Chapter Sixteen

Conclusions and Recommendations

Population and labour force trends

16.1 Australia is facing a number of challenges in relation to the transition from work to retirement.

a) Firstly, Australia's population is ageing. While the size of the labour force is projected to grow by just 14 per cent over the next two decades, the number of people aged 55-64 is projected to increase by more than 50 per cent. This is expected to be the fastest growing working-age cohort in the population.

b) Secondly, while there is expected to be significant growth in the number of people aged 55-64, they currently have very low levels of labour force participation. This is also the case internationally. Labour force participation rates in 2002 in Australia fell from 80.5 per cent for the 45-54 age cohort, to 62.9 per cent for the 55-59 age cohort, to only 36.7 per cent for the 60-64 age cohort.

The workforce experience of mature age workers

16.2 In its written submission, FaCS indicated that the majority of mature age workers in Australia retire involuntarily and prematurely from the labour force, as reflected in their low labour force participation rates. FaCS indicated that the causes of early retirement, listed in order of importance, are:

a) ill-health, disability, stress or caring for an elderly or sick relative;

b) involuntary retirement due to redundancy or dismissal (particularly for men);

c) other job related reasons, such as the impact of a company restructure, sale of business, or desire to move to another job;

d) choosing to live off investments and/or income support; and

e) personal reasons, such as a decision to take a break, family reasons, or a move to a new location.

16.3 FaCS also indicated that for a majority of mature age workers who lose a job, the search for a new job (if it occurs) is often unsuccessful.

16.4 Given this evidence, the Committee notes that the uncertainty of future employment for many workers aged 54-65, and the fact that a lot of job departures are not voluntary or planned, must significantly reduce the capacity of individuals to plan for their retirement.

Employer attitudes towards mature age workers

16.5 The Committee notes that under current age retirement legislation in Australia, only a select minority of employees can be compulsorily retired. However, despite this legislative restriction, the Committee was presented with significant evidence that the major cause of involuntary and premature retirement of mature age workers in Australia is discrimination in the workplace. A number of studies were cited to the Committee, variously suggesting that:

a) mature age workers are least preferred for recruitment, and most preferred for retrenchment. Drake found that the preferred age group when recruiting employees is 31-40, while the preferred age group when retrenching is 50 and over.

b) mature age workers are perceived by employers as having deteriorating physical and mental abilities, being unreceptive to new technology, being resistant to organisational change, lacking appropriate skills, and lacking the drive, ambition, energy and creativity of younger employees.

16.6 The Committee notes that the Commonwealth Government is currently moving to introduce federal age discrimination legislation in Australia. The Committee welcomes this initiative.

The productivity of mature age workers

16.7 As indicated above, the Committee believes that mature age workers face high levels of discrimination in the workforce. However, the Committee notes a large number of studies and anecdotal evidence which collectively strongly suggests that mature age workers are just as productive as younger workers. The only instance where this may not be the case is in relation to positions requiring hard physical labour. The Committee examined three issues in relation to the productivity of mature age workers:

a) <u>Education and training</u>: The evidence suggests that younger workers may have higher levels of educational attainment than mature age workers, but that mature age workers have greater experience (both work-related and general), corporate knowledge and more mature judgment.

b) <u>Health, mental and physical ability</u>: The evidence suggests that mature age workers generally have the same verbal ability, spatial reasoning, numeric ability and perceptual speed as younger workers.

c) Absenteeism and accidents: The evidence suggests that mature age workers have lower levels of absenteeism, and stay in a position longer than younger workers.

16.8 Given this evidence, the Committee believes that employers in Australia are wrong to discriminate on the basis of age against mature age employees and that in some instances employers are doing themselves a disservice by not employing or keeping in employment older workers.

The impact of unplanned retirement on mature age workers

16.9 Given the current patterns of involuntary and premature retirement for many mature age workers in Australia, the Committee notes that for many, forced withdrawal from the labour force can have quite serious personal and family consequences.

16.10 Involuntary and premature retirement can lead to the loss of status associated with work, the sense of making a contribution, contact with colleagues, and outside friends and networks. In turn, involuntarily unemployed people often experience depression, anxiety and general distress, together with low self-esteem and confidence, and a reduction in well-being. In many cases, this places a greater direct and indirect burden on immediate family members and the wider community.

16.11 Leaving aside pure economic and financial arguments discussed below, the Committee believes that there are good reasons for promoting the availability of employment for mature age workers on the basis of the individual's personal well-being and the well-being of society.

The case for change

16.12 The ageing of the population, coupled with the low levels of participation of mature age workers in the labour force, is expected to place significant strain on the superannuation system and the capacity of the government to guarantee retirement incomes and services in the future.

16.13 Accordingly, the Committee believes that it is in Australia's economic interest for mature age workers to be encouraged to remain in the workforce. Keeping mature age workers in the workforce would broaden the skills base of the Australian economy, with associated implications for Australia's productivity and GDP, and the government's capacity to fund the income support and social security systems.

16.14 There is evidence that the current under-employment of mature age workers may be reversed in the future simply by labour force pressure for mature age workers to remain in the workforce as the absolute numbers of workers declines. Nevertheless, the Committee believes that the Government should take positive steps to encourage progressive transition from work to retirement in Australia.

