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Improving the superannuation savings of people under 40

House of Representatives
Standing Committee on Economics, Finance and Public Administration

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Chairman's Foreword

By 2042 Australia's population is projected to comprise significantly more people aged over 60. This will coincide with the retirement of the majority of Australians currently aged under 40. Given the high costs associated with an ageing population it is vital that the future retirement income needs of this age group are considered now.

Australians under 40 will be the first to benefit from a fully mature Superannuation Guarantee (SG) system spanning most of their working lives. The SG was introduced in 1992 and fully phased in by 2001 to its current rate of nine per cent. It was designed to jointly reduce the future fiscal burden of providing Age Pensions to a growing ageing population and to enable more people to fund their retirement at a standard of living higher than the Age Pension.

The inquiry into improving the superannuation savings of people under age 40 has enabled the exploration of many issues including whether a superannuation savings gap exists in this age group; the fundamentals of Australia's retirement income system; whether the superannuation regulatory framework requires change; superannuation literacy; and incentives and system improvements.

The inquiry found that unlike previous generations the under 40s age group believes in the concept of self-funded retirement and they accept their compulsory contribution to a superannuation funded retirement. However, the lifestyle expected in retirement by many under 40s far exceeds that which could be funded from SG savings alone. At their current rate of contributions most under 40s would not meet their retirement income expectations without the aid of a part pension. Additional voluntary savings would be required to bridge this 'expectations gap'.

The inquiry considered three major aspects of the superannuation regime: preservation; the adequacy of the compulsory superannuation system; and the earnings threshold to qualify for access to the compulsory system.

The underlying principle of superannuation is that contributions may not be accessed until a certain age or event. This principle of preservation allows incremental savings to compound over time. The committee found that preservation of superannuation should not be eroded by schemes allowing early access to superannuation. Additionally, superannuation taxation concessions are provided by government to encourage savings for retirement purposes only, not for pre-retirement expenditure.

The adequacy of the SG rate, now set at nine per cent, was found to depend largely on whether the compulsory system is intended to provide self-sufficiency in retirement. Australia's retirement income system is based on three pillars—the Age Pension; the SG; and other personal contributions to retirement savings. Given this framework, the goal of self-sufficiency in retirement is ultimately the goal of an individual. In addition, increased superannuation savings will reduce future government spending.

To bridge some of the 'expectations gap' the committee recommended that when a new employee commences work they are automatically placed in a 'voluntary' contribution arrangement which they could chose to opt-out of at any time. This contribution scheme would initially be set at 3 per cent. Overseas experience in similar schemes has shown people are inclined to inertia and do not opt-out.

The ability to accumulate superannuation depends on an individual maintaining on-going, full-time employment over a working life, in a position earning above the SG threshold, currently $450 a month. A person earning less than the monthly threshold is not legislatively entitled to the SG. The committee believes retaining the threshold at its current rate of $450 or lower, will ensure, over an extended period of time, that more multiple/casual job employees will gain superannuation coverage with negligible impact on business compliance costs.

There is a need to inform and better educate Australians about superannuation. The committee made recommendations to strengthen and target the work of the Financial Literacy Foundation and for it to work with the Office for Women to specifically target policies for women's superannuation literacy. In addition to arming people with general education, fund members now require improved individualised information as more risk is being borne by them. Given this, the committee recommends the development of government regulated savings targets and individualised projections.

The self-employed, women and multiple casual job workers were found to be particularly disadvantaged in their ability to accrue superannuation. The committee recommended improving the access to the co-contribution scheme for those earning less than 10 per cent of their income from employment. It also recommended the government consider applying the SG to the self-employed and to paid maternity leave to broaden and continue superannuation coverage.

The inquiry revealed that a fully mature SG system will be enjoyed by most under 40s for their full working life. This, combined with additional voluntary savings will meet a large proportion of the 'expectations gap' and reduce the future government spending on a growing ageing population. Broadening access to superannuation and enabling people to remain in the contribution system are fundamental to improving the retirement incomes of those presently excluded from the SG system.

On behalf of the committee I would like to thank all those who participated in the inquiry.

The Hon Bruce Baird MP
Chairman

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Chair	The Hon Bruce Baird MP	
Deputy Chair	Dr Craig Emerson MP (from 7/12/05)	Mr Chris Bowen MP (to 7/12/05)
Members	Mr Steven Ciobo MP	
	Mr Joel Fitzgibbon MP	
	Ms Sharon Grierson MP	
	Mr Michael Keenan MP (from 9/2/06)	Mr Malcolm Turnbull MP(to 9/2/06)
	Mr Stewart McArthur MP	
	Mr Patrick Secker MP (from 9/2/06)	Mr Andrew Robb MP (to 9/2/06)
	Mr Alex Somlyay MP	
	Mr Lindsay Tanner MP	

Committee Secretariat

Secretary	Mr Stephen Boyd (from September 2005)
	Mr Peter Keele (July-September 2005)
	Ms Bev Forbes (to July 2005)
Inquiry Secretary	Ms Sharon Bryant
Technical Advisor	Mr James Benson
Research Officer	Mr Andrew McGowan
Administrative Officers	Ms Natasha Petrovic
	Mr Cameron Carlile

Terms of reference

The House of Representatives Standing Committee on Economics, Finance and Public Administration received a reference for an inquiry into improving the superannuation savings of people under age 40 on 11 May 2005 from the then Minister for Revenue and the Assistant Treasurer, The Hon Mal Brough MP.

Inquiry into improving the superannuation savings of people under age 40 with particular reference to:

- *Barriers and/or disincentives to contribute to superannuation*
- *Current incentives in place to encourage voluntary superannuation contributions*
- *Improving their awareness of the importance of saving early for their retirement*

List of abbreviations

AAS	Australian Administration Services
ABA	Australian Bankers' Association
ABS	Australian Bureau of Statistics
ACA	Australian Consumers' Association
ACCI	Australian Chamber of Commerce and Industry
ACTU	Australian Council of Trade Unions
Ai Group	Australian Industry Group
ANAO	Australian National Audit Office
APRA	Australian Prudential Regulation Authority
ASFA	Association of Superannuation Funds of Australia
ASIC	Australian Securities and Investments Commission
ATO	Australian Taxation Office
AWOTE	Average Weekly Ordinary Time Earnings
CPA	CPA Australia
CUT	Curtin University of Technology
ERF	Eligible Rollover Fund
ETP	Eligible Termination Payment
FaCSIA	Department of Families, Community Services and Indigenous Affairs

FINSIA	Financial Services Institute of Australasia
FPA	Financial Planning Association of Australia
FSRA	*Financial Services Reform Act 2001*
GDP	Gross Domestic Product
GESB	Government Employees Superannuation Board
HECS	Higher Education Contribution Scheme
HREOC	Human Rights and Equal Opportunity Commission
IFF	Industry Funds Forum
IFSA	Investment and Financial Services Association
LMR	Lost Members Register
MTAWE	Male Total Average Weekly Earnings
NATSEM	National Centre for Social and Economic Modelling
NICRI	National Information Centre on Retirement and Investments
OECD	Organisation for Economic Co-operation and Development
OSB	Office of Small Business
PAS	Productivity Award Superannuation
RBL	Reasonable Benefit Limit
REIA	Real Estate Institute of Australia
REST	Retail Employees Superannuation Trust
RIM	Retirement Income Modelling Unit
RSA	Retirement Savings Account
SDA	Shop Distributive and Allied Employees Association
SG	Superannuation Guarantee
SGC	Superannuation Guarantee Charge
SGN	Superannuation Guarantee Number
SISFA	Small Independent Superannuation Funds Association

SMSF	Self Managed Superannuation Fund
TCAA	Trustee Corporations Association of Australia
TFN	Tax File Number
TPD	Total and Permanent Disability
UK	United Kingdom
USA	United States of America
WEPAU	Women's Economic Policy Analysis Unit

List of recommendations

3 Superannuation savings environment

Default scheme for voluntary contributions

Without strong incentives or some form of soft compulsion people are inclined to accept the status quo.

The committee heard strong support for auto enrolment employee contribution arrangements with an option to decline the offer. Overseas research in relation to savings/retirement schemes indicates that people automatically enrolled in a scheme with a built in default will tend to remain enrolled in the scheme. Studies have shown that people will be mostly happy to stay with the status quo once enrolled.

Recommendation 1

The committee recommends that when a new employee commences work they are automatically placed in a 'voluntary' contribution arrangement which they could chose to opt-out of at any time, preferrably operating through salary sacrifice.

The starting point in savings contributions could be a default rate of three per cent with periodic adjustments.

Superannuation Guarantee levy threshold

The Regulation Taskforce 2006 recommended that the Superannuation Guarantee be raised on the basis that it poses direct and indirect costs on business. The committee is concerned that if the current Superannuation Guarantee threshold is raised, a large section of the under 40s workforce will be penalised with respect to superannuation and many will remain forever marginalised.

The committee believes retaining the threshold at its current rate of $450 or lower, will ensure, over an extended period of time, that more multiple/casual job employees will gain superannuation coverage with negligible impact on business compliance costs.

Recommendation 2

The committee recommends that the Superannuation Guarantee threshold not be increased by government and that consideration be given to reducing it, following consultation with employers and employees.

5 Superannuation literacy and planning for under 40s

The committee believes that if people are well equipped to manage their day-to-day financial affairs, it is logical that they are more likely to understand the benefit of contributing to superannuation.

The committee also believes that superannuation funds have an important role in improving superannuation literacy. Currently, they provide large amounts of superannuation information to their members. It is clear, however, that many under 40s simply do not read the information provided—largely because it is, or it is seen to be, too complicated.

The committee is also of the view that giving people access to long-term superannuation projections would stimulate interest in superannuation.

Recommendation 3

The committee recommends that the Financial Literacy Foundation work directly with superannuation funds on a combined strategy to improve Australians' interest in, and knowledge of, their superannuation. Some of the approaches that could be considered by this partnership include:

- *providing more assistance to state and territory governments to promote financial literacy in secondary school curriculum, with a particular focus on superannuation education;*
- *developing a strategy to improve the general financial literacy of the adult population with a particular focus on improving superannuation literacy; and*
- *providing all superannuation information, including the promotion of benefits and incentives, in the most straightforward manner.*

Superannuation savings targets and regulated superannuation projections

The committee found that a savings target, determined jointly by the government and superannuation industry, would be a useful tool for people to broadly determine their retirement goals.

The committee is in favour of superannuation funds providing long-term projections to their members in annual statements, on the strict proviso that the projections are based on regulated assumptions. This may encourage people to seek a higher retirement income through increased contributions, or, alternatively, allow people to know that their current level of contribution will be adequate.

Currently superannuation funds must be licensed to provide specific financial product advice if they wish to provide their members with projections. Essentially, under the current arrangements it would be an onerous task for super funds to provide long-term projections. The committee believes that ASIC and super funds should work together, as they have done in the case of superannuation calculators, to find a solution that is easily administered by funds, but also has sufficient safeguards in place to protect against consumers being misled.

The committee is encouraged by the seemingly successful experience of projections in both the United Kingdom and the United States.

Recommendation 4

The committee recommends that:

1. *the government develop a benchmark savings target to encourage savings goals and retirement planning, and a retirement saving matrix to show the level of savings required to achieve various retirement incomes and lifestyles.*
2. *ASIC and the superannuation industry work together so that all superannuation funds can provide individualised long-term projections to their members in annual statements. This process should include, among other things, the development of standardised investment assumptions to ensure consumer protection.*
3. *the government require all superannuation funds to provide individualised superannuation projections to their members in annual statements. These projections must utilise ASIC-regulated investment assumptions and should also show future outcomes for higher and lower levels of contribution.*

6 Superannuation issues for certain groups

Tax treatment of the unincorporated self-employed

The self-employed labour force, particularly the young, has been recognised as being vulnerable in their superannuation, income protection and life insurance strategies. If a self-employed person receives an eligible termination payment from a superannuation fund due to total and permanent invalidity the invalidity component is taxed unfavourably compared to an owner manager of an incorporated business.

Recommendation 5

The committee recommends the government align the tax treatment of invalidity payments of the incorporated and unincorporated self-employed.

Superannuation Guarantee—unincorporated self-employed

The low level of voluntary superannuation savings by unincorporated self-employed people indicates alternative retirement savings intentions or a reduced incentive to voluntarily save.

The committee heard that many owner managers intend to utilise their business for their retirement income. As they are not compelled to contribute to superannuation many have low retirement savings diversification and are thus exposed to risk if the business fails, if it proves unprofitable or the proceeds of business sale are used prematurely.

Recommendation 6

The committee recommends consideration be given by government to bringing unincorporated small business owners into the Superannuation Guarantee system.

Superannuation Guarantee entitlement on paid maternity leave and maternity payment

The definition of ordinary time earnings, upon which Superannuation Guarantee is determined, excludes paid maternity leave yet includes other personal leave including sick leave and recreation leave.

The committee is concerned that women taking unpaid leave to have and care for children have reduced or no superannuation coverage during this time. As a measure to provide greater ongoing superannuation coverage for women the committee believe the government's 'maternity payment' could incorporate an SG component.

Recommendation 7

The committee recommends that:

1. *the government review the non-entitlement of Superannuation Guarantee during periods of paid maternity leave including amending the definition of ordinary time earnings under the Superannuation Guarantee (Administration) Act 1992.*
2. *consideration be given to having a component of the maternity payment apportioned to Superannuation Guarantee.*

Financial literacy for women

Evidence to this inquiry indicates that women have different financial literacy learning preferences to men.

Many women under age 40 are employed in part-time or casual work whilst they balance work with the rearing of children. This often leads to them missing the exposure to financial information incidental to being in the full-time workplace. The committee believes women's financial literacy should be targeted.

Recommendation 8

That the Financial Literacy Foundation, in association with the Office for Women, target programs to improve the financial literacy of women under age 40 with respect to superannuation.

7 Incentives and system improvements

Co-contributions and under 40s

In the committee view, the key to increasing under 40s take-up of the co-contribution is to increase and simplify the scheme's promotion. The committee agrees with the evidence suggesting that the co-contribution scheme is not well understood by young people. In particular, the committee is concerned by misconceptions about the scheme's operation.

The committee did not find a need to extend access to the co-contribution scheme, as was suggested by various groups. The committee is more in favour of increasing and simplifying promotion of the current scheme.

Recommendation 9

The committee recommends that the government maintain the current co-contribution scheme, but, together with superannuation funds, increase the scheme's promotion to improve awareness and take-up. To specifically target young people, the committee recommends that the co-contribution always be promoted in a basic and understandable manner.

Removal of the 10 per cent work test

One of the qualification criteria for the co-contribution is that a person must earn 10 per cent of their income from eligible employment. This means that the co-contribution is currently not available to the unincorporated self-employed, stay at home parents and students and the unemployed who rely solely on government benefits.

The 2006 budget proposed allowing the unincorporated self-employed to access the co-contribution scheme. However, people who are not in paid work—stay at home parents, unemployed persons and students—but who are still making contributions, should have their contributions matched by the government, up to the relevant threshold.

Recommendation 10

The committee recommends that the government remove the 10 per cent work test as a determinant of co-contribution eligibility.

Choice, portability and multiple superannuation funds

While choice and portability should reduce the number of multiple accounts, the concern remains that, when taking on multiple jobs, many under 40s will simply adopt the default fund of each employer, rather than choosing one fund for all their contributions.

The committee heard that having a single default fund for casual, multiple job employees would ensure that fewer young people have multiple funds. The committee considers this concept viable, provided that employees are offered choice of fund first.

Recommendation 11

The committee recommends that government introduce a default superannuation fund for casual employees, so that when a casual employee does not wish to choose their superannuation fund, that employee is automatically placed in a government-determined default fund.

Overcoming lost superannuation issues

The definition of a lost member only allows for a two-year period of inactivity on a person's account; or that two pieces of mail have been returned to the super fund unclaimed. A fund is required to report a member as lost if they meet either of these criteria, unless the fund has received confirmation from the member within the last two years that the listed address is current.

Recommendation 12

The committee recommends that the government extend the definition of a 'lost member' to allow for longer than two years inactivity. In addition, the committee recommends that before a member can be defined as lost, a superannuation fund must also have written to the member's listed address seeking confirmation of their details.

Death and total and permanent disability insurance

Without death and total and permanent disability (TPD) insurance provided through superannuation, evidence suggests that most under 40s would have no life insurance. The committee is pleased that death and TPD insurance is generally offered on an opt-out basis, meaning that young people must make a conscious effort not to take out insurance.

The super choice legislation requires that employer default funds have a minimum level of insurance. However, given that many employees can now choose their superannuation fund, the committee is concerned that some funds do not offer insurance.

Recommendation 13

The committee recommends that all superannuation funds, not just employer default funds, be required to offer a minimum level of death and total or permanent disability insurance, on an opt-out basis. In determining the minimum insurance level, the committee recommends that the government raise the level above what is currently required of employer default funds, to a level more in line with expected needs.

1

Introduction

Background

1.1 The majority of Australians under age 40 have been subject to the framework of the compulsory Superannuation Guarantee (SG) contribution since the time they commenced paid work. The SG legislation commenced in 1992, when the eldest members of the group were aged 26. They are therefore the first generations of Australians to have the broadest access to superannuation contributions. Ironically, despite this level of coverage, surveys suggest that very few have a good understanding of superannuation and retirement savings.

1.2 Superannuation is a complex topic and as such appears to be shrouded in mystery to the average young Australian. While the simplification of the system proposed in the 2006–07 budget, *A Plan to Simplify and Streamline Superannuation*[1] (the superannuation plan), is welcome, there remain a number of widely held misconceptions about the current superannuation system.[2]

1.3 In 2002 the government tabled its Intergenerational Report[3] which indicated Australia will have a population imbalance by 2042, with more than half the population aged over 55 and with the high fiscal burden of an ageing population. The Investment and Financial Services Association

1 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

2 The superannuation plan is discussed in detail throughout this report and is summarised in Appendix E.

3 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

(IFSA) released a report in 2003 which claimed that a huge gap in retirement savings existed.[4] This was followed by the Productivity Commission's Ageing Report, released in 2005, which highlighted similar concerns to the Intergenerational Report, including the expected high cost of health care to this large old age demographic.[5] All of these reports discuss the projected situation for our current under 40s in retirement.

1.4 The inquiry into improving the superannuation savings for this particular demographic was therefore timely.

1.5 Owing to the broad nature of the topic the committee has received input on many issues and from a variety of sectors. Many submissions have focussed on the complexities of the system which make it difficult to provide clear and simple information to people and to raise the awareness of the importance and operation of superannuation.

1.6 It is important to note before beginning this report that all of the committee's evidence was received prior to the 2006–07 budget. Therefore, some of the issues raised will no longer be relevant if the government's budget proposals are implemented. The committee believes that this is a positive reflection on the quality of the evidence it received—many of the concerns raised have been directly addressed by the government in the budget.

1.7 The budget proposals will be subject to public consultation and then must pass through the parliament before they can be implemented. Therefore this report, while making reference to budget proposals, will still discuss issues as they stand under the current law. There are also, of course, many significant issues that are unaffected by the budget, and which remain of great importance. These are also discussed throughout this report.

Are the under 40s saving enough in superannuation?

Profile of the age group

1.8 The question of whether under 40s are saving enough in superannuation is an issue in itself. Superannuation saving during the pre-retirement years peaks when people have the most capacity to channel additional funds into this vehicle. This usually also coincides with maturing age and being

4 IFSA, *The Retirement Savings Gap*, Sydney, 2003.

5 Productivity Commission, *Economic Implications of an Ageing Australia*, Canberra, March 2005.

closer to retirement than the beginning of the working life. It is also not a coincidence that the awareness of retirement income increases as retirement looms in the near future rather than the distant.

1.9 The under 40s age group comprises two generations of people. One group born mid 1960s–late 1970s referred to by demographers as Generation X; the other from the late 1970s to the late 1980s, referred to as Generation Y. There has been much written about the unique general characteristics of individuals born in these two different eras and how their attitudes to life, relationships, authority and finances differ both between Generation X and Generation Y and between those of their parents and older age cohorts. However, all these generations will share one thing in common—they will all experience being at an age under 40, a time in their life when they are making the initial footprints of their life's goals including financial wellbeing.

1.10 The general life-cycle pattern of individuals means that the under 40s age group are more likely to be experiencing the high start-up costs of purchasing an owner-occupied dwelling and the high initial debt on infant mortgages, than any other age cohort. This group are also likely to forego household income whilst, simultaneously, household costs rise to have and rear children. Therefore, people under 40 are less likely to have the spare capacity to divert extra funds into this preserved savings vehicle.

1.11 Many submitters and witnesses have stated that the adequacy of retirement income is largely dependant upon whether the individual/couple own their own home. It may therefore be quite rational that the under 40s may prioritise buying and supporting the purchase of that asset over other asset classes and superannuation.

1.12 If a person has spare financial capacity to make additional superannuation contributions they have the market choice to decide where to rationally and practically place these funds. Surplus monies can be placed in alternative savings/investment strategies rather than formal superannuation contributions but which still feed into household wealth accumulation. The biggest difference is that funds in non-superannuation are not preserved and therefore can be accessed before retirement. This means these funds may be accessed when needed or desired and thus does not guarantee the monies will be available for retirement income.

What happens when the youngest of the age group turn 50?

1.13 The current under 40s age group is financially unique in that, provided they have been fully employed in positions that exceed the SG threshold, most of them will enjoy superannuation savings accruing from a compulsory scheme from the very early years of their working life.

1.14 Treasury, in its submission to the inquiry[6], estimates that a person aged 25 on median earnings, saving only the SG of nine per cent will, after 40 years of continuous working, amass enough retirement savings to provide, coupled with the receipt of a small part-Age Pension, an 83 per cent spending replacement rate.[7] This projection will be affected by the government's proposed changes to superannuation taxation (discussed in Chapter 2). The government has projected that should the budget changes proceed a person on average wages taking superannuation as a lump sum will be nine per cent better off than they are now; the same person taking a superannuation pension will be 17 per cent better off than they are now.[8]

1.15 In 2002 the Senate Select Committee on Superannuation noted the high level of consensus that a 60–65 per cent gross pre-retirement income replacement rate or a 70–80 per cent pre-retirement expenditure rate should be the savings target. When SG was implemented in 1992 a replacement rate of 40 per cent of pre-retirement income was calculated. Given this age group will have been exposed to the compulsory superannuation savings scheme most of their working life, the Treasury estimation on compulsory contributions alone, even prior to the government's proposed changes to superannuation taxation, looks positive.

1.16 However, the Treasury replacement rate assumes many things, the most obvious being the fiscal ability of the government at the time of retirement to bring the replacement rate up to 83 per cent. It also assumes a full-time continuous work pattern which is not enjoyed by all people, particularly women. In addition, self-employed persons are not covered by the SG requirements.

1.17 The Intergenerational Report[9] detailed estimates of how many Australians will be retired in 2042 and how many people will be in the workforce earning income and paying tax for government revenue. The report indicated that assuming the level of taxation remains a constant proportion of national output, in 2042 the federal budget deficit will blow out to $87 billion in 2002 dollar terms.

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6 The Treasury, *Submission no. 47*, p. 14.

7 Spending replacement rate is the ratio of an individual's income or spending power after retirement to that before retirement.

8 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 55.

9 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

1.18 The report claims there will be 10 million retirees in 2042 and 55 per cent of them will be dependent on the Age Pension. Given the oldest of Generation X will be aged 75+ in 2042 and the youngest of Generation Y will be in their mid 50s, the bulk of retirees in 2042 will comprise the current under 40 age group. The projections in the Intergenerational Report and the estimate in Treasury's submission[10] indicate that the current level of superannuation savings by the under 40 age group will still leave a heavy reliance on the government provision of the Age Pension in their retirement.

1.19 Treasury has stated that there has been no suggestion that the government will withdraw the Age Pension (as a safety net). Currently the Age Pension remains an essential pillar of retirement income policy. However, given the statistics presented in the Intergenerational Report and the Productivity Commission's Ageing Report[11] stating that government expenditure is likely to rise more rapidly than taxation revenue growth by 2044–45, it is clearly desirable for accumulated superannuation savings to be robust by the time this age group starts to retire. The debate is whether it is necessary or practical to increase the level of superannuation savings in this group, given the compulsory system will provide a large proportion of their retirement income needs.

1.20 Any additional saving for retirement income would be beneficial for the public purse. However, what may be more pertinent is the desirability of being able to meet the retirement lifestyle expectations of people in the current under 40 age bracket or more closely align their expectations with reality. Evidence provided to the committee, including from a specific research study commissioned by the Institute of Securities, Banking and Finance[12], indicates that under 40s are expecting a more comfortable lifestyle than could be met by their current average level of retirement savings.

1.21 The committee will consider a number of areas in the superannuation regulatory framework, in order to provide equity in superannuation coverage and to encourage additional savings by those who can afford it and are willing to save via superannuation.

1.22 Ultimately, without imposing additional compulsory superannuation requirements the choice as to whether to contribute more to superannuation lies with the individual.

10 The Treasury, *Submission no. 47*, p. 14.

11 Productivity Commission, *Economic Implications of an Ageing Australia*, Canberra, March 2005.

12 Institute of Securities, Banking and Finance (now the Financial Services Institute of Australasia), *Submission no. 49*.

2

Regulatory overview

Australia’s retirement income system

2.1 Australia has a multi-pillar approach to retirement income, which has been broadly endorsed by the World Bank. The three pillars of Australia's retirement income system are:

- a means-tested Age Pension and associated social security arrangements
- compulsory superannuation savings through the Superannuation Guarantee (SG)
- voluntary superannuation and other private savings.

2.2 The Age Pension is a core component of the retirement income system in Australia. It is unusual amongst developed countries in that it is non-contributory, funded from general revenue, paid at a flat rate, and means tested.

2.3 Its key objective is to provide an adequate basic level of income in retirement, and to provide a supplement to those with modest superannuation and private savings. In contrast, most other Organisation for Economic Co-operation and Development (OECD) countries administer insurance-based, contributory schemes.

2.4 As Australia's Age Pension is not based on previous earnings or contributions, it provides a significant degree of protection for individuals and families at risk or not able to accumulate significant savings for retirement (for example through superannuation).

2.5 The government will spend approximately $20.8 billion in 2005–06 providing Age Pension to over 1.9 million recipients (which equates to 2.9 per cent of Australia's Gross Domestic Product (GDP)). Projected expenditure in 2041–42 is 4.6 per of GDP.

2.6 The projected increase over this period is relatively modest compared with most other OECD countries and will remain affordable to the budget.[1]

2.7 The Age Pension is payable to men who are at least 65 years of age and women who are at least 63 (the Age Pension age for women is being increased gradually from 60 and will be 65 in 2014, making it the same for men and women).

2.8 The full pension rate for a single person is set at a minimum of 25 per cent of male total average weekly earnings which currently amounts to a payment $499.70 per fortnight. Each person in a couple receives $417.20 per fortnight. A person receiving the Age Pension also receives a pensioner concession card which entitles them to reduced cost medicines under the Pharmaceutical Benefits Scheme.

2.9 They may also be entitled to extra concessions from state and local government authorities, which may include:

- reductions in property and water rates
- reductions in energy bills
- a telephone allowance
- reduced fares on public transport
- reductions on motor vehicle registration
- one or more free rail journeys within the state each year.

2.10 Consistent with its safety net role, eligibility for the Age Pension is restricted according to an assets test and an income test, which are collectively referred to as the means test. As a person's income and/or assets exceed certain thresholds, the Age Pension that they are eligible to receive is reduced.

2.11 The means test reflects the basic principle that individuals should be required to draw on their own resources in retirement before calling on the support of the general community through the social security system.

1 Department of Family and Community Services, *Submission no. 38*, p. 5.

2.12 The SG directs some of an employee's current remuneration into a superannuation fund, by means of a compulsory employer contribution. The minimum level of employer superannuation support is generally nine per cent of an employee's ordinary time earnings (see *Superannuation Guarantee* within this chapter). Although paid by the employer, this contribution is essentially part of an employee's remuneration package.

2.13 The third pillar encourages individuals to make additional savings, including into superannuation. This is particularly relevant to groups that may not benefit or fully benefit from the SG, such as the self-employed, people with broken working patterns (including the injured, ill, sole parents and women who have historically been the main carers for children and other family members), mature workers and those with higher retirement income expectations.

2.14 The third pillar is supported by taxation concessions for voluntary superannuation contributions to encourage that part of the retirement income system (see *Taxation* within this chapter).

2.15 During the 2004–05 year, superannuation contributions totalling $65.9 billion were made. Total superannuation assets as at 30 June 2005 were $761.9 billion (an increase of 18.5 per cent on 30 June 2004).

2.16 The number of superannuation entities increased by 6.9 per cent during the 2004–05 year to end on 311 000 (including 302 000 self-managed superannuation funds[2]). There were 28 million member accounts.[3]

International retirement income systems

2.17 Comparing the Australian retirement income system with its international counterparts is difficult, due to the differing policy frameworks and systems. The overseas jurisdictions examined below have multi-tier retirement income systems, of which private superannuation-type savings play only a minor role as a supplement to universally available public pension benefits.

2 A self managed superannuation fund (SMSF) is a superannuation fund that amongst other requirements has fewer than five members, where each of the fund members is a trustee of the fund and vice-versa. SMSFs are generally subject to less onerous prudential requirements than other funds due to the involvement of all members/trustees in the running of the fund.

3 Australian Prudential Regulation Authority, *Annual Superannuation Bulletin*, Sydney, April 2006.

2.18 The United Kingdom (UK) has a basic state pension. Each tax year that an individuals pays (or is treated as having paid) enough National Insurance is called a 'qualifying year'. Generally speaking, the more qualifying years an individual has, the more basic state pension they will get when they reach state pension age.

2.19 In addition, there is a second UK state pension. Employees can choose to 'contract out' of this second state pension by joining an occupational plan, a personal pension or a stakeholder plan.

2.20 The United States of America (USA) has a two-tier retirement income system comprising government retirement income benefits and private retirement income options, namely tax-preferred retirement savings accounts and private pension funds.

2.21 The USA federal government social security programme provides a retirement income benefit to retirees between age 65 and 67 depending on their year of birth. Benefits can be received as early as age 62, but at reduced rates. The programme is funded by a compulsory social security contribution, which is levied as a tax on both employers and employees.

2.22 All employees in the USA, with few exceptions, contribute and all receive a benefit, which is not subject to either an income or asset test. The programme has a strict preservation rule of age 62.

2.23 All residents in New Zealand are eligible to receive the universal benefit, New Zealand Superannuation, at age 65. All other superannuation schemes are required to be registered under legislation which requires the schemes to be principally for the purpose of retirement. Few tax concessions are available and no preservation age is prescribed.

2.24 The New Zealand Government has also introduced legislation in order to commence KiwiSaver from 1 April 2007. Under Kiwisaver, employees will automatically have four per cent of their gross salary and wages before tax paid to Inland Revenue, which then forwards it to the investment vehicle of the employee's choosing.

2.25 Contributions to the scheme are preserved, with minimal exceptions including financial hardship and access for a deposit on a first home.

2.26 Employees can opt out of the scheme within a certain timeframe, although each time new employment is commenced, they are automatically enrolled again. They can also elect to increase their contributions to eight per cent. See Chapter 3 for further discussion on KiwiSaver.

2.27 Canada has a three-tier retirement income system which includes means-tested Old Age Security, the Canada Pension Plan and Registered Private Pensions and savings.

2.28 The Canada Pension Plan is financed by mandatory contributions from workers in all types of jobs and aims to replace up to 25 per cent of the average industrial wage. The standard preservation age is 65, with reduced amounts available if the pension is taken between the ages of 60 and 64.

2.29 In Chile, workers must contribute ten per cent of their monthly salary plus an additional amount to cover the premium for compulsory term life and disability insurance and the operating costs of the management companies to privately managed funds.

2.30 There is a minimum retirement age of 65 years for men and 60 years for women, before which the account balance cannot be cashed out. Early retirement is possible but subject to certain legal requests, and 20 years of work are required to qualify for a minimum pension (guaranteed by the State) after their pension account runs out.

The regulatory regime

2.31 The regulatory regime that superannuation operates under is renowned as one of Australia's most complex. There are a number of Acts, over which several bodies have regulatory powers.

2.32 The primary Acts are:

- The *Superannuation Industry (Supervision) Act 1993* (SIS Act)
- The *Retirement Savings Accounts Act 1997* (RSA Act)
- The *Income Tax Assessment Act 1936* (ITAA 1936)
- The *Income Tax Assessment Act 1997* (ITAA 1997)
- The *Superannuation Guarantee (Administration) Act 1992* (SG Act)
- The *Corporations Act 2001* (Corporations Act).

2.33 There is significant other legislation concerning a variety of matters including the government co-contribution (see Chapter 7), resolution of complaints, collection of data, imposition of levies and splitting of superannuation on marriage breakdown (see Chapter 6).

2.34 The primary regulators are:

- The Australian Prudential Regulation Authority (APRA). The role of APRA in respect of superannuation is to:

> Enhance the security of interests of superannuation entity members or depositors and retirement savings accounts (RSA)[4] holders and to assist in maintaining the Government's retirement incomes policy by:
>
> - regulating superannuation entities and RSA providers and related parties in accordance with the requirements of the relevant legislation and prudential requirements; and
> - developing the policy to be applied in performing the regulatory role[5];

- The Australian Taxation Office (ATO). The ATO is responsible, in relation to superannuation, for matters including the operation of structural mechanisms to support the superannuation system, administration of Superannuation Guarantee arrangements and administration of the tax laws that govern the tax treatment of superannuation contributions and benefits[6]. The ATO is the primary regulator of self managed superannuation funds (SMSF) and also manages a register of inactive or 'lost' superannuation accounts; and

- The Australian Securities and Investments Commission (ASIC), which outlined its role as follows:

> Amongst other things, one of ASIC's aims is to promote the confident and informed participation of investors and consumers in the financial system. We do this in a number of ways, including: enforcing financial services and company laws; checking compliance with those laws through on-site inspections of financial services licensees and desk audits; regulating the industry; keeping a vigilant watch on financial investment markets; working with the

4 An RSA is an alternative to a superannuation fund account. It is simpler, less costly and has a lower risk (and generally lower returns) due to it being capital guaranteed. It is not in the form of a trust, such as a superannuation fund, but more like a bank account and can be provided by RSA institutions which include banks and life insurance companies. However, it is still subject to the same taxation and superannuation rules as a superannuation fund account, for example, it must be preserved until a condition of release has been met.

5 APRA and ATO, *Memorandum of Understanding,* April 1999, paragraph 2.2, http://www.apra.gov.au/Media-Releases/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=3479.

6 APRA and ATO, *Memorandum of Understanding,* April 1999, paragraph 2.3, http://www.apra.gov.au/Media-Releases/loader.cfm?url=/commonspot/security/getfile.cfm&PageID=3479.

financial services industry to raise standards where relevant, including supporting the development of industry codes; taking compliance and enforcement action against any breaches of the law; and providing accurate and impartial consumer education and information to raise standards of financial literacy and help consumers make confident and informed decisions about their finances.[7]

Significant rules

2.35 The main provisions that will directly and most overtly affect the superannuation savings of a person under the age of 40 are those dealing with:

- Superannuation Guarantee (SG)
- taxation
- preservation.

Superannuation Guarantee

2.36 Superannuation coverage was largely restricted to white-collar professional workers until the introduction of productivity award superannuation (PAS) in 1986.

2.37 PAS created industrial agreements which provided for up to three per cent of wage increases to be contributed to approved superannuation funds. While the initiative successfully increased superannuation coverage to approximately two thirds of the population, administration and implementation problems, particularly with respect to the monitoring and enforcement of employer compliance, were rife. The Industrial Relations Commission cited these problems as the basis for its refusal to increase the provision by a further three per cent.

2.38 The SG was then announced in the 1991–92 Budget. It provides for a percentage of an eligible employee's remuneration to be directed into a superannuation fund by means of a compulsory employer contribution.

2.39 The motivation for the SG was twofold: to provide a mechanism through which employer contributions could be gradually increased, consistent

7 Mr M Larbey, ASIC, *Transcript*, 14 October 2005, p. 49.

with retirement income policy objectives and the economy's capacity to pay; and to extend superannuation coverage to a larger proportion of the population. Each of these objectives has been broadly satisfied: the SG rate was successfully phased up from three per cent to nine per cent from 1992–2002; and superannuation coverage now extends to approximately 90 per cent of employees.

2.40 In 2002–03 the SG represented an estimated 80 per cent of superannuation contributions made with respect to people under the age of 40.[8]

2.41 There are a number of exceptions to an employer's liability to pay the SG including:

- where the other party is in fact an independent contractor and not an employee
- employees who receive salary or wages of less than $450 per month
- part-time employees under 18 years of age (defined as working less than 30 hours per week).

2.42 From 1 July 2005 choice of fund legislation allows employees, rather than employers, to choose the fund that SG is paid into. It is hoped that this will bring about a change in people's attitude towards their retirement savings and encourage them to take greater ownership of their superannuation and consequently their futures.

2.43 The government also believes that being involved in the decisions about where their superannuation contributions are paid may mean that employees will start to consider the adequacy of their retirement savings sooner rather than later.

2.44 The new 'choice of fund' and 'portability' regimes (see Chapter 7 for detailed discussion) should provide an advantage to people who change jobs on a regular basis or are involved in casual work. Instead of having superannuation contributions paid into a different fund each time they change jobs, these people can choose a fund that suits their needs and ask each new employer to contribute to that fund. Rather than having multiple accounts with small balances being eroded by fees and charges, contributions may be combined into the one account, producing a better return for the employee.

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8 SG contributions estimated to be $9.6 billion and additional contributions estimated to be $2.4 billion, The Treasury, *Submission no. 47*, p. 10.

