SUBMISSION 28

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

Submission No: 28

Date Received: 01/8/05

Secretary: [illegible]

RECEIVED
- 1 AUG 2005
House of Representatives Standing Committee on Economics, Finance & Public Administration

Inquiry into Improving the Superannuation Savings of People under age 40

29 July 2005

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1. Introduction

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments to the House of Representatives Standing Committee on Economics, Finance and Public

Administration on its inquiry into improving the superannuation savings for people under age 40, as referred to it by The Hon Mal Brough MP, Minister for Revenue and Assistant Treasurer on 12 May 2005.

The terms of reference for the inquiry are:

To inquire into improving the superannuation savings of people under age 40 with particular reference to:

> *Barriers and/or disincentives to contribute to superannuation;*
> *Current incentives in place to encourage voluntary superannuation contributions;*
> *Improving their awareness of the importance of saving early for their retirement.*

This inquiry is important so that the Government, financial services industry and the community can gain a better understanding of the factors that may impact on the savings, investment decisions and retirement plans of 'Generation X' ('Gen Xers': born between 1961 and 1976) and 'Generation Y' ('Gen Yers': born between 1976 and 1991) Australians[1].

This year the older members of Generation X turn 44. When these people entered the workforce there was no compulsory superannuation; in fact older Gen Xers worked for over a decade before compulsory superannuation wasinitially introduced. This means that in considering the patterns of superannuation savings of people under age 40, it is not as simple as assuming that all Generation X and Generation Y cohorts will think the same way about superannuation savings and other private savings and investment.

People under age 40 are a heterogeneous group, and therefore factors impacting lifecycle stages and individuals' decisions impacting lifestyle choices will result in Gen Xers and Gen Yers having different dependencies on government welfare, superannuation and other private savings as well as having different responses to savings messages. Measures to improve superannuation savings will have different degrees of effectiveness due to the different savings capacities, other investment priorities and attitudes towards retirement.

Understanding how people under age 40 think about superannuation and other private savings will assist in identifying real incentives and removing disincentives for greater superannuation savings as well as devising strategies for promoting greater superannuation savings and other private savings.

ABA acknowledges the Government for the recent changes to superannuation, taxation and social security policy. These changes will have a long-term positive impact on the retirement incomes of Australians. However, despite these changes ABA believes that generally Australians are still not planning early enough, or saving enough, for their retirement. It is vital that sustainable public policies provide incentives as well as address disincentives for superannuation and other private savings, to ensure optimum living standards in retirement.

[1] 'Generation X' and 'Generation Y' definitions as contained in AMP/NATSEM research report. 'Generation X' immediately follows the 'Baby Boomers' generation. AMP/NATSEM (2003). *Generation Xcluded: Income and Wealth of Generation X*. Income and Wealth Report Issue 6. November 2003.

2. Background

The three basic pillars of Australia's retirement income system are:

> Age pension funded by Government revenue;
> Compulsory superannuation contributions made by employers (9% of earnings); and
> Voluntary superannuation contributions made by employees and self-employed.

Superannuation guarantee

The Superannuation Guarantee (SG) legislation was introduced in 1992, with the completion of the phased introduction in 2002 with minimum employer superannuation contributions of 9%. The compulsory superannuation system provides a balance between employees relinquishing current consumption and expenditure for increasing living standards in retirement.

Intergenerational changes

The central message of the Government's *Intergenerational Report* (May 2002) is that demographic changes over the next decades will lead to significant fiscal strain due to increased government expenditure. Modelling has demonstrated that the age pension and the health and aged care system are essential components of retirement incomes for retiring Australians. Without a reliable age pension 'safety net', many Australians will face standards of living inadequacy.

Superannuation and standards of living in retirement

In 2002, the Senate Select Committee on Superannuation considered the issue of superannuation adequacy. ABA's submission to the inquiry indicated that a significant gap exists between the expectations of Australians for their standard of living in retirement, and what the present system will actually deliver. ABA set out that a national goal should be established for significantly increased retirement provision through a combination of:

Increased superannuation contributions from individuals;
Extended Government co-contributions;
Reduced taxation, focusing on lowering up-front taxation on contributions, including removing the superannuation surcharge and making taxation more progressive at the benefit stage; and
• Generally improved incentives for voluntary contributions.
Furthermore, ABA considered that simplification of superannuation is feasible, and would improve not only simplicity and transparency but also equity and incentive. Simplification should be integrated with reform of the tax structure such as:
Crystallisation of 'long tail' grandfathering of pre-1983 and non-preserved benefit concessions so that they are taken out of the system;
Removal of both benefit and contribution limits; and
Removal of restrictions on who may contribute and differences of treatment among different recipients of benefits.

ABA believes that its recommendations made to the Senate Select Committee largely remain relevant for this inquiry into improving the superannuation savings of people under age 40. The key findings of the Senate Select Committee's report *Superannuation and Standards of Living in Retirement* (December 2002) include:

The available evidence demonstrates that the current arrangements for superannuation may not provide an adequate income in retirement for most people and that strategies need to be identified to address the shortfall;
The current taxation treatment of superannuation produces some inequities which need to be addressed;
The relationship between superannuation and the age pension and other social security measures could be better integrated;
The superannuation system in Australia is very complex, not easily understood and requires simplification.

Superannuation and planning for retirement

In 2003, the Senate Select Committee on Superannuation considered the issue of superannuation and planning for retirement. ABA's submission to the inquiry indicated that reform of the superannuation and welfare system should seek to, where possible, fully integrate based upon the development of an effective 'safety net', which will provide all Australians with an adequate income when they are unable to provide for themselves at any stage of their lives. ABA highlighted a number of key issues regarding planning for retirement, such as encouraging older employees to remain in the workforce longer, improving the structure of tax and social security benefits, making access to financial planning advice easier and retraining of mature aged workers.

Transition to retirement

On 25 February 2004, the Treasurer announced the Government's*Transition to retirement* policy. The consultation paper *A more flexible and adaptable retirement income system* (November 2004) proposed measures that would allow people who have not retired from the workforce to access their superannuation in the form of a non-commutable income stream, once they have reached their preservation age.

Since the introduction of compulsory superannuation, there have been substantial changes and reforms to superannuation, taxation and social security policy. Most recently, ABA commends the Government for implementing a number of public policy reforms seeking to encourage greater superannuation savings for all Australians, such as the recent extended superannuation co-contributions, adjusted personal income tax rates, removal of the work test for superannuation contributions, introduction of spouse contributions and pending splitting of contributions and abolition of the superannuation surcharge. The combination of these reforms will contribute to greater superannuation savings, particularly for Gen Xers and Gen Yers.

However, ABA believes there are a number of other measures the Government could consider to encourage greater superannuation and other private savings, thereby promoting higher retirement incomes and improved living standards in retirement.

3. Emerging trends impacting savings of people under age 40

Both men and women are living longer in retirement. According to Australian Bureau of Statistics (ABS) data, those men and women retiring in 2003 at 65 can expect to live on average for around 13 and 18 years respectively[2]. With improvements in medical treatment, health and aged care, by 2051, when almost all members of Generation Y have retired, men and women can expect to live on average for around 20 and 23 years respectively[3]. This means that people must plan and save for retirement early.

People under age 40 have experienced some significant demographic, social, economic and financial changes, meaning that the factors contributing to attitudes to savings, superannuation and retirement are different to those of older generations. Some Gen Xers and Gen Yers will enter the workforce later with a HECS debt; some are highly mobile in employment; some are saving a deposit for a house before accumulating other savings; some are delaying home ownership and undertaking overseas travel. Life expectancies are increasing and birth rates are decreasing. All these trends have an influence on attitudes towards, and decisions about superannuation and savings.

Generation X and Generation Y cohorts also have quite different retirement income characteristics, both across the generations and within the generations. While Gen Yers will have retirement savings reflecting the fact they have received compulsory superannuation for their entire working lives, this is not the case for all Gen Xers. Some say ‘Generation W’ (the lost generation between the ‘Baby Boomers’ and Generation X) will face a significantly different financial position at retirement than the previous generation, with demands from ageing parents, maturing children and their own age-related expenses. Lifecycle decision making, including planning, building and protecting wealth, will be important for Gen Xers and Gen Yers as the increasing cost of living and higher consumption expectations will affect total wealth accumulation[4].

ABA believes that Australians, particularly those people under age 40, are simply not saving enough for retirement. Many Gen Xers and Gen Yers will have a *retirement savings gap*; that is, their current superannuation levels will not be sufficient to sustain their expected lifestyle in retirement.

According to the 2001 census, there were 4.5 million Australians aged 25-40, constituting 24% of the Australian population, and 2.6 million Australians aged 15-24, constituting 14%[5]. The opportunity to educate these cohorts in secondary schooling about the importance of planning early for retirement and establishing financial independence in retirement has passed. Therefore, the Government, in partnership with the financial services industry, business sector and the community, must consider strategies for promoting the importance of saving and evaluating personal goals for retirement incomes for the approximate 7 million Australians currently under age 40 and in the workforce, or of working age.

[2] ABS Life Tables 2001-2003. (Cat 3302.0.55.001).

[3] Expected average life expectancy in 2051 for men is 82 years and for women 86 years. ABS (2003). *Mortality assumptions in Australian population projections: 1978 to present*. Paper for presentation at the Workshop on Mortality Modelling and Forecasting, University House, Australian National University, Canberra. 13-14 February 2003.

