Investment & Financial Services Association Ltd
ACN 080 744 163

9 September 2002

Ms Sue Morton
Secretary
Senate Select Committee on
Superannuation and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Ms Morton

Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002

Superannuation (Government Co-contribution for Low Income Earners) Bill 2002

Superannuation Legislation Amendment Bill 2002

The Investment & Financial Services Association represents Australia's leading investment managers and life insurance companies. Our 100 members hold more than $670 billion in assets under management on behalf of nine million Australians who have superannuation, life insurance and managed funds.

Superannuation (Government Co-contribution for Low Income Earners) Bill 2002 and **Superannuation Legislation Amendment Bill 2002**

Co-contributions measures

IFSA supports the co-contributions measures. We have completed significant research on the community response to Government co-contributions, which indicates there will be significant levels of take up for the scheme. The research inter alia shows strong levels of support amongst the various levels of income and age structure.

A copy of the research was provided to the Committee in its retirement living standards reference, and a further copy is included with this submission. Our estimate of the full-year cost of the current scheme is $134 million. Given that estimating actual response to these schemes is at best an inexact science, we consider this

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estimate to be reasonably comparable to the Budget estimate (which did not include community research).

One of the most interesting findings of this research was that the level of response was almost as high for $1 for $2 matching as it was for $1 for $1. This allows a wider range of affordable scheme designs, and many of these could extend the impact of the scheme of retirement savings for nil or relatively small increase in outlays.

IFSA would like to see possible scheme designs – such as those discussed by Dr Vince FitzGerald when releasing this research - considered in the context of future enhancements to a Government co-contributions scheme. We are not proposing this Bill be amended by the Senate to re-shape the scheme. Calculations completed by the Allen Consulting Group showed the following schemes and costs:

- A scheme offering $1 for $2 up to annual income of $30,000 (with shade-out as per the current scheme) would cost $102 million a year for total extra contributions of $251 million a year.
- A scheme offering $1 for $2 up to annual income of $40,000 (with shade-out as per the current scheme) would cost $158 million a year for total extra contributions of $371 million a year.

A copy of the media release about this project is attached.

Surcharge reduction measures

IFSA strongly supports the surcharge reduction measures in this Bill. We have consistently called for the reduction or removal of the superannuation contributions surcharge. IFSA believes that equity for superannuation contributors is addressed in the following ways:

- Contributions limits;
- Reasonable Benefits Limits; and
- Low income earner co-contribution which has the effect of very substantially lowering the contributions tax.

We presented information to the Committee in July 20 which demonstrated that the surcharge was affecting older people with relatively low superannuation balances. The examples were:

Fund A (Master Trust – most members have rolled in previous superannuation balances) - of members over 40 paying surcharge:

- Average balance $87,000
- Median balance is $40,000

Fund B (Retail + Master Trust) - of all members paying surcharge:

- Average age is 47
- Median balance is $50,000 (about median balance for this fund)
- Average surcharge paid (for 2000 - 2001): $4,500

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Superannuation Legislation Amendment (Choice of Superannuation Funds) Bill 2002

IFSA strongly supports the principle that Australians should be able to choose their superannuation fund. This choice should not be limited, except to funds that are subject to overall retirement incomes policy, and prudential regulation.

This Bill offers employees unlimited choice among complying superannuation funds (albeit slightly restricted to eligible choice funds). Consequently, IFSA supports the Bill in principle.

Default Funds

IFSA does, however, have difficulties with the arrangements that would apply if an employee does not make an active choice among funds. The default fund scheme in the Bill is unnecessary, and raises very significant issues. It is not competitively neutral. It would have the effect of applying additional criminal penalties on industrial relations matters through superannuation law. It contains a mechanism which would be cumbersome and probably uncertain in operation, and which could lock-in inappropriate default funds.

IFSA believes that it is unlikely that the majority, or even a large minority, of employees will actively exercise a choice, particularly in the short to medium term. Choice is very important for those who wish to remain with a particular fund or to select a fund that will meet their needs, however many employees are unlikely to make a choice though disinterest, lack of perceived relevance, lack of advice and education, or simple inertia.

The complex default fund scheme is unnecessary. When the Superannuation Guarantee legislation was developed over 10 years ago, it did not limit the funds to which employer contributions could be paid. The only stipulation was that the fund be complying. Industrial awards and agreements then (as now) stipulated that some contributions had to be paid to particular funds, but these requirements were not reproduced in superannuation legislation. The only penalty applying to employers has been for failure to pay the full amount of contributions to a complying fund.

In effect, the default provisions suggest that there is a major deficiency with the current superannuation laws and the rules governing employer obligations as they currently exist. To our knowledge, the Government has not indicated a concern about the operation of current superannuation law. In the ten years of this arrangement, IFSA is not aware of a public policy failure relating to the employer nominating a complying fund under the SG regime. Our concerns about the default fund follow.

Firstly, and most critically, the default scheme is anti-competitive. It would extend the reach of one particular segment of the market - under pain of criminal penalty. This is a separate issue to awards that may specify particular superannuation funds –

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this mechanism would extend that fund coverage to employees not under awards, and give significant market advantage to those funds. Moreover, the default mechanism would lock-in structural rigidities, and would mean that there was a significantly reduced level of competition in the default fund market. Such an outcome could result in, for example, contributions continuing to be made to a fund which was in decline, and not offering the prospect of sound returns and/or efficient administration for its members. Furthermore, the employer, in conjunction with their consultant, could do precious little to address this problem.

Secondly, it is totally inappropriate to apply criminal penalties through superannuation law to industrial relations issues. The place for such provisions and penalties is in industrial law.

Thirdly, the 'employer selected majority fund' is a cumbersome and unworkable arrangement. It entrenches a majority fund without any mechanism for change should that fund become undesirable. In workplaces where award coverage or employee fund choice fluctuates, it will have very uncertain effects. While the employer is only required to assess the majority fund once in 12 months, this could vary depending on when the assessment is made, and from year to year. The worst aspect of the 'employer selected majority fund' is that it extends award coverage of superannuation outside industrial legislation. In so doing, it exacerbates the anti-competitive nature of the default fund arrangement in the Bill.

IFSA suggests that the Committee recommend that the default fund provisions be removed from the Bill. In effect, if an employee does not actively choose his/her own superannuation fund, the status quo would apply. That is, these employees would be, by default, members of their employer's sponsored superannuation fund as it operated under the current Superannuation and Corporations Laws.

Removal of the default fund provision would also allow a number of the complicated provisions dealing with various Commonwealth and State awards to be removed from the Bill. This would have the advantage of rendering the Bill simpler and easier to understand.