Part-time work and labour market programs

Part-time work

16.15 The Committee notes that part-time work can be an integral step in a gradual transition from work to retirement. It enables mature age workers to retain a connection to the workforce, while maintaining an income and pro-rata conditions of employment such as annual leave and sick leave.

16.16 In its evidence to the inquiry, DEWR indicated that part-time work is increasingly available in awards and agreements. However, the Committee is concerned that the majority of available part-time positions may not be suitable to mature age workers – they may be of a piecework nature or be highly intensive, where younger and more active workers tend to be favoured.

16.17 Accordingly, the Committee believes that the Government should investigate mechanisms to promote the availability of appropriate part-time positions for mature age workers. Those mechanisms might involve tax incentives or training incentives for employers, or working with industry and the unions to develop progressive employment practices, such as those implemented by the Queensland DIR and the AWU.

Recommendation 1

The Committee recommends that the Government investigate mechanisms to promote the availability of appropriate part-time positions for mature age workers.

Labour market programs

16.18 In its evidence to the inquiry, DEWR indicated that it has a number of labour market programs and employment services designed to encourage and facilitate the participation of mature age workers in the workforce. They include Job Network services, the Active Participation Model, and Australians Working Together – an initiative to support mature age employment.

16.19 The Committee notes evidence that up until now, mature age job seekers have been under-represented amongst people using Job Network services, and amongst people with successful outcomes from the service. The DEWR Survey of Job Seeker Perceptions found that mature aged workers were less likely to be offered a job interview or training than younger workers by their job network provider.[1]

16.20 However, the Committee recognises and welcomes recent moves to provide specialist services for mature age people in the Job Network through the Australians Working Together initiative.

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1 Reported in Productivity Commission, *Independent Review of the Job Network Draft Report*, March 2002, p. 6.13.

16.21 The Committee also wishes to record its recognition of the work being done by private job matching organisations such as Workingconnections.

Using superannuation to finance retraining

16.22 The Committee's terms of reference raise the possibility of using superannuation to finance retraining of mature age workers to help them remain in the workforce, or to re-enter the workforce.

16.23 Current government policy is that superannuation savings should be used to provide income in retirement, and should not be withdrawn from the superannuation system for any other purpose prior to retirement. Although superannuation savings can be accessed prior to retirement in certain limited circumstances, such as severe financial hardship or on compassionate grounds, there are tight rules on such access.

16.24 Given these restrictions, the Committee acknowledges concerns expressed by ASIC and others that any move to allow access to superannuation to finance retraining would undermine the fundamental proposition that superannuation savings should be put aside to finance income and benefits in retirement. The Committee also notes a number of other arguments why superannuation savings should not be used to finance retraining:

a) Superannuation savings are needed to finance retirement;

b) Jobs may not be available at the end of any retraining; and

c) Responsibility for financing retraining rests with the government and employers.

16.25 Accordingly, the Committee does not believe that the Government should make superannuation savings available to finance retraining. The core role of the superannuation system is to finance retirement.

16.26 The Committee believes that responsibility for retraining of mature age workers rests with the Government. The Committee notes that the Australians Working Together package provided Training Credits of $800 each for 69,000 mature aged and indigenous job seekers in the Job Network. Consideration should be given to expanding this program to provide greater access to retraining for mature aged workers.

Recommendation 2

The Committee recommends that the Government consider expanding retraining assistance available to mature age workers under the Australians Working Together program.

The superannuation accumulation system

16.27 The Committee notes below a number of suggestions to improve the superannuation accumulation system as it relates to mature age workers.

The SG Rate

16.28 A number of parties to the inquiry recommended an increase in the SG rate from the current 9 per cent to anything up to 15 per cent, on the basis that SG contributions alone will not provide enough savings for many in retirement.

16.29 At the same time, the Committee considers that the current economic and employment climates are difficult ones in which to contemplate additional compulsory employer superannuation contributions. The Committee is also reluctant to propose compulsory member contributions because of the immediate reduction in living standards that would result.

16.30 The Committee notes that these matters were raised with the Government by the Committee in its earlier report on *Superannuation and standards of living in retirement*. The Committee is currently awaiting a response to that report.

The superannuation surcharge

16.31 Parties to the inquiry advocated the levying of the superannuation surcharge on the basis of savings over a lifetime, rather than on the basis of current income. Under such a scheme, someone of mature age with superannuation savings of less than say $150,000, but with a high income, would not be levied the superannuation surcharge, thereby giving them a greater incentive to contribute to their superannuation.

16.32 As noted in the Committee's earlier report entitled *Superannuation and standards of living in retirement*, the Committee believes that the surcharge is an inefficient tax which is costly to administer. It imposes costs on all members, irrespective of whether they are liable to pay the surcharge or not.

Rules relating to contributions

16.33 Various parties to the inquiry recommended reform of the work test rules which require that employees aged 65-75 can only contribute to a super fund if they are working 10 hours or more per week. The Committee understands that Treasury is currently examining this issue.

The superannuation benefits system

16.34 The Committee notes below a number of suggestions to improve the superannuation benefits system as it relates to mature age workers.

The superannuation preservation age

16.35 During the inquiry, a number of parties recommended an increase in the superannuation preservation age to the age of eligibility for the age pension, thereby preventing “double dipping”. A variation on this was for linking the taking of lump sum superannuation benefits (as opposed to taking an income stream) to the age of eligibility for the age pension.

