Industry Funds Forum

Submission to

House of Representatives

Standing Committee on Ageing

Inquiry into long-term strategies to address the ageing of the Australian population over the next 40 years

Industry Funds Forum
Level 2, 20 Queens Road
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Industry Funds Forum Submission

EXECUTIVE SUMMARY

1 Industry Funds Forum (IFF) believes that there is a need to boost the incomes available to Australians in their retirement so that they can enjoy a reasonable standard of living.

2 The current (from 1 July 2002) level of mandatory superannuation contributions of 9% will not provide an appropriate income for most Australians in their retirement. This is especially so in the context of the ageing of the Australian population.

3 The IFF supports the mandatory level of superannuation contributions increasing to 15%.

4 The IFF does not believe that taxation-based savings incentives are likely to lead to a major increase in overall national savings.

5 In addition to the position in point 3 above the IFF recommends:
   - (i) consideration be given to how to remove taxes on superannuation contributions and investment earnings, in favour of taxation biased to withdrawal of superannuation benefits;
   - (ii) further adjustments to the Surcharge be made to address the inequities inherent in the Surcharge for people, especially women, who may not have the opportunity to fully access taxation concessions during periods of lower income due to broken work patterns;
   - (iii) a ban be imposed on commission-based selling of compulsory superannuation contributions;
   - (iv) consideration be given to placing a cap on fees charged by superannuation funds;
   - (v) all superannuation funds accepting compulsory superannuation payments be required to have an appropriate arrears collection process in place;
   - (vi) Superannuation Guarantee contributions be required to be made on a monthly, or at least quarterly, basis; and
   - (vii) the definition of a complying pension be amended to include an allocated pension.

6. A publicly funded education campaign aimed at improving people's knowledge of superannuation issues should be introduced.

INDUSTRY FUNDS FORUM
SUBMISSION TO THE HOUSE OF REPRESENTATIVES
STANDING COMMITTEE ON AGEING

INQUIRY INTO LONG-TERM STRATEGIES TO ADDRESS THE AGEING OF THE AUSTRALIAN POPULATION OVER THE NEXT 40 YEARS

The Industry Funds Forum welcomes the opportunity to provide this submission.

The Forum consists of the CEO's of approximately 24 of Australia's largest industry superannuation funds. The aggregate membership of these funds is over 5 million and the combined member assets held in the funds totals over $ 30 billion.

This submission will focus on the issues relevant to the Forum's membership, namely, the provision of economic security for ageing Australians.

There are 4 specific elements in our submission:

1 Retirement Incomes
2 Contribution Levels
3 Taxation Arrangements and other Government Measures
4 Public Education

1 Retirement Incomes

In developing an equitable and sustainable retirement incomes policy a number of potentially conflicting issues need to be reconciled:

- The amount of money people *wish* to have in their retirement
- The amount of money people *need* to have in their retirement
- The amount of money people *will* have in their retirement *based on current conditions* (including contribution levels; taxation arrangements; working patterns; investment returns; and life expectancy) continuing
- The amount of money people *will* have in their retirement based on *changes to these conditions* – some of which are more amenable to change based on an individual's actions (possibly personal contributions and working patterns) than others (eg taxation arrangements and investment returns)
- The extent to which employers, members and Governments can *afford* to contribute to retirement incomes.

Research conducted for the Association of Superannuation Funds of Australia (ASFA) in 2001[1] amongst 750 Australians aged between 30 and 69 demonstrated the "self-delusion"[2] that exists in the community between the expectations and the likely reality of the standard of living that most Australians will experience in retirement.

88% of those surveyed said they would need a minimum of $20,000pa in retirement. 70% said they would need $30,000pa, and 30% say they would need $50,000pa.

However on the basis of current conditions an average worker with 9% Superannuation Guarantee contributions who works for 30 years will receive only around $19,000pa inclusive of age pension benefits of around $11,000pa.

Notwithstanding this latter point, fully 62% of those surveyed said they expected to receive their minimum required income in retirement.

There is considerable evidence that the age pension does not provide an adequate level of income to all its recipients. According to the National Centre of Social and Economic Modelling (NATSEM) 11% of Australians over 65 years of age are living in poverty.[3] The poverty rate for older Australians is increasing having been 7.3% in 1990. This data points to the need to *increase* the old age pension for those who rely on this income source in retirement. Thus the issue of retirement incomes is a serious issue and as the ageing of the Australian population increases (see below) is set to become an even more critical issue.