Caps on superannuation fees

IFSA does not support placing caps on, or proscribing certain fees on, superannuation accounts. IFSA believes that a strongly competitive and transparent market is the most appropriate means of placing downward pressure on fees, hence IFSA's support for the continuation of the FSR Regulations.

As is quite evident in the IFSA commissioned report entitled *Superannuation Fees & Competition*, there is a high level of price and product competition within the industry, particularly among providers of employer sponsored superannuation accounts. This is reflected in a large number of products and suppliers within each segment. Strong competition between these groups generally ensures that members, within regulatory constraints, receive good value. Competition coupled with extensive media coverage of funds and their features provides incentives for suppliers to continually provide better value.

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Placing caps for Superannuation Guarantee money would lead to:

- 'Creeping up' of prices so as to hit the 'ceiling' price;
- Potential withdrawal of advice and education on retirement incomes from the workplace.
- Scaling down of product features such administration, reporting, client servicing, and investment strategy so as to stay under the 'ceiling' price;
- Barriers to entry for new players to enter the market. New players either in the employer sponsored or public offer domain might not be able to enter the market because the initial revenues, as a consequence of the price cap, do not provide sufficient scope to justify the cost of the investment;
- Exit from market by product providers who find that the new price ceiling is below their economic shut down point. This could result in certain systemic risks during the transition period. The only winners when a fund is forced into liquidation/mandatory transfer are the providers of the liquidation services (e.g. Commercial Nominees administration); and
- Consumers being forced to split non-SG contributions and forward these to a fund that offers their desired product features. For these consumers, this will have the effect of doubling fund costs, not keeping costs down.

Yours sincerely,

Richard Gilbert
Chief Executive Officer

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Media Release

Investment & Financial Services Association Ltd

1 August 2002

Extending super co-contributions worthy of serious consideration

The results of new research into superannuation co-contributions, outlined today by Dr Vince FitzGerald of the Allen Consulting Group, Australia's leading savings commentator, indicates that extending the policy could generate significant new voluntary savings.

IFSA is a national not-for-profit organisation, which represents the retail and wholesale funds management and life insurance industry. IFSA has over 100 members who are responsible for investing approximately $670 billion on behalf of over nine million Australians.

"This new attitudinal research, released at the IFSA Annual Conference in Brisbane, shows people would respond to $1 for $2 matching (ie, Government contributes 50 cents for every $1 you save) almost as strongly as to the proposed $1 for $1, said Dr FitzGerald. "This offers the opportunity to get a considerable benefit in improving adequacy for a modest additional cost to government revenue".

Within the research are a number of cases, modelled by The Institute of Actuaries, through actuary Geoff Burgess, which show how co-contributions can boost an individual's retirement savings - particularly those who have lower income or shorter periods in work.

For example, a woman returning to the workforce at age 45, earning $35,000 a year, and who works for 15years until retirement at age 60 could improve her retirement income from $15,681 a year (or 58.6% of pre-retirement consumption expenditure) to $17,371 a year (or 64.9% of pre-retirement consumption expenditure) through 15 years of voluntary contributions at $1,000 a year with a co-contribution of $500 a year.

The project found that improved levels of adequacy could be achieved for a cost not much higher than the estimated cost of the co-contributions scheme in the 2002 Federal Budget.

- A scheme offering $1 for $2 up to annual income of $30,000 would cost $102 million a year for total extra contributions of $251 million a year.
- A scheme offering $1 for $2 up to annual income of $40,000 would cost $158 million a year for total extra contributions of $371 million a year.

"These numbers demonstrate that a co-contributions scheme could make a real difference to Australia's retirement savings effort at affordable cost. These estimates indicate that a wider co-contributions scheme is worthy of very serious consideration, Dr Fitzgerald concluded.

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The underlying consumer research was conducted for IFSA by Eureka! Strategic Research. Its key findings were:

- A dollar for dollar co-contribution is likely to produce a significant increase in the number of people making voluntary contributions to their super, both in the target group (ie individuals with income up to $20,000 per annum), and, if the scheme was extended, from individuals on higher incomes.

- Co-contribution at 50c for every dollar, while not as attractive as 1:1 matching, is likely to produce much of the same behaviour for a significantly lower fiscal outlay.

- The largest changes in voluntary contribution behaviour (ie largest percentage increases in the incidence of voluntary contributions) may be observed in groups such as low income earners, younger people, renters, those with large mortgages, and those with low amounts of super and other investments.

- A significant majority of those intending to participate in the co-contribution scheme are likely to do so to the full extent (ie $1,000 in the first 12 months).

- A scheme is likely to result in voluntary contributions being made by many individuals on an ongoing basis. Many people would contribute every year until close to retirement.

For further information please contact Richard Gilbert on mobile: 0417 247 998.

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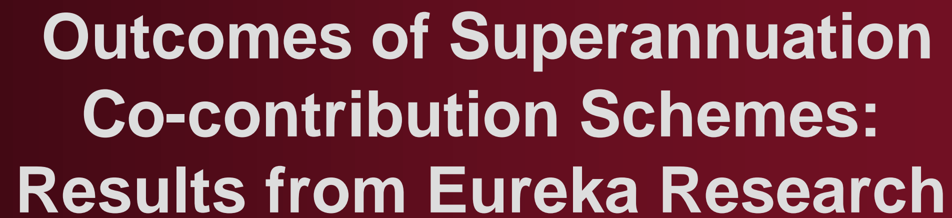