[4] Phillips, C (2003). *Old folks put more pressure on Gen Xers*. Money Management. 18 November 2003.

[5] Statistic for people aged 15-24 means that the youngest were born in 1986, where Generation Y refers to those born through to 1991. Notwithstanding, this statistic gives a reasonable indication of Gen Yers that are currently entering the workforce. ABS (2002). *2001 Census Basic Community Profile and Snapshot.* 19 November 2002.

Understanding the factors that influence younger peoples' decisions about superannuation, savings and investment will be important for determining how best to target savings messages, encourage greater superannuation contributions and promote greater voluntary and private savings. Ultimately, improving superannuation savings by encouraging voluntary superannuation and other private savings will assist in closing the retirement savings gap for people under age 40.

Whether by choice or by necessity, Gen Xers and Gen Yers are behaving differently to the previous generations. Changing lifecycle stages and lifestyle choices, shifts in household debt and increasing asset prices are all contributing factors to changing attitudes towards savings and investments by people under age 40. Generally, the drivers for savings tend to be the occurrence of lifecycle stages, such as finishing education, commencing employment, marriage or divorce, having children or children leaving home, receiving inheritance, fear of ill-health, pending retirement, etc. However, lifecycle stages are generally taking place at older ages for Gen Xers and Gen Yers, with such delays having implications for their consumption and expenditure rates, savings patterns and investment priorities.

Appendix 1 provides a snapshot of some of the factors that may be influencing Gen Xers and Gen Yers decisions about superannuation and other private savings.

What does this mean for the superannuation savings of people under 40?

With greater investment choice, but also greater pressure on private savings, Gen Xers and Gen Yers must have the ability to budget, save and invest. If people are to have greater confidence in superannuation, thereby increasing their own retirement provision voluntarily, then they must also have greater certainty and greater flexibility with their savings and investments.

The main priorities for retirees have been identified as access to social security benefits, access to capital and low risk investments (with tax advantages)[6]. Therefore, ABA believes that additional measures must be implemented that assist in delivering these retirement income priorities by better integrating superannuation, social security and taxation policy. Government strategies should also seek to encourage individuals to take more responsibility with managing their superannuation and other private savings. Superannuation, while a substantial part of many Gen Xers and Gen Yers wealth accumulation, should be considered as part of an individual's long-term savings strategy.

4. Superannuation: Adequacy, Simplicity and Literacy

4.1 Adequacy

What is adequate superannuation?

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[7]. In reality, for a majority of Australians a combination of public and private savings will be needed to fund retirement incomes.

[6] Drew, M, Stanford, J and Stanhope, B (2003). *Sustainable Retirement: A Look at Consumer Desires*. Eleventh Colloquium of Superannuation Researchers. University of New South Wales. 8 July 2003. This project interviewed people aged 45-69.

[7] ABS (1997). *Retirement and Retirement Intentions*. Catalogue No. 6238.0. November 1997.

What an adequate level of superannuation savings is can really only be answered by considering these questions:

What should be the aspiration of the Australian community for standards of living in retirement – as reflected in retirement incomes policy?
What superannuation contribution levels does this imply, given the compulsory nature of the superannuation system?
Are current levels of provision adequate?

The Government indicates that Australians should provide for their own retirement through compulsory superannuation and other savings as well as says that the age pension will be administered so that the majority of retirees will continue to receive either full or partial age pension. It is a widely held assumption that the superannuation system will operate in conjunction with a viable and sustained means-tested age pension. The age pension provides a ‘safety net’ and assists to stabilise outcomes for individuals with low savings capacities.

Consideration of superannuation adequacy for some Australians concerns whether superannuation, in conjunction with the age pension, will produce adequate savings outcomes. Therefore, superannuation adequacy for people with very low to low personal income concerns not so much superannuation, but more importantly, “age pension adequacy” (as those on very low incomes, even if only temporarily, fall outside the compulsory contributions regime and thereby may rely entirely on government assistance and then the age pension as a safety net to alleviate poverty).

Whereas for people with low personal incomes that have superannuation contributions made by their employer, superannuation co-contribution offers the ability to maximise their superannuation contributions, and therefore superannuation is becoming an increasingly important supplement to the age pension. Nevertheless, even for these people, the age pension will continue to contribute towards retirement income adequacy. ABA assumes that the Government will continue to support the three pillars retirement income system, in particular, by administering the age pension for Australians with very low to low retirement incomes.

With this assumption in place, “superannuation adequacy” therefore concerns the very broad group of people that earn low to middle incomes. Most Australians are in this group, with many not likely to benefit from the full age pension, but also likely to face retirement income inadequacy unless they contribute voluntarily to superannuation or other private savings.

The Government is cautious about establishing or endorsing a particular income replacement goal to guide the superannuation and retireme nt income system. The Senate Select Committee report *Superannuation and standards of living in retirement* presented a consensus view for an adequate standard of living in retirement as 60-65% of gross preretirement income (around 75-80% of pre-retirement consumption expenditure).

For people earning low incomes, 65% will include contributions from the age pension. Yet according to the Westpac/ASFA *Retirement Living Standard* (February 2004), most Australians want and need more than the age pension will provide. The following outlines an estimated budget for singles or couples seeking a modest lifestyle in retirement or a comfortable lifestyle in retirement.

Table 1: Modest and Comfortable Lifestyles (estimated average cost per week)

	Modest lifestyle – single (cost per week)	Modest lifestyle – couple (cost per week)	Comfortable lifestyle – single (cost per week)	Comfortable lifestyle – couple (cost per week)
Housing	$56.20	$58.10	$74.60	$76.50
Energy	$10.30	$12.30	$11.30	$13.30

Food	$58.60	$117.40	$110.90	$156.00
Clothing	$15.10	$26.10	$31.90	$58.20
Household goods and services	$47.90	$50.70	$85.20	$78.30
Health	$9.90	$18.70	$41.80	$82.20
Transport	$62.50	$63.20	$95.40	$96.10
Leisure	$43.30	$71.70	$138.60	$199.00
Personal care	$21.80	$34.80	$21.80	$34.80
Gifts and/or alcohol and tobacco	-	-	$19.20	$38.40
Total per week	$325.60	$452.90	$630.70	$833.60
TOTAL per year	**$16,930.00**	**$23,550.00**	**$32,800.00**	**$43,350.00**

Source: Westpac/ASFA Retirement Living Standard[8]

A modest lifestyle is very basic with restricted eating out and entertaining and no overseas travel. The shift to a comfortable lifestyle adds comfort and enjoyment, such as better clothes, improved household appliances and technology, better car, access to entertaining, purchase of magazines or CDs, purchase of alcohol/tobacco or gifts, occasional overseas travel, some eating out and entertaining, but importantly access to private health insurance[9].

Generally, Table 1 demonstrates that the level of pre-retirement income, savings and spending will impact on post-retirement income and standard of living in retirement. Relying merely on compulsory superannuation savings to deliver 65% of pre-retirement income is not going to deliver the retirement incomes needed or expected by many people under age 40. By way of example, using ASFA's online retirement income calculator, an individual with a $52,000 salary that receives superannuation contributions for 40 continuous years will still have a shortfall of 3 -4% to achieve a post-retirement income of around $33,000 each year[10].

Consumption rates and expected standards of living are increasing across the community. It is likely that the majority of older Australians will continue to rely on a combination of public and private savings to sustain their living standards. Importantly, for some people the age pension will continue to form an important part of retirement income adequacy.

[8] Westpac/ASFA (2004). *How much do you need to spend to have a comfortable Standard of Living in Retirement?* ASFA Research Centre. www.superannuation.asn.au

[9] ASFA (2004). *The impact of moving from a modest lifestyle in retirement to a comfortable lifestyle*. February 2004. www.superannuation.asn.au

ASFA's Super Smart Planner retirement income calculator is based on a number of assumptions regarding earnings rate, salary growth, conversion factors, etc. http://www.asfa.asn.au/calculator/rpm.cfm?page=ssp#

What contribution level is needed?

According to IFSA, in 2003, the national retirement savings gap as calculated by Rice Walker Actuaries is estimated to be $600 billion[11]. So we know that there is retirement income inadequacy. However, there is no simple answer as to what contribution level is needed to achieve retirement income adequacy.

External factors and lifecycle patterns, such as workforce participation, will affect an individual's retirement income provision outcomes. Nevertheless, a basic calculation can be made based on reasonable assumptions.

Table 2: Employer contributions (incl. SG 9%) for a person on AWE to achieve 60% gross pre-retirement income

	Years to Work		
	40	35	30
Contribution rate	12%	14%	17%

Source: Industry Modelling[12]

Table 2 demonstrates that additional contributions of at least 3% (above the SG contribution of 9%) is needed over an uninterrupted workforce participation of 40 years, and about 5% over 35 years. This shows that even those younger Gen Yers that at retirement would have received the full SG contribution of 9% will still have a retirement savings gap. ABA believes that supporting the other pillars of the retirement income system by lifting superannuation contributions and private savings will improve standards of living in retirement as well as address fiscal pressure concerns associated with Australia's ageing population.

How can retirement savings inadequacy be addressed?

Strategies to encourage greater superannuation savings must recognise that there is a cost for saving for retirement; lost consumption opportunities pre-retirement. Therefore, while ABA considers that superannuation co-contribution will provide incentives for improved savings, individuals' capacity to make a contribution may be reduced or limited during different lifecycle stages, debt/equity exposures and economic cycles.