16.36 The Committee notes that the Government is currently in the process of increasing the superannuation preservation age to 60.

Rules on the taking of superannuation benefits

16.37 As with the rules relating to contributions for the over 65, the Committee notes that the current rules on the taking of superannuation benefits are complex. Currently, a member between 65 and 75 must work at least 10 hours per week in order to avoid having to draw down their savings, while those over age 75 must work full-time (at least 30 hours per week).

16.38 The Committee again understands that Treasury is currently examining this issue.

Defined benefit schemes

16.39 The Committee acknowledges that some Commonwealth and state government defined benefit schemes act to discourage individuals from continuing to work beyond the age of 60, or even 55, or from continuing to work part-time.

16.40 In response, the Committee notes that various OECD countries have taken measures to make pension systems more neutral, so that people retiring later (having contributed more) will have a correspondingly greater pension. For example, in Sweden, Italy, Poland and Hungary, public pensions are being progressively transformed from defined benefit schemes to notional defined contribution schemes. In these systems, the level of benefit depends on time in the workforce and the notional interest rate.

Recommendation 3

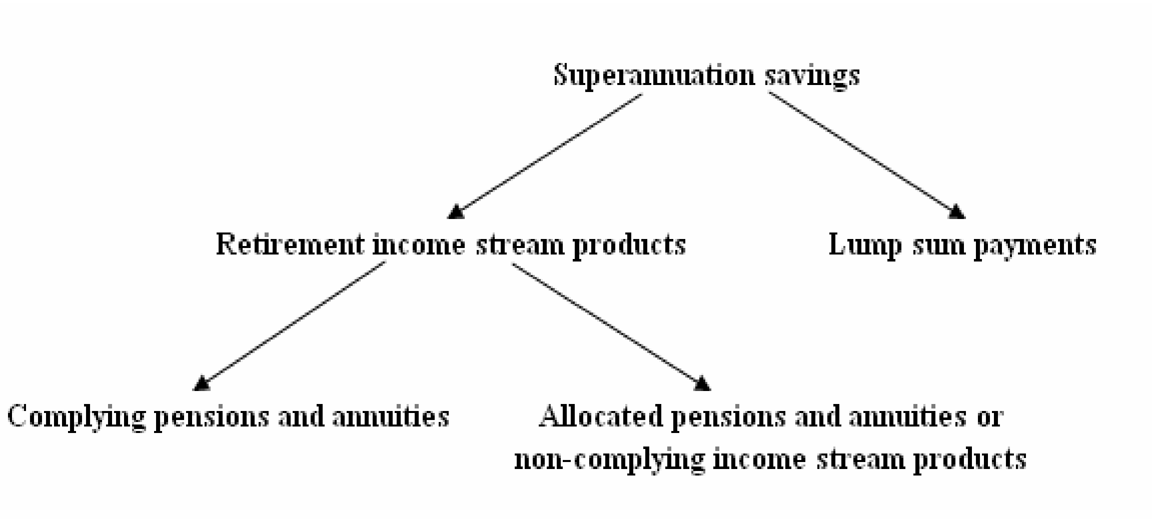
The Committee recommends that the Government look at means of reforming current Commonwealth Government defined benefit schemes to remove the disincentive to continue working beyond certain ages.

The taking of income stream products on retirement

The current retirement income system

16.41 The Committee notes that under the current retirement income arrangements in Australia, retirees have a number of options when taking their superannuation benefits. These are shown in Figure 16.1 below.

Figure 16.1: Current architecture of the retirement income system



16.42 Currently, the Government offers incentives to retirees through the tax system and the age pension means test to take retirement income pensions – either complying annuities or allocated pensions (the means tests are more generous for complying annuities) – as opposed to taking lump sum payments.

16.43 However, the Committee notes that APRA statistics show that only 27 per cent of superannuation payouts in 2001 were taken either directly (20 per cent) or indirectly (7 per cent rolled-over later) as a retirement income pension. The remaining 73 per cent were taken as a lump sum payment. This is shown in Table 16.1 below.

Table 16.1: Pension and lump sum payments from superannuation funds for 2001

Type of scheme	Lump sum payments ($)	Pension Payments ($)	Proportion of lump sum payments
Public sector	7,170	3,628	66%
Industry	1,570	70	96%
Corporate	2,887	463	86%
Retail	10,958	2,084	84%
Small fund	2,008	63	97%
Total	**24,008**	**6,308**	**80%**

16.44 The Committee notes that complying lifetime annuities are particularly unpopular with retirees. Only 4 per cent of income stream sales in 2001 were of complying lifetime annuities. The unattractiveness of complying lifetime annuities is due to several factors:

a) Complying life annuities in the market place have a built in longevity margin because of the risk that only healthy people will be in the market to buy them (so-called adverse selection). As a result, returns are low.

b) Complying life annuities must provide a guaranteed rate of return to investors. The capital backing the annuities must therefore generally be invested long-term in conservative assets (bonds and cash). Times of low interest rates make it unattractive to "lock-in" to a guaranteed long-term investment. As a result, returns are lowered further.

c) Complying life annuities entail a loss of capital to the estate on death. The longest the capital can be guaranteed for is 10 years, which is less than the life expectancy of most people.