Outcomes of Superannuation Co-contribution Schemes: Results from Eureka Research

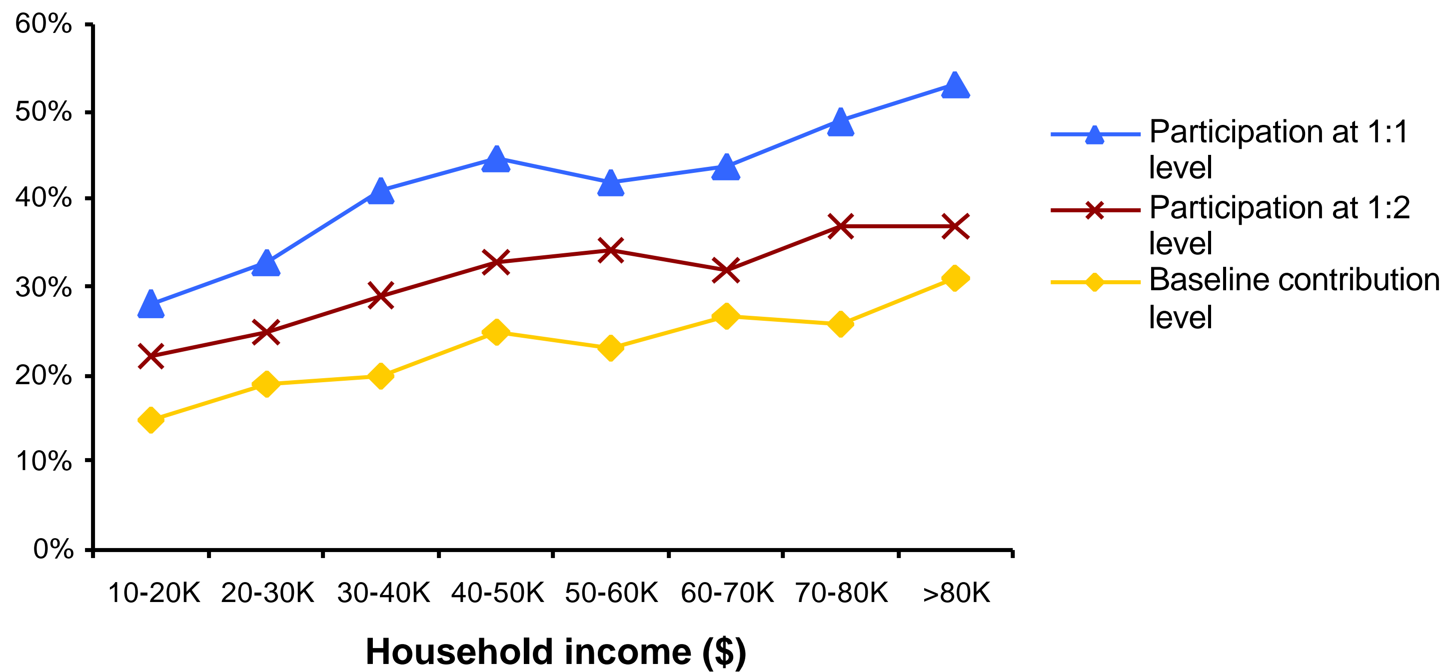
Presentation by
Dr Vince FitzGerald
Co-Chairman
The Allen Consulting Group

Eureka Survey

- Telephone Survey - 1069 respondents
- Data collected on people's attitudes to Superannuation:
  - **Contribution history and future contributions**
    - 1:1 co-contribution scheme
    - 1:2 co-contribution scheme
  - **Attitudes to super and saving**
  - **Demographics, income etc**

Participation by household income

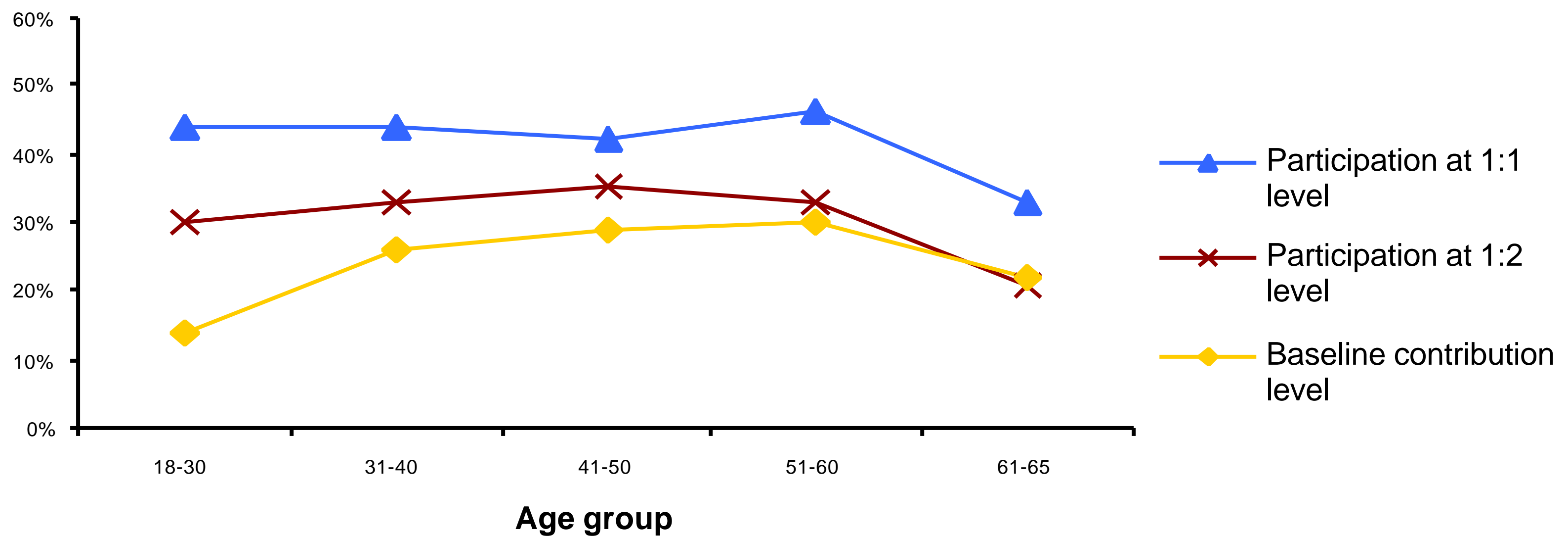
… absolute response rises significantly with income, relative response (c.f. baseline) less so



Source: Eureka Report

Participation by age

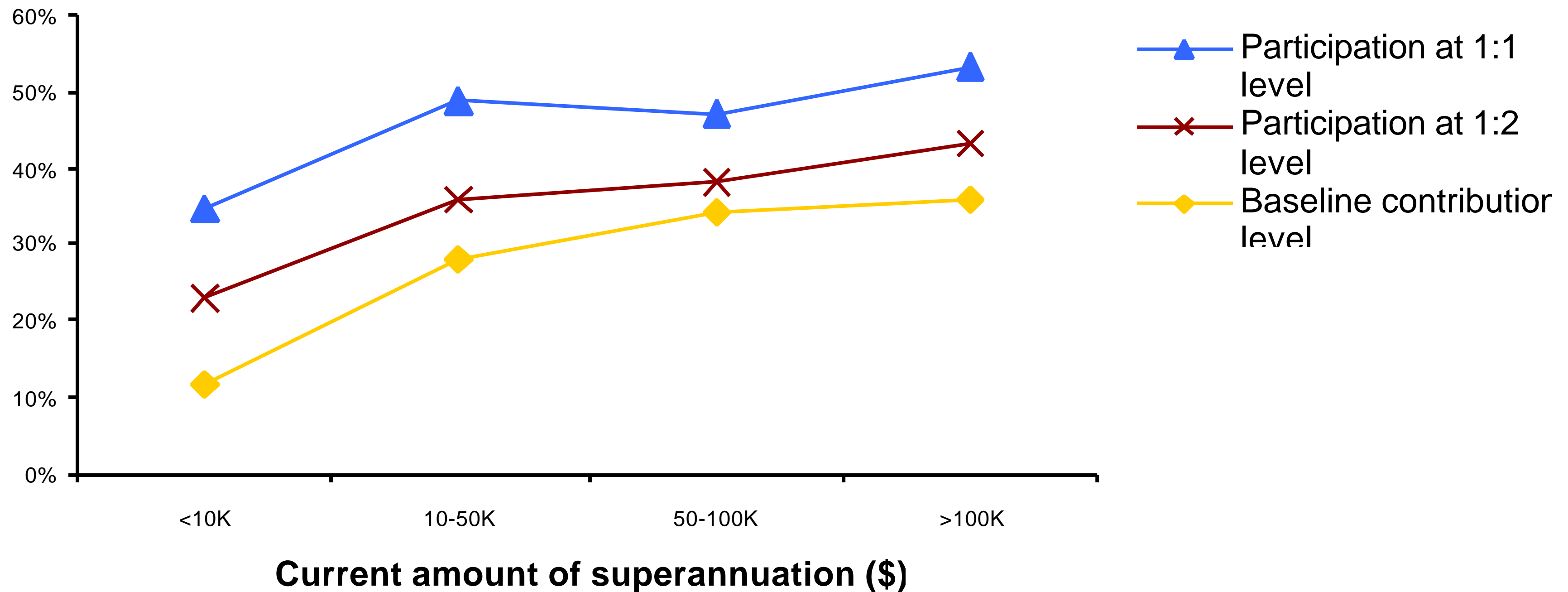
… absolute response flat over working ages, relative response declines (strongest for young)



