, saving is made more difficult by various financial demands requiring immediate consumption. We live in a world where younger people have grown up in an increasingly materialistic society with success often measured by size of income or assets. Many people strive to do well by buying large homes (using large mortgages) and everyone strives to buy the latest appliances and to go on overseas holidays.

In this environment, it is difficult to encourage young people to divert some of their income into superannuation savings. It is easy to demonstrate that saving early makes a huge difference later in life but less easy to get people to make the necessary sacrifices now!

Further, unforeseen personal setbacks, particularly divorce, have a severe impact on savings. This makes it even more important to save early while there is time to build a buffer against misfortunes later.

1.4. Variability of Retirement Benefits

Before we can encourage anyone to save for retirement, we need to set them a realistic target. Unfortunately, it is extremely difficult for young people to know whether their superannuation will be sufficient to provide a reasonable lifestyle in retirement. There is a lack of appreciation as to how much capital is needed to generate an adequate income in retirement.

The future standard of living in retirement depends on many uncertain factors, including:

- Age at Retirement;
- Longevity in retirement;
- Overall financial position at retirement, including assets and income outside the superannuation system, and whether they are a home-owner or a renter;
- Uncertainty as to how much income is needed to live on once a person ceases work (and how that income might fluctuate from year to year in retirement);
- Marital status;
- Health and aged care costs, which rise substantially later in life; and
- Level of likely government pension support.

A major factor which could have an even greater influence on financial security is the rate at which World GDP rises together with extended periods of global peace. Obviously, governments and individuals need to assume stable economic periods whenever they are planning for their long term future.

1.5. Adequacy of Retirement Benefits

There have been several attempts to set a reasonable target in retirement. For example, Labor introduced a policy at the last Federal election campaign of targeting "65 @ 65", that is, receiving a pension of 65% of income from age 65.

We broadly support the general conclusion reached in the report of the former Senate Committee on Superannuation "Superannuation and Standards of Living in Retirement"(2002) that the desirable target for a person on average earnings is a replacement rate of 70-80% of pre-retirement expenditure (which equates to approximately 60-65% of gross pre-retirement income). This target would have to be higher for those who get significantly less than average weekly earnings but it should be lower for those on incomes significantly above AWOTE.

The situation is also complicated by different family structures. Social securities rules are based on the combined financial position of couples whereas superannuation rules are based on individual's accumulations within their own careers.

The above targets would be seen as reasonably modest by most people. Many Australians will have far more ambitious plans. However, there is a huge gap between expectations and actual retirement benefits.

Two years ago, IFSA commissioned Rice Walker to calculate the "Savings Gap" for working Australians. Our report showed that the gap was about $600 billion in respect of workers earning less than twice average earnings. We have recently updated this report and are pleased that recent government initiatives within superannuation have helped lower the gap *per capita*. Nonetheless, the expectations of most Australians will still not be met without further additional contributions into superannuation.

The actual benefit at retirement will depend on the level of contributions made and the earnings returned on their investments (after taxes and fees). Consequently, the longer a person is contributing to superannuation the larger will be the final benefit. However, persons under 40 have different priorities and many believe it is more important to meet their immediate needs.

The following table shows the average contribution rates (from after tax income) required for people to close the savings gap between likely retirement income and the targeted one of 62.5% of salary at retirement. While the rates represent averages, and there are wide differences between individuals, they give an indication of the additional contributions required.

Required Contributions (above-SG) to Bridge the Retirement Savings Gap

Age Band	Males %	Females %
25-29	7.4	8.4
30-34	8.7	8.8
35-39	10.0	9.3
40-44	11.8	11.0

A substantial additional contribution is required even for workers in the 25-29 age bands who will receive the full Superannuation Guarantee Contributions over most of their working life.

While these contributions are significant, a simple deferment of Age Pension eligibility to age 67 would have the same effect. While most Australians would prefer to retire early rather than later, we should recognise that people under 40 today are likely to live *on average* 20 or more years beyond age 65. This may even be conservative given that projected future improvements in mortality rates are usually surpassed in practice!

Every improvement in mortality requires additional funds to be saved for the same standard of living unless the retirement age can be deferred. It is possible that consideration will need to be given to increase the eligibility Age Pension progressively over the coming generations or there will be unsustainable increases in government expenditure. Obviously it will be politically difficult to increase this age for those close to retirement but it is possible to do so provided a long period of notice is given. For example, deferral of the Age Pension eligibility from 60 to 65 for women has been accepted by the community, largely due to the lengthy time over which the change has been introduced.