[11] IFSA defines the "national retirement savings gap" as a measure of the current shortfall in national savings between the amount required to be saved by the nation as a whole to ensure "adequacy" in retirement, and in particular non-reliance on the age pension; and the amount saved in the superannuation system, and estimated to be saved in future years up to retirement, by the current workforce. IFSA (2003). *Retirement Incomes and Long term Savings: Living well in an ageing society.* Investment and Financial Services Association.

[12] Based on modelling conducted by a group of industry experts released at the 'Retirement Incomes Forum' on 19 March 2001. Statement released by D Chessell, V Fitzgerald, B Fraser, S Grant, D Knox, M Robertson, S Ryan, I Silk, P Smith, G Weaven. Table 2 assumes that all contributions are employer (i.e. deductible) contributions. Similar results would be achieved through additional employee contributions or additional co-contributions; however, after tax contributions are more 'powerful' than deductible contributions.

According to the Department of Treasury's Retirement Income Modelling (RIM) Unit, the extended co-contribution and abolished superannuation surcharge provide real incentives for low to medium and higher income earners respectively[13]. The real impact of these incentives has been confirmed by Government and industry data[14]. However, ABA believes that medium income earners that do not have access to co-contribution or salary sacrifice may not necessarily have an incentive to forego current consumption and lock away savings in superannuation until preservation age.

Therefore, given that retirement incomes are based on three pillars (age pension, compulsory superannuation and voluntary superannuation and other private savings), retirement income inadequacy must be addressed through measures that provide certainties and incentives regarding the entire retirement income system. ABA considers that such measures for addressing retirement incomes inadequacy should include:

A viable and sustained age pension that is better integrated into the superannuation system;

Greater superannuation contributions through removal of superannuation contributions tax and additional voluntary employee contributions; and

Greater participation of Australians in the financial services industry and enhanced private savings.

According to a detailed report conducted by the National Centre for Social and Economic Modelling (NATSEM) for CPA Australia *Superannuation – The Right Balance?* (November 2004), which evaluates the outcome of a number of superannuation options for living standards before and after retirement, the best average improvement in post-retirement income is gained from 6% additional standard employee contributions. However, standard employee contributions also have the largest impact on pre-retirement income[15].

[13] Bingham, C and Rothman, G (2005). *Incentives to save more in superannuation.* Paper presented to the Thirteenth Colloquium of Superannuation Researchers, University of New South Wales. 4 & 5 July 2005. Retirement Income Modelling (RIM) Unit. Department of Treasury. http://rim.treasury.gov.au/content/pdf/CP05_01.pdf

[14] The Hon Mal Brough MP, Minister for Revenue and Assistant Treasurer, indicates that as at 3 February 2005, the ATO has paid out approximately $244 million in co-contribution payments to the superannuation funds of around 450,000 Australians. Women have received 63% of payments, with average co-contribution payments of $570; and men have received 37% of co-contribution payments, with average co-contribution payments of $490. http://assistant.treasurer.gov.au/mtb/content/pressreleases/2005/008.asp. Eureka Strategic Research/IFSA indicate that more than half of the respondents in a recent survey said that they would probably or definitely make additional contributions to superannuation in the next 12 months due to the removal of the superannuation surcharge. http://www.ifsa.com.au

CPA/NATSEM (2004). *Superannuation – The Right Balance?* Financial Advisory Services. CPA Australia. November 2004. This report updates the research conducted initially in 2001.

Table 3: Retirement Income Living Standards
(average across case types change from base scenario of alternative scenarios)

Scenario	
6% standard employee contributions	+56%
15% employer contributions	+27%
3% standard employee contributions	+27%
6% sacrificed contributions	+22%
0% surcharge tax, 0% contributions tax	+22%
0% contributions tax	+15%
12% employer contributions	+13%

3% sacrificed contributions	+11%
5.5% real superannuation earnings	+8%
Complying pension benefit	+6%
0% surcharge tax	+6%
Part retire at 60	-2%
Part retire at 55	-4%
3.5% real superannuation earnings	-6%
Lump sum benefit	-8%
Retire at 60	-26%
Retire at 55	-40%

Source: NATSEM modelling scenarios

Table 3 highlights that on average a change to the basic scenario for retirement living standards for various family types (family types: single males, single females, couples with children and couples without children) can have a significant impact on the level of retirement income. In some respects the analysis highlights the obvious; those on higher incomes have greater capacity to save, while those on lower incomes face greater pressures from the cost of living pre-retirement. However, more importantly the analysis identifies that incentives for encouraging superannuation savings should not be limited to increasing contributions, but also provide a more favourable taxation treatment for superannuation.

The NATSEM/CPA report reveals that compulsory superannuation savings will still not be enough for many people to be able to maintain their standard of living in retirement. Those that have not had the benefit of compulsory superannuation over their whole working life, due to starting employment late, broken work patterns or early retirement, the reduction in standards of living will be even more dramatic. For Australians to enjoy a reasonable standard of living in their retirement, they will have to take on the responsibility of contributing to their own retirement savings.

Adding standard employee contributions of 3-6% has a very strong positive impact on retirement income standards and on the transition of living standards to retirement (with improvements in retirement income levels of 27% and 56% respectively). However, at the same time, standard employee contributions reduce pre-retirement living standards through the reduction in disposable or discretionary income. With 3% standard employee contributions, pre-retirement living standards are reduced by about 4 -5%; whereas with 6% standard employee contributions, pre-retirement living standards are reduced by about 9-10%[16].

CPA/NATSEM (2004). *Superannuation – The Right Balance?* Financial Advisory Services. CPA Australia. November 2004. p34

Standard employee contributions provide greater gains in retirement income living standards, however contributions are made from after-tax income and thus there is a trade-off due to the impact on pre-retirement living standards. ABA believes that tax deductions on personal contributions would likely provide an incentive for employees to make additional voluntary contributions, particularly medium income earners. This approach would balance long-term savings accumulation with current consumption. If needed, a limit could be placed on the amount that can be made rather than a deduction limit, thereby making no distinction between employed or self-employed. A tax deduction for additional voluntary contributions could be restricted to those contributions that are not subject to superannuation co-contributions.

Given that not all employers offer salary sacrifice, a tax deduction for additional voluntary standard employee contributions would apply more equitably across various income levels. In addition, this incentive would target the vast majority of Australians that are low to middle income earners and who may not be able to access superannuation cocontributions as well as those people that do not have access to co-contributions.

Notwithstanding the improvement in superannuation savings of additional voluntary standard employee contributions, some employers offer the opportunity for employees to sacrifice some of their salary in return for increased superannuation contributions made by the employer on behalf of the employee. 'Salary sacrifice' is attractive for employees as it results in a lower tax liability as the amount payable is based on the employee's income less the amount being sacrificed. However, the employer's SG obligations are calculated on the reduced salary and contributions are subject to the current contribution and benefit limits. For some people, particularly those with a 42%+ marginal tax rate, salary sacrifice can offer savings advantages.

Given the tax treatment, salary sacrifice contributions of 3-6% have a strong positive impact on retirement income standards, but to a lesser extent than standard employee contributions, with improvements in retirement income levels of 11% and 22% respectively. Greater access to personal income pre-retirement is a significant advantage of salary sacrificing, and therefore should be encouraged as a method of voluntary superannuation savings for those where standard employee contributions may not be as appealing.

The NATSEM/CPA report also highlights how removing the superannuation contributions tax has a substantial impact on living standards in retirement of all family types. By shifting the distribution of taxes to the back-end (i.e. benefits stage) contributions can accumulate taking advantage of compounding, with the overall impact being greater accumulations. Modelling indicates that reducing or removing the contributions tax produces significantly improved living standards in retirement, with all family types achieving, on average, a 15% higher standard of living in retirement[17]. ABA believes that removal of the contributions tax provides a more equitable and effective method of increasing the overall retirement savings for all Australians, including those that may not have the ability to contribute voluntary savings.

Ultimately it is for the community to determine its expectations or aspirations for living standards in retirement. However, ABA believes that it is important for the Government to acknowledge a benchmark or retirement savings goal and identify long-term policies that more accurately reflect the community's needs and expectations in relation to retirement income adequacy. This will enable all Australians to consider whether their current superannuation contributions and other private savings and investments will deliver their anticipated retirement incomes, or whether they are likely to have a retirement savings gap.

[17] Ibid. p46

4.2 Simplicity

Consumers must be confident that their superannuation savings are safe over the long-term. Australia's superannuation system is significantly cumbersome and inflexible. The regulatory complexities are essentially to do with the taxation treatment of superannuation, but the inflexibility is essentially to do with the application of maximum deductible contribution (MDC) limits and the preservation age.

Different tax treatments apply to different people with employer contributions and employee contributions taxed differently. Employer contributions are deductible and taxed at the fund level; whereas employee contributions are not deductible, but are not taxed at the fund level. Self-employed people have a different regime to employees. Restrictions apply to both contributions (e.g. age-based limits) and benefits (e.g. reasonable benefit limits (RBLs), with the apparent purpose to limit the benefit available for deductible contributions.

The regulatory complexities are driven by the perception held by many in politics that the present taxation treatment for superannuation is 'concessional'. This perception has produced a regime that focuses on limiting the level of benefits that can be funded as well as the level of contribution that can be made. Most Australians largely misunderstand these restrictive elements of the superannuation system. ABA considers that the various limits placed on contributions and benefits are not only cumbersome and confusing, but remain inequitable.

