SUBMISSION 26

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From: Carly.Okeefe@au.towerlimited.com
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To: Committee, EFPA (REPS)
Subject: Submission to the Economics Committee in relation to saving for under 40s

Please find attached our submission to the Economics Committee in relation to the inquiry into saving for under 40s.

We bring to your attention our unique solution of encouraging additional contributions to superannuation.

Should the Committee need to talk about this in more length, either Grahame Evans or myself would be happy to provide more information.

Regards

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SUBMISSION 26

TOWER

Submission to the Standing Committee on Economics, Finance and Public Administration

Inquiry into improving the superannuation savings of people under 40

22 July 2005

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1. Executive Summary

Superannuation is one investment which a large proportion of individuals under 40 have. Rather than having a sense of ownership many individuals display little or no interest in their superannuation and do not adequately plan for their retirement. In addition they often feel that it is too early to start saving towards their retirement.

There are many barriers in the superannuation system that act as disincentives to contributing to superannuation, such as:

- Lack of awareness
- Competing priorities to saving and expenditure
- Complexity and instability of superannuation rules and regulation
- Preservation of superannuation benefits
- Reasonable Benefit Limits; and
- Superannuation Surcharge.

In order to promote superannuation and to encourage individuals under 40 to start to make additional contributions to superannuation we have proposed the following:

- Increasing financial literacy by educating the community on the need to save early for retirement
- Introduce a mortgage relief scheme for individuals who make additional contributions to superannuation
- Simplifying the superannuation system
- Explore the option of a medium term savings vehicle
- Provide access to 20% of superannuation savings above the superannuation guarantee for home deposits, purchase of car, travel etc
- Abolish the Reasonable Benefit Limits system
- Remove the nexus between deriving employment income and being eligible for the co-contribution
- Increase the amount of thresholds and maximum rebate for the spouse contribution rebate

Whilst it is recognised that some of these initiations negatively impact the budget we believe there are many compensating financial and social benefits.

We commend this report for your consideration.

2. Introduction

We have pleasure in making a submission to the Standing Committee on Economics, Finance and Public Administration in regards to the "Inquiry into improving the superannuation savings of people under 40".

This submission is offered on behalf of TOWER Australia Limited, a financial services company which provides personal life insurance, superannuation and retirement solutions to the Australian community.

TOWER Australia is part of the Trans-Tasman financial services organisation, TOWER Limited. TOWER has been operating in Australia for many years providing life insurance and superannuation for both individual and groups. It also provides investment opportunities and presently has more than $3 billion in Funds under Management.

TOWER Australia Investments is headed by CEO, Mr Grahame Evans. It comprises the funds management and investment arm supported by the Beacon platform and the Pivotal Financial Services group of financial advisers. TOWER Australia Investments therefore has knowledge and experience of the full investment cycle.

2.1 Objective

This submission aims to describe the current superannuation environment that exists for individuals who are under the age of 40. In particular it specifically examines:

- barriers and/or disincentives to contribute to superannuation
- current incentives in place to encourage voluntary superannuation contributions
- ways of improving the awareness of the importance of saving early for retirement.

3. Barriers and/or disincentives to contribute to superannuation

The structure of the Australian superannuation system is extremely complex and brings with it some real and significant barriers to saving for one's retirement. The main barriers to voluntarily contributing to superannuation are:

- Lack of Awareness
- Competing priorities to saving and expenditure
- Complexity and instability of superannuation
- Preservation of superannuation benefits
- Reasonable Benefit Limits; and
- Superannuation Surcharge.

These barriers need to be examined and where possible, solutions need to be formulated to promote superannuation and to raise awareness of the need to plan early for retirement.

3.1 Lack of Awareness

In writing this submission we decided to ask some individuals aged under 40 for their thoughts in relation to superannuation and its use for retirement. The responses were as expected with most not knowing much about superannuation. The main responses that we received were:

- I don't know much about it
- I don't know how much I'm allowed to put in
- I don't know if it's a good investment
- I'm not interested in saving at this stage of my life
- I don't need to start to think about saving yet
- I prefer my bank account as it is simple and I understand it
- I'm not interested in super as I can't access it
- I don't think about super much as it is taken care of by my company
- I haven't thought about retirement
- I don't have enough money to contribute to super as I have mortgage and a family
- Are there any incentives
- I would do the co-contribution if I had enough money
- It changes too much and I don't what changes could happen in 10 years time
- I invest in property instead as it is tangible and I can access the money if I need to

- Super does not grow as quickly as property
- You need to wait too long to get your money and you may not be around at 65
- I love super and come from a family that is educated on the value of super
- I have been thinking about salary sacrifice but haven't done it yet – maybe I'll do it in a couple of years as I have other commitments

What is frightening is that all of these people are in the financial services industry.