One modern trend which inhibits successful saving for retirement is the tendency for young people to stay out of full time employment for longer periods and to travel extensively whilst they are young. As a result many Australians marry later and do not begin their careers in earnest until they are in their early 30's. When we combine this with the much longer period of life after retirement this gives a much shorter time span to save for an adequate retirement benefit.

1.5.1. Recommendations

We recommend that the Committee support the previous recommendation by the former Senate Committee on Superannuation that the desirable pension target for a person on average earnings is a replacement rate of 70-80% of pre-retirement expenditure (which equates to approximately 60-65% of gross pre-retirement income). This measure should be reviewed from time to time.

Further, it would be helpful if superannuation funds would encourage members to be aware of such a target. Calculators should be made available for members to monitor their progress towards a suitable retirement benefit.

We recommend that the Government consider shifting the retirement age for Age Pension purposes to a higher age, at least age 67 and conceivably age 70, for people currently under age 40. Obviously, those people who accumulate enough levels of superannuation to be self-sufficient can retire earlier.

2. The Role of Superannuation

On the surface, superannuation is simply a means of accumulating money to provide income in retirement. However, Government sends mixed messages to the population:

- Superannuation is encouraged – but then it is taxed on contributions, investment earnings and retirement benefits. The removal of the contributions surcharge has partly reduced this anomaly.
- It supplements the Age Pension, but, for many, the means tests often dramatically reduce the value of additional savings. Sometimes, the combined benefit from superannuation and the Age Pension can be quite small as an increase in one simply reduces the other.
- Life insurance is taxed advantageously for members with dependants (but is taxed prohibitively for members leaving their benefit to (say) their non-dependant parents. Further, the types of life insurance benefits allowed are restricted.
- When people retire, they have accumulated a large lump sum and they then need to invest this appropriately for use in their retirement. It is difficult for a layman to work through the issues of superannuation rules, taxation policy and social security entitlements.

It is no wonder that individuals are confused about superannuation.

2.1. Making Superannuation Relevant

Young people will not engage in superannuation unless it is made more relevant to their needs. Some industry commentators have suggested that members be allowed to use their superannuation to assist in providing a deposit for a home; others have suggested allowing members to withdraw their own contributions from time to time to pay their HECS debt. We do not consider that either of these proposals has any particular merit, but we do consider it possible to make some other innovative changes in a way that protects the integrity of the system.

In this submission, we recommend a number of changes. Some of these could be made immediately, but most need to be phased in over time. This has to be done to reduce the impact on those who are close to retirement and unable to adjust for the changes. Therefore, they will have most impact on younger Australians, the subject of this inquiry.

We recognise that many of our recommended changes have fiscal implications, but, in some cases, there will be a long lead time for their introduction. This will reduce the immediate financial impact and also avoid changing too many things for those approaching retirement, where there is less time to adjust.

2.2. Simplification of Superannuation

2.2.1. Superannuation Account Identification

There are nearly three superannuation accounts for every employed Australian. Many of these accounts can no longer be traced back to their owners. There is approximately $7 billion held in trust for lost beneficiaries and this continues to increase.

The lack of an adequate identification protocol has cost both contributors and the superannuation industry many millions over the past 23 years in unnecessary administration costs to provide *member protection*. Clearly, it is inefficient for the industry to hold small accounts, and it is even more inefficient for members not to consolidate all their superannuation into one fund.

We have been advised by one of the largest industry funds that 37% of its members under the age of 41 have account balances of less than $1,000. This represents 29% of its younger contributory members and 43% of its non-contributory members (those who remain in the fund after they have changed jobs and no longer get employer support).

Under the Choice of Fund regime, many members will decide to remain in one fund throughout their career. It would be useful if they were able to simply notify their new employer of this fund when they take on a new job. This is akin to the way they notify an employer about their bank account into which they want their wages to be paid. The current Choice structure attempts to do this, but there are a number of barriers which prevent member's wishes from being fulfilled. For example, it requires proactivity on behalf of the member, yet many funds aim to retain accounts to maximise funds under management, even if they are inactive. Furthermore, there is a lack of industry-wide protocols to encourage people to keep their accrued benefits in a single fund. This makes consolidation of accounts difficult.