Source: Eureka Report

Participation by current super amount

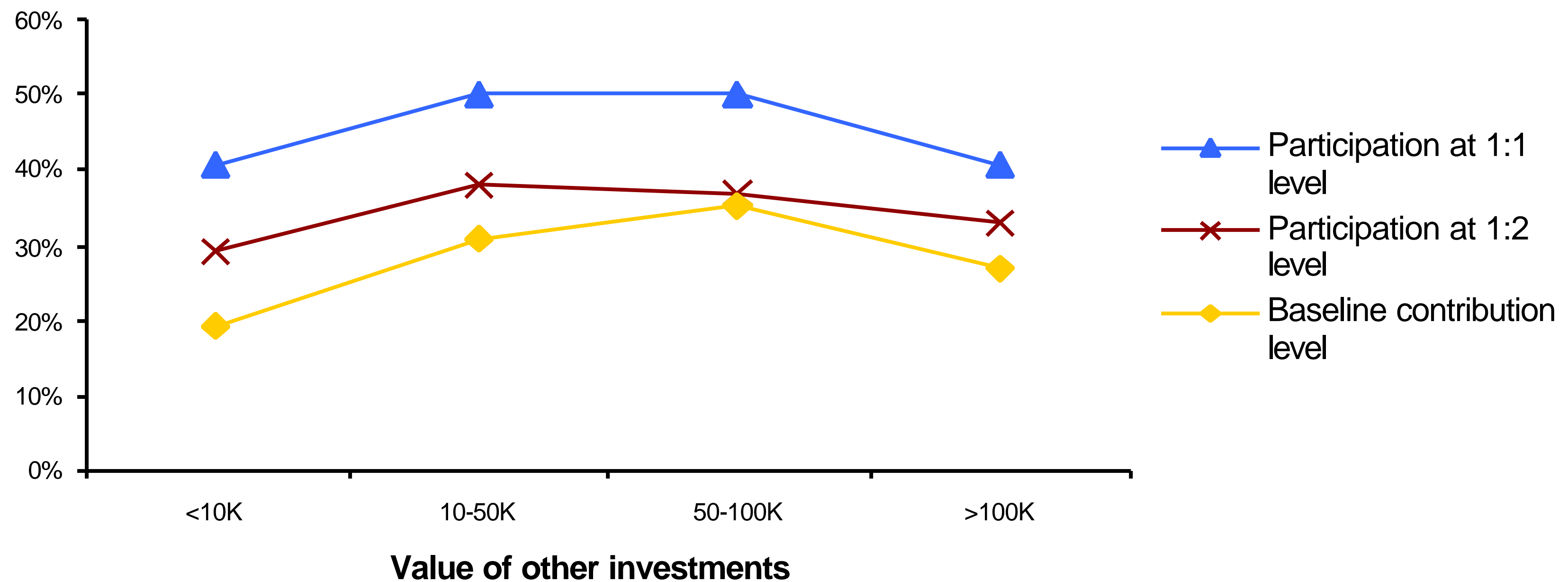
… absolute response rises, relative declines (greatest for low balance now)



Source: Eureka Report

Participation by current value of other assets

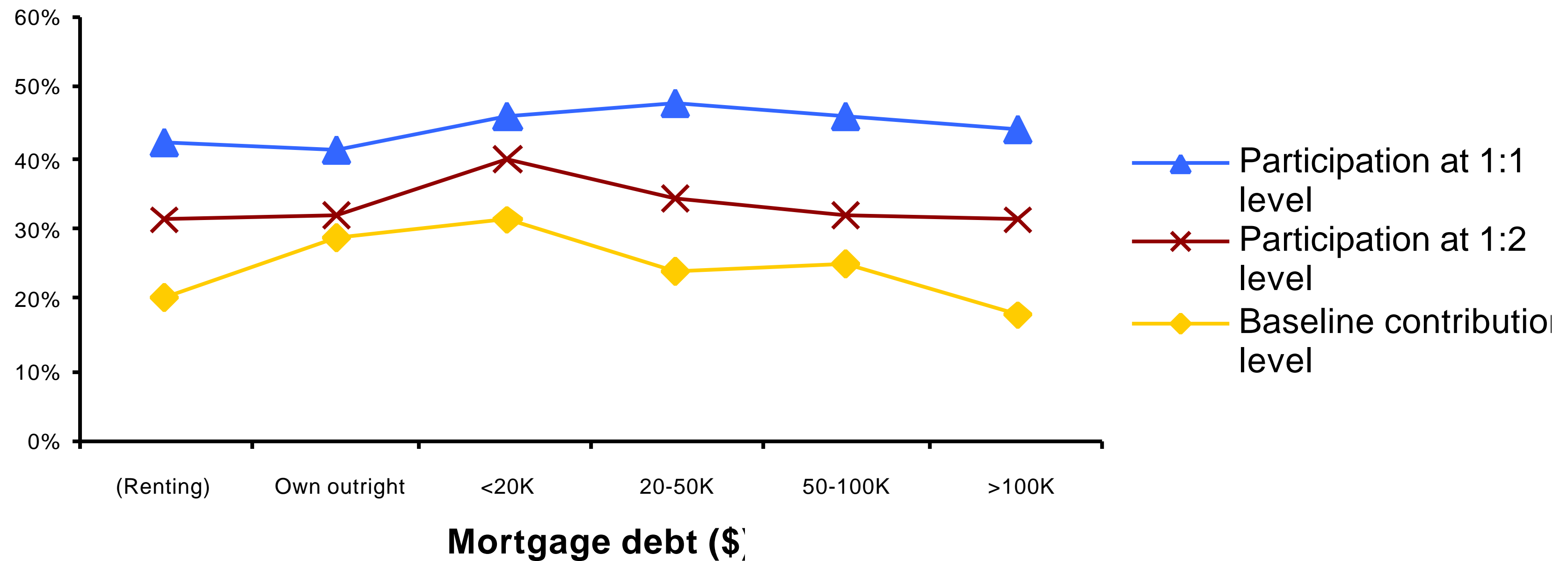
… absolute response flat, relative declines (i.e. strongest for low assets)