Australia is unique in the world; it is the only country to tax the superannuation system (or the equivalent pension system) at three separate intervals: contributions tax, earnings tax and benefits tax. A simple and efficient approach to taxation of superannuation is to shift taxation of superannuation to the benefit stage. Contributions tax reduces compulsory superannuation contributions of 9% to a maximum net contribution of 7.65%. The contributions tax means there is no, or marginal, incentives or financial advantages for those on 15% or 30% personal income tax rates, once the lack of access and cumulative impact of taxes is removed.

With the removal of contributions tax, many of the complications associated with MDC limits would also be eliminated, as people would only be taxed on benefits, and at ordinary progressive personal income tax rates. Assessing and adjusting taxes when the actual level of accumulation is known would ensure greater equitability, as those people with similar wealth accumulation would be treated the same way regardless of the level and timing of their superannuation contributions.

Simpler tax treatment will encourage some Gen Xers and Gen Yers to save for the long-term through superannuation by providing a real incentive for voluntary superannuation contributions. A simpler superannuation system will also reduce costs associated with maintaining complex systems and administering and tracking many components within the fund. Increased contributions will in itself generate an even higher level of superannuation contributions, due to the compounding effect, that over the life of the fund will create a higher level of retirement income. The larger asset pool will also generate greater national savings with an increased capacity to meet the needs of Australia's ageing population. ABA considers that removing the contributions tax provides an incentive that is equitable and accessible. This incentive to greater superannuation savings does not need to consider capacity to save or rely on individuals' knowledge of the retirement income system.

In addition to the complexity of the taxation treatment of superannuation, MDC limits reduce flexibility that may be required to achieve retirement income adequacy. For some Australians, and increasingly so with younger generations where workforce participation has shifted from full-time employment to other forms of employment, broken work patterns may mean that in some years they are unduly restricted from making superannuation contributions, whereas in other years these same people may not be able to make contributions at all. Women are most likely to be affected by these restrictions, where they may seek to make additional voluntary contributions to make up for periods where they are out of the workforce.

Maximum deduction limits on contributions to complying superannuation funds by employers for eligible employees have applied since 1994/95. From 1 July 1997 age-based limits apply to determine the maximum deductible contributions that can be made by an employer on behalf of an eligible employee. The age-based limits are based on the 1994/95 limits indexed and increased for movements in AWOTE. The 2005-06 age-based limits for deductible contributions for those under age 35 is $14,603, for those under age 35-49 is $40,560, and for those above age 50 is $100,587.

Aged-based limits impose a restriction on the annual contribution that can be made where a tax deduction applies. Rather than imposing a lifetime cumulative limitation, age-based limits impose a restriction on contributions made during the year without regard for total contributions made. Age-based limits restrict the ability for particularly younger people to take advantage of making greater superannuation contributions when their personal incomes may allow greater flexibility in savings. This restriction especially disadvantages individuals that are subject to broken work patterns, where in some years these people will have capacity for additional voluntary contributions, but will have restrictions imposed preventing such contributions, and in other years may not receive contributions at all.

The impact of broken workforce participation on overall superannuation savings can be substantial. By way of example, using ASIC's online superannuation calculator, a woman that starts receiving superannuation contributions at age 25 and retires at age 6 5 with a salary of $52,000 should receive around $360,000. Whereas the same woman who has broken employment for 4 years due to family commitments commencing at around age 30 will retire with around $305,000. This difference of $55,000 is significant to the retirement savings of this woman[18].

Age-based limits do not allow flexibility for smoothing income over the lifetime of contributions. Furthermore, attempting to calculate the remaining contributions that may be made by an individual voluntarily after employer contributions have been made is not well known or understood. Therefore, ABA believes a lifetime cumulative limit, rather than age-based limits, would generate a higher level of superannuation contributions by smoothing the affects of broken work patterns and leverage greater voluntary savings.

Reasonable benefit limits (RBLs) apply to superannuation benefits. RBLs impose restrictions on the level of benefit that receives different taxation treatments, and in doing so operate to determine the maximum amount of superannuation benefits that a person is entitled to receive during an individual's lifetime on a concessionally taxed basis. There are two types of RBLs – lump sum RBL and pension RBL.

Since 1 July 1994, lump sum and pension RBLs have been a dollar amount. The 2005-06 RBL for lump sum payments is $648,946, and for pension payments is $1,297,886. RBLs do not limit the overall amount of contributions a person can make or benefits a person can receive, however where a person receives a lump sum b enefit which exceeds the lump sum RBL, the amount of the maximum limit is taxed as an excessive component. Similarly, where a person receives a pension or annuity which exceeds the pension RBL, the excessive part does not benefit from the 15% rebate and is taxed at marginal tax rates. Excessive components are calculated using particular rules, such as life expectation factors for pensions and annuities.

[18] ASIC's FIDO Superannuation calculator is based on a number of assumptions based on contributions made to an accumulation fund. http://www.fido.asic.gov.au/fido/fido.nsf/byheadline/Superannuation+calculator?openDocument

While these restrictions are intended to impose a limit of the level of benefit that can be paid, the restrictions also encourage people to take income streams rather than lump sum payments. ABA agrees that people should generally be encouraged to take income streams over lump sum payments; however, it is also important for individuals to have flexibility with their retirement incomes to tailor to their circumstances and needs. For example, increasing housing prices are likely to result in people having household debt (i.e. mortgages) as they enter retirement. ABA believes RBLs should be adjusted to better support a combination of lump sum and pension payments.

Imposing deduction limits and limiting access to the benefits of superannuation has created distinctions of treatment of people considered in different categories. More and more complexity has been added in an attempt to address some of the inequities arising from such distinctions. Complexity is a significant disincentive for those people with the capacity, and desire, to make voluntary superannuation contributions.

Not all Australians have access to the superannuation system. Contributions are deductible or non-deductible depending on the deduction rules for employees or self-employed. Deduction limits also apply to persons aged under 18. From 1 July 2002, individuals aged over 70 (but less than 75) can make personal superannuation contributions so long as they work at least, on average, a minimum of 10 hours per week. In addition, employees paid less than $450 per month (or $1350 per quarter) are not covered by the SG.

ABA commends Government for removing the work test, as eligibility to the superannuation system has been vastly improved[19]; however, further broadening access would likely generate a higher level of superannuation contributions, promote income streams and encourage transition from the workforce to retirement. ABA considers a simple approach to participation in superannuation is to allow anyone to make after-tax contributions. This approach would then not require an extension of the age limit for personal contributions and facilitate greater flexibility for the transition from the workforce to retirement.

With the substantial changes made over recent years to the legislative and regulatory framework for superannuation, Australians are unclear as to the affects that taxation and limitations may have on their contributions in the long-term. For this reason, individuals may seek alternative investments that may not have the same consumer protections, but provide greater flexibility and/or performance, such as self-managed superannuation funds (SMSFs) or high yield property schemes. ABA believes that removing up-front taxes, removing age-based contribution limits, adjusting RBLs to encourage greater flexibility in retirement incomes and broadening participation in the superannuation system will make the superannuation system not only easier to understand, but also more equitable and efficient.

4.3 Literacy

ABA supports the Government's efforts to address the financial literacy of consumers, in particular the establishment of the Consumer and Financial Literacy Taskforce and subsequent Consumer and Financial Literacy Foundation. The banking sector's strong commitment to promoting financial literacy amongst Australians is evidenced by former ABA Chairman and ANZ CEO, John McFarlane's CFLF membership and ABA member banks' financial literacy programs and advocacy of the importance of financial literacy.

[19] From 1 July 2004, individuals under age 65 may contribute to a superannuation fund even if they are not employed (i.e. removal of the work test).

ABA supports the Consumer and Financial Literacy Foundation's program of running an Australia-wide information and awareness-raising campaign, incorporating financial literacy programs in schools and workplaces, and setting up a one-stop website to serve as a portal for financial literacy education and information. Enhancing financial literacy and addressing lack of understanding with the superannuation system must form part of the Government's strategy to address the savings of people under age 40.

According to ANZ *Survey of Adult Financial Literacy in Australia*, only 37% of respondents had calculated how much they needed to save for retirement. Furthermore, many people have unrealistic expectations with 50% expecting to be living at least as comfortably in retirement as they are today[20]. While introducing curriculum in secondary schools will likely address financial literacy deficiencies of younger generations, Gen Xers and Gen Yers also need to better understand their savings and investment choices and become aware of the importance of planning early for their retirement.

According to IFSA research *Retirement Savings – Desires and Drivers*, many pre-retirees do not have a clear idea of when they would retire. Furthermore, it was identified that the median age at which people commence to consciously save for retirement is 45[21]. While prudent retirement income projections and realistic life expectancy tables are invaluable tools for consumers in understanding the implications of the impact of their savings and investment decisions on their standard of living in retirement, it is also important for individuals to have the skills to understand their pre-retirement lifestyle choices, attitudes to debt, savings capacities and access to other investments so that they can plan earlier and better for their retirement.

Many Gen Xers and Gen Yers have not, or will not, plan adequately for their retirement early enough. According to a CBA survey, 78% of pre-retirees knew little or nothing about the types and styles of investments in their superannuation and only one in seven consider planning for retirement a top priority[22]. Generally reasons given for not planning or saving for retirement include other financial commitments, inability to save, lack of disposable or discretionary income, disinterest in accessing financial advice, failure to think long-term and more immediate goals, general complacency or ill-conceived reliance on the adequacy of their superannuation savings.