16.45 The unpopularity of complying lifetime annuities is despite the fact that they have some attractive features. Under the *Social Security and Veterans' Affairs Legislation Amendment (Budget and Other Measures) Act 1998*, complying life annuities qualify for a higher RBL and are eligible for asset test exemption and preferential income test treatment. In effect, retirees can still draw the age pension according to generous means testing arrangements in addition to their annuity.

<u>Reform of the retirement income system</u>

16.46 During the inquiry, various parties again raised issues in regard to the take-up of retirement income products, as opposed to lump sum payments, on retirement. Many of these issues reiterated concerns expressed by the Committee in its report *Superannuation and standards of living in retirement*.

16.47 In particular, the Committee notes the evidence of Associate Professor Covick. He argued that the Government should be encouraging or even compelling individuals to purchase a genuine complying annuity on retirement. Doing so, he argued, would ensure retirees had a capital guaranteed rate of return, and an orderly drawdown of assets, thereby removing the risk that they would run out of money in retirement. Where necessary, Associate Professor Covick argued, such a life annuity should be topped up by government through the age pension system.

16.48 In addition, Associate Professor Covick advocated to the Committee a lowering of RBLs, on the basis that RBLs are the only means at present of encouraging individuals to put their retirement savings into prudently managed vehicles which pay a steady income stream.

16.49 <u>Members of the Committee wish to highlight that Australia has three options for the future architecture of the retirement income payment system:</u>

a) <u>Firstly, a continuation of the current complex tax and social security rules, which have resulted in insufficient incentives for retirees to take up income streams or for life offices to offer such products. In the Committee's opinion, the present retirement income stream arrangements are complex, not easily understood and have resulted in life offices withdrawing from the annuity market. As a result, the Committee believes that people are being disadvantaged in their retirement through the complex interaction between the superannuation and tax/social security systems.</u>

b) Secondly, Labor Senators advocate improving the existing system by developing an aggressive education campaign to educate the public to encourage them to take up income streams on retirement, together with reform of the existing tax and social security rules to offer greater incentive to individuals to voluntarily take up an income stream, with a review of the effectiveness of this option after a 3-5 year period. Such reforms might include the option of including lump-sums under the age pension asset test for Centrelink/DVA purposes.

c) Thirdly, Government Senators and Senator Cherry from the Australian Democrats (the Committee majority) support the argument of Associate Professor Covick and believe that the Government should, at some time in the future, move to follow world's best practice as stated by the World Bank and mandate the use of a proportion of superannuation savings for the purchase of either lifetime or term-certain complying annuities/pensions (growth pensions) on retirement.

16.50 The World Bank has indicated that Australia is one of only two countries with mandatory, individual superannuation accounts which allow members access to their whole fund balance when they retire.[2] The World Bank offers a number of arguments in favour of forcing retirees to convert a set amount of their pre-retirement savings into an annuity:

a) It solves the problem of 'myopia'. Myopic people spend their savings early in retirement;

b) It addresses the lack of information people have – on inflation or life expectancy, for example – when making income choices; and

c) It is an obvious response to the so-called 'moral hazard' of adverse selection – people will not save enough if they expect the government to rescue them in their old age.[3]

16.51 The full text of the World Bank paper *Annuities: Regulating withdrawals from individual pension accounts* is at **Appendix Eight**.

16.52 The Committee majority believe that the use of a proportion of superannuation savings for the purchase of either lifetime or term-certain complying annuities/pensions (growth pensions) on retirement would have three significant benefits:

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2 World Bank Pension Reform Primer, *Annuities: Regulating withdrawals from individual pension accounts*, p. 5.

3 World Bank Pension Reform Primer, *Annuities: Regulating withdrawals from individual pension accounts*, p. 3.

a) It would provide greater capital certainty in superannuation pension products and greater certainty for low-income retirees in particular in the drawdown of their assets. This need for greater certainty and security in the drawdown of assets is only increased by the increasing life expectancy of retirees.

b) It would significantly simplify financial planning for retirees by largely removing the complexities of matching superannuation benefits with the tax and social security rules.

c) It would discourage retirees from using superannuation to pay off debt on housing or credit cards, which is contrary to the intended purpose of superannuation to finance retirement as required by the 'sole purpose' test.

16.53 Under the proposal of the Committee majority for mandating the purchase of either lifetime or term-certain complying annuities/pension on retirement, the Government would need to restrict access to lump sum payments. However, the Committee majority acknowledge that there may need to be arrangements for individuals with small superannuation nest eggs to continue to take a lump sum payment.

