Investment & Financial Services Association Ltd
ACN 080 744 163

24 March 2003

The Secretary
Senate Select Committee on
Superannuation and Financial Services
Parliament House
CANBERRA ACT 2600

Dear Ms Morton

Reference:

Planning for Retirement

The Investment and Financial Services Association 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 $620 billion on behalf of over 9 million Australians.

In this submission, we will provide some of the findings from our own research and explore some general issues in preparation for retirement. We will also make some comments about the way the current superannuation rules impede people who are somewhere between "full" participation in the labour market and "completely" retired.

Preparation for retirement

As part of IFSA's 2001 research project, *Retirement Savings – Desires and Drivers*, we explored when and why, and to a lesser extent how, people aged over 45 commenced financial preparations for retirement.

- We found that many pre-retirees did not have a clear idea of when they would retire (Chart 1).
- We found that median age at which people commence to consciously save for retirement was 45, while the mean age was 36 (Chart 2).
- We found that people were neutral on the proposition that they know or knew at what age they would retire several years in advance (Chart 3). This suggests that retirement is somewhat unplanned for many people.

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We also found those who were pre-planning at all (the minority) tended to be those who displayed one or more of the following characteristics[1]:

- Looking forward to retirement (early retirement for some) because of lifestyle aspirations (reduce stress and/or pursue a hobby or low intensity small business interest).
- Encouraged by their employer to pay attention to their retirement financing (via education/provision of information or advice from the company's superannuation fund).
- In a very favourable superannuation scheme or one that otherwise encouraged higher employee contributions.
- Feared ill health, redundancy or a forced early retirement for any reason.
- Business failure or other severe denting of life savings to date
- Women for whom divorce or death of spouse had triggered them to plan for retirement.
- Sudden inheritance and associated realisation this is the only nest egg they have for retirement.
- Wealth accumulation occurring naturally. (eg by luck or good management a person finds themselves owning a successful business or earning a lot of money and needing to manage it).
- Wealth accumulation by nature or background.
- Children leaving home, triggering a realisation among parents that retirement is now a possibility and increasing the level of disposal income available for saving.

In quantitative research[2], there was agreement with the statement that "*saving or investing for my retirement is important to me*". We also found there was strong disagreement with the statement "*I live for today and don't worry about saving money*". Despite these findings, behaviour or confidence does not appear to have changed: the sample overall neither agreed nor disagreed with the statement "*I feel confident I will have enough money in retirement to provide a good standard of living*".

Need for advice

Choosing the right mix of retirement income investments – inside and outside superannuation - is well understood to be more a complex decision than selecting an accumulation superannuation fund in which to save until retirement.

- Consumers face a far more intricate array of taxation and social security regulation, both of which can have a direct impact on their annual income.

- The consequences of investment attributes such as volatility and liquidity have a more immediate impact in an allocated income stream than during the accumulation phase.

[1] IFSA Retirement Savings- Desires and Drivers Project – Qualitative findings
[2] IFSA Retirement Savings – Desires and Drivers Project – Quantitative findings

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- Individual attributes such as general health, expected longevity, desire or need to leave an estate, also have a direct bearing on the features consumers will look for in particular products.

There are a number of general information services available to the general public on retirement investments, such as the Centrelink Financial Information Service and the National Information Centre on Retirement Investments. IFSA is in the process of producing a third edition of the publication Understanding Retirement Income Streams, a joint publication with the Department of Family and Community Services.

Despite this information, the choices facing new retirees are sufficiently complex that many wish to obtain individual financial advice. This advice must be paid for: the current options for individuals are to pay on a fee for service basis, or to pay via commissions sourced from fees on the products actually purchased. Commissions received by financial planners may be rebated to clients, depending on the agreement between the client and the planner on remuneration. All commissions must be disclosed to the client, a position IFSA strongly supports.

Some employers provide funding for basic retirement investment information and /or advice, and some corporate and public sector superannuation funds may do so as well, whether through information seminars or individual advice. There have been some issues with the funding of advice from superannuation accounts: APRA has expressed reservation about whether these might breach the sole purpose test.

There are some additional tax impediments to the provision of retirement planning advice, such as:

- an employer who provides retirement planning advice services to employees is levied FBT on the cost; and
- an individual cannot get a tax deduction for the cost of advice about their superannuation investments - yet they can get a deduction for advice in respect of non-superannuation investment.

These have the effect of discouraging fee-for-service advice in superannuation, as there is no tax relief for a client. However, if advice is funded through commission, there will be tax relief for the client.