2.45 The competition benefits from choice of funds have been seen in the market already. Superannuation funds have been cutting fees, improving services and introducing new products, in particular, low cost products. According to the Investment and Financial Services Association (IFSA) there have also been new players entering the market.

> The number of accounts is likely to contract because of the backpacker effect—that is, people combining their super. The competition in the marketplace is increasing. There is a lot of competition for money and a lot of competition on price and service.[9]

2.46 Studies have shown however, a tendency for inertia. A recent survey commissioned by the Association of Superannuation Funds of Australia (ASFA) showed that during the first thee months of the operation of choice of fund legislation only four per cent chose a new fund as a conscious act of choice. There is also anecdotal evidence to suggest that some funds have made changing to another fund difficult.[10]

Taxation

2.47 Superannuation is generally concessionally taxed. Superannuation taxation concessions are estimated to be $16 billion in 2005–06.

2.48 The overall tax treatment of superannuation depends on a number of factors, including:

- who contributed to the fund (for example, employer, employee, self employed)
- whether the fund is taxed or untaxed[11]
- the type of benefit paid out (that is, pension or lump sum)
- the amount of the benefit
- the components of the benefit (for example undeducted contributions)
- the age of the member

9 Mr R Gilbert, IFSA, *Transcript*, 28 July 2005, p. 38.

10 Mr R Clare, *The Introduction of Choice of Superannuation Fund - Results to Date*, ASFA, Sydney, February 2006.

11 Untaxed funds include certain Commonwealth and state government run funds. These are a small minority of funds and members and will not be elaborated on for the purposes of this report other than to explain that while the contributions tax does not apply, benefits tax is increased correspondingly and the pension rebate generally does not apply.

- the type and amount of benefits previously received.

2.49 The government announced a number of proposed changes to the laws governing superannuation in the 2006–07 budget handed down by the Treasurer on 9 May 2006. This included changes to the taxation of superannuation benefits, which were outlined in the government's *Plan to Simplify and Streamline Superannuation* (the superannuation plan).[12]

2.50 The proposals in the plan are subject to public consultation and being passed by parliament. As a result, the following paragraphs address the current superannuation tax system initially. Relevant elements of the budget will then be discussed.

2.51 Employer superannuation contributions (including salary sacrifice) and deductible member superannuation contributions are taxed in the fund at 15 per cent in the year in which they were contributed (known as taxable contributions).

2.52 It should be noted, however, that the effective tax rate of a fund can be reduced by imputation credits attached to dividends received by the fund and the concessional treatment of capital gains in the fund. As a result, the average rate of tax paid by funds on assessable income (which includes taxable contributions) is somewhat less than 15 per cent at 9.7 per cent.[13]

2.53 Undeducted superannuation contributions, for example, amounts paid 'out of a person's pocket' after their income has been taxed, are not taxed again when they enter (nor when they are later withdrawn from) the superannuation system.

2.54 Investment earnings on accumulated benefits are taxed at 15 per cent in the fund. However, due to imputation credits and capital gains tax concessions discussed above, the effective rate of tax paid on investment earnings (which do not include taxable contributions) is estimated to be around 6.5 per cent for a typical fund. [14]

2.55 In the case of a lump sum benefit withdrawn on or after the member's preservation age (60 years of age for anyone born after 30 June 1964, see *Preservation* below), the first $129 751 attributable to post-June 1983 is tax free. Any remaining post-June 1983 component below the individual's

12 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

13 Superannuation funds paid tax of $5.37 billion on total income of $54.71 billion in 2002-03, meaning that the average tax rate on total income (including taxable contributions) was 9.8 per cent. ATO, *Taxation Statistics 2002–03*, 2005, pp. 105–106.

14 G Rothman, *Tax Advantages of Investment in Superannuation*, 2003, Canberra, p. 16.

lump sum reasonable benefit limit (RBL) of $648 946 is taxed at a maximum rate of 15 per cent.

2.56 The post-June 1983 component that exceeds the individual's lump sum RBL is taxed at 38 per cent. Of the 308 000 lump sums paid in 2002–03, 518 had excessive components.[15]

2.57 In the case of a lump sum taken before preservation age (see paragraph 2.60), the post-June 1983 component below the individual's lump sum RBL is taxed at a maximum rate of 20 per cent. Any excessive component is taxed in the same way as for a lump sum taken after preservation age except that the RBL threshold reduces by 2.5 per cent for every year that the person is below preservation age.

2.58 Five per cent of the pre-July 1983 component of a lump sum payment is subject to tax at a taxpayer's marginal tax rate while the remainder of this component is tax free. It is highly unlikely that someone currently under the age of 40 would have a significant pre-July 1983 component given that the oldest person in that age group would have been 17 in 1983.

2.59 That part of a lump sum benefit which represents the return of an individual's undeducted contributions is not subject to further tax.

2.60 The superannuation plan includes a proposal to make lump sum superannuation payments exempt income when paid to an individual aged over 60 after 1 July 2007. This means they would not incur any tax, nor would they push other income into higher tax brackets.

2.61 Under the plan, a lump sum payment to a person aged under 60 would still be subject to tax. However the calculation of the tax liability would be far simpler as the lump sum will be split into fewer components for tax purposes. As a result, some of the components that currently exist would be taxed at a lower rate than at present. A person aged under 55 would pay tax on the post-June 1983 component at the rate of 20 per cent, while a person aged 55–59 would pay zero per cent tax on the first $129 751 of the post-June 1983 component and 15 per cent on the remainder.

2.62 Superannuation pensions are taxed as ordinary income at marginal tax rates. A 15 per cent rebate applies to the proportion of the pension that does not exceed the individual's RBL. If more than half of a person's benefits are taken as a pension then the pension RBL applies ($1 297 886 in 2005–06).

15 ATO, *Taxation Statistics 2002-03*, 2005, Canberra, p. 14.

2.63 Undeducted contributions are not subject to tax again when they are returned to the individual as pension payments (this is known as the undeducted purchase price and the amount returned each year is called the deductible amount).

2.64 The 2006–07 budget superannuation plan would make pension payments from a taxed source exempt income when paid to an individual aged over 60. Once again, this means the individual would not incur any tax, nor would his/her other income be pushed into higher tax brackets. While this would commence on 1 July 2007, it would apply from that date to pensions that commenced previously.

2.65 Under the plan, a pension paid to a person under the age of 60, would still be subject to tax. However, for pensions that commence after 1 July 2007, more components would be classified as part of the undeducted purchase price and would not be subject to tax (for example the pre-July 1983 component). A person aged 55–59 would continue to be eligible for the pension rebate. Once the recipient turns 60, their pension would be tax free.

Preservation

2.66 The preservation arrangements for superannuation, which generally restrict a member's access to their superannuation benefits until retirement, on or after they have attained preservation age, ensure that concessionally taxed superannuation is used for retirement income purposes.

2.67 The preservation age is increasing from 55 to 60 on a phased basis between the years 2015 and 2025. The preservation age will remain at 55 years for a person born before 1 July 1960, while for someone born after 30 June 1964, the preservation age will rise to 60.

2.68 The legislation provides for the early release of superannuation benefits only in certain limited circumstances, such as retirement due to incapacity, severe financial hardship and in a limited number of compassionate circumstances.

2.69 Individuals can access their preserved benefits before reaching preservation age on termination of employment where such benefits are taken in the form of a non-commutable life-time pension or annuity.

2.70 Furthermore, from 1 July 2005, fund members who have reached their preservation age but not retired are able to access their superannuation in the form of a non-commutable income stream.

3

Superannuation savings environment

Retirement income 'adequacy'

3.1 The notion of retirement income 'adequacy' was discussed at length in the 2002 Senate Select Committee on Superannuation report into *Superannuation and Standards of Living in Retirement*.[1] The Senate Select Committee noted the high degree of consensus expressed by witnesses that a desirable net retirement savings target was 60–65 per cent of gross pre-retirement income for a person on average earnings. The Senate Select Committee determined that a person earning less than average earnings would need to target a greater percentage of their gross pre-retirement income to achieve the same living standard whilst a person earning more than average earnings could target a smaller percentage.

3.2 The Senate Select Committee recognised there was an adequacy gap but did not actually determine a desirable retirement savings target to achieve an 'adequate' retirement income.

3.3 The issue of 'adequacy' has been impacted by the government's proposed changes to the laws governing superannuation in the 2006–07 budget. These included changes to the taxation of superannuation benefits, which were outlined in the government's *Plan to Simplify and Streamline Superannuation*[2] (superannuation plan).

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1 Senate Select Committee on Superannuation, *Superannuation and Standards of Living in Retirement, Report on the Adequacy of the Tax Arrangements for Superannuation and Related Policy,* Canberra, 2002.

2 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

3.4 The proposals in the plan are subject to public consultation and being passed by parliament. As a result, the following paragraphs are largely based on the current superannuation tax system. However, relevant elements of the budget will be discussed where necessary.

Lifestyle differences

3.5 There appear to be quite different views on what level of retirement income should be planned to be achieved by individuals. In practice each individual's definition of an 'adequate level of retirement income' will vary depending on a number of factors, including the standard of living prior to retirement and the drop in standard of living they would be willing to accept in retirement. An adequate retirement income would therefore be based on what the individual requires to meet their desired living standard, given that a basic living standard is provided by the Age Pension.

3.6 Westpac and the Association of Superannuation Funds of Australia (ASFA) jointly constructed retirement expenditure budgets to reflect a perceived 'modest' retirement lifestyle and separately, a 'comfortable' retirement lifestyle.[3] These expenditure budgets have been used by ASFA to determine retirement income benchmarks.

3.7 ASFA follows an adequacy rule of thumb which would entail a couple accruing at least $500 000 to generate sufficient retirement income to allow them to live a 'comfortable' lifestyle (assuming both have eligibility for a part-Age Pension during the course of their retirement).[4] The $500 000 lump sum, using ASFA's assumptions, would translate to an income stream of approximately $45 000 for the household. This is slightly more than twice the full pension for a couple.

3.8 The Westpac/ASFA budgets contain subjective and value judgements about the type of lifestyle and priorities of people in retirement. In reality individual needs and choices differ markedly.

Is there a 'retirement savings gap' for individuals?

3.9 The Investment and Financial Services Association (IFSA) stated that there was approximately a $600 billion 'retirement savings gap' as at 31

3 Social Policy Research Centre, University of New South Wales, *The Westpac/ASFA Retirement Living Standard*, Sydney, 2004.

4 The Association of Superannuation Funds of Australia (ASFA), *Submission no. 16*, p. 10.

December 2002.[5] This has since been revised downwards to an estimated gap of $452 billion as reported in IFSA's 2006 retirement incomes policy statement.[6]

3.10 The gap was calculated taking into account the type of retirement lifestyle deemed desirable by people aged 25–65 earning between 75 per cent and twice average weekly earnings. Desirable retirement income was assumed to be 62.5 per cent of pre-retirement income for all age cohorts. IFSA describe the 'retirement savings gap' as the difference between Australians' expectations for their standard of living in retirement and the standard of living their current savings will achieve.

3.11 IFSA concluded from the study released in 2003 that the then current level of retirement savings (which included pension components) would not meet the needs of the expected retirement living standards of working age people. The updated 2005 report (commissioned by IFSA and undertaken by Rice Walker Actuaries[7]), concludes the 'gap' has narrowed mainly due to government policy incentives and changes in the treatment of the Age Pension integration in the model assumptions.

3.12 There is an opposing view held, including by some industry stakeholders, that the quantum retirement savings gap is not quite as large. The method of determining retirement lifestyle expectations in the IFSA model was to set retirement income at 62.5 per cent of pre-retirement income (the level of income in the year prior to retirement). Setting a percentage across the board omits differing expectations and capacities of individuals/families in their working life-cycle.

3.13 A savings gap would be expected to differ depending upon the assumptions underlying the determination of retirement lifestyle expectations. Results would differ markedly in studies where participants were asked what they would like as a living standard in retirement versus what they would be prepared to forgo now for a future desired living standard. ASFA claim their studies asked participants questions about requirements:

> It was expressed more as 'How much will you need?' It was not 'How much would you like at Christmas?' Initially we found a huge gap between people's expectations and how much they were saving. What has happened over the years is that people now have

5 Investment and Financial Services Association (IFSA), *The Retirement Savings Gap*, Sydney, 2003.

6 IFSA, *Retirement Incomes & Long Term Savings Policy Options*, Sydney, 2006.

7 Rice Walker Actuaries, *The Retirement Savings Gap – Two Years On*, Sydney, September 2005.

> an awareness that there is a mismatch between what they think they will need in retirement and how much they are saving.[8]

3.14 While people's expectations of their lifestyle and consequent income needs in retirement exceed the level of retirement income their superannuation savings will allow, a personal retirement savings gap will exist. The government provided Age Pension goes some way to bridge this expectations gap with part pensions:

> Unfortunately significant evidence shows that there is disparity between Australians' retirement income expectations and aspirations and what their current levels of superannuation will actually achieve. According to ABS data, almost half (44%) of Australians believe that their main source of income at retirement will be superannuation. In reality, for a majority of Australians a combination of public and private savings will be needed to fund retirement incomes.[9]

3.15 Another reason the 'retirement savings gap' has not been considered to be as large as purported is that the IFSA model makes only a small allowance for non-superannuation savings, taking account of 'investment properties of wealthier individuals' only.[10] Interestingly, the first report on the retirement savings gap did not consider non-superannuation savings at all, which form a part of Australia's retirement savings system.

3.16 Treasury's Retirement Income Modelling Unit (RIM) and its predecessor have performed work on retirement income since the early 1990s. The Unit's 2003 paper[11] on private savings discusses the importance of this third pillar in Australia's three pillared retirement income system:

> The voluntary private savings component includes employer contributions that are beyond SG requirements, voluntary member superannuation contributions and other forms of saving such as property, shares and other non-superannuation financial assets.[12]

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8 Association of Superannuation Funds of Australia (ASFA), *Transcript*, 28 July 2005, p. 9.

9 Australian Bankers Association (ABA), *Submission no. 28*, p. 5.

10 Rice Walker Actuaries, *The Retirement Savings Gap – Two Years On*, Sydney, September 2005, p. 5.

11 Cliff Bingham, Retirement and Income Modelling Unit, The Treasury, *Impact of Private Saving and Longer Careers on Retirement Income*, Paper Presented to the Eleventh Colloquium of Superannuation Researchers, University of New South Wales, July 2003.

12 Cliff Bingham, Retirement and Income Modelling Unit, The Treasury, *Impact of Private Saving and Longer Careers on Retirement Income*, Paper Presented to the Eleventh Colloquium of Superannuation Researchers, University of New South Wales, July 2003, p. 2.

3.17 The paper concluded that non-superannuation savings and assets contribute to improved standards of living in retirement and/or retirement savings and are often underestimated in the calculation of future retirement incomes. It included owner occupied properties in this category on the basis that home ownership increases retirement living standards as housing costs are considerably lower than those renting in retirement.

2006–07 budget and a 'retirement savings gap'

3.18 The issue of a retirement savings gap is impacted by the government's 2006–07 budget 'superannuation plan'. The plan contains proposals that reduce the amount of tax paid when superannuation benefits are received in retirement. From 1 July 2007, benefits received from a taxed fund by a person aged 60 or over will be tax exempt. This means they will not pay any tax on that money, nor will that money push their other income into higher tax brackets. In essence, people should have more superannuation money available to them in retirement.

3.19 This additional tax concession alone will increase the retirement benefits of those aged under 40. The government predicts that:

> Under a fully mature SG system, a person on $1,000 per week (about average income) is projected to have accumulated superannuation benefits of approximately $466,000 over a working life of 40 years through the SG arrangements alone. Under the proposed plan, tax of around $37,000 payable when the benefit is paid would be abolished. This average worker would thus gain around $37,000 in retirement, an increase of approximately 9 per cent if they take a lump sum.[13]

3.20 If the same person chose to take their benefits as a superannuation pension, they are estimated to have an average of around $136 per week in additional retirement expenditure under the proposed new system. This would represent an increase in retirement expenditure of approximately 17 per cent.

3.21 It is also hoped that the change to the taxation of superannuation will encourage additional voluntary contributions:

> If the person taking a lump sum in the earlier example also made an additional 5 per cent tax deductible (salary sacrifice) contribution to superannuation each year over a working life of 40

13 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 55.

> years, their retirement benefit would increase from $466,000 to $706,000. Under current arrangements, this extra saving would have provided for an 11 per cent increase in average retirement expenditure. Under the proposed changes, there would be a gain in average retirement expenditure of 35 per cent.[14]

3.22 Furthermore, the fact that superannuation benefits will not impact on the tax paid on other income is expected to provide greater incentive for individuals to continue to work past traditional retirement age, in a part-time capacity, and supplement that income with superannuation drawings. This will allow a higher standard of living than would otherwise be achieved.

Australia's retirement savings system

3.23 Australia's retirement savings system is based on three pillars—the Age Pension, a compulsory Superannuation Guarantee (SG) levy and other savings including voluntary superannuation contributions. Treasury has the view:

> Australia's retirement income system encourages people to achieve a higher standard of living in retirement than would be possible from the age pension alone, while ensuring Australians have security and dignity in retirement.[15]

3.24 The full-Age Pension is designed to provide a safety net living standard to cover essentials and allow a pensioner to maintain a level of dignity in retirement. The SG supplements the Age Pension for those who have enjoyed employment prior to the pensionable age. Additional voluntary superannuation savings by individuals raises their retirement living standard.

3.25 A 25 year old on median earnings (approximately $40 000), contributing the SG for 40 years, will obtain a spending replacement rate of 82 per cent of pre-retirement income.[16] Treasury has not provided a break down of the components of the retirement income in that case, that is, how much Age Pension contributes to the replacement rate and how much private savings (SG) contributes. However, in a submission to an earlier inquiry[17] Treasury

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14 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 56.

15 The Treasury, *Submission no. 47*, p. 4.

16 The Treasury, *Submission no. 47*, p. 14.

17 Senate Select Committee on Superannuation, *Superannuation and Standards of Living in Retirement, Report on the Adequacy of the Tax Arrangements for Superannuation and Related Policy,* 2002 – Treasury, *Submission no.78,* p. 21.

indicated that a person in similar circumstances, but on average weekly ordinary time earnings (AWOTE),[18] would have a replacement rate of 73 per cent with 44 per cent of retirement income provided by the Age Pension.

3.26 It is presumed that a person on median earnings (less than AWOTE) would have a higher Age Pension component.

The fiscal cost of the under 40s retirement

3.27 If the under 40s by and large rely solely on the SG contributions to fund their retirement there is a projected considerable Age Pension burden on the government in their retirement (as many people are expected to receive a healthy part pension).[19] Currently the proportion of voluntary contributions over compulsory contributions has been declining in this age group since 1999, although the co-contribution measures are expected to reverse this trend.[20] (This period of time has coincided with a property boom and the ages at which many under 40s may have made first purchases on owner occupied properties.)

3.28 The Intergenerational Report[21] stated that:

> The projections in this report suggest that, if policies are not adjusted, the current generation of taxpayers is likely to impose a higher tax burden on the next generation. The required adjustment in taxes and spending is about 5.0 per cent of GDP by 2041–42, or $87 billion in today's dollars.[22]

3.29 A key priority listed in the report was 'maintaining a retirement incomes policy that encourages private saving for retirement, and reduces future demand for the Age Pension'.[23]

3.30 There is clearly a fiscal rationale to encourage under 40s to place monies into voluntary superannuation.

Conclusions

3.31 The committee concluded that the level of retirement income 'adequacy' is greatly dependant upon an individual's lifestyle needs/desires and varies

18 AWOTE is higher than median earnings at approximately $50 000 per annum.
19 The Treasury, *Submission no. 47,* pp. 8–9.
20 The Treasury, *Submission no. 47*, p. 9 (chart 2) *and* p. 23 (chart 11).
21 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.
22 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.
23 The Treasury, *Intergenerational Report 2002-03,* Budget Paper No. 5, Canberra, 2002.

from person to person. The committee recognised that a benchmark of around 60 per cent of pre-retirement income (in the average earnings range) has become established by industry as providing a comfortable retirement income but that it should not be used as a universal benchmark for 'adequacy'.

3.32 An individual's 'retirement savings gap' is dependent upon their expectations of their lifestyle in retirement and whether their level of retirement savings will meet this. This shortfall could be better described as an 'expectations gap'.

3.33 The concept of retirement income adequacy is sometimes confused with retirement income self-sufficiency (where a retiree receives no government Age Pension benefits). These concepts are very different. A person/couple may derive an 'adequate' retirement income under Australia's three pillared system and yet not be self-sufficient.

3.34 Undoubtedly, the superannuation proposals within the 2006–07 budget, if implemented, will have a significant effect on the projection of any alleged 'gap'. Generally speaking, these proposals should mean that people have more money available in superannuation, and, therefore, any 'expectations gap' may be significantly reduced.

3.35 The notion of a 'retirement savings gap' originated from a report prepared in 2003 within the superannuation industry.[24] The report which first raised this concept took into account two pillars of Australia's retirement income system in the modelling. It originally did not take account of private savings outside of superannuation, which forms part of the third pillar. A revised report[25] released two years later made a small allowance for investment properties of wealthier individuals but did not include owner-occupied property or other savings. Treasury's RIM Unit considers owner occupied property as a non-superannuation asset falling within the third pillar and which enables higher living standards in retirement.

3.36 'Retirement savings gap' or not, the government will still be contributing a significant component of overall retirement incomes in the future. Projections indicate that increasing voluntary superannuation in this age group is necessary to ease the fiscal burden of providing aged care and Age Pensions to a very large old population when the under 40s are in retirement. There is expected to be a very large number of 'very old' people making up the population, requiring government assistance. This

24 IFSA, *The Retirement Savings Gap*, Sydney, 2003.

25 Rice Walker Actuaries, *The Retirement Savings Gap – Two Years On*, Sydney, September 2005.

'very old' group will comprise the generation prior to the baby boomers and some of the older baby boomers.

The rationality of under 40s contributing more to superannuation

3.37 People under age 40 have to balance saving for retirement against current expenses such as education, housing and family commitments. Lower levels of income and labour force participation are also significant barriers for this cohort to contribute to superannuation.

3.38 Rice Walker Actuaries wrote in their submission:

> As a large number of people have significant and immediate commitments, such as saving or paying off a home, raising a family or even beginning their own business, most of this generation gives long-term savings a low priority.[26]

3.39 The Financial Services Institute of Australasia (formerly the Institute of Securities Finance and Banking and previously the Securities Institute) noted that:

> In *Saving the future: changing under-40's retirement planning behaviour* those aged 25 to 34 are significantly more likely to consider credit card debts and personal loans their most important financial priority or goal. More than half of people cite accommodation costs as their main financial priority or goal, which obviously may act as a barrier to contributing to superannuation.[27]

3.40 It was also noted during the committee's hearings:

> The financial pressure is the greatest at exactly the same time as the need for superannuation contributions for your retirement is greatest, or the benefit from it is greatest.[28]

3.41 Those who can save may choose to do so outside of the superannuation system so that they have access to the funds if and when required. Some options for saving include interest-bearing deposits, shares and other equity instruments, owner-occupied housing, investment property and their own business—some of which are also concessionally taxed.

26 Rice Walker Actuaries, *Submission No. 64*, p. 4.

27 Ms K Foster, Institute of Securities, Finance and Banking (now Financial Services Institute of Australasia), *Transcript,* 18 October 2005, p. 7.

28 Dr C Emerson MP, *Transcript,* 10 February 2006, p. 17.

3.42 Max Super (a newly formed superannuation fund targeting the under 40s age group) listed some of the competing savings methods utilised by the under 40s:

> The obvious advantage that banks, online investment services and the like have over super when competing for the under 40's limited saving dollar, is the ability to release funds on demand. This flags accessibility as the real issue for the under 40's, and is therefore an area that needs to be fully explored in reviewing the attractiveness of super as an investment option.[29]

3.43 Overall it seems that a lack of disposable income, combined with the potential need to access any savings in unforeseen circumstances, mean that superannuation is generally not an attractive savings vehicle for under 40s.

3.44 Despite these concerns, much of the evidence the committee has received has suggested there is a gap between under 40s' retirement income expectations, and the reality of what they will have at retirement. For example, the Financial Services Institute of Australasia (FINSIA) stated in evidence:

> For example, there is not a capacity to fully appreciate how current inadequate savings patterns will inhibit lifestyle in retirement, there is not a recognition of the reality that the under-40s will not simply be okay—that there is no magical pot of gold at the end for most—and there is an unwillingness to confront the pain of analysing realistic retirement savings.[30]

3.45 In view of the alleged 'gap', throughout the committee's evidence additional incentives were suggested which aim to ensure that the gap between expectations and reality is reduced. While incentives directed at this cohort will be enjoyed by those who currently can and do contribute to superannuation, it is also hoped they will entice many new people to make voluntary contributions.

3.46 Mandating increased saving by increasing the SG to above nine per cent, or legislating a compulsory personal contribution, may impact on peoples' ability to provide essentials, reasonable lifestyle choices or engage in short to medium-term savings at this stage of their lives. However, some argue that a mandatory increase in contributions is the only way to ensure that

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29 max Super, *Submission no. 72*, p. 8.

30 Ms K Foster, Institute of Securities, Finance and Banking (now Financial Services Institute of Australasia), *Transcript*, 18 October 2005, p. 6.

all Australians, particularly those on low incomes, have an adequate retirement income.

Expectations of under 40s

3.47 Evidence to the committee has suggested that many under 40s have unrealistic expectations of their retirement income.

3.48 For example, an Industry Funds Forum member from the Retail Employees Superannuation Trust told the committee that an average member of his fund expected an annual income of $39 000 upon retirement.[31] At current levels of contribution, he believed this goal was unachievable for most members.

3.49 Despite a low level of additional contributions above SG in the under 40s age group many continue to have positive expectations of what their retirement income will eventually be.[32] They also increasingly view self-reliance in retirement as the norm:

> But I would also add to that the reality that this cohort realises that they will be responsible for their retirement, that they intend to be fully or at least partially self-reliant and that they are perplexed right now about how they will achieve that given the other financial priorities that are immediately in their face at this age...[33]

3.50 One strategy for people to reach this retirement goal is to voluntarily contribute to superannuation from a young age, and thus allow their money to build over a long period. However, as the committee has seen throughout the evidence it has received, most under 40s do not make voluntary contributions.

3.51 Another concern, as CPA Australia noted, is that:

> People see the compulsory SG level set at nine per cent and assume that that must be enough, because that is the amount the government has set for them—especially young people.[34]

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31 Mr N Cochran, Retail Employees Superannuation Trust (REST), Industry Funds Forum member, *Transcript,* 3 February 2006, p. 61.

32 The Treasury, *Submission No. 47*, p. 10—additional contributions fell by 7 per cent between 1999–2000 and 2002–2003.

33 Mr B Salter, Institute of Securities, Finance and Banking (now Financial Services Institute of Australasia), *Transcript*, 18 October 2005, p. 8.

34 Mr M Davison, CPA Australia, *Transcript,* 10 February 2006, p. 17.

3.52 This view was echoed in submissions, including max Super:

> Research commissioned by max Super indicates that many under 40's have not considered whether current contribution levels are adequate. They either simply do not know, or perhaps assume that having established a compulsory scheme, the government ensured there will be adequate funds available. [35]

3.53 One way to ensure that under 40s have realistic retirement income goals, and know what is required to achieve them, is through regular personal financial advice. Another way to allow people to see what their current levels of super contributions are likely to amount to is to allow super funds to provide long-term projections in members' annual statements. This is currently practice in the United Kingdom (UK) and Sweden. However, 'Corporations Law and the attitudes of ASIC'[36] currently prevent Australian funds from doing so.

3.54 To ensure that projections are realistic, the assumptions on which projections are made could be set by the regulator. Also, as suggested by ASFA, 'there might be three scenarios shown—a conservative scenario, a likely scenario and an optimistic scenario'.[37]

Age-based issues

3.55 A number of submissions have raised concerns about the attitudes to superannuation of people under 40. Generally speaking, they are seen to be too worried about short-term consumption, with little concern for their retirement income. It is also human behaviour, probably due to mortality, to avoid focussing on the distant future.

3.56 McCrindle Research, who were commissioned to conduct a qualitative study on under 40s' attitude to super, received the following responses when asking why saving for retirement is unattractive for this age group:

> $100 today means a lot more to me than the promise of $100 years from now; and
>
> Do the maths, retirement for me is 2 life times away.[38]

35 max Super, *Submission no. 72*, p.5.

36 Mr R Clare, ASFA, *Transcript,* 28 July 2005, p. 6.

37 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 5.

38 McCrindle Research, *Submission no. 2*, p. 9.

3.57 As to broad reasons why under 40s are disinterested in super, McCrindle Research highlighted: practicality, accessibility, flexibility, transparency and security.[39] These findings have been highlighted throughout the committee's evidence.

3.58 Max Super and the FINSIA have both conducted recent research on the behaviour of under 40s in relation to superannuation and savings and have found them to be more concerned with their future financial stability than is generally portrayed.

3.59 FINSIA stated:

> Our research has found that, contrary to wide-held beliefs, the under-40s are not spendthrifts, they do not live for today only and they do not adopt cavalier attitudes towards saving for the future. Indeed, as a general statement, the conundrum is whether Australia's compulsory system has in fact stopped this generation of under-40s from thinking and emotionally engaging on retirement planning issues.[40]

3.60 Other evidence suggests that not only are the under 40s concerned with their financial wellbeing but are actively addressing it. Max Super's submission discusses this:

> In spite of this demand on financial resources, a large number of respondents were attempting to stick to a budget. Contrary to the 'live for the day' label often used to describe this demographic, over a quarter of survey respondents indicated that their budget reflected their desire for a secure future with less than 10% budgeting for self gratifying purchases.[41]

3.61 It seems that the problems in making this age cohort more interested in super are well established; the solutions, however, appear somewhat more difficult.

3.62 The options to improve incentives, which are mentioned throughout this paper, are one way to attempt to change under 40s behaviour. Other ways include arming this age group with well targeted information and providing better access to financial advice.

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39 McCrindle Research, *Submission no. 2*, pp. 11–13.

40 Mr B Salter, Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 4.

41 max Super, *Submission no. 72*, p. 10.

Preservation

Principles of preservation

3.63 Superannuation saving is based on the premise that contributions are inaccessible and compounding earnings until the point at which a person retires and draws down the funds. Since 1 July 1999 all contributions to superannuation funds, including personal contributions and earnings are to remain with the fund until a member reaches a certain age. Some very limited exceptions to the preservation rules, in cases of genuine hardship, enable the early release of benefits. For the under 40s age group the preservation age will be 60 years of age.[42]

3.64 Preservation plays a dual role of preventing dissipation of savings for retirement and ensuring that funds placed in a concessionally taxed environment are used for people's retirement income. Treasury has stated in its submission that increasing the preservation age from 55 to 60 aims to ensure 'that retirement income expectations are achieved for a longer lived population.'[43]

3.65 A number of submissions to the inquiry have suggested the very nature of preservation is an impediment to the under 40s age group making additional superannuation contributions (ironically, including Treasury). This is largely based on demographics – this age group face financial constraints associated with first home purchase, high debt commitments and family formation, making it difficult and possibly irrational to channel additional funds into a vehicle which locks them away for many years. This was encapsulated by ASFA in evidence:

> The real problem is that retirement seems so far off and there are other immediate priorities. You do need extra incentives to ask people to lock away money until retirement because you are asking them to commit to that objective over and above any other objective they might have in their life without the flexibility of being able to withdraw it.[44]

3.66 The other reason preservation is cited as a barrier to superannuation savings is that the two generations comprising the under 40s age group are said to have unique characteristics which make them less prone to save for the future. This age cohort works in a jobs market quite different to that of

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42 The preservation age is currently 55 and will eventually phase in to 60 between 2015 and 2025.

43 The Treasury, *Submission no. 47*, p. 28.

44 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 5.

their predecessor generations. There is a higher degree of casual, part-time and non-ongoing employment than 30 years ago and more of the paid workforce are women.[45]

3.67 Home purchase is now more often tied to two household breadwinners and women tend to return to paid work in some capacity, after having children. Preservation can therefore be seen as an impediment when the employment market is less certain and the economy is geared to a higher household income. People may value more liquid and shorter-term assets in this environment. The submission from the Government Employees Superannuation Board (GESB) of Western Australia notes this:

> Attitudinal data indicates that conflicting interests such as the responsibilities to pay off mortgages, HECS debts and loans, and the opportunity to invest in more short-term investments such as shares or term deposits are impacting on the decisions of members under the age of 40 with respect to investing their money in the longer-term option of superannuation.[46]

3.68 IFSA stated in their evidence to the committee that preservation was a major barrier to people making additional voluntary contributions.

> The issue in superannuation seems to be the investment horizon: that is, that the money is there for a long time and you may get a reversal in life. Although you can go through the hardship provisions, one wonders how many people are aware of that.[47]

3.69 It was also suggested in one submission that setting a restricted preservation age detracts from flexible working arrangements and some people's desire to retire prior to the set preservation age:

> The need to lock-in savings also requires regulation to define an inflexible retirement age (when funds can be released). This makes superannuation poorly suited to emerging trends of people wanting an earlier and more gradual transition through a part-time 'working retirement'. [48]

45 In 2004, 44.4 per cent of the total labour force were women. Australian Bureau of Statistics, *Australian Social Trends – Work,* cat. no. 4102.0, ABS, Canberra, 2004.

46 Government Employees Superannuation Board (GESB), *Submission no. 35*, p. 2.

47 Mr B Stanhope, IFSA, *Transcript*, 28 July 2005, p. 32.

48 Dr D Thorp, *Submission no. 60*, p. 4.

Early access to superannuation savings

3.70 A number of submissions suggested the ability to access superannuation balances to enable the early payment of Higher Education Contribution Scheme (HECS) debts or to provide greater affordability of an owner occupied home.

3.71 There are two main aspects to consider when suggesting access to superannuation prior to preservation age for uses other than retirement income. One is that favourable taxation treatment is afforded to employer and salary sacrifice superannuation contributions and to earnings in the fund. The other is that voluntary contributions by an employee, whilst not attracting a concession on contribution do enjoy low tax rates on earnings.

3.72 A concessional tax rate for employer and salary sacrifice contributions reflects the desire of the government to encourage people to save for their retirement income and to ensure that the savings vehicle is effective. The tax rates were discussed in Chapter 2 and the concessionary nature discussed in Chapter 4.

3.73 The concessional taxation treatment and the long-term nature of the superannuation savings vehicle are the two common reasons put forward to prevent early access to funds. Superannuation works on the basis of a long-term investment and any at call phenomenon would change the investment strategy.

3.74 Superannuation is an investment vehicle which is widely accessible to most income earners to enable savings for retirement income. This is because it requires no large initial investment[49], does not involve financing and is based on repeated, relatively small investment chunks which people can make as they earn income. However, because of this, balances take time to build and compounding growth relies on continuous deposits over the long term, with no withdrawals.

3.75 One individual’s submission noted:

> Because superannuation contributions are very long-term investments, the compounding effect on earnings to produce the required retirement benefits is nearly as important as additional co-contributions.[50]

3.76 The inquiry has raised suggestions to sanction parts of superannuation to allow some accessibility. These have mostly related to access to voluntary

49 Self managed funds require a significant capital outlay to start-up.

50 Mr H Hinde, *Submission no. 36*, p. 6.

superannuation contributions. Tower Australia suggested that 20 per cent of voluntary contributions could be made accessible:

> Preservation is a huge deterrent for people putting money in super. Having access to some of that would go quite a long way towards encouraging people to put money into super.[51]

3.77 Other suggestions included access to superannuation balances to utilise for a first home purchase or reduce the cost of an existing mortgage.

3.78 In their supplementary submission to the inquiry the Real Estate Institute of Australia (REIA) supported a scheme allowing early access to voluntary superannuation savings to allow the purchase of a first home. People over the age of 23 were eligible to participate in the proposed scheme 'for the purpose of purchasing their first home when their total account balance exceeded a minimum of $10,000'.[52] Max Super supported a similar idea but with more age discrimination:

> Max Super recommends that the Federal government consider a broader interpretation of the sole purpose test, legislating for first home buyers to be given access to 75% of their accumulated non Super Guarantee contributions made to age 35, to be used for a home deposit. [53]

3.79 A proposal was also submitted to the committee regarding a 'mortgage off-set option' on superannuation balances. The concept was to encourage superannuation savings yet the balance in superannuation did not earn interest but offset the interest on a mortgage. The idea was to enable young people to afford a mortgage on a home whilst forming a super savings habit. At a later point in time, having reduced their mortgage, they would elect a lower 'off-set' to enable greater growth in superannuation savings. This was explained by Mr Zeitoun at an inquiry hearing :

> It is the same way as the current redraw facilities operate with a bank product, whereby the extra money you have put into your loan reduces the amount payable in terms of interest with your regular payments. …In this way, people know that if they put it into super, it will offset their interest, they will pay off the capital more quickly, and therefore they can concentrate on their super strategy.[54]

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51 Ms O'Keefe, Tower Australia Ltd, *Transcript*, 18 October 2005, p. 56.

52 REIA, *Submission no. 53*, p. 2.

53 max Super, *Submission no. 72*, p. 10.

54 Mr A Zeitoun, *Transcript*, 10 February 2006, p. 44.

3.80 Tower Australia also proposed a mortgage relief scheme that 'would be relatively simple in that an individual who contributes to super above the superannuation guarantee, would be able to claim a small amount of mortgage interest back on their tax'.[55]

3.81 To all suggestions incorporating using superannuation for housing, Mr Noel Whittaker said it was '…plain stupid' because:

> The reason is you have competing interests. If I have a home loan, I want the lowest rate possible; if I have superannuation, I want the highest rate possible.[56]

3.82 One individual, Mr John Dimeski, suggested access to superannuation balances to allow more under 40s to obtain financial advice about their superannuation.