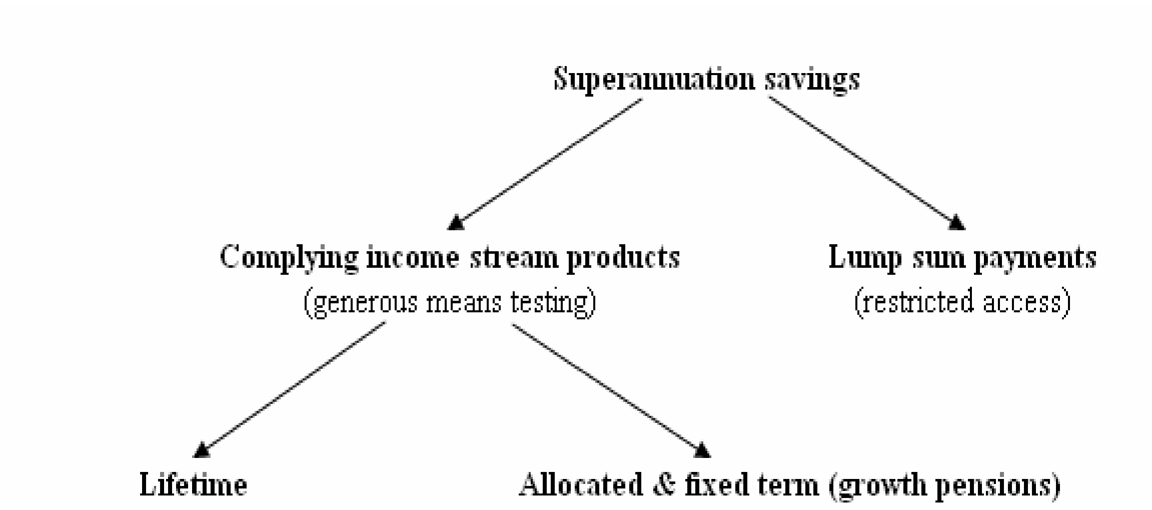
Recommendation 4

The Committee majority recommend that the Government move in the future to make retirees convert a proportion of their pre-retirement savings into a complying annuity.

16.54 The Committee majority note that the timing of such a move to mandate the purchase of a genuine complying annuity on retirement will depend on the increase in superannuation savings in Australia as the superannuation system matures. Currently, average retirement savings are in the order of $65,000 – although many superannuants, such as DIY superannuants, have significantly greater savings.

16.55 Based on the conclusions outlined above, the Committee majority believe that the architecture of the retirement income system in Australia in the future should resemble that shown in Figure 16.2 below.

Figure 16.2: Proposed architecture of the retirement income system



16.56 By mandating the use of a proportion of superannuation savings for the purchase of a genuine complying annuity on retirement in Australia, the Committee majority believe that life insurance offices and other providers will re-enter the annuity market and offer a range of new and different products to retirees that are currently not on offer. This is because they will have a guaranteed market.

16.57 The Committee majority also anticipate that under these revised arrangements, retirees would mix and match between lifetime annuities and allocated/fixed term annuities (growth pensions) according to their individual circumstances and risk profiles. For example, certain retirees, for personal reasons such as their health, may not wish to purchase lifetime annuities, and would be better served by a fixed term annuity (with term annuities, the remaining capital can be left to the estate).

16.58 As indicated above, Labor Senators also support the greater take-up of lifetime or term-certain complying annuities/pensions, but do not support mandating the purchase of such products.

Transitional arrangements

16.59 The Committee majority recognise that any move to mandate the purchasing of complying annuities on retirement would need to be accompanied by transitional arrangements over a long period of time.

16.60 Importantly, the Committee notes that many retirees currently take their entire superannuation savings as a lump sum payment on their exit from the workforce to pay off their house or credit card. Accordingly, they may not wish to purchase a complying annuity on retirement.

16.61 In the short-term, the Committee majority do not believe that such people should be disadvantaged by being forced to purchase a complying annuity. However, in the long-term, the Committee majority believe that measures must be taken to reverse the practice of using all superannuation savings to pay off consumer debt.

16.62 To allow retirees to continue to access lump sum payments in the short to medium term, the Committee majority believe that the Government should consider placing a minimum threshold on the purchase of a complying annuity, below which individuals would not be compelled to purchase an annuity and could instead take a lump sum payment. Again, this could be a transitional arrangement which could be revisited in the long term as the superannuation system matures.

Recommendation 5

The Committee majority recommend that in moving to make compulsory the taking of complying annuities on retirement, the Government implement transitional arrangements so that individuals can have access to restricted lump sum payments.

Growth pensions

16.63 Government, Democrat and Labor Senators all agree that in order to increase the competitiveness of complying annuity products offered privately in the market place, the Government should move to make complying annuity products more attractive to retirees. The Committee notes evidence provided by AMP that complying annuities would be more attractive to retirees if they could be invested in a range of assets:

a) First, this would allow the providers to remove the rate of return guarantee from the product and pass some of the investment risk and reward to the retirees, making the annuity cheaper as a result;

b) Second, retirees would have greater investment choice, allowing them to select assets; and

c) Third, this would allow retirees to benefit from a long-term investment in growth assets, with the potential for capital growth and therefore improved retirement income. It also avoids retirees having to lock in at a low rate of return.[4]

16.64 The Committee notes that in its report *Superannuation and standards of living in retirement*, the Committee made a recommendation that the Government remove the requirement of guaranteed returns from complying annuities, thereby promoting the development of growth pensions which provide higher returns. The Committee reiterates this recommendation.

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4 AMP submission to the Committee's inquiry into superannuation and standards of living in retirement.

Recommendation 6

The Committee recommends that the Government consider the appropriateness of the current restrictions on the purchase of complying annuities, to encourage the availability of so-called growth pensions.

Government pensions and allowances

16.65 The Committee notes below a number of suggestions to improve the government pensions and allowances system as it relates to mature age workers.

