3

Superannuation savings environment

Retirement income ‘adequacy’

3.1 The notion of retirement income ‘adequacy’ was discussed at length in the 2002 Senate Select Committee on Superannuation report into *Superannuation and Standards of Living in Retirement*.[1] The Senate Select Committee noted the high degree of consensus expressed by witnesses that a desirable net retirement savings target was 60–65 per cent of gross pre-retirement income for a person on average earnings. The Senate Select Committee determined that a person earning less than average earnings would need to target a greater percentage of their gross pre-retirement income to achieve the same living standard whilst a person earning more than average earnings could target a smaller percentage.

3.2 The Senate Select Committee recognised there was an adequacy gap but did not actually determine a desirable retirement savings target to achieve an ‘adequate’ retirement income.

3.3 The issue of ‘adequacy’ has been impacted by the government’s proposed changes to the laws governing superannuation in the 2006–07 budget. These included changes to the taxation of superannuation benefits, which were outlined in the government’s *Plan to Simplify and Streamline Superannuation*[2] (superannuation plan).

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1 Senate Select Committee on Superannuation, *Superannuation and Standards of Living in Retirement, Report on the Adequacy of the Tax Arrangements for Superannuation and Related Policy,* Canberra, 2002.

2 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

3.4 The proposals in the plan are subject to public consultation and being passed by parliament. As a result, the following paragraphs are largely based on the current superannuation tax system. However, relevant elements of the budget will be discussed where necessary.

Lifestyle differences

3.5 There appear to be quite different views on what level of retirement income should be planned to be achieved by individuals. In practice each individual's definition of an 'adequate level of retirement income' will vary depending on a number of factors, including the standard of living prior to retirement and the drop in standard of living they would be willing to accept in retirement. An adequate retirement income would therefore be based on what the individual requires to meet their desired living standard, given that a basic living standard is provided by the Age Pension.

3.6 Westpac and the Association of Superannuation Funds of Australia (ASFA) jointly constructed retirement expenditure budgets to reflect a perceived 'modest' retirement lifestyle and separately, a 'comfortable' retirement lifestyle.[3] These expenditure budgets have been used by ASFA to determine retirement income benchmarks.

3.7 ASFA follows an adequacy rule of thumb which would entail a couple accruing at least $500 000 to generate sufficient retirement income to allow them to live a 'comfortable' lifestyle (assuming both have eligibility for a part-Age Pension during the course of their retirement).[4] The $500 000 lump sum, using ASFA's assumptions, would translate to an income stream of approximately $45 000 for the household. This is slightly more than twice the full pension for a couple.

3.8 The Westpac/ASFA budgets contain subjective and value judgements about the type of lifestyle and priorities of people in retirement. In reality individual needs and choices differ markedly.

Is there a 'retirement savings gap' for individuals?

3.9 The Investment and Financial Services Association (IFSA) stated that there was approximately a $600 billion 'retirement savings gap' as at 31

3 Social Policy Research Centre, University of New South Wales, *The Westpac/ASFA Retirement Living Standard*, Sydney, 2004.

4 The Association of Superannuation Funds of Australia (ASFA), *Submission no. 16*, p. 10.

December 2002.[5] This has since been revised downwards to an estimated gap of $452 billion as reported in IFSA's 2006 retirement incomes policy statement.[6]

3.10 The gap was calculated taking into account the type of retirement lifestyle deemed desirable by people aged 25–65 earning between 75 per cent and twice average weekly earnings. Desirable retirement income was assumed to be 62.5 per cent of pre-retirement income for all age cohorts. IFSA describe the 'retirement savings gap' as the difference between Australians' expectations for their standard of living in retirement and the standard of living their current savings will achieve.

3.11 IFSA concluded from the study released in 2003 that the then current level of retirement savings (which included pension components) would not meet the needs of the expected retirement living standards of working age people. The updated 2005 report (commissioned by IFSA and undertaken by Rice Walker Actuaries[7]), concludes the 'gap' has narrowed mainly due to government policy incentives and changes in the treatment of the Age Pension integration in the model assumptions.

3.12 There is an opposing view held, including by some industry stakeholders, that the quantum retirement savings gap is not quite as large. The method of determining retirement lifestyle expectations in the IFSA model was to set retirement income at 62.5 per cent of pre-retirement income (the level of income in the year prior to retirement). Setting a percentage across the board omits differing expectations and capacities of individuals/families in their working life-cycle.

3.13 A savings gap would be expected to differ depending upon the assumptions underlying the determination of retirement lifestyle expectations. Results would differ markedly in studies where participants were asked what they would like as a living standard in retirement versus what they would be prepared to forgo now for a future desired living standard. ASFA claim their studies asked participants questions about requirements:

> It was expressed more as 'How much will you need?' It was not 'How much would you like at Christmas?' Initially we found a huge gap between people's expectations and how much they were saving. What has happened over the years is that people now have

5 Investment and Financial Services Association (IFSA), *The Retirement Savings Gap*, Sydney, 2003.

6 IFSA, *Retirement Incomes & Long Term Savings Policy Options*, Sydney, 2006.

7 Rice Walker Actuaries, *The Retirement Savings Gap – Two Years On*, Sydney, September 2005.

> an awareness that there is a mismatch between what they think they will need in retirement and how much they are saving.[8]

3.14 While people's expectations of their lifestyle and consequent income needs in retirement exceed the level of retirement income their superannuation savings will allow, a personal retirement savings gap will exist. The government provided Age Pension goes some way to bridge this expectations gap with part pensions:

> Unfortunately significant evidence shows that there is disparity between Australians' retirement income expectations and aspirations and what their current levels of superannuation will actually achieve. According to ABS data, almost half (44%) of Australians believe that their main source of income at retirement will be superannuation. In reality, for a majority of Australians a combination of public and private savings will be needed to fund retirement incomes.[9]

3.15 Another reason the 'retirement savings gap' has not been considered to be as large as purported is that the IFSA model makes only a small allowance for non-superannuation savings, taking account of 'investment properties of wealthier individuals' only.[10] Interestingly, the first report on the retirement savings gap did not consider non-superannuation savings at all, which form a part of Australia's retirement savings system.

3.16 Treasury's Retirement Income Modelling Unit (RIM) and its predecessor have performed work on retirement income since the early 1990s. The Unit's 2003 paper[11] on private savings discusses the importance of this third pillar in Australia's three pillared retirement income system:

> The voluntary private savings component includes employer contributions that are beyond SG requirements, voluntary member superannuation contributions and other forms of saving such as property, shares and other non-superannuation financial assets.[12]

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8 Association of Superannuation Funds of Australia (ASFA), *Transcript*, 28 July 2005, p. 9.

9 Australian Bankers Association (ABA), *Submission no. 28*, p. 5.

10 Rice Walker Actuaries, *The Retirement Savings Gap – Two Years On*, Sydney, September 2005, p. 5.

11 Cliff Bingham, Retirement and Income Modelling Unit, The Treasury, *Impact of Private Saving and Longer Careers on Retirement Income*, Paper Presented to the Eleventh Colloquium of Superannuation Researchers, University of New South Wales, July 2003.

12 Cliff Bingham, Retirement and Income Modelling Unit, The Treasury, *Impact of Private Saving and Longer Careers on Retirement Income*, Paper Presented to the Eleventh Colloquium of Superannuation Researchers, University of New South Wales, July 2003, p. 2.

3.17 The paper concluded that non-superannuation savings and assets contribute to improved standards of living in retirement and/or retirement savings and are often underestimated in the calculation of future retirement incomes. It included owner occupied properties in this category on the basis that home ownership increases retirement living standards as housing costs are considerably lower than those renting in retirement.

2006–07 budget and a 'retirement savings gap'

3.18 The issue of a retirement savings gap is impacted by the government's 2006–07 budget 'superannuation plan'. The plan contains proposals that reduce the amount of tax paid when superannuation benefits are received in retirement. From 1 July 2007, benefits received from a taxed fund by a person aged 60 or over will be tax exempt. This means they will not pay any tax on that money, nor will that money push their other income into higher tax brackets. In essence, people should have more superannuation money available to them in retirement.

3.19 This additional tax concession alone will increase the retirement benefits of those aged under 40. The government predicts that:

> Under a fully mature SG system, a person on $1,000 per week (about average income) is projected to have accumulated superannuation benefits of approximately $466,000 over a working life of 40 years through the SG arrangements alone. Under the proposed plan, tax of around $37,000 payable when the benefit is paid would be abolished. This average worker would thus gain around $37,000 in retirement, an increase of approximately 9 per cent if they take a lump sum.[13]

3.20 If the same person chose to take their benefits as a superannuation pension, they are estimated to have an average of around $136 per week in additional retirement expenditure under the proposed new system. This would represent an increase in retirement expenditure of approximately 17 per cent.

3.21 It is also hoped that the change to the taxation of superannuation will encourage additional voluntary contributions:

> If the person taking a lump sum in the earlier example also made an additional 5 per cent tax deductible (salary sacrifice) contribution to superannuation each year over a working life of 40

13 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 55.