Source: Eureka Report

Participation by mortgage debt or renting

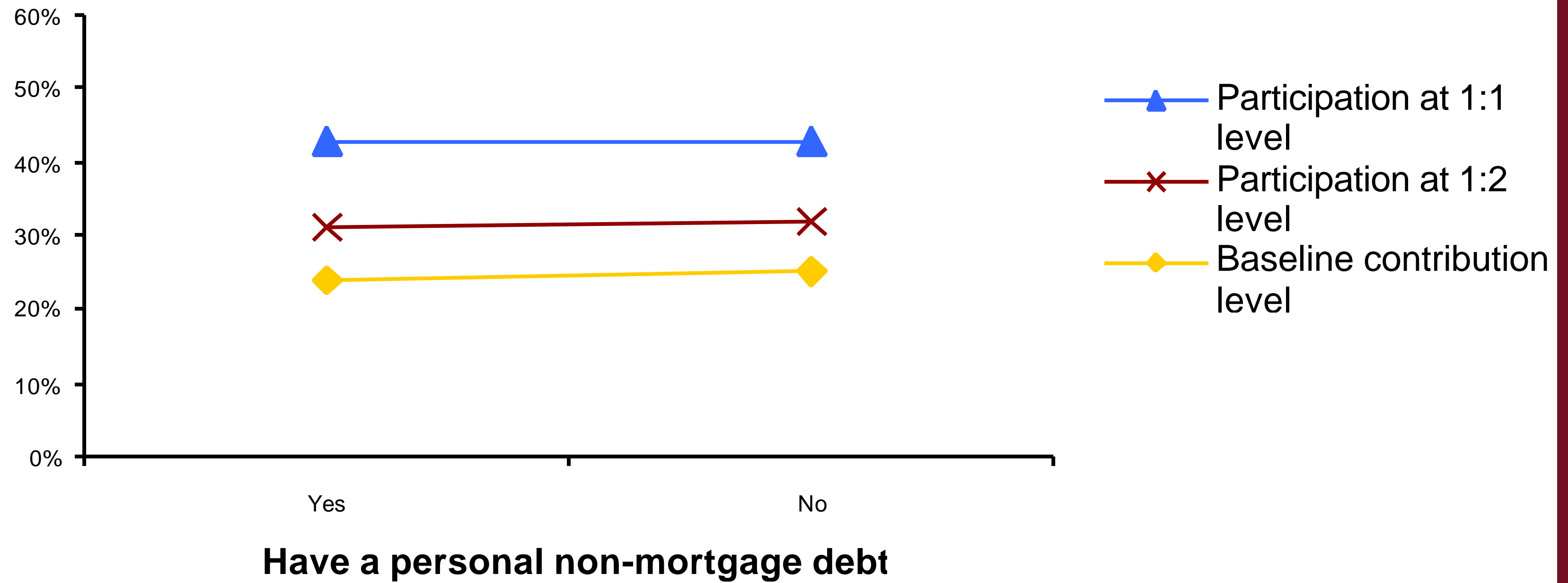
… absolute response flat, relative greatest for renters, higher mortgage debtors



Source: Eureka Report

Participation by non-mortgage debt

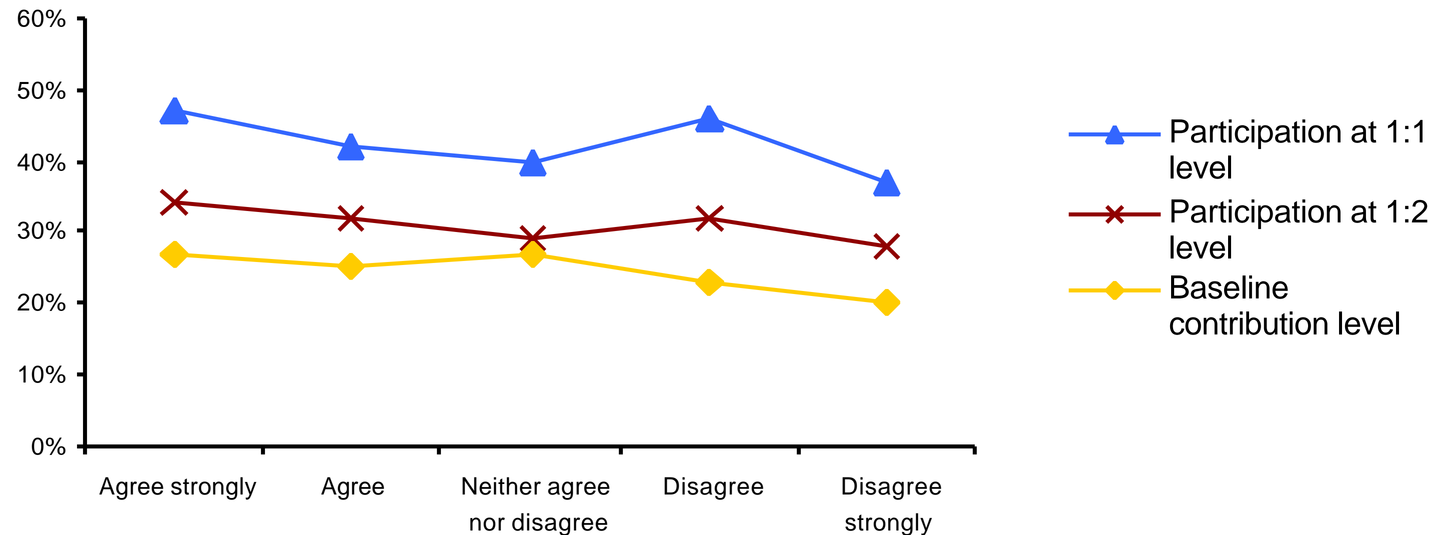
… no clear relationship



Source: Eureka Report

Participation by perception of adequacy of retirement savings

… relationship not strong (greater response if agree?)