Transition to retirement

As the Committee noted in its Report on Living Standards, many rules in tax and superannuation legislation appear to assume that a person retires once, and once only, and that on a day they have selected in advance.

The reality of people's experience may be very different from this assumption. Unexpected or early redundancy, ill health, carer responsibilities and many other upsets make take people out of the workforce earlier than they had planned. Once out, the complexities of rearranging superannuation and retirement income streams on re-entry to work are unnecessary and counter-productive. People who retire early

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voluntarily and then find they would like to return to work for personal, social or economic reasons face the same complexities.

This single-case assumption pervades the regulatory system, and has such outworkings as:

- an income stream, once commenced, cannot be suspended if the purchaser returns to work – it must be commuted and re-started;

- an income stream, once commenced, cannot be topped up by new monies, even by later release from other superannuation accounts – it must be commuted, added to, and a new income stream commenced. This is particularly perverse in account-based products, where the design would readily accommodate new amounts.

- The release of benefits rules do not allow someone to continue in the same employment – say on a part time or project basis – and draw the benefits that they had accumulated up to the change in the nature of their employment.

- The release of benefit rules do not permit someone aged under 60 to draw benefits unless permanently retired, and would technically prevent someone reducing from fulltime work and working part time or for lower pay while drawing partial retirement income.

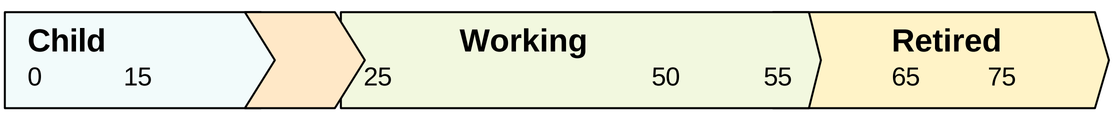
Some particular issues arise for older small business owners who may wish to take advantage of the capital gains tax concessions available for superannuation.

- The capital gains concession operates in isolation of the superannuation rules – so an owner who is no longer working and over age 65 is likely to be unable to convert business proceeds into a specific retirement product (eg a superannuation pension).

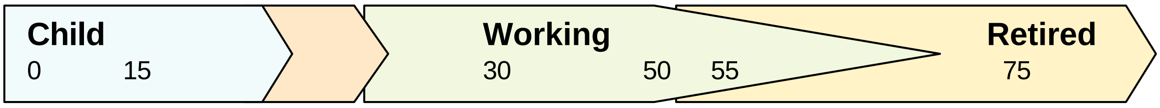
- Small business proprietors who want to convert the whole proceeds of their small business to a retirement income stream – rather than only the notional capital gain – are quite often precluded from doing this because of the operation of Part 7A of the Income Tax Assessment Act.

The transition from highly paid work - at or close to peak income, to not working at all, can be quite long. Even current settings could see a transition stretch over the two decades from preservation age at 55 to losing eligibility to contribute for part time work at 75. David Connolly (of Rice Walker Actuaries) has produced a graphic illustration of this overlapping on part work and part-retirement in a diagram, which we have adapted here. These diagrams capture only some of the changes that rules have not adjusted for.

  - Legislation assumes virtually no transition from work to retirement:



- Experience suggests people will see combinations of work and retirement over a quite lengthy period between fulltime, peak participation in the labour market and eventual complete retirement.



That legislation is well out of date is hardly surprising: the main provisions affecting retirement have not changed since the Occupational Superannuation Standards Act, which the SIS legislation replaced a decade ago.

We have not explored the nature of changes in labour market participation patterns – what we illustrate here is that the rules are inflexible in the face of changing experience. The critical point is that superannuation rules need to accommodate a much longer and less ordered transition.

A wholesale rewrite of the release of benefit rules and income stream provisions in superannuation, tax and social security legislation is required to remove these anachronisms. The amendments introduced to income tax legislation to overcome Reasonable Benefits Limit problems arising from internal rollovers are a good start, as is the increase in the age for personal super contributions from 70 to 75. Much more effort is needed.

The Committee's December Report on Superannuation and standards of living in retirement included exploration of options to allow workers to remain in the workforce beyond preservation age (recommendation 12). We would suggest that this exploration commence soon and that it must include a detailed review of the current legislative impediments to flexible combinations of work and retirement income between preservation age and at least age 75.

The Committee also recommended that the 'employment nexus' be removed from voluntary superannuation (Recommendation 3), and that the rules preventing non-superannuation assets moving into retirement income streams be removed (Recommendation 3). These are both important changes needed to give older workers maximum opportunity to build up superannuation and retirement incomes.

