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FINANCIAL SERVICES INSTITUTE OF AUSTRALASIA

Supplementary Submission: superannuation and the under-40s

1 May 2006

The Hon Bruce Baird MP Chair
Standing Committee on Economics, Finance and Public Administration
Parliament House
Canberra ACT 2600

Via email: efpa.reps@aph.gov.au

Dear Mr Baird

Re: Saving the Future: can the under-40s afford to grow old?

Finsia welcomed your invitation to provide a private briefing to the parliamentary committee on Finsia's *'Saving the Future: can the under-40s afford to grow old'* campaign and Finsia's views on New Zealand's KiwiSaver Bill on 30 March 2006.

As highlighted in previous submissions to this inquiry, research commissioned by Finsia and conducted by Crosby|Textor in 2005, as part of Finsia's *'Saving the Future campaign: can the under-40s afford to grow old?'* found that young Australians (in the 25-44 age cohort) welcome the principle of forced savings that compulsory superannuation underscores. Morever, incentive schemes for saving above the 9% compulsory threshold are overwhelmingly supported; especially given that: mortgages, education and costs of raising a family mitigate against the best intentions of the under-40s; the majority believe the aged pension will not exist; and, more than 50% expect to work through their retirement.

However, there is a major gap between the importance the under-40s place on retirement planning, their expectations for living in retirement and the funds they currently set aside. As such, Finsia's view is that incentive schemes are needed to encourage additional savings above the 9% compulsory superannuation.

The nature of these schemes and their costing will be addressed at Finsia's Saving the Future Summit in Sydney on 5 July. If the Committee has any further questions please do not hesitate to contact Ms Kristen Foster, Senior Manager Consumer and Public Policy on 02 8248 7660 or via email k.foster@finsia.edu.au Finsia looks forward to the public release of the Committee's final report and its recommendations.

Yours sincerely

Brian Salter F Fin
Chief Executive Officer

1. Incentive Schemes

Within the context of an ageing population; the public provision of pensions; and savings patterns, Finsia considers that incentive schemes are required to encourage more Australians to contribute over and above the 9% compulsory superannuation level. Economic theory assumes that households aim to smooth consumption during their lifecycle and that households decide how much they need to save according to each stage of their lifecycle. However, the economic theory is not easily borne out in practice as behavioural research has repeatedly revealed a lack of emotional and active engagement amongst people when saving for retirement.

In the United States, there is increasing consensus amongst researchers that incentive schemes are needed to increase the overall savings rate and that auto-enrolment plans work in encouraging more participation. The UK has also considered auto-enrolment schemes as outlined in its report of November 2005.

2. KiwiSaver Bill

Following the 2005 merger of the SIA and AIBF, Finsia now has a membership base in New Zealand. In February 2006, Finsia consulted with key government officials to better understand retirement literacy and incentive schemes in New Zealand. Even though New Zealand has a different superannuation and pension scheme, Finsia was interested in learning more about New Zealand's KiwiSaver Bill and, in particular, both the incentive components and flexibility of the scheme.

The KiwiSaver Bill which was announced in New Zealand's May 2005 Budget and introduced on 27 February 2006, is just one example of an 'opt-out' scheme which could potentially be applied in the Australian context to voluntary contributions. The inertia created by 'opt in' schemes has been reported internationally.

Obviously, as mentioned above, the retirement systems in Australia and New Zealand differ markedly. Australia's system is based on the compulsory employee-based Superannuation (not universal in NZ), the aged pension (which is similar to New Zealand Superannuation, however NZS provides a "floor" for retirement in NZ and is not means or assets tested) and voluntary options above the 9% including the Government's co-contribution scheme, and of course, private market-invested savings. Notwithstanding these differences, there are two components of the KiwiSaver Bill which deserve close inspection, namely the 'opt-out' or 'soft compulsion' approach to voluntary contributions and secondly, the incentives (tax and others).

Finsia supports the voluntary nature of the KiwiSaver scheme. The Bill aims to overcome inertia created by 'opt in' schemes and instead utilise an auto-enrolment feature where employees commencing a new job those who are aged between 18 and 65 – have the right to opt out of the scheme. Finsia also supports the availability of an 'opt-in' option for existing employees. If the forward projections by the Inland Revenue Department are correct, then an 'opt out' scheme such as KiwiSaver will see 25 percent of New Zealand's eligible population joining KiwiSaver after seven years which equates to approximately 680,000 people.

In its submission to the Finance and Expenditure Committee, dated 27 April 2006, Finsia supported the general intent of the KiwiSaver Bill to increase household savings by New Zealanders and to *"encourage a long-term savings habit and asset accumulation by individuals who are not currently* *saving enough, with the aim of increasing individuals' well-being and financial independence, particularly in retirement".* Finsia supports the auto-enrolment nature of KiwiSaver, which, given that New Zealand does not have compulsory superannuation, is crucial in the New Zealand context to encourage more participation and emotional engagement in saving for retirement. Finsia also supports the view expressed by Dr Cullen on 2 March 2006 that, *"workplace schemes have the advantage of reaching a broad section of the population and international research shows more will participate if enrolment in retirement schemes is automatic".* According to the New Zealand Government, the UK Pensions Commission is also considering KiwiSaver in relation to the British pension system.