Strategies for improving financial literacy should target those sectors of the community with the lowest levels of financial literacy, as improvements in financial literacy can result in lifestyle gains for individuals of all ages across the community[23]. The benefits of improved financial literacy are well-informed consumers, greater personal savings and investment opportunities, improved management of household debt and a reduction in the likelihood of periods of financial stress, decreased need for welfare or other government assistance, greater national savings and more efficient markets and increased personal economic security.

[20] *ANZ Survey of Adult Financial Literacy in Australia* commissioned by ANZ and conducted by Roy Morgan Research, May 2003. http://www.anz.com.au/aus/aboutanz/Community/Programs/FinLitResearch.asp

[21] IFSA/Chantlink and Associates research study on consumers' issues and concerns in relation to their finances during retirement. This project interviewed people aged 45-69. http://www.ifsa.com.au

[22] *Retire Ready* survey commissioned by the Commonwealth Bank of Australia and conducted by Newpoll, May 2004.

[23] Commonwealth Bank of Australia Foundation study of the economic and social impacts of financial literacy in Australia*. Improving financial literacy in Australia: benefits for the individual and the nation*. http://about.commbank.com.au

Recently ABA, IFSA and FPA released a financial literacy guide especially for superannuation in a choice environment: *Smarter Super: Make the most of Your Retirement*[24]. This publication seeks to explain some of the technical aspects of superannuation as well as provide some useful tips and suggestions so that individuals feel more confident about their superannuation savings. The Government's own booklet *Super Choices: Think about your future*, is also a useful tool for assisting consumers to make informed investment decisions about superannuation. 'Super Choice' is certainly an opportunity for raising awareness of the importance of superannuation at younger ages.

However, while consumer guides are useful in enhancing knowledge across the community, gaining access to professional financial advice is also important for consumers[25]. The financial services industry is constantly evolving with the introduction of new products and services and the legislative and regulatory setting of many elements of the Government's superannuation, taxation and social security policy is not well known or understood. It is vital that Australians are able to access information and advice that will assist them better understand how to get the best out of their superannuation and other private savings as well as better comprehend how external factors may impact on their superannuation savings.

Currently there are some anomalies in the system that do not encourage individuals to seek professional assistance in managing their superannuation savings. For example, current taxation arrangements inhibit incentives for financial advice relating to superannuation, such as individuals being unable obtain a tax deduction for advice on superannuation, while a deduction is available on non-superannuation investment advice. Taxation arrangements also inhibit fee-for-service financial advice and the ability for employers to provide retirement income planning for their employees; for example, FBT is levied on the cost of an employer paying for advisory services.

ABA suggests that disincentives for accessing financial advice should be removed through providing a rebate for those that seek professional financial advice in relation to superannuation and retirement income products. This approach would acknowledge through public policy the enduring importance of the service of financial advice. Financial literacy is the key to getting the most out of the superannuation system. Therefore, encouraging access to professional financial advice is particularly important not just for ensuring that individuals have access to information necessary for them to make a decision about savings and investments, but also for promoting financial literacy within the community.

The FSR disclosure reforms will develop consumers' understanding of their financial circumstances and the superannuation and retirement incomes system. Similarly, the 'Super

Choice' and portability reforms will likely encourage individuals to be more active with their superannuation savings. However, while the FSR disclosure regime and recent superannuation changes will promote greater awareness of the superannuation system, ABA believes that consumer education should also focus on basic budgeting skills and promotion of discretionary saving (both additional employer contributions from salary sacrificing and voluntary employee contributions).

Knowledge of superannuation and other private savings options, coupled with the capacity and incentive to save, will better promote a wider savings culture. A good level of financial literacy is essential for enabling individuals to be both aware of the decisions they need to make about retirement and to take sound decisions about matters such as when they will retire, how much they need (or want) for retirement, etc.

[24] http://www.bankers.asn.au/

[25] http://www.fido.asic.gov.au/asic/pdflib.nsf/LookupByFileName/Super_Choices.pdf/$file/Super_Choices.pdf

Australians are living longer, yet the trend is for earlier retirement; however, this is feasible only where sufficient savings are attained and available. Ultimately it is for the community to determine whether the retirement age for men and women should be increased beyond age 65. Certainly flexibility in the superannuation system should allow for improved management of postponing retirement, paying off a mortgage or increasing/supplementing retirement income. ABA commends the Government for its *Transition to retirement* policy measures that will allow transitional access to superannuation.

5. Superannuation: Improving savings for people under age 40

According to APRA, total estimated superannuation assets increased by 2.4% during the March 2005 quarter to stand at $710 billion, representing a 12.5% ($79.1 billion) increase from June 2004, largely due to strong investment performance for the three quarters to March 2005. Importantly, APRA report that during the quarter, of total contributions, 70.3% ($8.3 billion) were from employers, 27% ($3.2 billion) were from members, and other contributions made up 2.6% ($0.3 billion)[26].

While both contributions and superannuation fund investment performance have increased superannuation assets during the March 2005 quarter, APRA have indicated that it is mainly fund investment performance that has increased assets. While the real impact of recent changes to superannuation, social security and taxation policy will not likely be measurable until early next year, it is clear that from current data, employer contributions still make up a significant majority of all superannuation contributions.

Essentially, there are four factors that determine the level of retirement income and how much superannuation can be accumulated:

- When the person starts saving;
- The amount and frequency of deposits or contributions;
- The performance of the superannuation fund or other investment; and
- How long the person lives.

A number of these factors are outside the control of the Government. However, lifting superannuation contributions, promoting participation in the financial services industry, enhancing confidence in, and performance, of long-term superannuation savings and raising the profile of the importance of saving for retirement can be influenced by public policy. ABA considers that for the retirement savings gap to be closed, employees must start planning and saving for retirement much earlier, by increasing their contributions to superannuation and other private savings vehicles.

Incentives should seek to boost savings for those people that have the opportunity to save. Disincentives should be removed for those people that have the capacity and desire to save, but otherwise decide not to make additional voluntary contributions. Effective measures for improving the savings of Gen Xers and Gen Yers should be based on an understanding of the drivers and barriers for saving. However, g enerally current data on superannuation and asset values for people under age 40 is unknown[27].

[26] APRA (2005). *Statistics: Quarterly Superannuation Performance*. March 2005 (issued 14 July 2005). http://www.apra.gov.au

[27] NATSEM indicates that a household headed by a person aged 15-24 years typically has assets of just under $50,000. A household headed by a person aged 25-34 have seen their average accumulated savings decrease to $121,000 in June 2002 compared with $198,000 in 1993, representing a decline of 39%. However, average household wealth between 1993 -2002 grew by 3.9% each year. *Levels, patterns and trends of Australian household saving* commissioned by FPA and conducted by NATSEM, September 2002. p14.

ABA suggests that as part of this inquiry, the Government should conduct thorough analysis of current levels of superannuation savings, current consumption and expenditure rates and expected retirement incomes for people under age 40. ATO and/or Treasury data could be useful in gaining a better understanding of current savings and therefore identify incentives for closing the retirement savings gap.

Notwithstanding the absence of critical data regarding savings of people under 40, ABA believes there are three broad policy areas that will further assist in improving superannuation savings: *adequacy*, *simplicity* and *literacy*.

5.1 Adequacy

Reforms should be made to enhance individuals' financial independence and improve the standard of living for people under the age 40. ABA considers the Senate Select Committee's finding that the goal for an adequate level of retirement income should be around 65% of pre-retirement income provides a reasonable target for retirement income. Efforts should continue to focus on closing the retirement savings gap by encouraging a savings culture, with Generation X and Generation Y cohorts establishing financial goals and planning for retirement earlier.

ABA believes that initiatives which focus on extending co-contributions, increasing voluntary contributions and enhancing long-term wealth accumulation may be useful for the Government to consider in improving incentives for long-term superannuation savings.

5.1.1 Co-contributions

ABA believes that the Government should extend the Government superannuation co-contribution to allow greater access for the vast majority of Australians that are low to middle income earners[28].

Some options for the Government to consider include:

- Extend access to co-contributions for low to middle income earners by pegging the maximum co-contributions threshold to the 30% personal tax rate ($63,000 for 2005-06) thereby providing greater incentive for superannuation savings.
- Extend access to co-contributions for low to middle income earners by rescaling phasing-out (currently 5 cents for every $1000) so that more low to medium income earners can gain access to the full co-contribution thereby providing greater incentive for superannuation savings.
- Remove work test for superannuation co-contributions (i.e. permit access for self-employed) thereby broadening access to the Government co-contribution for low to medium income earners.

Currently the superannuation co-contribution is available for people that earn up to a maximum of $58,000 assessable income per year. For every $1 of voluntary employee contribution, the Government will contribute $1.50 for income up to $28,000 and phasing out to the maximum threshold.

5.1.2 Voluntary contributions

ABA believes that the Government should encourage additional voluntary standard employee contributions of between 3-6%. Those people that have access to co-contributions currently have an incentive to make additional voluntary superannuation contributions. For those people with a 42%+ marginal tax rate, salary sacrifice provides advantages for additional voluntary superannuation contributions; however, not all employees have access to salary sacrifice. Therefore, ABA suggests that the Government consider conducting thorough analysis of the impact on Government revenue of providing tax deductions for additional voluntary standard employee contributions. Tax deductions would not be available for co-contributions. This approach would provide an incentive to those middle income earners that are not eligible for co-contributions.