> years, their retirement benefit would increase from $466,000 to $706,000. Under current arrangements, this extra saving would have provided for an 11 per cent increase in average retirement expenditure. Under the proposed changes, there would be a gain in average retirement expenditure of 35 per cent.[14]

3.22 Furthermore, the fact that superannuation benefits will not impact on the tax paid on other income is expected to provide greater incentive for individuals to continue to work past traditional retirement age, in a part-time capacity, and supplement that income with superannuation drawings. This will allow a higher standard of living than would otherwise be achieved.

Australia’s retirement savings system

3.23 Australia’s retirement savings system is based on three pillars—the Age Pension, a compulsory Superannuation Guarantee (SG) levy and other savings including voluntary superannuation contributions. Treasury has the view:

> Australia's retirement income system encourages people to achieve a higher standard of living in retirement than would be possible from the age pension alone, while ensuring Australians have security and dignity in retirement.[15]

3.24 The full-Age Pension is designed to provide a safety net living standard to cover essentials and allow a pensioner to maintain a level of dignity in retirement. The SG supplements the Age Pension for those who have enjoyed employment prior to the pensionable age. Additional voluntary superannuation savings by individuals raises their retirement living standard.

3.25 A 25 year old on median earnings (approximately $40 000), contributing the SG for 40 years, will obtain a spending replacement rate of 82 per cent of pre-retirement income.[16] Treasury has not provided a break down of the components of the retirement income in that case, that is, how much Age Pension contributes to the replacement rate and how much private savings (SG) contributes. However, in a submission to an earlier inquiry[17] Treasury

14 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 56.

15 The Treasury, *Submission no. 47*, p. 4.

16 The Treasury, *Submission no. 47*, p. 14.

17 Senate Select Committee on Superannuation, *Superannuation and Standards of Living in Retirement, Report on the Adequacy of the Tax Arrangements for Superannuation and Related Policy,* 2002 – Treasury, *Submission no.78,* p. 21.

indicated that a person in similar circumstances, but on average weekly ordinary time earnings (AWOTE),[18] would have a replacement rate of 73 per cent with 44 per cent of retirement income provided by the Age Pension.

3.26 It is presumed that a person on median earnings (less than AWOTE) would have a higher Age Pension component.

The fiscal cost of the under 40s retirement

3.27 If the under 40s by and large rely solely on the SG contributions to fund their retirement there is a projected considerable Age Pension burden on the government in their retirement (as many people are expected to receive a healthy part pension).[19] Currently the proportion of voluntary contributions over compulsory contributions has been declining in this age group since 1999, although the co-contribution measures are expected to reverse this trend.[20] (This period of time has coincided with a property boom and the ages at which many under 40s may have made first purchases on owner occupied properties.)

3.28 The Intergenerational Report[21] stated that:

> The projections in this report suggest that, if policies are not adjusted, the current generation of taxpayers is likely to impose a higher tax burden on the next generation. The required adjustment in taxes and spending is about 5.0 per cent of GDP by 2041–42, or $87 billion in today's dollars.[22]

3.29 A key priority listed in the report was 'maintaining a retirement incomes policy that encourages private saving for retirement, and reduces future demand for the Age Pension'.[23]

3.30 There is clearly a fiscal rationale to encourage under 40s to place monies into voluntary superannuation.

Conclusions

3.31 The committee concluded that the level of retirement income 'adequacy' is greatly dependant upon an individual's lifestyle needs/desires and varies

18 AWOTE is higher than median earnings at approximately $50 000 per annum.

19 The Treasury, *Submission no. 47,* pp. 8–9.

20 The Treasury, *Submission no. 47*, p. 9 (chart 2) *and* p. 23 (chart 11).

21 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

22 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

23 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

from person to person. The committee recognised that a benchmark of around 60 per cent of pre-retirement income (in the average earnings range) has become established by industry as providing a comfortable retirement income but that it should not be used as a universal benchmark for 'adequacy'.

3.32 An individual's 'retirement savings gap' is dependent upon their expectations of their lifestyle in retirement and whether their level of retirement savings will meet this. This shortfall could be better described as an 'expectations gap'.

3.33 The concept of retirement income adequacy is sometimes confused with retirement income self-sufficiency (where a retiree receives no government Age Pension benefits). These concepts are very different. A person/couple may derive an 'adequate' retirement income under Australia's three pillared system and yet not be self-sufficient.

3.34 Undoubtedly, the superannuation proposals within the 2006–07 budget, if implemented, will have a significant effect on the projection of any alleged 'gap'. Generally speaking, these proposals should mean that people have more money available in superannuation, and, therefore, any 'expectations gap' may be significantly reduced.

3.35 The notion of a 'retirement savings gap' originated from a report prepared in 2003 within the superannuation industry.[24] The report which first raised this concept took into account two pillars of Australia's retirement income system in the modelling. It originally did not take account of private savings outside of superannuation, which forms part of the third pillar. A revised report[25] released two years later made a small allowance for investment properties of wealthier individuals but did not include owner-occupied property or other savings. Treasury's RIM Unit considers owner occupied property as a non-superannuation asset falling within the third pillar and which enables higher living standards in retirement.

3.36 'Retirement savings gap' or not, the government will still be contributing a significant component of overall retirement incomes in the future. Projections indicate that increasing voluntary superannuation in this age group is necessary to ease the fiscal burden of providing aged care and Age Pensions to a very large old population when the under 40s are in retirement. There is expected to be a very large number of 'very old' people making up the population, requiring government assistance. This

24 IFSA, *The Retirement Savings Gap*, Sydney, 2003.

25 Rice Walker Actuaries, *The Retirement Savings Gap – Two Years On*, Sydney, September 2005.

'very old' group will comprise the generation prior to the baby boomers and some of the older baby boomers.

The rationality of under 40s contributing more to superannuation

3.37 People under age 40 have to balance saving for retirement against current expenses such as education, housing and family commitments. Lower levels of income and labour force participation are also significant barriers for this cohort to contribute to superannuation.

3.38 Rice Walker Actuaries wrote in their submission:

> 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.[26]

3.39 The Financial Services Institute of Australasia (formerly the Institute of Securities Finance and Banking and previously the Securities Institute) noted that:

> In *Saving the future: changing under-40's retirement planning behaviour* those aged 25 to 34 are significantly more likely to consider credit card debts and personal loans their most important financial priority or goal. More than half of people cite accommodation costs as their main financial priority or goal, which obviously may act as a barrier to contributing to superannuation.[27]

3.40 It was also noted during the committee's hearings:

> The financial pressure is the greatest at exactly the same time as the need for superannuation contributions for your retirement is greatest, or the benefit from it is greatest.[28]

3.41 Those who can save may choose to do so outside of the superannuation system so that they have access to the funds if and when required. Some options for saving include interest-bearing deposits, shares and other equity instruments, owner-occupied housing, investment property and their own business—some of which are also concessionally taxed.

26 Rice Walker Actuaries, *Submission No. 64*, p. 4.

27 Ms K Foster, Institute of Securities, Finance and Banking (now Financial Services Institute of Australasia), *Transcript*, 18 October 2005, p. 7.

28 Dr C Emerson MP, *Transcript*, 10 February 2006, p. 17.

3.42 Max Super (a newly formed superannuation fund targeting the under 40s age group) listed some of the competing savings methods utilised by the under 40s:

> The obvious advantage that banks, online investment services and the like have over super when competing for the under 40's limited saving dollar, is the ability to release funds on demand. This flags accessibility as the real issue for the under 40's, and is therefore an area that needs to be fully explored in reviewing the attractiveness of super as an investment option.[29]

3.43 Overall it seems that a lack of disposable income, combined with the potential need to access any savings in unforeseen circumstances, mean that superannuation is generally not an attractive savings vehicle for under 40s.

3.44 Despite these concerns, much of the evidence the committee has received has suggested there is a gap between under 40s' retirement income expectations, and the reality of what they will have at retirement. For example, the Financial Services Institute of Australasia (FINSIA) stated in evidence:

> For example, there is not a capacity to fully appreciate how current inadequate savings patterns will inhibit lifestyle in retirement, there is not a recognition of the reality that the under-40s will not simply be okay—that there is no magical pot of gold at the end for most—and there is an unwillingness to confront the pain of analysing realistic retirement savings.[30]

3.45 In view of the alleged 'gap', throughout the committee's evidence additional incentives were suggested which aim to ensure that the gap between expectations and reality is reduced. While incentives directed at this cohort will be enjoyed by those who currently can and do contribute to superannuation, it is also hoped they will entice many new people to make voluntary contributions.

3.46 Mandating increased saving by increasing the SG to above nine per cent, or legislating a compulsory personal contribution, may impact on peoples' ability to provide essentials, reasonable lifestyle choices or engage in short to medium-term savings at this stage of their lives. However, some argue that a mandatory increase in contributions is the only way to ensure that

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29 max Super, *Submission no. 72*, p. 8.

30 Ms K Foster, Institute of Securities, Finance and Banking (now Financial Services Institute of Australasia), *Transcript*, 18 October 2005, p. 6.

all Australians, particularly those on low incomes, have an adequate retirement income.

Expectations of under 40s

3.47 Evidence to the committee has suggested that many under 40s have unrealistic expectations of their retirement income.

3.48 For example, an Industry Funds Forum member from the Retail Employees Superannuation Trust told the committee that an average member of his fund expected an annual income of $39 000 upon retirement.[31] At current levels of contribution, he believed this goal was unachievable for most members.

