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House of Representatives Standing Committee on Economics, Finance & Public Administration

SUBMISSION 23

The Institute of Chartered Accountants in Australia

House of representatives Standing Committee on Economics, Finance and Public Administration
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The Secretary of the Committee
Standing Committee on Economics, Finance and Public Administration

Dear Secretary,

Re: Inquiry into improving the superannuation savings of people under 40.

Thank you for the opportunity to provide a submission to the House of Representatives Economics Committee examining issues associated with the superannuation savings of people under 40 years of age.

This submission is made by The Institute of Chartered Accountants in Australia (The Institute). The Institute is one of Australia's peak professional bodies and our members represent many of Australia's peak business and finance professionals. These members act as advisers and key decision-makers in all facets of the superannuation industry.

This submission represents the views of The Institute as based on the input from a variety of members. The Institute supports the Government's commitment to the improving superannuation savings of people under age 40. This initiative should be closely linked to the Government's Financial Literacy Foundation's objectives.

Key issue

There are a large number of barriers and disincentives to those under 40 supporting the use of superannuation as a savings vehicle for their retirement funding. These include the associated complexity of superannuation, individuals' financial priorities and general understanding of superannuation. (In addition, it should be noted that it is well documented that overall savings patterns generally are not high.)

The Institute believes that the issue is not just a lack of support for superannuation savings for those under the age of 40 but rather a lack of focus on retirement funding overall. The questions needing to be addressed in relation to this issue are:

- "Are those under 40 reluctant to use superannuation as a savings vehicle or are they reluctant to allocate income/ resources to retirement funding?"
- "Are those under 40 prioritising their financial situation based on perceived more pressing or important issues?"
- "Is the issue a reluctance to incorporate super as part of their retirement funding or is there a reluctance to look at retirement funding as important."
- "Are those under 40 currently funding their retirement goals but not doing so via superannuation strategies?"

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Recommendation: A detailed attitudinal survey should be developed to assess the level of importance and priority of retirement funding. Based on the results of this survey an education program on the need and benefits of retirement funding should be a priority. This program should focus on retirement funding rather than specifically on superannuation savings.

Barriers to Retirement Funding

Debt management, workplace change and change in the family structure

There have been many financial environmental changes for individuals including those under the age of 40. The key is the reduction in available disposable income.

- There has been a change in the workplace structure;
- level of debt and types of debt;
- costs of the housing market;
- changes in family structures.

Individuals under 40 are experiencing changes in workplace structure not experienced by previous working generations. They are finding increasing level of casualisation of the work force and therefore the need to increase accessible savings to compensate for unpredictable work patterns. This increase in casualisation and at times preference for part-time working environment has increased the need for an individual's financial position to be more flexible.

Those under 40 are finding their debt management structure requirements to be larger and of a more complex nature. As a result many of these under 40s have a significant focus and priority on debt management. This includes a number of areas of consideration which reduce the availability of disposable income for savings:

- The increased use of credit cards which current statistics show a high level of personal debt.
- Individuals under 40 are more likely to have debts associated with higher learning due to the introduction of the HECS scheme.
- Individuals are experiencing increased costs of entry to the housing market. Individuals require higher levels of debt to purchase homes. As a result a larger proportion of their incomes are allocated to mortgage repayments and therefore less disposable income available for savings.
- With the higher entry costs to the housing market many individuals have opted to enter the housing market in regions that are a significant distance from major cities. This results in increased travel costs.

The key issue of these is the allocation of income to the payment of the individual's mortgage. A prime consideration and priority for an individual is to "pay-off" the mortgage as soon as possible. A cornerstone of any financial planning recommendation is to reduce your debt, in particular, non-tax deductible debt. Where possible the vast majority of individuals are allocating spare savings to reducing the mortgage.

Individuals under the age of 40 are also those usually who are experiencing the increased costs of family. These costs include child-care, schooling etc. As a result an individual's key focus and therefore priority is on debt repayment and the cost of child up bringing. As has been demonstrated many individuals and families have a high level of debt commitments and the important financial strategy is to reduce this debt as soon as possible.

Over recent years the increase in divorce rates has also seen changes in the financial responsibilities and implications for individuals. The increase in single parent families, blended families and child support responsibilities has impacted on the availability of disposable income for savings generally and superannuation.

Barriers to Superannuation Savings and the under 40s

As will be discussed later in this submission superannuation should not be seen as an "either / or" alternative but should complement an overall retirement funding plan.