5.1.3 Long-term wealth accumulation

There is a strong tendency for Australians to concentrate on saving a deposit for a home before shifting their attention to other private savings and investment vehicles. ABA acknowledges that home ownership may be an impediment to additional voluntary superannuation savings. Proposals made in the past have considered the possibility of earlier restricted access to superannuation savings, "guaranteed" leverage from superannuation savings into other investments or medium term savings vehicles as a way of encouraging superannuation savings without compromising other spending priorities
(i.e. home ownership).

ABA is concerned that using superannuation savings to, for example, contribute to a mortgage, would likely be practically and administratively cumbersome and also compromise the intent of preservation of superannuation for retirement. Nevertheless, a *s* home ownership contributes to retirement income wealth accumulation, ABA believes that a better understanding of the inter-relationship between home ownership, superannuation and private savings is required to assist in formulating real incentives for long-term savings of people under age 40.

ABA suggests that the Government conduct thorough analysis of the impact of home ownership on superannuation and other private savings, including assessing the benefits and costs of possible approaches to leveraging into other forms of long-term wealth accumulation, where this shift in superannuation policy does not compromise the Government's retirement incomes policy.

5.2 Simplicity

Measures should seek to reduce the complexity of the superannuation and retirement incomes system so that consumers have greater confidence in, and understanding of, methods of private savings and performance of superannuation savings. Furthermore, better integration of superannuation, social security and taxation systems will promote enhanced superannuation savings and other private savings.

ABA believes that rationalising legislative restrictions and taxation treatments within the superannuation system would remove significant disincentives for greater superannuation savings.

5.2.1 Legislation

ABA believes that the legislative and regulatory framework for the superannuation system is far too complex and restrictive. Superannuation is a long-term investment; therefore, legislative changes and limitations impact on the security, certainty and confidence in the performance of superannuation.
Some options for the Government to consider include:

Conducting thorough analysis of the impact of contribution and benefit limits on long-term superannuation savings, including the affect on long-term superannuation savings of applying only a lifetime cumulative limit; with a view to removing age-based limits on annual contributions.

Adjusting RBLs to encourage income streams rather than lump sum payments, or a combination of income stream and lump sum payments, as appropriate.

Broadening access to superannuation, including removing differences in taxation between employed and self-employed.

Removing rules that exclude non-superannuation monies from retirement income stream products, thereby enhancing retirement savings.

5.2.2 Taxation treatment

ABA believes that the Government should encourage greater contributions during the accumulation phase with the aim of enhancing long-term individual and national savings for the benefit of all Australians. ABA suggests that the Government conduct thorough fiscal analysis of the impact of front-end taxation of superannuation, including the affect on long-term superannuation savings with the removal of contributions tax, as well as changes in current Government revenue and future fiscal position, national savings and expenditure; with a view to removing the 15% contributions tax and shifting taxation to the benefit stage.

5.3 Literacy

Strategies should acknowledge the differences across the Generation X and Generation Y cohorts to ensure that savings messages are effective. Improving individuals' knowledge of superannuation and other private savings vehicles is essential in developing a savings culture.

ABA believes that collaboration between the Government, the financial services industry and the community is required to promote long-term superannuation and other private savings through better consumer education and financial literacy.

Some options for the Government to consider include:

Conducting thorough analysis of the drivers and barriers for saving by people under age 40, thereby identifying how savings messages may best target Generation X and Generation Y cohorts.

Providing Australians with a greater understanding of investment and savings through initiatives, such as the Consumer and Financial Literacy Foundation, aiming to promote the benefits of sound budgeting and early planning for retirement.

Enhancing access to professional financial advice by providing a rebate for financial advice on superannuation; thereby removing anomalies between access to superannuation and other investment planning.

6. Private savings: Supporting retirement incomes for people under age 40

ABA considers that while superannuation forms a vital part of retirement incomes, other private savings are equally as important. Self-provision in retirement should be the aim of strategies for enhancing financial independence and retirement income adequacy. ABA believes that part of improving retirement income adequacy, incentives for private savings as well as for superannuation should promote long-term savings and address current inequities between particular financial services and products.

Encouraging diversified pre-retirement savings and post-retirement incomes (cash, securities, real property) will supplement superannuation savings and enable greater financial independence and a higher standard of living in retirement.

Improving the private savings environment will also reduce future fiscal pressure of Australia's ageing population.

Protecting retirement incomes

Financial stress can contribute to higher levels of household debt and lower levels of household savings. Therefore, addressing the drivers for financial stress, such as the loss of a job or the loss of a family member providing supporting income can provide improvements in long-term private savings for Australian families and individuals.

Therefore, ABA suggests that the Government consider strategies for supporting the financial services industry in developing alternative savings vehicles and risk products for increasing national savings to assist long-term savings for the purposes of sustaining retirement incomes and managing age-related expenditure. For example, the Government could introduce a rebate for those people that invest in life insurance (i.e. death and disability cover) or other risk products (i.e. income protection cover), etc. Furthermore, anomalies in tax treatment could be removed, such as FBT on life insurance cover offered to employees by their employers.

Enhancing alternative superannuation savings

Currently there are differences between how managed investments, superannuation and self managed superannuation funds (SMSFs) are licensed and regulated. Unlike managed investments where licensed financial advisers provide advice to consumers, unlicensed practitioners, such as accountants, often promote SMSFs. Advice given by a registered tax agent is not financial product advice if the advice is given in the ordinary course of activities and is reasonably regarded as a necessary part of those activities. Accountants have a number of exemptions where they may not be required to hold an Australian financial services licence.

While SMSFs provide an alternative superannuation vehicle for some people (such as individuals that have the time and skill to manage their own superannuation savings and meet the “trustee” obligations contained in the SIS Act), those people that seek ‘advice’ on SMSFs may not have the same consumer protections awarded to those people that seek ‘advice’ on other managed investments or superannuation vehicles (e.g. training and competence standards set out in PS 146 may not be met).

Essentially, SMSFs are a product designed to hold financial assets for retirement, therefore regulation should be product neutral. This approach will ensure that the prudential and conduct of business framework (including sound investment strategy and quality of financial advice) is maintained and SMSFs, as an alternative superannuation vehicle, can continue to grow as a viable savings vehicle for retirement. Given the rapid growth of these superannuation vehicles over recent years, ABA suggests that the Government conduct an assessment of the regulatory treatment for SMSFs to ensure funds are prudentially and safely invested.

7. Conclusion

Over the past decade household assets held in superannuation funds has grown to be the second largest component of household wealth in Australia, after home ownership[29]. Nevertheless, a retirement savings gap still exists between the aspirations and expectations of Gen Xers and Gen Yers for their standard of living in retirement with what the present system will actually deliver. Significantly, Australians are likely to achieve outcomes lower than in comparable OECD countries. Therefore, it is important for demographic, social, economic and financial factors to be considered in the design of public policy strategies for improving the superannuation savings of people under age 40.

ABA believes that:

Adequacy of retirement incomes should be a public policy priority. At least 3% additional contributions are necessary for Gen Xers and Gen Yers (and across younger generations) to achieve adequate retirement income levels. For the broad group of low to middle income earners, where the bulk of the adequacy problem lies, an additional 5-6% contribution will be necessary.

Improving incentives for greater self-reliance through additional voluntary contributions is important. Incentives should be equitable and sustainable, and should not create further anomalies. Incentives should be built on thorough analysis of the drivers and barriers to saving for people under age 40.

It is equally important to remove disincentives for superannuation contributions and other private savings. Removing the complexity of the legislative framework for superannuation should be a public policy priority. A less cumbersome system will be of benefit to all ages.

Simplifying the retirement income system will give Gen Xers and Gen Yers greater confidence in, and understanding of, the performance of their superannuation savings and other private savings. Removing structural impediments for superannuation should be coupled with greater emphasis on consumer and financial literacy programs.

The present 'three pillar' structure of the retirement income system must be maintained and enhanced. Additional pillars should supplement the retirement income system, including support for the financial services industry in developing better targeted and innovative retirement income and risk products; formal recognition and promotion of part-time work as a transition from work to retirement; and acknowledgment of the importance of home ownership as part of Australians wealth accumulation.

Strategies for making savings relevant (thereby raising long-term savings) for people under age 40 must consider capacity to save, incentives for superannuation and knowledge of the retirement income system.

ABA believes financial independence, financial security and a better lifestyle in retirement should not be unattainable for Gen Xers and Gen Yers, despite some significant changes in saving capacities and attitudes to saving and investing. However, it will take a multi-dimensional approach from the Government, financial services industry and the community to ensure that all Australians take responsibility for their savings early so they are well prepared for retirement. Such a multi-dimensional approach should involve strategies to promote confidence in the retirement incomes system by addressing three broad policy areas: *adequacy*, *simplicity* and *literacy*.

Connolly, E, Kohler, M (2003). *The Impact of Superannuation on Household Saving and Wealth*. Economic Research. Reserve Bank of Australia. June 2003.