Newstart Allowance

16.66 The Committee notes the evidence from representatives of Centrestone in relation to the opportunities available for high wealth individuals, through various strategies and loopholes, to access the Newstart Allowance from age 55 to 65.

16.67 The Committee acknowledges these arguments and believes that there is scope for preventing access to Newstart Allowance for high wealth individuals. At the same time, the Committee notes that the majority of retirees who currently rely on Newstart Allowance would not have large superannuation savings. As a result, if they were not able to access Newstart Allowance, the effect might be that they run-down their superannuation saving before age 65, and would be forced to rely even more heavily on the age pension at 65.

Recommendation 7

The Committee recommends that the Government investigate the opportunities for retirees age 55-65 to access the Newstart Allowance, without genuinely looking for work, while also continuing to access superannuation payments.

The age pension means test

16.68 The Committee notes that receipt of an earned income does not preclude an individual from receipt of the age pension. However, in determining age pension entitlement, different types of income are treated differently:

a) Personal earnings (salary and wages) are included in the income test on the basis of income received in the applicable two weeks;

b) Other forms of income are, in effect, averaged over the entire year, even though such earnings are attributed to specific fortnights.

16.69 These arrangements mean that people in receipt of the age pension are discouraged from intermittent and casual work. For example, a person can earn $30 a week without a reduction in the pension. However, a person earning $1,560 in a week (rather than $30 a week over 52 weeks) loses a fortnight's pension. This arrangement in effect penalises those earning income in blocks rather than in small weekly increments.

Recommendation 8

The Committee recommends that the Government look at reforming the age pension means test to treat personal earnings (salary and wages) in the same manner as other forms of income.

The Pension Bonus Scheme

16.70 The Committee notes arguments that the Pension Bonus Scheme has not been particularly successful in encouraging individuals to work past age pension eligibility. Various points were raised during the inquiry:

a) The scheme has not been well publicised;

b) The quantum of bonus payment in lieu of the age pension is not great;

c) There is a requirement to work 960 hours a year, which is high for individuals who may only want to work on a part-time or intermittent basis; and

d) The labour force participation rate for persons of age pension age is very low and is mostly made up of professionals and the self-employed who are less likely to be eligible for the age pension.

Recommendation 9

The Committee recommends that the Government revisit the provisions of the Pension Bonus Scheme to increase its attractiveness to individuals working past age pension eligibility.

Carer's benefits

16.71 The Committee notes the recommendation of the COTA National Seniors Partnership that carer's benefits similar to those available in the UK, Canada and Germany be introduced such that contributions to a superannuation account are made by government on behalf of women caring for another person (child, parent or significant other) for the duration of their absence from the workforce.

Recommendation 10

The Committee recommends that the Government investigate making contributions to a superannuation account on behalf of individuals caring for another person outside of the workforce.

Income support arrangements for women

16.72 The Committee notes evidence from Dr Olsberg that women in particular are likely to have inadequate income in retirement due to insufficient time in the workforce, women's working patterns, women's longer life expectancy and the impact of family break-up.

16.73 In response, Dr Olsberg summarised four strategies for increasing the retirement income of women:

a) Greater equity for women in the paid workforce, including the payment of SG contributions during maternity/paternity leave and the payment of a carer's benefit.

b) Better education about the importance of saving and additional incentives to save such as co-contributions from government and subsidies and tax-cuts for those on low incomes.

c) Better financial planning to maximise women's investments, including the development of financial products which offer maximum investment opportunities for savings patterns that fluctuate over the course of a lifetime.

d) Increasing the role of women in the governance of Australia's superannuation and retirement incomes system.

16.74 The Committee notes that many of these issues, such as paid maternity/paternity leave, carer's benefits, financial education standards, co-contributions and tax-cuts for low income earners are addressed elsewhere in this report, or are currently being considered by the Government or the Parliament. The Committee accepts, however, that in many instances, successful resolutions on many of these issues are of particular importance to women.

Income support arrangements for self-funded retirees

16.75 During the inquiry, concern was expressed by various parties that the government should be providing additional concessions and assistance to self-funded retirees, on the basis that throughout their working lives, self-funded retirees have foregone other spending in order to maintain some degree of independence in retirement.

16.76 The Committee noted in its earlier report *Superannuation and standards of living in retirement* that various concessions for self-funded retirees, including the Senior Australian Tax Offset (SATO), were introduced in the 2001-02 Budget. SATO allows self-funded single retirees to have an income up to $20,000 a year without paying income tax or the Medicare levy. The SATO phases-out over the income range $20,000 to $37,840 (for singles). Similarly, couples can have combined incomes up to $32,612 without paying tax (depending on the income split between the partners). For couples, the SATO phases out between $32,612 and $58,244, if incomes are evenly divided.

16.77 The Committee also noted in its earlier report that the Government substantially increased in the 2001-02 Federal Budget eligibility for the CSHC. Singles with incomes below $50,000 and couples with incomes below $80,000 are now eligible for the card, even where they are not entitled to the age pension. Over 225,000 self-funded retirees currently hold a CSHC.[5]

Retirement and eligibility for the age pension

16.78 The Committee notes that a number of parties to the inquiry expressed the view that the concept of a fixed retirement age is no longer relevant, on the basis that governments have encouraged workers to plan for and contribute to their own retirement income, and that different individuals have different health and social circumstances and different expectations in retirement.