I feel confident I will have enough money in retirement to provide for a good standard of living

Source:: Eureka Report

Our costing methodology

- Survey responses on making co-contributions under both the 1:1 and 1:2 matching rates were interpreted as probabilities in a conservative way.
- Survey responses are on *full awareness* basis. Given that this will not occur in practice, we assume an awareness of 75% in practice and estimate likely responses accordingly.
- The contribution *outcomes* under both matching rates are assumed to be 80% of the amount nominated by respondents – to allow for various reasons for not making, in the event, all intended contributions.

➢ **Hence estimates conservative**

Government scheme

- Details of Policy
  - **Limit of $1,000 per annum**
  - **1:1 co-contribution up to $20,000 income**
  - **Shade out from $20,000 at a rate of 8 cents in the $ of income**
- Treasury cost estimate is $85m in 1st yr, rising to $95m in 3rd yr
  - **Based on old tax rebate experience (affected by low awareness etc)**
- Our cost estimate of Government Scheme is $134m pa

Government scheme - aggregate estimates

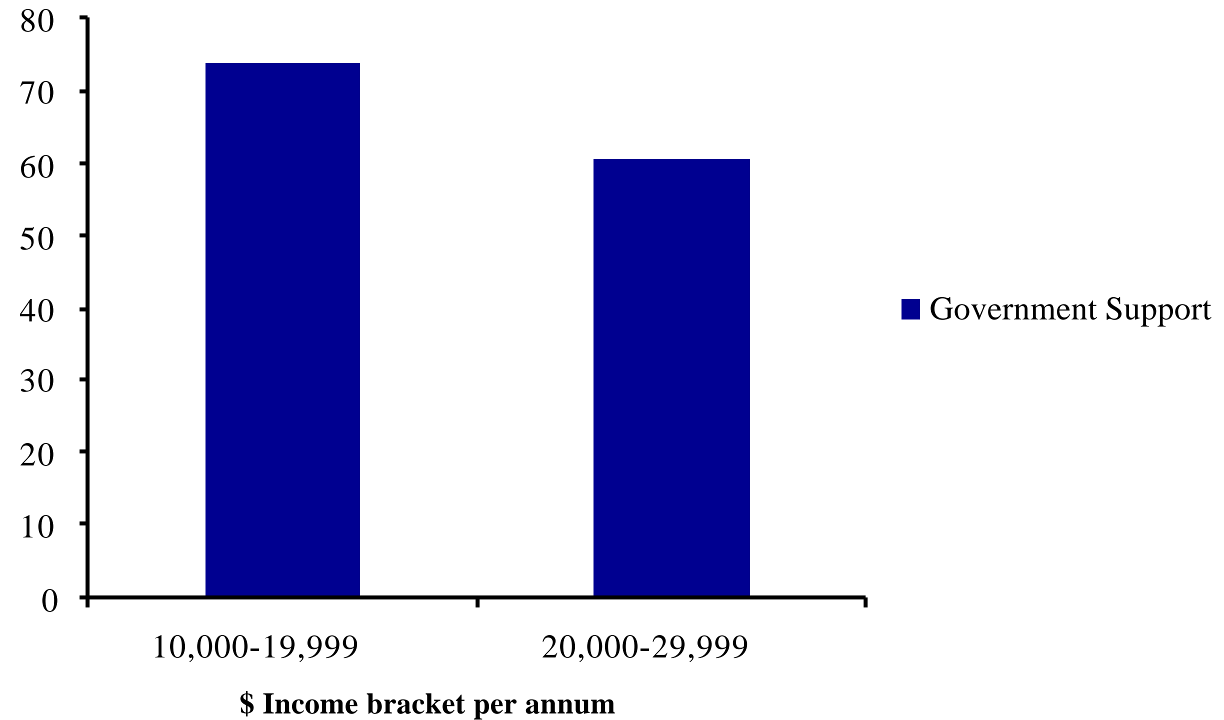
Income Bracket	Govt. Support	Extra Individual Contributions	Total Extra Contributions
$pa	$m	$m	$m
10,000-19,999	73.7	54.9	**128.6**
20,000-29,999	60.3	55.2	**115.4**
30,000-39,999	-	-	
	134.0	**110.1**	**244.1**

Note : A proportion of individuals in the income bracket 30,000-39,999 would be eligible under the Government scheme, however their response and co-contribution support are negligible and excluded for the purposes of this analysis.

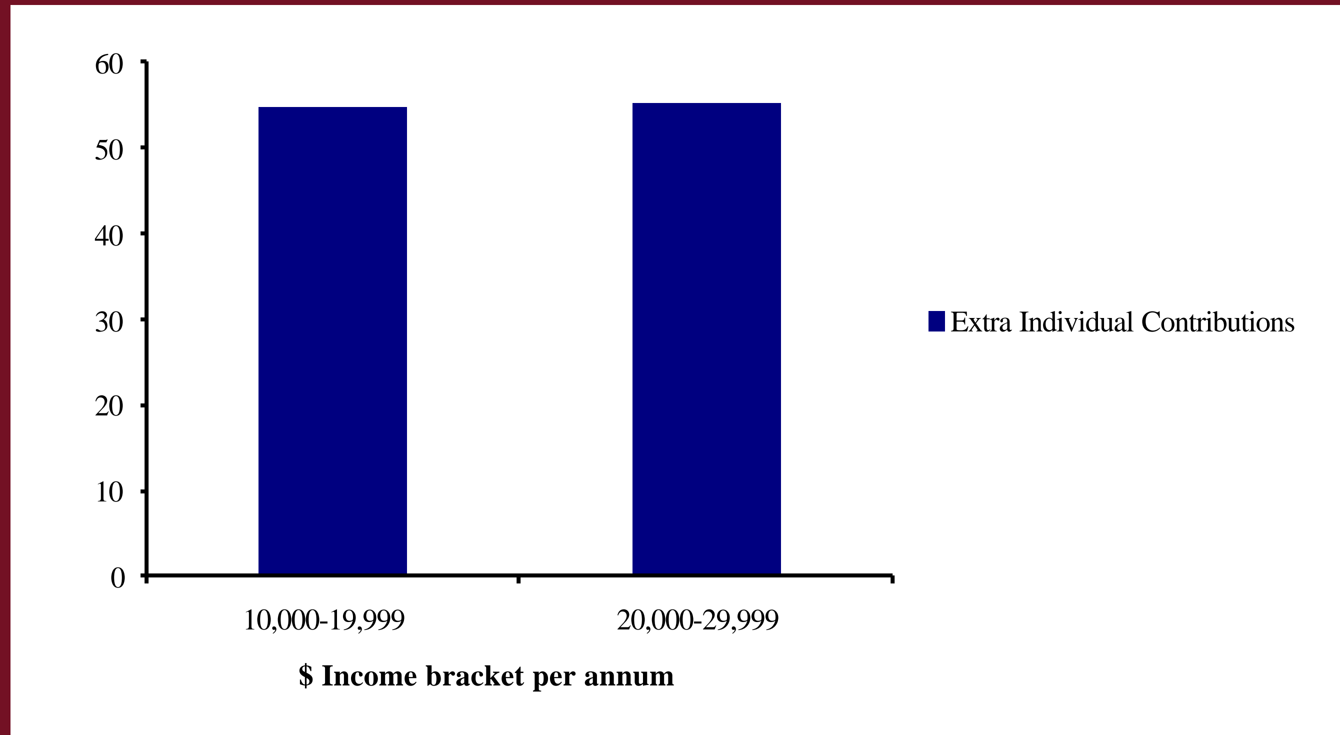
Government scheme - per person estimates (all persons in sample)