3.49 Despite a low level of additional contributions above SG in the under 40s age group many continue to have positive expectations of what their retirement income will eventually be.[32] They also increasingly view self-reliance in retirement as the norm:

> But I would also add to that the reality that this cohort realises that they will be responsible for their retirement, that they intend to be fully or at least partially self-reliant and that they are perplexed right now about how they will achieve that given the other financial priorities that are immediately in their face at this age...[33]

3.50 One strategy for people to reach this retirement goal is to voluntarily contribute to superannuation from a young age, and thus allow their money to build over a long period. However, as the committee has seen throughout the evidence it has received, most under 40s do not make voluntary contributions.

3.51 Another concern, as CPA Australia noted, is that:

> People see the compulsory SG level set at nine per cent and assume that that must be enough, because that is the amount the government has set for them—especially young people.[34]

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31 Mr N Cochran, Retail Employees Superannuation Trust (REST), Industry Funds Forum member, *Transcript,* 3 February 2006, p. 61.

32 The Treasury, *Submission No. 47*, p. 10—additional contributions fell by 7 per cent between 1999–2000 and 2002–2003.

33 Mr B Salter, Institute of Securities, Finance and Banking (now Financial Services Institute of Australasia), *Transcript*, 18 October 2005, p. 8.

34 Mr M Davison, CPA Australia, *Transcript,* 10 February 2006, p. 17.

3.52 This view was echoed in submissions, including max Super:

> Research commissioned by max Super indicates that many under 40's have not considered whether current contribution levels are adequate. They either simply do not know, or perhaps assume that having established a compulsory scheme, the government ensured there will be adequate funds available. [35]

3.53 One way to ensure that under 40s have realistic retirement income goals, and know what is required to achieve them, is through regular personal financial advice. Another way to allow people to see what their current levels of super contributions are likely to amount to is to allow super funds to provide long-term projections in members' annual statements. This is currently practice in the United Kingdom (UK) and Sweden. However, 'Corporations Law and the attitudes of ASIC'[36] currently prevent Australian funds from doing so.

3.54 To ensure that projections are realistic, the assumptions on which projections are made could be set by the regulator. Also, as suggested by ASFA, 'there might be three scenarios shown—a conservative scenario, a likely scenario and an optimistic scenario'.[37]

Age-based issues

3.55 A number of submissions have raised concerns about the attitudes to superannuation of people under 40. Generally speaking, they are seen to be too worried about short-term consumption, with little concern for their retirement income. It is also human behaviour, probably due to mortality, to avoid focussing on the distant future.

3.56 McCrindle Research, who were commissioned to conduct a qualitative study on under 40s' attitude to super, received the following responses when asking why saving for retirement is unattractive for this age group:

> $100 today means a lot more to me than the promise of $100 years from now; and
>
> Do the maths, retirement for me is 2 life times away.[38]

35 max Super, *Submission no. 72*, p.5.

36 Mr R Clare, ASFA, *Transcript,* 28 July 2005, p. 6.

37 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 5.

38 McCrindle Research, *Submission no. 2*, p. 9.

3.57 As to broad reasons why under 40s are disinterested in super, McCrindle Research highlighted: practicality, accessibility, flexibility, transparency and security.[39] These findings have been highlighted throughout the committee's evidence.

3.58 Max Super and the FINSIA have both conducted recent research on the behaviour of under 40s in relation to superannuation and savings and have found them to be more concerned with their future financial stability than is generally portrayed.

3.59 FINSIA stated:

> Our research has found that, contrary to wide-held beliefs, the under-40s are not spendthrifts, they do not live for today only and they do not adopt cavalier attitudes towards saving for the future. Indeed, as a general statement, the conundrum is whether Australia's compulsory system has in fact stopped this generation of under-40s from thinking and emotionally engaging on retirement planning issues.[40]

3.60 Other evidence suggests that not only are the under 40s concerned with their financial wellbeing but are actively addressing it. Max Super's submission discusses this:

> In spite of this demand on financial resources, a large number of respondents were attempting to stick to a budget. Contrary to the 'live for the day' label often used to describe this demographic, over a quarter of survey respondents indicated that their budget reflected their desire for a secure future with less than 10% budgeting for self gratifying purchases.[41]

3.61 It seems that the problems in making this age cohort more interested in super are well established; the solutions, however, appear somewhat more difficult.

3.62 The options to improve incentives, which are mentioned throughout this paper, are one way to attempt to change under 40s behaviour. Other ways include arming this age group with well targeted information and providing better access to financial advice.

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39 McCrindle Research, *Submission no. 2*, pp. 11–13.

40 Mr B Salter, Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 4.

41 max Super, *Submission no. 72*, p. 10.

Preservation

Principles of preservation

3.63 Superannuation saving is based on the premise that contributions are inaccessible and compounding earnings until the point at which a person retires and draws down the funds. Since 1 July 1999 all contributions to superannuation funds, including personal contributions and earnings are to remain with the fund until a member reaches a certain age. Some very limited exceptions to the preservation rules, in cases of genuine hardship, enable the early release of benefits. For the under 40s age group the preservation age will be 60 years of age.[42]

3.64 Preservation plays a dual role of preventing dissipation of savings for retirement and ensuring that funds placed in a concessionally taxed environment are used for people's retirement income. Treasury has stated in its submission that increasing the preservation age from 55 to 60 aims to ensure 'that retirement income expectations are achieved for a longer lived population.'[43]

3.65 A number of submissions to the inquiry have suggested the very nature of preservation is an impediment to the under 40s age group making additional superannuation contributions (ironically, including Treasury). This is largely based on demographics – this age group face financial constraints associated with first home purchase, high debt commitments and family formation, making it difficult and possibly irrational to channel additional funds into a vehicle which locks them away for many years. This was encapsulated by ASFA in evidence:

> The real problem is that retirement seems so far off and there are other immediate priorities. You do need extra incentives to ask people to lock away money until retirement because you are asking them to commit to that objective over and above any other objective they might have in their life without the flexibility of being able to withdraw it.[44]

3.66 The other reason preservation is cited as a barrier to superannuation savings is that the two generations comprising the under 40s age group are said to have unique characteristics which make them less prone to save for the future. This age cohort works in a jobs market quite different to that of

42 The preservation age is currently 55 and will eventually phase in to 60 between 2015 and 2025.

43 The Treasury, *Submission no. 47*, p. 28.

44 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 5.

their predecessor generations. There is a higher degree of casual, part-time and non-ongoing employment than 30 years ago and more of the paid workforce are women.[45]

3.67 Home purchase is now more often tied to two household breadwinners and women tend to return to paid work in some capacity, after having children. Preservation can therefore be seen as an impediment when the employment market is less certain and the economy is geared to a higher household income. People may value more liquid and shorter-term assets in this environment. The submission from the Government Employees Superannuation Board (GESB) of Western Australia notes this:

> Attitudinal data indicates that conflicting interests such as the responsibilities to pay off mortgages, HECS debts and loans, and the opportunity to invest in more short-term investments such as shares or term deposits are impacting on the decisions of members under the age of 40 with respect to investing their money in the longer-term option of superannuation.[46]

3.68 IFSA stated in their evidence to the committee that preservation was a major barrier to people making additional voluntary contributions.

> The issue in superannuation seems to be the investment horizon: that is, that the money is there for a long time and you may get a reversal in life. Although you can go through the hardship provisions, one wonders how many people are aware of that.[47]

3.69 It was also suggested in one submission that setting a restricted preservation age detracts from flexible working arrangements and some people's desire to retire prior to the set preservation age:

> The need to lock-in savings also requires regulation to define an inflexible retirement age (when funds can be released). This makes superannuation poorly suited to emerging trends of people wanting an earlier and more gradual transition through a part-time 'working retirement'. [48]

45 In 2004, 44.4 per cent of the total labour force were women. Australian Bureau of Statistics, *Australian Social Trends – Work,* cat. no. 4102.0, ABS, Canberra, 2004.

46 Government Employees Superannuation Board (GESB), *Submission no. 35*, p. 2.

47 Mr B Stanhope, IFSA, *Transcript*, 28 July 2005, p. 32.

48 Dr D Thorp, *Submission no. 60*, p. 4.

Early access to superannuation savings

3.70 A number of submissions suggested the ability to access superannuation balances to enable the early payment of Higher Education Contribution Scheme (HECS) debts or to provide greater affordability of an owner occupied home.

3.71 There are two main aspects to consider when suggesting access to superannuation prior to preservation age for uses other than retirement income. One is that favourable taxation treatment is afforded to employer and salary sacrifice superannuation contributions and to earnings in the fund. The other is that voluntary contributions by an employee, whilst not attracting a concession on contribution do enjoy low tax rates on earnings.

3.72 A concessional tax rate for employer and salary sacrifice contributions reflects the desire of the government to encourage people to save for their retirement income and to ensure that the savings vehicle is effective. The tax rates were discussed in Chapter 2 and the concessionary nature discussed in Chapter 4.

3.73 The concessional taxation treatment and the long-term nature of the superannuation savings vehicle are the two common reasons put forward to prevent early access to funds. Superannuation works on the basis of a long-term investment and any at call phenomenon would change the investment strategy.