2.2.2. Maximum contributions

The current system of Reasonable Benefit Limits and maximum annual contributions is complicated. It would be relatively easy to replace this with a system of maximum lifetime contributions. Under an old Coalition policy introduced in the 1993 election campaign, it was proposed that contributions be limited to $300,000 (appropriately indexed) over a lifetime to attract maximum tax deductibility.

A lifetime limit would be easier to maintain and it would be fairer for members who made erratic payments from year to year. For example, self-employed persons might defer making contributions until their businesses are successful.

If members were still working after age 65, the lifetime limit would be increased to reflect the longer working life.

If lifetime contributions were used, there would be no need to have Reasonable Benefit Limits. People starting to contribute earlier in life would get higher benefits in retirement for the same levels of contributions. This occurs because of the longer period on which they would generate investment earnings on these contributions. There is no particular reason why they should be penalised via a RBL for being an early contributor, given that we want to encourage early savings.

2.2.3. Recommendations

Consideration should be given to the introduction of a specific individual superannuation guarantee number (SGN) or the use of the tax file number (TFN) to identify multiple accounts and reduce the number of lost accounts. Members could use this to advise their employers of their nominated superannuation fund.

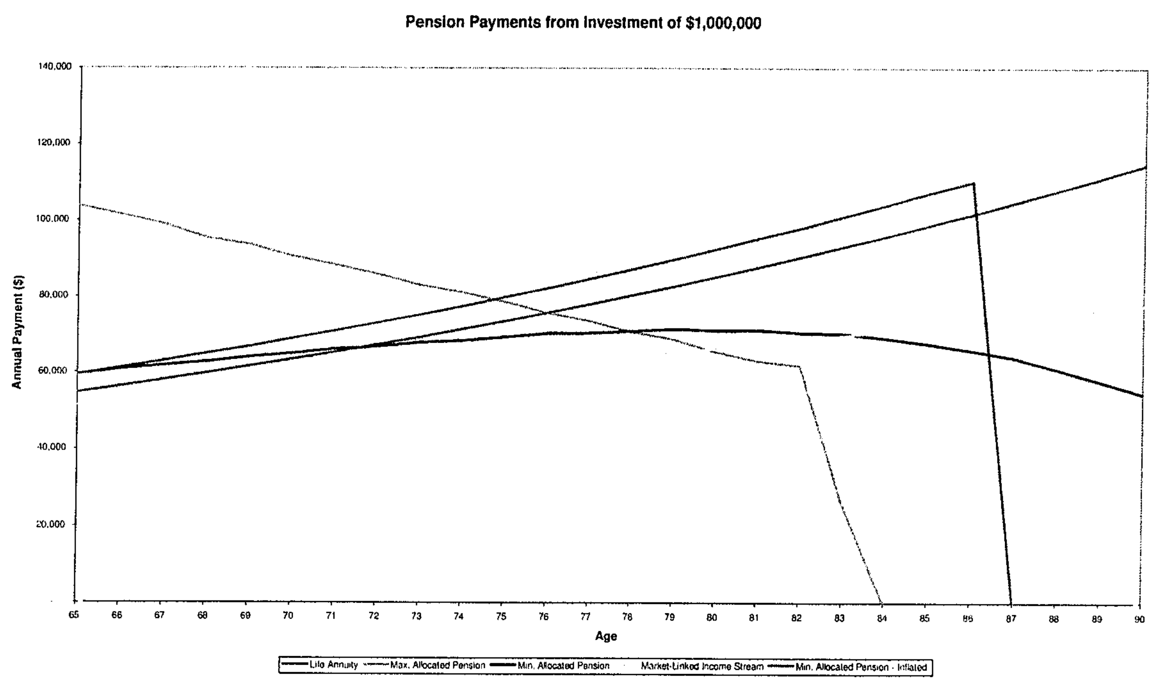
Lifetime contribution limits should replace annual contribution limits and Reasonable Benefit Limits.

2.3. Retirement Products

The structure of superannuation is that members accumulate their benefit and build a large lump sum at retirement. At present, many simply take the benefit as a lump sum (since the average benefit is below the tax-free threshold $129,751). Only a small number of retirees, perhaps 5%, actually have sufficient money to convert their superannuation into a reasonable pension.

