Chapter 14

Other Issues

Introduction

14.1 During the inquiry a number of other issues were raised which could have the potential to affect the adequacy of retirement incomes. In addition, the adequacy of the Australian Prudential Regulation Authority's (APRA's) regulatory powers, were also raised.

14.2 This chapter therefore examines:

- other savings vehicles;
- the indexation of Commonwealth superannuation pensions; and
- APRA's powers.

Other savings vehicles

14.3 The Committee was informed during the inquiry that superannuation is the only tax effective long-term savings vehicle that exists in Australia. Some of the evidence, for example from Dr Vince FitzGerald, called for additional savings to be directed into areas such as health, education, or even in raising the deposit on a home. In the context of deciding not to recommend the use of superannuation savings in either health or any of the other areas, the Committee was interested to look at the potential for new purpose built tax effective savings vehicles to fill any identified gap. Some detail of the current tax treatment of savings vehicles in Australia is contained in **Appendix 14.**

14.4 Dr FitzGerald put the issue of superannuation savings and non-superannuation savings into context in the following extract from his March 1999 paper *Refocussing and Reinvigorating Retirement Policy – A Stocktake and Suggested Agenda for Advance*:

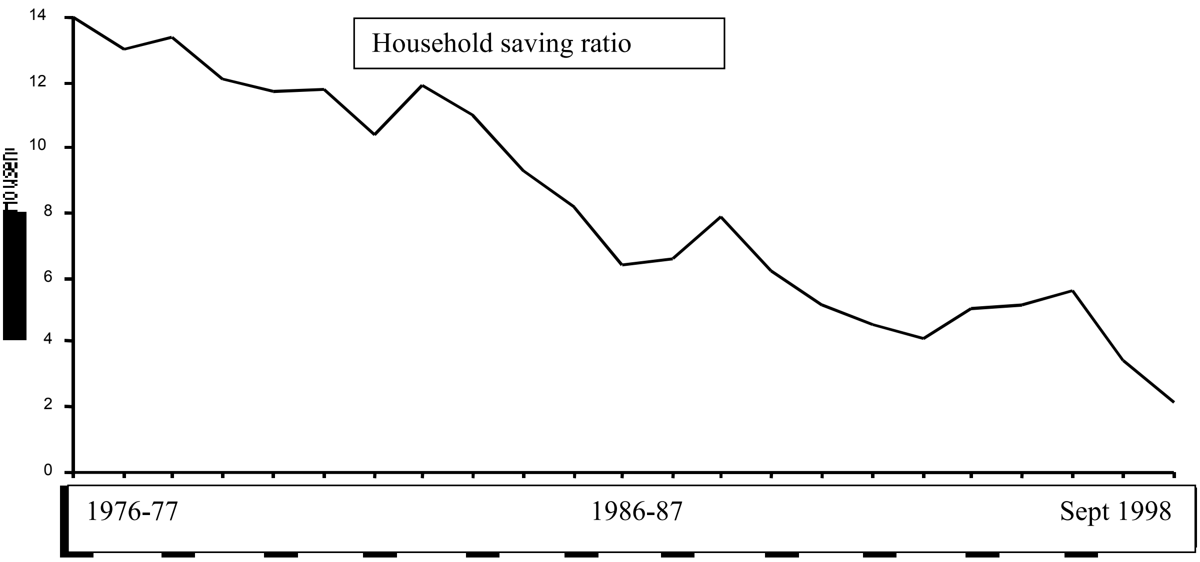
> …it is important to place superannuation policy in the wider context of what is happening to total saving. For example, if people are responding to the requirement to contribute a minimum amount to superannuation by holding lower savings in other forms, and by carrying more debt until retirement, then at least part of the aims of compulsory provision will be nullified. On retirement, part of a superannuation benefit may simply go to reduce debt—and the balance, plus net other saving, may reflect little net effect from the Superannuation Guarantee policy.
>
> Unfortunately, despite what has been occurring in superannuation, private saving has weakened markedly over the late 1990s. The positive effect of increased compulsory superannuation has been more than offset by the

cumulative effects of financial deregulation and, especially, the low inflation and low nominal interest rate environment of the mid/late 1990s.