3.2 Competing Priorities to Saving and Expenditure

In looking at the responses above, it also becomes very apparent that individuals have competing priorities to saving for retirement. Many individuals in this stage of their life are looking to start a family and buy a home. This all requires money and often results in little or no money being contributed to superannuation other than mandated contributions. In addition when students leave university they often are burdened with a Higher Education Contribution Scheme (HECS) debt which can run up to $30,000.

In attempting to increase the amount of additional contributions that under 40s contribute to superannuation a "carrot and/or stick approach" can be taken. To encourage individuals to emotionally own their superannuation a "carrot approach" would be more favourable.

In order to encourage additional contributions into superannuation we propose the introduction of a mortgage interest relief scheme. This would be very attractive for individuals under 40 as they are often heavily financially committed and therefore some form of tax-mortgage benefit would provide the best opportunity to encourage saving.

The scheme 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. For people under 40, meeting the mortgage and other living costs, is a priority ahead of saving for a retirement which may be over 25 years away.

The scheme need not cost the Government a significant amount in tax revenue given that increased super savings generates added contribution tax income and superannuation investment earnings income. Additionally, the long-term benefit to the Government of having a significantly larger part of the population as self-funded retirees would be great.

Obviously, the community is in desperate need of education in relation to superannuation and the need to save early. The Financial Literacy Foundation would be well placed to drive that education campaign in the community and in schools.

One important point to note is that the education needs to be relevant, engaging and pitched at the right audience and constant. Not a "one off" campaign.

3.3 Complexity and Instability of the System

It is well established that the Australian superannuation system is extremely complex. So complex that many Australians would have trouble understanding it. Is this a desirable outcome considering that most of the community have superannuation as their retirement vehicle?

If we wish to encourage individuals to contribute to their superannuation and to take an active role in saving for their retirement, it is essential that individuals firstly understand how superannuation works and take ownership. This can only be achieved if the superannuation system is simplified. The impact would be a quantum improvement in appreciation of the benefits as a result of educating the community in an understandable environment.

In the current climate many individuals do not seek financial advice as they believe they may not be able to afford the service as the superannuation system is so complex and financial advisers will charge accordingly. If the superannuation system was simplified the fees that may be charged in relation to superannuation may become more affordable and therefore more individuals may seek financial advice. This in turn would help to build financial awareness.

Contributing to the high level of complexity within the superannuation system are the constant changes that generally occur every year. Historically many of the changes have disincentivised the community as the Government of the day used legislation as a vehicle to halt the small percentage of potential "tax avoiders" in the wider community. For example prior to 1 July 1983 superannuation was viewed as a very tax effective savings vehicle for retirement as no contributions tax, superannuation surcharge or tax on investment earnings applied. When a person withdrew their superannuation benefits 95% of the benefit was not taxed at all. The remaining 5% was taxed at the individual's marginal rate of tax.

Much has changed since then, contributions tax and tax on investment earnings was introduced in 1988, surcharge was introduced in 1996, and the post June 1983 ETP component was introduced in 1983. All of these changes have dramatically changed the tax treatment of superannuation and have reduced the tax effectiveness. This example shows a snapshot of the high degree of legislative risk that is associated with superannuation. Changes occur and they are not always to the community's direct advantage. This makes the community weary and reluctant to invest additional funds in superannuation, as once you are in the system as the money is preserved you can be at the mercy of legislative change.

Due to the ever-changing rules of superannuation, often previous rules are grandfathered, which is one of the contributing factors to the complexity of the system. If the system keeps getting more complicated the community faces a smaller chance of understanding superannuation and promotes disinterest.