Income Bracket $pa	Govt. Support $	Extra Individual Contributions $	Total Extra Contributions $
10,000-19,999	113.7	84.8	**198.5**
20,000-29,999	70.7	64.7	**135.5**

Government scheme - distribution of support by income bracket



Government scheme - extra individual contributions by income bracket



Alternative schemes

- Alternative 1
  - **1:2 co-contributions up to $30,000 income**
  - **Shade out from $30,000 at a rate of 8 cents in the $**
  - **Limit of $1,000 per annum ($500 subsidy)**
  - **Total Cost to Government estimated to be $103m**
- Alternative 2
  - **1:2 co-contributions up to $40,000 income (~AWE)**
  - **Shade out from $40,000 at a rate of 8 cents in the $1**
  - **Limit of $1,000 per annum ($500 subsidy)**
  - **Total Cost to Government estimated to be $159m**

  - Note: Some individuals in the income brackets $40,000 - $50,000 and $50,000-$60,000, for alternative 1 and alternative 2 respectively, would be eligible under these schemes, however their response and co-contribution support are negligible and excluded for the purposes of this analysis.

Alternative 1 - aggregate estimates

Income Bracket	Govt. Support	Extra Individual Contributions	Total Extra Contributions
$pa	$m	$m	$m
10,000-19,999	30.5	44.7	**75.2**
20,000-29,999	50.3	55.1	**105.3**
30,000-39,999	21.9	48.5	**70.3**
	102.6	**148.3**	**250.9**

Alternative 1 - per person estimates (all persons in sample)

Income Bracket	Govt. Support	Extra Individual Contributions	Total Extra Contributions
$pa	$	$	$
10,000-19,999	47.1	69.0	**116.1**
20,000-29,999	59.0	64.7	**123.6**
30,000-39,999	25.9	57.4	**83.2**

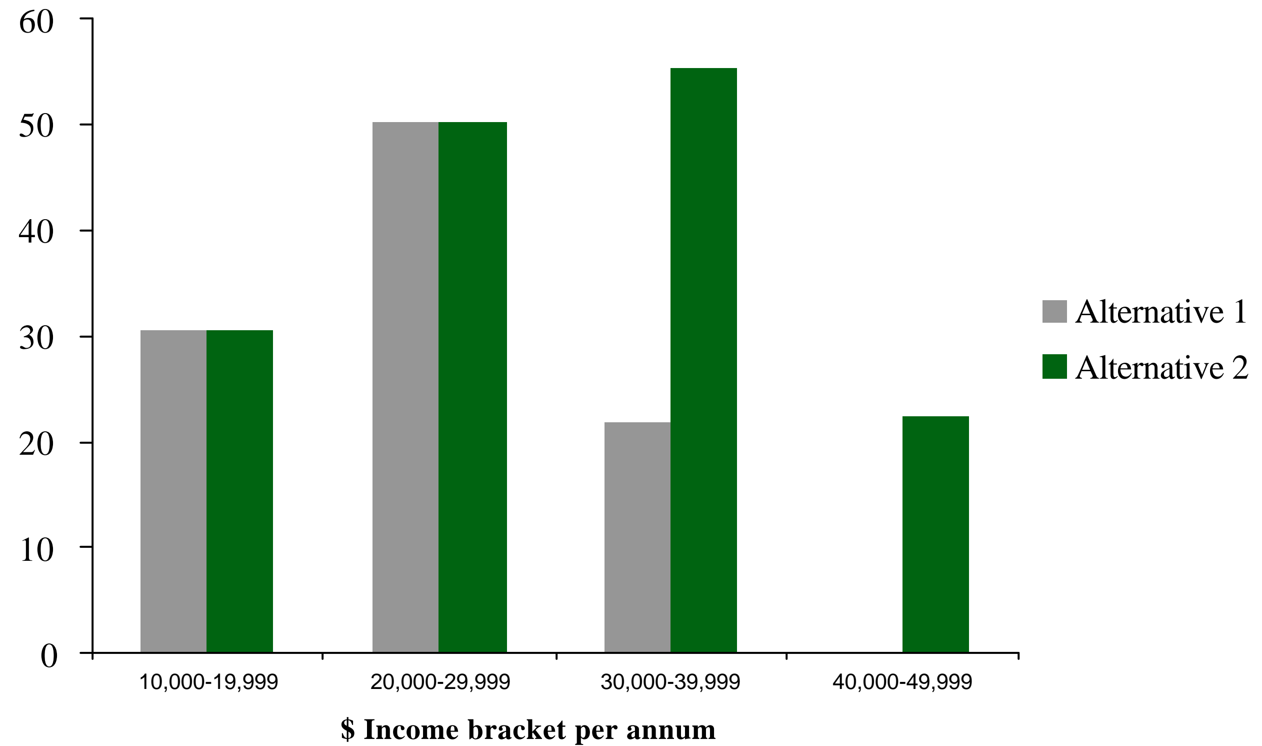
Alternative 2 - aggregate estimates

Income Bracket	Govt. Support	Extra Individual Contributions	Total Extra Contributions
$pa	$m	$m	$m
10,000-19,999	30.5	44.7	**75.2**
20,000-29,999	50.3	55.1	**105.3**
30,000-39,999	55.4	73.8	**129.2**
40,000-49,999	22.4	38.8	**61.2**
	158.6	**212.4**	**371.0**

