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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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Membership of the Committee

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.