16.79 However, other parties noted that people have expectations of retirement at certain ages, built around the preservation age for superannuation, the age at which people may claim the age pension, and the age up until which people can contribute to superannuation. These points represent the age beyond which the community considers there to be no obligation to work.

16.80 The Committee also notes that some countries are increasing the age of eligibility for the age pension as a means of forcing mature age workers to remain in the workforce. The Committee does not agree with this approach, and believes that the focus of the Government should be on encouraging rather than forcing mature age workers to remain in or return to the workforce.

Current planning for retirement in Australia

16.81 The Committee notes evidence to the inquiry that a significant proportion of the Australian population does not plan adequately for retirement. This is clearly of concern to the Committee. For a successful and fulfilling retirement, planning for retirement should begin well in advance of withdrawal from the labour market.

16.82 The Committee notes that the failure of many in the Australian population to plan for retirement may be attributable in part to their lack of financial education. The Committee endorses calls for the Government to play a primary role in making individuals aware of the need to secure their own futures.

Recommendation 11

The Committee recommends that the Government increase efforts to educate the general population about the importance of planning for retirement.

The quality of paid financial advice

16.83 The quality of paid financial advice for pre-retirees and retirees was a significant issue during the inquiry.

5 Senate Select Committee on Superannuation, *Superannuation and Standards of Living in Retirement*, pp. 142-143.

16.84 The Committee notes with concern evidence that financial planners are not in some instances acting in the best interests of their clients, with the result that retirees are being placed in inappropriate retirement products which do not serve them well in retirement. The basis of this concern is that while individuals are seeking professional and unbiased advice, the structure of the industry operates to prevent this.

Financial industry commissions

16.85 The Committee is of the opinion that the mechanisms for remunerating financial planners need reform. Currently, most financial planners are remunerated for their services through trailing commissions, which may be deducted from the consumer's account on a recurring basis for an indefinite period. The Committee does not believe that this system encourages financial planners to provide conflict-free, objective advice, simply because some financial products provide greater commissions than others. A more desirable outcome would be a more direct relationship between the amount of work for the financial planner and the fee charged.

16.86 In this regard, the Committee welcomes the reforms that the Government has introduced through the new FSR Act to improve financial disclosure standards, including obligating financial advisers to disclose to their clients any conflict of interest. In addition, the new FSR Act includes requirements that advice given to consumers must be appropriate to their needs, circumstances and objectives.

16.87 Nevertheless, the Committee believes that the Government should consider means by which to apply a more direct relationship between the amount of work involved for the financial planner and the fee charged.

Recommendation 12

The Committee recommends that the Productivity Commission investigate the remuneration arrangements for financial planners, especially whether there should be a more direct relationship between the amount of work performed and the fee charged.

The deductibility of financial planners' fees

16.88 Following on from its recommendation above, the Committee notes that the payment of an up-front fee for a financial plan is currently not tax deductible, whereas ongoing fees are perceived as relating to income, and hence are tax deductible.

16.89 Treasury indicated that the reason for this is the general tax principle that deductions can only be claimed for expenses incurred in earning assessable income, and that superannuation advice paid for by an individual in advance is not incurred in earning an assessable income.

16.90 Nevertheless, the Committee believes that the current taxation arrangements provide an undesirable inducement to pay for financial services through trailing commissions.

Recommendation 13

The Committee recommends that the Government re-examine the deductibility rules for financial planners' fees to remove the inducement to pay for financial planners' services through trailing commissions.

Not-for-profit funds

16.91 The Committee notes the evidence of Mr Brookes from the CSA that not-for-profit funds are being forced out of the superannuation market and progressively replaced by for-profit, commission driven financial conglomerates, to the detriment of consumers.

16.92 The Committee accepts that it is unlikely, despite the provisions of the FSR Act, that financial planners would recommend that their clients invest in industry, corporate and public sector funds which do not pay commissions, and which are not on their list of products to recommend.

16.93 The Committee believes that the solution to this problem is to ensure that financial planners provide independent and unbiased advice by removing any commercial advantage from the provision of that advice. In the Committee's opinion, the decline of not-for-profit funds makes more urgent the recommendations made by the Committee above.

Government and superannuation fund assistance

Government provided financial advice

16.94 The Committee notes that there is a range of well regarded, independent financial advice provided to pre-retirees and retirees by the government through FaCS. The Committee believes that the availability of such advice is very important, in the light of evidence cited above about the difficulty of obtaining independent, unbiased financial advice privately.

16.95 The Committee observes in particular that a number of parties to the inquiry were highly complimentary about the FIS provided by FaCS, and the services provided by NICRI. The Committee recognises, however, that NICRI operates on a budget of only $450,000 per annum, which severely curtails its capacity to provide assistance to pre-retirees and retirees.

Recommendation 14

The Committee recommends that the Government provide significant additional funding to NICRI to expand the scope and availability of the assistance it offers to pre-retirees and retirees.