Yours sincerely

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Chief Executive Officer

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Chart 1

Planned Age of Retirement (Actual Age for Retirees)

- Only 140 of the 400 pre-retirees knew fairly well when they would retire.
- Of these 140, 2% expected to retire before age 55, and another 29% between 55 and 59. 66% expect to be retired by age 65, and only 3% expect to be working beyond age 70. Mean retirement age was expected to be 60.8 years.
- Among those already retired, 17% had retired before age 55, and a further 35% between 55 and 59. 76% had retired by age 65, and 5% had retired beyond 70 years of age. Mean retirement age was 59.2 years.
- In the overall sample, 81% of females expect to be retired by age 65 (or had done so already at that age) compared to 62% of males.

n = 340 (retirees n=200; and pre-retirees n=140 of 400 who were fairly sure when they would retire. 260 or 65% of pre-retirees were unsure when they would retire)

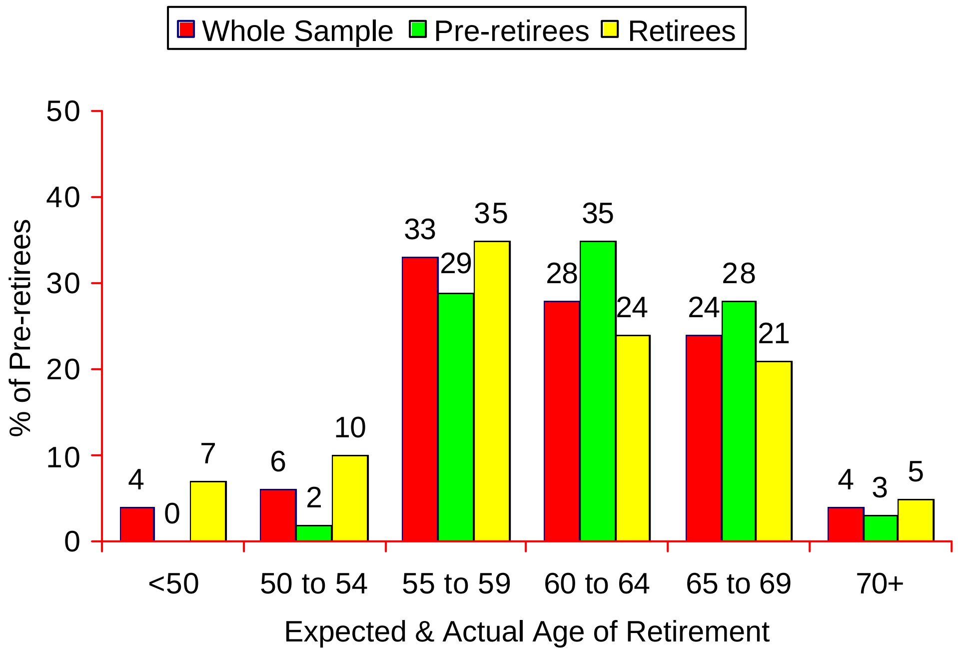

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Chart 2

Age at Which Started/Expecting to Start to Save for Retirement

- The median age at which respondents in the sample started to consciously save for retirement was 45, and the mean was 36 years. This compares with the mean current age of those in the sample, of 56 years. (Pre-retirees were currently 53 on average and retirees 64).
- 28% of people felt they started saving for retirement before the age of 30.
- Higher income households tended to commence retirement savings earlier than lower income households, which was explained by surplus cash availability in the qualitative phase of the research.