Australians now have much easier access to credit than ever before and the cost of servicing debt is at historically low levels. Australians are enthusiastically spending rather than saving—indeed around the later months of 1998 and running into the early months of 1999, there has been little short of a 'mini boom' in consumer spending. Where is that spending coming from? Australian households first significantly increased borrowing secured against housing over the mid 1990s; and then, more recently, have rapidly increased the use of other credit at about 18 per cent per annum (albeit on a base considerably smaller than housing debt[1]). Household debt has in just 5 years risen from under 50 per cent of disposable income to over 75 per cent (although interest costs have stayed around 8 per cent of income).[2]

14.5 According to Dr FitzGerald, the result is that the net proportion of household current disposable income being saved, *including via superannuation*, is down to just 2–3 per cent, which is an extraordinarily low figure historically. This is shown in **Chart 14.1** below.

Chart 14.1 Australia's household savings rate



Note: annual data except for September quarter 1998.

Source: ABS, cited in V.W.FitzGerald, *Refocussing and Reinvigorating Retirement Policy – A Stocktake and Suggested Agenda for Advance*, March 1999.

1 Total household debt is now approximately $370 billion, of which $215 million is housing debt, whose growth has slowed to under 10 per cent per annum over the past two years. Other debt (including e.g. credit card debt) has at the same time accelerated, rising by 18 per cent over the latest year.

2 V.W.FitzGerald, *Refocussing and Reinvigorating Retirement Policy – A Stocktake and Suggested Agenda for Advance*, March 1999, p 12.

14.6 A number of submissions sought the introduction of a new tax advantaged medium to long-term savings vehicle to complement the current superannuation arrangements. For example, IFSA submitted that, while it supports the development of a simple, transparent long-term savings vehicle with tax benefits (in timing and possible final level of tax payable) as an adjunct to superannuation:

> Superannuation, particularly since the 1999 preservation rules, locks up money for retirement that individuals and families might require earlier access to. Insurance bonds currently provide for medium/long-terms savings, however the tax payable on these can be difficult for individuals to assess, particularly so for periods less than 10 years. At present, re-draw mortgages and re-gearing of housing equity appear to provide the only simple, tax-effective vehicle for such saving.
>
> IFSA research,[3] with a number of other studies, shows Australians are saving for their retirement outside as well as inside superannuation. A significant reason for this is that superannuation is preserved for a longer period and as such is less useful to individuals and families who need medium to long-term savings for other lifecycle needs, such as reduced employment income and higher costs in parenting, or unexpected loss of employment.
>
> A medium/long-term savings vehicle, based on managed investments principles, could easily be structured so that the tax differences were only in timing, and also allow a fiscal benefit to government from compounding investment earnings. Such a vehicle would contribute to a savings culture, as people could see more immediate outcomes for their savings decisions.[4]

14.7 The Financial Planning Association (FPA) raised in its written submission the need for new medium-term savings vehicle in the context of superannuation adequacy and debt levels as follows:

> … the current policy intent of making super a tax preferred vehicle for people to fund their retirement is being compromised by the application of super monies by those reaching retirement into funding debt accumulated prior to retirement.
>
> An ASFA report in 2001 showed that the main perceived disadvantage of super was the lack of accessibility to the money.[5] The latest ING - Melbourne Institute Household Savings Report also shows that potential future changes to tax law and government rules about when the money could be accessed was one of the main reasons people did not contribute to super. The report further illustrated that instead, many people would use

3 IFSA, *Retirement Savings – Desires and Drivers Qualitative Report.*

4 Submission 70, IFSA, p. 20.

5 ASFA 2001 Conference in Cairns, “It’s time for a retirement reality check”, Rod Cameron, ANOP Research Services Ltd.

> that money to fund other lifestyle choices, such as education and mortgages.[6]
>
> Hence a gap exists in the national savings policy for a tax preferred medium-term savings vehicle. This vehicle would provide an incentive for individuals to fund large lifestyle expenditure items though equity rather than debt. This in turn would result in superannuation funds being used to fund retirement, hence improving the adequacy of the current system.[7]