3.4 Preservation of Superannuation Benefits

One of the major barriers to contributing to superannuation is the compulsory preservation of benefits. From 1 July 1999 all contributions (including voluntary member contributions) that are made into an individual's superannuation account are automatically classified as preserved benefits. The direct consequence for members is that these benefits will be inaccessible and therefore cannot be released by the Trustee of a superannuation fund until the member meets a condition of release that is outlined in Schedule 1 of the Superannuation Industry (Supervision) Regulations 1994. For most individuals that are aged under 40, it means they cannot access their benefits until they have attained preservation age, which is currently age 60.

Preservation makes superannuation a very long term savings vehicle as an individual's money is locked up. For example younger individuals aged 20, would be required to wait 40 years (under the current rules) before they could access any of their benefit. This is unless they meet another condition of release such as severe financial hardship, compassionate grounds or permanent incapacity, each of which has rigorous and prescriptive eligibility requirements.

Preservation raises the following questions:

- Will an individual contribute to superannuation if they need access to capital?
- As the money will be locked up for years, would it be more appropriate to save for a house and/or pay a mortgage?

- Will an individual believe they need to start to think about saving so early as the benefit will be accumulating for years?

Our experience suggests that many younger individuals do not believe they need to consider retirement – they have the view that there is plenty of time to consider retirement later. For many, their first priority in terms of their future is purchasing a home and starting a family; both of which leaves very little income to contribute to superannuation.

As superannuation is largely inaccessible, many individuals will be very reluctant to invest additional funds by way of salary sacrifice or personal contributions, as they may need access to these benefits in case of emergencies and to achieve a home deposit. The sole purpose test of superannuation (outlined in section 62 of the Superannuation Industry (Supervision) Act 1993 does not allow for this as it generally states that superannuation benefits can be paid:

- on or after a member's retirement;
- when a member reaches a prescribed age
- to a member's dependants or legal representative in the event of the member's death
- in the event of a member ceasing employment due to ill health
- when a member terminates employment with an employer that has made contributions to the fund for that member; or
- other ancillary purposes approved in writing by APRA (eg compassionate grounds).

While these preservation rules have existed for some time, recently they were tightened again which has effectively made superannuation a more unattractive alternative for younger individuals and has reduced the scope of when it can be used. The Superannuation Industry (Supervision) Regulations 2004 (No. 4) 2004 was gazetted which served to automatically preserve employer ETPs that are rolled into a superannuation fund from 1 July 2004. When an individual receives an employer ETP (eg golden handshake or ETP part of a bona fide redundancy payment) they have a choice to receive it in cash or to roll the proceeds into their superannuation account.

Prior to 1 July 2004, if the individual chose to roll over the proceeds of their employer ETP into superannuation, the benefit was readily available as it was classified as an unrestricted non-preserved benefit within the superannuation system. This provided individuals with more flexibility. The new provision discourages individuals from choosing superannuation as a destination for their employer ETPs and actively encourages them to receive it directly in the form of cash where it is at hand. If the intention is to increase contributions to an individual's superannuation account and to promote saving early for retirement, it must be questioned whether this new measure achieves this outcome. We believe that it serves the opposite purpose. The recent reduction of personal tax rates whilst welcomed, also do not encourage individuals to use superannuation as they dilute the tax concessions that are available within the superannuation environment.

As the need to access capital can be an insurmountable hurdle for some individuals, consideration should be given to the introduction of a medium term savings vehicle. This is not an entirely new concept as it was recommended by the Senate Select Committee on Superannuation in the inquiry into "Superannuation and Standards of Living in Retirement".

In their report the Committee recommended that it be a tax preferred vehicle that would allow access to funds before retirement for:

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

In relation to the design of the vehicle we propose that it should be structured similarly to a life insurance bond. Rather than having the current tax rate of 30%, we propose that the tax rate should be lowered to approximately 20% which would encourage individuals to use this vehicle. To increase the attractiveness we also suggest that the medium term savings vehicle be eligible to receive the same CGT discount that superannuation funds enjoy (ie 33.3% discount).

Another initiative that could be explored to address the barrier of preservation is to allow individuals to access 20% of superannuation savings above the superannuation guarantee. If an individual contributed say, $1000 in addition to the superannuation guarantee, $200 would be classified as unrestricted non-preserved benefits with the balance (ie $800) being classified as a preserved benefit. This would enable individuals to access some of their superannuation in case of emergencies and could also allow savings to be accumulated in a concessionally taxed environment.

