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SUBMISSION 40

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ASIC
Australian Securities & Investments Commission

Level 18, No.1 Martin Place, Sydney
GPO Box 9827 Sydney NSW 2001
DX 653 Sydney

Telephone: (02) 9911 2000
Facsimile: (02) 9911 2333

23 August 2005

Bev Forbes
Committee Secretary
Standing Committee on Economics, Finance and Public Administration
Department of the House of Representatives
Parliament House
Canberra ACT 2600

Dear Ms Forbes

Inquiry into improving the superannuation savings of people under age 40

I refer to your letter of 6 June 2005 addressed to ASIC Chairman, Jeffrey Lucy, inviting ASIC to respond to the above inquiry. ASIC is happy to be consulted and Mr Lucy has asked me to respond on his behalf.

ASIC's role

ASIC is the national consumer protection regulator for financial services, including superannuation. We are responsible for administering, amongst other things, the *Corporations Act 2001* and the *Australian Securities and Investments Commission Act 2001*. In relation to superannuation, our role is protect consumers by:

- administering the requirements about what information must be disclosed to consumers about superannuation products (primarily through the Product Disclosure Statement);
- administering the licensing regime, conduct and dispute resolution requirements for any person providing financial services in relation to superannuation, such as giving financial product advice;
- administering the general prohibitions against misleading and deceptive conduct, and other unfair practices;
- providing comprehensive consumer education and information about superannuation to help consumers make informed decisions.

Together with the Treasury and the Tax Office, ASIC played a key part in developing and delivering the Australian Government's public information campaign about the new choice of superannuation fund initiative, which came into effect on 1 July. In particular, ASIC prepared *Super Choices* the main Government resource about super choice for consumers. ASIC will be closely monitoring compliance by the financial services industry following the introduction of super choice.

General comments

Our response to this inquiry is based on ASIC's regulatory role and our experience of consumer education in superannuation. We have also drawn on a range of recent research reports about consumers' attitudes towards and experience of superannuation.

It is not clear whether the inquiry is limited only to making recommendations for boosting the voluntary superannuation contributions of under 40 year olds within the current superannuation system, or whether the committee has a mandate to recommend law reform. For the most part, we have focussed on the current system of superannuation in this response and in addressing the specific criteria detailed in the inquiry's terms of reference.

Before doing so, however, it is important to make some general observations about the target group. These observations are based on research commissioned by ASIC and other published reports. We recommend that the Committee study these and other research reports to fully understand the attitudes of this group towards money generally and saving for retirement in particular. We also recommend that the Committee consider commissioning further research in this area, as most studies have focussed on the retirement phase rather than the accumulation phase of superannuation. We would be happy to talk to the Committee about this further.

Most importantly, it is important to recognise that the "under 40s" are not a homogenous group and comprise at least two generational cohorts (commonly known as generation X and generation Y). The diverse attitudes, views and opinions of these cohorts need to be taken into account. A number of research studies have looked into this. For example, AMP/NATSEM found in their research that there was enormous diversity within the generation X group.

In terms of spending patterns, the research suggested that generation Xers were consuming rather than trying to build wealth (for example, by increasing home equity).[1] Similarly, research conducted by CPA Australia/Newton Wayman Chong found that amongst generation X and Y, many people saw saving as something that will be done in the future. They believed they would be responsible for saving for their own retirement, but also believed it to be a difficult task.[2]

ABS census statistics show that income levels for under 40s vary widely, including a significant proportion of people who report negative or nil, or very low, weekly

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[1] AMP/NATSEM *Income and wealth of Generation X: Generation Xcluded* November 2003

[2] CPA Australia/Newton Wayman Chong *Debt and the X & Y Generation* June 2004

income.[3] For many younger people therefore, making additional voluntary contributions is unlikely to be an affordable or attractive option.

When looking at improving the superannuation savings of under 40s – at least in terms of increasing the amount of money voluntarily contributed by this group – the committee should consider the other competing financial priorities of this group, and how they may be different to older Australians – regardless of income levels. For example, research conducted by the ING-Melbourne Institute into household savings and investment found that under 45 year olds carried significantly higher levels of debt relative to over 45 year olds.[4] The main sources of debt for under 45 year olds were mortgages, credit cards and bank loans, HECS debts and car finance. In each category, the under 45 year olds had a greater level of debt than over 45 year olds. People over 45 years old were also less likely to have any debt than people under 45.