Obviously, we expect the current generation of under-forties will retire with much greater benefits. When they do retire, many will regard a lifetime annuity as the most suitable product. This will convert their lump sum into a guaranteed income for life as well as providing modest annual increases. Effectively, the investment and longevity risks are transferred from the retiree to the life company.

Current practice is that most retirees take allocated pensions which are a form of a managed fund. There are some restrictions set on how much can be drawn down from these products. There is also a community perception that people who die early can leave their residual allocated pensions to their dependants whereas life time annuities are lost. Furthermore, as shown in the chart below, the yields on lifetime annuities compare unfavourably to other retirement income streams in the early years of retirement.



The wide variations in annual payments, not only at retirement, but in future years make it almost impossible for individuals to plan their superannuation finances satisfactorily. The situation is even more complicated when social security (Age Pension) and taxation treatment are also taken into account.

2.3.1. *Lifetime Annuities and Longevity Risks*

There are a number of reasons for the apparent unattractiveness of lifetime annuities:

- Life companies tend to invest in fixed interest securities to back these liabilities. While these assets are generally considered to be unsuitable for long term liabilities, they do not require large capital reserves. If a life company were to back these products with growth assets such as equities, the reserves would be considerable (15% to 20% of the initial purchase amount of the annuity).

- Life insurers have to be wary about the longevity risks given the potential for significant improvements in mortality over the next two decades. Therefore, they assume that there will be major improvements in mortality. Ironically, all annuity rates set over the last 50 years have been insufficient as mortality has continued to improve even faster than actuarial expectations used in pricing annuities.
- Lifetime annuities often allow for regular indexation increases (usually limited to 5% p.a.). Therefore, they provide a steadily increasing growth in income each year. Other products may eventually provide a declining income but this is not always apparent at the time of retirement.
- Retirees who die before their life expectancy do not receive many payments relative to the price they paid. Of course, this is a pooling issue as those retirees living much longer benefit enormously from their better longevity.

If it were possible to provide more certainty about the conversion of a lump sum into income in retirement, it would be easier for people to calculate how much money they will need at retirement. This could be done in a number of ways including:

- Paying a universal Age Pension from an advanced age (perhaps age 90) so members can plan to use their superannuation retirement benefit over a fixed future lifetime.
- Issuance of long-term indexed-linked Government Bonds for superannuation funds and life companies which can then immunise the pension liabilities with appropriate assets.
- The Government guaranteeing the liability tail of the longevity risk held by funds and life companies offering guaranteed pensions.

2.3.2. Market-linked pensions

Many members appear to be prepared to take on their own investment risks in retirement and they will purchase Allocated Pensions or Market-linked Income Streams (colloquially known as Term Allocated Pensions, or TAPS). Recent changes to the drawdown rules for Market-linked income streams now provide good flexibility for the system but members still take the longevity risk. Consequently, most members will fall back on an Age Pension in later life.

Rice Walker has analysed trends in Age Pension dependency and we have noted that the number of people on a full pension increases dramatically from about age 75 onwards[1]. This reflects that active retirees tend to give up part-time work at that stage and many retirees have simply exhausted their benefits by that age. Unfortunately, most retirees tend to look at their position at the time that they retire and they don't have a very good understanding of how their circumstances can change during their retirement years.

The current system is complex and no individual layman can understand the superannuation, taxation and social security rules. Hence, it requires retirees with large lump sums to seek financial advice (which costs of the order of $3,000 to $10,000 depending on the complexity).

We question the value of a system that requires such a large financial outlay and, even then, places that individual in a position where they are taking on both the investment and longevity risks in retirement. It is preferable for elderly retirees to have certainty and not to worry about those risks.

Consequently, we recommend that the government review the range of retirement products and attempt to provide a suitable pooled arrangement to protect retirees. Once again, it would be easier to introduce new rules for younger people who have not yet thought about, nor committed to, their choice of product in retirement.

[1] Refer to graphs attached with this report as Appendix A and B.

2.3.3. *Integration with social security pensions*

The integration of superannuation with taxation and social security is poor. We attach a copy of a Paper written by two of our actuaries which was presented to the Institute of Actuaries of Australia last year. It highlights a number of problems in this area (though the removal of the surcharge has improved the situation).