8. Appendix 1:

The following data has been extrapolated from social trends information available from the Australian Bureau of Statistics (ABS).[30]

8.1 Demographic and social trends

Lifecycle stages

Generation X is tending to behave differently compared to the previous generation. According to AMP/NATSEM, between 1989 and 1999, the behaviour of people aged 25-39 has changed in terms of lifecycle stages and lifestyle choices. Some of the main characteristics of Gen Xers include:

Couples delaying/deciding not to have children: 18.5% are a couple with no children (compared to 13.7%); 48.6% are a couple with children (compared to 61.0%)

Singles tending to live alone: 8.9% are single (living alone) (compared to 6.6%); 6.4% are sole parents (compared to 4.8%)

Living at home longer: 9.2% live in the parental home (compared to 6.4%)

Living in shared accommodation: 6.0% live in shared house (compared to 5.5%)[31]

Younger people are tending to live in the parental home longer, delaying marriage and delaying or deciding not to have children. This means that initial living costs may be reduced, but these savings are offset by other expenses that are increasing, such a s higher education and housing, which are both increasing above CPI. In addition, consumption and expenditure of younger people is increasing.

With the delay in having children and increases in life expectancy rates, Gen Xers and Gen Yers are likely to have demands on their savings from ageing parents (health and aged care), maturing children (living in the parental home) and their own age-related needs as they approach retirement themselves. Improved life expectancy rates and greater demands on savings and investments will necessarily lead not only to longer workforce participation, but shifts in family structures and responsibilities.

Education participation rates

In 2001, about one-fifth (21%) of people aged 25-29 years held a higher education qualification. The proportion of young people aged 20-24 years with higher education qualifications was lower due to them still studying (see Figure 1). Young women aged 2024 years were more likely to have higher education qualifications than men of the same age, 25% and 18% respectively.

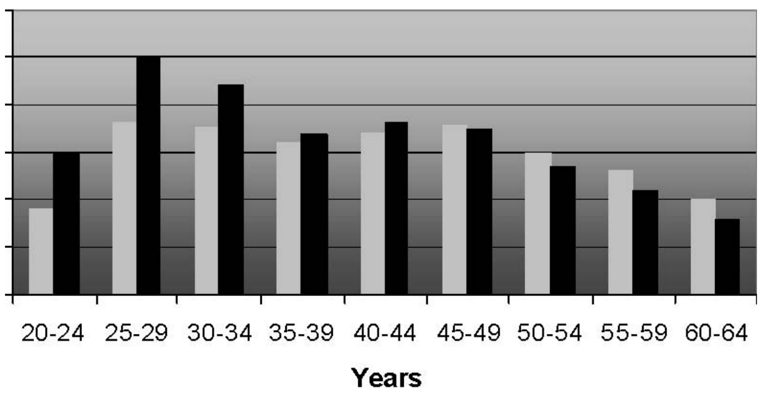
[30] http://www.abs.gov.au/Ausstats

AMP/NATSEM (2003). *Generation Xcluded: Income and Wealth of Generation X*. Income and Wealth Report Issue 6. November 2003.

Figure 1: People with Higher Education Qualifications as a Proportion of Age Groups (2001)

30 25 20 **$** 15

10 5 0



Females

Males

Source: ABS 2001 Census of Population and Housing

Generation X is the most highly qualified generation ever, with a high proportion of women attaining tertiary or higher education qualifications. However, some Gen Xers and many Gen Yers that attain such qualifications will enter the workforce later and also with a HECS debt[32]. In 2002, almost four-fifths of HECS-liable university students in Australia deferred their payment. Given that the HECS liability is taken out of additional tax contributions when the student earns over a particular personal income threshold and lump-sum payments receive a discount, paying off an education-related debt generally takes precedent over building savings.

Home ownership

Traditionally Australians have held aspirations of owning their own home. Indeed for many Australians the purchase of their home will be the largest purchase (or investment) they ever make. However, home ownership rates for Gen Xers is declining, with 64.0% of people aged 25-39 in 1989 and 54.0% in 1999 owning their home.

Between 1986 and 1996 the decline in home ownership among younger people occurred mainly due to the period of recession and higher interest rates. Between 1997 and 2003 during the period of recovery, the price index for established houses rose steeply, by 71%. Therefore, home ownership rates for Gen Xers have not been as high as for the previous generation.

[32] The Higher Education Contribution Scheme (HECS) was introduced in 1989. Most students must make a contribution towards the cost of their tertiary education. Students have a choice of paying their contribution up-front, and receiving a discount of 20%, or deferring payment by taking out a loan from the Federal Government. Deferred HECS payments are reimbursed by additional tax contributions when the student earns in excess of $36,184 for 2005–06. HECS was changed on 1 January 2005 to the Student Learning Entitlement (SLE) and HECS-HELP arrangements.

Figure 2: Age Distribution of Home Owners and Purchasers(a) (1981 – 2001)

25 20 15

%

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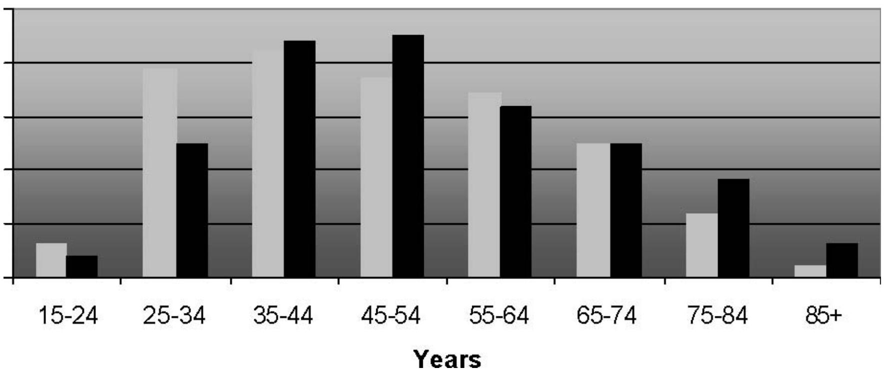

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1981 2001

(a) Based on the age of the household reference person in the dwelling.

Source: ABS 2001 and 1981 Censuses of Population and Housing

The past few years of strong growth in the property sector is mixed news for the private savings of Gen Xers and Gen Yers. For those people that already own homes, an increase in house prices represents an increase in personal wealth. However, for those people looking to purchase their first home, a larger investment will be required. Generally, home ownership is being deferred, as demonstrated through the shift to renting for people under age 40 (see Figure 2).

But as home ownership remains an important component of wealth accumulation for many Australians, delayed home ownership coupled with increasing asset prices means Gen Xers and Gen Yers are likely to enter retirement with a substantial mortgage. This will impact on how retirement incomes will be accessed, whether that is via lump sum payments, income streams or a combination of both. On the other hand, the absence of home ownership in retirement will impact on the level of post-retirement income required. Many of the scenarios used to estimate retirement income adequacy assumes home ownership. If this is not the case, additional income will be required to cover rental expenses.

The main demographic and social trends for people under age 40 include:

1 Delaying having children (or not having children)
2 Living longer at home, but then working longer and living longer
3 Attaining higher education qualifications
4 Delaying home ownership

8.2 Economic and financial trends

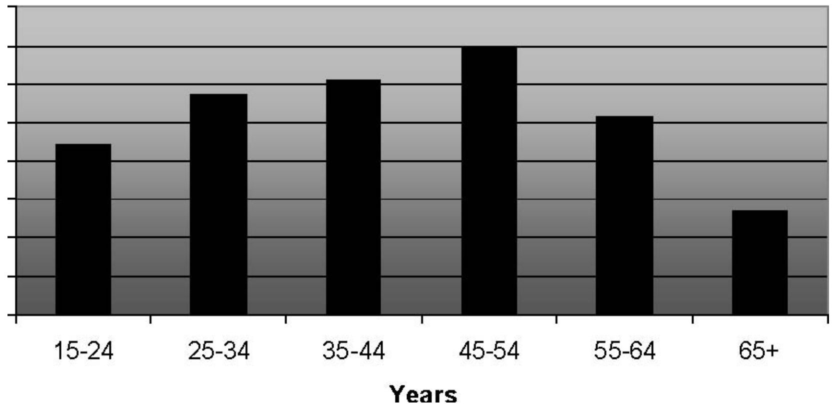
Personal income

Many people enter the workforce for the first time between the ages 15-24 years. Between 1984 and 2004, the workforce participation rate for all people aged 15 years and over increased slightly (from 60% to 63%), as did the workforce participation rate for those aged 25-34 years (from 74% to 80%).
Over the same period, average weekly ordinary time earnings (AWOTE) for male employees increased by 54%, from $648.70 to $1,000.70; while AWOTE for female employees increased by 56%, from $546.70 to $851.00. However, in 2004, females earned 85% of the male average weekly earnings; although when this figure is adjusted for earnings and hours, women earned 66% of total earnings of men. Given that women are also more likely to have broken work patterns, pre-retirement income level significantly impacts on the level of post-retirement income.

In March 2005, according to the ATO, AWOTE was $992.90[33]. Notwithstanding increases in AWOTE for both men and women, AWOTE may not be the best measure for considering the personal income of Generation X and Generation Y cohorts. The range of income levels across the population is in part a reflection of the different lifecycle stages that particular people are at. Generally, compared to older employed people, younger people have lower income earning capacity, reflecting lower levels of work experience, skills or education. In 2002, according to ABS data, people aged 15-19 years had the lowest mean weekly earnings of all full-time employees, $395 compared with $854 for full-time employees aged 25-34 years (see Figure 3).