There are two major issues to address. The ASFA research demonstrates that there is a major expectation gap to manage. However there is a second and far more fundamental issue requiring action, and that is the need to boost the incomes available to Australians in their retirement so that they can enjoy a reasonable standard of living. The ageing of the Australian population – see below – compounds the need for these changes.

The Australian population *is* ageing. Today around 12% of the population is 65 or older. In 30 years time this figure is forecast to be 21% of the population. The baby boomer bulge in the population; advances in health care and medical technology; improved health, nutrition, and exercise practices; and increases in life expectancy will

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[1] "It's time for a retirement reality check", ANOP Research Services Pty Ltd, Presented to ASFA National Conference, September 2001.
[2] Ibid, p9
[3] A. Harding, R. Lloyd, H. Greenwell,"Financial Disadvantage in Australia 1990 to 2000: The Persistence of Poverty in a Decade of Growth", National Centre for Social and Economic Modelling, p17

all contribute to there being a higher proportion of the population who have retired from the workforce than currently exists.

A further issue to consider in this context is the total dependency ratio which measures the percentage of the population below working age plus the percentage of the population above working age, as a percentage of the whole population. Even by this more conservative measure the increased costs to Government of the ageing population are apparent. The costs to Government of meeting the needs of children are lower than the costs of meeting the needs of older adults.

The increasing pressures of our ageing population have two opposite effects that combine to place pressure on retirement incomes. Firstly, the proportion of the population who are in the workforce generating wealth and paying taxes (to be expended on such matters as age pensions and health costs) is falling. Secondly the proportion of the population who are out of the workforce and not making substantial contributions to public revenue (many of whom are partially or fully reliant on social security support, and contributing to increased health care costs in the community) is rising.

How then to address this emerging problem of inadequate retirement incomes?

2 Contribution Levels

The Australian retirement incomes model has been built on the so-called 3 pillars:

(i) age pension
(ii) compulsory superannuation
(iii) voluntary savings.

(i) Age Pension

The IFF asserts in the strongest terms that the age pension must be at least maintained at its current modest levels.. As the NATSEM data above demonstrates there is a sound case to argue for an increase in the age pension to ensure that all older Australians can enjoy a reasonable standard of living in retirement.

A very large number of Australians do not meet the image of the standard working Australian that much policy work in this area is based on. An increasing number of people in the paid workforce – quite apart from those who do not participate in the paid workforce – work for less than 35 or 40 years, and/or take time out of the workforce to raise families or pursue other activities, and/or are involuntarily unemployed for periods at a time, and/or work on a part-time or casual basis whether by choice or otherwise. The increasing number of people in these categories will receive less support from the second and third pillars than those who do meet the "standard" picture of a full-time employee.

Likewise a large number of Australians who participate in the paid workforce do not earn sufficient income to enable them to make voluntary savings and so reach retirement with little or no support from the third pillar.

Accordingly the age pension, which the IFF submits should continue to be means tested, remains a critical and essential element in Australia's retirement income system.

(ii) Compulsory Superannuation

The Superannuation Guarantee amount of 9% from July 2002 is not a sufficient level of mandatory superannuation contributions to provide an appropriate standard of living for most Australians – especially in the context of the increasing pressures on the public purse due to the ageing of the population and the consequent pressures on social security expenditure. The IFF acknowledges that for a small percentage of the workforce who earn high incomes, a 9% superannuation contribution level may be sufficient. However public policy in this area should be guided by the interests of the majority of the population – for whom 9% is a plainly inadequate figure. It is also to be noted that the Government's tax treatment of superannuation means that the amount of money that initially makes its way into a member's superannuation account is less than 8%, rather than 9% (from 1 July 2002).

It appears that the reluctance of the shrinking number of parties who do *not* acknowledge the inadequacy of the 9% level, is based on a concern as to which stakeholders will be required to contribute to taking the level of contributions beyond 9%. However the threshold issue of the inadequacy of the 9% level needs first to be acknowledged. The 9% contribution level is increasingly becoming an insufficient level to provide a reasonable standard living for most Australians in their retirement – the IFF supports a total level of contributions of 15%.