Although it will be many years until those under age 40 retire, it is important to consider better integration well in advance. Some of the initiatives which could be taken include:

- Capping the family home at $1 million (indexed at CPI) for means-testing purposes for the Age Pension;
- Planning to increase the Age Pension from 26% to 30% of full-time male earnings over the next two decades, recognising that the Government will only be able to pay higher pensions to disadvantaged members of the community if it is able to make a greater number of Australians self-sufficient in retirement.
- Deferring the age of receipt of the Age Pension from 65 to age 70 for those currently under age 40. It will also be easier to pay a higher pension if it only commences at age 70.
- Similarly, the benchmark of male earnings should be replaced gradually by one applying to all adult earnings. For example, the current pension could be expressed as 28% of adult full-time earnings rather than 26% of adult male full-time earnings.

2.4. Taxation

Superannuation taxation is very complicated, though the removal of the surcharge on contributions for high income earners has simplified the structure.

Government concessions for superannuation have several benefits for the economy:

- They encourage employees and the self-employed to save for their own retirement. This increases the pool of people who will be wholly or partly self-sufficient in retirement, thus reducing expenditure on the Age Pension in future years.
- It encourages people to save more and this provides a pool of capital which benefits the economy.
- It encourages people to save early and this provides them with greater value for their investment through the real rates of returns which should be made over lengthy periods.

There are constant calls for lower taxation of superannuation funds. At various times, economists have argued for the removal of taxes on contributions, investment earnings or end benefits. There are valid reasons for all of these but we question whether any can be considered in isolation. Cleary, the removal of a significant tax must result in lower levels of government services or higher taxes from other sources.

However, any full analysis of superannuation taxation needs to be looked at as part of a longitudinal study. There is in fact, no clear link between the tax concessions provided now and the likely benefits (that is lower Age Pensions payments) they are intended to produce many years into the future. Consequently, it is difficult to argue for lower taxes without understanding the long-term outcome of any change.

We consider that the tax on contributions is perceived to be the biggest burden of all superannuation taxes. It requires funds to keep separate records of different types of contribution. There would also be considerable simplification of pension rules if this tax were eliminated – particularly, if our recommendation to have a career-long limit on all contributions was also adopted.

We recognise that it would be expensive to remove the contributions tax. However, we also note that superannuation taxes are growing in real terms and should continue to do so. We have previously recommended to government that all superannuation taxes should be capped as a percentage of GDP. If this were done, it might be possible to remove the tax on contributions gradually over a period of several years (since the taxes from fund earnings would eventually be sufficient to collect the necessary revenue).

We also note that the distinction between working and being retired has been removed. Therefore, we question whether it still makes sense to have a 15% tax on income for benefits still in the accumulation phase but with no tax on earnings for assets held beyond retirement. If contributions tax were eliminated, there could be partial trade-off by taxing benefits after retirement at the same rate as before – that is, at 15%. This would also simplify the system, though the change should also be introduced over a lengthy period to reduce the impact on people who have already retired.

2.4.1. Recommendation

Subject to revenue implications, the current 15% contributions tax should be phased out over about 12 years, but earnings for assets held for retirees should be subject to the 15% tax rate.

As a trade off, and to maintain simplicity, the investment earnings of assets held to support pensions will no longer be exempt from tax (at 15%).

2.5. Encouraging additional contributions

2.5.1. Voluntary Contributions

We consider that the introduction of the co-contribution scheme provides adequate opportunity for most young people to make personal contributions from a young age. It could be enhanced by allowing members up to age 40 to "catch-up" for any years they have missed in the past five financial years. This might assist those who are in a position to save to make an extra effort when they can afford to do so.

2.5.2. Self Employed Persons

There appears to be a trend for many younger persons to establish their own businesses. This provides some disadvantages for superannuation purposes, in that they are subject to different taxation rules on contributions. Further, as they do not have an employer, they are more likely to enter a retail product and they do not get the forced savings of the 9% SG. In some cases, they do not automatically apply for life insurance.

The current co-contribution arrangements only apply to persons who earn at least 10% of their employment from wages and salary. A wholly self-employed person cannot qualify. This is a serious disincentive to young people establishing their own businesses, and should be addressed.

In many other respects, the nexus between employment and superannuation has been broken. Perhaps it is time to give all self-employed persons a notional salary of (say) $25,000 and treat them similarly to employed persons. They should then be subject to the SGC on this notional salary. This would generate minimum contributions for the self-employed of $2,250 a year. However, it makes sense to enable them to obtain the same tax concession on contributions as can be obtained by employers.