> 'How do young people access a couple of thousand dollars to get quality advice upfront?'[57]

3.83 The Australian Council of Trade Unions (ACTU) made suggestions that a joint super-health fund be established to enable the use of superannuation for medical purposes. This is based on research that 'one of the biggest—if not the biggest—strains on that [purchasing power of the pension] is going to be the increasing cost of the health care system'.[58] They did not elaborate on how a linked system could operate.

3.84 Others have made claims that preservation of superannuation makes other savings vehicles relatively more attractive:

> The superannuation preservation rules may concern some, as they prevent people from accessing superannuation savings until preservation age (except in limited circumstances). This inflexibility may prompt some to invest money in alternative vehicles, which allow access to the funds;[59]

3.85 Mr Mark McCrindle of McCrindle Research saw benefits to access superannuation for housing as it gave superannuation a tangible element for people much younger than preservation age. He stated 'I do not know about the wisdom of allowing them to spend it on depreciable assets or

55 Tower Australia Ltd, *Submission no. 26*, p. 4.

56 Mr N Whittaker, *Transcript*, 10 February 2006, p. 72.

57 Mr J Dimeski, *Transcript*, 28 July 2005, p. 77.

58 Australian Council of Trade Unions (ACTU), *Transcript*, 3 February 2006, p. 45.

59 Department of Family and Community Services, *Submission no. 38*, p. 12.

travel. But certainly, if they could use it to get a leg into the housing market or use it to invest in some other way, then it was real to them'.[60]

3.86 The committee also heard from many interested parties, including Australian Administration Services (AAS) and the Industry Funds Forum (IFF), who were strong advocates of preservation because the purpose of superannuation is to provide funds in retirement.

3.87 Ms Kerry Flanagan, from the Office for Women indicated that it is hard to 'make up' for previously unsaved monies and similarly, it would be hard to recoup monies accessed early from superannuation balances. She stated:

> I have heard suggestions many times before about people being able to access their superannuation in those early stages, but inevitably if you are not able to recontribute to it, as you go through life, you end up poorer in retirement.[61]

3.88 Additionally, allowing access to superannuation for other purposes may have skewing effects in the market and prove counterproductive. For example one individual, Mr Christopher Moore, suggested in his first submission to the inquiry that being able to access superannuation to pay a mortgage would not help housing affordability:

> It would also mean an instantaneous step up in prices due to extra cash available, and the ratio of house price to yearly earnings, would increase further. The only gain is to those who already own a home.[62]

3.89 Unintended impacts on the housing market were mentioned by those against early access, for example by AAS:

> Finally, consideration should be given to the macro-economic effect of releasing superannuation monies to purchase a home and whether, analogous to the first home-buyers' scheme, this may have the unintended consequence of increasing house prices further.

3.90 These consequences were also raised by those supporting access to superannuation prior to preservation age:

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60 Mr M McCrindle, McCrindle Research, *Transcript*, 18 October 2005, p. 64.

61 Ms K Flanagan, Office of Women, Department of Families, Community Services and Indigenous Affairs, *Transcript*, 10 February 2006, p. 6.

62 Mr C Moore, *Submission no. 57*, p. 2.

> I want to mention a few issues that will come out of such a proposal. One is the potential to boost house prices by having such an offer in the market.[63]

3.91 Treasury also highlighted the administrative and practical issues associated with allowing superannuation contributions to be released for housing:

> How is the fund to determine who to release it to? If you are releasing it to low-income earners, how is the fund going to know that? How is it going to stop people from buying a big house instead of a normal house and improving the house overall? How is it going to be measured? How is it going to be paid back if they do default later?[64]

3.92 Interestingly, FINSIA's market research indicated that:

> Only 21 per cent of people polled strongly agreed with the statement: 'Superannuation has limited accessibility; I would rather have current access to my retirement savings in case of emergency.'[65]

Conclusions

3.93 The committee saw merit in many of the proposals to allow access to post-tax voluntary superannuation contributions. However, the overriding drawback was that the purpose for which the contributions were being made was being undermined.

3.94 The purpose of superannuation is to allow for monies to be used in a person's retirement. The sole purpose test in the *Superannuation Industry (Supervision) Act 1993* details this intent, notwithstanding a small number of exceptions in the Act, such as financial hardship or imminent foreclosure on the owner-occupied home.

3.95 Decrements to superannuation balances, even early in a person's working life, must be reinvested later to reinstate the foregone balance. As the span of a person's working life shortens there is reduced time to make up for depletions as the success of the superannuation vehicle depends upon compounding balances. This will therefore translate to much greater contributions being required to make up the shortfall.

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63 Mr A Zeitoun, *Transcript*, 10 February 2006, p. 43.

64 Mr T Coles, The Treasury, *Transcript*, 14 October 2005, p. 7.

65 Ms K Foster, Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 6.

3.96 Proponents of early access, particularly for the purchase of a first home, infer that the garnering of a deposit for home purchase is a greater stumbling block than the potential future financial burden of making up for lost superannuation balances.

3.97 It has been argued that the proportion of household outgoings are the greatest when people are under 40 as this is the time when many people are purchasing a home, paying large mortgage repayments, and are rearing and educating children. However, with the average age of first childbirth shifting to age 30 and a greater proportion of remarriages and second families, costs of child rearing and education to tertiary levels are increasingly still with people after age 50. It is therefore risky to deduce that depleted superannuation may be made up and made up easily when people are older.

3.98 Whilst the committee acknowledges the difficulties that young people face in saving for their first home (and particularly in a high cost housing market) they believe other savings vehicles are more appropriate for this purpose.

3.99 Muddying superannuation's purpose with early access schemes will not only increase complexity but will introduce inequities in the system. Where an access scheme specifically incorporates a sector of the economy, for example housing, it may also cause unintended and adverse consequences, like price inflation.

3.100 In addition, all forms of superannuation accretions receive some level of concessional taxation treatment, if only when the effective rate of taxation is calculated.[66] This concessional tax treatment is given on the basis that when a person draws down on their superannuation balance in retirement that it is utilised to improve the retiree's living standard.

3.101 Additionally, in a global environment of structural ageing, reducing the fiscal cost of a growing quantum of Age Pensions is vital. Thus taxation incentives are given to encourage voluntary superannuation contributions. The monies are therefore not intended to be used for non-retirement purposes.

3.102 Despite the committee being lobbied by various groups to allow early access to superannuation it believes the sole purpose test—the principle of restricting what can be done with superannuation monies whilst in the accumulation phase—should continue.

66 Refer to Chapter 2, on *Taxation*.

3.103 The committee believes that the greater concessional tax treatment proposed under the government's superannuation plan will improve retirement incomes in its own right, as well as encouraging additional contributions from under 40's who have the capacity to do so.

Superannuation Guarantee Levy adequacy

3.104 The Superannuation Guarantee levy (SG) was introduced in 1992 to extend the range of people who could benefit from compulsory superannuation. Prior to 1992 superannuation existed in certain industrial awards (from 1986) and was also enjoyed by public servants and senior white collar workers.

3.105 The SG has increased superannuation coverage—superannuation now covers 90 per cent of employees and 67 per cent of self-employed people.

3.106 The purpose of the SG is to assist employees to be able to enjoy a higher standard of living in retirement than would be possible under the Age Pension alone. It also reduces reliance on the Age Pension and thus the cost to the Commonwealth budget.

3.107 The SG commenced at a rate of three per cent of an employee's notional earnings base and over a ten year phase-in period increased to its current level of nine per cent. The SG itself was not originally intended to increase beyond nine per cent. Policy changes were announced in the 1995 budget to accompany the SG with an additional employee contribution of three per cent along with an income scaled matching of this contribution by the then Australian Government.[67] This was intended to phase in between July 1997 and July 1999.

3.108 A change of government followed in 1996 and the SG remained, to reach nine per cent in 2002. The present government has previously stated that it does not intend to increase the rate further.

3.109 Conflicting evidence has been received as to whether current arrangements will provide an 'adequate' standard of living in retirement.

3.110 The inquiry has highlighted concerns that the nine per cent rate of SG is not sufficient to fund the under 40s retirement incomes and without sufficient voluntary savings to meet the shortfall the fiscal burden will be significant. The ACTU's submission noted that:

67 The Hon Ralph Willis MP, Treasurer, *House of Representatives Hansard*, Budget speech, 9 May 1995, p. 68.

> Congress [ACTU Congress] is concerned at clear evidence that the 9% SG is insufficient to fund an adequate retirement income for average workers.[68]

3.111 In contrast, Treasury estimates that for Australians on median earnings with SG contributions over a full working life, the Age Pension and SG system combine to provide relatively high spending replacement rates (82 per cent of pre-retirement income). Employees on lower than median earnings will have higher replacement rates, while those on higher than median earnings will have lower replacement rates but higher retirement incomes in dollar terms.

3.112 In addition, the government predicts that its superannuation plan—in particular cutting tax on benefits—will mean that a person on average earnings, receiving only the SG for a working life of 40 years would increase the value of a lump sum on retirement by 9 per cent or alternatively increase the value of a pension by 17 per cent.[69]

3.113 Employees with broken periods of labour force participation will have lower replacement rates unless they have additional savings—for example voluntary superannuation contributions:

> However, for people with higher retirement income expectations or for people who may not fully benefit from the SG system, such as the self-employed, older employees and those with broken periods of labour force participation, voluntary superannuation contributions are the key to ensuring these groups' retirement income expectations are met.[70]

3.114 Such projections presuppose that the Age Pension will remain at its current level. Given the reality of Australia's ageing population, the ability of future governments to maintain the level of the current pension may come under question. Moreover, it would appear desirable for any future government to have their Age Pension burden lessened by increased superannuation savings.

3.115 Therefore, irrespective of the future level of the Age Pension, Treasury's projections suggest that most people wanting to retire independently of any government assistance will need to make personal contributions well above the SG.

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68 ACTU, *Submission no. 29*, p. 2.

69 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, pp. 55–56.

70 The Treasury, *Submission no. 47*, p. 2.

3.116 FINSIA's research revealed many in their survey sample expected to retire independently despite '…only 32 per cent (less for women at 29 per cent) considered themselves 'prepared' for retirement':

> When asked at what age they expect to retire and whether they expect to be fully-funded retirees, the mean age of retirement was an unprecedented 61.6 and 45% expected to be a fully self-funded retiree (ie. expected not to be reliant on the Government for a full, or part, pension.[71]

3.117 Much of the committee's evidence has conflicted with Treasury's projections, suggesting that the current level of SG is too low to provide even a modest level of retirement income. This mostly stemmed from the view of self-sufficiency in retirement. Mr Brian Salter of FINSIA stated in relation to the level of nine per cent:

> We know that, alone, it is inadequate. There has been sufficient modelling done to suggest that something north of 13 per cent of today's incomes would be required to reach a reasonable level of security in retirement.[72]

3.118 Mr Salter suggested there was scope to increase the levy but that he felt compulsory increases were not the only way to achieve this:

> …rather, let us find the combination of compulsion, incentive, education and encouragement to change the psychology and behaviour.[73]

3.119 Some, however, have suggested that mandatory superannuation contributions should be increased to 12 per cent or 15 per cent (if contributions continue to be taxed).

3.120 The ACTU contended that economic circumstances have been such to enable this increase:

> Record terms of trade (highlighted in the graph below) amongst other factors provided the fiscal circumstances for a once in a generation opportunity to:
>
> - Increase the SG contribution paid by employers from 9% to 12% over 3 to 5 years;[74]

71 FINSIA, *Submission no. 49*, p. 5.

72 Mr B Salter, The Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 10.

73 Mr B Salter, The Institute of Securities, Finance and Banking (now FINSIA), *Transcript*, 18 October 2005, p. 10.

74 ACTU, *Submission no. 29*, p. 4.

3.121 The Transport Workers' Union proposed a compulsory increase:

> This has significant ramifications for retirement incomes knowing, as we do, that a 9% superannuation contribution will not adequately fund retirement (see above for CPA study). Education may alter perceptions to a limited extent. Government action will alter it more profoundly and with longer-lasting effects. Governments must pursue the policy pursued by the Keating Government to ensure that superannuation contributions reach at least 15%.[75]

3.122 In their submission to the inquiry ASFA supported a mix of compulsory and voluntary increases (and tax concessions) to reach 15 per cent, but did not break them down:

> ASFA recommends that, in order to better meet retirement income needs and expectations, contributions be increased in effect to an amount equivalent to 15% of wages through a combination of compulsory contributions, voluntary contributions and tax relief.[76]

3.123 One argument put forward was that the SG levy at nine per cent would not provide people with a reasonable level of retirement income because it was subjected to a contributions tax of 15 per cent.

3.124 Max Super alluded to a 15 per cent savings goal in their submission:

> Abolishing the 15% contribution tax will increase super guarantee, in after tax terms from 7.65% to the full 9% employer contribution, and accompanied by further Government incentives will help achieve the desired retirement savings goal of 15%. [77]

3.125 Others have made passing comments that the level is inadequate. For example, one individual, Mr Peter Mair, indicated this in his submission:

> That paying off mortgages on overpriced houses leaves little scope to put more into superannuation, over and above the (admittedly inadequate) compulsory 9 per cent levy on employment income.[78]

3.126 Another individual submitter, Mr Howard Hinde, effectively proposed an increase in the SG through a compulsory additional contribution:

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75 Transport Workers Union, *Submission no. 27*, p. 8.

76 Association of Superannuation Funds of Australia (ASFA), *Submission no. 16*, p. 12.

77 max Super, *Submission no. 72*, p. 20.

78 Mr P Mair, *Submission no. 54*, p. 1.

> Make co-contribution compulsory. It would become a payroll deduction and paid across by the employer with the Superannuation Guarantee Levy.[79]

3.127 Interestingly, Ms Anne-Marie Esler of the Financial Planning Association of Australia (FPA) concluded that the current SG rate for the under 40s may even be sufficient enough to breach the reasonable benefit limits (RBL) requirements for many of these working a 40 year span:

> Most of the people who are under 40 now will have 40 years of an SG at a substantial rate, which means that they will have deductible contributions going in—at least at the minimum 9 per cent SG—over a 40-year period. That means that they are more likely at retirement to be subject to the RBLs.[80]

3.128 There have also been arguments that compulsory superannuation, at any rate, reduces disposable income and takes away an individuals' choice to save for their retirement in a different way. The Australian Consumers Association (ACA) 'vigorously oppose the imposition of greater compulsory superannuation upon consumers under the age of 40'[81] for disposable income reasons:

> We think this group is so financially stretched that people will have to do things like borrow money from elsewhere to fund their children's education because they are now overcommitted in the superannuation area.[82]

3.129 The opposing view is that this generation have been accustomed to, and have accepted, forced retirement savings habits. FINSIA stated:

> I think it is more that it is gratefully accepted as something that was perhaps difficult to swallow when it was first introduced, but this generation we are talking about has known nothing different. This is part of the way they are accustomed to their work and budgetary habits. [83]

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79 Mr H Hinde, *Submission no. 36*, p. 4.

80 Ms A Esler, Financial Planning Association of Australia (FPA), *Transcript*, 18 October 2005, p. 33.

81 Australian Consumers Association, *Submission no. 34*, p. 3.

82 Dr N Coates, Australian Consumers Association (ACA), *Transcript,* 18 October 2005, p. 50.

83 Mr B Salter, FINSIA, *Transcript*, 18 October 2005, p. 14.

3.130 ASFA's 2004 polling research[84] revealed that 'around 70 per cent of those aged 30 to 39 consider that more than the 9% compulsory employer superannuation contribution is needed'.[85]

3.131 However, there is also anecdotal evidence that some under 40s assume the SG at nine per cent has been universally, rather than generally, calculated to meet their retirement income needs:

> There is an assumption that nine per cent is going to be adequate and people have not thought through what they need to save.[86]

3.132 The CPA supported this view:

> Some of the anecdotal evidence we have had from our members is that people see the compulsory SG level set at nine per cent and assume that that must be enough, because that is the amount the government has set for them—especially young people.[87]

3.133 AMP Financial Services (AMP), in their submission, suggested ongoing work should be undertaken in this area:

> Increasing the rate of Superannuation Guarantee contributions should only be undertaken with broad community support, although as a community we should continue to debate this option.[88]

3.134 Industry groups have stated that employers already bear enough of the burden through the current rate of nine per cent on top of salaries. The Australian Chamber of Commerce and Industry (ACCI) stated:

> ACCI does not support an increase in the contributions paid for by employers, as they are already asked to bear a significant burden of providing for retirement incomes — through the guarantee, and through contributing around 40 percent of general tax revenue which is in turn used to pay for pensions. If there is to be an increase in compulsory super contributions, then this should be paid for by the introduction of employee contributions rather than further demands being made on already burdened employers.[89]

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84 May/June 2004 ANOP Research Services Pty Ltd telephone polling of 755 Australians aged 30–69 years commissioned by ASFA.

85 ASFA, *Submission no. 16*, p.15.

86 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 3.

87 Mr M Davison, CPA Australia, *Transcript*, 10 February 2006, p. 17.

88 AMP Financial Services (AMP), *Submission no. 48*, p. 3.

89 Australian Chamber of Commerce and Industry (ACCI), *Submission no. 41*, p. 5.

3.135 The Australian Industry Group (Ai Group) supported this view:

> An increase in the SGC [super guarantee charge] would have the same impact as a rise in the rate of payroll tax.[90]

3.136 The nine per cent paid by employees is often seen as an added cost to employers when in fact it forms part of total remuneration. The transitional SG rate increases introduced between 1992 and 2002 were designed to coincide with wage rises and the superannuation amounts were traded off for direct salary. The nine per cent component therefore forms part of an employees overall wages/salary package.

3.137 ASFA noted at an inquiry hearing that employees understand where the nine per cent super guarantee contribution comes from:

> We have talked to people and they now understand that, in paying that nine per cent, it comes out of their income. It is not magically coming out of somewhere else or from the employers.[91]

3.138 There remains, however, a perception that the SG is an add-on cost of the employer. This may be compounded by the fact the employer can claim a tax deduction for SG contributions paid on behalf of an employee. This was indicated by Australian Administration Services (AAS):

> Of course, an alternative to removing the contributions tax would be to increase the amount of superannuation guarantee contributions, thereby effectively transferring the cost from the government to employers, but this has obvious implications for business.[92]

3.139 Employers should, from an add-on perspective, be in a neutral cost position with respect to SG. It may not, however, be as easy to maintain a neutral cost position if further increases to SG were to occur. This is because the wage fixing environment has become less centralised. Nonetheless, approximately 80 per cent of the workforce are employed under some form of enterprise bargaining and so super/wage trade-offs are not impossible but may not synchronise as well with a mandated SG increase.

> An increase in the compulsory component would be across the board and apply to all employees, all those who are subject to the levy obviously, but that would reduce the discretion, I would have

90 Ai Group, *Submission no. 15*, p. 2.

91 Mr R Clare, ASFA, *Transcript*, 28 July 2005, p. 10.

92 Australian Administration Services (AAS) *Submission no. 67 (supplementary)*, p. 2.

> thought, for a variety of negotiations, some of which people may well prefer instead of an increase.[93]

3.140 Irrespective of the level of SG, there are administrative costs for employers associated with the SG compliance.

Conclusions

3.141 Most people in the workforce aged under 40 have been exposed to the superannuation guarantee system all their working lives. It seems that not only have they become accustomed to it, they accept it.

3.142 Any form of compulsion necessarily removes alternative choice. However, it appears that as the SG compulsion started early (and transitionally) in the under 40s working lives it is not viewed negatively. On the contrary, many seem happy that it will contribute to their retirement living standard without being missed from their take home pay.

3.143 Determining whether the current nine per cent level of the superannuation guarantee is adequate very much rests with the definition of retirement income adequacy, and whether the SG is intended to provide an individual with a self-sufficient retirement income.

3.144 Australia's retirement income framework is based on a mix of private and public contribution to retirement incomes. The goal of self-sufficiency in retirement, although being of fiscal benefit, is ultimately the goal of the individual. The achievement of a self funded retirement will be contingent upon a number of factors, importantly, an individual's income earning capacity.

3.145 It appears, however, that many under 40s view the level of the SG as mandated by the government to allow them to achieve self-sufficiency. There is anecdotal and polling evidence that this is a psychological barrier to contributing outside the SG regime.

3.146 Employer groups opposed any increases to SG on the basis that it would form an additional cost impost on them. The introduction of SG and subsequent increases were absorbed through a mostly centralised wage system. This may not be as easy with a changed labour market environment.

3.147 Interestingly, Australia's largest consumer advocate also strongly opposed any increase in compulsory superannuation citing already high financial

93 Dr P Burn, Australian Industry Group (Ai Group), *Transcript*, 10 February 2006, p. 37.

burdens borne by this age group and presumably the desirability of disposable income over further retirement contributions at this life stage.

3.148 A number of groups believe the contribution tax is lowering the effective level of SG contributions and that this alone means that the rate of contribution is not high enough.

3.149 The committee notes that there may be some inadequacy in the nine per cent rate given the high reliance by the under 40s on the SG alone. Whilst the committee does not recommend a current change to the SG rate, retirement income research suggests that a 12 per cent rate of superannuation savings would allow more people to meet their retirement income expectations. In making this assessment, it is important to recognise that the government's superannuation plan, if implemented, will have a significant impact on retirement savings.

3.150 It is difficult to determine whether the retirement savings behaviour of the under 40s is due to conflicting financial demands, a belief that the SG alone will meet their retirement needs or that they would not otherwise be contributing but for compulsion. For these reasons the committee recommends a voluntary default savings scheme supplement the compulsory SG to bring retirement savings more in line with expectations (recommendation 1 below).

Default scheme for voluntary contributions

3.151 Whilst the nine per cent SG provides an adequate retirement income for those with a continuous work pattern for their full working life at incomes at or above average earnings, others may fall short. An additional voluntary opt-out scheme would provide an opportunity for people to maximise their retirement income or to enable those who have not enjoyed full-time continuous employment for their full working life to supplement their compulsory component.

3.152 Approximately 26 per cent of the workforce is employed in casual labour (non-ongoing contracts of service) and of those casuals 69 per cent hold part-time positions.[94] Approximately 15 per cent of the total workforce is employed in a part-time capacity (this covers those in on-going and non-

94 Australian Bureau of Statistics (ABS), *Year Book Australia 2006*, cat. no. 1301.0, ABS, Canberra, 2006.

ongoing positions).[95] Many of these casual and/or part-time employees who exceed the SG threshold may have low income levels from which contributions may come.

3.153 Additionally, many who have full-time, continuous work but earn less than Average Weekly Ordinary Time Earnings (AWOTE) will find that their SG amount (coupled with pension eligibility) will provide them with an even lower retirement replacement income. Approximately 70 per cent of employees earn less than AWOTE.[96]

3.154 There are others, who although having enjoyed periods of work at above average earnings levels have also taken time out of work to care for children, elderly relatives, their own health or to make contributions to unpaid community pursuits.

3.155 Voluntary savings are an important element in boosting overall retirement living standards. If an individual has the capacity to save a little more above the SG over their working life they may supplement their future lifestyle. This is particularly so with the present generous co-contribution scheme for low income earners.

3.156 The level of voluntary savings in superannuation by the under 40s fell between the late nineties and 2002–03 (last known data set on under 40s).[97] This may be more the result of a demise of some defined benefits funds (no new members and retiring members) which required members to make personal contributions, rather than a savings shift. Treasury predicts an increase in after-tax contributions of $900 million in 2003–04 to $1.5 billion in 2008–09.[98]

3.157 Recent results from ASFA on the impact of super choice legislation indicate that people tended not to change their funds given the choice.[99] This either indicates they were happy with the fund they were in or that people have the tendency to inertia. Given the likelihood of inertia, it would appear that people are less likely to make voluntary superannuation contributions with no trigger mechanism or alternatively are less likely to stop making them once they start.

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95 Australian Bureau of Statistics (ABS), *Labour Force Australia*, cat. no. 6202.0, ABS, Canberra, March 2006.

96 Australian Bureau of Statistics (ABS), *Employee Earnings and Hours*, cat. no. 6306.0, ABS, Canberra, May 2000.

97 The Treasury, *Submission no. 47*, p. 10.

98 The Treasury, *Submission no. 47*, p. 23.

99 Mr R Clare, ASFA Research Centre, ASFA, *The Introduction of Choice of Superannuation Fund - Results to Date* , February 2006.

3.158 CPA Australia suggested a proposal whereby an individual commencing a new job defaulted to make a 'voluntary' contribution to superannuation but could opt-out at any time by completing the necessary paperwork.

> I suppose, as a starting point, what you do not have you do not miss. If it is set up as an opt-out system when you first start work, you effectively would have a percentage of your salary being salary sacrificed into superannuation. The opt-out bit could be done easily in terms of giving your employer the form to say, 'Do not put money into super for me, only have the compulsory super'.[100]

3.159 ASFA also supported this type of mechanism in order to boost superannuation savings through a mix of compulsion and voluntary decision making. In evidence Ms Philippa Smith of ASFA discussed 'soft compulsion' schemes:

> In the US, for example, where the corporate fund situation is stronger, what has been very successful is what is called the soft compulsion option, which is automatic enrolment. It is not current wages that you are asking people to forgo; you are asking them to forgo part of their future wages. And, if they sign up for these programs, it then becomes an automatic deduction thing. Extra savings are going into their plan, which they can opt out of.[101]

3.160 The ANZ submission outlined a designed default system proposed by Dr Nicholas Gruen[102] whereby the default (voluntarily contributing to superannuation) is the preferable position for both individual and Government. Dr Gruen's paper provides examples of where choice can paralyse people, even where lack of choice is detrimental to eventual outcome. The ANZ submission outlined this:

> Under this option, contributions to superannuation could be increased by one percent each year up until a target level of savings was met, say 15 percent. The increased savings would be in the form of employee contributions (sometimes known as salary sacrifice contributions), which would be on top of the compulsory nine percent Superannuation Guarantee (SG) contributions already in place. [103]

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100 Ms N Kelleher, CPA Australia, *Transcript*, 10 February 2006, p. 17.

101 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 11.

102 Dr Nicholas Gruen, *Designed Defaults: How the Backstop Society Can Failsafe Australians' Superannuation*, 15 September 2005.

103 ANZ, *Submission no. 48*, p. 6.

3.161 Under this scheme any increases in employee contributions would occur automatically each year so the employee would need to make a conscious decision to opt-out of the scheme, rather than a conscious decision to enrol. Importantly, to enable flexibility and choice 'they would be able to opt out of making all or some of these extra contributions at any time'.[104]

3.162 A system designed around default has been shown to have a high participation rate compared to a voluntary enrolment system:

> Gruen (2005) shows that where US employees are automatically enrolled in 401(k) retirement saving plans but they are able to opt out, the participation rate exceeds 85 percent. On the other hand, where employees are not automatically enrolled in the 401(k) plans, the participation rates can be much lower, somewhere between 26 and 43 percent.[105]

3.163 The New Zealand government has this year introduced a designed default system for voluntary savings called KiwiSaver. New employees aged 18 to 65 will be automatically enrolled in the savings plan when they commence a new job and will have six weeks to opt out. Employees' contributions will be deducted at a default rate of four per cent unless the employee chooses to double this. Contributions will be held by Inland Revenue in the first three months during which time the employee elects a KiwiSaver provider. Inland Revenue estimates there will be a high level of take-up or rather non-drop out.

3.164 The findings of FINSIA's CrosbyITextor polling indicate that despite 82 per cent of people being aware they can make a personal contribution to their superannuation beyond the SG only 33 per cent currently do so.[106] FINSIA has recently investigated the merits of KiwiSaver, following the merger which gave the former Institute of Securities a New Zealand focus. This, coupled with the results of CrosbyITextor polling has led FINSIA to support a voluntary savings opt-out scheme as outlined in their supplementary submission.[107]

3.165 The committee received no views directly opposing voluntary savings for this age group however Mr Noel Whittaker suggested that because you could not gear the compounding in superannuation there were more

104 ANZ, *Submission no. 48*, p. 6.

105 ANZ, *Submission no. 48*, p. 6.

106 FINSIA, *Submission no. 74 (supplementary)*, p. 4.

107 FINSIA, *Submission no. 74 (supplementary)*, pp. 2–4.

lucrative investments.[108] That said, he believed that superannuation has the best tax advantages—'Since the surcharge has gone it is the best'.[109]

3.166 There was, however, almost universal recognition that in general, people aged under 40 are at a point in their lives where their living expenses are high and they may not be in a position to make additional contributions.

3.167 The set-up costs to business to develop and establish an employer superannuation contribution scheme with an opt-out provision would not be likely to be onerous. It could, however, piggyback off the existing SG arrangement.

3.168 A potential problem with encouraging voluntary opt-out contributions, recognised by the CPA in evidence[110], is the maximum deduction limits for contributions into superannuation for various age groups. An employer may only receive a deduction for contributions made on behalf of an employee (SG and salary sacrifice) up to $14 603 in 2005–2006 for those under 35 and $40 560 for those aged 35 to 49. If an employer could not obtain a deduction for these additional voluntary savings (via salary sacrifice) they may not be willing to offer such a scheme. However, an employer would not need to contribute any more than the age-based deduction limit for any employee.

3.169 The government's superannuation plan would abolish age-based deduction limits and replace them with a single limit of $50 000 for deductible contributions. This is not a limit on contributions but a limit on the concessional taxation of the contribution within the fund. Employers would continue to receive a full tax deduction for all contributions (including those in excess of $50 000) made on behalf of employees under age 75. If an employee receives more than $50 000 in deductible contributions (from all employers) the excess amount would be taxed in the fund at the top marginal tax rate.

3.170 The other issue with a voluntary opt-out scheme is potential system inequity. If salary sacrifice were not to be universally offered some people would enjoy a considerable upfront voluntary savings advantage over those who could only make post-tax contributions. This is something Mr Noel Whittaker noted in evidence:

> Again you have two types of workers; those workers whose bosses offer salary sacrifice which governments do, and those workers who are not offered salary sacrifice. The ones who offer it, their

108 Mr Noel Whittaker, *Transcript*, 10 February 2006, p. 71.

109 Mr Noel Whittaker, *Transcript*, 10 February 2006, p. 76.

110 Ms N Kelleher, CPA, *Transcript*, 10 February 2006, p. 18.

> employees get a deduction because it comes out of pre-tax dollars but if the employer does not offer it, they have to pay their super out of after-tax dollars. There is an anomaly there.[111]

Conclusions

3.171 The committee heard evidence that the rate of voluntary employee contributions has fallen since 1999–2000 to the last known data set in 2002–03. This may be the result of many things. These may include low levels of disposable income associated with the life-cycle spending pattern of this age group; a historically high property market increasing housing costs; the SG reaching nine per cent in 2002 or the demise of defined benefits schemes requiring employee contribution.

3.172 Another explanation is that without strong incentives or some form of soft compulsion, people are inclined to accept the status quo.

3.173 Evidence to the inquiry has suggested that many people under 40 anticipate a level of retirement income that will exceed the level they will acquire. It is therefore likely that voluntary savings above the SG will be required to bridge this expectations gap.

3.174 A number of organisations have stated that a soft compulsion employee contribution scheme would significantly boost the number of people committing to additional superannuation savings.

3.175 The committee heard strong support for auto enrolment employee contribution arrangements with an option to decline the offer. Overseas research in relation to savings/retirement schemes indicates that people automatically enrolled in a scheme with a built in default will tend to remain enrolled in the scheme. Studies have shown that people will be mostly happy to stay with the status quo once enrolled.

3.176 A default scheme could operate in tandem with the SG. Assuming the SG remains at its current level, the default rate could be initially set at three per cent.

111 Mr Noel Whittaker, *Transcript*, 10 February 2006, p. 70.

Recommendation 1

3.177 **The committee recommends that when a new employee commences work they are automatically placed in a 'voluntary' contribution arrangement which they could chose to opt-out of at any time, preferably operating through salary sacrifice.**

The starting point in savings contributions could be a default rate of three per cent with periodic adjustments.

Superannuation Guarantee earnings threshold

3.178 The committee has regularly heard, both in submissions and at public hearings, that the $450 a month income threshold for the SG should be removed. This is the same threshold that existed in 1992 when the SG was implemented.

3.179 At that time the SG was only three per cent of salary and wages. The concern was that without a minimum threshold people on very low wages would end up with small amounts of SG which would just get eroded by fees. A threshold of $250 was originally considered but 'The reason that that did not proceed was on the basis that that nine per cent of $250, back in 1992, would probably be eaten away by fees and charges'.[112]

3.180 Ms Philippa Smith of ASFA noted the concerns at introduction of the SG about additional business administration.

> If you go back in history, that threshold was introduced in about 1992, at the time when the SG was three per cent. There was a concern about multiple small accounts being left around the place and the costs and administrative burden of those. Now we have the SG of nine per cent and we have choice and portability. [113]

3.181 When asked about the purpose of the threshold, the Treasury said:

> …it is a balancing of the policy rationale as to how much should be given to these people to create their superannuation savings, and how much of that is going to be an effective mechanism to actually

112 Mr A Coles, The Treasury, *Transcript*, 10 February 2006, p. 55.

113 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 4.

> give them something for their retirement income that will not be eaten away by fees, charges and other expenses.[114]

3.182 During the hearing in Canberra on 10 February, it was noted that a person could have three jobs earning $400 a month, which could effectively raise their SG threshold to $1200 a month yet receive no SG.[115] Therefore, despite a much higher overall income they are ineligible for the SG contribution. Thus people with multiple employers may miss out on SG payments entirely despite earning equivalent to full time employment. This was summarised by ASFA in their submission.

> There also has been a substantial increase in the number of casual employees, with 26% of employees casual in 2003, compared to 22% in 1993, leading to an increase in casual jobs from 1.3 million to 1.9 million (ABS 2005). A significant proportion of these job holders achieve the equivalent of full-time employment through the combination of two or more jobs.[116]

3.183 Interestingly, the Senate Select Committee on Superannuation, in its 2002 report, recommended that the government examine removing the threshold. In its response to that report, the government stated that it:

> Is not convinced that the retirement income benefits of removing the $450 earnings threshold for Superannuation Guarantee contributions outweigh the possible extra cost imposed on business, especially small business.[117]

3.184 Within the context of a generally increasing casualisation of the entire work force, young people are particularly at risk of having fragmented work patterns and of being employed long-term in the casual, part-time or multi-job paid labour force. The ACTU commented:

> From a policy perspective, the large number of employees with several part-time and/or casual jobs calls into question the $450 a month earnings threshold for SG contributions. This may have made sense when SG was 3%. However in a choice environment with 9% SG employees are in a better position to nominate an account for small payments.[118]

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114 Mr A Coles, Treasury, *Transcript*, 10 February 2006, p. 55.

115 Mr N Whittaker, *Transcript*, 10 February 2006, p. 75.

116 ASFA, *Submission no. 16*, p. 21.

117 Government Response to the Senate Select Committee on Superannuation report: *Superannuation and Standards of Living in Retirement*, 14 February 2005.

118 Australian Council of Trade Unions (ACTU), *Submission no. 29*, p. 10.

3.185 While casual employees are compensated for lack of paid leave entitlements by a casual loading of their hourly rate of pay there is no such specific loading in relation to foregone superannuation if a person earns below the SG threshold.

3.186 The committee also heard suggestions of a black market operating at the margin to avoid payment of SG or employers deliberately devaluing salaries/wages to fall under the threshold.

3.187 Mr David Elia of Industry Funds Forum (IFF) advised of under-employment occurring so employers could avoid the SG:

> We certainly know of the disadvantages to low-paid workers, casualised workers in the industry, single mothers. There are some employers out there that will simply employ staff up to the threshold and move away…[119]

3.188 Ms Catherine Bowtell of the ACTU noted manipulation of rosters such that wages fall below the SG threshold:

> It is not just in hospitality. I think the SDA will tell you that it is an active program built into some of the rostering arrangements in the large retail industry as well, so that when you are approaching the $450 someone else is rostered to avoid that cost.[120]

3.189 The Taskforce on Reducing Regulatory Burdens on Business released its report on 7 April 2006.[121] One of its recommendations was to allow employers to use a quarterly exemption threshold (equal to the monthly exemption threshold multiplied by three).[122] The focus of the Taskforce was on business compliance costs only. It was thought that this measure would reduce compliance costs and decrease the number of itinerant and short-term employees eligible for SG. Clearly, this measure would also impact on other workers.

3.190 There is a perception that the earnings threshold has already moved from a monthly earnings calculation to a quarterly earnings calculation. This did not occur—legislation was introduced on 16 May 2002 to jointly align quarterly payment of SG with a quarterly threshold, but the Senate

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119 Mr D Elia, Industry Funds Forum (IFF), 3 February 2006, p. 66.

120 Ms C Bowtell, ACTU, *Transcript*, 3 February 2006, p. 56.

121 Regulation Taskforce 2006, *Rethinking Regulation: – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006.

122 Regulation Taskforce 2006, *Rethinking Regulation: – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, p.126.

rejected the quarterly threshold.[123] The Senate rejected this because there was the potential for more workers to miss out on SG coverage. Senator Hogg stated in *Senate Hansard* during the second reading of the Bill:

> The people who are going to be affected are casual workers, seasonal workers and piece rate workers. These are people who are in the most precarious forms of employment in our community, the people who are most vulnerable and need to have superannuation such that they can establish a reasonable retirement income. [124]

3.191 Equally, moving to a quarterly threshold may actually increase SG coverage where an employee has sporadic work patterns over the year and earns a great deal more in some months than others. For example $400 in April, $700 in May and $400 in June. Under the monthly SG system only May would receive SG but under the quarterly threshold the full $1500 would be subject to SG.

3.192 Mr Bill Stanhope of IFSA believed the change in the period of calculation of the threshold may have brought more superannuation coverage because it was harder for employers to massage figures over a quarter:

> We hypothesise—I am not sure that anybody really knows—that it has probably brought more people into the net. There had been some anecdotes of employers keeping money below the threshold in a given month.[125]

3.193 It is unlikely to impact at the margin, where an employer may deliberately keep monthly wages under the threshold. It is just as easy to massage the figures or manipulate rosters over a three month period as it is over a month. For example, where an employee earns $400 in April, $500 in May and $400 in June (totalling $1300) they would fall short of the quarterly amount of $1350 but would have received SG for May under the previous monthly system.