An increase in the level of superannuation contributions from 9% to 15% is based on a range of factors outlined in this paper including:

- Assumptions based on an average of 35 – 40 years full time employment do not reflect the working experience of most Australians
- Superannuation assets will need to be larger to accommodate the longer lives of people and their greater costs, especially health costs
- Failure to address these issues will either condemn future generations of retired Australians to a retirement involving an

unsatisfactory standard of living, or will see an oppressive level of taxation being levied to finance substantially increased social security and health expenditure.

In relation to any contributions required to be made by members as part of the process to increase contributions to an increased level, the IFF believes that such contributions should:

- be relatively modest in quantum;
- be introduced on a staged basis; and
- take account of the capacity of members to make such contributions. For example it may be appropriate for income tax cuts to be paid by way of contributions to members' superannuation accounts. It may be appropriate for there to be an earnings threshold below which contributions which would otherwise be made by a member would be made by the Government.

The IFF believes that the second pillar of compulsory superannuation contributions remains an essential element of Australia's retirement income system but that the 9% (gross) figure needs to be increased to provide an appropriate standard of living for Australians in their retirement.

(iii) Voluntary Savings

The IFF believes that there are 2 key issues concerning voluntary savings. Firstly it should be acknowledged that many Australians including a large number who participate in the paid workforce do not earn a sufficient amount of money to enable them to make voluntary savings – whether into superannuation or elsewhere. Secondly it is difficult to develop a model of taxation incentives to encourage a large percentage of people to make voluntary contributions into preserved savings (superannuation) because the taxation treatment has to be of such a generous level that widespread adoption would be uneconomic from the Government's viewpoint. The IFF notes that there is no data to demonstrate that tax incentives have increased savings ratios anywhere in the world. Typically such incentives redirect the savings of those who can or would already save. One effect of such incentives is that a government subsidy is provided to those least in need of this assistance.

3 Taxation and Government Initiatives

In addition to the above the IFF believes that there are a number of measures that the Government should consider in addressing the issue of improving living standards for Australians in retirement.

(i) Taxation

The IFF supports the removal of taxes on contributions and investment earnings in favour of taxation that occurs at the time of withdrawal. This would simplify the current arrangements and provide greater retirement options for members.

The IFF acknowledges the Government's intention to reduce the level of the superannuation surcharge. The IFF believes further work is required in relation to the surcharge. For example the surcharge is inequitable for many people especially women who may not have the opportunity to fully access taxation concessions during periods of lower income due to broken work patterns.

(ii) Ban Commission-Based Selling of Compulsory Superannuation Payments

The mandatory nature of Superannuation Guarantee contributions distinguishes them from most other financial products. The IFF believes that it is wrong for superannuation contributions that are mandated by the Federal Parliament to inappropriately enrich parties other than the member for whom they are intended. To the extent that this occurs it reduces the living standards of these members in their retirement. Accordingly the IFF believes there should be greater regulation to ensure that members receive maximum benefit from the contributions intended to be paid into their superannuation account. The IFF believes that financial planners, accountants, sellers of superannuation products, and other intermediaries should not be able to receive commission-based remuneration for legislatively mandated superannuation payments and rollovers.

(iii) Cap on Fees

Consideration should be given to placing a cap on fees charged to members of superannuation funds. The UK Government has recently introduced a similar arrangement for their stakeholder pensions. The imposition of high fees by some providers of superannuation products serves to reduce the living standards of members in retirement. A number of recent reports[4] have highlighted the dramatic effect that high fees charged by some providers of superannuation services can have on the end benefit received by members.

(iv) Arrears Procedures in Superannuation Funds

The most extreme form of diminution of members' expected retirement benefits occurs when Superannuation Guarantee contributions that are expected to be made, are not in fact paid. This occurs when employers (a small percentage, but of critical importance to the

[4] H. Bateman,"Disclosure of Superannuation Fees and Charges", AIST, August 2001.
R. Clare, "Are Administration and Investment Costs in the Australian Superannuation Industry Too High", ASFA, November 2001

employees of these employers) who fail to make the payments that should be made to their employees' superannuation fund. This practice is effectively condoned by those superannuation funds that do not have effective mechanisms to follow-up employers who have failed to make appropriate payments. The IFF believes that all superannuation funds should be required to have such mechanisms in place, and failure to do so should render the Fund incapable of receiving Superannuation Guarantee contributions.