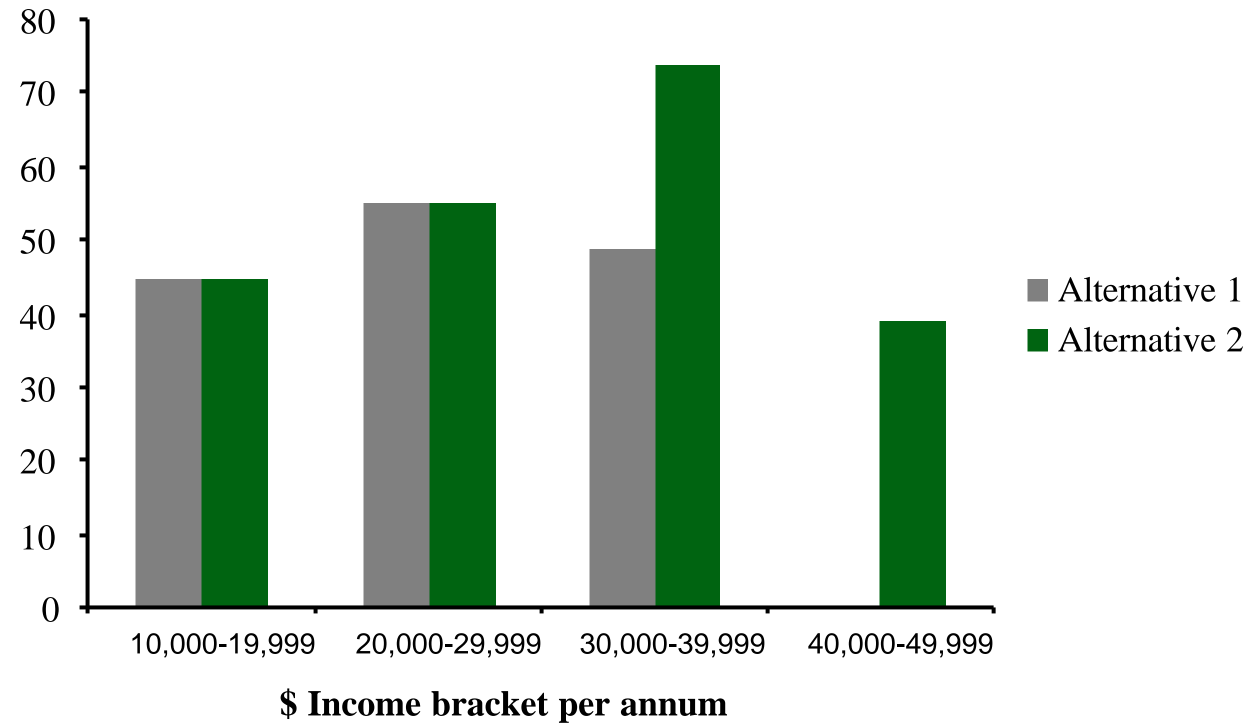
Alternative 2 - per person estimates (all persons in sample)

Income Bracket	Govt. Support	Extra Individual Contributions	Total Extra Contributions
$pa	$	$	$
10,000-19,999	47.1	69.0	**116.1**
20,000-29,999	59.0	64.7	**123.6**
30,000-39,999	65.6	87.2	**152.8**
40,000-49,999	33.8	58.4	**92.2**

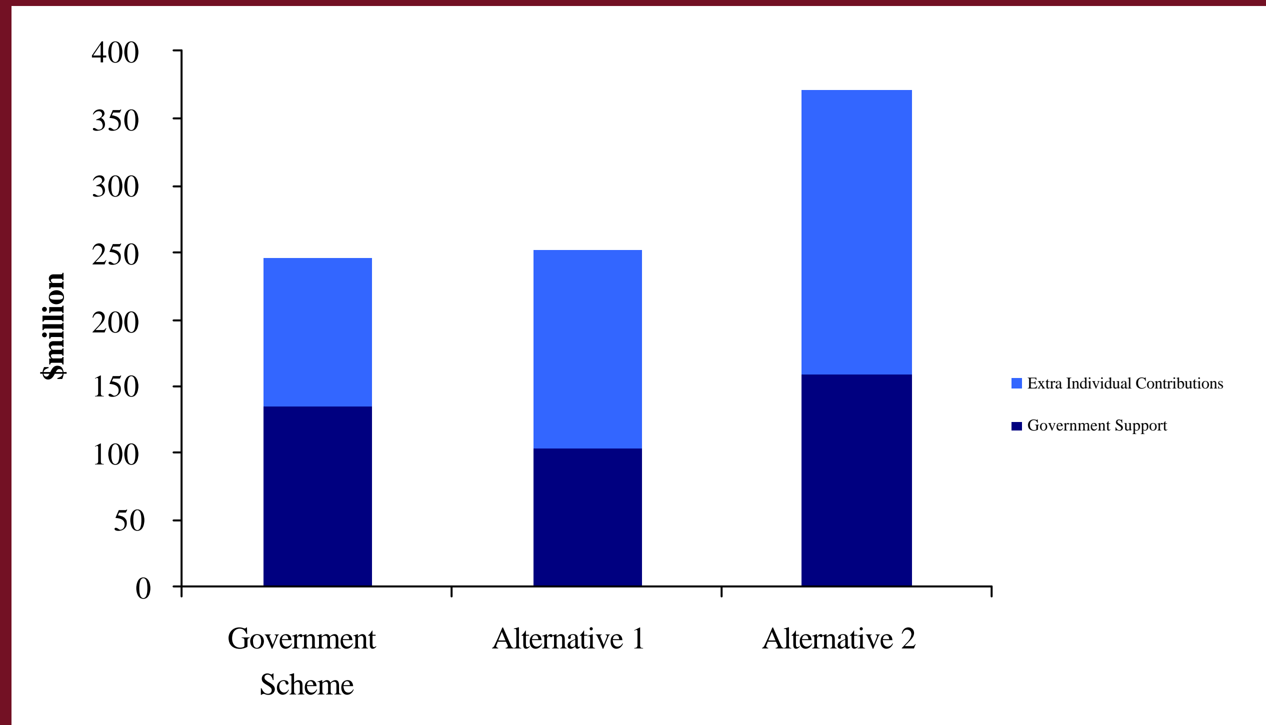
Alternative schemes - distribution of government support by income bracket



Alternative schemes - extra individual contributions by income bracket



Extra contributions to super funds - comparison of schemes



Conclusions

- Dollar for dollar matching incentives will produce a very strong response
  - **but one dollar for two produces a response that is still quite strong**
  - **more significantly, the private response is considerably greater *per taxpayer dollar spent* ($148m for $103m or $$212m for $159m c.f. $110m for $134m)**
- Hence the opportunity for a broader more cost effective scheme
  - **Taking into account distribution of support by income (bearing age pension in mind)**
- Largest responses *relative* to existing behaviour among younger people, renters, those with large mortgages, those with low super balances — less strong link with low income
- Most people responding nominate the full eligible amount
- Most would maintain their response through to retirement.