3.194 Mr David Elia of IFF noted that many awards in industries with prevalence for casualisation set SG thresholds lower than $450:

> In fact, under various awards underpinning the hospitality and tourism sector, that threshold is, in fact, a lot lower. It could be as low as $320 to $350.[126]

123 Taxation Laws Amendment (Superannuation) Bill (No.2) 2002.

124 *Senate Hansard*, Second Reading, Senator Hogg, 27 June 2002.

125 Mr B Stanhope, IFSA, *Transcript*, 28 July 2005, p. 34.

126 Mr D Elia, IFF, *Transcript*, 3 February 2006, p. 65.

3.195 However, he noted that 'The brutal truth is that most employers within our sector—and we have about 30 000 of them—do not know what award underpins their particular employment—whether it is hotels, motels, restaurants, catering companies'.[127]

3.196 The Taskforce on Reducing Regulatory Burdens on Business recommended that the SG threshold be raised to almost double its current level—to $800 a month to represent approximate indexation to average ordinary time earnings since 1992.[128] As previously noted, their focus was on compliance costs, direct costs, and administrative burden on business, not on the level of superannuation coverage or on individuals' retirement incomes.

3.197 The Taskforce acknowledged that at the expense of reducing costs on business increasing the threshold '…will reduce superannuation guarantee coverage and may disadvantage some long-term casual and part-time workers in particular'.[129]

Conclusions

3.198 The SG threshold was set in 1992 following debate about what level of threshold would create the right balance between allowing an employee on low wages access to a universal superannuation scheme or to have their small contributions eroded away by fees and charges.

3.199 Contributions today would still be subject to fund expenses. However, consolidation of funds is now possible and Superannuation Choice enables an employee to utilise their preferred fund at each job they work thereby mitigating fee impacts.

3.200 The threshold struck in 1992 has remained the same. The committee has heard the argument that as the threshold has not moved it has enabled more employees to be covered with real wages growth. The committee has seen evidence to the contrary, that employees at the margin have been subject to a continually devalued wage setting or masterminded rostering to keep employees below this threshold. Any real wage growth would

127 Mr D Elia, IFF, *Transcript*, 3 February 2006, p. 66.

128 Regulation Taskforce 2006, *Rethinking Regulation – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, p. 126.

129 Regulation Taskforce 2006, *Rethinking Regulation – Report of the Taskforce on Reducing Regulatory Burdens on Business*, Report to the Prime Minister and the Treasurer, Canberra, January 2006, p. 126.

have boosted the existing balances of people already earning above the threshold.

3.201 Increased direct business costs and compliance burdens have been cited as reasons why the threshold should not be lowered and may explain some of the black market behaviour referred to in evidence. There is no reason to believe that employer behaviour around the threshold will change.

3.202 Many under 40s are at risk of not being exposed to the SG because of the increasing incidence of casual and multiple jobs and the preponderance of people aged under 40 in these types of jobs. This type of employment is not solely undertaken by students or as 'temporary' positions. A high proportion of people employed in this way are employed long-term in sectors where the rates of pay are low and people necessarily work multiple jobs. The SG is only determined on the basis of the work performed for one employer, irrespective of any other employment positions held.

3.203 Women and sole parents working in part-time or casual positions due to caring responsibilities are also particularly at risk of accruing no superannuation coverage despite earning an income.

3.204 The Regulation Taskforce 2006 recommended that the SG be raised on the basis that it poses direct and indirect costs on business. The committee is concerned that if the current SG threshold is raised, a large section of the under 40s workforce will be penalised with respect to superannuation and many will remain forever marginalised.

3.205 Other groups recommended the threshold be lowered or abolished.

3.206 The committee believes retaining the threshold at its current rate of $450 or lower, will ensure, over an extended period of time, that more multiple/casual job employees will gain superannuation coverage with negligible impact on business compliance costs.

Recommendation 2

3.207 **The committee recommends that the Superannuation Guarantee threshold not be increased by government and that consideration be given to reducing it, following consultation with employers and employees.**

4

Superannuation taxation issues

Impact of contributions tax

4.1 Superannuation contributions made by an employer on behalf of an employee, and contributions by unincorporated self-employed individuals, are taxed at 15 per cent in the superannuation fund. Superannuation contributions made by an employer include Superannuation Guarantee (SG) and salary sacrifice amounts.

4.2 Personal voluntary superannuation contributions or 'undeducted contributions' are not subject to the 15 per cent superannuation fund tax, having already been taxed at an individual's marginal income tax rate.

4.3 Prior to 1988, contributions to a superannuation fund were not subject to tax. Lump sum payments from a fund attributable to post-30 June 1983 service were generally subject to a maximum marginal tax rate of 30 per cent.

4.4 Effective from 1 July 1988, the then government reduced the tax on the post-30 June 1983 component of a lump sum to 15 per cent, at the same time imposing a 15 per cent tax on the taxable income of the fund, including employer and deductible personal contributions. The government also introduced a rebate of 15 per cent to apply to income streams.

4.5 It has been suggested that in order to provide further incentive for people to make contributions and to ensure that the full value of contributed amounts is put to work for fund members (given the 'magic of compound earnings'), that contributions should be tax exempt either for everyone, or at least the under 40s.

4.6 The Association of Superannuation Funds of Australia (ASFA) were among many to advocate the removal of contributions tax given it reduced the compounding on SG contributions from the outset:

> For instance, an individual receiving employer contributions at the standard Superannuation Guarantee rate of 9% of their applicable earnings only receives net contributions of 7.7% once the tax on contributions is taken out.[1]

4.7 ASFA estimated the cost to revenue of a full exemption to be $3.3 billion while Treasury estimated that it would be 'appreciably higher'[2].

4.8 Whether the actual number is $3.3 billion or appreciably higher, it is a lot of revenue. AMP Financial Services (AMP) made the following point:

> Such a significant reduction in tax would come at a large fiscal cost and would need to be assessed against other national priorities, including extending other, existing incentives for superannuation such as the co-contributions regime.[3]

4.9 Although the Small Independent Superannuation Funds Association (SISFA) pointed out that over time it is not a one way street:

> As identified by Treasury itself, the concessions conferred on superannuation will amount to savings to revenue in the longer term in the form of reduced Age Pension outlays. Such estimated savings must be factored into any assessment of the true cost of superannuation tax concessions as they represent an investment in the future (i.e. capital versus revenue expenditure).[4]

4.10 Numerous submissions contended that the current nine per cent rate of SG is insufficient. While proposed targets ranged between 12 and 15 per cent (as a combination of both employer and employee contributions), it was calculated that the impact of removing the contributions tax would be to reduce the target savings rate by three percentage points. CPA Australia noted this:

> As a result of this tax, the effective level of the compulsory SG contribution going to some superannuation accounts is not nine

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1 ASFA, *Submission no. 16*, p. 19.

2 Mr P Gallagher, The Treasury, *Transcript*, 10 February 2006, p. 64.

3 AMP Financial Services (AMP), *Submission no. 48,* p. 7.

4 SISFA, *Submission no. 20*, p. 3.

> per cent but only 7.65 per cent. Our research, which is conducted by the National Centre for Social and Economic Modelling out at the University of Canberra, found that, for many Australians, this level of contribution is not enough for them to maintain a reasonable standard of living in retirement. Our research also found that removing this tax has a rough equivalent effect of raising the compulsory contribution to 12 per cent.[5]

4.11 The removal of contributions tax may enable some very high income earners to salary sacrifice much of their income and thereby minimise their marginal tax rates. On this scenario Australian Administration Services (AAS) commented:

> Not removing (or reducing) the contributions tax simply because a very small number of high income individuals may salary sacrifice what are considered to be excessive amounts, thereby denying the vast majority of the Australian people the benefit afforded by the reduction in the contributions tax, could well be considered to be 'using a sledgehammer to crack a nut'. [6]

4.12 AAS further noted:

> This is especially the case given that currently there exist two mechanisms designed to effectively limit the amount of superannuation which is subject to concessional tax treatment - the existence of age deduction limits and the reasonable benefits limits.[7]

4.13 The flipside of the argument to reduce or remove contributions tax is that superannuation is already concessionally taxed. At an estimated cost in 2005–06 of $15.9 billion, it is the Commonwealth Government's largest tax expenditure.[8] Treasury stated:

> This [the tax rate on contributions] compares favourably with most marginal income tax rates. Investment income from superannuation is also taxed at 15 per cent, which again compares favourably to the tax rates that apply to most other investment income. Superannuation benefits are also taxed concessionally…..Concessional taxation arrangements make

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5 Mr M Davison, CPA Australia, *Transcript*, 10 February 2006, p. 14.

6 AAS, *Submission no. 67 (supplementary)*, p. 2.

7 AAS, *Submission no. 67 (supplementary)*, p. 2.

8 Commonwealth Government, *Tax Expenditures Statement 2005*, pp 113 and 163.

> superannuation relatively attractive compared to other investments and help to boost superannuation savings.[9]

4.14 AMP made the following comment:

> AMP believes a far reaching, forward looking review of superannuation taxation is required, but we recognise that any changes to the taxation of superannuation should preferably be neutral in terms of the tax collected as a proportion of national income.[10]

4.15 In an attempt to limit the impact on the Commonwealth budget, a number of suggestions were made that attempt to target tax cuts to those needing the most assistance and/or those requiring greater enticement to save in superannuation. The Industry Funds Forum (IFF) proposed a reduction in contributions tax for those on low incomes:

> It is proposed that this reduction be by way of providing a tax credit of 15% on employer superannuation contributions for those with taxable incomes up to $28,000 scaling back to zero for those with taxable incomes above $58,000…Many of whom would be under age 40.[11]

4.16 AAS suggested that consideration could be given to introducing an age-based tax deduction or rebate for voluntary contributions made to superannuation:

> Akin to the Lifetime Health Cover loadings but in reverse, commencing with the maximum available deduction at age 18 and phasing out to zero after age 40. This could be achieved by means of allowing 1) a sliding scale percentage (subject to a maximum amount) or 2) a fixed dollar amount. As a matter of policy, interaction with the existing co-contributions measure will need to be determined.[12]

4.17 A number of witnesses believed that targeting concessions at particular age groups added complexity to an already complex system. In fact the AAS commented that it was 'difficult/impossible to base contributions tax on age/income'.[13]

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9 The Treasury, *Submission no. 47*, p. 17.

10 AMP, *Submission no. 48*, p. 7.

11 Industry Funds Forum, *Submission no. 22*, p. 16.

12 AAS, *Submission no. 17*, p. 5.

13 AAS, *Submission no. 67 (supplementary)*, p. 4.

4.18 Treasury commented that changes to the taxation of contributions, including a reduction in the tax rate, would generally increase complexity.

4.19 It was also pointed out that existing complexity tended to overshadow existing concessions. Mercer Human Resource Consulting stated:

> Australian superannuation is taxed in a concessional manner. However, there are significant issues in the current arrangements that adversely affect many younger members. These include…the perception that there is no concession… This lack of a clear tax concession, together with preservation, means that additional superannuation contributions by the employer (eg as part of a remuneration package) is perceived as unattractive.[14]

4.20 SISFA agreed:

> The principles of superannuation as embraced in the governing legislation (principally the Superannuation Industry (Supervision) Act 1993 (S/S *Act))* are relatively straight forward, and most would accept a degree of complexity with any system subject to regulation by statutory law. The real complexity with superannuation lies in the layers of taxation—complexity, actual or perceived, results in negative public sentiment.[15]

4.21 Tower Australia noted the disincentive to salary sacrifice to superannuation or for unincorporated self-employed persons to make contributions due to the lack of understanding about pre-tax and post tax contributions. Tower Australia stated in evidence:

> The system as it stands, from a tax perspective, is still quite attractive. Even though there is complexity it is still very attractive. It is about getting the message across. Referring back to the contributions tax issue, an example is that when many of our customers get their statements they see a dollar go into their super fund and all of a sudden they have lost 15 per cent. They do not understand. They think: 'What sort of investment is this? I have lost 15 per cent already. I put a dollar in and now I have 85 cents.' They do not understand the nexus between pre-tax money and post-tax money and the relationship associated with the contributions tax. So it discourages them straightaway.[16]

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14 Mercer Human Resource Consulting, *Submission no. 44*, p. 5.

15 SISFA, *Submission no. 20*, p. 3.

16 Mr G Evans, Tower Australia Limited, *Transcript*, 18 October 2005, p. 57.

4.22 Similarly, the Australian Chamber of Commerce and Industry (ACCI) felt that people did not understand the tax implications arising from investing in superannuation:

> ACCI argues that the super tax system should be made simpler. This will make it easier for individuals to understand the tax consequences of decisions relating to super. [17]

4.23 This divergence between perception and reality in relation to how contributions tax fits into the bigger picture was illustrated in a recent article written by Peter Haggstrom in the *Australian Financial Review*.

4.24 He makes the point that it is a 'trivially true observation' that a tax on contributions reduces the end benefit. There are a number of basic points that need to be included in the discussion that are continually overlooked or misunderstood. Haggstrom states:

> The first point is that we have a superannuation system that produces extremely low effective tax rates on retirement income for the vast majority of people.[18]

4.25 This is due to a combination of rebates, such as the low income rebate, the Senior Australians Tax Offset and the 15 per cent pension rebate along with common financial planning strategies. Haggstrom noted:

> The effective tax rate for someone aged 65 with [superannuation] pension income in the first year of about $46,000 is a tad over 3 per cent.[19]

Taxation of benefits

4.26 The government announced a number of proposed changes to the laws governing superannuation in the 2006–07 budget handed down by the Treasurer on 9 May 2006. This included changes to the taxation of superannuation benefits, which were outlined in the government's *Plan to Simplify and Streamline Superannuation*[20] (superannuation plan).

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17 ACCI, *Submission no. 41*, p. 7.

18 P Haggstrom, 'Retirement is not really too taxing', *Australian Financial Review*, 3 April 2006, p .63.

19 P Haggstrom, 'Retirement is not really too taxing', *Australian Financial Review*, 3 April 2006, p. 63.

20 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

4.27 The main effect of the proposal is that from 1 July 2007 superannuation benefits would be exempt income when paid to a person over the age of 60. This means they would not incur any tax nor would they push other income into higher tax brackets. Superannuation taxation is also simplified for those under the age of 60.

4.28 Prior to the budget a number of submissions recognised that the taxation of end benefits is complicated and quite often problematic. Rice Walker Actuaries submission, for example, recognised explicitly that the contributions stage is not the only point at which tax applies and that any changes to the taxation of superannuation need to be considered from a whole of system perspective:

> There are constant calls for lower taxation of superannuation funds. At various times, economists have argued for the removal of taxes on contributions, investment earnings or end benefits. There are valid reasons for all of these but we question whether any can be considered in isolation. Clearly, the removal of a significant tax must result in lower levels of government services or higher taxes from other sources.[21]

4.29 Treasury also pointed out that a great deal of the complexity lies in how end benefits are taxed.

> When we look at the way we tax end benefits now, we see that we have seven or eight different lump sum components and they are taxed in seven or eight different ways. And that is without looking at how people can access pension arrangements. The majority of the complexity lies at the back end of the system—at the end benefit stage of taxing superannuation. We point out in our submission that for someone making superannuation contributions it is reasonably straightforward.[22]

4.30 The Financial Planning Association (FPA) talked about this other end of the tax time line. They raised the tax treatment of investment bonds, whereby after a certain period of time, and assuming various rules are abided by, the benefit is tax free on withdrawal.[23]

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21 Rice Walker Actuaries, *Submission no. 64*, p. 12.

22 Mr J Lonsdale, Treasury, *Transcript*, 14 October 2005, p .3.

23 Ms A Esler, FPA, *Transcript*, 18 October 2005, p. 37.

Other taxation issues

4.31 While the vast majority of discussion on taxes involved the taxing of contributions and benefits, there was some discussion of other taxation issues.

4.32 A number of submissions, including the Australian Bankers Association, called for personal superannuation contributions to receive tax concessions. Personal superannuation contributions are those made after an individual's marginal rate of income tax has been levied (undeducted contribution). The Australian Bankers' Association support the idea of an individual being able to claim a tax deduction for their undeducted contributions:

> ABA believes that tax deductions on personal contributions would likely provide an incentive for employees to make additional voluntary contributions, particularly medium income earners. This approach would balance long-term savings accumulation with current consumption.[24]

4.33 Not all employers offer salary sacrifice arrangements so for many employees their only avenue to boost their superannuation savings beyond SG is to make post-tax, personal contributions.

4.34 It was suggested a number of times, that in terms of targeting age groups, education would be a more useful option than tax cuts. ASFA made the following comment:

> We do not support policies that are age based, per se. If you follow a system that says, 'Something is available for just the under 40s,' it is likely to add to the complexity of super, create other anomalies and inequities…But to the extent that your inquiry is about putting super on the radar of people under 40 and getting them to save more at an earlier age, that is obviously going to make it much more likely that they will get to the goal of an adequate retirement income down the track.[25]

4.35 Many of the submissions and witnesses focussed on the immediate benefits of reducing or removing tax on various elements of the superannuation system, for example, 'the removal of tax on contributions would ensure that the full nine per cent SG contributions would

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24 Australian Bankers' Association, *Submission no. 28*, p. 11.

25 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 2.

experience the magic of compounding'. However very few talked about the net value gained for each public dollar. AMP was an exception:

> We believe that before we consider extending existing tax concessions to encourage savings, it is important that we undertake more extensive research to understand what policy changes will deliver the greatest improvements in savings behaviour for a given dollar of public expenditure.[26]

4.36 AMP also questioned whether further tax concessions were needed at all:

> In many respects, the Australian system already has the basic tenets to achieve more saving through superannuation: compulsory or voluntary. This puts Australia in a much better position than most other developed countries. The real questions are to what extent should these be varied or extended, and to what extent could Australians benefit more from existing arrangements, were we able to improve financial literacy and offer greater access to scaleable and affordable financial advice.[27]

Conclusions

4.37 Australia's superannuation system enjoys significant tax concessions. These concessions will be considerably increased from 1 July 2007 under the government's proposed *Plan to Simplify and Streamline Superannuation*, particularly for those who are aged 60 or over when they receive their benefits.

4.38 The committee broadly endorses the proposed budget amendments to the taxation of superannuation benefits, because they address two key barriers preventing under 40s from contributing to superannuation. The first barrier is the perception that superannuation is not concessionally taxed. The second related barrier is the reality that superannuation taxation is very complicated.

4.39 The committee believes that one of the keys to encouraging greater investment in superannuation, particularly for the under 40s, is to simplify how it is taxed. The committee notes that the government's budget proposals will largely achieve this goal. The next step, in the committee's view, is to promote the simplified end benefit tax concessions so that they are more apparent to all people.

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26 AMP, *Submission no. 48*, p .2.

27 AMP, *Submission no. 48*, p. 5.

4.40 If people can more clearly understand the tax concessions that apply to their superannuation savings, they are more likely to contribute more money to superannuation. Emotive statements such as 'superannuation is taxed three times' are misleading at best, because they do not reflect the lower tax rates, the tax-free thresholds and rebates that apply to superannuation. To this end, the government's simplification and streamlining of the tax on superannuation payments will be beneficial.

4.41 A change to the taxation of contributions may have the undesirable effect of further complicating the overall taxation regime from the point of view of both fund members and the administration of the fund itself.

4.42 Furthermore, the tax system is so complicated, that merely processing transactions in a particular order can result in a higher or lower tax liability on superannuation benefits. Similarly, the form in which superannuation benefits are accessed can impact on a person's eligibility for the Age Pension and associated benefits.

4.43 The government has proposed removing the existing 50 per cent assets test exemption for certain income streams. Consistent treatment of all assets for Age Pension means test purposes will remove further complexity from the retirement income system.

4.44 Reducing system complexity should lead to financial advice being geared towards increasing savings rather than unravelling the complexity of tax concessions or contriving to qualify for age pensions.

4.45 Given that the taxation of contributions and earnings within a fund is already concessional, coupled with the 2006–07 budget's proposed simplification of taxation of end benefits, the committee did not see the need to also reduce or eliminate the tax applying to contributions.

4.46 The committee believes that targeted incentives that do not further complicate the system for fund members, such as the co-contribution scheme (see Chapter 7), simplification of the superannuation tax system, and education (see Chapter 5), remain the most effective methods of increasing the superannuation savings of under 40s.

Limits on superannuation tax concessions

Reasonable Benefit Limits

4.47 Because of the scale of superannuation tax concessions, limits apply to the amount of superannuation savings receiving these concessions. The reasonable benefit limit (RBL) is the maximum amount of retirement and termination of employment benefits that a person can receive over their life time at concessional tax rates.

4.48 However, the government's superannuation plan would abolish RBLs from 1 July 2007. The proposals in the plan are subject to public consultation and being passed by parliament. As a result, the following paragraphs address the existing RBL system.

4.49 Currently, if more than half of a person's benefits are withdrawn as a lump sum then their RBL is $648 946 in 2005–06. Any amount in excess of the lump sum RBL is taxed at either 38 per cent or 47 per cent depending on the components of the lump sum.

4.50 If more than half of a person's benefits are withdrawn in the form of a certain type of annuity or pension[28], then their RBL is $1 297 886. Any excessive amount will reduce the proportion of the pension that qualifies for the 15 per cent pension rebate.

4.51 Therefore, the way in which a person takes their end benefit of superannuation affects the amount of superannuation that is entitled to a concession.

4.52 A person on average earnings is unlikely to reach the lump sum RBL, let alone the pension RBL, without significant salary sacrifice, especially when undeducted contributions (those where income tax has already been paid) are not included in the calculation of excess benefits. Of the 308 000 lump sums paid in 2002–03, only 518 were in excess of the RBL.[29]

4.53 There was conflicting evidence given on the impact that RBLs have on saving practices. Some suggested that due to the resource constraints on most under 40s the existence of the RBL is unlikely to affect their decision to make additional superannuation payments.

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28 Among other things, the pension or annuity must: be payable for life or life expectancy; be paid at least annually; only be commuted in limited circumstances, and not have a residual capital value.

29 Australian Taxation Office (ATO), *Tax Stats 2002-03*, Canberra, 2005, p. 14.

4.54 CPA Australia suggested that there were more transparent reasons that people under 40 were not contributing to superannuation:

> Younger Australians have competing demands for their income, such as housing, family and education, and when they do save it is generally through more accessible investment vehicles than superannuation.[30]

4.55 Some said that the RBL was clearly a disincentive, including the Financial Planning Association (FPA):

> With most people in the under- 40 age group uncertain of their futures and hopeful that their income will increase over the years, there is little incentive to contribute to superannuation early in life if it will simply push you over your RBL so that later in your working life, when you would be better placed to take advantage of the superannuation system, you would receive no benefit.[31]

4.56 While others questioned whether it was a disincentive at all. Tower Australia stated:

> Also, I think the question of whether it would change people's habits if we removed the RBL is in doubt. The ability for people to have excess benefits in an allocated pension and just pay normal income tax while it accrues, tax exempt, is there today, and people use that environment. I do not think removing that is really going to change people's habits.[32]

4.57 The FPA questioned how the government can at the same time encourage and limit the accumulation of retirement benefits:

> However, when encouraging people to work longer and build up retirement benefits, there is a contradiction between wanting people to become self-sufficient and limiting the amount of superannuation that can be received.[33]

4.58 The FPA also suggested that the existence of age-based deduction limits (see *Age-based deduction limits below*) removed the need for RBLs:

> So the fact that you have the member deductible limits, which, based on your age, limit the amount that your employer or your

30 CPA Australia, *Submission no. 18*, p .2.

31 Mr J Anning, Financial Planning Association, *Transcript,* 18 October 2005, p. 30.

32 Mr G Evans, Tower Australia Limited, *Transcript*, 18 October 2005, p. 59.

33 Mr J Anning, FPA, *Transcript,* 18 October 2005, p. 30.

> salary sacrifice contributions equate to, means that it is unnecessary then to have the reasonable benefit limits as well.[34]

4.59 Representatives from Tower Australia Limited did go on to talk of the compliance burden involved with RBLs. Presumably this cost is passed on to members, including those under age 40:

> I will mention one other thing on RBLs, just so the committee is aware of it. RBL reporting does represent a substantial burden for the financial services industry in having to report these benefits. There is enormous complexity in that reporting process, and that complexity should only be maintained if it is delivering a benefit to the community.[35]

4.60 While most suggestions regarding the removal of the RBL were based on the effectiveness of the age-based deduction limits, Rice Walker Actuaries suggested that the RBL and the age-based deduction limits (discussed below) both be replaced by a life-time deduction limit on contributions:

> It would be relatively easy to replace this with a system of maximum lifetime contributions. Under an old Coalition policy introduced in the 1993 election campaign, it was proposed that contributions be limited to $300 000 (appropriately indexed) over a life time to attract maximum tax deductibility. A life-time limit would be easier to maintain and it would be fairer for members who made erratic payments from year to year...People starting to contribute earlier in life would get higher benefits in retirement for the same levels of contributions. This occurs because of the longer period on which they would generate investment earnings on these contributions. There is no particular reason why they should be penalised via a RBL for being an early contributor, given that we want to encourage early savings.[36]

4.61 The Small Independent Superannuation Funds Association (SISFA) noted that RBLs would encourage the use of income streams (because the pension RBL is higher than the lump sum RBL):

> There must be an increased focus on encouraging retirement income streams in preference to lump sums—this could be achieved by increasing pension RBLs and tightening eligibility, or

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34 Ms A Esler, Financial Planning Association (FPA), *Transcript*, 18 October 2005, p. 32.

35 Mr D Glen, Tower Australia Limited, *Transcript*, 18 October 2005, p. 60.

36 Rice Walker Actuaries, *Submission no. 64*, p. 9.

> by capping lump sums (explicitly, or by implication through the introduction of harsher tax treatment).[37]

4.62 AMP had a similar suggestion, however they also advocated simplification:

> The reasonable benefit limits (RBLs) regime needs to be simplified and the levels at which they cut in need to be reviewed to make the rules simpler for people to understand, and to strengthen the incentive to take an income stream.[38]

Age-based deduction limits

4.63 There is no limit to the amount of superannuation contributions that can be made by, or in respect of, a member in any one year. There is an age-based limit, however, to the amount that can be claimed as a tax deduction by each employer in respect of each employee, and that can be claimed by a self-employed person.

4.64 However, the government's superannuation plan would abolish age-based deduction limits from 1 July 2007. They would be replaced with an annual limit for all individuals of $50 000 for deductible contributions and $150 000 for undeducted contributions.

4.65 The proposals in the superannuation plan are subject to public consultation and being passed by parliament. As a result, the following paragraphs address the current age-based deduction limits.

4.66 As at 1 July 2005 the maximum deductible contribution in respect of a person under age 35 was $14 603; between age 35 and under 50 was $40 560 and 50 and over was $100 587.

4.67 The maximum SG that is payable by an employer in respect of each employee is approximately $12 000[39]. Therefore an employer's SG contributions are always fully deductible.

4.68 A person aged under 35 who earns a salary of $50 000 would have to salary sacrifice approximately $10 000 in a year in addition to the SG payment of $4500 to reach the tax deductible contribution limit.

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37 SISFA, *Submission no. 20*, p. 6.

38 AMP, *Submission no. 48*, p. 13.

39 If an employee's salary or wages exceed the maximum superannuation contribution base of $33 720 for each quarter in 2005–06, SG is calculated on $33 720. Therefore the maximum SG payable for the year is ($33 720 x 4) x 9 per cent = $12 140.

4.69 However, a person who has turned 35 years of age, on the same salary, would have to salary sacrifice an additional $36 000 each year (above the SG contribution) before reaching their deduction limit.

4.70 Treasury provided evidence suggesting that the age-based limits are not a barrier for the vast majority of individuals under age 40 to contribute voluntarily to superannuation.

> Chart 13 [of Treasury's submission] shows that few people under age 40 made annual contributions greater than $5,000 (14 per cent of self-employed and 13 per cent of employees). For the 2002–03 financial year the average employer annual contribution for those under age 40 was about $3,000. Contributions made by the self-employed averaged about $4,000.[40]

4.71 A number of submitters to the inquiry have voiced concern that the age-based limit should be raised or removed as it provides a disincentive to place funds into superannuation for under 40s who have the capacity to make substantial voluntary contributions early in their retirement savings phase.

4.72 It has been proposed that the nature of some under 40s work is that they have the capacity to earn more when they are young because their income earnings are essentially linked to good health and youth. ACCI believes that these income earners are penalised for their ability to make early superannuation contributions in careers where their earnings are likely to trend down:

> Yearly contribution limits penalise people with fluctuating income compared to those with steady incomes. Depending on design, RBLs can treat people with the same life-time contributions the same. In addition, it is not clear why contribution limits should be related to age. The lower limits for younger people discourage them from planning for retirement. It particularly penalises those with very high incomes when they are young, such as sports people.[41]

4.73 The trending down of disposable income was raised as an issue for women taking time out of paid work after having children. It was argued that the age-based limit restricted some females with large savings capacity to place more into superannuation when they could most afford to:

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40 The Treasury, *Submission no. 47*, p. 29.

41 ACCI, *Submission no. 41*, p. 5.

> The present model is such that it caters basically for a typical average life time of some 40 years and it does not take into account unusual working patterns which include those taking breaks from work, which would include those people who choose to retire early, those people who have a sea change, possibly going from a high-income profession to a low-income profession, and perhaps women who want to cease work temporarily to raise a family.[42]

4.74 Treasury raised the issue of behavioural change if the limits were removed:

> I think the pivotal issue here is that if you are going to remove or amend these limiters in any way, the question then becomes: what would you put in its place? Is anything needed in its place? Would that create a behavioural impact into superannuation and affect the sustainability of the system?[43]

4.75 AMP said that these limits introduced complexity and disincentives when the potential for tax abuse was more effectively dealt with elsewhere:

> Limits on how much can be contributed to superannuation were established to prevent people abusing the tax advantages that superannuation offers. However, these limits have introduced complexity to the system and reduce the incentive to save. It would be preferable to remove any barriers to save and instead, reduce the potential tax abuse by placing restrictions on how people can access their money when they retire. In effect, moving the brake on the system from the front to the back end which, in some respects is already achieved through the Reasonable Benefit Limits (RBLs).[44]

4.76 ASFA agreed:

> The other thing we have highlighted is the removal of the age based contribution limits. We see it as not being necessary. It reduces the flexibility to save when they can. The RBL limits would still be there, so that would be the mechanism in terms of putting a cap on the amount of concession or savings, if you put it that way. We see the two things in combination as not being necessary.[45]

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42 Mr S Woods, *Transcript*, 18 October 2005, p. 67.

43 Mr J Lonsdale, The Treasury, *Transcript*, 10 February 2006, p. 63.

44 AMP, *Submission No. 48*, p. 6.

45 Mrs P Smith, ASFA, *Transcript*, 28 July 2005, p. 4.

4.77 While ideally advocating their removal entirely, Mercer Human Resource Consulting suggested that if the deduction limits were to stay there should be an increase in the amount that under 35's could contribute tax effectively:

> However, this inquiry is concentrating on members under age 40. Mercer therefore recommends, as a minimum:
>
> - That the separate limit on deductible contributions for members under age 35 be abolished and that the same contribution limit apply to all members under age 50.[46]

4.78 AAS suggested a single annual deduction limit but also an alternative path based on remuneration:

> …consideration could be given to amending the deduction as follows:
>
> - abolishing the age-based deduction limits and replacing with one deduction limit (say $70,000 - $80,000) indexed annually; or
> - replacing the current flat dollar based limits with 'percentage of total remuneration' limits, whereby an employer (or self-employed person) would only be able to contribute up to a certain proportion of 'total remuneration' - salary plus all employer superannuation contributions (notional in the case of defined benefit) plus reportable fringe benefits for employees and 'income' for the self-employed.[47]

4.79 CPA Australia and ACCI believe that a life-time contribution limit is more appropriate because it smooths when extra savings may be placed in superannuation in a tax concessional way at times when an individual can most afford to do so. One proposed model of the life-time limit used a flat limit per year across an individual's working life of $40 000. CPA Australia also suggested a carry forward of unused limit amounts whereby:

> If you do not actually approach that limit in any one year, you could have the balance of the limit roll over into the next year so you are accumulating your unused limit through your life time.[48]

4.80 Moving to life-time contribution limits would require the maintenance of life-long records and this may increase the Australian Taxation Office's administrative resource requirements.

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46 Mercer Human Resource Consulting, *Submission no. 44*, p. 10.

47 AAS, *Submission no. 67 (supplementary)*, p. 3.

48 Mr M Davison, CPA Australia, *Transcript*, 10 February 2006, p. 23.

Conclusions

4.81 The government's 2006–07 budget superannuation plan to abolish RBLs addresses a number of concerns raised during this inquiry including the disincentive for under 40s to contribute for fear of eventually breaching the RBL, and administration expenses for superannuation funds in reporting payments.

4.82 However, the committee is concerned that when combined with additional tax concessions on benefits, particularly tax-free benefits for over 60s, significant tax concessions could be enjoyed by high wealth individuals.

4.83 The committee notes that this will be reduced to some extent by the proposed introduction of contribution limits on both deducted and undeducted contributions.

4.84 The proposed increase in the deductible contribution limit for people under 50 to $50 000, as announced in the 2006–07 budget, will also assist those under 40 whose income earning capacity, and therefore saving capacity, peaks in their younger years.

5

Superannuation literacy and planning for under 40s

Financial literacy and superannuation

5.1 Many submissions to this inquiry suggested that one of the key reasons that many under 40s do not voluntarily contribute to their superannuation is a lack of understanding, both about how the system works (tax incentives etc.) and about the benefit of contributing early.

5.2 As the Trustee Corporations Association of Australia (TCAA) noted:

> Improving the level of financial literacy of the general public is a crucial first step in achieving … heightened awareness [about superannuation][1]

5.3 Poor financial and superannuation literacy appears to be more prevelant among women. The Office for Women stated in evidence that 'research has shown that women experience lower levels of financial literacy than men'.[2] This trend is particularly concerning given that women are more likely to have broken work patterns and thus less opportunity to contribute to superannuation.[3]

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1 TCAA, *Submission no. 11*, p. 2.

2 Ms K Flanagan, Office for Women, *Transcript*, 10 February 2005, p. 4.

3 Womens' issues are discussed in more detail in Chapter 6, *Superannuation issues for certain groups.*

5.4 Apart from women, there are also a number of other groups with generally lower financial literacy. The Department of Family and Community Services told the Committee that:

> Levels of financial literacy are comparatively low amongst certain sectors of the population including … those on low incomes, with lower educational attainment, the young and the very old.[4]

5.5 From the perspective of this inquiry it is clear that financial literacy is a problem for many people under age 40—particularly women, those with lower levels of education and those with lower incomes.

The Financial Literacy Foundation

5.6 In terms of improving Australians' general financial literacy, several submissions[5] welcomed the government's introduction of the Financial Literacy Foundation. The Australian Consumers' Association (ACA) summarised the importance of the foundation, stating:

> The Commonwealth government's Financial Literacy Foundation is a significant and welcome measure designed to address consumers' ability to protect their own interests in relation to financial matters.[6]

5.7 Key aspects of the foundation's approach are:

- an Australia-wide information and awareness-raising campaign;
- financial literacy programmes in schools and workplaces;
- a one-stop website to serve as a portal for financial literacy education and information resources; and
- original research to build understanding of influences on community attitudes to financial literacy and best practice approaches to extending and measuring literacy.[7]

5.8 Although still in its infancy, the foundation has already undertaken a number of measures aimed at improving financial literacy, some of which have targeted under 40s. They include:

- developing a National Curriculum Framework for Consumer and Financial Literacy for years 3, 5, 7 and 9;

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4 Department of Family and Community Services, *Submission no.* 38, p. 2.

5 See submissions 11, 13, 18, 26, 28, 34.

6 ACA, *Submission no. 34*, p. 3.

7 The Treasury, *Submission no. 47*, p. 34.

- holding Financial Literacy Forums, which were attended by over 80 business, community, government and education sector leaders;
- conducting a pilot with the Master Builders Association (MBA) that will see 200 apprentices and cadets receive training in money management; and
- developing a Financial Literacy Educators and Trainers Network.[8]

5.9 With respect to the foundation's role in improving superannuation literacy, Treasury's submission noted that:

> Improved financial literacy should result in better engagement with superannuation by those under age 40, through recognising that the decisions they make now will affect their retirement income and lifestyle.[9]

Financial literacy at school

5.10 A number of submissions[10] focussed on the importance of teaching financial literacy throughout primary and secondary schooling. These views can be summarised by the comments of Senator Judith Adams, who stated:

> If superannuation and other financial management issues were addressed at a middle or high school level, it is anticipated that school leavers would graduate with at least a basic level of awareness about savings and retirement income.[11]

5.11 While there was agreement that financial literacy in schools is important, the same can not be said for exactly when financial education should occur, or what form it should take.

5.12 The Financial Literacy Foundation has an important role in determining how and when financial literacy education in schools should occur. As mentioned above, the foundation has already been involved in developing a framework for consumer and financial literacy for years 3, 5, 7 and 9.

5.13 The TCAA discussed the importance of the foundation's role in developing school curriculum, stating:

8 Financial Literacy Foundation, *Latest News*, viewed 31 March 2006, <http://www.understandingmoney.gov.au/news.asp#Education>

9 The Treasury, *Submission no. 47*, p. 34.

10 See submissions 3, 10, 11, 12, 13, 17, 22, 33, 36, & 41.

11 Senator J Adams, *Submission no. 33*, p. 3.

> The Foundation's efforts should be to encourage more attention being given at the school level to basic financial understanding, irrespective of the career path that a student maybe following.[12]

Superannuation funds and improving superannuation literacy

5.14 Superannuation funds also have an important role to play in improving under 40s superannuation literacy—particularly those not of school age. This role specifically involves the information that they provide to their members by way of mailed annual statements and brochures, seminars, websites and customer service teams.