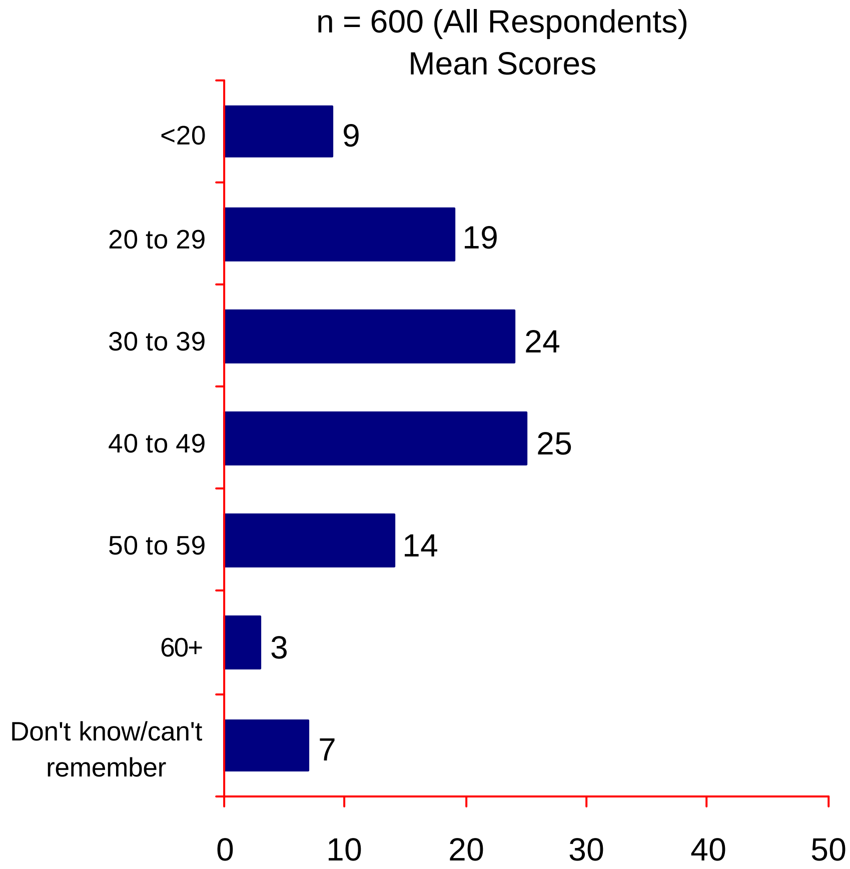

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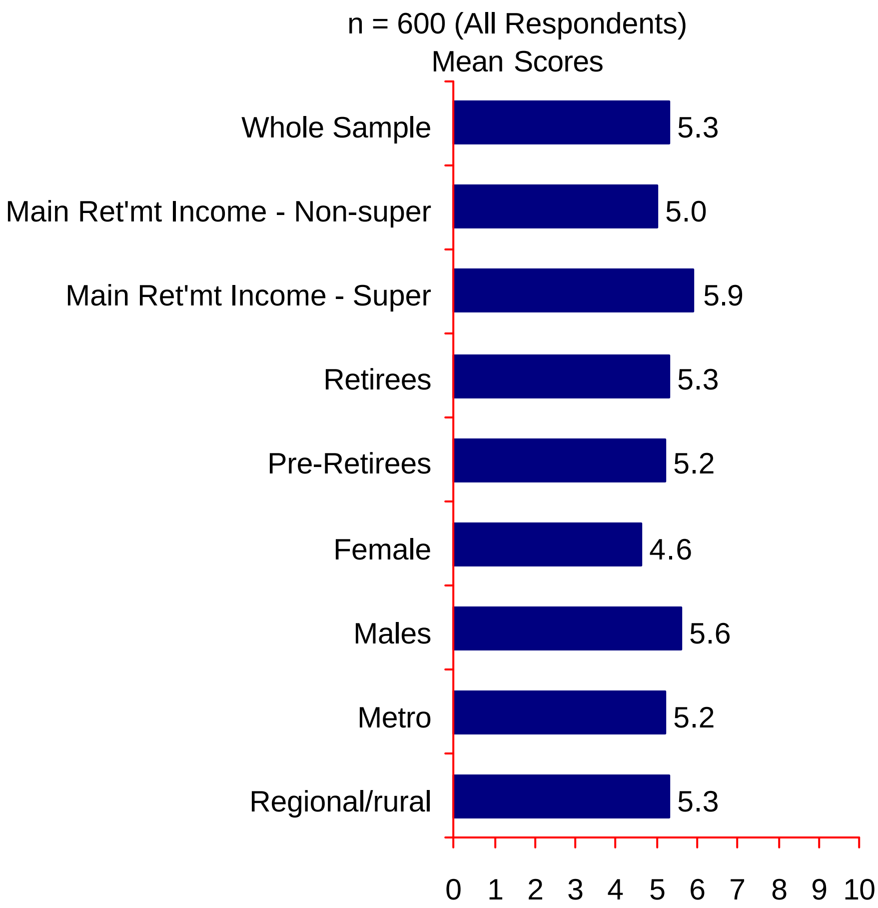
Chart 3

"I know at what age I will retire / I knew several years in advance of retiring at what age I would retire"

- Overall, respondents were neutral about this statement. It achieved a mean score of 5.3.
- Those mainly relying on superannuation savings were more in agreement with this statement than those relying on non-super savings (5.9 versus 5.0).
- Males were slightly more inclined to agree with the statement (at 5.6, versus 4.6 for females).
- Retirees (5.3) were no different to pre-retirees (5.2), in reacting to this statement.
- Regional and rural respondents were both neutral with regard to this statement.



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