Gender also has an affect on how much superannuation savings people accrue. Research conducted by ASFA found that women are less likely to have superannuation than men across all age groups and for those women who do, their average account balance at retirement is around half that of men. Women are disadvantaged by having higher rates of both part-time work and time out of the labour force to raise children or to undertake other family responsibilities.[5]

In relation to Indigenous Australians, the Committee may already be aware that the superannuation guarantee is not payable on payments made to Indigenous people employed under a CDEP (Community Development Employment Projects) scheme. CDEP is a significant feature of labour force participation by Indigenous people, particularly, but not exclusively, sparsely settled regions[6]. As at June 2004, there were over 36,000 CDEP participants.[7] Indigenous case workers have put to ASIC that that expanding the superannuation guarantee to include CDEP payments would significantly improve the superannuation savings of many Indigenous people (approximately 80% of whom were under 40 years old, compared to approximately 56% of the non-Indigenous population in 2001).[8]

Turning now to the 3 criteria listed as part of the inquiry's terms of reference, ASIC makes the following comments and observations.

Barriers and/or disincentives to contribute to superannuation
Our research and experience suggests there are a number of factors that act as barriers or disincentives to contributing to superannuation.

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[3] ABS *Census of Population and Housing* 2001 and *Understanding and improving data quality relating to low-income households,* David Johnson and Rosanna Scutella, April 2005, Department of Family and Community Services

[4] ING-Melbourne Institute Household Savings and Investment Report, March Quarter 2005

[5] "Why can't a woman be more like a man – gender differences in retirement savings", Ross Clare, ASFA, November 2004

[6] ABS *Census of Population and Housing,* August 2001

[7] Steering Committee for the Review of Government Service Provision 2005, *Overcoming Indigenous Disadvantage: Key Indicators 2005,* Productivity Commission, Canberra, July 2005

[8] ABS *Experimental Estimates and Projections, Aboriginal and Torres Strait Islander Australians,* September 2004

Research by the ING-Melbourne Institute found that while the most popular reasons for hesitating to invest further in superannuation included a preference for spending the money, a desire to pay off debt and a belief that the returns are inadequate, overall there was no one clear reason for Australian households' reluctance to invest further in superannuation. [9] This research also found that there was evidence a significant portion of respondents did not regard superannuation as a form of saving. The ABS found the most common reasons given for not making personal contributions were "Cost/Cannot afford to" (37%) followed by "Have not bothered/Never thought about it/not interested" (17%).[10]

Research commissioned by IFSA, which included both pre-retirees and recent retirees, identified the following barriers to contributing more to superannuation: lack of available funds, super rules are too complex, government keeps changing rules and may change them again, and apathy.[11] Conversely, participants believed the positive attributes of compulsory superannuation were: easy to contribute to, requires little decision-making, enforced saving that may otherwise not occur given other financial spending needs, appears safe, and is "locked away". From this research, we can conclude that people are unlikely to engage with something voluntarily if it is difficult to understand or the steps required to contribute are onerous.

Behavioural economists have identified complexity and choice overload as barriers to encouraging people to take an active role in managing their retirement savings. For example, Mitchell and Utkus conclude:

> "It is because retirement saving decisions are at least an order of magnitude more complex than other economic decisions, that people need help. The thought process requires a sequence of critical savings and investment decisions over a lifetime, backed by a complex and ongoing forecast of needs and resources. It should not be surprising, then, that for a substantial segment of the workforce, this task proves daunting and discouraging. And for some people, the problem may be so complex that they are forced to rely on decision heuristics that simplify decision-making, but may not necessarily produce appropriate outcomes. While much has been learned, a central question remains: how can the various stakeholders strike the best balance between encouragement and compulsion? What system can both preserve participant decision-making while offering limits on choice, so as to encourage the outcomes that rational and forward thinking consumers would want for themselves?"[12]

Young people are at a particular disadvantage in overcoming these barriers due to the greater length of time between their savings decisions and their actual retirement.