14.8 The Committee notes that at a colloquium of superannuation researchers at the University of New South Wales, Mr Ross Clare from ASFA was somewhat critical of Treasury's line on household savings at the time. In commenting on the Spring 1999 Treasury Economic Round-Up Supplement, Mr Clare suggested that the Round-Up Supplement appeared to set out to demonstrate that household savings had not really declined, but that if they had, then 'it does not matter much'. While stating that the Round-Up Supplement contained a variety of useful material, which made it clear that some caution is needed in interpreting developments in national accounts measures of savings, Mr Clare interpreted this approach as a rather weak excuse.[8]

Committee view – other savings vehicles

14.9 The Committee notes the evidence from the savings and investment community proposing the introduction of a new medium to long-term savings vehicle to complement the superannuation arrangements. In this context the Committee is concerned about Australia's historically low, and declining, level of household savings.

14.10 The Committee is also aware that there have been sustained calls, which have accelerated since the early 1990s, to use compulsory superannuation savings for other purposes. These purposes include health, housing, education and unemployment.

14.11 The Committee has noted in Part II of this report that the current nine per cent Superannuation Guarantee (SG) system is unlikely to meet the retirement income needs of most Australians. Accordingly the Committee has not recommended access to the current level of superannuation savings for non-retirement purposes. Having said that, however, the Committee considers that the introduction of a tax preferred medium to long-term savings vehicle which could be accessed prior to retirement for purposes such as:

- health;
- savings for a home deposit; and

---

6 ING, Melbourne Institute Household Saving Report, March Quarter 2002.

7 *Submission* 44, FPA, p. 8.

8 Ross Clare, Principal Researcher, ASFA, *National Household savings over the last decade,* paper presented at the Eight Annual Colloquium of Superannuation Researchers, University of New South Wales, July 2000.

- education

should be examined by the Government as means of increasing national savings and reducing the temptation for people to accumulate debt which is repaid with superannuation on retirement. The Committee also notes that access to additional savings for education may also assist older workers in retraining or gaining new or updated skills to stay relevant to the workforce and to stay in work for longer periods. If so the result would be higher superannuation savings and shorter periods of retirement.

14.12 The Committee emphasises that superannuation is an investment for the long term, that is, in excess of 30 years. While tax concessions assist in providing for retirement, other arrangements would need to be in place for those without a full working life, or those seeking to access superannuation funds for other purposes.

Recommendation

14.13 **The Committee recommends that, as means of increasing national savings and reducing the temptation for people to accumulate debt which is repaid with superannuation on retirement, the Government examine the introduction of a tax preferred medium to long-term savings vehicle which could be accessed prior to retirement for purposes such as:**

- **health;**
- **savings for a home deposit; and**
- **education.**

Indexation of Commonwealth superannuation pensions

14.14 In 2001, the former Senate Select Committee on Superannuation and Financial Services, presented a report on the benefit design of Commonwealth public sector and defence force unfunded superannuation funds and schemes. The report was entitled, *A Reasonable and secure retirement*? In that report, the Committee drew attention to the need to examine the feasibility of adopting an indexation method other than the CPI for Commonwealth public sector and defence force superannuation schemes, to more adequately reflect the actual increases in the cost of living.

14.15 During that inquiry, the Committee was advised that the CPI is not a measure of the cost of living and its application to Commonwealth public sector and defence force superannuation pensions has not enabled Commonwealth and defence force superannuants to maintain parity with living standards in the community. The majority of evidence to that inquiry suggested that the application of AWOTE or the CPI, whichever is the greater, would deliver a more reasonable standard of living in retirement.