5.15 Generally speaking, it seems that a large amount of information is provided by, and available from, superannuation funds. A glance over various superannuation websites confirms this assertion.[13]

5.16 The problem is that a lot of members simply do not read the information available to them. As the submission of Guided Decisions noted:

> An industry fund research study assessing member opinion of information and educational material show most (53%) read less than half of what is sent to them, let alone understand and then act on the information.[14]

5.17 This statement is aided by research conducted on the attitudes to superannuation of Generation X and Y, in which one participant stated: 'They send me statements and brochures, but it doesn't mean much to me.'[15]

5.18 On the whole, it seems the attitude of under 40s to information provided by their super fund is that 'they want … access to relevant and understandable information.'[16]

Superannuation investment options

5.19 Investment options determine the strategy a person will take with the investment of their superannuation. Each option has a specific investment strategy and is categorised by the risk involved in that particular strategy. These range from defensive through to high growth.

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12 TCAA, *Submission no. 11,* p. 2.

13 See, for example, www.rest.com.au; www.pss.gov.au; www.hesta.com.au; www.ing.com.au. There are, of course, numerous other relevant sites with equally good information.

14 Guided Decisions, *Submission no. 46*, p. 2.

15 McCrindle Research, *Submission no. 2,* p. 10.

16 McCrindle Research, *Submission no. 2,* p. 10.

5.20 Fund members are generally able to design their own investment stategies by investing in one or more of the options offered by the fund. Members of self-managed funds have greater control over their investment, with the ability to place their money in particular companies, for example, rather than simply structured options.

5.21 Fund members can base their strategy on their own needs and principles. However, as was noted by Guided Decisions:

> Young people of 20, 25, 30 years of age going into [the default] balanced portfolios when they could go into growth portfolios.[17]

5.22 While a high-growth portfolio may not suit every young person, it seems that it is an option that most are not even considering. As one submission noted:

> Whilst some individuals will be aware of some investment fundamentals, many others will need to be educated about principles of risk, return and diversification.[18]

Conclusions

5.23 The committee is concerned that financial literacy is lowest among those groups who are most likely to have a low level of retirement savings; women and low income earners, many of whom are under 40 and have broken work patterns. These are groups who need to understand the superannuation system, and who need to be making the most voluntary contributions.

5.24 The committee acknowledges that the proposed changes to superannuation, outlined in the government's 2006–07 budget, would go a long way to simplifying the superannuation system. While this simplification is certainly very welcome, it does not preclude the need for Australians to have improved financial literacy.

5.25 The committee believes that improved superannuation literacy should be the joint responsibility of governments, both state and federal, and superannuation funds. However, for any financial literacy programs to be successful, there also needs to be a willingness to learn on the part of the individual. The committee acknowledges that achieving superannuation literacy across all, or even a majority, of this age group is an inherently difficult task.

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17 Mr A Stewart, Guided Decisions, *Transcript*, 3 February 2006, p. 33.

18 Tower Australia, *Submission no. 26*, p. 13.

5.26 The committee agrees with the numerous submissions that espoused the benefits of promoting financial literacy from a young age. It is incumbent on state governments to provide a greater focus on financial literacy in their schools' curriculum. From a federal perspective, the Financial Literacy Foundation can assist the state and territory governments in developing curriculum, as it already has in the circumstances outlined above.

5.27 For those under 40s not of school age, the improvement of financial and superannuation literacy must occur outside the classroom. In this regard, the committee acknowledges the federal government's establishment of the Financial Literacy Foundation and some of the early work the foundation has conducted with under 40s. The committee urges the foundation to continue and extend their efforts.

5.28 The committee also believes that superannuation funds have an important role in improving superannuation literacy. Currently, they provide large amounts of superannuation information to their members. It is clear, however, that many under 40s simply do not read the information provided—largely because it is, or it is seen to be, too complicated. Superannuation funds must recognise this fact and work to provide easy-to-understand information to their members. In light of the changes proposed by the 2006 budget this task should be made considerably easier.

5.29 It terms of developing strategies to generate interest in superannuation, the committee believes that incentives (tax breaks, co-contribution etc.) are among the most effective tools. However, it is clear that incentives are best understood by those who already have a detailed knowledge of the super system, not those who have low literacy and interest.

5.30 The committee therefore considers that if incentives are to act as a stimulus for interest, knowledge and participation, their benefits must always be conveyed in a straightforward manner. This, in turn, should encourage people to seek further information about the incentives, and then the superannuation system as a whole.

5.31 Another way to expand interest in superannuation is through the improvement of more general financial literacy. The committee believes that if people are well equipped to manage their day-to-day financial affairs, it is logical that they are more likely to understand the benefit of contributing to superannuation.

5.32 The committee also is of the view that giving people access to long-term superannuation projections (discussed in more detail below in the section *Regulated savings targets and projections)* would stimulate interest in superannuation. Doing so would provide a 'real' view to the relatively distant subject of retirement.

Recommendation 3

5.33 **The committee recommends that the Financial Literacy Foundation work directly with superannuation funds on a combined strategy to improve Australians' interest in, and knowledge of, their superannuation. Some of the approaches that could be considered by this partnership include:**

- **providing more assistance to state and territory governments to promote financial literacy in secondary school curriculum, with a particular focus on superannuation education;**
- **developing a strategy to improve the general financial literacy of the adult population with a particular focus on improving superannuation literacy; and**
- **providing all superannuation information, including the promotion of benefits and incentives, in the most straightforward manner.**

Regulated savings targets and projections

Superannuation savings targets

5.34 The Senate Select Committee on Superannuation, in their 2002 report *Superannuation and Standards of Living in Retirement,* noted:

> The high degree of consensus expressed by witnesses … that the desirable target for a person on average earnings is a replacement rate of 70–80 per cent … (which equates to approximately 60–65 per cent of gross pre-retirement income).[19]

5.35 This consensus, however, was not supported by the Federal Government, who preferred that people set their own savings goals depending upon their circumstances and that:

19 Senate Select Committee on Superannuation, 2002, *Superannuation and Standards of Living in Retirement,* Canberra, December 2002, p. xv.

> Retirement income policy should encourage people to achieve a higher standard of living in retirement than would be possible from the age pension alone, while ensuring that all Australians have security and dignity in retirement.[20]

5.36 In line with the Senate committee's findings, the committee heard on numerous occasions[21] that having a broadly defined savings target, which is agreed to by government and the superannuation industry, would allow people to plan for retirement with greater certainty. For example, Rice Walker Actuaries asserted that 'before we can encourage anyone to save for retirement, we need to set them a realistic target'.[22]

5.37 One aspect of greater certainty involves those people who are only contributing the nine per cent Superannuation Guarantee (SG). For many people—particularly low income earners and people with broken work patterns across their life time—the SG alone may provide less retirement income than they desire or expect. As CPA Australia noted:

> Some of the anecdotal evidence we have had from our members is that people see the compulsory SG level set at nine per cent and assume that that must be enough, because that is the amount the government has set for them—especially young people.[23]

Regulated superannuation projections

5.38 A number of groups[24] have proposed that individualised long-term superannuation projections be included in members' annual statements. Each group suggested that projections must only be based on government-regulated assumptions to be used by all industry participants. Such projections could enable a fund member to see their forward financial position in terms of a lump sum and an income stream.

5.39 Currently, individualised superannuation projections are not provided by funds to their members. The Association of Superannuation Funds of Australia (ASFA) told the committee that the Australian Securities and Investments Commission (ASIC) discourages this behaviour given super funds may over inflate projected returns:

20 Government Response to the Senate Select Committee on Superannuation's report *Superannuation and Standards of Living in Retirement*, Canberra, 14 February 2005, p. 1.

21 See, for example, *Transcript* from 28 July 2005 & 10 February 2006; and Submission nos. 18, 28 & 64.

22 Rice Walker Actuaries, *Submission no. 64*, p. 5.

23 Mr M Davison, CPA Australia, *Transcript*, 10 February 2006, p. 7.

24 See ASFA, *Transcript,* 28 July 2005, pp. 2–17; ASFA, *Submission no. 16*; CPA Australia, *Transcript,* 10 February 2006, pp. 14–29; and Guided Decisions, *Submission no. 46.*

> It is most probably more of a general fear. ASIC has certainly made it clear in a number of the policy statements and other materials that it has released that it is very uncomfortable with projections. There has also been a history of life insurance companies not using real projections but future dollars, using high earnings rates.[25]

5.40 CPA Australia commented on the potential importance of projections, stating:

> The issue that people have, particularly when they are younger or even all the way through, until they are staring retirement in the face, is that nobody really has an appreciation of what they need to have saved to be able to get the income they want. I suppose it would be nice to say, 'Yes, people, go and get your projections on a regular basis,' but the reality is that if you make it too hard, and there is not a rule of thumb that they can use to estimate what they are aiming for or whatever, they will just ignore it, particularly when they are younger, because it is too hard.[26]

5.41 ASIC advised the committee that there is no direct restriction on superannuation funds providing individualised projections. However, in order to provide projections superannuation funds must be licensed to provide financial product advice under Chapter 7 of the *Corporations Act 2001.* While some superannuation funds are currently licensed under this Act, many are not. Presently there are no funds that provide annual projections to their members.

5.42 Interestingly, all superannuation funds have relief from the requirements of the *Corporations Act* so that they can provide generic superannuation calculators on their websites. According to ASIC, while relief has been given, there are a number of conditions in place which protect against funds misleading consumers.[27] This relief, however, does not enable superannuation funds to provide specific product advice to members—i.e. long-term projections.

5.43 A number of European countries allow funds to provide fund members with savings projections. These countries, including the United Kingdom, have strong regulation in terms of the assumptions used to generate the projections. In relation to the United Kingdom, ASFA stated:

> There is actually an obligation on funds to provide such projections to members on an annual basis. From 6 April 2003, an

25 Mr R Clare, ASFA, *Transcr*ipt, 28 July 2005, p. 6.

26 Ms N Kelleher, CPA Australia, *Transcript*, 10 February 2006, p. 16.

27 ASIC, *ASIC Releases Policy on Calculators,* media release, 20 December 2005.

> annual illustration … must be given to scheme members of most approved pension schemes … The main principle behind the legislation is to help individuals plan for their retirement and to encourage long term savings.[28]

5.44 Personalised projections are also utilised in the United States. Guided Decisions told the committee that:

> In the US, personalised projections are one of the most commonly used guidance tools. One of the most popular guidance and advice providers recently stated that they give … members a personalised statement showing the member's account status and how a particular action such as a higher contribution, would impact take-home pay and future retirement savings. "We don't want to kill people off with reams of data," they stated. "We want to do a simple gap analysis. At the very least, it gets people to question: Am I on track?"[29]

5.45 In addition, evidence from the United States' experience shows the effectiveness of projections in generating interest and participation:

> A study of 48 different company plans encompassing over 300,000 employees measured the effectiveness of the different communication, education and guidance programs on both participation in the Plans … as well as contribution rates from existing Plan members. This study found that those Plans that offered High Communication programs (ie. integrated education, personalised projections, internet guidance tools) facilitated a 35% higher participation rate and a 49%higher contribution rate than those Plans that offered basic Plan information to their members.[30]

5.46 Overall, the argument for personalised projections is summarised by ASFA, who stated:

> Super funds should provide benefit projections to individual members on a standardised basis and as part of their annual reporting to members. We see this as a way of providing clearer targets to people. It is something tangible in terms of where they are on their own savings track.[31]

28 ASFA, *Submission no.* 16, p. 24.

29 Guided Decisions, *Submission no. 46,* p. 5.

30 Guided Decisions, *Submission no. 46,* p. 6.

31 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 5.

Conclusions

5.47 The committee believes that savings targets would allow people to know sooner whether or not their expectations will be met with SG alone, and thus, if necessary, allow them to increase their savings according to their desired retirement.

5.48 In addition, and as was outlined above in *Financial literacy and superannuation*, many people under age 40 do not understand superannuation and have little interest in it. The committee considers that savings targets may provide an impetus to take more interest in superannuation planning from an early age.

5.49 The committee has found that, as the Senate Select Committee on Superannuation did in 2002, an industry consensus centres around replacement spending rates of 70–80 per cent—approximately 60–65 per cent of gross pre-retirement income.

5.50 Overall, the committee found that a savings target, determined jointly by the government and superannuation industry, would be a useful tool for people to broadly determine their retirement goals.

5.51 The committee is also in favour of superannuation funds providing long-term projections to their members in annual statements, on the strict proviso that the projections are based on regulated investment assumptions. The committee is encouraged by the seemingly successful experience of projections in both the United Kingdom and the United States.

5.52 The benefits of providing projections, in the committee's view, are potentially large. It would allow people to have a rough idea about their future financial position, which is currently very difficult. If combined with a defined saving goal, projections would allow a much higher degree of retirement certainty than is currently available.

5.53 Currently superannuation funds must be licensed to provide specific financial product advice if they wish to provide their members with projections. Essentially, under the current arrangements it would be an onerous task for super funds to provide long-term projections. The committee believes that ASIC and super funds should work together, as they have done in the case of superannuation calculators, to find a solution that is easily administered by funds, but also has sufficient safeguards in place to protect consumers against being misled.

5.54 The committee also notes that the government demonstrated the benefits of its proposed superannuation changes by using projections.[32] Given that the government is prepared to utilise projections in these circumstances, the committee feels it would be equally useful for similar projections to be allowed for individuals' real-life situations.

5.55 The committee believes that if projections are allowed, superannuation funds should also provide their members with alternate projections for increased and decreased contributions. This may encourage people to seek a higher retirement income through increased contributions, or, alternatively, allow people to know that their current level of contribution will be adequate.

Recommendation 4

5.56 **The committee recommends that:**

1. **the government develop a benchmark savings target to encourage savings goals and retirement planning, and a retirement saving matrix to show the level of savings required to achieve various retirement incomes and lifestyles.**
2. **ASIC and the superannuation industry work together so that all superannuation funds can provide individualised long-term projections to their members in annual statements. This process should include, among other things, the development of standardised investment assumptions to ensure consumer protection.**
3. **the government require all superannuation funds to provide individualised superannuation projections to their members in annual statements. These projections *must* utilise ASIC-regulated investment assumptions and should also show future outcomes for higher and lower levels of contribution.**

32 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 55.

Financial advice

5.57 On average only around ten per cent of the population seeks advice from financial planning services.[33] Several submissions[34] argued that this trend is particularly true of under 40s for two general reasons: lack of interest in financial matters and the cost of advice.

Financial advice and under 40s' interest in superannuation

5.58 As discussed above in *Financial literacy and superannuation*, many under 40s lack an understanding of, and interest in, the superannuation system, as well as their financial matters more generally.

5.59 Furthering this point, the 2003 ANZ survey of *Adult Financial Literacy in Australia* found that:

- about 16 per cent of the adult population spend all their income as soon as they get it and do not plan for the future;
- only 5 per cent claimed to have no difficulty managing their finances;
- only 67 per cent of adults claimed to understand the term 'compound interest' either 'very well' or 'fairly well'[35]; and
- only 37 percent of respondents having thought about planning for their retirement.[36]

5.60 A number of submissions suggested that professional financial advice was one way to improve the evident deficiencies in under 40s' superannuation interest and knowledge. For example, the submission of AMP Financial Services (AMP) cited evidence from the United Kingdom, which asserted that 'there is a direct causal link between the availability of advice and saving levels; more advice means more saving'.[37]

5.61 Rice Walker Actuaries summarised both the benefit and detriment of financial planning, asserting:

33 Rice Walker Actuaries, *Submission no. 64,* p. 17.

34 See submissions 12, 18, 26, 28, 34, 39, 46, 48, 64.

35 The Treasury, *Submission no. 47,* p. 31.

36 AMP Financial Services (AMP), *Submission no. 48,* p. 10.

37 AMP, *Submission no. 48,* p. 10.

> Financial planners provide a good service for those individuals who are able to pay the fees to get personal attention relative to their individual circumstances.[38]

Cost of financial advice

5.62 There is little doubt that the cost of seeking professional financial advice is prohibitive for many people—particularly those on low incomes. Therefore, many of the submissions that suggested under 40s should be seeking more financial advice also put forward proposals to reduce its cost.

5.63 One such suggestion was to make financial advice on superannuation tax deductible—either just for the under 40s age group, or for all. Currently, a tax deduction is allowable for normal investment advice, but not for superannuation advice. This fact was highlighted in the Australian Bankers' Association's submission, which asserted:

> Current taxation arrangements inhibit incentives for financial advice relating to superannuation, such as individuals being unable to obtain a tax deduction for advice on superannuation, while a deduction is available on non-superannuation investment advice.[39]

5.64 The Australian Taxation Office (ATO) describes an allowable tax deduction as 'money you spend to enable you to earn income'.[40] Therefore, the rationale behind the non-deductibility of superannuation advice is that, technically, 'a super fund does not generate assessable income for the client'.[41] In other words, superannuation advice is not money spent to earn an assessable income and therefore is not deductible.

5.65 Another suggestion put to the committee was to allow people access to their superannuation to pay for superannuation advice. This suggestion was discussed at a number of the committee's hearings but did not receive overwhelming support.[42]

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38 Rice Walker Actuaries, *Submission no. 64,* p. 17.

39 Australian Bankers' Association, *Submission no. 28,* p. 16.

40 ATO, *Definitions,* ATO, Canberra, viewed 11 April 2006, <http://www.ato.gov.au/corporate/content.asp?doc=/content/8153.htm&page=1&pc=&mnu=1236&mfp=001/002&st=&cy=>.

41 Imperator Financial, *Financial Plan Fees Upfront or Ongoing?,* Imperator Financial, Sydney, viewed 11 April 2006, <http://aol.imperator.com.au/informationoutline.asp?nocache=1&SubTopicDetailsID=1268>.

42 See *Transcript,* 28 July 2005; and *Transcript,* 3 February 2006.

Financial Services Reform Act 2001

5.66 A number of submissions align the high cost of financial advice to the *Financial Services Reform Act 2001* (FSRA). For example, Senator John Watson suggested that 'the cost of that advice is becoming prohibitively high because of the FSR[A] regime'.[43]

5.67 Furthering this point, CPA Australia's submission noted that with:

> The introduction of the Financial Services Reform Act, the complexity and cost of providing financial advice has increased considerably.[44]

5.68 While there is seemingly a consensus view that the FSRA has increased costs, there is also some agreement that its introduction was necessary. As Treasury's submission noted, the FSRA:

> Introduced a uniform licensing, conduct and disclosure regime for all financial service providers. The disclosure requirements of the FSRA help to ensure consumers have adequate information to make informed financial decisions. …
>
> The FSRA also provides a framework in which consumers can be assured that licensed financial advisors are competent and that the services they offer will be provided efficiently, honestly and fairly.[45]

5.69 The ACA agreed with the Treasury viewpoint, stating that 'the disclosure requirements of the FSR[A] regime are also generally welcome'.[46] Furthermore, AMP stated that they 'strongly support the principles underlying Financial Services Reform'.[47]

5.70 While not disagreeing with the FSRA regime's general principles, the Financial Planning Association of Australia (FPA) described some of the FSRA compliance costs as 'unnecessary' and urged the government to continue to refine the disclosure processes.[48] Despite their agreement with the principles of the FSRA, the ACA also stated that they 'would welcome a simplification of the FSR[A]'.[49]

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43 Senator J Watson, *Submission no. 31,* p. 3.

44 CPA Australia, *Submission no. 18,* p. 6.

45 The Treasury, *Submission no. 47*, p. 33.

46 ACA, *Submission no. 34*, p. 2.

47 AMP, *Submission no. 48,* p. 10.

48 Mr J Anning, FPA, *Transcript,* 18 October 2005, p. 35.

49 Mr N Coates, ACA, *Transcript,* 18 October 2005, p. 47.

Reliability of superannuation advice

5.71 The submission of the ACA stated that there is 'significant levels of poor or biased financial advice'.[50] A recent report of ASIC, *Shadow shopping survey on superannuation advice,* appears to confirm the ACA's assertion. The report states:

> The survey found the financial advice industry still has significant work to do before the quality of advice will be consistently at a level that ASIC and consumers would regard as acceptable.
>
> The survey identified several key problem areas:
>
> - 16% of advice was not reasonable, given the client's needs (as required by law) and a further 3% was probably not reasonable.
> - Where consumers were advised to switch funds, a third of this advice lacked credible reasons and risked leaving the consumer worse off.
> - Unreasonable advice was 3–6 times more common where the adviser had an actual conflict of interest over remuneration (e.g. commissions) or recommending associated products.
> - Consumers were rarely able to detect bad advice.
> - In 46% of cases, advisers failed to give a written Statement of Advice (SOA) where one was required. However in a fifth of these cases, the verbal advice was a reasonable, non-conflicted recommendation for the person to stay in their current fund.[51]

5.72 For those people who were advised to switch funds without 'credible reasons', the report calculated that, based on various assumptions, they each stood to lose an average of '$37,043' from their retirement income.[52]

5.73 In response to the report's findings, the FPA stated that the results:

> Reflect the significant improvements made by [advisers] in recent years … 88 per cent of clients were satisfied with the advice they received, 80 per cent of super advice had a reasonable basis and was compliant.[53]

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50 ACA, *Submission no. 34*, p. 2.

51 ASIC, *Shadow Shopping Survey on Superannuation Advice,* ASIC, Canberra, p. 2.

52 ASIC, *Shadow Shopping Survey on Superannuation Advice,* ASIC, Canberra, p. 37.

53 FPA in J Collett, 'Another bad report card for advisers', *The Sydney Morning Herald,* 12 April 2006, viewed 13 April 2006, <http://www.smh.com.au/news/superannuation/another-bad-report-card-for-advisers/2006/04/10/1144521273870.html>.

5.74 However, the ACA preferred to view the results as demonstrating that 'conflicts of interest are still undermining the quality of advice available to Australian consumers'.[54]

5.75 ASIC concluded that:

> While some progress has been made, the cultural changes mandated by the *Financial Services Reform Act* are not happening quickly enough. [55]

Conclusions

5.76 The committee can see the benefit for under 40s in seeking professional financial advice on their superannuation. However, the committee does not believe that the government should provide financial incentives to those who decide to seek advice.

5.77 The committee, therefore, does not support the proposal to allow a tax deduction for superannuation advice. The committee believes that a tax deduction would be of most benefit to the people who are already able to afford advice—high income earners on higher marginal tax rates—not low income earners who would actually need the assistance.

5.78 The committee is also not in favour of allowing access to superannuation for the purpose of superannuation advice. The committee believes that this would undermine the fundamental tenet of Australia's superannuation system—preservation.

5.79 The committee is supportive of the stringent requirements introduced by the FSRA. However, it is clear from the results of ASIC's recent survey of superannuation advice that the FSRA regime has not yet been embraced by all advice providers. The committee urges the government to ensure that all financial advisers are complying with the FSRA, and to impose penalties on those who are not.

5.80 The committee also urges the government, in line with the earlier recommendations, to remove any barriers the FSRA might impose on superannuation funds providing long-term projections.

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54 ACA in J Collett, 'Another bad report card for advisers', *The Sydney Morning Herald,* 12 April 2006, viewed 13 April 2006, <http://www.smh.com.au/news/superannuation/another-bad-report-card-for-advisers/2006/04/10/1144521273870.html>.

55 ASIC, *Shadow Shopping Survey on Superannuation Advice,* ASIC, Canberra, p. 2.

6

Superannuation issues for certain groups

Unincorporated self-employed

6.1 The majority of owner managers are unincorporated self-employed structures. As was noted by the Office of Small Business only 'around 20% of owner managers without employees had a company structure [incorporated] in 2004'.[1]

6.2 Treasury discussed the low level of superannuation contributions by the unincorporated self-employed:

> Superannuation coverage for self-employed people is considerably lower than for employees. The last Australian Bureau of Statistics Survey of Employment Arrangements and Superannuation found that only 67 per cent of the self-employed had superannuation, with an even smaller proportion making regular contributions.[2]

6.3 Additionally, the level of voluntary contributions by those self-employed business owners aged under 40 has fallen markedly:

> The number of self-employed people under age 40 making superannuation contributions fell from 41,000 to 31,000 over the period 1999-2000 to 2002-03.[3]

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1 Office of Small Business, Department of Industry, Tourism and Resources, *Submission no. 14*, p. 2.

2 The Treasury, *Submission no. 47*, p. 8.

3 Office of Small Business, Department of Industry, Tourism and Resources, *Submission no. 71 (supplementary)*, p. 2.

6.4 There are concerns that unincorporated small business and micro business owners are not saving in superannuation but rather in their own business:

> The results suggest that the net wealth of the median self-employed household was around $147,000 more than that of an employee ... This is consistent with the notion that many small business operators save for their retirement by reinvesting in their businesses. [4]

6.5 AMP Financial Services (AMP) noted in their submission the results of the 2005 AMP-NATSEM report[5] on small business and retirement savings patterns:

> Many small business operators rely almost entirely on the value of their businesses for their retirement savings. But relying on the value of the small business alone to fund their retirement can be risky, particularly for sole traders whose own knowledge and skills are often their businesses chief assets.[6]

6.6 The committee heard of the danger in doing this given a high percentage of small businesses established close prematurely or end in bankruptcy. Mr Noel Whittaker stressed the importance of superannuation to small business in regard to the business failing:

> As you said before, 90 per cent fail anyway. One thing about super is that it is the one asset the trust in bankruptcy cannot get off them. That is why when I give talks to small business people I say, 'Look, if you incorporate it is a tax deduction and it is the one thing they cannot take off you if you go broke.'[7]

6.7 Not all small businesses end in bankruptcy. This is fortunate given 95 per cent of businesses are small businesses. Mr Peter Chesworth of the Office of Small Business (OSB) stated in evidence that many are successful and the numbers often quoted as failing are over-exaggerated:

> It would be fair to say that there is a level of misconception out there. The levels of business failure in Australia are actually far lower than that bush telegraph anecdote that so many fail in such a

4 Office of Small Business, Department of Industry, Tourism and Resources, *Submission no. 71 (supplementary)*, p. 2.

5 AMP-NATSEM (2005), *Smallbusiness in Australia 1995–2004*, issue no. 11, Sydney, July 2005.

6 AMP Financial Services (AMP), *Submission no. 48*, p. 7.

7 Mr N Whittaker, *Transcript*, 10 February 2006, p. 74.

> short period of time. Most succeed and there are other ways in which businesses can end as well.[8]

6.8 However, successful small business owners are prone to invest in the business alone and hope to make a handsome sale of the business at a future point in time to help fund retirement. This is not always possible and the retiree then faces a lower retirement income than expected. AMP noted the value of diversified savings/investment:

> When they retire, the value of their businesses often falls significantly, meaning that they could have much lower retirement savings than anticipated.
>
> Small business operators should be encouraged to diversify their retirement savings and invest in other assets through the use of superannuation.[9]

6.9 Additionally, even though a business may not fail, it may not be as financially successful as anticipated. This is likely to be particularly relevant to a younger self-employed owner who may either be starting a business (rather than taking on an established one) or have limited business acumen. A non-business payment (personal superannuation contributions) which attract a limited tax deduction and do not contribute to disposable income may rank low as a savings priority.

Co-contributions[10]

6.10 At present the co-contribution can only be received by people who earn at least 10 per cent of their income from eligible employment. As a result, a wholly self-employed (unincorporated) person cannot qualify. The reason for the restriction has been so that the unincorporated self-employed cannot claim both a tax deduction (of the first $5000 and 75 per cent of the balance up to the age-based deduction limits) and a co-contribution in respect of the same contribution. Conversely, owner-managers of incorporated enterprises are eligible to receive co-contributions on undeducted super payments made to their own super funds.

6.11 However, in the 2006–07 budget the Treasurer announced changes with respect to the unincorporated self-employed's eligibility for the co-contribution scheme. The budget proposes that, from 1 July 2007, the

8 Mr P Chesworth, Office of Small Business, Department of Industry, Tourism and Resources, *Transcript*, 10 February 2006, p. 32.

9 AMP, *Submission no. 48*, pp. 7–8.

10 The co-contribution scheme and its rules are discussed in detail in Chapter 7. This discussion focuses wholly on the co-contribution with respect to the self-employed.

unincorporated self-employed be eligible to receive the government co-contribution for their post-tax superannuation contributions. To do this, the government will amend the ten per cent work test rule to include business earnings as well as employment earnings. Treasury will conduct a public consultation process on these and other proposed measures concluding early August 2006.

6.12 Prior to the budget announcements, a number of submissions to this inquiry commented that the unincorporated self-employed were effectively discriminated against by their exclusion from the co-contribution scheme. The Office of Small Business (OSB), for example, stated:

> Where income falls within the low levels that might attract the Government co contribution, personal contributions by the unincorporated self-employed are generally ineligible. Essentially, the eligibility conditions require that 10% or more of the person's total income be from working arrangements that result in them being treated as an employee for superannuation guarantee purposes.[11]

6.13 In light of these facts the committee heard from many who supported access to co-contributions for the self-employed as an incentive to make voluntary superannuation contributions.

6.14 One of Tower Australia's proposals was to allow co-contributions to be paid to self-employed people. [12] Rice Walker Actuaries believed that for young people it was not only a disincentive to contribute to superannuation but also to start a small business.

> The current co-contribution arrangements only apply to persons who earn at least 10% of their employment from wages and salary. A wholly self-employed person cannot qualify. This is a serious disincentive to young people establishing their own businesses, and should be addressed.[13]

6.15 The OSB discussed the financial pressures of many unincorporated self-employed people and non-access to co-contribution:

> Unincorporated self-employed business operators that have tried to set aside money into superannuation earlier in life, when they are still struggling to establish their businesses, have reported that

11 OSB, Department of Industry, Tourism and Resources, *Submission no. 14*, pp. 4–5.

12 Ms C O'Keefe, Tower Australia, *Transcript*, 18 October 2006, pp. 55–56.

13 Rice Walker Actuaries, *Submission no. 64*, p. 13.

> they are unassisted by the operation of the co-contribution scheme. For many, financial pressures may not sufficiently ease before they are in their 30's to early 40's.[14]

Conclusions

6.16 The issue of access to co-contributions by the self-employed arose time and again during the inquiry. A number of submissions received by the committee discussed the matter and it was raised as an issue at the majority of public hearings. The committee concluded the treatment of self-employed in relation to access to the co-contribution particularly disadvantaged young people in business, where income levels are often lower.

6.17 The committee therefore endorses the government's plan, announced in the 2006–07 budget, to include unincorporated self-employed in the co-contribution scheme. However, the committee notes that the budget proposal means that the ten per cent rule still remains; it has just been broadened. Therefore, some groups remain ineligible to receive the co-contribution—those not earning at least ten per cent of their income from business or employment earnings. In Chapter 7 under *Co-contribution*, the committee recommends the removal of the 10 per cent work test rule.

Tax deductibility of contributions

6.18 An employer can claim a 100 per cent tax deduction for superannuation contributions in respect of an employee up to the particular employee's age-based deduction limit. This includes the contributions that an owner-manager makes to their own superannuation account. This is presently not so for unincorporated self-employed employers. Under the current rules, only $5000 of an unincorporated self-employed person's personal contributions are fully tax deductible. Any contributions over this limit, up to their relevant age-based deduction limit, are only 75 per cent tax deductible.

6.19 However, the 2006–07 budget proposes the full tax deductibility of superannuation contributions for unincorporated self-employed persons. This is planned to be introduced on 1 July 2007, but, as with the other budget proposals, will be subject to a public consultation process in early August 2006.

14 OSB, Department of Industry, Tourism and Resources, *Submission no. 14*, p. 5.

6.20 Prior to the budget announcement, a number of groups and individuals were critical of the discrimination posed by the different deductibility arrangement for incorporated and unincorporated self-employed persons. As Noel Whittaker indicated in evidence, this distinction does not appear to have much relevance:

> Why can some people claim a tax deduction and why can some not claim? Why should it be $5,000 and three-quarters as opposed to all?[15]

6.21 The current tax treatment also creates a distinction between the treatment of superannuation contributions made by the self-employed owner and that of their employees. CPA Australia noted:

> Essentially, a self-employed individual must contribute more to have the same amount go into their superannuation fund. This represents an unfair difference and discourages self-employed people from contributing more than $5,000 pa. In some circumstances the employer is entitled to a lesser deduction for their own contributions than those for their employees.[16]

Conclusions

6.22 It appears to be ironic that the self-employed labour force, and particularly the young component, has been recognised by Treasury and others as being vulnerable in their ability to accrue superannuation and yet they face obvious business structure discrimination in this respect. They are currently disadvantaged because their business is not incorporated, and therefore they are not employees. [17]

6.23 The committee acknowledges and endorses the federal budget announcement to allow full tax deductibility of contributions by the unincorporated self-employed.

Invalidity payment

6.24 A person who receives an eligible termination payment (ETP) in consequence of the termination of employment due to disability can receive part of that payment tax free (known as an invalidity payment).

15 Mr Noel Whittaker, *Transcript*, 10 February 2006, p. 76.

16 CPA Australia, *Submission no. 18*, p. 5.

17 There are some exceptions. The definition of employee in the *Superannuation Guarantee (Administration) Act 1992* includes circumstances where a person works under a contract that is wholly or principally for the labour of the person.

6.25 This is effectively not available to the self-employed where they receive an ETP from their superannuation fund due to permanent disability. The reason for this is that there can not be any termination of employment in that circumstance because the self-employed person was never technically 'employed' by an employer.

6.26 The invalidity part of the payment therefore remains assessable income. This disadvantages wholly self employed persons under age 40—particularly those who work in physical environments where the possibility of injury is high. This was raised by the OSB, who stated:

> The Institute of Chartered Accountants expressed the same views in its 2005-06 pre-Budget submission stating that "The Government should bring the tax treatment of contributions and invalidity payments of the self-employed into line with that of employed people."[18]

Conclusions

6.27 This committee believes that, as the government has done for co-contributions and tax deductibility, the treatment of invalidity payments for incorporated and unincorporated business owners should be aligned.

6.28 The committee believes that this measure is particularly important for unincorporated small business operators, who work in physically demanding and risky environments. These people are vulnerable to injury and disability through their work, and as such may become recipients of an eligible termination payment from their superannuation fund, which contains an invalidity component.

Recommendation 5

6.29 **The committee recommends the government align the tax treatment of invalidity payments of the incorporated and unincorporated self-employed.**

18 OSB, Department of Industry, Tourism and Resources, *Submission no. 14*, p. 3.

Superannuation Guarantee

6.30 The self-employed, because they do not employ themselves, are not subject to the Superannuation Guarantee Charge—the tax that employers incur if they decide not to pay the minimum superannuation contribution for their employees under the Superannuation Guarantee (SG) provisions—and do not have the forced nine per cent savings.

6.31 Many small business owners may choose to save for their retirement by building up the value of their business in addition to, or instead of, contributing to superannuation.

6.32 It has been suggested that the risky nature of small business means that small business operators *should* be putting money into superannuation. CPA Australia told the committee:

> The Productivity Commission in its report *Business Failure and Change in Australia* found that only 50 percent of small businesses continue to exist after 10 years. This implies there is a significant risk of the self-employed having all their savings in the one basket. Therefore, it is imperative that independent superannuation savings are also encouraged.[19]

6.33 As previously mentioned, superannuation is generally protected from bankruptcy proceedings meaning that the small business person will not lose everything in the event that their business fails. Mr Noel Whittaker stated in evidence that the most persuasive reason a small business owner should invest in superannuation is that in the event of bankruptcy a person's superannuation balance is safe.[20]

6.34 Statistics indicate that without some form of compulsion the self-employed will remain in a position of limited superannuation cover compared to employees. Treasury noted in their submission:

> The coverage of superannuation in Australia has grown significantly since the introduction of compulsory superannuation and now extends to around 90 per cent of employees and 67 per cent of self-employed people.[21]

6.35 However, many may not have the cash flow to contribute to superannuation, and to reduce working capital in that respect may exacerbate any financial difficulties they may face. A number of initiatives recognise this and allow small business owners to reduce significantly, or

19 CPA Australia, *Submission no. 18*, p. 5.

20 Mr N Whittaker, *Transcript*, 10 February 2006, p. 74.

21 The Treasury, *Submission no. 47*, p. 2.

eliminate, their capital gains tax liability when selling a small business. In many cases their business is their sole asset and nest egg for retirement. As previously mentioned, 'putting all their eggs into one basket' can prove detrimental to final retirement income.

6.36 As Industry Funds Forum highlighted in their submission, the sale of a business at an age under 40 often results in proceeds not being put towards retirement income savings:

> Most self employed see their business as their quasi-superannuation, but many under age 40 are likely to use the proceeds from any sale for home purchase or to meet other expenditure, even though there is an incentive for those who invest the proceeds of the sale into superannuation.[22]

6.37 Treasury views the third pillar of the retirement income system (voluntary superannuation savings and other savings) as particularly relevant to those without access or having only limited access to the SG:

> The third pillar encourages individuals to make additional savings. This is particularly relevant to groups that may not benefit or fully benefit from the SG, such as the self-employed, people with broken working patterns (including many women), mature workers and those with higher retirement income expectations.[23]

6.38 However there is little incentive for them to voluntarily invest in superannuation, especially in the early stages of a business, whilst they are unable to receive co-contributions nor full tax deductions for voluntary savings. Treasury's submission showed that for those self-employed under age 40 the 100 per cent tax deduction cut out point at $5000 appeared to influence low voluntary superannuation behaviour:

> For most self-employed people under age 40 annual contributions are within the $5,000 full deduction limit (Chart 13). ATO data for 2002-03 also shows an increase in the proportion of people making contributions at or near the new $5,000 threshold.[24]

6.39 A number of proponents of compulsory superannuation for the unincorporated self-employed were heard over the course of the inquiry. The OSB indicated support for compulsory superannuation for the self-employed:

22 Industry Funds Forum, *Submission no. 22*, p. 14.

23 The Treasury, *Submission no. 47*, p. 4.

24 The Treasury, *Submission no. 47*, p. 30.

> Your question is whether we think there would be advantages in it being compulsory for self-employed people. I would have to say that essentially that would be a policy decision of the government to make in that area. Obviously the compulsory superannuation system has worked fairly well in the case of employees.[25]

6.40 Mr Graeme McDougall from the Small Independent Superannuation Funds Association (SISFA) felt compulsion was important for both employees and self-employed to ensure people don't solely focus on the short term:

> If you make it compulsory that the employee or the self employed make a contribution you are going to make them aware of another part of the structure that is going to be part of their short-, medium- and long-term life.[26]

6.41 Rice Walker Actuaries proposed setting a nominal salary for the unincorporated self-employed on which their SG could be based.