Clark-Murphy et al studied a sample of Australians presented with a specific, real retirement savings decision: whether to remain in a defined benefit fund or change to a defined contribution plan.[13] In all, 61% of the sample found the decision difficult. Those aged under 55 reported a higher level of difficulty than those aged over 55. Four broad causes of difficulty were identified:

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[9] ING-Melbourne Institute Household Savings and Investment Report, March Quarter 2005

[10] ABS Catalogue 6360, Superannuation: Coverage and Financial Characteristics, April to June 2000, released May 2001

[11] Chant Link & Associates for IFSA, Retirement savings – desires and drivers, 2000

[12] Mitchell, O and Utkus, S (2003) *Lessons from Behavioural Finance for Retirement Plan Design.* Pension Research Council, Philadelphia.

[13] Clark-Murphy, M., Kristofferson, I. & Gerrans, P. (2002) *What Makes Superannuation Decisions Difficult?* International Journal of Business Studies, 10(1), 73-94.

1. uncertainty/risk (38%)
2. information/knowledge (32%)
3. nature of the decision/time effect (22%)
4. emotion (8%).

Nature of the decision/time effect was the top concern for those aged 18-34 and *uncertainty/risk* and *information/knowledge* were equally the top concerns for those aged 35-44.

Those whose decision was to not make a decision (ie to remain with the default option) had particular trouble with *information/knowledge* and *emotion*. Principal emotional responses were frustration, lack of control and distrust of the super system. Some participants felt the information available to them was ambiguous.

Recent research we conducted into self-managed superannuation funds suggests a number of reasons why people want to leave managed superannuation funds to manage their own funds. These reasons included dissatisfaction with existing funds / poor returns and a sense that they could do a better job than fund managers.[14] It is reasonable to conclude that the reasons why people set up a SMSF are also reasons for dissatisfaction with mainstream superannuation funds. All of these factors, therefore, act as a disincentive to some to make contributions to superannuation.

These research findings suggest that measures designed to promote confidence in the superannuation system would be beneficial. This is where regulatory bodies like ASIC have a role to play and we would be happy to discuss this further with the Committee in due course.

Current incentives in place to encourage voluntary superannuation contributions
The Committee will be aware of the Australian Government's co-contribution initiative to encourage lower income earners to contribute voluntarily to their superannuation savings. Under this measure, anyone earning less than the upper threshold who makes a personal contribution to their super fund can receive a co-contribution from the Government up to a maximum of $1,500 a year. According to the Federal Treasurer, more than half a million Australians took up the co-contribution offer last financial year, making personal contributions to their retirement savings and receiving an average top-up to those savings of $530.[15]

Research conducted by ANOP for AFSA found that the people believed the government's main role in helping people increase superannuation savings was to provide incentives to save.[16] The top two incentives were reduce super contributions tax (37%) and co-contributions for low and middle income earners (30%).

Reasons for contributing more into super were that it was a good way to provide income in retirement, it is a good way to save (because it can't be touched), it is tax effective and that it is a good investment with a good return. Reasons for not

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[14] Chant Link & Associates, A Report for ASIC on Self Managed Super Funds, Project Number 2715, May 2005
[15] Superannuation Co-Contribution Campaign, Press Release No.024, 24 March 2005
[16] ANOP Research for AFSA, 2004 *Community Attitudes to Saving for Retirement*, 2004

contributing more into super included cannot afford to (no spare money), other investments such as property were preferred, it was not a good investment and that there wasn't a tax advantage (too much tax).[17]

Our research has identified low awareness, understanding and/or acceptance of the taxation benefits associated with superannuation in the recent retiree population. [18] Given that recent retirees are likely to be more aware of superannuation features than younger people due to their greater exposure to superannuation decisions, those aged under 40 are even less likely to appreciate tax incentives.

Improving awareness of the importance of saving early for retirement
ASIC believes that improving awareness of the importance of saving early for retirement is fundamental to improving the superannuation savings of all Australians. We aim to convey this message in all of our consumer education and information programs about superannuation. The recent Government mass media advertising around choice of superannuation fund specifically made the connection between superannuation and your future.