14.16 The issue of the indexation arrangements applying to Commonwealth public sector superannuation pensions was raised again during the current inquiry. Organisations such as the Australian Council of Public Sector Retiree Organisations (ACPSRO) and the Superannuated Commonwealth Officers' Association (SCOA) advised the Committee that their members' living standards had been eroded through the use of the CPI, rather than a wage-based index such as AWOTE or Male Total Average Weekly Earnings (MTAWE).

14.17 The Association of Independent Retirees (AIR) also pointed out that the benefits of Commonwealth public sector and defence force retirees have 'significantly lost relativity with those at equivalent levels retiring now.' For this reason, the Association supported changes to the indexation arrangements for Commonwealth public sector and defence force retirees, to more adequately reflect the actual increases in the cost of living.[9]

14.18 In its written submission to the inquiry, ACPSRO submitted that it was convinced that changing the indexation to CPI/MTAWE, whichever is the higher, is 'entirely manageable', and that, according to the Commonwealth actuary, in the long term, 'is not a matter for concern'. One of the reasons for this, according to the Commonwealth actuary, is that the Commonwealth's liabilities in respect of defined benefit schemes are diminishing significantly when expressed as a percentage of Gross Domestic Product.[10]

14.19 According to Mr Johnson from ACPSRO, at 30 June 2001, there were 116,000-plus Commonwealth Superannuation Scheme (CSS) and Public Sector Superannuation (PSS) pensioners of whom 62 per cent receive $20,000 per annum or less; while of the 57,500 military superannuants, 80 per cent receive $20,000 per annum or less.[11]

14.20 In answer to a Question on Notice from Senator Sherry, tabled on 14 March 2002, the Minister for Finance and Administration, Senator Minchin, provided costings from the Department of Finance and Administration for a change to indexation of Commonwealth superannuation pensions using AWOTE. These are cited in **Table 14.2** below.

Table 14.2: Costing of the indexation of Commonwealth superannuation pensions using AWOTE

	2002-03 ($m)	2003-04 ($m)	2004-05 ($m)
Fiscal balance	**-605**	**-595**	**-630**
Underlying cash	**-25**	**-65**	**-105**
Operating balance	**-7,505**	**-595**	**-630**

Source: Answer to Question on Notice, Senate, 14 March 2002

14.21 The Minister also provided costings for a change to indexation of Commonwealth superannuation pensions using male total average weekly earnings (MTAWE). These are cited in **Table 14.3** below.

9 *Submission* 16, AIR, p. 6.

10 *Submission* 66, ACPSRO, pp. 3, 14-15.

11 *Committee Hansard*, 1 July 2002, p. 60.

Table 14.3: Costing of the indexation of Commonwealth superannuation pensions using MTAWE

	2002-03 ($m)	2003-04 ($m)	2004-05 ($m)
Fiscal balance	**-370**	**-365**	**-385**
Underlying cash	**-20**	**-45**	**-70**
Operating balance	**-4,670**	**-365**	**-385**

Source: Answer to Question on Notice, Senate, 14 March 2002

14.22 In a report commissioned by the SCOA on the *Impact of indexation change on the Commonwealth's superannuation schemes*, NATSEM found that, although the introduction of a superannuation indexation based on earning growth rather than CPI will increase Budget outlays, a large proportion of these outlays (between 37-58 per cent) will be returned to government through reduced age pension outlays, increased income taxation and greater GST receipts.[12] **Table 14.4** below demonstrates the effect on Budget outlays and clawback.

Table 14.4: Impact on Budget outlays and clawback, various years

	2002-03 $m	2003-04 $m	2004-05 $m
DOFA underlying cash	-25	-65	-105
Upper clawback	15	38	61
Typical clawback	9	24	39
SCOA underlying cash – upper	-10	-27	-44
SCOA underlying cash – typical	-16	-41	-66

Source: NATSEM, *Impact of indexation change on the Commonwealth's superannuation schemes,* Report for the Superannuated Commonwealth Officers' Association, 23 August 2002, p.5.