(v) Frequency of Superannuation Guarantee Payments

The IFF welcomes the Federal Government requirement for more frequent SG payments (to quarterly). This will protect affected members and improve their investment returns. The IFF strongly favours a requirement for monthly contributions. This would create consistency between the regulation and the widespread contractual arrangements between funds and contributing employers.

The Australian Tax Office will require additional resourcing to monitor and police the quarterly payment requirement. The ATO has been under-resourced in this areas since the introduction of the GST.

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(vi) Complying Pensions

The IFF supports changes to the definition of a complying pension to include allocated pensions. This would be likely to increase the demand for allocated pensions and have the following benefits:

- More suppliers could be expected to offer such products thus increasing the options available to retirees with consequent price pressures leading to a drop in fees.
- The investment in growth assets would be likely to produce higher long-term returns than is available through current complying pensions.
- Government outlays would be reduced if the amount of pension payments was higher or the term of income payment was longer. With lower costs and market earning rates, an allocated pension may be expected to achieve these conditions.

4 Public Education Campaign

It is our understanding that the Federal Government may be considering a funded public education campaign prior to the introduction of any 'Choice of Fund' legislation.

It is the Forum's view that such a public education campaign is necessary for at least the following reasons.

- There is a clear gap between people's expectations of their retirement incomes and their actual retirement incomes as calculated by independent experts (see 1 above).
- There is a wide discrepancy in the minimum annual income people believe they will need to achieve a reasonable standard of living in retirement.
- Very few people calculate their retirement needs on the basis of a realistic total-cost budget.
- It is likely that people commonly underestimate the impact of inflation, increasing community standards and expectations, and the impact of taxes, fees and charges on their long-term savings.
- There is a comparatively complex set of relationships between the tax system, social security provisions and accumulated savings which is not widely understood.
- The superannuation industry is not governed by an adequate disclosure system requiring providers to disclose all fees and charges. The currently required Ongoing Management Charge (OMC) is misleading, does not include all fees, and can cause a lower cost fund to appear to be a higher cost fund because of an inappropriate calculation formula.
- Very few people understand the magnitude of a percentage administration charge, or a trailing fee over the long term. Prospective fund members are not required to be shown the impact of fees on the actual dollar amount of their future superannuation balance (assuming standardised investment returns, contributions, years of contribution, etc). In the absence of such a requirement, a public education campaign may help Australians to avoid making costly choices to their substantial detriment. However, immediate reform of the superannuation disclosure regime is required.

- There is currently no independent agency to provide objective advice in the client's best interest. In this regard it is worth noting that the dominance of percentage commissions as a payment system by financial institutions to financial planners means that financial planners are frequently not independent nor should they claim to provide advice in the best interest of the client. For instance, where a financial planner is proposing a superannuation fund to a client, he/she will be unlikely to recommend a fund which will not provide them with a commission (eg industry funds do not provide sales agents/planners with any commission). However, where financial planners reject all commissions and charge an hourly rate, they can afford to be independent and to act in the member's best interests. Unfortunately the practice of an hourly fee is rare and the whole issue needs reform

The educational campaign must be aimed at improving people's knowledge of retirement planning issues. It must not be a campaign aimed at selling a particular political party's platform or achievements.

At the end of the campaign, people must have significantly improved knowledge tools to help them ask the right questions, lay the right plans, make the best choices, and improve their economic security in retirement.

It is also important that the campaign occurs prior to the introduction of Choice of Fund requirements.

Appendix: Submission made on behalf of the following IFF Members

AGEST – Australian Government Employees Superannuation Trust

AMIST – Australian Meat Industry Superannuation Trust

ARF – Australian Retirement Fund

BUSSQ – Building Unions Superannuation Scheme (Queensland)

CBUS – CBUS Superannuation Fund

CARE – CARE Superannuation Plan

FINSUPER – Finsuper

HESTA – Health Employees Superannuation Trust Australia

HOST SUPER

ISST - Independent Schools Superannuation Trust

JUST – JUST Super

MIESF – Meat Industry Employees' Superannuation Fund

NGS Super – Non-Government Employees' Superannuation Fund

PRINT – PRINT Super

REST – REST Superannuation

SERF – Employees Retirement Fund

STA – Superannuation Trust of Australia

SUNSUPER – Sunsuper

TISS – Timber Industry Superannuation Scheme

TWU – TWU Superannuation Fund

WESTSCHEME - Westscheme