> In many other respects, the nexus between employment and superannuation has been broken. Perhaps it is time to give all self-employed persons a notional salary of (say) $25,000 and treat them similarly to employed persons. They should then be subject to the SGC on this notional salary. This would generate minimum contributions for the self-employed of $2,250 a year.[27]

6.42 It is difficult to see how this could be equitably based given business profits, stages and types would vary.

6.43 The contrasting view was that as superannuation is deductible for the self-employed, be it fully, or partially, this is incentive enough for voluntary contributions to be made, countering the argument for compulsion. Mr Michael Perry of Taxpayers Australia stated at the Melbourne hearing:

> I am a bit reluctant to say that it should be mandatory. It is hard to generalise on this. What we tend to find is that the people who are in a position of being self-employed are inclined to look at ways and means of getting funds into super. Essentially, it is a tax deduction so people will tend to do that. As to whether it needs to

25 Mr A Greenwell, OSB, Department of Industry, Tourism and Resources, *Transcript*, 10 February 2006, p. 29.

26 Mr G McDougall, Small Independent Superannuation Funds Association (SISFA) *Transcript*, 28 July 2005, p. 62.

27 Rice Walker Actuaries, *Submission no. 64*, p. 13.

> be mandatory, I am not quite sure that I would go down that track.[28]

6.44 Superannuation may also offer a side benefit of providing a degree of life insurance cover and the ability to elect a higher cover by paying a higher premium. The superannuation fund is able to offer the cover to members at a low premium and the premium is paid with contributions.

6.45 Some unincorporated self-employed without voluntary superannuation may have no independent life insurance cover. This places their dependents in a precarious financial situation in the event of their death. Rice Walker actuaries noted the high availability of basic life cover through superannuation:

> Death and Total and Permanent Disability (TPD) benefits are so popular that almost all funds provide an insured benefit for their members, although the average levels are fairly low.
>
> Many funds also provide disability benefits in income form to replace lost wages whilst disabled. These are usually limited to benefits payable for two years as it is considered more tax-effective to pay longer periods as "ordinary" life insurance rather than as a superannuation benefit.[29]

Conclusions

6.46 The low level of voluntary superannuation savings by unincorporated self-employed people indicates alternative retirement savings intentions or a reduced incentive to voluntarily save.

6.47 The committee heard that many owner managers intend to utilise their business for their retirement income. As they are not compelled to contribute to superannuation many have low retirement savings diversification and are thus exposed to risk if the business fails, if it proves unprofitable or the proceeds of business sale are used prematurely.

6.48 People aged under 40 were reported to have the tendency to place the proceeds of an early business sale into their home, rather than into superannuation. This behaviour results in lost years of potential retirement income saving and the benefit of compounding from an early age.

6.49 There are practical impediments to implementing a mandated superannuation regime for the self-employed, particularly where incomes

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28 Mr M Perry, Taxpayers Australia, *Transcript*, 3 February 2006, p. 25.

29 Rice Walker Actuaries, *Submission no. 64*, p. 1.

and business circumstances fluctuate and types of business differ. However the committee saw merit in bringing the self-employed under the SG system as it would provide preserved retirement savings particularly where business longevity, success and capital realisation were uncertain.

6.50 Additionally, superannuation offers a level of life insurance and total and permanent disability cover for the self-employed, many of whom work in physically demanding careers.

Recommendation 6

6.51 **The committee recommends consideration be given by government to bringing unincorporated small business owners into the Superannuation Guarantee system.**

Women

6.52 If a person is not in the paid workforce they are at a significant disadvantage in accumulating their own superannuation. In 2002–03 SG contributions by those under 40 amounted to approximately $10 billion, whereas the non-SG (salary sacrifice, undeducted contributions, self-employed contributions) equalled approximately $2 billion.[30] Therefore the vast majority of superannuation contributions are the compulsory contributions made by employers under the SG provisions. Self-employed people are not covered by the compulsory nature of the SG so may choose not to place savings into superannuation.

6.53 There are a number of individuals who spend significant amounts of time outside the paid workforce. These include the disabled, injured, those with redundant skills, the long-term unemployed and full and part-time carers. Sole parents may also spend time outside the paid workforce (6.4 per cent of Generation X are sole parents[31]).

6.54 In 2003, 2.5 million people provided informal care to 2.1 million disabled or elderly people living at home.[32] Most people under 40 taking on an

30 Unpublished Australian Taxation Office data from The Treasury, *Submission no. 47*, p. 10.

31 Australian Bankers' Association, *Submission no. 28*, p. 23.

32 Australian Bureau of Statistics (ABS), *Australian Social Trends—2005*, cat. no. 4102.0, Canberra, July 2005.

unpaid carer role are women. In 2003 the proportion of women who were carers peaked at age 55–64 years—pre-retirement years for the current under 40s and likely to be a time when their elderly family members will require care.

6.55 Women are also generally the primary child rearing carers in families and may spend time out of the workforce to raise children. Therefore, due to their traditional caring roles, women spend time out of the workforce which impedes superannuation accumulation.

> The average superannuation balances of women across the lifecourse are lower than those of men. On average, when women retire from the workforce they will have half as much superannuation as men (Olsberg et al. 2001).[33]

6.56 In addition, women face some unique disadvantages in accumulating adequate superannuation balances:

- on average, women live longer than men
- they tend to earn lower salaries
- many married women rely on their husband's superannuation yet with high divorce rates many are independent at older ages.

6.57 Women have lower participation rates than men and (like men) are only eligible for the Superannuation Guarantee contribution if they earn in excess of $450 a month.

6.58 Dr Ross Clare of ASFA commented at the first hearing:

> You can do a lot of research and determine quite conclusively that on average women tend to have less entitlement to superannuation than men—or you can ask your mum. Each will give you the same answer.[34]

6.59 According to NATSEM, women are a particularly vulnerable group because:

> - they are more likely than men to work part-year, part-time or in casual positions (eg. in October 2000, 43% of female employees worked part-time, compared with only 13% of male employees);
> - even when they work full-time, women's average earnings amount to only 84 per cent of male average full-time earnings; and

33 Department of Family and Community Services (now Department of Families, Community Services and Indigenous Affairs), *Submission no. 38*, p. 9.

34 Dr R Clare, *Transcript*, 28 July 2005, p. 13.

- women are more likely to have interrupted labour force careers, due to child bearing and rearing.[35]

6.60 Treasury's submission noted:

> The lower incomes and lower levels of labour force participation for women under age 40 identify them as a particular group who may need to improve their savings to meet their retirement income expectations.[36]

6.61 The low level of labour force participation for women under age 40 is mostly related to their traditional mothering roles—time out of the paid work force following births and often reduced time at work on return to the labour force (in part-time or job sharing roles) to balance work and family life. Interestingly, in their submission, the Office for Women referred to an Australian Bureau of Statistics (ABS) survey which revealed that two thirds of women return to work less than twelve months after having their youngest child with only 18 per cent not returning to work.[37]

6.62 The tendency of women with children to return to work in a part-time or casual capacity impinges on their ability to reach the same superannuation level as their male colleagues working full-time and continuously.

6.63 That said, it is anticipated that around 1 in 4 women under 40 will not have children[38]; more males now share child rearing responsibilities and work part-time (13 per cent of male employees work part-time[39]); and some women, with or without children, earn well above median earnings. The ABS Catalogue Australian Social Trends 2005 also noted that 'Women earned 92 per cent of the average (hourly ordinary-time) earnings of men in May 2004 (calculation based on full-time adult non-managerial employees)' which is a marked increase on the 78 per cent that women were earning 30 years ago.[40]

6.64 However, on all earnings, women earn less than men when you take into account part-time work and overtime. In May 2005 women earned 66 per

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35 Australian Institute of Banking and Finance, *Submission no. 49*, pp. 8–9.

36 The Treasury, *Submission no. 47*, p. 27.

37 Office for Women, Department of Families, Community Services and Indigenous Affairs, *Submission no. 73*, p. 2 (reference to Career Experience, Australian Bureau of Statistics, 2002).

38 In 2000, it was estimated that 24 per cent of women who had not yet completed their fertility would remain childless for life if fertility rates for 2000 remained constant into the future. Australian Bureau of Statistics, *Australian Social Trends 2000*, cat. no. 4102.0, ABS, Canberra, July 2000.

39 Australian Institute of Banking and Finance, *Submission no. 49*, pp.8-9.

40 Australian Bureau of Statistics, *Australian Social Trends 2005*, cat. no. 4102.0, ABS, Canberra, July 2005.

cent of the male employee total earnings figure.[41] The ABS attributed the difference in the total earnings of the genders to more women than men working part-time (45 per cent of women work part-time) and more men than women earning overtime.[42]

6.65 A number of superannuation initiatives have been particularly identified in submissions as benefiting women. These include the co-contribution scheme and superannuation splitting.

6.66 Discussions in public hearings also raised the concept of the government's maternity payment initiative incorporating a superannuation component to benefit women. Others believed the aim was to maintain income levels (through maternity leave pay) to allow choice and continuity. Remarkably, even if more employers were to pay maternity leave, there is currently no legislative requirement to pay SG.[43]

6.67 A significant number of comments were also received about women's poor financial literacy levels. Given that the first impediment to superannuation accumulation for women is workforce participation, the second is a lack of knowledge about retirement savings of those women in the labour force and those having SG contributions.

6.68 Ms Kristin Foster of the Financial Services Institute of Australasia (FINSIA) discussed these impediments at the October hearing in Sydney:

> In *Saving the future,* 60 per cent of women are either not employed or employed in part-time or casual positions. Only 25 per cent of women earn more than $50,000 per annum compared with men at 55 per cent. Crucially, 40 per cent of women as opposed to 19 per cent of men expect to be not employed for 12 months or more before retirement. Interestingly, of that number 56 per cent do not know how they will contribute to retirement savings during this period, and even more interesting is that only 22 per cent nominate their spouse as a fall-back plan.[44]

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41 Australian Bureau of Statistics, *2006 Year Book Australia—A Comprehensive Source of Information About Australia*, Denis Trewin, Australian Statistician, no. 88, cat. no. 1301.0, ABS, Canberra, p. 184.

42 Australian Bureau of Statistics, *2006 Year Book Australia—A Comprehensive Source of Information About Australia*, Denis Trewin, Australian Statistician, no. 88, cat. no. 1301.0, ABS, Canberra, p. 184.

43 Superannuation Guarantee Taxation Ruling, SGR 94/4, *Ordinary Time Earnings*.

44 Ms K Forster, the Institute of Securities, Banking and Finance (now FINSIA), *Transcript*, 18 October 2005, p. 7.

Co-contribution[45]

6.69 The government's co-contribution scheme has been embraced by women. It was noted in Treasury's submission that:

> In general, more females than males benefited from a co-contribution and the numbers of people who benefited tended to increase with age... For those under age 40, the numbers of people who benefited increased as income increased and again more women benefited than men...[46]

6.70 The Department of Families, Community Services and Indigenous Affairs also determined from information they have recently collated that 'as at the beginning of February 2005, around 63 per cent of co-contribution payments had been made on behalf of women with an average payment of $570'.[47]

6.71 Under the current rules, to be eligible for the co-contribution an individual must earn more than 10 per cent of their income from wages and salaries. While the 2006–07 budget proposes to amend the 10 per cent work test, it does not remove the work test completely. This means that during periods away from work—for example, a career break to care for children, or a period of unemployment—a woman may not qualify to receive the co-contribution. In other words, if a woman is not earning an 'income' but is still contributing to her superannuation she is *not* entitled to a co-contribution.

6.72 The ability to make even small ongoing contributions to a fund in a period of leave without pay may reduce the disadvantage to women of maintaining on-going contributions to superannuation.

6.73 In Australia the average age for first births has increased to 30.5 years and in 2003 the contribution to the total fertility rate of women aged 35–39 equalled that of women aged 20–24 (at 16 per cent).[48] This means more women are entering motherhood at a later age, some with their own assets and the ability to earn supplementary income during career breaks from sources other than employment.

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45 The co-contribution scheme and its rules are discussed in detail in Chapter 7. This discussion focuses wholly on the co-contribution with respect to women.

46 The Treasury, *Submission no. 47*, p. 20.

47 Department of Family and Community Services (now the Department of Families, Community Services and Indigenous Affairs), *Submission no. 38*, p.17.

48 Australian Bureau of Statistics, *Australian Social Trends 2005*, cat. no. 4102.0, ABS, Canberra, July 2005.

6.74 The ineligibility of a woman to access the co-contribution scheme during periods of unpaid leave impacts her ability to fully participate in a system which operates on the basis of continuous, long-term contributions.

Conclusions

6.75 The committee notes that people were once excluded from the ability to contribute to superannuation if they did not meet minimum work requirements. This is no longer the case, so any person on a career break may continue payments into their superannuation fund. Thus, if a person has the capacity to make ongoing payments from non-employment sources, they may.

6.76 However, the co-contribution scheme does not apply to these people. A woman on maternity leave who is not earning an income from employment is ineligible to receive a government co-contribution for her superannuation contributions, despite being in a very low or no income earning position. For example, if a woman had savings and was able to contribute via her savings, she would be ineligible to receive the co-contribution. Equally, if she had an alternative income source such as interest, rent or dividends from which she could make a contribution to her superannuation fund, she would be ineligible for the co-contribution.

6.77 The proposed budget changes to the ten percent work test will mean that a person earning at least ten per cent of their income from a business and or employment will be eligible to participate in the government co-contribution scheme. This may assist some women operating small and home-based micro businesses but is unlikely to assist those on an employment work break.

6.78 Most women without ongoing employment income would be unable to match their pre-break contribution level, with or without external assistance, even if they had supplementary earnings. However, if a woman has the ability to make a small superannuation contribution when she is most limited in her income earning capacity, government assistance through the co-contribution may give greater assurance that her balance grows in her absence from paid employment.

6.79 The committee therefore believes the ten per cent income rule applying to co-contributions impacts negatively on a woman's ability to continue superannuation payments during absences from the paid workforce. In Chapter 7, under *Co-contribution*, it is recommended that the 10 per cent rule be removed.

Superannuation Guarantee entitlement on paid maternity leave

6.80 The Human Rights and Equal Opportunity Commission's (HREOC) 2002 report on paid maternity leave noted that '…the majority of women in paid work do not have access to paid maternity leave'.[49] The report also stated that 'available data suggests that paid maternity leave is predominantly available in the public sector and larger organisations'.[50]

6.81 It may be concluded from HREOC's report that many non-government employers do not offer paid maternity leave. Of those employers that do, there is no requirement for the SG to be paid. This is because SG is payable on ordinary time earnings only which does not include maternity leave.[51]

6.82 On a practical level, an employer who pays an employee SG and provides a period of paid maternity leave may choose to continue to pay the SG. For example, some government employees do continue to accrue superannuation benefits during paid, and, in some schemes, unpaid maternity leave.

Government maternity payment

6.83 The government's maternity payment is a non-income tested, non-taxed amount of money provided to a mother following the birth of a baby or adoption of a child under age two. The maternity payment commenced 1 July 2004 replacing both the means tested one-off maternity allowance and the means tested refundable tax offset, the 'baby bonus'.

6.84 The maternity payment is currently $3166 and is paid as a lump sum unless the mother is deemed to be in circumstances which would warrant instalment payments. It is indexed annually and increases to $4000 on 1 July 2006 and then to $5000 on 1 July 2008.

6.85 The payment is primarily paid to a mother in recognition of the legal relationship between her and the infant and the role of the mother in the birth and extra costs associated with the birth or adoption of a child.

6.86 Australia and the United States are the only two OECD countries that do not have a national scheme of paid maternity leave. On the introduction of the maternity payment the Sex Discrimination Commissioner Pru Goward indicated that the maternity payment was a step towards national paid

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49 Human Rights and Equal Opportunity Commission, *A Time to Value – Proposal for a National Paid Maternity Leave Scheme*, Sydney, 2002, Section 3.3.2.

50 Human Rights and Equal Opportunity Commission, *A Time to Value – Proposal for a National Paid Maternity Leave Scheme*, Sydney, 2002, Section 3.3.2.

51 Superannuation Guarantee Taxation Ruling, SGR 94/4, *Ordinary Time Earnings*.

maternity leave. The Commissioner stated in the Human Rights and Equal Opportunity Commission Annual Report 2003–04:

> The payment, which is to be $3,000 for each child whether or not the mother is in work, is equivalent to 6.4 weeks of paid leave at about the minimum wage. The federal Government has said it will increase this amount to $5,000, roughly equivalent to 10.7 weeks paid leave. This falls below the recommended 14 weeks of paid leave … [52]

6.87 Ms Goward noted the payment is made to a mother for each baby whether or not they are in paid employment. It is on this basis that it is difficult to see a straight connection between the payment and paid maternity leave. However, given there is no national paid maternity leave scheme, the maternity payment could be seen to fill this gap—particularly by women who are in the paid workforce and whose work conditions do not include paid maternity leave.

6.88 It was noted at an inquiry hearing that the maternity payment is a poor substitute for maternity leave as maternity leave provides an income stream.[53]

6.89 The Family Assistance Office states that the maternity payment is intended to cover the extra costs associated with the birth of a baby or the adoption of a child and to recognise the role of a mother in the birth of a baby.[54] However these costs are unspecified. It is therefore difficult to determine whether these costs are intended to include possible employment income foregone whilst the mother cares for the new child or only the direct costs associated with the birth or adoption.

6.90 The committee heard that women are generally less likely to accrue the levels of superannuation that men do due to the biological fact that women bear society's children and are the intimate nurturers of babies. This means that women who mother children are extremely likely to spend time out of the paid workforce, at least initially, and their superannuation would be impacted by this.

6.91 The need to ensure a woman is not disadvantaged in accruing superannuation during maternity leave was mentioned at a number of

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52 Human Rights and Equal Opportunity Commission (HREOC), *Human Rights and Equal Opportunity Commission Annual Report 2003-2004*, Chapter 10, Sex Discrimination, Statement by Commissioner, Sydney, 2004.

53 Ms S Grierson MP, *Transcript*, 10 February 2006, p. 12.

54 <http://www.familyassist.gov.au/internet/fao/fao1.nsf/content/publications-factsheets-maternity_payment_guidelines.htm#1>

hearings. There were suggestions that superannuation could be incorporated into the maternity payment.[55]

6.92 However, the Department of Families, Community Services and Indigenous Affairs stated that introducing a superannuation purpose into the maternity payment would water down the intent of the initiative:

> I would just reiterate the point that was made about maternity payments. Maternity payment is a very important contribution by the government toward the costs of having a child and ... it is geared very much around the costs of early childhood and supporting younger families at that time. …We would suggest to the committee that that is the prime focus of those payments, and taking anything away from those payments at an early point in time would have disadvantages.[56]

6.93 One individual, Ms Melinda Finch, stated at an inquiry hearing:

> Tying the baby bonus to some sort of super would be a brilliant idea.[57]

6.94 Ms Finch thought a link between the maternity payment and a superannuation guarantee payment was worthwhile because it would '…keep it [superannuation] in people's minds'.[58]

Conclusions

6.95 Paid maternity leave is not a legislated right. However it may be payable under various awards or workplace agreements and some employers may offer a period of paid maternity leave as a goodwill gesture. In cases where maternity leave is paid a superannuation component equivalent to the SG may or may not be paid.

6.96 The definition of ordinary time earnings, upon which SG is determined, excludes paid maternity leave yet includes other personal leave including sick leave and recreation leave.

6.97 The committee contends that the non-requirement to pay SG on paid maternity leave is a little known fact and many women may assume they have superannuation coverage during this period of payment when in fact

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55 Dr C Emerson MP, *Transcript*, 10 February 2006, p. 58.

56 Mr R Barson, *Transcript*, 10 February 2005, p. 7.

57 Ms M Finch, *Transcript*, 28 July 2005, p. 89.

58 Ms M Finch, *Transcript*, 28 July 2005, p. 89.

they may not. The committee believe the non-entitlement to SG during paid maternity leave should be reviewed by government.

6.98 The concept of incorporating SG into the lump sum maternity payment was considered by the committee. The committee noted that the Sex Discrimination Commissioner has likened the maternity payment to the equivalent of a short period of paid leave on a minimum wage. In the absence of a national paid maternity leave scheme the maternity payment may enable a mother to take 'paid' leave for a short period of time after the birth or adoption of a child.

6.99 The committee is concerned that women taking unpaid leave to have and care for children have reduced or no superannuation coverage during this time. As a measure to provide greater ongoing superannuation coverage for women the committee believe the government's maternity payment could incorporate an SG component.

6.100 The maternity payment is paid to all mothers, whether they are in the paid workforce or not. Mothers who are not in the paid workforce perform valuable unpaid work in the home and community and yet have virtually no superannuation coverage. Sanctioning a component of the maternity payment for a superannuation contribution would enable all mothers to accrue a small amount of superannuation during periods of unpaid parenting.

Recommendation 7

6.101 **The committee recommends that:**

1. **the government review the non-entitlement of Superannuation Guarantee during periods of paid maternity leave including amending the definition of ordinary time earnings under the *Superannuation Guarantee (Administration) Act 1992.***

2. **consideration be given to having a component of the maternity payment apportioned to Superannuation Guarantee.**

Superannuation splitting and the spouse contribution tax offset

6.102 Superannuation contribution splitting was introduced on 1 January 2006. It enables a fund contributor to transfer, at year end, some of their superannuation contributions to the fund of their spouse. Up to 85 per cent of deductible contributions and 100 per cent of undeducted contributions may be transferred. The regulation was introduced to '…allow non-working spouses to have superannuation assets under their own control and to have their own income in retirement'.[59]

6.103 This mechanism enables a low income or non-working spouse to maintain growth in their superannuation fund even though they are not themselves the contributor. It enables a household to access two reasonable benefit limits and two low rate threshold amounts from one person's income or the higher income of one person.

6.104 Most spouses who are not working are women. Women bear children and take maternity leave and are generally the carers in families. Therefore superannuation splitting is likely to favour the account balances of women. Evidence given to the committee indicates this is a way to empower women with their own superannuation and/or to maintain the growth in funds they have worked hard to contribute to.

6.105 In their submission Treasury noted:

> It will assist low-income spouses to hold superannuation assets in their own name and under their own control, creating better incentives to contribute to superannuation.[60]

6.106 Another initiative listed by some groups as an incentive to assist non-working or low income women to maintain superannuation balances is the superannuation spouse tax offset. It provides a spouse with a tax offset if they provide voluntary superannuation contributions to their partner. This initiative allows an 18 per cent tax offset for monies contributed to a spouse's superannuation, up to $3000 per annum. Given most women are the primary care givers it is more likely female superannuation balances will benefit from the tax offset.

6.107 The incidence of relationship breakdown was cited during evidence by Mr Richard Gilbert of the Investment and Financial Services Association (IFSA) as a reason why superannuation splitting and the spouse rebate were important:

> Particularly in light of some of the comments that were made in the previous set of evidence about divorce, it is important that each spouse has an independent retirement savings amount.[61]

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59 The Hon Mal Brough, MP, Minister for Revenue and the Assistant Treasurer, Media Release, *Super Contribution Split Starts on January 1*, 9 December 2005.

60 The Treasury, *Submission no. 47*, p. 19.

61 Mr R Gilbert, IFSA, *Transcript*, 28 July 2005, p. 31.

6.108 In the case of a relationship breakdown the superannuation in a woman's name would be considered as general property of the relationship (as would her husband's) and could be dealt with by agreement or by a court order. From 28 December 2002 the *Family Law Act 1975* enables superannuation interests to be treated as property and superannuation interests can be divided on a marriage breakdown.

6.109 In a lasting relationship a household which utilises superannuation splitting may enjoy a tax offset, benefit from two superannuation incomes in retirement, and currently access two RBLs and two tax free components of superannuation income.

6.110 The Financial Planning Association of Australia (FPA) recognised the benefit in superannuation splitting and spouse rebates to the household unit:

> These two mechanisms act (or will act) as an incentive for a family to place money within the superannuation system by contributing on a temporary or a more permanent basis. It may also assist those who are on low incomes due to family or other reasons to accumulate some superannuation savings.[62]

6.111 Similarly, the Department of Families, Community Services and Indigenous Affairs (FaCSIA) stated:

> This voluntary initiative will provide a way for couples to share their superannuation and enable a low-income or non-working member of a couple to have their own superannuation, and hence income in retirement.[63]

Conclusions

6.112 The committee recognise the value of superannuation splitting and the spouse rebate for contributions to a partner's superannuation. These measures will particularly encourage household superannuation accumulation.

6.113 Women are more likely to take time out of paid work under age 40 than men, to have and to care for children. Superannuation splitting is therefore likely to favour women's balances in periods of low or no income earning capacity.

62 Financial Planning Association of Australia (FPA), *Submission no. 39*, pp. 5–6.

63 Department of Family and Community Services, (now the Department of Families, Community Services and Indigenous Affairs), *Submission no. 38*, p. 18.

6.114 Superannuation is now treated as general property of a marriage and may be the subject of property settlement. Therefore the value to women of superannuation splitting and the spouse contribution offset lies in the increased value of household superannuation savings, rather than in a woman having a guaranteed individual superannuation income on retirement.

Financial Literacy for Women

6.115 One point which came out in views to the inquiry was the particular lack of financial literacy of women. This covered general financial literacy and understanding about superannuation at basic levels. The Department of Families, Community Services and Indigenous Affairs (FaCSIA) wrote:

> Further, a recent survey of women, conducted by Security for Women (S4W), shows that many women know little about superannuation and the importance of saving for retirement. Key findings of the survey include: 51 per cent of women surveyed were unaware of the Superannuation Guarantee Contribution entitlements, 62 per cent did not know how their superannuation was taxed, 55 per cent had two or more superannuation accounts, 43 per cent had never made voluntary superannuation contributions, and 68 per cent did not know how much superannuation they needed to retire comfortably. [64]

6.116 FaCSIA also commented that one of the barriers to women contributing to superannuation and saving for retirement was poor understanding and that :

> …women of all ages, and especially women under 40, need to be educated about the importance of retirement savings generally – [as they have] limited knowledge about superannuation terms and concepts, including compulsory superannuation entitlements…[65]

6.117 Mr Ross Clare of the Association of Superannuation Funds of Australia (ASFA) also noted that women's perception of their superannuation savings needs changing through education:

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64 Department of Family and Community Services (now the Department of Families, Community Services and Indigenous Affairs), *Submission no. 38*, p. 10.

65 Department of Family and Community Services (now the Department of Families, Community Services and Indigenous Affairs), *Submission no. 38*, p. 11.

> There is the matter of education, there is the matter of encouraging women to regard superannuation as their asset rather than the family's asset.[66]

6.118 It also appears that women under 40 should be informed about the characteristics of their retirement and likely trends when they retire. Some of these, as mentioned by FaCSIA, include:

> The current life expectancy of women is 82 years while men can expect to live to 78 years (Olsberg et al. 2001). This means that the smaller retirement incomes of women will also need to last longer. Higher divorce rates are likely to result in more women living alone and being dependent on their own financial resources in their retirement (Goward 2004).[67]

6.119 The committee heard that improving financial literacy for all people is fundamental to a person's attitude to saving for retirement (refer Chapter 5). It increases their awareness and confidence to make decisions about managing household finances, saving and planning for changes in their lives.

6.120 In addition, the Office for Women believes that financial literacy and superannuation education should be specifically targeted at women in order to have the best outcomes:

> Women of all ages, and especially women under 40, need to be able to access relevant advice about the importance of retirement savings generally. Limited knowledge about superannuation terms and concepts, including basic compulsory superannuation entitlements, and a lack of available information sources targeted towards women's circumstances make it difficult for women to understand how they can increase their superannuation savings.[68]

6.121 The Women's Economic Policy Analysis Unit (WEPAU) of Curtin University of Technology stated in their submission the three key items that exacerbated the structural problems of being able to accrue superannuation by women were:

> …the relevance of the term retirement to women's working lives; an expectation that retirement incomes will be provided through

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66 Mr R Clare, ASFA, *Transcript*, 28 July 2005, p. 13.

67 FaCSIA, *Submission no. 38*, p. 9.

68 Ms K Flanagan, Office for Women, Department of Families, Community Services and Indigenous Affairs (FaCSIA), *Transcript*, 10 February 2006, p. 4.

> transfers from a partner; and the availability and use of resources for retirement planning.[69]

6.122 WEPAU suggested women may not consider 'retirement' as relevant to them. Women have more fragmented working patterns and as such they may associate 'retirement' with the end of a more traditional uninterrupted male working pattern. Retirement for them is also often blurred by the continuation of a heavier load of unpaid household work than men.[70] The under 40s age group may have less defined male/female roles than the previous generations but on the whole, regardless of employment or marital status, women undertake more unpaid work than men. WEPAU outlined this issue in their submission:

> Many women view both their unpaid and paid roles as "work" and while there is a recognition that the balance between the two roles may alter over time, they do not consider that there will be a time when they cease "working". The perception that work does not cease at some point in the life cycle appears to discourage active consideration of retirement. [71]

6.123 The under 40s generation of women are more likely than their mothers to return to work after having children but their rates of pay are on average lower than men's and their return to work is not often full-time. Therefore, in the majority of households the male partner may be still the main 'breadwinner' and viewed as the party responsible for providing retirement income for the couple. WEPAU contended in their submission that women may therefore not be as attuned to saving for retirement themselves and are dependent upon transfers for their retirement wellbeing.

6.124 Given the increase in relationship breakdowns WEPAU contends that the assumption that a woman will be in a couple in retirement is a contentious one and that divorced women tend to move down the income distribution. WEPAU stated:

> However, households are dynamic structures and the traditional view that women's retirement incomes will be provided through shared household resources is being challenged by rising divorce rates.[72]

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69 WEPAU, Curtin University of Technology, *Submission no. 12*, p. 9.

70 The most recent ABS data on unpaid household work shows that 65 per cent was performed by women. Australian Bureau of Statistics, *Australian Economic Indicators*, cat. no. 1350.0, ABS, Canberra, July 2001.

71 WEPAU, Curtin University of Technology, *Submission no. 12*, p. 9.

72 WEPAU, Curtin University of Technology, *Submission no. 12*, p. 11.

6.125 Data released in 2004 on the under 40s age group reveals the 35–39 age cohort has the highest divorce rate in both males and females than in any other age cohort.[73] The rate of remarriage fell significantly between 1986 and 2001.[74] However, the rate of divorce and remarriage reveals only one aspect of household formation and likely retirement living arrangements—many under 40s may remain in defacto relationships or remain single. These facts alone indicate that under 40s women should be educated about the importance of retirement planning for themselves.

6.126 Women are often not as exposed to resources for retirement planning as men owing to the availability of information in their working environment or their preferred information gathering methods. For example, many women working part-time may have limited or no access to the internet. WEPAU's submission wrote:

> Women are more likely than men to state that they have not received any information on retirement planning and this is particularly the case among those working part time (Onyx 1998). Men are more likely than women to value access to written and web-based information and it is possible that this is linked to occupational structures which give greater access to resources such as computers. [75]

6.127 This was consistent with information given by Ms Kerry Flanagan from the Office for Women that women's financial literacy was 'Lower than men's, and that they need to receive financial information in different ways'.[76]

6.128 It appears women prefer to approach information seeking with a more personal style and so are more inclined to consult colleagues, family and friends and attend seminars than would men. Studies indicate that women are more likely than men to consult a professional for advice yet they place less value on this kind of advice than more personal information gathering methods.[77] This may be tied to the economic constraints of seeking professional advice.

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73 Divorce rate 12.6 per cent for males aged 35-39 and 13 per cent for females aged 35-39. Australian Bureau of Statistics, *Divorces Australia 2004*, cat. no. 3307.0.55.001, ABS, Canberra, November 2005.

74 ABS, *Australian Demographic Statistics*, cat. no. 3101.0, ABS, Canberra, September 2004.

75 WEPAU, Curtin University of Technology, *Submission no. 12*, p. 10.

76 Ms K Flanagan, Office for Women, FaCSIA, *Transcript*, 10 February 2006, p. 10.

77 M Clark-Murphy & P Gerrans, School of Finance and Business Economics, Edith Cowan University, 'Consultation and Resource Usage in Retirement Savings Decisions: Australian Evidence of Systematic Gender Differences', *Financial Services Review,* vol. 10, no. 2001, pp. 273–290.

6.129 The committee heard from the Office for Women that the Commonwealth, States and Territories and New Zealand Ministers' Conference on the Status of Women are undertaking work to improve women's overall financial literacy levels including superannuation:

> The women's ministers around Australia are working to champion women's understanding of superannuation and the importance of saving for retirement.[78]

Conclusions

6.130 As superannuation is a complex financial area a lack of knowledge persists in this area in both sexes (as discussed in Chapter 5). The committee heard that on the whole women have a lower level of financial literacy than men or are more likely to admit to this lack of knowledge. Superannuation is traditionally one of the financial areas where women are prone to a lack of financial literacy.

6.131 Moreover, the lack of knowledge about superannuation by women is tied to their view of what retirement is, and whether it relates to them. People tend to only seek out the information they require and do not pursue what is perceived to be non-relevant information.

6.132 The women of Generation X and Y have high levels of workforce participation and thus the majority have been subject to a compulsory superannuation system from their early working lives. There is evidence to suggest that without targeted education they may rely solely on the SG for their retirement income or rely on external transfers from a partner or government.

6.133 Additionally, Australian women in their prime childbearing years—this has now shifted more to the thirties—experience time out of work and many return to work in reduced capacities after having children. The return to work may not occur until the late thirties or early forties. This is a time when a man would otherwise be considering his, and/or his family's future financial wellbeing. Due to environmental constraints, day to day activities, and reduced or no income earning capacity, women are less likely to independently pursue information on retirement savings.

6.134 A woman may also earn below the SG threshold in pursuing a work-family balance or because she could not return to work in a greater time capacity due to unavailability of external child care. Being outside of

78 Ms K Flanagan, Office for Women, FaCSIA, *Transcript*, 10 February 2006, p. 4.

the compulsory system results in a lack of direct engagement in retirement planning.

6.135 The types of environments people operate in determine the level of exposure to information and the type of information they are exposed to. In many cases women do not have the opportunity to garner financial information because they are either out of the employed workforce or in the workforce in a reduced capacity. This is a result of women's traditional social responsibilities of bearing and raising children and being carers.

6.136 Women also tend to abrogate responsibility for their retirement wellbeing to a male partner—often because he is working full-time and has not experienced long or repeated periods of unpaid absences. This compounds lack of knowledge and interest in superannuation as these women have little ownership.

6.137 Much work has already been undertaken on a gender-neutral basis to boost the general financial literacy of Australians. However evidence to this inquiry indicates that women have particular learning preferences and they often miss the exposure to financial information incidental to being in the full-time workplace. It is for these reasons that the committee believes women's financial literacy should be targeted.

6.138 Empowering women with information about superannuation and its relevance to them throughout their life course (irrespective of their work and non-work periods) will allow them to make better informed decisions about their retirement savings, including ways to boost household retirement savings.

Recommendation 8

6.139 **That the Financial Literacy Foundation, in association with the Office for Women, target programs to improve the financial literacy of women under age 40 with respect to superannuation.**

Casual employees

6.140 Another group at a significant disadvantage in accumulating superannuation are those employed in part-time or casual employment.

6.141 The number of casual employees in the labour force has increased over the last ten years with 26 per cent of the labour force in casual positions in

2004.[79] The disproportionate increase in casual employment occurred in males, with the rate increasing from 16 per cent in 1994 to 22 per cent in 2004.[80] However the rate for women remained higher and relatively stable, at around 30 per cent.[81] There is also a high level of part-time work in the casual workforce with 69 per cent of casual employees working part-time compared to 15 per cent of permanent employees.[82]

6.142 Dr Diana Olsberg from the Research Centre on Ageing and Retirement, University of New South Wales, noted the issues associated with casual employment for employees and how it affects superannuation balances:

> Casual employees do not enjoy the same rights and entitlements as ongoing employees. Apart from low pay and low career opportunities, they are particularly disadvantaged in their access to superannuation, so their retirement savings continue to be severely negatively affected. There is a continuing increase in casual employment and part-time and fragmented employment profiles—in particular, there is casualisation in the lower skilled occupations such as elementary clerical, sales and service workers, labourers and related workers.[83]

6.143 The Department of Families, Community Services and Indigenous Affairs noted that being in part-time or casual work was one of the two main factors that can impact on the level of earnings which is critical to the ability to make superannuation savings:

> The main factors that can impact on level of earnings are:
>
> - casual or part-time work - work patterns may affect the level of Superannuation Guarantee contributions received, as employers are only obliged to pay superannuation contributions if the employee has earnt more than $450 per month; and
> - education and skill levels, as higher paid work often requires, or is undertaken by those with high levels of educational attainment.[84]

79 Australian Bureau of Statistics, *Year Book Australia 2006*, cat. no. 1301.0, ABS Canberra, Details, 2006.

80 Australian Bureau of Statistics, *Year Book Australia 2006*, cat. no. 1301.0, ABS Canberra, Details, 2006.

81 Australian Bureau of Statistics, *Year Book Australia 2006*, cat. no. 1301.0, ABS Canberra, Details, 2006.

82 Australian Bureau of Statistics, *Year Book Australia 2006*, cat. no. 1301.0, ABS Canberra, Details, 2006.

83 Dr D Olsberg, Research Centre on Ageing and Retirement, University of New South Wales, *Transcript*, 28 July 2005, p. 18.