14.23 The Committee requested the Department of Finance and Administration (DOFA) to evaluate the NATSEM report. In response to this request, DOFA questioned in its supplementary written submission the validity of the clawback approach adopted by NATSEM, indicating that it was not the usual practice of the Department to make an allowance for second order effects, such as future reduced social security payments and increased taxation revenue, when preparing cost estimates for policy proposals.

14.24 Further, DOFA advised:

> Even if a reliable clawback estimate could be produced, the net financial impact of a change in indexation could still be expected to be very large when the cumulative impact is taken into account.[13]

---

12 NATSEM, *Impact of indexation change on the Commonwealth's superannuation schemes,* Report for the Superannuated Commonwealth Officers' Association, 23 August 2002, p. 6.

13 *Submission* 143, DOFA, p. 2.

Committee view – indexation of Commonwealth superannuation pensions

14.25 The Committee notes the evidence it has seen, in both the current and previous inquiries, that Commonwealth public sector and defence force superannuants are having their living standards eroded through the use of the CPI alone, rather than the higher of the CPI or a wage-based index such as AWOTE or MTAWE.

14.26 The Committee notes that the Reserve Bank of Australia's Officers Superannuation Fund Board of Trustees has recently reviewed the method of indexing the pensions of its members, and that the RBA has changed from an annual indexation linked to the CPI to half-yearly indexation based on the change in MTAWE. The Committee commends the RBA on this initiative.

14.27 The Committee notes the advice from DOFA that there are difficulties in quantifying for the clawbacks expected to be derived from the NATSEM figures. However, the Committee considers that under favourable fiscal conditions the cost of such a change could be absorbed.

Recommendation

14.28 **The Committee recommends that the Government consider indexing Commonwealth funded superannuation benefits to Male Total Average Weekly Earnings (MTAWE) or the Consumer Price Index (CPI), whichever is the higher, in order that recipients share in the increases in living standards enjoyed by the wider community.**

14.29 Related to this issue, the Committee acknowledges the dichotomy which exists between the closed public sector and defence force schemes, and those which remain open. The former have their preserved benefits linked to the fund earning rate, while the latter are linked to the CPI. The Committee considers that deferred beneficiaries of Commonwealth public sector and defence force schemes should be able to share in the growth of the fund in the same way as the beneficiaries of the closed schemes.

APRA's powers

14.30 During the inquiry a number of issues relating to the safety of small superannuation funds and the supervisory role of the regulator, APRA, came to the Committee's attention.

14.31 Mr Graeme Thompson, Chief Executive Officer of APRA, during an interview on *Business Sunday* on 7 July 2002, said that APRA had been stepping up the intensity of its supervision of superannuation, had visited every fund and completed a risk assessment of each of the 3,000 or so funds that it regulates. Of these, according to Mr Thompson, about 150 funds were rated as being 'high risk' and these were under close supervision by APRA. Mr Thompson also identified that a further 200-300 funds, or ten per cent of APRA regulated funds, would have difficulty meeting the sorts of entry tests that APRA hoped to impose to help protect retirement savings.

14.32 The Committee was concerned that such statements could give rise to a crisis of confidence in the superannuation industry and that care was needed in reporting these matters. In order to discuss these matters with the regulator, the Committee invited APRA to give evidence at a public hearing in Sydney on 8 August 2002.

14.33 In evidence at the public hearing, Mr Venkatramani from APRA elaborated on Mr Thompson's remarks. Mr Venkatramani indicating that, in APRA's experience, at any one time 'about 150 small to medium funds have serious weaknesses warranting close surveillance and possibly active enforcement', while another 150 or so funds managing less than $1 million 'would arguably be too small to satisfy the minimum requirements of a prudent licensing test'.[14]

14.34 Mr Venkatramani continued that the introduction of a licensing test might see some 300 or so small or problematic funds exit the industry and that 'this would do much to improve the overall safety of the industry'.[15]

14.35 The Superannuation Industry Supervision Act currently requires licensing for approved trustees offering retail superannuation to the general public, but not for trustees managing standard employer superannuation for particular workplace and industry groups. This means that only about 400 superannuation funds run by approved trustees need a licence, leaving more than 2,500 funds that have not gone through any licensing approval process. In the wake of the collapse of HIH insurance and Commercial Nominees Australia Ltd, APRA has been giving consideration to increasing the standards by which funds are allowed to operate. The key ingredient which is missing from the regulator's 'toolkit', according to APRA, is licensing.