3.74 Superannuation is an investment vehicle which is widely accessible to most income earners to enable savings for retirement income. This is because it requires no large initial investment[49], does not involve financing and is based on repeated, relatively small investment chunks which people can make as they earn income. However, because of this, balances take time to build and compounding growth relies on continuous deposits over the long term, with no withdrawals.

3.75 One individual's submission noted:

> Because superannuation contributions are very long-term investments, the compounding effect on earnings to produce the required retirement benefits is nearly as important as additional co-contributions.[50]

3.76 The inquiry has raised suggestions to sanction parts of superannuation to allow some accessibility. These have mostly related to access to voluntary

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49 Self managed funds require a significant capital outlay to start-up.

50 Mr H Hinde, *Submission no. 36*, p. 6.

superannuation contributions. Tower Australia suggested that 20 per cent of voluntary contributions could be made accessible:

> Preservation is a huge deterrent for people putting money in super. Having access to some of that would go quite a long way towards encouraging people to put money into super.[51]

3.77 Other suggestions included access to superannuation balances to utilise for a first home purchase or reduce the cost of an existing mortgage.

3.78 In their supplementary submission to the inquiry the Real Estate Institute of Australia (REIA) supported a scheme allowing early access to voluntary superannuation savings to allow the purchase of a first home. People over the age of 23 were eligible to participate in the proposed scheme 'for the purpose of purchasing their first home when their total account balance exceeded a minimum of $10,000'.[52] Max Super supported a similar idea but with more age discrimination:

> Max Super recommends that the Federal government consider a broader interpretation of the sole purpose test, legislating for first home buyers to be given access to 75% of their accumulated non Super Guarantee contributions made to age 35, to be used for a home deposit. [53]

3.79 A proposal was also submitted to the committee regarding a 'mortgage off-set option' on superannuation balances. The concept was to encourage superannuation savings yet the balance in superannuation did not earn interest but offset the interest on a mortgage. The idea was to enable young people to afford a mortgage on a home whilst forming a super savings habit. At a later point in time, having reduced their mortgage, they would elect a lower 'off-set' to enable greater growth in superannuation savings. This was explained by Mr Zeitoun at an inquiry hearing :

> It is the same way as the current redraw facilities operate with a bank product, whereby the extra money you have put into your loan reduces the amount payable in terms of interest with your regular payments. …In this way, people know that if they put it into super, it will offset their interest, they will pay off the capital more quickly, and therefore they can concentrate on their super strategy.[54]

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51 Ms O'Keefe, Tower Australia Ltd, *Transcript*, 18 October 2005, p. 56.

52 REIA, *Submission no. 53*, p. 2.

53 max Super, *Submission no. 72*, p. 10.

54 Mr A Zeitoun, *Transcript*, 10 February 2006, p. 44.

3.80 Tower Australia also proposed a mortgage relief scheme that 'would be relatively simple in that an individual who contributes to super above the superannuation guarantee, would be able to claim a small amount of mortgage interest back on their tax'.[55]

3.81 To all suggestions incorporating using superannuation for housing, Mr Noel Whittaker said it was '…plain stupid' because:

> The reason is you have competing interests. If I have a home loan, I want the lowest rate possible; if I have superannuation, I want the highest rate possible.[56]

3.82 One individual, Mr John Dimeski, suggested access to superannuation balances to allow more under 40s to obtain financial advice about their superannuation.

> 'How do young people access a couple of thousand dollars to get quality advice upfront?'[57]

3.83 The Australian Council of Trade Unions (ACTU) made suggestions that a joint super-health fund be established to enable the use of superannuation for medical purposes. This is based on research that 'one of the biggest—if not the biggest—strains on that [purchasing power of the pension] is going to be the increasing cost of the health care system'.[58] They did not elaborate on how a linked system could operate.

3.84 Others have made claims that preservation of superannuation makes other savings vehicles relatively more attractive:

> The superannuation preservation rules may concern some, as they prevent people from accessing superannuation savings until preservation age (except in limited circumstances). This inflexibility may prompt some to invest money in alternative vehicles, which allow access to the funds;[59]

3.85 Mr Mark McCrindle of McCrindle Research saw benefits to access superannuation for housing as it gave superannuation a tangible element for people much younger than preservation age. He stated 'I do not know about the wisdom of allowing them to spend it on depreciable assets or

55 Tower Australia Ltd, *Submission no. 26*, p. 4.

56 Mr N Whittaker, *Transcript*, 10 February 2006, p. 72.

57 Mr J Dimeski, *Transcript*, 28 July 2005, p. 77.

58 Australian Council of Trade Unions (ACTU), *Transcript*, 3 February 2006, p. 45.

59 Department of Family and Community Services, *Submission no. 38*, p. 12.

travel. But certainly, if they could use it to get a leg into the housing market or use it to invest in some other way, then it was real to them'.[60]

3.86 The committee also heard from many interested parties, including Australian Administration Services (AAS) and the Industry Funds Forum (IFF), who were strong advocates of preservation because the purpose of superannuation is to provide funds in retirement.

3.87 Ms Kerry Flanagan, from the Office for Women indicated that it is hard to 'make up' for previously unsaved monies and similarly, it would be hard to recoup monies accessed early from superannuation balances. She stated:

> I have heard suggestions many times before about people being able to access their superannuation in those early stages, but inevitably if you are not able to recontribute to it, as you go through life, you end up poorer in retirement.[61]

3.88 Additionally, allowing access to superannuation for other purposes may have skewing effects in the market and prove counterproductive. For example one individual, Mr Christopher Moore, suggested in his first submission to the inquiry that being able to access superannuation to pay a mortgage would not help housing affordability:

> It would also mean an instantaneous step up in prices due to extra cash available, and the ratio of house price to yearly earnings, would increase further. The only gain is to those who already own a home.[62]

3.89 Unintended impacts on the housing market were mentioned by those against early access, for example by AAS:

> Finally, consideration should be given to the macro-economic effect of releasing superannuation monies to purchase a home and whether, analogous to the first home-buyers' scheme, this may have the unintended consequence of increasing house prices further.

3.90 These consequences were also raised by those supporting access to superannuation prior to preservation age:

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60 Mr M McCrindle, McCrindle Research, *Transcript*, 18 October 2005, p. 64.

61 Ms K Flanagan, Office of Women, Department of Families, Community Services and Indigenous Affairs, *Transcript*, 10 February 2006, p. 6.

62 Mr C Moore, *Submission no. 57*, p. 2.

> I want to mention a few issues that will come out of such a proposal. One is the potential to boost house prices by having such an offer in the market.[63]

3.91 Treasury also highlighted the administrative and practical issues associated with allowing superannuation contributions to be released for housing:

> How is the fund to determine who to release it to? If you are releasing it to low-income earners, how is the fund going to know that? How is it going to stop people from buying a big house instead of a normal house and improving the house overall? How is it going to be measured? How is it going to be paid back if they do default later?[64]

3.92 Interestingly, FINSIA's market research indicated that:

> Only 21 per cent of people polled strongly agreed with the statement: 'Superannuation has limited accessibility; I would rather have current access to my retirement savings in case of emergency.'[65]

Conclusions

3.93 The committee saw merit in many of the proposals to allow access to post-tax voluntary superannuation contributions. However, the overriding drawback was that the purpose for which the contributions were being made was being undermined.

3.94 The purpose of superannuation is to allow for monies to be used in a person's retirement. The sole purpose test in the *Superannuation Industry (Supervision) Act 1993* details this intent, notwithstanding a small number of exceptions in the Act, such as financial hardship or imminent foreclosure on the owner-occupied home.

3.95 Decrements to superannuation balances, even early in a person's working life, must be reinvested later to reinstate the foregone balance. As the span of a person's working life shortens there is reduced time to make up for depletions as the success of the superannuation vehicle depends upon compounding balances. This will therefore translate to much greater contributions being required to make up the shortfall.

63 Mr A Zeitoun, *Transcript*, 10 February 2006, p. 43.

64 Mr T Coles, The Treasury, *Transcript*, 14 October 2005, p. 7.

65 Ms K Foster, Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 6.

3.96 Proponents of early access, particularly for the purchase of a first home, infer that the garnering of a deposit for home purchase is a greater stumbling block than the potential future financial burden of making up for lost superannuation balances.

3.97 It has been argued that the proportion of household outgoings are the greatest when people are under 40 as this is the time when many people are purchasing a home, paying large mortgage repayments, and are rearing and educating children. However, with the average age of first childbirth shifting to age 30 and a greater proportion of remarriages and second families, costs of child rearing and education to tertiary levels are increasingly still with people after age 50. It is therefore risky to deduce that depleted superannuation may be made up and made up easily when people are older.

3.98 Whilst the committee acknowledges the difficulties that young people face in saving for their first home (and particularly in a high cost housing market) they believe other savings vehicles are more appropriate for this purpose.

3.99 Muddying superannuation's purpose with early access schemes will not only increase complexity but will introduce inequities in the system. Where an access scheme specifically incorporates a sector of the economy, for example housing, it may also cause unintended and adverse consequences, like price inflation.

3.100 In addition, all forms of superannuation accretions receive some level of concessional taxation treatment, if only when the effective rate of taxation is calculated.[66] This concessional tax treatment is given on the basis that when a person draws down on their superannuation balance in retirement that it is utilised to improve the retiree's living standard.