2.5.3. *Unemployment*

There are record numbers of employed persons under age 40. However, this situation cannot be guaranteed and periods of higher unemployment will occur from time to time. Under current superannuation arrangements, extended periods of unemployment have serious consequences to an individual's fund balance. The major effect is the withdrawal of employer support for the period whilst unemployed. If they are unemployed for a full financial year, they also lose the opportunity to take advantage of the co-contributions.

The unemployment benefit is too low to divert any of it into superannuation, but the government could consider paying an additional 9% into funds for those people who have been unemployed for more than six months. The advantage is that the fund will remain relevant and will continue to grow, albeit at a slower pace.

Clearly, this is an expensive suggestion. A cheaper alternative is simply to remove employment status so that long-term unemployed persons can continue to take advantage of the co-contribution should they be able to save $20 a week.

2.6. Life Insurance

2.6.1. *Role of Insurance*

Certain types of life insurance are allowed within superannuation. Trustees are allowed to offer relatively high benefits provided they insure the difference between the promised benefit and the amount held on behalf of the member. Death and Total and Permanent Disability (TPD) benefits are so popular that almost all funds provide an insured benefit for their members, although the average levels are fairly low.

Many funds also provide disability benefits in income form to replace lost wages whilst disabled. These are usually limited to benefits payable for two years as it is considered more tax-effective to pay longer periods as "ordinary" life insurance rather than as a superannuation benefit.

The types of insurance allowed within superannuation are largely a function of historical changes. The current allowable insurances within superannuation are set out in the table below:

Insurance in Superannuation

Type	Benefit	Recipient	Tax
Life Insurance (death cover)	Up to pension RBL ($1.3M)	Dependant	Nil
	If not to a dependant or if Amount > $1.3M	Any	5% of Pre-July '83 Component and balance taxed at individual marginal rates
TPD	(i) Post June '94 invalidity (ii) + Balance up to lump sum RBL ($650K) (iii) + Balance remaining		i) Nil marginal rate ii) As ETP iii) 39.5%
Income Protection	Up to two years benefit payments		Individual marginal rates

2.6.2. *Levels of Insurance*

There is no particular limit on the amount of life insurance that can be paid from superannuation funds. If the benefits are excessive, they are simply taxed punitively. In general, benefits consist of two components, namely, the accumulated member balance and any insured benefits that have been arranged by the trustees. As the insured benefits are entirely discretionary, the variation in benefits between funds is significant.

Superannuation legislation allows insurance premiums to be deducted from superannuation accounts and therefore receive the same tax deductibility in the hands of employers as do superannuation payments. However, evidence strongly suggests that the current average levels of Death and TPD insurance cover are grossly inadequate to cover the economic loss caused by death or disablement.

In a report to IFSA[2] (May 2005), Rice Walker advised on the needs of couples in their mid thirties with young children indicates that the life insurance needs for parents range from 10 to 13 times their taxable earnings, depending on the level of their partner's earnings. For part-time workers, the multiples of earnings are much higher. Couples in their mid forties with older children have insurance needs from 6 to 9 times their taxable earnings. Consequently, a full-time worker with young children on average earnings of approximately $50,000 per annum should have life insurance of between $500,000 and $650,000. However, the average amount insured for this group is estimated to be only in the order of $70,000 for those with superannuation cover, or $400,000 for those with both superannuation and non-superannuation cover.

While the averages for amounts of cover in force include individuals without children, nevertheless, the "under-insurance gap" is sufficiently wide for us to say that many parents are under-insured. A broad estimate of the total of under-insurance in Australia for parents with children is of the order of $1,370 billion. For those with average levels of superannuation death cover only, the level of cover held represents less than 20% of the average needs. We have estimated that this under-insurance has an additional annual social security cost in the order of $250 million. Our estimates do not take account of the cost of providing welfare housing and loss of income tax revenue.

Rice Walker recommends that the Committee address the issue of under-insurance in the context of using the SG arrangements to further encourage all superannuation fund members with dependants to have adequate group Death and Total and Permanent Disability (TPD) cover. Under current superannuation regulations, a default fund is required to offer minimum death insurance cover of a weekly contribution of 50c per week, or alternatively, a minimum level of cover based on the employee's age as follows:

Age	Death cover
20-34	$50,000
35-39	$35,000
40-44	$20,000

Clearly, these minimum amounts are not sufficient to provide adequate protection to the dependants of an employee who dies prior to age 40 when their mortgage payments and other debts are in most cases significant. IFSA advised us that on the basis of its Life Insurance members' statistics, only around 10% of the population in the 20-50 age group have death cover outside their superannuation funds.