84 Department of Family and Community Services (now Department of Families, Community Services and Indigenous Affairs), *Submission no. 38*, p. 11.

6.144 Many of these positions are filled by women as Dr Olsberg noted in evidence:

> The main focus of my own research has been on the disadvantaged position of women in accessing retirement savings as a result of their fragmented work patterns and the preponderance of women in the part-time and casual paid labour force.[85]

6.145 Treasury's submission did not see casualisation as such a negative in terms of superannuation accumulation, but rather a positive in enabling people to return to work in a reduced capacity where full-time work would be unsuitable for them:

> Also, work patterns are changing. Working arrangements are more flexible, including part-time and casual work. These arrangements provide scope for students, those with caring responsibilities and those approaching retirement to continue to participate in the labour force and to save for their retirement.[86]

6.146 The high degree of casualisation of the workforce means a significant number of these people may be employed in these positions on an on-going long-term basis and as such are vulnerable to having reduced, fragmented or negligible superannuation savings. As casualisation trends increase more young people are employed in this way. Dr Olsberg noted:

> My most important point is that young people are disproportionately represented among casual employees. Although young people made up only 21 per cent of all employees in 2003, two-fifths—40 per cent—of casual employees were young people aged 15 to 24.[87]

6.147 As previously discussed in Chapter 3, the SG monthly earnings threshold of $450 reduces the chances of this category of employees accumulating superannuation. This is because some have a single low paying or low monthly hours position whilst others have multiple low paying or reduced hours positions where each position earns less than the monthly threshold. Ms Philippa Smith of ASFA noted this problem:

> A good number of people in the work force are cobbling together multiple casual or contract jobs to provide their total wages. So removing that $450 threshold as a substantive factor in savings for

85 Dr D Olsberg, Research Centre on Ageing and Retirement, University of New South Wales, *Transcript*, 28 July 2005, p. 17.

86 The Treasury, *Submission no. 47*, p. 3.

87 Dr D Olsberg, Research Centre on Ageing and Retirement, University of New South Wales, *Transcript*, 28 July 2005, p. 18.

> people who are in the casual and contract work force would be significant for the under 40s because of the number of people under 40 who achieve their income through casual and other work.[88]

6.148 Additionally, SG payments are made on the basis of ordinary time earnings so people working shifts in sectors where their overall wage is dependent upon overtime are not necessarily receiving SG contributions commensurate with the nature of their work. The Transport Workers Union noted in their submission:

> Nine per cent of a worker's ordinary time earnings is the amount provided to a worker's superannuation fund pursuant to compulsory superannuation contribution. Unfortunately this system works to the disadvantage of many casual workers.[89]

6.149 Casual employment has been associated with short-term or irregular employment but this is a common misunderstanding. Many people are employed in the casual labour market on an on-going basis which means they may have a long-term disadvantage in accumulating superannuation. The Australian Bureau of Statistics Year Book Australia 2006 noted that 'In August 2004, 55% of the 2.0 million casual employees in Australia had been with their employer for 12 months or more, compared with 83% of the 5.7 million ongoing employees'.[90]

6.150 In certain industries (for example retail and hospitality), holding more than one employment position is common place, because full-time employment is unavailable or rostering and contracting systems prevent earning sufficient monthly wages. Dr Olsberg noted in her submission that people employed in a casual capacity are more likely to hold multiple jobs:

> Casual employees are more likely to have more than one job. In 2003, 8% of employees who were casual in their main job were multiple job holders, compared with 4% of employees who were ongoing in their main job.[91]

6.151 Dr Olsberg also cited nursing as an occupation affected:

> In the research that I have done, particularly nurses, when they are in the private sector doing community care and those sorts of

88 Ms P Smith, ASFA, *Transcript*, 28 July 2005, p. 4.

89 Transport Workers' Union (TWA), *Submission no. 27*, p. 6.

90 Australian Bureau of Statistics, *Year Book Australia 2006*, cat. no. 1301.0, ABS Canberra, Details, 2006.

91 Dr D Olsberg, Research Centre on Ageing and Retirement, University of New South Wales, *Submission no. 30*, p. 3.

> things, work for a range of employers, many of them earning substantially more than $450 a month. But of course, because they do not earn $450 from any one employer, they do not get anything. So they are severely disadvantaged.[92]

6.152 This tendency to hold multiple casual positions was also mentioned by ASFA:

> There also has been a substantial increase in the number of casual employees, with 26% of employees casual in 2003, compared to 22% in 1993, leading to an increase in casual jobs from 1.3 million to 1.9 million (ABS 2005). A significant proportion of these job holders achieve the equivalent of full-time employment through the combination of two or more jobs.[93]

6.153 People aged under 40 are particularly prone to work in casual positions because newcomers to the labour force have constrained market power and casual work offers work experience opportunities. Additionally, casual work enables people to combine work with study, women returning to the workforce after having children tend to take part-time or casual work, and there has been a general labour market movement to casualisation of positions.

6.154 The ACTU's submission quoted the under 40 age group as particularly prevalent in the casual labour force and mentioned those most likely to be employed in this way:

> First and foremost, amongst the under 40's are a very substantial group of employees who are part-time, casual and low paid. This is particularly the case amongst women, migrant workers, those who left school early before completing their HSC, the unemployed, as well as those who move off other social security benefits and participate in the low paid end of the labour market. A significant proportion of this group is likely to have labour market experiences over their working life that will prevent them accumulating enough super savings to meet the target of two thirds of pre-retirement income at age 65, even with the pension.[94]

6.155 Even if a person in a casual position or multi-job casual positions were to earn above the threshold in each job they face other issues in growing their superannuation balances.

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92 Dr D Olsberg, Research Centre on Ageing and Retirement, University of New South Wales, *Transcript*, 28 July 2005, p. 19.

93 ASFA, *Submission no. 16*, p. 21.

94 ACTU, *Submission no. 29*, p. 9.

6.156 One is that with shorter timeframes per month or per position they are less exposed to information about superannuation savings than those in full-time work and often work in environments where they do not have access to the internet or other in-work information resources. Ms Kerry Flanagan from the Office for Women noted this problem with casualisation:

> For example, if women move jobs a lot and work in casual employment and part-time work then it is difficult for them, because they have superannuation balances all over the place. So giving them some assistance to understand how they can combine those and reduce administrative fees and things like that are important elements.[95]

6.157 The other is that broken work patterns tend to give reduced opportunity to contribute to superannuation. Casual employees do not have an on-going permanent position and may find a placement or position prematurely ceases. Research discussed in the Australian Bankers' Association submission indicated that many young people in casual positions are actively seeking more hours of work:

> However, not all younger people working part-time are necessarily doing so by choice (i.e. completing studies, having children, etc). Some are working part-time as longer hours or full-time positions are not available. In 2003, 12% of part-time workers aged 15-24 years were actively seeking more hours of work, and were available to work more hours. Similar levels are receiving government assistance.[96]

6.158 The final issue is that multiple employment positions can often lead to multiple superannuation funds. The superannuation choice regime and portability of a selected fund attempt to alleviate multiple fund issues by allowing people to consolidate their superannuation into a single fund (discussed in detail in Chapter 7). However, this often requires the individual to have the knowledge of how and why to consolidate their super. Issues associated with multiple superannuation funds and the initiatives to overcome these problems are discussed in detail in Chapter 7.

Conclusions

6.159 The committee recognises that people under age 40 are exposed to more casualised work arrangements than other age cohorts for a variety of reasons including the higher degree of these positions on offer, combining

95 Ms K Flanagan, Office for Women, *Transcript*, 10 February 2006, p. 6.

96 Australian Bankers' Association, *Submission no. 28*, p. 28.

work with tertiary studies and women under forty balancing the unpaid work of family life with shorter hours of paid employment.

6.160 Under 40s employed in a casual work environment are less likely to accumulate as much superannuation as their full-time permanent equivalents. This is mainly due to the prevalence of restricted hours in casual positions of employment which leads to lower wages and possibile exclusion from the compulsory superannuation savings system. A lower waged person, even if they earn at or above the SG monthly threshold will have difficulty pursuing a robust superannuation balance.

6.161 Many people employed in casual work are employed by more than one employer as this is the pattern of the workforce in certain sectors and holding multiple jobs allows them to enjoy the income level of a full-time position. However, some would not receive the same SG contribution enjoyed by a person in an equivalent full-time position as each position must earn above the monthly threshold in its own right. SG entitlement is tied to earnings with an employer, not to overall income levels.

6.162 Whilst the committee acknowledges that the superannuation choice arrangements may act to encourage young people to nominate a preferred single fund for their superannuation, impediments to this remain. The problem with having multiple accounts is not only the likelihood of one or more falling into inactivity but also that each account will levy fees associated with the running of the fund, irrespective of the balance in the account. Such impediments associated with multiple superannuation funds are discussed in detail in Chapter 7.

6.163 Consolidation of funds may be costly in terms of time and money. Although an employee now has the advantage of portability of superannuation out of a fund into a preferred fund (this is discussed in more detail in Chapter 7) the committee heard that some funds impede the process and some charge high exit fees. These actions can impact on casual workers attempting to consolidate many small superannuation fund balances.

6.164 The committee has recommended that the government develop policies to ensure people with multiple casual jobs are not at a disadvantage in accruing superannuation (Chapter 3). It also endorses changes announced in the 2006 budget to encourage consolidation of superannuation accounts and locate lost benefits (refer Chapter 7).

6.165 On a general level the committee's recommendations to improve the financial literacy and superannuation savings awareness of all young Australians will help to improve the superannuation savings of casual employees (Chapter 5). Promoting greater awareness of the co-contribution scheme and how it works may also assist those employed in casual positions to strengthen their superannuation savings position.

7

Incentives and system improvements

Co-contributions

Overview

7.1 The co-contribution scheme is an initiative to assist eligible individuals—low and middle income earners—to save for their retirement. The scheme was established by the *Superannuation (Government Co-Contribution for Low Income Earners) Act 2003*. As was noted by the Hon Peter Slipper MP in the bill's second reading speech:

> The government co-contribution will replace the existing taxation rebate for personal superannuation contributions made by low-income earners with a more generous co-contribution.[1]

7.2 Initially, the government's co-contribution was $1.00 for every $1.00 contributed, up to a maximum of $1000 for individuals earning $27 500 or less. The amount of co-contribution reduced 8c for every $1.00 earned above $27 500, phasing out completely at $40 000. [2]

7.3 In the 2004–05 budget, the government announced changes to the co-contribution, which are still in place today. Individuals earning $28 000 or less per annum are now entitled to a co-contribution of $1.50 for every $1.00 contributed, up to a maximum co-contribution of $1500. The amount

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1 The Hon P Slipper MP, Parliamentary Secretary to the Minister for Finance and Administration, *House of Representatives Hansard,* 29 May 2003, p. 15394.

2 *Superannuation (Government Co-Contribution for Low Income Earners) Act 2003*, s. 10A, pp. 6–7.

of co-contribution reduces 5c with every $1.00 earned above $28 000, phasing out at $58 000.[3] Table 7.1 below demonstrates the current co-contribution.

Table 7.1 Current co-contribution phase out

Personal Contributions	**$1000**	**$800**	**$500**	**$200**
Total Income				
$28 000 or less	$1500	$1200	$750	$300
$30 000	$1400	$1200	$750	$300
$36 000	$1100	$1100	$750	$300
$40 000	$900	$900	$750	$300
$46 000	$600	$600	$600	$300
$50 000	$400	$400	$400	$300
$56 000	$100	$100	$100	$100

Source *L Neilson, Superannuation ready reckoner, Parliamentary Library, Canberra, p. 4.*

7.4 Co-contributions are treated as undeducted contributions and thus are not taxed on entry or exit.

7.5 Currently, to be eligible for the co-contribution individuals must:

- make undeducted contributions (after-tax, not SG) to their superannuation fund;
- earn 10% or more of their total income from eligible employment;
- earn less then $58 000 per annum; and
- be under 71 years of age at the end of an income year.[4]

7.6 However, the changes proposed in the 2006 budget would extend the co-contribution to unincorporated self-employed. The proposal is that people must earn 10% or more of their total income from carrying on a business, eligible employment or a combination of both[5], rather than *only* from eligible employment.

7.7 In the 2003–04 financial year, 650 000 people participated in the co-contributions scheme, with the government contributing around $327 million.[6] As figure 7.1 below demonstrates, the number of people who

3 *Superannuation (Government Co-Contribution for Low Income Earners) Act 2003* (as amended), s. 10A, pp. 6–7.

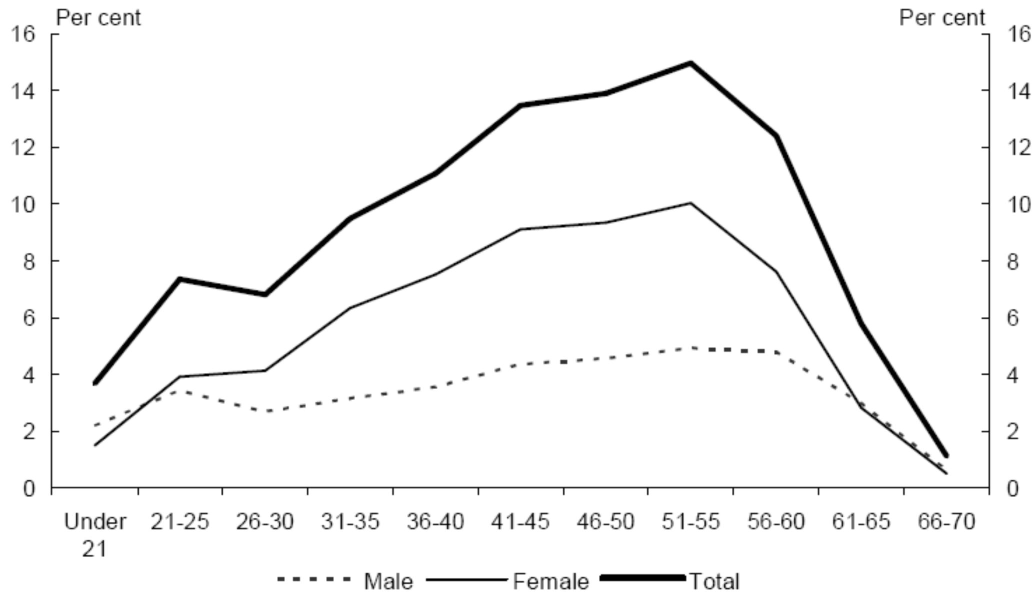
4 L Neilson, *Superannuation Ready Reckoner*, Parliamentary Library, Canberra, p. 4.

5 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 32.

6 The Treasury, *Submission no. 47,* p. 20.

benefited from the co-contribution tended to increase with age, until the current retirement and preservation age, 55. Therefore, under 40s participation in the scheme is quite low when compared to people older than 40.

Figure 7.1 Distribution of co-contribution beneficiaries by age 2003–04



Source *The Treasury, Submission no. 47, p. 21.*

Co-contributions and under 40s

7.8 A large majority of the evidence to this inquiry complimented the government on the introduction of the co-contribution scheme. Most argued that the scheme provides a good incentive for under 40s to voluntarily contribute to their superannuation. For example, the Financial Planning Association of Australia (FPA) stated that:

> The co-contribution scheme has clearly been a successful initiative amongst low to middle income earners. Apart from encouraging people to contribute to their superannuation, it also engages people with their superannuation. This engagement creates a familiarity and sense of ownership that may not have otherwise existed and this can only be beneficial.[7]

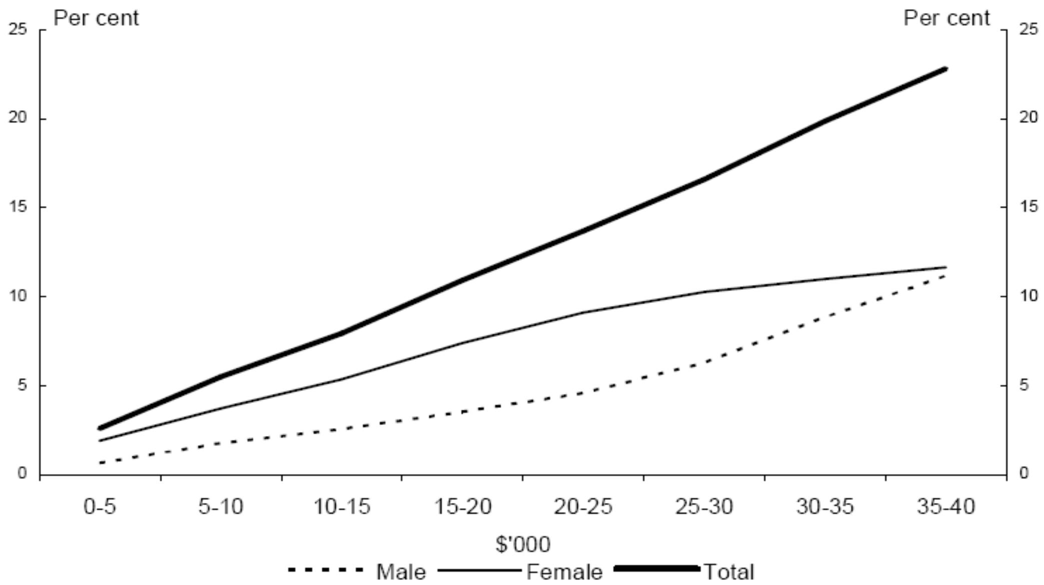
7.9 Of the Australians who received a co-contribution for the 2003–04 financial year, 219 000—around 36 per cent—were under age 40. In total, under 40s received co-contributions of nearly $103 Million.[8] Figure 7.2 below shows

7 Financial Planning Association of Australia, *Submission no. 39*, p. 5.

8 The Treasury, *Submission no. 47*, p. 20.

the percentage of under 40s at various income levels who have received a co-contribution.

Figure 7.2 Distribution of under 40s co-contribution beneficiaries by income 2003–04



Source The Treasury, Submission no. 47, p. 21.

7.10 In regard to under 40s participation in the scheme, Treasury stated:

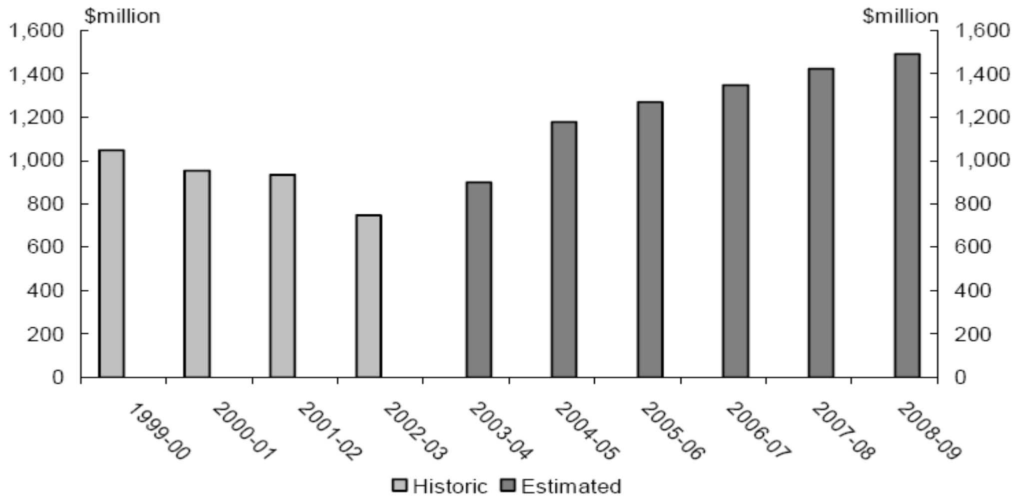
> In general, more females than males benefited from a co-contribution and the numbers of people who benefited tended to increase with age … For those under age 40, the numbers of people who benefited increased as income increased and again more women benefited than men … The largest average benefit was gained by those with income for co-contribution purposes of $25,000 to $30,000.[9]

7.11 Treasury also commented that the co-contribution scheme is expected to start to reverse the downward trend in under 40s voluntary contributions.[10] Treasury's projections are shown below in figure 7.3.

9 The Treasury, *Submission no. 47,* p. 25.

10 The Treasury, *Submission no. 47*, p. 2.

Figure 7.3 Projected growth in post-tax contributions (including government co-contribution payments) made by under 40s from 2003–04 to 2008–09



Source *The Treasury, Submission 47, p. 23.*

Improvements to the co-contribution

7.12 Although most submissions praised the co-contribution scheme, there were many submissions that also proposed ways the scheme might be improved—particularly to advantage under 40s. These proposals are discussed below.

Co-contribution awareness

7.13 There were concerns that, despite the positive co-contribution take-up levels, there are many people under age 40 who still do not understand how the scheme works. For example, Australian Administration Services (AAS) stated:

> There is a misunderstanding that co-contribution requires the ability to save $1,000 in a lump sum, which is not the case. The other misapprehension … perpetuated is that it requires paperwork—a member to apply for co-contribution. It does not. It is an automatic mechanism, leveraging off the old surcharge reporting, where super funds report to the ATO the amount of undeducted contribution made and the ATO combines that with the individual's tax return and determines the amount of co-contribution.[11]

11 Ms F Galbraith, AAS, *Transcript*, 3 February 2006, p. 3.

7.14 Likewise, the submission of Senator Judith Adams commented that 'while the co-contribution scheme is generally well received, it is generally poorly understood'.[12]

7.15 In response to this perceived lack of understanding, the Australian Industry Group recommended:

> The Government develop and execute strategies aimed at improving the awareness and take-up of the Superannuation Co-contribution Scheme among people under 40.[13]

7.16 The submission of the Government Employees Superannuation Board (GESB) of Western Australia highlighted a campaign to increase members' involvement in the co-contribution. They stated:

> An email campaign … was distributed through 97% of GESB's employer agencies … Direct contributions increased by 245% during May compared to May 2004 , indicating that the email campaign was an effective way to encourage people to make voluntary contributions.[14]

7.17 The submission of the Institute of Chartered Accountants surmised that any co-contribution awareness campaign 'must [focus] on the simplicity of the process and how it will benefit [people] in retirement'.[15]

Extending the co-contribution

7.18 A number of submissions suggested that the government could look at extending the co-contribution through one or more of the following:

- increase the current $58 000 phase out threshold so that higher income earners can access the scheme
- increase the current $28 000 threshold at which a full contribution can be received so that more people are receiving the full co-contribution
- reduce the rate at which the scheme phases out so more people are receiving higher co-contributions.

7.19 The Australian Bankers' Association (ABA), for example, suggested that the maximum co-contribution threshold could be increased to encompass all people subject to the 30 per cent personal tax rate—an income of $63 000 for 2005–06. The ABA also proposed that the phase-out could be

12 Senator J Adams, *Submission no. 16,* p. 4.

13 Australian Industry Group, *Submission no. 15,* p. 3.

14 GESB, *Submission no. 35,* p. 4.

15 Institute of Chartered Accountants, *Submission no. 23,* p. 5.

rescaled so that 'more low to medium income earners can gain access to the full co-contribution'.[16] These measures, the ABA argued, would 'provide greater incentive for superannuation savings'.[17]

7.20 The Association of Superannuation Funds of Australia (ASFA) proposed that:

> The parameters [of the co-contribution] be extended to individuals on low/middle incomes of up to $60 000 per year, and that the phase-out rate for the co-contribution be adjusted so as to provide a greater incentive for middle income earners in particular. More specifically, it is recommended that … the maximum co-contribution remain at $1500, but this be available for persons with assessable income … of less than $40 000 a year. It is also recommended that the maximum co-contribution phase down as income exceeds $40,000 a year, at a rate of 7.5 cents in the dollar.[18]

Co-contribution to pay off debts

7.21 One submission suggested that co-contribution payments could be used to pay off Higher Education Contribution Scheme (HECS) debts. The purported advantages of this concept were:

- This is extremely attractive for low-income earners to pay off their HECS debt.
- The more they invest in super, the more years of co-contributions they receive in a single year to accelerate debt reduction. They are also accelerating their savings.[19]

7.22 The submission of Senator Gary Humphries argued that the co-contribution could be put aside for a housing deposit, rather then being preserved in superannuation. The submission stated:

> For a person earning under $28,000 this would mean a Government contribution of $1500 towards buying a house—a powerful incentive to contribute to superannuation.[20]

Removal of the 10 per cent work test

7.23 As discussed above, one of the current qualification criteria for the co-contribution is that a person must earn 10 per cent of their income from

16 ABA, *Submission no. 28*, p. 18.
17 ABA, *Submission no. 28*, p. 18.
18 ASFA, *Submission no. 16*, p. 2.
19 Mr C Moore, *Submission no. 69,* p. 6.
20 Senator G Humphries, *Submission no. 4*, p. 4.

eligible employment. This means that, at present, the co-contribution is not available to the unincorporated self-employed, stay at home parents and people who rely solely on government benefits—students and the unemployed, for example.[21]

7.24 However, the Federal Government's 2006 budget proposed changes to this test. As outlined above, people who earn at least 10 per cent of their income from carrying on a business—the unincorporated self employed—will be eligible for a co-contribution, provided that they meet the other criteria (age, income and undeducted contributions).

7.25 Prior to the budget, a number of submissions criticised the fact that the unincorporated self-employed were not eligible for a co-contribution. For example, the National Information Centre on Retirement and Investments (NICRI) stated:

> We consider the co-contribution scheme to be positive but restrictive because it is only available to employees. Those that are unemployed or self employed are ineligible to take advantage of this scheme, therefore are effectively discriminated against.[22]

7.26 While the changes outlined in the 2006 budget would allow access to co-contributions for the unincorporated self-employed, it does not remove the 10 per cent work test completely. Therefore, the other groups outlined above—stay at home parents and people whose only income is government benefits—remain ineligible for a co-contribution on any voluntary undeducted contributions that they make. A number of groups were opposed to these restrictions and therefore argued that the work test should be removed completely.

7.27 The ABA, for example, recommended that the government:

> Remove work test for superannuation co-contributions … thereby broadening access to the government co-contribution for low to medium income earners.[23]

7.28 Similarly, CPA Australia commented:

> If you are talking about how to improve super savings for women, people at home, students et cetera, the fact that they are ineligible

21 Chapter 6, *Superannuation issues for certain groups,* discusses the issues for the self-employed and women in more detail.

22 NICRI, *Submission no 13,* p. 7.

23 ABA, *Submission no. 28*, p. 18.

> for the co-contribution is a bit of a shame. It would certainly be a good step in the right direction to help improve their savings.[24]

7.29 The Institute of Chartered Accountants also stated:

> For example [the] co-contribution does not allow those at home caring for families to claim the co-contribution, acting as a disincentive to voluntary savings. Consideration should be made for this to be paid.[25]

Conclusions

7.30 Overall, the committee has found that the co-contribution scheme is an excellent incentive for under 40s to voluntarily contribute to their superannuation. The number of Australians who have participated in this scheme is a testament to its early success. The committee is especially pleased to see that a considerable number of under 40s—women in particular—have benefited from a co-contribution.

7.31 While the take-up of the scheme has been positive, under 40s take-up is low when compared to people older than 40, as is demonstrated by figure 7.1 above. This trend is undoubtedly caused by the fact that people older than 40 are more likely to be focussed on retirement. The committee believes that this trend will always be prevalent—it is inevitable that superannuation becomes important to a person as they get older. Nonetheless, the committee does believe that is possible to significantly increase under 40s' involvement in the scheme.

7.32 In the committee's view, the key to increasing under 40s take-up of the co-contribution is to increase and simplify the scheme's promotion. The committee agrees with the evidence suggesting that the co-contribution scheme is not well understood by young people. In particular, the committee is concerned by misconceptions about the scheme's operation. Young people should be aware that it is very easy to receive a co-contribution, and that contributions can be made weekly or fortnightly, rather than in lump sums.

7.33 The committee urges both the government and superannuation funds to promote the scheme in a straightforward manner—for example, 'if you earn less then $28 000 a year, $20 a week will give you $1500 in your super account for free'.

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24 Mr M Davison, CPA Australia, *Transcript*, 10 February 2006, p. 16.

25 Institute of Chartered Accountants, *Submission no. 23,* p. 5.

7.34 The committee did not find a need to increase the current income thresholds or the level of co-contribution paid, as was suggested by various groups. The committee is more in favour of increasing and simplifying promotion of the current scheme.

7.35 The committee also does not support setting aside co-contributions for the purpose of paying off other debts. As stated throughout this report, the committee believes any early access to superannuation undermines the key feature of the system, preservation.

7.36 The 2006 budget proposes that the current 10 per cent work test, which is a determinant of co-contribution eligibility, be extended to include the unincorporated self-employed. While the committee agrees that the self-employed should be eligible for the co-contribution, it does not believe that this reform goes far enough. The committee would prefer to see the 10 per cent work test removed completely, rather than simply amended. The committee believes that people who are not in work—stay at home parents, unemployed persons and students—who are still making contributions to their super, should have their contributions matched by the government, up to the relevant threshold.

Recommendation 9

7.37 **The committee recommends that the government maintain the current co-contribution scheme, but, together with superannuation funds, increase the scheme's promotion to improve awareness and take-up. To specifically target young people, the committee recommends that the co-contribution always be promoted in a basic and understandable manner.**

Recommendation 10

7.38 **The committee recommends that the government remove the 10 per cent work test as a determinant of co-contribution eligibility.**

Choice, portability and multiple accounts

Choice

7.39 The introduction of 'superannuation choice', as of 1 July 2005, allows employees to choose their superannuation fund, whereas as previously employers were able to choose an employee's fund. However, as was noted in Treasury's submission, some employees are not subject to the legislation:

> Employers are required to offer choice of fund to an employee unless superannuation contributions for that employee are made under a certified agreement, Australian Workplace Agreement or a state award or industrial agreement. Some public servants and some members of defined benefit schemes will not be offered choice.[26]

7.40 Choice of superannuation fund currently applies to 'over five million Australians'.[27] However, from 1 July 2006, changes introduced by the 'work choices' legislation will mean that more people will come under the superannuation choice regime:

> Employees working for corporations who previously could not choose a fund because they were employed under a state award will be able to choose a fund. These employees are now covered under a Federal workplace agreement called a notional agreement preserving state awards.[28]

7.41 Generally speaking, employers must issue eligible employees with a 'standard choice form' within 28 day of their start date. If an employee does not choose a fund then the employer must contribute to a default fund. An employer's default fund can be chosen by the employer but 'must be a complying fund and also offer a minimum level of life insurance'.[29]

7.42 Treasury stated that the choice regime aims to:

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26 The Treasury, *Submission no. 47*, p. 23.

27 The Hon M Brough MP, Minister for Revenue and Assistant Treasurer, *Super Choice Arrives,* media release, 1 July 2005.

28 Australian Government, *Super Choice,* viewed 24 April 2006. <http://www.superchoice.gov.au/default.asp>

29 Australian Government, *Super Choice – Employer Funds,* viewed 24 April 2006. <http://www.superchoice.gov.au/employers/employer_fund/>

> Enable employees to choose a superannuation fund based on matters of value to them, for example, fees and charges, death and disability insurance or ethical investments. It encourages people to take more active ownership of their superannuation and their retirement future and allows them to have a better connection with their superannuation savings throughout their life.[30]

7.43 Commenting on the early successes of the regime, the Industry Funds Forum (IFF) stated that 'while still in its infancy, choice has significantly raised all consumers' consciousnesses of superannuation'.[31]

7.44 The Australian Consumers Association (ACA) claimed that 'the introduction of Super Choice provides both opportunities and risks for consumers'.[32] The risks, according to the ACA, largely centre on the provision of biased or poor financial advice, leading consumers to make bad choices.

7.45 Given that Super Choice is still in its infancy, there is not a great deal of qualitative data available to show how many people have taken the opportunity to choose a superannuation fund. However, a recent survey commissioned by ASFA showed:

> Out of those surveyed, during the first thee months of the operation of choice of fund legislation 7% changed funds. However, only 4% of the sample chose a new fund as a conscious act of choice, as 2% of respondents went to a new fund because it came with a new job, and 1% changed because of the closure of the old employer fund.
>
> …
>
> On top of the 4% of respondents who have already actively exercised choice of fund … another 4% are likely to change funds in the next twelve months.[33]

Portability

7.46 The portability legislation, which commenced on 1 July 2004, requires superannuation funds to allow members to transfer part or all of their accrued entitlement out of the fund.[34]

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30 The Treasury, *Submission no. 47,* p. 24.

31 Industry Funds Forum, *Submission no. 22,* p. 12.

32 ACA, *Submission no. 34,* p. 2.

33 Mr R Clare, ASFA Research Centre, *The Introduction of Choice of Superannuation Fund - Results to Date*, ASFA, Sydney, February 2006.

7.47 Initially, superannuation funds were only required to transfer funds if a member's account had been inactive (had not received a contribution) for 6 months. At 1 July 2005, changes were implemented to the portability arrangements to withdraw this requirement—most fund members can now transfer their funds at any time, regardless of account activity.[35]

7.48 According to Mercer Human Resource Consulting, other key features of the current portability arrangements are:

- portability is not required for unfunded public sector funds, self managed superannuation funds, defined benefit interests where the member is still an employee of the contributing employer or benefits that are being paid as a pension (other than an allocated pension);
- where portability applies, on receiving a written request from the member, a trustee must transfer the amount (up to the withdrawal benefit) specified by the member to a fund nominated by the member. The transfer must be made as soon as practical but, in any case, within 90 days; and
- trustees can limit the number of transfers for a member in any 12 month period and can refuse transfer requests if the amount remaining in the member's account would become less than $5,000 (unless the whole balance is being withdrawn).[36]

7.49 The 2006–07 budget proposed two significant changes to the portability arrangements:

- reduce the maximum 90 days for funds to process transfer of benefits to 30 days; and
- introduce a standard portability form to be used by all superannuation funds.[37]

7.50 Treasury highlighted the principles underpinning the portability regime, stating that it 'allows employees to consolidate their superannuation benefits in one account, avoiding multiple sets of fees'.[38]

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34 Mercer Human Resource Consulting, *Working with choice and portability,* Mercer, Melbourne, viewed 24 April 2006. <http://www.mercerhr.com.au/referencecontent.jhtml?idContent=1185850>

35 Treasury, *Submission no. 47,* p. 24.

36 Mercer Human Resource Consulting, *Working with Choice and Portability,* Mercer, Melbourne, viewed 24 April 2006. <http://www.mercerhr.com.au/referencecontent.jhtml?idContent=1185850>

37 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006, p. 52.

38 The Treasury, *Submission no. 47,* p. 24.

7.51 The ABA commented on a consequential benefit of portability, suggesting that 'the reforms will likely encourage individuals to be more active with their superannuation savings'.[39]

Multiple superannuation accounts

7.52 A number of submissions raised concerns that too many young people have multiple superannuation accounts. The FPA, for example, argued:

> Environmental changes in recent years have seen a significant shift in the dynamic of the workforce with a growing number of part-time and casual employees. Young employees have also tended to shift employment more regularly. This has caused young Australians to often have multiple superannuation accounts and they are therefore paying multiple fees.[40]

7.53 Max Super highlighted the problems associated with having multiple accounts, asserting:

> It is broadly acknowledged that the incidence of individuals with multiple funds (higher for young people), is undesirable due to the eroding effect of multiple fees and the general disconnect that many small amounts instils in these members.[41]

7.54 Treasury submitted that the introduction of portability and choice arrangements assist those people with multiple superannuation accounts:

> Individuals who experience broken work patterns and those who change jobs on a regular basis will benefit from choice of fund. Instead of having superannuation contributions paid into a different fund each time they change jobs, these people can choose a fund that suits their needs and can ask each new employer to contribute to that fund.[42]
>
> …
>
> Together, choice and portability allow employees to consolidate their superannuation benefits in one account, avoiding multiple sets of fees and charges.[43]

39 ABA, *Submission no. 28,* p. 16.

40 FPA, *Submission no. 39,* p. 9.

41 max Super, *Submission no. 72,* p. 15.

42 The Treasury, *Submission no. 47,* p. 23.

43 The Treasury, *Submission no. 47,* p. 23.

7.55 This was also recognised by ASFA who stated that 'there are mechanisms which mean that we should not end up with multiple accounts around the place'.[44]

Lost superannuation accounts

7.56 Many people with multiple superannuation accounts lose track of their money. This is confirmed by the fact that the Lost Members Register (LMR), administered by the Australian Taxation Office (ATO), has 'over 5.4 million names on it'.[45] Furthermore, Tower Australia told the committee that 'there are nearly three superannuation accounts for every employed Australian'.[46]

7.57 Superannuation funds are required to register lost accounts with the ATO. Accounts are regarded as 'lost' if:

- 2 pieces of written communications have been returned to the super fund unclaimed; or
- the fund has not received a contribution or rollover from the member within the last two years; unless
- within the last two years of the member's membership the trustee of the fund has verified that the members address is correct and has no reason to believe that that address is incorrect.[47]

7.58 AAS outlined a number of concerns with this current definition:

> Given the long-term nature of superannuation the frequency with which people change jobs and that, under choice, contributions may be directed to a different fund, a two-year period of inactivity is far too short. By way of contrast, the period of inactivity for every-day, transactional bank accounts to be declared lost is generally six or seven years.
>
> By legislating such a relatively short period of time the number of members reported as lost, who in fact may be well aware of where their superannuation is located, is augmented. Accordingly, we submit that consideration should be given to increasing the inactivity period from two to a more realistic seven years.[48]

44 Ms P Smith, ASFA, *Transcript,* 28 July 2005, p. 4.
45 IFF, *Submission no. 68*, p. 2.
46 Tower Australia, *Submission no. 64,* p. 8.
47 Superannuation Industry (Supervision) Regulations, Reg. 1.03A.
48 AAS, *Submission no. 68,* p. 9.