3.101 Additionally, in a global environment of structural ageing, reducing the fiscal cost of a growing quantum of Age Pensions is vital. Thus taxation incentives are given to encourage voluntary superannuation contributions. The monies are therefore not intended to be used for non-retirement purposes.

3.102 Despite the committee being lobbied by various groups to allow early access to superannuation it believes the sole purpose test—the principle of restricting what can be done with superannuation monies whilst in the accumulation phase—should continue.

66 Refer to Chapter 2, on *Taxation*.

3.103 The committee believes that the greater concessional tax treatment proposed under the government's superannuation plan will improve retirement incomes in its own right, as well as encouraging additional contributions from under 40's who have the capacity to do so.

Superannuation Guarantee Levy adequacy

3.104 The Superannuation Guarantee levy (SG) was introduced in 1992 to extend the range of people who could benefit from compulsory superannuation. Prior to 1992 superannuation existed in certain industrial awards (from 1986) and was also enjoyed by public servants and senior white collar workers.

3.105 The SG has increased superannuation coverage—superannuation now covers 90 per cent of employees and 67 per cent of self-employed people.

3.106 The purpose of the SG is to assist employees to be able to enjoy a higher standard of living in retirement than would be possible under the Age Pension alone. It also reduces reliance on the Age Pension and thus the cost to the Commonwealth budget.

3.107 The SG commenced at a rate of three per cent of an employee's notional earnings base and over a ten year phase-in period increased to its current level of nine per cent. The SG itself was not originally intended to increase beyond nine per cent. Policy changes were announced in the 1995 budget to accompany the SG with an additional employee contribution of three per cent along with an income scaled matching of this contribution by the then Australian Government.[67] This was intended to phase in between July 1997 and July 1999.

3.108 A change of government followed in 1996 and the SG remained, to reach nine per cent in 2002. The present government has previously stated that it does not intend to increase the rate further.

3.109 Conflicting evidence has been received as to whether current arrangements will provide an 'adequate' standard of living in retirement.

3.110 The inquiry has highlighted concerns that the nine per cent rate of SG is not sufficient to fund the under 40s retirement incomes and without sufficient voluntary savings to meet the shortfall the fiscal burden will be significant. The ACTU's submission noted that:

67 The Hon Ralph Willis MP, Treasurer, *House of Representatives Hansard*, Budget speech, 9 May 1995, p. 68.

> Congress [ACTU Congress] is concerned at clear evidence that the 9% SG is insufficient to fund an adequate retirement income for average workers.[68]

3.111 In contrast, Treasury estimates that for Australians on median earnings with SG contributions over a full working life, the Age Pension and SG system combine to provide relatively high spending replacement rates (82 per cent of pre-retirement income). Employees on lower than median earnings will have higher replacement rates, while those on higher than median earnings will have lower replacement rates but higher retirement incomes in dollar terms.

3.112 In addition, the government predicts that its superannuation plan—in particular cutting tax on benefits—will mean that a person on average earnings, receiving only the SG for a working life of 40 years would increase the value of a lump sum on retirement by 9 per cent or alternatively increase the value of a pension by 17 per cent.[69]

3.113 Employees with broken periods of labour force participation will have lower replacement rates unless they have additional savings—for example voluntary superannuation contributions:

> However, for people with higher retirement income expectations or for people who may not fully benefit from the SG system, such as the self-employed, older employees and those with broken periods of labour force participation, voluntary superannuation contributions are the key to ensuring these groups' retirement income expectations are met.[70]

3.114 Such projections presuppose that the Age Pension will remain at its current level. Given the reality of Australia's ageing population, the ability of future governments to maintain the level of the current pension may come under question. Moreover, it would appear desirable for any future government to have their Age Pension burden lessened by increased superannuation savings.

3.115 Therefore, irrespective of the future level of the Age Pension, Treasury's projections suggest that most people wanting to retire independently of any government assistance will need to make personal contributions well above the SG.

68 ACTU, *Submission no. 29*, p. 2.

69 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, pp. 55–56.

70 The Treasury, *Submission no. 47*, p. 2.

3.116 FINSIA's research revealed many in their survey sample expected to retire independently despite '…only 32 per cent (less for women at 29 per cent) considered themselves 'prepared' for retirement':

> When asked at what age they expect to retire and whether they expect to be fully-funded retirees, the mean age of retirement was an unprecedented 61.6 and 45% expected to be a fully self-funded retiree (ie. expected not to be reliant on the Government for a full, or part, pension.[71]

3.117 Much of the committee's evidence has conflicted with Treasury's projections, suggesting that the current level of SG is too low to provide even a modest level of retirement income. This mostly stemmed from the view of self-sufficiency in retirement. Mr Brian Salter of FINSIA stated in relation to the level of nine per cent:

> We know that, alone, it is inadequate. There has been sufficient modelling done to suggest that something north of 13 per cent of today's incomes would be required to reach a reasonable level of security in retirement.[72]

3.118 Mr Salter suggested there was scope to increase the levy but that he felt compulsory increases were not the only way to achieve this:

> …rather, let us find the combination of compulsion, incentive, education and encouragement to change the psychology and behaviour.[73]

3.119 Some, however, have suggested that mandatory superannuation contributions should be increased to 12 per cent or 15 per cent (if contributions continue to be taxed).

3.120 The ACTU contended that economic circumstances have been such to enable this increase:

> Record terms of trade (highlighted in the graph below) amongst other factors provided the fiscal circumstances for a once in a generation opportunity to:
>
> - Increase the SG contribution paid by employers from 9% to 12% over 3 to 5 years;[74]

71 FINSIA, *Submission no. 49*, p. 5.

72 Mr B Salter, The Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 10.

73 Mr B Salter, The Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 10.

74 ACTU, *Submission no. 29*, p. 4.

3.121 The Transport Workers' Union proposed a compulsory increase:

> This has significant ramifications for retirement incomes knowing, as we do, that a 9% superannuation contribution will not adequately fund retirement (see above for CPA study). Education may alter perceptions to a limited extent. Government action will alter it more profoundly and with longer-lasting effects. Governments must pursue the policy pursued by the Keating Government to ensure that superannuation contributions reach at least 15%.[75]

3.122 In their submission to the inquiry ASFA supported a mix of compulsory and voluntary increases (and tax concessions) to reach 15 per cent, but did not break them down:

> ASFA recommends that, in order to better meet retirement income needs and expectations, contributions be increased in effect to an amount equivalent to 15% of wages through a combination of compulsory contributions, voluntary contributions and tax relief.[76]

3.123 One argument put forward was that the SG levy at nine per cent would not provide people with a reasonable level of retirement income because it was subjected to a contributions tax of 15 per cent.

3.124 Max Super alluded to a 15 per cent savings goal in their submission:

> Abolishing the 15% contribution tax will increase super guarantee, in after tax terms from 7.65% to the full 9% employer contribution, and accompanied by further Government incentives will help achieve the desired retirement savings goal of 15%. [77]

3.125 Others have made passing comments that the level is inadequate. For example, one individual, Mr Peter Mair, indicated this in his submission:

> That paying off mortgages on overpriced houses leaves little scope to put more into superannuation, over and above the (admittedly inadequate) compulsory 9 per cent levy on employment income.[78]

3.126 Another individual submitter, Mr Howard Hinde, effectively proposed an increase in the SG through a compulsory additional contribution:

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75 Transport Workers Union, *Submission no. 27*, p. 8.

76 Association of Superannuation Funds of Australia (ASFA), *Submission no. 16*, p. 12.

77 max Super, *Submission no. 72*, p. 20.

78 Mr P Mair, *Submission no. 54*, p. 1.

> Make co-contribution compulsory. It would become a payroll deduction and paid across by the employer with the Superannuation Guarantee Levy.[79]

3.127 Interestingly, Ms Anne-Marie Esler of the Financial Planning Association of Australia (FPA) concluded that the current SG rate for the under 40s may even be sufficient enough to breach the reasonable benefit limits (RBL) requirements for many of these working a 40 year span:

> Most of the people who are under 40 now will have 40 years of an SG at a substantial rate, which means that they will have deductible contributions going in—at least at the minimum 9 per cent SG—over a 40-year period. That means that they are more likely at retirement to be subject to the RBLs.[80]

3.128 There have also been arguments that compulsory superannuation, at any rate, reduces disposable income and takes away an individuals' choice to save for their retirement in a different way. The Australian Consumers Association (ACA) 'vigorously oppose the imposition of greater compulsory superannuation upon consumers under the age of 40'[81] for disposable income reasons:

> We think this group is so financially stretched that people will have to do things like borrow money from elsewhere to fund their children's education because they are now overcommitted in the superannuation area.[82]

3.129 The opposing view is that this generation have been accustomed to, and have accepted, forced retirement savings habits. FINSIA stated:

> I think it is more that it is gratefully accepted as something that was perhaps difficult to swallow when it was first introduced, but this generation we are talking about has known nothing different. This is part of the way they are accustomed to their work and budgetary habits. [83]

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79 Mr H Hinde, *Submission no. 36*, p. 4.