From our experience, with industry and corporate sector superannuation funds, over 80% of members select as their default the minimum level of life cover. In the retail sector (including master trusts), the take-up rate would be even lower. We estimate that the average cover for a 40-year old member is of the order of $70,000 after making allowance for those with no cover.

[2] Rice Walker report to IFSA: Cost of Under-insurance – Analysis of Life Insurance Needs, May 2005

2.6.3. *Tax on Life Insurance Benefits*

The government has recently extended the definition of dependant to allow tax free benefits to be paid to a greater group of individuals. For example, the definition now includes same sex partners, siblings living together and adult children caring for parents. It may be more appropriate to bring the tax treatment of death benefits into line for all types of beneficiaries and make no distinction between them in terms of allowing the same tax free benefits for all.

2.6.4. *Health Insurance*

It is government policy to encourage as many Australians as possible to take out private health insurance. Most younger people do not consider that they are likely to become injured so they often regard private health insurance as unnecessary and indeed, relatively expensive. The situation has changed slightly with the introduction of the government rebate on private health insurance premiums. However, most young people would not regard this as a high priority given the demands for other consumption.

Ironically, most young people now have reasonable accumulated amounts in their superannuation funds. Certainly, they have sufficient to pay for health insurance premiums from these balances if this were allowable. We consider that it would be desirable to allow trustees to negotiate group private health cover on behalf of members, so that they can use their superannuation benefits to meet their premiums. In order to make this tax neutral, individuals would not be able to claim the tax rebate where their premiums were made through a superannuation fund. This facility would lead to an increase in the take up of private health insurance and cut the administration costs as the funds would be able to remit the contributions in bulk, making this more efficient for all parties.

Obviously, any money that is taken out of member's account is going to reduce the balance available at retirement. So it will be necessary to put some limit on the amounts deducted. The one option is to allow this only to people who are under age 40 where their disposable income outside of superannuation is on average, likely to be quite small.

Another advantage of this initiative is that young people would see an immediate benefit in their superannuation and this would help them engage at a much earlier age.

2.6.5. *Recommendations*

- The issue of under insurance should be addressed by using the SG arrangements to encourage all fund members with dependants to have adequate Group Death and TPD cover.

  Consideration should be given to increasing the minimum level of Group Insurance Cover for an employee up to age 40 with dependants to a reasonable level.

- Young individuals be allowed to pay their private health insurance contributions through superannuation.

- Employers providing health cover for their employees to receive a tax deduction equivalent to the deduction for SG payments.

2.7. Major Issues needing formal review

2.7.1. Particular difficulties facing women

Women in retirement face additional problems. They are at a competitive disadvantage, as they tend to live longer, have shorter periods in the workforce, retire earlier and have lower salaries, often including extended periods of part-time work whilst raising families. Many married women rely on their husbands. Yet high divorce rates mean that many women become independent at older ages without sufficient savings of their own – and with poor knowledge of the superannuation system.

When a person qualifies for the co-contribution, if they later take maternity leave, we recommend that the 10% income rule should be waived. The co-contribution should continue at the same rate, or a reduced rate, regardless of the person's low income for the period they are out of the workforce or unable to qualify for SG. This would enable mainly women's superannuation accounts to remain viable when no voluntary contributions are made. We appreciate that many employers provide SG contributions during maternity leave but this is not a universal practice, especially for temporary and part-time employees.

We consider the difficulties facing females in planning for retirement are worthy of a separate in-depth analysis.

2.7.2. Education on savings & investments

Traditionally superannuation was provided by employers and they chose a benefit design to suit their workforce. Under Choice of Fund and with the shift of all major funds to industry funds and master trusts, most employers will have a smaller impact on their employees superannuation arrangements.

We have already noted how all risks have now been passed to members but this is being done in a way that far outstrips education of the population. We consider it vital that superannuation be simplified and made easier for the average Australian. In this regard, we note the relatively high non-English speaking Australians who must find superannuation jargon to be incomprehensible.