7.59 Once registered with the ATO, names of people who have lost accounts are placed on the LMR, which individuals can securely search on the ATO's *SuperSeeker* website. If a person finds that they have lost accounts, they can then move to rollover the funds to their current superannuation account.

7.60 Superannuation funds also offer services to reunite members with their lost superannuation benefits, provided that members have authorised funds to utilise their tax file number. This was explained by ASFA, who stated:

> Many funds are using the Australian Taxation Office's [SuperMatch] facility. On entry to many funds these days, there is an automatic search by that fund, which is authorised as part of the standard sign up, to look for records of inactive accounts on the ATO's register.[49]

7.61 In the 2006–07 budget, the government proposed that the ATO become more involved in the process of locating lost members:

> To make finding, transferring and consolidating accounts simpler, the Australian Tax Office would take on a more active role in reuniting members with their lost superannuation and consolidating accounts. Importantly, the decision on whether and how to consolidate lost accounts would remain with the member but once that decision is made the ATO would organise consolidation. The process envisaged would be simple for a person:
>
> - The ATO would contact people with lost accounts and provide them with a simple standard form to complete.
> - If a person wished to consolidate these accounts, they could complete this form and the ATO would do the rest. The person would not need to deal with multiple funds with different processes and procedures.[50]

Difficulties associated with rolling over superannuation

7.62 While portability mechanisms are in place, some submissions reported that there are practical issues for individuals trying to rollover their superannuation. Max Super noted:

> Difficulties still exist with portability regulations. Some of the problems … include:

49 Mr R Clare, ASFA, *Transcript,* 28 July 2005, p. 8.

50 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

- Funds can have very different rollover form requirements, from a simple one page to an overbearingly complex eight;
- Funds have different identification requirements for establishing the authenticity of rollover requests;
- Trustees are allowed up to 90 days to action a rollover request, commencing once they have all the information they consider necessary (which can take multiple communications to establish);
- Some fund trustees have been suspected of using 'dirty tricks' as retention strategies, making it difficult to leave the outgoing fund;
- The inefficiencies and flow of paperwork to consolidate super can make it all too confusing and time consuming, with members often giving up.[51]

7.63 Further, the Australian Consumers Association (ACA) told the committee:

> There are numerous examples of consumers not knowing how to fill out the paperwork and the superannuation fund not telling them what is required … Rather than being told exactly what is required of them, they often have to, through trial and error, work out what has to be done. I know of examples where eight or nine times someone has tried to consolidate a particular fund.[52]

7.64 It does appear, however, that many of these concerns will be addressed by the portability measures proposed in the 2006 budget, which were outlined above—standardising forms and reducing the maximum transfer time.

7.65 In addition to the practical difficulties, AAS was also concerned that there are varying exit fees imposed on members:

> While most superannuation funds levy some kind of exit fee, generally of the order of $50– $100, to cover the costs of paying the benefit, in some funds the withdrawal fee is much more substantive and is in fact an early termination fee. The portability regulations do not override fees, so members who choose to exercise their right to transfer their benefit from such a fund would still be liable for this fee.[53]

51 max Super, *Submission no. 72,* p. 15.
52 Dr N Coates, ACA, *Transcript*, 18 October 2005, p. 44.
53 AAS, *Submission no. 67*, p. 8

Overcoming multiple fund and lost superannuation issues

7.66 Treasury noted that 'the government's position in relation to [multiple] accounts is that choice and portability are the most effective way for people to keep control of their superannuation.'[54] Adding to the strategy, if implemented, are the changes to portability outlined in the 2006 budget, combined with the proposal to have the ATO more involved in locating and consolidating lost superannuation.

7.67 However, some submissions suggested alternative ways in which multiple and lost account issues might be overcome. Dr Diana Olsberg from the Research Centre on Retirement and Ageing, University of New South Wales, for example, suggested the creation of a single central fund for casual and multiple job workers. In advocating this solution, Dr Olsberg discussed the operation of a single fund system in Finland:

> They have a central pension institute into which the money goes for casual employees. Only when an employee moves into longer-term employment do they then go into one of the separate decentralised funds. This has tremendous advantages. You do not have this multiplicity of funds—and largely, I think, a lot of these funds which young people have end up in the lost moneys register.[55]

7.68 This concept was raised with the IFF, which includes the Retail Employees Superannuation Trust (REST) and Hostplus—two of Australia's largest super funds for casual and multiple job employees. The IFF did not support the proposal for a single, centralised fund for casual employees, but instead proposed a central eligible rollover fund (ERF).

7.69 An ERF, according to ASFA's website, is:

> A superannuation fund or approved deposit fund which is eligible to receive benefits automatically rolled over from other funds. ERFs generally accept inactive small accounts and lost member account rollovers from other superannuation funds.[56]
>
> A centralised ERF with a specific mandate to undertake searching, matching and consolidation activities could ensure that proper scrutiny could be given to all lost superannuation monies once transferred to the ERF. This would need to be supported by a

54 Mr A Coles, Treasury, *Transcript,* 10 February 2006, p. 66.

55 Dr D Olsberg, Research Centre on Retirement and Ageing, University of New South Wales, *Transcript*, 28 July 2006, p. 19.

56 ASFA, *Eligible Rollover Fund,* ASFA, Sydney, viewed 24 April 2006. <http://www.superannuation.asn.au/dictionary/e/eligible%20rollover%20fund.htm>

> transfer policy for lost superannuation accounts so that funds who have failed to locate a member are required to transfer the account to the ERF so it can be included in searching, matching and consolidation activities.[57]

7.70 Another suggestion to overcome multiple fund issues was the introduction of a unique superannuation identifier, which could be issued to every person who holds a superannuation account. This would enable any lost superannuation benefits to easily be tracked back to the person's current superannuation account.

7.71 This concept was raised with the Investment and Financial Services Association (IFSA). IFSA agreed that an identifier would be a useful tool, but maintained that a sufficient system is already in place—the tax file number (TFN). IFSA argued that TFNs should be 'more open' so that they can be used 'more aggressively by the industry to protect people's money'.[58] Currently, a member must approve a superannuation fund to use their TFN for the purpose of searching the LMR.

7.72 Similarly, Tower Australia recommended 'the introduction of a specific individual superannuation guarantee number (SGN) or the use of the tax file number (TFN) to identify multiple accounts'.[59]

Conclusions

7.73 The committee believes that the superannuation choice regime is a positive measure, primarily because it allows and encourages under 40s to take more control over their superannuation. It does, however, appear that, based on the limited available evidence, the incidence of people changing funds post-choice is quite low. The committee found that it is not yet clear whether this indicates that people are simply making a conscious choice to stay with their current fund, or that they are ignoring the opportunity to choose.

7.74 It is, generally speaking, undesirable for a young person to have multiple superannuation accounts—fees and charges tend to erode small amounts and multiple accounts often lead to lost accounts. Therefore, the committee commends the current portability provisions, which allow people to consolidate multiple accounts. The committee also commends the changes to portability outlined in the 2006 budget—standardising the rollover form

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57 IFF, *Submission no. 68*, p. 5.

58 Mr R Gilbert, Investment and Financial Services Association (IFSA), *Transcript*, 28 July 2005, p. 35.

59 Tower Australia, *Submission no. 64*, p. 9.

and reducing the number of days in which funds can transfer benefits from 90 to 30. The current provisions, which will be vastly improved by the budget proposals, are particularly important for under 40s, as they are more likely to be in causal employment, and are therefore more likely to have multiple super accounts.

7.75 While choice and portability should reduce the number of multiple accounts, the concern remains that, when taking on multiple jobs, many under 40s will simply adopt the default fund of each employer, rather than choosing one fund for all their contributions. To reduce this occurrence, the committee heard that there should be a single default fund for casual, multiple job employees. The committee considers this concept viable, provided that employees are offered choice of fund first. If they do not wish to choose their fund then the committee believes that it would be appropriate for the employer to put the employee into a government-determined default fund.

7.76 In taking this approach, the committee believes that the principles of the choice regime can be upheld, but also that the issues of multiple accounts can be addressed. This initiative would ensure that those people with multiple casual jobs, who do not wish to choose their fund, do not end up with multiple superannuation accounts and the associated issues—lost accounts and benefits being depleted by fees.

7.77 While the above initiative would reduce the occurrence of multiple accounts in the future, it will not reduce the number of multiple accounts that already exist, nor will it completely stop the occurrence of new multiple accounts. The committee believes that choice and improved portability (by the 2006 budget proposals) are the most effective ways to address these issues. The recommendations in Chapter 5 of this report address the issue of financial literacy, which is vitally important to the consolidation of multiple accounts. Individuals who are financially literate are more likely to understand the detriments of multiple accounts, and therefore are more likely to seek consolidation.

7.78 The committee believes that people will also be encouraged to consolidate their super if the process of 'rolling over' is simplified, as was proposed in the 2006 budget. In the evidence gathered on the current portability arrangements, the committee was concerned that several submissions reported that portability can be an onerous and difficult task. The committee considers that portability will be simplified if the government's budget proposals are implemented. It is particularly pleased that the government plans to introduce a standardised rollover form, as well as reducing the transfer period from 90 to 30 days.

7.79 The committee also considered the consequential issue resulting from excessive multiple accounts—lost superannuation. The committee deliberated on two issues in relation to lost accounts: the definition of 'lost' and how best to consolidate lost accounts.

7.80 The definition of a lost member only allows for a two-year period of inactivity on a person's account; or that two pieces of mail have been returned to the super fund unclaimed. A fund is required to report a member as lost if they meet either of these criteria, unless the fund has received confirmation from the member within the last two years that the listed address is current.

7.81 The committee believes that the current definition of a lost member is inadequate. For example, a person may take four years away from work to care for a family. Even if this person has been receiving the mail that their fund is sending them, they are still determined to be lost after two years inactivity, unless their fund has written to confirm their details. A better approach, in the committee's view, would be to alter the definition of a lost member in two ways. Firstly, increase the inactivity period beyond two years; and secondly, legislate that funds *must* attempt to confirm a member's details before a member can be declared lost. This would ensure that only truly inactive accounts are determined as lost.

7.82 The committee supports the government's plans to have the ATO involved in finding and consolidating lost accounts. The committee believes that this would be an excellent measure to reduce the number of lost accounts, particularly in combination with the proposed improvements to portability.

7.83 Prior to the budget, the committee heard that a centralised eligible rollover fund would assist in reducing the amount of lost superannuation. The proposal was that all 'lost' monies be forwarded to a central fund, which is mandated to find and consolidate this money. The committee believes that this concept will be unnecessary if the government's proposal to involve the ATO in locating and consolidating lost accounts is implemented.

7.84 The committee also believes that the concept of a unique superannuation identifier is unnecessary provided that the ATO is involved in the location and consolidation of lost accounts. This is because the ATO can use tax file numbers to locate members, and therefore another unique number is not required.

Recommendation 11

7.85 **The committee recommends that government introduce a default superannuation fund for casual employees, so that when a casual employee does not wish to choose their superannuation fund, that employee is automatically placed in a government-determined default fund.**

Recommendation 12

7.86 **The committee recommends that the government extend the definition of a 'lost member' to allow for longer than two years inactivity. In addition, the committee recommends that before a member can be defined as lost, a superannuation fund must also have written to the member's listed address seeking confirmation of their details.**

Death and TPD insurance

7.87 For many, an important aspect of holding an account with a superannuation fund is the death and total or permanent disability (TPD) cover that is included. Most funds offer this type of insurance, with the premiums deducted from a person's account balance on a pre-arranged basis—often weekly. For people under 40, the death and TPD cover offered by super funds is particularly important, given that most people in this cohort would not consider taking out separate insurance. Rice Walker Actuaries told the committee that 'only around 10% of the population in the 20–50 age group have death cover outside their superannuation funds'.[60]

7.88 A number of submissions to the inquiry commented on the importance of death and TPD insurance as a part of superannuation accounts. For example, ASFA stated:

> If you look at the very small accounts, often the most valuable thing they have is in fact the death cover, which is bought at a fairly low cost because of the economies of scale that the fund has attached to it.

60 Rice Walker Actuaries, *Submission no. 64*, p. 15.

> …
>
> We have looked at a range of case studies where someone with automatic cover—which the family did not know about—has died. The account might have been $2,000 but they had death cover of $50,000 or whatever. It can be a significant thing.[61]

7.89 Dr Diana Olsberg agreed that death and TPD cover is important, but she was concerned that most young people would not even be aware that their superannuation contains an insurance component.[62] Dr Olsberg also raised concerns about insurance in the context of the recent choice of fund legislation, stating:

> There will be a lot of marketing of a no-frills type of fund which does not offer death and disability insurance. It is very important for the government to try to regulate this and ensure that all funds offer this death and disability insurance.[63]

7.90 Other groups raised concerns about the level of death and TPD insurance that is offered with superannuation accounts, as well as Australians' level of life insurance more generally. Rice Walker Actuaries, for example, stated:

> Evidence strongly suggests that the current average levels of Death and TPD insurance cover are grossly inadequate to cover the economic loss caused by death or disablement.
>
> …
>
> A full-time worker with young children on average earnings of approximately $50,000 per annum should have life insurance of between $500,000 and $650,000. However, the average amount insured for this group is estimated to be only in the order of $70,000 for those with superannuation cover, or $400,000 for those with both superannuation and non-superannuation cover.
>
> …
>
> For those with average levels of superannuation death cover only, the level of cover held represents less than 20% of the average needs.[64]

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61 Mr R Clare, ASFA, *Transcript*, 28 July 2005, p. 8.

62 Dr D Olsberg, Research Centre on Ageing and Retirement, *Transcript*, 28 July 2005, p. 21.

63 Dr D Olsberg, Research Centre on Ageing and Retirement, *Transcript,* 28 July 2005, p. 20.

64 Rice Walker Actuaries, *Submission no. 64*, p. 15.

7.91 Perpetual Trustees Australia raised this issue, with particular reference to the minimum level insurance required of an employer's default fund under the super choice legislation:

> In Australia we do have a massive underinsurance problem. Ultimately … the level of minimum cover is totally inadequate within the super choice legislation. Through that lack of cover … ultimately it is the government that will wind up funding people's lack of attention to insurance through increased social security payments.[65]

7.92 The minimum insurance for employer default funds under the Super Choice legislation is either:

- A premium of at least 50c per week; or
- At least the level of insurance cover shown below in Table 7.2.[66]

Table 7.2 Minimum death insurance cover

Age	Death Cover
20–34	$50 000
35–39	$35 000
40–44	$20 000
45–49	$14 000
50–55	$7 000

Source *Australian Government, Insurance, viewed 24 April 2006, <http://www.superchoice.gov.au/employers/employer_fund/insurance.asp>.*

Conclusions

7.93 The committee acknowledges that death and TPD insurance is an important component of an under 40s' superannuation account. Without this insurance, evidence suggests that most under 40s would have no other life insurance.

7.94 The committee is pleased that death and TPD insurance is generally offered on an opt-out basis, meaning that young people must make a conscious effort not to take out insurance. The committee is also pleased that the Super Choice legislation requires that employer default funds have a minimum level of insurance. However, given that many employees can now choose their superannuation fund, the committee is concerned

65 Mr S Davis, Perpetual Trustees Australia, *Transcript,* 18 October 2005, p. 27.

66 Australian Government, *Super Choice – Insurance,* viewed 24 April 2006. <http://www.superchoice.gov.au/employers/employer_fund/insurance.asp>

that some funds do not offer insurance. The committee therefore considers that all superannuation funds should be required to offer, at very least, a minimum level of death and TPD insurance.

7.95 The committee is also disturbed by the evidence that most Australians are hugely underinsured. To lessen this problem, the committee considers that the minimum level of insurance offered by super funds could be raised.

Recommendation 13

7.96 **The committee recommends that all superannuation funds, not just employer default funds, be required to offer a minimum level of death and total or permanent disability insurance, on an opt-out basis. In determining the minimum insurance level, the committee recommends that the government raise the level above what is currently required of employer default funds, to a level more in line with expected needs.**

Tax deduction/rebate on voluntary contributions

7.97 A number of initiatives were suggested to the committee to entice people under the age of 40 to place voluntary savings in superannuation. AAS proposed an initiative to encourage people under 40 to make voluntary superannuation savings without depleting the monies in the fund. The scheme was based on an age-based tax deduction, or tax rebate, for people making voluntary contributions, starting at age 18 and phasing out at age 40.

7.98 The scheme was argued to have a number of advantages:

> Firstly, as preservation acts as a considerable disincentive to making superannuation contributions, especially for those under 40, a deduction or rebate may prove a more effective incentive than a co-contribution. Being returned at year-end as part of the tax return and assessment process (as opposed to being contributed to a superannuation fund as a co-contribution) may prove to be of particular assistance to younger persons and to those with little disposable income.[67]

67 AAS, *Submission no. 17*, p. 6.

7.99 The proposed scheme was discussed with both Treasury and CPA Australia. Treasury noted:

> It is an interesting proposal; it would cost money and would impose a range of complexity issues for both the ATO and for industry.[68]

7.100 CPA Australia commented that they 'would like to see any tax cuts relating to super actually going into super'.[69]

7.101 The ABA also discussed a tax deduction for voluntary contributions, but in a more general sense:

> [The] ABA believes that tax deductions on personal contributions would likely provide an incentive for employees to make additional voluntary contributions, particularly medium income earners.
>
> …
>
> Given that not all employers offer salary sacrifice, a tax deduction for additional voluntary standard employee contributions would apply more equitably across various income levels.[70]

Conclusions

7.102 The committee was interested in the concept of an age-based tax deduction/rebate for voluntary contributions, because it would provide significant incentive for under 40s to contribute to their superannuation. However, the committee found that any deduction or rebate would be undesirable for two primary reasons:

- the cost to government would be large; and
- such a large expenditure would be better spent adding to young peoples' super balances—just as the co-contribution does.

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68 Mr A Coles, Treasury, *Transcript*, 10 February 2006.

69 Ms N Kelleher, CPA Australia, *Transcript*, 10 February 2006, p. 26.

70 ABA, *Submission no .28*, p. 11.

Default scheme for voluntary contributions

7.103 This concept would automatically commit employees to make voluntary contributions to their superannuation, with an option to opt-out at any time. This concept is discussed in detail in Chapter 3, *Superannuation savings environment.*

Early access to superannuation savings

7.104 A number of submissions suggested that allowing early access to superannuation savings for, among other things, a housing deposit, would provide an incentive for under 40s to voluntarily contribute to their super. These proposals are discussed in detail in Chapter 3, *Superannuation savings environment.*

The Hon Bruce Baird MP
Chairman
25 May 2006

A

Appendix A—Submissions

No.	Provided by
1	Ms Melinda Finch
2	McCrindle Research
3	The Hon David Hawker MP
4	Mr John Dimeski
5	Mr John C Dewan
6	Ms Caroline Cavanagh
7	Mr Brett Arandall
8	Senator Gary Humphries
9	Real Estate Institute of Australia
10	Mr Leo Bator, ComSuper
11	Trustee Corporations Association of Australia
12	Women's Economic Policy Analysis Unit, Curtin University of Technology
13	National Information Centre on Retirement Investments
14	Office of Small Business, Department of Industry Tourism and Resources
15	Australian Industry Group
16	The Association of Superannuation Funds of Australia

17	Australian Administration Services
18	CPA Australia
19	The Hon Jackie Kelly MP
20	Small Independent Superannuation Funds Association
21	Mr Stephen Woods
22	Industry Funds Forum
23	The Institute of Chartered Accountants in Australia
24	Mr Warren McKeown, RMIT University
25	Taxpayers Australia
26	Tower Australia
27	Transport Workers' Union of Australia
28	Australian Bankers' Association
29	Australian Council of Trade Unions
30	Dr Diana Olsberg, Research Centre for Ageing and Retirement, University of New South Wales
31	Senator John Watson
32	Ms Lois Carey
33	Senator Judith Adams
34	Australian Consumers’ Association
35	Government Employees Superannuation Board of Western Australia
36	Mr Howard Hinde
37	The Hon Mike Rann MP
38	Department of Family and Community Services
39	Financial Planning Association of Australia
40	Australian Securities and Investments Commission
41	Australian Chamber of Commerce and Industry
42	Mr Peter Goddard
43	Department of Health and Ageing
44	Mercer Human Resource Consulting

45	Mr Bill Adams
46	Guided Decisions
47	The Treasury
48	AMP Financial Services
49	Institute of Securities, Finance and Banking
50	Tower Australia (supplementary)
51	Institute of Securities, Finance and Banking (supplementary)
52	Mr Anthony Zeitoun
53	Real Estate Institute of Australia (supplementary)
54	Mr Peter Mair
55	The Investor's Club
56	Mr Stephen Woods (supplementary)
57	Mr Christopher Moore
58	The Treasury (supplementary)
59	Senator John Watson (supplementary)
60	Dr David Thorp
61	Confidential
62	Mr Christopher Moore (supplementary)
63	Financial Planning Association of Australia (supplementary)
64	Rice Walker Actuaries
65	Tower Australia (supplementary)
66	Mr Anthony Zeitoun (supplementary)
67	Australian Administration Services (supplementary)
68	Industry Funds Forum (supplementary)
69	Mr Christopher Moore (supplementary)
70	Australian Council of Trade Unions (supplementary)
71	Office of Small Business, Department of Industry Tourism and Resources (supplementary)
72	max Super

73	Office for Women, Department of Families, Community Services and Indigenous Affairs (supplementary)
74	Financial Services Institute of Australasia - formerly Institute of Securities, Finance and Banking (supplementary)
75	The Treasury (supplementary)
76	Real Estate Institute of Australia (supplementary)

B

Appendix B—Exhibits

No.	Description
1	Mr J Hewison, *The Economic Impact of Australia's Ageing Population; The Adequacy of Australia's Retirement Savings Provisions,* November 2004.
2	Women's Economic Policy Analysis Unit, *Adjusting the Focus: Perceptions on Life; Work and Saving for Retirement,* May 2005, (Related to submission no. 12).
3	Investment and Financial Services Association Ltd, *Government Co-contribution to Superannuation Market Research,* May 2004, (Related to submission no. 31).
4	Australian Chamber of Commerce and Industry, 'Retirement Incomes & Superannuation Taxation', *Taxation Reform Blueprint: A Strategy for the Australian Taxation System 2004–2014,* November 2004, (Related to submission no. 41).
5	Dr D Thorp, *Simple and Flexible Super for Aspirational Consumers and Employees,* September 2005, (Related to submission no. 60).
6	Committee for Economic Development of Australia, *Future Directions in Australian Social Policy: New Ways of Preventing Risk,* December 2001, (Related to submission no. 9).
7	Mr Peter Mair, 'How to Buy a Mansion with Your Super and Win', *Eureka Report,* 28 October 2005, (Related to submission no. 54).
8	Trustee Corporations Association of Australia, *Typical Annual Statement of Superannuation Fund Member,* (Related to submission no. 11).

9 Perpetual Trustees Australia Ltd, *Superannuation Comparisons,* November 2005.

10 Mr G Dunsford & Mr M Rice, *Retirement Incomes Integration Superannuation, Social Security and Taxation,* February 2004, (Related to submission no. 64).

11 Retirement Income Modelling Task Force, *Aggregate Analyses of Policies for Accessing Superannuation Accumulations,* (Related to submission no. 47).

12 Industrial Development Australia Pty Ltd, *Proposal to Establish a 'Housing Unit Trust' Allowing Residential Property Purchases to Utilise Accumulated Superannuation in Acquiring Realty,* 14 October 2005.

13 Investment and Financial Services Association (IFSA), *Retirement Incomes and Long Term Savings Policy Options,* 2006.

14 Office for Women, Department of Families, Community Services and Indigenous Affairs, *Report on Focus Group Findings – Financial Literacy Among Marginalised Women* (Related to submission no. 73).

15 Rice Walker Actuaries, *The Retirement Savings Gap – Two Years On.*

16 Real Estate Institute of Australia, *KiwiSaver Bill* (Related to submission no. 76).

C

Appendix C—Hearings and witnesses

Thursday, 28 July 2005—Sydney

Individuals

Mr John Dimeski

Ms Melinda Finch

Institute of Chartered Accountants in Australia

Mr Hugh Elvy, Manager, Financial Planning and Superannuation

Mr Bill Palmer, General Manager, Standards and Public Affairs

Investment and Financial Services Association

Mr Richard Gilbert, Chief Executive Officer

Mr Bill Stanhope, Senior Policy Manager

Research Centre for Ageing and Retirement, University of NSW

Dr Diana Olsberg, Director

Small Independent Superannuation Funds Association Ltd

Mr Graeme McDougall, Chief Executive Officer

Mr John McIlroy, Deputy Chairman

The Association of Superannuation Funds of Australia

Ms Philippa Smith, Chief Executive Officer

Mr Ross Clare, Principal Researcher

Friday, 14 October 2005—Canberra

Australian Bankers' Association

Mr David Bell, Chief Executive Officer

Ms Diane Tate, Director, Corporate and Consumer Policy

Australian Chamber of Commerce and Industry

Mr Michael Potter, Director, Economics and Taxation

Australian Securities and Investments Commission

Mr Miles Larbey, Senior Policy and Education Officer, Consumer Protection Directorate

Ms Clare Marlin, Senior Research Analyst, Consumer Protection Directorate

The Treasury

Mr John Lonsdale, General Manager, Superannuation Retirement and Savings Division

Mr Antony Coles, Manager, Superannuation Retirement and Savings Division

Ms Erica Lejins, Senior Advisor, Superannuation Retirement and Savings Division

Mr Phil Gallagher, Manager, Retirement Income Modelling

Mr David Love, Manager, Corporations & Financial Services Division

Mr John Riley, Senior Advisor, Financial Literacy Foundation

Real Estate Institute of Australia

Mr Bryan Stevens, Chief Executive Officer

Mr Mathew Munro, Policy Manager

Tuesday, 18 October 2005—Sydney

Individuals

Mr Stephen Woods

Australian Consumers' Association

Dr Nicholas Coates, Senior Policy Officer

Financial Planning Association of Australia

Mr John Anning, Manager, Policy and Government Relations

Mr Peter Bobbin, Member of Taxation Committee

Ms Anne-Marie Esler, Member of Superannuation Committee

Institute of Securities, Finance and Banking

Mr Brian Salter, Chief Executive Officer, National Office

Ms Kristen Foster, Senior Manager, Policy and Public Affairs

McCrindle Research

Mr Mark McCrindle, Social Researcher

Tower Australia Ltd

Mr Grahame Evans, Chief Executive Officer

Ms Carly O'Keefe, Manager, Sales Marketing—Superannuation

Mr David Glen, Tax Counsel

Trustee Corporations Association of Australia

Mr Ross Ellis, Executive Director

Mr Benjamin Heap, Member; and Chief Executive Officer, Asset Management, Australian Wealth Management

Mr Peter Burgess, Member; and Technical Superannuation Sales Manager, Australian Executor Trustees Ltd

Mr Stephen Davis, Member; and Head of Dealer Services, Private Clients Division, Perpetual Trustees Australia

Friday, 3 February 2006—Melbourne

Australian Administration Services

Ms Fiona Galbraith, Senior Legal & Compliance Manager

Australian Council of Trade Unions

Mr Nixon Apple, Industry and Investment Policy Advisor

Ms Catharine Bowtell, Industrial Officer

Guided Decisions

Mr Daniel Shuttleworth, Principal

Mr Anthony Stewart, Principal

Industry Funds Forum

Ms Helen Hewett, Executive Officer

Mr Neil Cochrane, Member; and Chief Executive Officer, Retail Employees Superannuation Trust

Mr David Elia, Member; and Chief Executive Officer, HOSTPLUS

Mercer Human Resource Consulting

Mr David Knox, Principal

School of Economics, Finance and Marketing, RMIT University

Mr Warren McKeown, Senior Lecturer, Financial Planning

Taxpayers Australia

Mr Michael Perry, Superannuation Specialist

Friday, 10 February 2006—Canberra

Individuals

Mr Anthony Zeitoun

Mr Noel Whittaker

Australian Industry Group

Dr Peter Burn, Associate Director—Public Policy

CPA Australia

Mr Michael Davison, Superannuation Policy Advisor

Ms Noelle Kelleher, Member, Financial Advisory Services Centre of Excellence

Department of Families, Community Services and Indigenous Affairs

Mr Roger Barson, Acting Group Manager, Social Policy

Ms Lee Emerson, Branch Manager, Office for Women

Ms Kerry Flanagan, Group Manager, Women and Youth

Dr Nick Hartland, Branch Manager, Seniors and Means Test

Mr Mark Warburton, Branch Manager, Financial Well-Being Taskforce

Office of Small Business, Department of Industry, Tourism and Resources

Mr Peter Chesworth, Head of Division (AIG)

Mr Anthony Greenwell, General Manager, Policy

Ms Margaret Lee, Manager, Tax and Workplace Relations

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Mr Antony Coles, Manager, Superannuation Retirement and Savings Division

Ms Erica Lejins, Senior Advisor Superannuation, Retirement and Savings Division

Mr Phil Gallagher, Manager, Retirement Income Modelling

Mr David Love, Manager Corporations & Financials Services Division

Mr John Riley, Senior Advisor, Financial Literacy Foundation

D

Appendix D—Glossary of terms

Age Pension	A means tested government payment to individuals and couples over the age of 65 (men) and 63 (women, increasing to 65 over time). It ensures a minimum level of income in retirement.
Annuities	A series of payments purchased with a lump sum, usually from a life insurance company.
Assessable income	Gross income including salary and wages, dividends, interest and rent before any deductions are allowed. Assessable income also includes net capital gains, ETP and other amounts that are not ordinarily classed as income.
ATO	Australian Taxation Office
Australian Prudential Regulation Authority (APRA)	One of the Federal Government agencies which regulates superannuation funds and other bodies in the financial sector, ensuring they operate within the requirements of retirement income legislation.
Australian Securities and Investment Commission (ASIC)	ASIC is the Australian Government organisation which collects information on public and private companies and other corporate bodies registered under the Corporations Law in Australia.
Beneficiary	A person entitled to, or in receipt of, a benefit under a fund, which is normally the member and/or his/her financial dependants.

Benefit	The amount of a member's entitlement in the fund to which the estate and/or dependants are entitled.
Co-contribution	The government makes a co-contribution of $1.50 to an eligible person's superannuation account for each $1.00 of undeducted contributions the person makes. An eligible person is someone who is less than 71 years old, has an income of less than $58 000 of which 10 per cent or more is attributable to eligible employment. The maximum co-contribution of $1500 is payable to someone with an income of $28 000 or less who has made a personal contribution of at least $1000. The maximum co-contribution phases down at the rate of five cents for each dollar of income over $28 000.
Commute	Converting all or part of a pension into a lump sum.
Complying superannuation funds	A superannuation fund that has elected to be regulated under the *Superannuation Industry (Supervision) Act 1993*.
Deductible amount	The part of the members pension received which represents a return of a portion of the undeducted purchase price. This is deducted from their taxable pension income. This tax-free part is called the deductible amount.
Eligible termination payment (ETP)	An ETP is a lump sum superannuation benefit or similar payment made to a person because they, or another person, were a member of a superannuation fund, Approved Deposit Fund (ADF) or a depositor with a Retirement Savings Account (RSA). ETPs also include payments made to an employee in consequence of termination of employment. ETPs can be rolled over into another superannuation fund, ADF or RSA.
Employee	A person who receives salary or wages.
Employer	A person (or group) who pays people salary or wages.
Exempt income	Income that is not assessable, that is, it is not taxed.
Income	The amount of money earned from personal exertion and investments.

Lost Members Register (LMR)	The LMR is a central register of lost superannuation fund members and RSA holders administered by the ATO.
Lump sum	A capital amount payable as a single lump sum amount or by instalments, for example, an ETP. This can be contrasted with a pension or annuity which is a series of payments that are in the nature of income rather than capital.
Median Earnings	The level of earnings that has an equal number of employees earning above it as below it. Currently approximately $40 000 per annum.
Pension	A series of regular payments made as an income stream which, for example, may be provided by a superannuation fund or RSA (excludes "age pension").
Preserved benefits	Generally, preserved benefits must be retained in a superannuation fund, ADF or RSA until the member has met a condition of release under the *Superannuation Industry (Supervision) Act 1993*. A condition of release is satisfied when a member has reached at least age 55 and retired from all employment prior to age 65. At age 65 there is no restriction on the payment of the benefit. If a member has not attained their preservation age and permanently retired, the benefit can be paid where it is as a result of the members death, disablement, severe financial hardship or because of compassionate reasons.
Privacy Act	An Act of Parliament which among other things protects Tax File Numbers against misuse.
Reasonable Benefit Limits (RBLs)	RBLs are the maximum amount of retirement and termination of employment benefits that individuals can receive over their lifetime at concessional (reduced) tax rates. Benefits greater than a persons RBL limit are taxed at the highest personal income tax rate. There are two types of RBLs—a lump sum RBL and a pension RBL.
Retirement Savings Accounts (RSAs)	An RSA is an account that provides low cost and low risk savings. It is offered by banks, building societies, credit unions, life insurance companies and prescribed financial institutions (RSA providers). It is used for retirement savings.

Rollover	A rollover is the transfer of all or part of an ETP into a complying superannuation fund, complying ADF, RSA or towards purchase of an annuity from a life insurance company or registered organisation.
Self managed superannuation funds (SMSFs)	A self managed superannuation fund (SMSF) is a complying superannuation fund under the *Superannuation Industry (Supervision) Act 1993* which has: ▪ fewer than five members; ▪ each individual trustee of the fund is a fund member; ▪ each member of the fund is a trustee; and ▪ no member of the fund is an employee of another member of a fund, unless those members are related. If the trustee of the fund is a body corporate each director of the body corporate is a member of the fund.
Superannuation	A system where money is placed in a fund to provide for a persons retirement.
Superannuation fund	A fund which invests members funds to provide for their retirement.
Superannuation Guarantee (SG)	A prescribed minimum level of superannuation required under the *Superannuation Guarantee (Administration) Act 1992* that an employer must contribute for employees. The employer can avoid paying the Superannuation Guarantee Charge if sufficient superannuation contributions are made to a complying superannuation fund or RSA.
Superannuation Guarantee Charge (SGC)	A charge imposed under the *Superannuation Guarantee Charge Act 1992* on employers who do not meet the minimum superannuation guarantee requirements on behalf of employees.
Superannuation Holding Accounts Reserve (SHAR)	A reserve administered by the ATO whereby employers may make superannuation contributions for their employees in instances where the employer is unable to locate a superannuation fund account or RSA for the employee.

Superannuation Industry (Supervision) Act 1993	The legislation providing prudential standards for superannuation funds. The legislation is administered by three regulators, the ATO, ASIC and APRA. The ATO is responsible solely for the administration of SMSFs.
Superannuation plan (the)	In this report refers to the The Treasury's *A Plan to Simplify and Streamline Superannuation*. On 10 May 2006 the government announced a significant number of measures impacting on superannuation and retirement incomes generally. These are summarised in Appendix E.
Superannuation surcharge	A surcharge (tax) of up to 15% imposed on certain superannuation contributions, specified rollover amounts, and termination payments (now repealed).
Spending replacement rate	The ratio of an individuals income or spending power after retirement to that before retirement.
Tax File Number (TFN)	A unique number issued by the ATO to individuals and organisations to increase the efficiency administering tax and other Commonwealth Government systems such as Income Support payments.
Tax offset	An entitlement which reduces the amount of income tax to be paid.
Undeducted contributions	Contributions for which a person has not claimed a tax deduction. Commonly known as after-tax contributions, personal contributions and member contributions. These are not assessable income when returned to the member.
Undeducted purchase price	The amount a member contributes towards the purchase price of a pension for which they did not claim a tax deduction (for example, undeducted contributions).

E

Appendix E—A plan to simplify and streamline superannuation

On 10 May 2006 the Treasurer announced a significant number of proposed changes to the superannuation and retirement income systems generally. These are detailed in *A Plan to Simplify and Streamline Superannuation.*[1] A summary of these proposals is outlined below.

From 1 July 2007:

- superannuation benefits paid from a taxed fund either as a lump sum or as an income stream, such as a pension, would be tax free for people aged 60 and over
  - ⇒ people would still be able to access superannuation benefits before the age of 60, although they would continue to be taxed on their benefits under new simplified rules
- benefits paid from an untaxed scheme (mainly affecting public servants) would still be taxed, although at a lower rate than they are now for people aged 60 and over
- reasonable benefit limits would be abolished
- individuals would have greater flexibility as to how and when to draw down their superannuation in retirement. There would be no forced payment of superannuation benefits

1 The Treasury, *A Plan to Simplify and Streamline Superannuation*, Canberra, May 2006.

- the concessional tax treatment of superannuation contributions and earnings would remain. Age-based restrictions limiting tax deductible superannuation contributions would be replaced with a streamlined set of rules
  - ⇒ contributions up to an annual limit of $50 000 per annum per person would be taxed at a concessional rate of 15 per cent. Contributions above this limit would be taxed at the top marginal tax rate
  - ⇒ undeducted contributions would be limited to $150 000 each year. Amounts above this limit would be returned to the individual. Earnings on the excess would be effectively taxed at the top marginal tax rate
- the self-employed would be able to claim a full deduction for their superannuation contributions as well as being eligible for the Government co-contribution for their after-tax contributions
- the ability to make deductible superannuation contributions would be extended up to age 75.

To increase further the incentives to save for retirement, it is proposed from 20 September 2007 to halve the pension assets test taper rate to $1.50 per fortnight for every $1000 of assets above the assets test free area.