80 Ms A Esler, Financial Planning Association of Australia (FPA), *Transcript*, 18 October 2005, p. 33.

81 Australian Consumers Association, *Submission no. 34*, p. 3.

82 Dr N Coates, Australian Consumers Association (ACA), *Transcript,* 18 October 2005, p. 50.

83 Mr B Salter, FINSIA, *Transcript*, 18 October 2005, p. 14.

3.130 ASFA's 2004 polling research[84] revealed that 'around 70 per cent of those aged 30 to 39 consider that more than the 9% compulsory employer superannuation contribution is needed'.[85]

3.131 However, there is also anecdotal evidence that some under 40s assume the SG at nine per cent has been universally, rather than generally, calculated to meet their retirement income needs:

> There is an assumption that nine per cent is going to be adequate and people have not thought through what they need to save.[86]

3.132 The CPA supported this view:

> Some of the anecdotal evidence we have had from our members is that people see the compulsory SG level set at nine per cent and assume that that must be enough, because that is the amount the government has set for them—especially young people.[87]

3.133 AMP Financial Services (AMP), in their submission, suggested ongoing work should be undertaken in this area:

> Increasing the rate of Superannuation Guarantee contributions should only be undertaken with broad community support, although as a community we should continue to debate this option.[88]

3.134 Industry groups have stated that employers already bear enough of the burden through the current rate of nine per cent on top of salaries. The Australian Chamber of Commerce and Industry (ACCI) stated:

> ACCI does not support an increase in the contributions paid for by employers, as they are already asked to bear a significant burden of providing for retirement incomes — through the guarantee, and through contributing around 40 percent of general tax revenue which is in turn used to pay for pensions. If there is to be an increase in compulsory super contributions, then this should be paid for by the introduction of employee contributions rather than further demands being made on already burdened employers.[89]

84 May/June 2004 ANOP Research Services Pty Ltd telephone polling of 755 Australians aged 30–69 years commissioned by ASFA.

85 ASFA, *Submission no. 16*, p.15.

86 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 3.

87 Mr M Davison, CPA Australia, *Transcript*, 10 February 2006, p. 17.

88 AMP Financial Services (AMP), *Submission no. 48*, p. 3.

89 Australian Chamber of Commerce and Industry (ACCI), *Submission no. 41*, p. 5.

3.135 The Australian Industry Group (Ai Group) supported this view:

> An increase in the SGC [super guarantee charge] would have the same impact as a rise in the rate of payroll tax.[90]

3.136 The nine per cent paid by employees is often seen as an added cost to employers when in fact it forms part of total remuneration. The transitional SG rate increases introduced between 1992 and 2002 were designed to coincide with wage rises and the superannuation amounts were traded off for direct salary. The nine per cent component therefore forms part of an employees overall wages/salary package.

3.137 ASFA noted at an inquiry hearing that employees understand where the nine per cent super guarantee contribution comes from:

> We have talked to people and they now understand that, in paying that nine per cent, it comes out of their income. It is not magically coming out of somewhere else or from the employers.[91]

3.138 There remains, however, a perception that the SG is an add-on cost of the employer. This may be compounded by the fact the employer can claim a tax deduction for SG contributions paid on behalf of an employee. This was indicated by Australian Administration Services (AAS):

> Of course, an alternative to removing the contributions tax would be to increase the amount of superannuation guarantee contributions, thereby effectively transferring the cost from the government to employers, but this has obvious implications for business.[92]

3.139 Employers should, from an add-on perspective, be in a neutral cost position with respect to SG. It may not, however, be as easy to maintain a neutral cost position if further increases to SG were to occur. This is because the wage fixing environment has become less centralised. Nonetheless, approximately 80 per cent of the workforce are employed under some form of enterprise bargaining and so super/wage trade-offs are not impossible but may not synchronise as well with a mandated SG increase.

> An increase in the compulsory component would be across the board and apply to all employees, all those who are subject to the levy obviously, but that would reduce the discretion, I would have

90 Ai Group, *Submission no. 15*, p. 2.

91 Mr R Clare, ASFA, *Transcript*, 28 July 2005, p. 10.

92 Australian Administration Services (AAS) *Submission no. 67 (supplementary)*, p. 2.

> thought, for a variety of negotiations, some of which people may well prefer instead of an increase.[93]

3.140 Irrespective of the level of SG, there are administrative costs for employers associated with the SG compliance.

Conclusions

3.141 Most people in the workforce aged under 40 have been exposed to the superannuation guarantee system all their working lives. It seems that not only have they become accustomed to it, they accept it.

3.142 Any form of compulsion necessarily removes alternative choice. However, it appears that as the SG compulsion started early (and transitionally) in the under 40s working lives it is not viewed negatively. On the contrary, many seem happy that it will contribute to their retirement living standard without being missed from their take home pay.

3.143 Determining whether the current nine per cent level of the superannuation guarantee is adequate very much rests with the definition of retirement income adequacy, and whether the SG is intended to provide an individual with a self-sufficient retirement income.

3.144 Australia's retirement income framework is based on a mix of private and public contribution to retirement incomes. The goal of self-sufficiency in retirement, although being of fiscal benefit, is ultimately the goal of the individual. The achievement of a self funded retirement will be contingent upon a number of factors, importantly, an individual's income earning capacity.

3.145 It appears, however, that many under 40s view the level of the SG as mandated by the government to allow them to achieve self-sufficiency. There is anecdotal and polling evidence that this is a psychological barrier to contributing outside the SG regime.

3.146 Employer groups opposed any increases to SG on the basis that it would form an additional cost impost on them. The introduction of SG and subsequent increases were absorbed through a mostly centralised wage system. This may not be as easy with a changed labour market environment.

3.147 Interestingly, Australia's largest consumer advocate also strongly opposed any increase in compulsory superannuation citing already high financial

93 Dr P Burn, Australian Industry Group (Ai Group), *Transcript*, 10 February 2006, p. 37.

burdens borne by this age group and presumably the desirability of disposable income over further retirement contributions at this life stage.

3.148 A number of groups believe the contribution tax is lowering the effective level of SG contributions and that this alone means that the rate of contribution is not high enough.

3.149 The committee notes that there may be some inadequacy in the nine per cent rate given the high reliance by the under 40s on the SG alone. Whilst the committee does not recommend a current change to the SG rate, retirement income research suggests that a 12 per cent rate of superannuation savings would allow more people to meet their retirement income expectations. In making this assessment, it is important to recognise that the government's superannuation plan, if implemented, will have a significant impact on retirement savings.

3.150 It is difficult to determine whether the retirement savings behaviour of the under 40s is due to conflicting financial demands, a belief that the SG alone will meet their retirement needs or that they would not otherwise be contributing but for compulsion. For these reasons the committee recommends a voluntary default savings scheme supplement the compulsory SG to bring retirement savings more in line with expectations (recommendation 1 below).

Default scheme for voluntary contributions

3.151 Whilst the nine per cent SG provides an adequate retirement income for those with a continuous work pattern for their full working life at incomes at or above average earnings, others may fall short. An additional voluntary opt-out scheme would provide an opportunity for people to maximise their retirement income or to enable those who have not enjoyed full-time continuous employment for their full working life to supplement their compulsory component.

3.152 Approximately 26 per cent of the workforce is employed in casual labour (non-ongoing contracts of service) and of those casuals 69 per cent hold part-time positions.[94] Approximately 15 per cent of the total workforce is employed in a part-time capacity (this covers those in on-going and non-

94 Australian Bureau of Statistics (ABS), *Year Book Australia 2006*, cat. no. 1301.0, ABS, Canberra, 2006.

ongoing positions).[95] Many of these casual and/or part-time employees who exceed the SG threshold may have low income levels from which contributions may come.

3.153 Additionally, many who have full-time, continuous work but earn less than Average Weekly Ordinary Time Earnings (AWOTE) will find that their SG amount (coupled with pension eligibility) will provide them with an even lower retirement replacement income. Approximately 70 per cent of employees earn less than AWOTE.[96]

3.154 There are others, who although having enjoyed periods of work at above average earnings levels have also taken time out of work to care for children, elderly relatives, their own health or to make contributions to unpaid community pursuits.

3.155 Voluntary savings are an important element in boosting overall retirement living standards. If an individual has the capacity to save a little more above the SG over their working life they may supplement their future lifestyle. This is particularly so with the present generous co-contribution scheme for low income earners.

3.156 The level of voluntary savings in superannuation by the under 40s fell between the late nineties and 2002–03 (last known data set on under 40s).[97] This may be more the result of a demise of some defined benefits funds (no new members and retiring members) which required members to make personal contributions, rather than a savings shift. Treasury predicts an increase in after-tax contributions of $900 million in 2003–04 to $1.5 billion in 2008–09.[98]

3.157 Recent results from ASFA on the impact of super choice legislation indicate that people tended not to change their funds given the choice.[99] This either indicates they were happy with the fund they were in or that people have the tendency to inertia. Given the likelihood of inertia, it would appear that people are less likely to make voluntary superannuation contributions with no trigger mechanism or alternatively are less likely to stop making them once they start.

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95 Australian Bureau of Statistics (ABS), *Labour Force Australia*, cat. no. 6202.0, ABS, Canberra, March 2006.

