



Investment & Financial Services Association Ltd

Retirement Savings Gap

Australians' expectations for their living standards in retirement are higher than their current levels of superannuation will provide. This was a finding of the Senate Select Committee on Superannuation Report *Superannuation and standards of living in retirement*, December 2002.

The Retirement Savings Gap is a single value, expressed in today's dollars. It estimates of the difference between the retirement living standard people currently aged 25 to 65 expect to have, and the retirement living standard that current compulsory and voluntary superannuation contributions, combined with the age pension, will eventually produce.

The **Retirement Savings Gap** is estimated to be **\$600 billion**. This is larger than the current stock of superannuation savings.

IFSA commissioned Rice Walker Actuaries to quantify the Retirement Savings Gap. Dr David Knox of PricewaterhouseCoopers Actuarial independently reviewed the work.

Target Retirement Income

The retirement income expectation is modest at 62.5% of pre-retirement earnings, within the range of 75 to 80% of pre-retirement living standards. The Senate Select Committee on Superannuation noted that this a consensus target for adequate retirement income.

Definition of 'Gap'

The Retirement Savings Gap is a measure of the current shortfall in national savings between two amounts:

- the amount required to be saved by the nation as a whole to ensure "adequacy" in retirement, and in particular non-reliance on the Age Pension; and
- the amount saved in the superannuation system, and estimated to be saved in future years up to retirement, by the current workforce.

Calculation model

In order to determine the Retirement Savings Gap, Rice Walker projected current superannuation savings, allowed for likely future contributions (assuming current levels are maintained) and compared the sum of these two amounts to the projected required amount of savings to meet the adequacy standard. This process was undertaken for each 5-year age group aged between 25 and 65 in 2003 and earning 0.75 to 2.0 times Average Weekly Earnings. The total required savings amount was adjusted to reflect the retirement income provided through the Age Pension.

The model uses data from a number of sources; specifically the ATO for details of current taxable earnings, and APRA for details on current savings. Based on these data, superannuation contributions higher than 9% were included: employers 11%; employees 4%.

Assumptions were selected which tend to understate the Retirement Savings Gap.

- The income range included was limited because: (a) the equalising effect of the age pension leads to higher replacement rates for lower income groups; and (b) people earning above twice average earnings are widely regarded as beyond the scope of retirement incomes policy.

- Retirement was set at 65 (average retirement ages are lower than 65).
- No future career breaks were modelled for women.

General assumptions used:

Economic

- ? 7.5% gross return on the accumulation of assets / 4.5% salary inflation / 3.0% price inflation
- ? 1.25% expense rate
- ? 15.0% tax on future employer contributions / 6.0% investment tax on investment roll up

Demographic

- ? 30% of self-managed funds, 5% of corporate funds and 25% of public sector funds are in the "retirement phase".
- ? Mortality in accordance with the Australian Life Tables 1999 – 2001 (from ABS 3302.0), future improvement to post retirement mortality in accordance with the 25 year improvement rates published by the Australian Government Actuary in the Australian Life Tables 1995 – 1997

Retirement Savings Gap by age

The Retirement Savings Gap for each age group, and the contributions required to overcome it, were calculated. This table shows the gap and contributions required, before allowing for the age pension.

Age Band	Retirement Savings Gap – Males (\$millions)	Additional Contribution (Males)	Retirement Savings Gap – Females (\$millions)	Additional Contribution (Females)
25 – 29	30,957	2.9%	67,396	5.6%
30 – 34	31,395	3.5%	76,039	6.7%
35 – 39	29,595	4.1%	84,939	9.0%
40 – 44	30,143	5.1%	88,143	12.2%
45 – 49	26,143	6.1%	84,160	17.0%
50 – 54	27,287	8.8%	78,950	23.3%
55 – 59	21,961	13.5%	55,071	34.3%
60 – 64	-	-	13,574	27.3%

The rates increase with age, as expected. The older age groups have not enjoyed Superannuation Guarantee contributions over their working lives and they have less time over which to overcome the Retirement Savings Gap.

The rates for females are considerably higher, and reflect a number of factors. The pool of current savings will be less than for males due to career breaks; and a larger pool of assets will be required at retirement to fund pension payments than for males given the longer expectation of life for females.

Non-Superannuation Savings

This calculation of the Retirement Savings Gap does not allow for retirement income from non-superannuation assets. This is because people included in this analysis are unlikely to hold significant non-superannuation income producing assets other than their homes. Individuals who earn more than twice average weekly earning at any time during their life were excluded from the calculation of the Retirement Savings Gap. NATSEM research on the wealth of older households (still in the workforce) shows higher wealth households hold almost all wealth, including non-superannuation financial assets, and almost all of these households would have been excluded through the upper income limit of twice average earnings. This data on non-superannuation wealth is only reported on a family rather than individual basis, so it could not be directly included in the calculation.

A note on the nature of this calculation: This calculation provides a reasonable and credible estimate of the Retirement Savings Gap. A fuller analysis, such as through the large models of the Retirement & Incomes Modelling group could include finer detail and stochastic testing. Assumptions in this calculation are conservative to avoid overstating the Retirement Savings Gap.

Further Information

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