We believe that the inquiry should look at ways in which new employees not only receive information from their employer about their superannuation options, but also why superannuation is important. This would be particularly beneficial for employees who were entering the workforce for the first time.

Under the new choice of superannuation fund arrangements, employers are required to give all new employees who are eligible to choose a superannuation fund a *Standard choice form.* This form tells the employee which superannuation fund their employer has chosen and allows them to choose a different one if they wish. The format of the form is prescribed by the Tax Office. Since this form will be given to many new employees, it could be amended to include simple statements about the importance of superannuation and the benefits of making extra voluntary contributions.

Similarly, employers could be required or encouraged to provide a co-contributions brochure to their employees. This would bring the initiative to the attention of eligible employees in the workplace, when they might be more minded to focus on such issues. Even employees who were not themselves eligible for the co-contribution might well have relatives or friends who would qualify. Posters could be produced and made available for employers to put up in staff communal areas.

Another way of engaging younger people more with superannuation is to make it less abstract. As noted above, younger people in research studies often feel that retirement is too far away to worry about now. A focus on the actual amounts of money that people will need to live on in dollar terms when they retire would help people to relate to the subject.

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[17] Attitudes to Super, Savings, Retirement and Choice, 2004 National Survey of the Australian population conducted for ASFA by ANOP [Miles, this is the AFSA presentation, the other similar ref above is the overview paper]

[18] Chant Link & Associates for ASIC, *Consumer decision making at retirement*, 2004

Industry groups such as IFSA and AFSA have documented the predicted income needs and shortfalls in their work on the retirement savings gap (ie the gap between what income Australians expect they will need in retirement and what their superannuation will actually provide).[19] ASFA research found that 7 in 10 estimated they would require a minimum annual income of at least $30,000.[20] In their factsheet, *An Adequate Retirement Income?,* ASFA state that around $370,000 in superannuation would be needed to achieve an income of $30,000pa. However, ASFA superannuation statistics show that the average superannuation balance is $78,700 for men, and $43,300 for women.

The Victorian state government has recently launched a survey to look at how women manage their money and plan for retirement. According to the State Government Minister for Women's Affairs, women need about $300,000 in superannuation to live modestly in retirement, but states that half of women who have retired or will retire in the next 10 years will probably only have $20,000 to retire on.[21]

ASIC's consumer website FIDO, www.fido.gov.au, contains a wealth of information for consumers about superannuation. This includes a superannuation calculator allows users to compare the expected returns from different super funds. Amongst other things, the calculator can show how final superannuation pay-outs vary depending on the level of contributions made over the years. We actively promote the calculator as it helps to illustrate to people why superannuation is important and how it relates to their particular circumstances.

The SMarT Program

Notwithstanding the importance of raising awareness, the Committee may also be interested in the findings of the "Save More Tomorrow" (SMarT) program trialled in the US by behavioural theorists, Thaler and Benartzi.[22]

The program, which used default options such as automatic, annual increases in the level of employees' savings, was designed to address certain types of consumer behaviour impeding consumers' ability to save for retirement, for example:

- poor self-control and willpower
- inertia and procrastination
- hyperbolic discounting ie people tend to be averse to saving today but they are willing to push off their commitment to the future.

It revealed that if an increase in the amount contributed to savings is designed to coincide with pay raises for example, employees were more likely to believe that the savings increase had little or no cost, even though their real current consumption may have declined by a small amount.

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[19] ANOP Research for AFSA, *2004 Community Attitudes to Saving for Retirement*, 2004; Rice Walker Actuaries for IFSA, *Retirement Savings Gap*, 2003

[20] Rod Cameron, ANOP Research Services *What do consumers think? Attitudes to super, savings, retirement and choice* ASFA November 2004

[21] *How do women manage money for their retirement?* Minister for Women's Affairs press release, 18 July 2005

[22] cited in Mitchell, O and Utkus, S (2003) *Lessons from Behavioural Finance for Retirement Plan Design*. Pension Research Council, Philadelphia, pp11-12

I trust that the above comments are helpful to the Committee. We would be happy to meet with you if you wish to discuss any aspect of the above in more detail. We will look forward to reading the Committee's recommendations in due course.

Yours sincerely

Delia Rickard
Deputy Executive Director
Consumer Protection