Individuals will allocate resources to investments/ savings that they understand and that are perceived to be easy to access. (For many individuals their largest investment/ savings is through superannuation but this is through default as a result of the Superannuation Guarantee requirements as opposed to a conscious strategy to build savings.)

Whilst Australia has a high per capita level of share ownership following a large number of floats over the last 10 years the two areas where savings continue to be invested in is cash (e.g. bank or like) and wealth creation options revolving around property. Many individuals who are under 40 years of age continue to live at home with their parents but are investing in property for wealth creation purposes. The key reasons - simplicity and ease of understanding. For example, property as an asset for investment is tangible, it is a strategy that individuals have used successfully over a number of years and the process of entry is, whilst requiring a large initial investment, simple. In addition, the associated taxation implications are relatively simple.

Further, many individuals see their home as part of their retirement funding strategy. That is they will pay it off as soon as possible, then upon retirement will down size and use the balance for retirement income.

Similarly, the use of banks accounts and the like are due to the perception of security, ease of access and again simplicity of use.

The relatively high level of per capita share ownership can again be attributed to perceived simplicity and ease of entry and access. Whilst many individuals may not fully understand the implications and associated risks of share ownership they have still invested.

Superannuation savings should not necessarily be seen as an alternative to these investment strategies and preferences but should be used to complement or incorporate them. That is, an individual's retirement plan should be built on a combination of superannuation and non-superannuation structures. The advent and popularity of Self Managed Superannuation Funds is an opportunity to incorporate an individual's preference for property, shares and cash. Thus encouraging support for superannuation savings.

Superannuation complexity and understanding

Superannuation is generally misunderstood and ignored by individuals including those under the age of 40. Superannuation is viewed as a complex and costly investment. One of the key messages in recent times as a result of Superannuation Choice is to seek professional advice. The basis of this is the associated issues and complexity. There are a myriad of rules in regards to contributions, access and taxation.

In addition, individuals view superannuation as an investment vehicle whose rules constantly change. These ongoing changes further increase an individuals concern over investing in a superannuation savings strategy.

Individuals/ consumers often when faced with complexity will prefer to revert to simple alternatives or will not do anything.

The negative understanding of superannuation also comes from those individuals who run their own businesses. They see it as an additional burden/ cost to the business without any perceived benefit. Individuals see superannuation as complex and without the opportunity to access it.

The Institute believes that as these perceptions and misunderstandings continue to exist that superannuation as a savings vehicle will not be a preferred option. A far-reaching and ongoing education campaign is required to change these perceptions. In addition, a simplifying of the rules is required.

A crucial component of this education campaign would be to focus on superannuation in terms of the final outcome, that it is - tax effective income in retirement. Superannuation is usually seen only in the context of the accumulation phase, particularly for those under 40 years of age. An education campaign cannot be a short-term program but ongoing in order to change perceptions in the long term. It is also critical that such a campaign be incorporated with the Financial Literacy Foundation.

The Institute believes that the focus on superannuation benefits should be widened in terms of consumer understanding. A key issue is insurance cover within superannuation. As for many individuals the home and mortgage rank highly in financial consideration, an education program should be implemented which draws on the benefits of insurance in regards to protecting their home. In this way superannuation is tied to the benefits of the home and concerns over the mortgage.

Currently the income protection/ salary continuance provided within a superannuation structure is often limited to a benefit period of 2 years. As a result individuals need to also arrange cover outside their superannuation. This again increases the complexity of the individual's financial situation. The option should available to insure for longer benefit periods.

Current incentives

The current incentives to encourage savings through superannuation are generally seen to be too complex.

In addition, some individuals who could benefit from superannuation savings incentives are precluded. For example co-contribution does not allow those at home caring for families to claim the co contribution acting as a disincentive to voluntary savings. Consideration should be made for this to be paid to those in receipt of Family Tax Benefit B.

Whilst the thresholds for co contribution have been widened, the thresholds could be further increased. However this would not in itself encourage superannuation savings an ongoing education campaign would be required. The focus on such a campaign must be on the simplicity of the process and how it will benefit in retirement.

In summary, superannuation has a significant role to play in an individual's retirement funding plans, including those under the age of 40. Superannuation should be positioned as a strategy to complement current retirement planning options. It is not an "either/or" situation. The critical issue is ongoing education and simplification.

We look forward to the opportunity of discussing these issues in more detail and responding to particular questions you may have at the hearing.

Yours sincerely

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The Institute of Chartered Accountants in Australia