Figure 3: Mean Weekly Income by Age (2002-03)

1600 1400 1200 1000 **$** 800 600 400 200 0

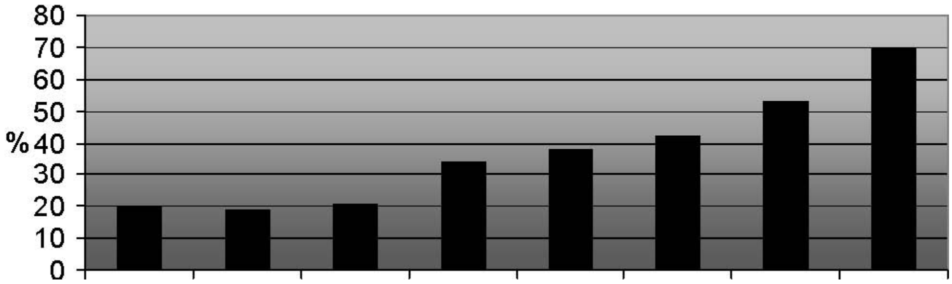


Source: ABS Household Income and Income Distribution (Cat 6523.0)

However, people with tertiary or higher education qualifications tend to gain higher personal incomes (see Figure 4). With the increase in education participation rates for Gen Xers and Gen Yers, personal income is likely to be higher than the previous generation over the long-term. This shift is certainly reflected in the general narrowing of the income distribution gap for people age 25-34 and 35-44 over the past 7 years. People with tertiary or higher education qualifications were also less vulnerable to unemployment during the economic downturn of the early 1990s, when the unemployment rate for people without higher education qualifications increased more rapidly and to a greater extent.

[33] http://www.ato.gov.au

Figure 4: People with Higher Education Qualifications as a Proportion of People in Selected Income Brackets(a) (2001)



300-400-500-600-700-800-1000-1500+ 399 499 599 699 799 999 1499

Weekly income ($)

(a) People aged 20-64 years who were working full-time.

Source: ABS 2001 Census of Population and Housing

Despite the long-term advantages of job security and income level for people with higher education qualifications, in the short-term delayed workforce participation and HECS debt means lower initial personal income, limiting an individuals' ability to save and invest.

Workforce participation

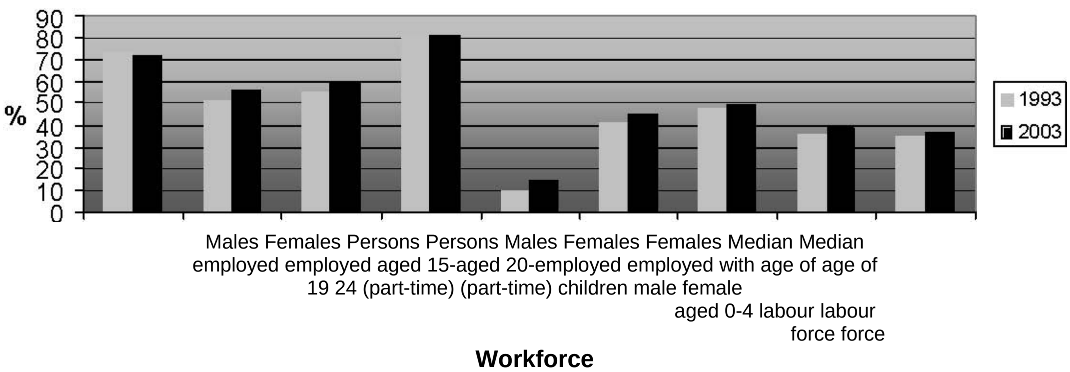
Regardless of sustained low national unemployment figures, overall employment stability and higher education participation rates for Gen Xers and Gen Yers, major shifts between full-time employment and other forms of employment for younger people has occurred.

In 1983, less than one-fifth (18%) of employed people aged 15-24 years were employed on a part-time basis. By 2003, this had risen to almost a half (46%). Similarly, casual employment for younger people has also increased. In 1993, 22% of employees were casual, compared with 26% in 2003. Of these casual employees in 2003, two-fifths (40%) were aged 15-24 years. The significant increase in part-time and casual work does not reflect necessarily increased participation, but does reflect a change in employment dynamics from full-time to part-time and casual work.

Women are more likely to work part-time than men. In 2003, almost half (46%) of employed women worked part-time compared to 15% of men. The proportion of part-time work has increased for both women and men (see Figure 5). However, the increase in the proportion of casual employees is due mainly to changes for men rather than women. The proportion of male employees who were casual increased over the period 1993 to 2003 (15% to 21%), while the proportion for women remained relatively stable over the same period (30% to 31%).

Participation of women in the workforce is increasing, especially in part-time work, but so is the participation of women in the workforce with children. In 2003, almost half (49.5%) of women with children under four years were also working. This increase is also reflected with the increase of children aged under four years spending time in formal child care (such as long day care, family day care, occasional care or preschool) (see Figure 5). Both men and women are working longer, with an increase in the median age of workforce participation.
Changes in the pattern of full-time and part-time or casual employment undertaken by younger people tends to be correlated with the increased participation in tertiary or other higher education (non-compulsory education) and the growing trend to combine work with study as well as the growing trend to combine work and family, especially for women. In 2003, of part-time workers aged 15-19 years, almost four-fifths (79%) were studying full-time, and over half (55%) of part-time workers aged 20-24 years were studying full-time.

Figure 5: National Summary of Workforce Participation (1993-2003)



Source: ABS National and State Workforce Summary

However, not all younger people working part-time are necessarily doing so by choice (i.e. completing studies, having children, etc). Some are working part-time as longer hours or full-time positions are not available. In 2003, 12% of part-time workers aged 15-24 years were actively seeking more hours of work, and were available to work more hours. Similar levels are receiving government assistance.

In the 12 months to February 2002, 19% of 15-19 year olds had changed jobs, but the 2024 year age group were the most mobile, with 26% changing jobs in the previous 12 months. The level of job mobility tends to decrease after the mid-twenties, with 20% of people aged 25-34 years having changed jobs in the previous 12 months. Some of this trend can be explained through the correlation of those working while also studying and therefore may not have held a professional career job. However, the career long position held for 30+ years is certainly not a characteristic of Gen Xers or Gen Yers, as was prevalent in the previous generation.

The shift from full-time to other forms of employment amongst Gen Xers and Gen Yers, such as broken work patterns (i.e. non-continuous full-time employment), emergence of casual forms of employment (i.e. consultants) and job mobility all have an impact on superannuation and private savings patterns.

Private savings and investments

Wealth accumulation of Gen Xers and Gen Yers reflects changes within the financial services industry, including deregulation, which has led to better access to innovative and competitive products and services; for example, younger people have greater access to diversified portfolios and direct share ownership. Growth in managed investments, including in vehicles such as investor directed portfolios, is evidence of an increased awareness of saving and investment options for some Generation X and Generation Y cohorts.
However, Gen Xers have tended to consider superannuation as a separate asset class; an investment that they do not have much influence over. The compulsory nature of superannuation contributions, and until recent inability to have choice of fund, may have been drivers for such attitudes. However, the introduction of 'Super Choice' and portability is likely to have a significant impact on attitudes towards superannuation as a secure and flexible investment vehicle, with individuals likely to be more active with, and better able to manage their superannuation savings.

Notwithstanding, one of the 'pillars' of wealth accumulation in Australia remains housing, despite falls in home ownership rates for Gen Xers and Gen Yers. Estimated household wealth is still dominated by equity in the home. In 2002, of all households, 16% had less than $100,000 equity in their home and at the other end of the range, 10% had $400,000 or more equity in their home, with the majority of households holding several hundred thousand of equity in their home. Of these same households, about half the households with people in the lowest income quintile have less than $1,000 in cash savings and no other investments. However, in this instance, high personal income and high wealth accumulation are not necessarily correlated. 8.6% of households with people in the highest income quintile also have less than $1,000 in cash or other investments, while 14% of those in the lowest quintile had savings and investments in excess of $50,000. Importantly, wealth through home ownership is 'locked up' being accessed usually only in later life.

Different lifecycle stages and lifestyle choices influence wealth accumulation; for example, many retirees may have low income but substantial savings; whereas younger people may have high income, but have not yet acquired investments due to other expenditure priorities, such as higher education, overseas travel, entertainment, etc. Changes in banking lending practices acknowledge the 'buying-power' of younger generations; for example, low deposit home loans. According to AMP/NATSEM, in June 2 003, the estimated average personal wealth accumulation of Gen Xers was about half that of the 'Baby Boomers'[34].

The main economic and financial trends for people under age 40 include:

1. Increasing AWOTE, but also increasing inflation and asset prices
2. Gaining higher education qualifications leading to long-term higher personal income
3. Shifting between full-time employment to other forms of employment (including broken work patterns)
4. Increasing workforce participation by women, but also increased participation of women with children leading to greater part-time employment and higher child care costs
5. Increasing asset prices, but also increasing equity in housing (however, wealth tends

to be 'locked up' until later life)

6 Increasing direct share ownership, but greater exposure to market volatility

7 Savings diversification and greater access to managed or investor directed financial products

8 Increasing consumption rates and changing attitudes (and access) to opportunities to spend disposable or discretionary income on overseas travel, recreation and entertainment

[34] AMP/NATSEM (2002). *The Income and Wealth of Older Australians: Trends and Projections.* Discussion Paper 56. February 2002.