3.5 Reasonable Benefit Limits (RBLs)

Reasonable Benefit Limits (RBLs) can be seen as another barrier that deters individuals from contributing to superannuation, as their purpose is to limit the amount of superannuation benefits that an individual can receive at concessional tax rates. If an individual has accumulated superannuation benefits that exceed their RBL they will pay up to 47% (plus Medicare Levy) on that excessive portion, if they take it in the form of a lump sum. If, rather than paying excessive lump sum tax, the individual commences a retirement income stream such as an allocated pension (which is the most popular due to its flexibility) the individual will either receive no or a reduced ETP pension and annuity rebate. RBLs do not encourage extra saving into superannuation as individuals will be penalised if they save past a set limit (which is set at a low level).

To illustrate the inflexible nature of RBLs and to show how they discourage additional contributions to superannuation, if an individual aged 20 made additional contributions to superannuation and also received 9% superannuation guarantee for their working life (ie the next 45 years) it is possible that on retirement they would have an accumulated superannuation benefit that exceeds their lump sum RBL. Therefore they could potentially be paying tax on some of their benefit at up to 47% plus Medicare Levy of 1.5% and in effect would be penalised for adopting a self responsible approach to saving. This situation does not encourage individuals to make additional contributions to their superannuation.

We propose that the Government explore the option of abolishing RBLs as they discourage people from making additional contributions to superannuation as they impose a cap on the amount that can be saved for retirement. In addition they are not high enough as younger individuals in the community can exceed their RBL when they contribute to superannuation also, which begs the question; how reasonable are the reasonable benefit limits? We also believe that RBLs are not required as the current system of maximum deductible contribution (MDC) limits is in place which limits the tax deduction that can be claimed by an employer when they contribute to superannuation for each of their employees.

We believe it would have minimal impact from a budgetary perspective as there are only a very small number of people each year that pay excessive tax. In the Senate Select Committee on Superannuation report in relation to the inquiry "Superannuation and Standards of Living in Retirement" (Dec 2002) it was stated that ASFA had given evidence that approximately 650 individuals a year pay tax on excessive benefits. It seems counterproductive to have such a significant amount of administration required when it does not generate much revenue and serves to make superannuation much more complex.

3.6 Superannuation Surcharge

Superannuation surcharge is one of the most confusing and complex areas of superannuation and rather than getting simpler has only got more complex due to frequent changes.

Currently at the time of writing this submission, the Government has proposed to abolish superannuation surcharge from 1 July 2005 so it does not apply to surchargeable contributions and relevant termination payments. We applaud and support this move as the surcharge represents another barrier to contribute to superannuation and removing it will increase the attractiveness of superannuation especially for those in the community that have more potential to save.

4. Current incentives in place to encourage voluntary superannuation contributions

There are four main incentives currently in place to encourage voluntary superannuation contributions:

- The Government co-contribution
- Spouse contribution rebate
- Tax deduction for superannuation contributions; and
- Investment earnings taxed at a concessional rate of 15%.

These incentives are attractive for some although we believe they should be examined to determine if they are attracting large numbers of individuals to contribute to superannuation. Of particular attraction is the third initiative of receiving a tax deduction for superannuation contributions which is available for self employed, substantially self employed and some unsupported individuals who are not eligible for the co-contribution.

However, the co-contribution and the spouse contribution rebate could be enhanced further to actively encourage individuals to contribute more to superannuation.

4.1 The Government Co-contribution

This initiative was introduced in July 2003, where originally the Government matched an individual's personal contributions dollar for dollar, up to a maximum of $1,000. In July 2004 the co-contribution was extended so that for every dollar an individual personally contributed to superannuation the Government would match it with a $1.50 co-contribution, up to a maximum of $1,500.