Key components of KiwiSaver

- KiwiSaver is a voluntary, work-based incentives scheme. Its aim is to encourage well-informed savings habits and asset accumulation to improve New Zealanders' financial well-being, particularly for retirement.
- Inland Revenue will administer the scheme using the existing PAYE tax system. Inland Revenue will forward members' contributions on their allocated or registered KiwiSaver scheme provider for investment.
- New employees aged 18 to 65 will be automatically enrolled into KiwiSaver when they start a new job and will have six weeks to decide whether to opt out.
- Employees' contributions will be deducted from wages at a rate of 4% of gross salary or wages, unless the employee opts for the higher rate of 8% and be held by Inland Revenue for an initial 3 months period during which the employee can seek financial advice and select a KiwiSaver scheme provider.
- Member's contributions will be locked-in until the age of eligibility for New Zealand Superannuation or five years after the first contribution, whichever is later, with the following exceptions: a one-time withdrawal to assist with the purchase of a first home after at least 3 years membership of KiwiSaver; serious financial hardship; if the person ceases to become a KiwiSaver member (ie permanent emigration or upon death of the member).
- Flexibility with 'contributions holiday periods' (after 12 months of contributions to the KiwiSaver scheme, all individuals can stop contributions for up to five years at a time with a minimum 3 months).
- Government makes a $1000 kick-start contribution to each member's account at first joining, to be locked in until the recipient is eligible for NZS or for five years of membership, whichever is the later.
- Government will make a contribution towards members' fees.
- Offers a one-off first home deposit subsidy of $1000 per year of membership in the scheme, up to a maximum of $5000 for five years, to qualifying KiwiSaver members who meet the eligibility criteria after at least three years of saving.
- It is estimated by Inland Revenue that 25 percent of NZ's eligible population will have joined KiwiSaver after 7 years.

3. Relevance of the KiwiSaver scheme in the Australian context

As demonstrated by Finsia's polling conducted by Crosby|Textor in 2005, many under-40s lack the emotional engagement to independently save for their retirement. As outlined above, Finsia's poll found that the 25-44 age cohort overwhelmingly supported compulsory employee contributions of 3-5% over and above the compulsory employer contribution of 9%. Furthermore, while 82% of respondents were aware that they could currently voluntarily commit a greater percentage of salary to superannuation, only 33% actually made contributions over the 9%.

Rather than raising the 9% compulsory contribution as such, the savings gap could be reduced by an 'opt out' scheme where, as in the New Zealand context, employees who commence a new job and are aged between 18 and 65 have the right to opt out of the KiwiSaver scheme and existing employees can opt in to the scheme. Given that KiwiSaver is just one example of an auto-enrolment scheme, in the Australian context, further economic analysis of 'opt-out' schemes would be required, particularly in relation to potential engagement rates, the impact on the individual's savings and the public purse in the long-term.

Flexibility of opt out schemes

Finsia supports the flexibility of the KiwiSaver scheme that allows savers to cease contributions by applying to Inland Revenue for a contributions holiday after an initial contribution period of 12 months and for a period of up to 5 years (with renewal at the end of this period). This allows flexibility for those with changed work patterns or life circumstances that affect a saver's financial situation.

A challenge is to ensure that with the casualisation of the workforce that employment profiles (for example employees working part-time or transferring from full-time to part-time work) do not disadvantage such savers but at the same time allow them the flexibility to contribute to their retirement savings without experiencing financial hardship in the process. Contributions holidays are useful for those employees who may take some time out of the workforce for example primary carers of the elderly and young children or people with a serious illness who cannot work for a period of time.

4. Economic modeling

Specifically, Finsia's *'Saving the Future'* campaign considers positive enhancements and additions to the Government's existing incentive schemes (such as co-contributions) and possible future incentive schemes.

As highlighted at the Economics, Finance and Public Administration Committee's meeting, as a result of Finsia's poll (particularly in relation to issues supported by those polled such as extending government co-contributions), Finsia has commissioned Access Economics to conduct economic modeling of various incentive schemes including:

- **A 'baseline' scenario**, showing 'where we are headed' – that is, likely outcomes for today's under 40s if policies are unchanged. This will provide projected outcomes both for the system as a whole, and the under 40s target group, as well as identifying the effects of current incentives.
- **A 're-alignment' scenario**, showing the effect of members taking full advantage of current incentives, but maintaining their current overall savings effort in super. By reflecting an increased knowledge and planning on the part of members, this scenario would: measure the 'lost opportunities' present in the current system and show the increase in retirement incomes if members were to get the most out of super incentives.
- **An 'extended co-contributions' scenario**, showing the effect of changes to the scheme designed to help repair current imbalances in contribution incentives at a modest cost to

government. This scenario will represent a change to current policy, and will show the effect of that change over time on government revenues and retirement incomes.

An 'under 40s incentive' scenario, which would extend the SuperSim model to include a new 'co-contribution style' incentive for under 40s to contribute to super, but leave incentives for older members unchanged. This scenario will explore the potential of policies aimed directly at members under 40 to boost future retirement incomes.

Finsia looks forward to continuing its campaign on superannuation and the under-40s and releasing its findings on 5 July 2006