96 Australian Bureau of Statistics (ABS), *Employee Earnings and Hours*, cat. no. 6306.0, ABS, Canberra, May 2000.

97 The Treasury, *Submission no. 47*, p. 10.

98 The Treasury, *Submission no. 47*, p. 23.

99 Mr R Clare, ASFA Research Centre, ASFA, *The Introduction of Choice of Superannuation Fund - Results to Date* , February 2006.

3.158 CPA Australia suggested a proposal whereby an individual commencing a new job defaulted to make a 'voluntary' contribution to superannuation but could opt-out at any time by completing the necessary paperwork.

> I suppose, as a starting point, what you do not have you do not miss. If it is set up as an opt-out system when you first start work, you effectively would have a percentage of your salary being salary sacrificed into superannuation. The opt-out bit could be done easily in terms of giving your employer the form to say, 'Do not put money into super for me, only have the compulsory super'.[100]

3.159 ASFA also supported this type of mechanism in order to boost superannuation savings through a mix of compulsion and voluntary decision making. In evidence Ms Philippa Smith of ASFA discussed 'soft compulsion' schemes:

> In the US, for example, where the corporate fund situation is stronger, what has been very successful is what is called the soft compulsion option, which is automatic enrolment. It is not current wages that you are asking people to forgo; you are asking them to forgo part of their future wages. And, if they sign up for these programs, it then becomes an automatic deduction thing. Extra savings are going into their plan, which they can opt out of.[101]

3.160 The ANZ submission outlined a designed default system proposed by Dr Nicholas Gruen[102] whereby the default (voluntarily contributing to superannuation) is the preferable position for both individual and Government. Dr Gruen's paper provides examples of where choice can paralyse people, even where lack of choice is detrimental to eventual outcome. The ANZ submission outlined this:

> Under this option, contributions to superannuation could be increased by one percent each year up until a target level of savings was met, say 15 percent. The increased savings would be in the form of employee contributions (sometimes known as salary sacrifice contributions), which would be on top of the compulsory nine percent Superannuation Guarantee (SG) contributions already in place. [103]

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100 Ms N Kelleher, CPA Australia, *Transcript*, 10 February 2006, p. 17.

101 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 11.

102 Dr Nicholas Gruen, *Designed Defaults: How the Backstop Society Can Failsafe Australians' Superannuation*, 15 September 2005.

103 ANZ, *Submission no. 48*, p. 6.

3.161 Under this scheme any increases in employee contributions would occur automatically each year so the employee would need to make a conscious decision to opt-out of the scheme, rather than a conscious decision to enrol. Importantly, to enable flexibility and choice 'they would be able to opt out of making all or some of these extra contributions at any time'.[104]

3.162 A system designed around default has been shown to have a high participation rate compared to a voluntary enrolment system:

> Gruen (2005) shows that where US employees are automatically enrolled in 401(k) retirement saving plans but they are able to opt out, the participation rate exceeds 85 percent. On the other hand, where employees are not automatically enrolled in the 401(k) plans, the participation rates can be much lower, somewhere between 26 and 43 percent.[105]

3.163 The New Zealand government has this year introduced a designed default system for voluntary savings called KiwiSaver. New employees aged 18 to 65 will be automatically enrolled in the savings plan when they commence a new job and will have six weeks to opt out. Employees' contributions will be deducted at a default rate of four per cent unless the employee chooses to double this. Contributions will be held by Inland Revenue in the first three months during which time the employee elects a KiwiSaver provider. Inland Revenue estimates there will be a high level of take-up or rather non-drop out.

3.164 The findings of FINSIA's CrosbyITextor polling indicate that despite 82 per cent of people being aware they can make a personal contribution to their superannuation beyond the SG only 33 per cent currently do so.[106] FINSIA has recently investigated the merits of KiwiSaver, following the merger which gave the former Institute of Securities a New Zealand focus. This, coupled with the results of CrosbyITextor polling has led FINSIA to support a voluntary savings opt-out scheme as outlined in their supplementary submission.[107]

3.165 The committee received no views directly opposing voluntary savings for this age group however Mr Noel Whittaker suggested that because you could not gear the compounding in superannuation there were more

104 ANZ, *Submission no. 48*, p. 6.

105 ANZ, *Submission no. 48*, p. 6.

106 FINSIA, *Submission no. 74 (supplementary)*, p. 4.

107 FINSIA, *Submission no. 74 (supplementary)*, pp. 2–4.

lucrative investments.[108] That said, he believed that superannuation has the best tax advantages—'Since the surcharge has gone it is the best'.[109]

3.166 There was, however, almost universal recognition that in general, people aged under 40 are at a point in their lives where their living expenses are high and they may not be in a position to make additional contributions.

3.167 The set-up costs to business to develop and establish an employer superannuation contribution scheme with an opt-out provision would not be likely to be onerous. It could, however, piggyback off the existing SG arrangement.

3.168 A potential problem with encouraging voluntary opt-out contributions, recognised by the CPA in evidence[110], is the maximum deduction limits for contributions into superannuation for various age groups. An employer may only receive a deduction for contributions made on behalf of an employee (SG and salary sacrifice) up to $14 603 in 2005–2006 for those under 35 and $40 560 for those aged 35 to 49. If an employer could not obtain a deduction for these additional voluntary savings (via salary sacrifice) they may not be willing to offer such a scheme. However, an employer would not need to contribute any more than the age-based deduction limit for any employee.

3.169 The government's superannuation plan would abolish age-based deduction limits and replace them with a single limit of $50 000 for deductible contributions. This is not a limit on contributions but a limit on the concessional taxation of the contribution within the fund. Employers would continue to receive a full tax deduction for all contributions (including those in excess of $50 000) made on behalf of employees under age 75. If an employee receives more than $50 000 in deductible contributions (from all employers) the excess amount would be taxed in the fund at the top marginal tax rate.

3.170 The other issue with a voluntary opt-out scheme is potential system inequity. If salary sacrifice were not to be universally offered some people would enjoy a considerable upfront voluntary savings advantage over those who could only make post-tax contributions. This is something Mr Noel Whittaker noted in evidence:

> Again you have two types of workers; those workers whose bosses offer salary sacrifice which governments do, and those workers who are not offered salary sacrifice. The ones who offer it, their

108 Mr Noel Whittaker, *Transcript*, 10 February 2006, p. 71.

109 Mr Noel Whittaker, *Transcript*, 10 February 2006, p. 76.

110 Ms N Kelleher, CPA, *Transcript*, 10 February 2006, p. 18.

> employees get a deduction because it comes out of pre-tax dollars but if the employer does not offer it, they have to pay their super out of after-tax dollars. There is an anomaly there.[111]

Conclusions

3.171 The committee heard evidence that the rate of voluntary employee contributions has fallen since 1999–2000 to the last known data set in 2002–03. This may be the result of many things. These may include low levels of disposable income associated with the life-cycle spending pattern of this age group; a historically high property market increasing housing costs; the SG reaching nine per cent in 2002 or the demise of defined benefits schemes requiring employee contribution.

3.172 Another explanation is that without strong incentives or some form of soft compulsion, people are inclined to accept the status quo.

3.173 Evidence to the inquiry has suggested that many people under 40 anticipate a level of retirement income that will exceed the level they will acquire. It is therefore likely that voluntary savings above the SG will be required to bridge this expectations gap.

3.174 A number of organisations have stated that a soft compulsion employee contribution scheme would significantly boost the number of people committing to additional superannuation savings.

3.175 The committee heard strong support for auto enrolment employee contribution arrangements with an option to decline the offer. Overseas research in relation to savings/retirement schemes indicates that people automatically enrolled in a scheme with a built in default will tend to remain enrolled in the scheme. Studies have shown that people will be mostly happy to stay with the status quo once enrolled.

3.176 A default scheme could operate in tandem with the SG. Assuming the SG remains at its current level, the default rate could be initially set at three per cent.

111 Mr Noel Whittaker, *Transcript*, 10 February 2006, p. 70.

Recommendation 1

3.177 **The committee recommends that when a new employee commences work they are automatically placed in a 'voluntary' contribution arrangement which they could chose to opt-out of at any time, preferably operating through salary sacrifice.**

The starting point in savings contributions could be a default rate of three per cent with periodic adjustments.

Superannuation Guarantee earnings threshold

3.178 The committee has regularly heard, both in submissions and at public hearings, that the $450 a month income threshold for the SG should be removed. This is the same threshold that existed in 1992 when the SG was implemented.

3.179 At that time the SG was only three per cent of salary and wages. The concern was that without a minimum threshold people on very low wages would end up with small amounts of SG which would just get eroded by fees. A threshold of $250 was originally considered but 'The reason that that did not proceed was on the basis that that nine per cent of $250, back in 1992, would probably be eaten away by fees and charges'.[112]

3.180 Ms Philippa Smith of ASFA noted the concerns at introduction of the SG about additional business administration.

> If you go back in history, that threshold was introduced in about 1992, at the time when the SG was three per cent. There was a concern about multiple small accounts being left around the place and the costs and administrative burden of those. Now we have the SG of nine per cent and we have choice and portability. [113]

3.181 When asked about the purpose of the threshold, the Treasury said:

> …it is a balancing of the policy rationale as to how much should be given to these people to create their superannuation savings, and how much of that is going to be an effective mechanism to actually

112 Mr A Coles, The Treasury, *Transcript*, 10 February 2006, p. 55.

113 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 4.