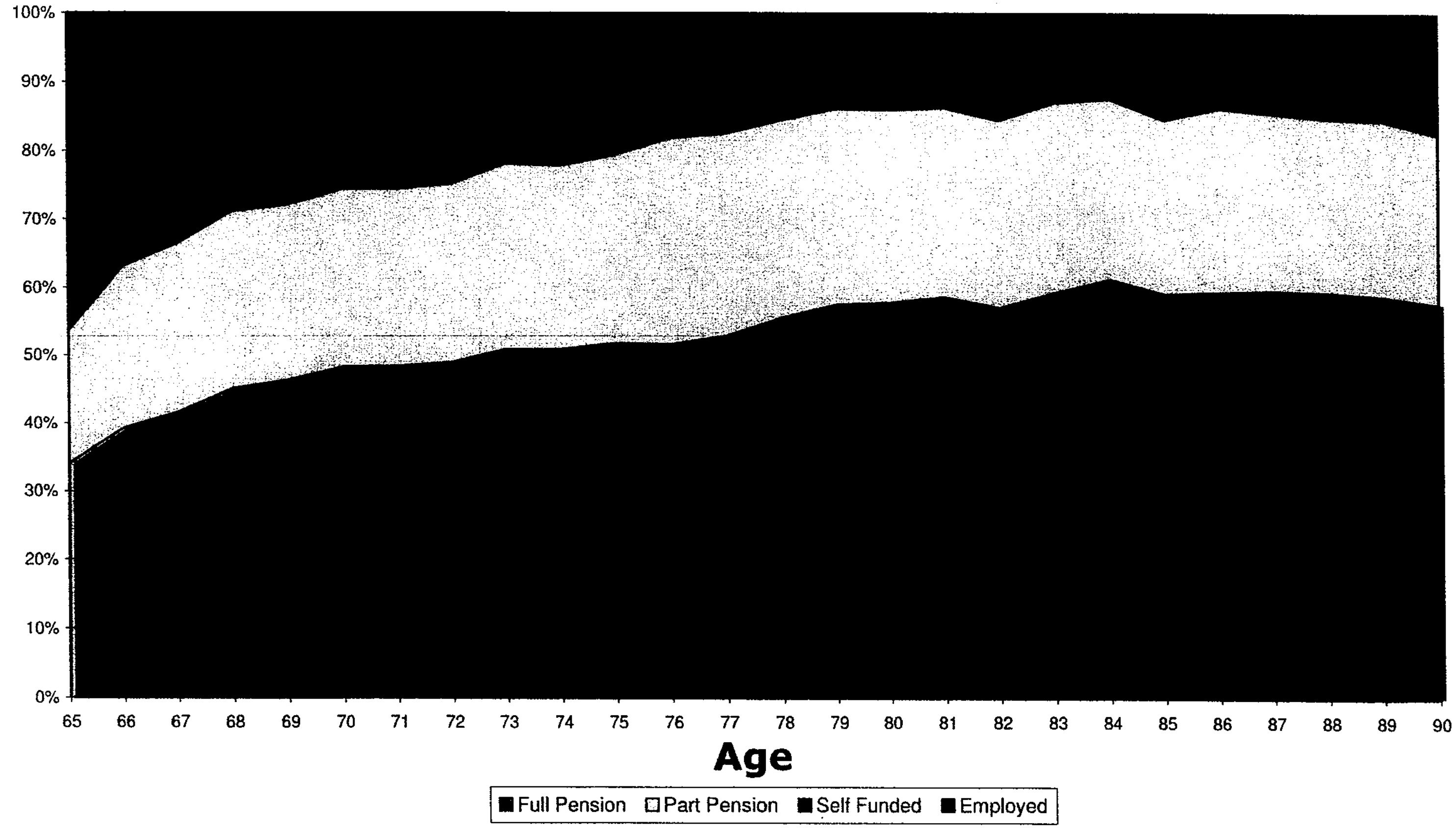
2.7.3. Role of financial advice

Financial planners provide a good service for those individuals who are able to pay the fees to get personal attention relative to their individual circumstances. However, only about 10% of the population take advantage of financial planning services and it seems unlikely that this will increase given the cost of the service.

Many superannuation funds are attempting to provide educational and financial planning services but there is a significant gap between the standards required and the services delivered. This reflects the complexity of the legislation, the strictness of the ASIC licensing regime and the sheer number of people that need to be educated.

We consider it worthwhile for Government to review the role of education and to support initiatives to broadern single communications messages to members.

A. Age Pension Dependency – Male Dependency



B. Age Pension Dependency – Female Dependency