14.36 Mr Venkatramani from APRA advised the Committee that APRA has proposed the extension of its licensing powers to trustees managing standard employer superannuation for workplace and industry groups, and that the proposal is under consideration by a government working group.[16]

Committee view - APRA's powers

14.37 The Committee considers it imperative to take all reasonable steps to instil confidence in the superannuation system and to ensure that the retirement savings of individuals are safe. As the adequacy of superannuation in retirement is directly related to the safety of its investments, the Committee sees merit in APRA's proposal to seek an extension of its licensing powers. Firstly, because extending new licensing requirements would allow unsuitable parties to be kept out of the industry, and secondly, because it would constrain industry players by formal conditions.

14.38 However, the Committee is concerned to ensure that the equal representation of employers and members is maintained on boards of trustees. The Committee would be

---

14 *Committee Hansard*, 8 August 2002, p. 632.

15 *Committee Hansard*, 8 August 2002, p. 632.

16 *Committee Hansard*, 8 August 2002, p. 631.

concerned if licensing of trustees as individuals, rather than as notional collective trustee entities or trustee corporations, proceeded as this may result in changing this balance, to the disadvantage of the member representatives.

14.39 The Committee notes that, following the release of the Superannuation Working Group report,[17] the Government has recently announced the requirement for all trustees of APRA-regulated superannuation funds to obtain a superannuation trustee licence.[18] The Committee commends this initiative and welcomes the Government's approach to enhancing the safety of superannuation through the other measures outlined in its response to the Working Group's report.

14.40 The Committee also notes that the Organisation for Economic Cooperation and Development has recently released a set of voluntary guidelines, which are the first international standards to be set for the governance of pension funds. The initiative followed the collapse of the USA company Enron, and mounting concern that corporate pension schemes elsewhere are underfunded. The new 12-point guidelines state that trustees should be accountable to pension fund members and their beneficiaries, and cannot absolve themselves of responsibility by using external service providers. Under the guidelines, auditors are also encouraged to act as 'whistleblowers'.

14.41 The Committee commends these new guidelines to APRA for consideration and notes that the financial services regulator is giving consideration to the guidelines.[19]

14.42 While considering the robustness of the governance framework, the Committee takes this opportunity to support ASIC's stronger focus on meeting higher level corporate governance standards.

Overall conclusions – other issues

14.43 The Committee notes that, in order to improve the safety of superannuation, the Government has recently announced the requirement for all trustees of APRA regulated superannuation funds to obtain a superannuation trustee licence and has proposed a number of other measures designed to provide greater protection of employee retirement savings.

14.44 While the Government's initiative is to be commended, the Committee considers that there are some other issues which the Government should consider in a

---

17 Superannuation Working Group, *Options for improving the safety of superannuation*, Report of the Superannuation Working Group (Don Mercer, Chair), 28 March 2002, released by the Government 28 October 2002.

18 This excludes self-managed superannuation funds and exempt public sector superannuation schemes.

19 Australian Financial Review, '*Liability threat to fund trustees*', 26 October, 2002.

timely manner to ensure that people have confidence in the superannuation system and that they have adequate savings and incomes in retirement. These include:

- developing alternative savings vehicles, to maximise the potential for increasing national savings and to assist long-term savings for purposes such as health, housing and education;
- considering indexing Commonwealth funds superannuation benefits to the CPI or MTAWE, whichever is the higher, to maintain parity with community living standards for Commonwealth public sector and defence force retirees and considering linking the preserved benefit to the fund earning rate, rather than the CPI.

14.45 Finally, as some of the matters raised in the report have the potential for significant impacts on the budget, the recommendations would have to be viewed in the light of the budget position at the time.

Senator John Watson

Committee Chair