> give them something for their retirement income that will not be eaten away by fees, charges and other expenses.[114]

3.182 During the hearing in Canberra on 10 February, it was noted that a person could have three jobs earning $400 a month, which could effectively raise their SG threshold to $1200 a month yet receive no SG.[115] Therefore, despite a much higher overall income they are ineligible for the SG contribution. Thus people with multiple employers may miss out on SG payments entirely despite earning equivalent to full time employment. This was summarised by ASFA in their submission.

> There also has been a substantial increase in the number of casual employees, with 26% of employees casual in 2003, compared to 22% in 1993, leading to an increase in casual jobs from 1.3 million to 1.9 million (ABS 2005). A significant proportion of these job holders achieve the equivalent of full-time employment through the combination of two or more jobs.[116]

3.183 Interestingly, the Senate Select Committee on Superannuation, in its 2002 report, recommended that the government examine removing the threshold. In its response to that report, the government stated that it:

> Is not convinced that the retirement income benefits of removing the $450 earnings threshold for Superannuation Guarantee contributions outweigh the possible extra cost imposed on business, especially small business.[117]

3.184 Within the context of a generally increasing casualisation of the entire work force, young people are particularly at risk of having fragmented work patterns and of being employed long-term in the casual, part-time or multi-job paid labour force. The ACTU commented:

> From a policy perspective, the large number of employees with several part-time and/or casual jobs calls into question the $450 a month earnings threshold for SG contributions. This may have made sense when SG was 3%. However in a choice environment with 9% SG employees are in a better position to nominate an account for small payments.[118]

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114 Mr A Coles, Treasury, *Transcript*, 10 February 2006, p. 55.

115 Mr N Whittaker, *Transcript*, 10 February 2006, p. 75.

116 ASFA, *Submission no. 16*, p. 21.

117 Government Response to the Senate Select Committee on Superannuation report: *Superannuation and Standards of Living in Retirement*, 14 February 2005.

118 Australian Council of Trade Unions (ACTU), *Submission no. 29*, p. 10.

3.185 While casual employees are compensated for lack of paid leave entitlements by a casual loading of their hourly rate of pay there is no such specific loading in relation to foregone superannuation if a person earns below the SG threshold.

3.186 The committee also heard suggestions of a black market operating at the margin to avoid payment of SG or employers deliberately devaluing salaries/wages to fall under the threshold.

3.187 Mr David Elia of Industry Funds Forum (IFF) advised of under-employment occurring so employers could avoid the SG:

> We certainly know of the disadvantages to low-paid workers, casualised workers in the industry, single mothers. There are some employers out there that will simply employ staff up to the threshold and move away…[119]

3.188 Ms Catherine Bowtell of the ACTU noted manipulation of rosters such that wages fall below the SG threshold:

> It is not just in hospitality. I think the SDA will tell you that it is an active program built into some of the rostering arrangements in the large retail industry as well, so that when you are approaching the $450 someone else is rostered to avoid that cost.[120]

3.189 The Taskforce on Reducing Regulatory Burdens on Business released its report on 7 April 2006.[121] One of its recommendations was to allow employers to use a quarterly exemption threshold (equal to the monthly exemption threshold multiplied by three).[122] The focus of the Taskforce was on business compliance costs only. It was thought that this measure would reduce compliance costs and decrease the number of itinerant and short-term employees eligible for SG. Clearly, this measure would also impact on other workers.

3.190 There is a perception that the earnings threshold has already moved from a monthly earnings calculation to a quarterly earnings calculation. This did not occur—legislation was introduced on 16 May 2002 to jointly align quarterly payment of SG with a quarterly threshold, but the Senate

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119 Mr D Elia, Industry Funds Forum (IFF), 3 February 2006, p. 66.

120 Ms C Bowtell, ACTU, *Transcript*, 3 February 2006, p. 56.

121 Regulation Taskforce 2006, *Rethinking Regulation: – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006.

122 Regulation Taskforce 2006, *Rethinking Regulation: – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, p.126.

rejected the quarterly threshold.[123] The Senate rejected this because there was the potential for more workers to miss out on SG coverage. Senator Hogg stated in *Senate Hansard* during the second reading of the Bill:

> The people who are going to be affected are casual workers, seasonal workers and piece rate workers. These are people who are in the most precarious forms of employment in our community, the people who are most vulnerable and need to have superannuation such that they can establish a reasonable retirement income. [124]

3.191 Equally, moving to a quarterly threshold may actually increase SG coverage where an employee has sporadic work patterns over the year and earns a great deal more in some months than others. For example $400 in April, $700 in May and $400 in June. Under the monthly SG system only May would receive SG but under the quarterly threshold the full $1500 would be subject to SG.

3.192 Mr Bill Stanhope of IFSA believed the change in the period of calculation of the threshold may have brought more superannuation coverage because it was harder for employers to massage figures over a quarter:

> We hypothesise—I am not sure that anybody really knows—that it has probably brought more people into the net. There had been some anecdotes of employers keeping money below the threshold in a given month.[125]

3.193 It is unlikely to impact at the margin, where an employer may deliberately keep monthly wages under the threshold. It is just as easy to massage the figures or manipulate rosters over a three month period as it is over a month. For example, where an employee earns $400 in April, $500 in May and $400 in June (totalling $1300) they would fall short of the quarterly amount of $1350 but would have received SG for May under the previous monthly system.

3.194 Mr David Elia of IFF noted that many awards in industries with prevalence for casualisation set SG thresholds lower than $450:

> In fact, under various awards underpinning the hospitality and tourism sector, that threshold is, in fact, a lot lower. It could be as low as $320 to $350.[126]

123 Taxation Laws Amendment (Superannuation) Bill (No.2) 2002.

124 *Senate Hansard*, Second Reading, Senator Hogg, 27 June 2002.

125 Mr B Stanhope, IFSA, *Transcript*, 28 July 2005, p. 34.

126 Mr D Elia, IFF, *Transcript*, 3 February 2006, p. 65.

3.195 However, he noted that 'The brutal truth is that most employers within our sector—and we have about 30 000 of them—do not know what award underpins their particular employment—whether it is hotels, motels, restaurants, catering companies'.[127]

3.196 The Taskforce on Reducing Regulatory Burdens on Business recommended that the SG threshold be raised to almost double its current level—to $800 a month to represent approximate indexation to average ordinary time earnings since 1992.[128] As previously noted, their focus was on compliance costs, direct costs, and administrative burden on business, not on the level of superannuation coverage or on individuals' retirement incomes.

3.197 The Taskforce acknowledged that at the expense of reducing costs on business increasing the threshold '…will reduce superannuation guarantee coverage and may disadvantage some long-term casual and part-time workers in particular'.[129]

Conclusions

3.198 The SG threshold was set in 1992 following debate about what level of threshold would create the right balance between allowing an employee on low wages access to a universal superannuation scheme or to have their small contributions eroded away by fees and charges.

3.199 Contributions today would still be subject to fund expenses. However, consolidation of funds is now possible and Superannuation Choice enables an employee to utilise their preferred fund at each job they work thereby mitigating fee impacts.

3.200 The threshold struck in 1992 has remained the same. The committee has heard the argument that as the threshold has not moved it has enabled more employees to be covered with real wages growth. The committee has seen evidence to the contrary, that employees at the margin have been subject to a continually devalued wage setting or masterminded rostering to keep employees below this threshold. Any real wage growth would

127 Mr D Elia, IFF, *Transcript*, 3 February 2006, p. 66.

128 Regulation Taskforce 2006, *Rethinking Regulation – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, p. 126.

129 Regulation Taskforce 2006, *Rethinking Regulation – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, p. 126.

have boosted the existing balances of people already earning above the threshold.

3.201 Increased direct business costs and compliance burdens have been cited as reasons why the threshold should not be lowered and may explain some of the black market behaviour referred to in evidence. There is no reason to believe that employer behaviour around the threshold will change.

3.202 Many under 40s are at risk of not being exposed to the SG because of the increasing incidence of casual and multiple jobs and the preponderance of people aged under 40 in these types of jobs. This type of employment is not solely undertaken by students or as 'temporary' positions. A high proportion of people employed in this way are employed long-term in sectors where the rates of pay are low and people necessarily work multiple jobs. The SG is only determined on the basis of the work performed for one employer, irrespective of any other employment positions held.

3.203 Women and sole parents working in part-time or casual positions due to caring responsibilities are also particularly at risk of accruing no superannuation coverage despite earning an income.

3.204 The Regulation Taskforce 2006 recommended that the SG be raised on the basis that it poses direct and indirect costs on business. The committee is concerned that if the current SG threshold is raised, a large section of the under 40s workforce will be penalised with respect to superannuation and many will remain forever marginalised.

3.205 Other groups recommended the threshold be lowered or abolished.

3.206 The committee believes retaining the threshold at its current rate of $450 or lower, will ensure, over an extended period of time, that more multiple/casual job employees will gain superannuation coverage with negligible impact on business compliance costs.

Recommendation 2

3.207 **The committee recommends that the Superannuation Guarantee threshold not be increased by government and that consideration be given to reducing it, following consultation with employers and employees.**