We applaud the Government for introducing this initiative and increasing the eligibility rules so that more low to middle income earners are able to take advantage of this benefit. This is proving to be such a popular initiative with 450,000[1] Australians receiving the co-contribution in the 2003/2004 financial year alone. Therefore, we propose that the measure be extended further to remove the nexus between employment and the co-contribution. Currently to be eligible for the co-contribution an individual must be receiving at least 10% of their total income

1. Mal Brough press release, *$244 million injection into Australians' Retirement Savings.* 8 February 2005.

from eligible employment. If this requirement was removed self employed individuals and non-working spouses staying at home to look after children would also receive the co-contribution which currently is not the case.

Extending the co-contribution to self employed and substantially self employed individuals would promote superannuation and would serve as an encouragement for those that would benefit from the co-contribution rather than a tax deduction.

In addition, non working spouses who remain at home to look after children should also be eligible for the co-contribution. As they may be out of the workforce for some time, they will not be receiving superannuation guarantee and therefore will have a lower superannuation balance. To boost women's superannuation accounts and to encourage additional superannuation contributions, the co-contribution should be made available to non-working mother/parents.

4.2 Spouse contribution rebate

The spouse contribution rebate was introduced in 1997. It provided that if a spouse or defacto made a contribution into their spouse or defacto's superannuation account they would generally be entitled to an 18% rebate of the contribution, up to a maximum rebate of $540. This was based on the provision that the receiving spouse did not have assessable income and reportable fringe benefits exceeding $10,800. The amount of the rebate reduced when the $10,800 threshold was passed, until it phased out completely when the receiving spouse's assessable income and reportable fringe benefits reached $13,800.

Now approximately eight years later the relevant thresholds and the amount of the rebate are still the same. We believe the thresholds and the amount of the rebate should be increased to bring them in line with inflation. This would serve to make this initiative more attractive to individuals and will allow parents staying at home to engage in part time employment which will allow them to earn more income which is very important given the high levels of debt that prevails in Australia.

5. Ways of improving the awareness of the importance of saving early for retirement

Our community is in great need of being educated on the importance of saving early for retirement. In the world that we live in today many individuals do not adopt a self responsible approach to saving and start to consider saving for retirement much too late.

When we conducted a '"straw pole" of the need to start saving early for retirement amongst individuals under 40, most respondents believed that it was too early to start saving and that there was plenty of time left in the future. They did not fully understand the fundamentals of investing, the concept of compound interest and they had not set financial goals for wealth creation for retirement.

In order to educate the community so they take an active interest in their superannuation and retirement savings it is essential that they feel as though it is their own money. And if they want their money to grow at a quicker rate, they need to be involved and make decisions to ensure they get the most from their portfolio. Whilst some individuals will be aware of some investment fundamentals, many others will need to be educated about principles of risk, return and diversification.

To help individuals gain a better understanding of the need to start saving early, the focus of education should be on the additional benefits that they will gain if they start to save early (eg compound interest, the co-contribution, tax concessions, access to funds within a medium term savings vehicle). When promoting the benefits of superannuation the Government needs to ensure that where possible the superannuation system is simplified which will help financial literacy adoption.

In addition, individuals should also be in an informed position on the disadvantages of saving too late and the impact it will have on their standard of living in retirement. It may also be worthwhile to launch an awareness campaign that highlights how much age pension a person can expect to receive and compare that amount with the individual's income requirements in retirement. This would help to paint a picture of how an individual's standard of living can reduce if they do not adequately plan for their retirement.

When designing an education campaign, thought should be given to exploring the most effective medium that would reach out to individuals aged under 40, such as the internet. In addition large industry bodies such as IFSA and ASFA should be encouraged to participate in the education process.

We also believe that the Government should offer incentives to employers that have initiatives in place which foster financial literacy, such as financial internet cafes in lunch rooms so employees can go online and look at their superannuation. The main aim is to make superannuation part of everyday life.

6. Conclusion

We support the Government's initiative to increase awareness of the need to start saving early for retirement for individuals under 40. In particular we support the Government's proactive approach and various initiatives that are in place that encourage additional savings in superannuation.

To extend and encourage additional contributions to superannuation by under 40s, we feel that the initiatives that we have outlined in this submission should be considered and explored, in particular the mortgage relief scheme proposal, which would make superannuation more attractive as it is linked to the favoured investment of many, the family home.

There is a need however for reform to simplify the superannuation system. This is crucial if we want individuals to take an active interest and own their superannuation, which should improve national economic efficiency.