Assistance provided by superannuation funds

16.96 The Committee notes that superannuation funds provide varying levels of direct advice and assistance to their members. Based on the evidence available to the Committee, the Committee makes the following observations:

a) Almost all corporate, industry and public funds make available education services to their members. The Committee welcomes this commitment.

b) Fewer corporate, industry and public funds make available financial advice services to their members. The Committee notes that there are regulatory issues under the new ASIC licensing regime in relation to what is general advice and what is specific advice requiring licensed individuals to be involved. However, the Committee notes that some funds have addressed this problem by setting up an independent organisation that provides advice on behalf of the fund.

c) Only a certain number of corporate, industry and retail funds provide pension annuity products for their members to select from in retirement. As a result, some fund members are forced to move their accumulated superannuation upon retirement to a separate income product provider, with associated costs, and the risk of receiving poor advice.

Recommendation 15

The Committee recommends that the Government continue to encourage superannuation funds to provide assistance to pre-retirees and retirees beyond the accumulation phase, including the provision of appropriate financial education, advice and retirement products.

Forecasting superannuation savings using government guidelines

16.97 The Committee notes the proposal that the Government establish guidelines which could be used by superannuation funds to project superannuation savings for individuals in retirement. In the UK, the regulator, the Financial Services Authority, requires that a benefit projection statement be provided annually for all accumulation style superannuation benefits, based on standard assumptions.

16.98 During the inquiry, a number of parties welcomed such a proposal, on the basis that it would assist individuals in their planning for retirement. At the same time, however, a number of parties drew attention to the uncertainties involved in projecting superannuation savings far into the future, due to the difficulties of projecting long-term rates of returns, tax levels and so forth.

16.99 The Committee believes that there may be merit in the Government investigating the standard assumptions established by the Financial Services Authority in the UK for the generation of benefit projection statements. At the same time, the Committee is doubtful whether similar assumption and projection statements could realistically be adopted in Australia.

Non-financial planning for retirement

16.100 The Committee believes that planning for retirement should involve more than just financial planning. Clearly, lifestyle planning of personal relationships, health, housing and intellectual and social activities are an equally important part of the equation.

16.101 However, the evidence before the Committee suggests that often lifestyle planning does not receive the attention it deserves. The Committee believes this to be a cause for concern, given the evidence that good lifestyle planning in retirement can significantly improve an individual's mental alertness and well being, and decrease the need for health and community care.

16.102 The Committee notes that FaCS makes available a range of booklets on lifestyle planning in retirement. However, the Committee believes that the Government should investigate whether they are readily available to retirees, including through employers, superannuation funds and retiree groups.

Recommendation 16

The Committee recommends that the Government take steps to ensure the wide distribution of information on the need for lifestyle planning in retirement.

Other Issues

<u>A major review of the superannuation system</u>

16.103 The Committee notes the call of the ABA for a major review of the superannuation system, something perhaps akin to a Royal Commission. However, the Committee does not believe such a major review is warranted at this time, and prefers to pursue ongoing incremental improvement to the superannuation system.

<u>The remuneration of superannuation investment fund managers</u>

16.104 Although not specifically raised during the inquiry, the Committee wishes to comment on the remuneration arrangements for superannuation investment fund managers. Currently, investment fund managers are generally paid a fixed fee, based on the size of their portfolio under management, regardless of the performance of the fund. The Committee considers, however, that there may be merit in a component of investment fund managers' remuneration being determined on the basis of their performance and movement in the fund's assets under management.

Recommendation 17

The Committee recommends that the Productivity Commission investigate the remuneration arrangements for superannuation investment fund managers.

16.105 This should not be taken as an endorsement of commission-based remuneration, about which the Committee has expressed its concerns in Recommendations 12 and 13.

16.106 The Committee also wishes to comment on the desirability of superannuation fund managers moving to standardise the terms used in their fund prospectuses, and making information on financial performance, fees and charges available to readers in a simple format on the one page.

Investment by superannuation trustees in hedge funds

16.107 Although not specifically raised during the inquiry, the Committee wishes to comment on investment by superannuation trustees in hedge funds.

16.108 On 26 June 2003, APPA reported the results of its survey on the level of superannuation monies invested in hedge funds. The survey found that 15 per cent of surveyed trustees reported making hedge fund investments, although on average they invested only 4 per cent of their portfolio in hedge funds. Nevertheless, this is a large increase on the levels of three or four years ago. A small proportion of funds reported that over 10 per cent of their portfolio had been allocated to hedge funds.

16.109 The Committee is aware that APRA is currently exploring ways to work with the hedge fund industry association, the Alternative Investment Managers' Association (AIMA), to develop more guidance for disclosure by hedge funds and asset consultants to superannuation trustees. In addition, APRA is keen to ensure that investment in hedge funds is consistent with superannuation fund's investment objectives.

16.110 The Committee endorses these moves by APRA, and will continue to monitor APRA's scrutiny of investment by superannuation trustees in hedge funds.

State government superannuation schemes

16.111 The Committee notes the evidence of the South Australian Government Superannuation Federation in relation to the progressive closure of South Australian Government defined benefit schemes. Members of the Federation argued that this is inconsistent with the objectives of the Commonwealth Government in seeking to ensure an adequate retirement income for all Australians, and suggested that the Commonwealth should urge the states to offer retirees post-retirement income products, in particular allocated pensions.

16.112 In response, as discussed in this report, the Committee supports the widespread provision of post-retirement income products, but does not feel that the Commonwealth can legitimately comment directly on the superannuation arrangements of individual state governments.

Senator John Watson
Committee Chair