



Investment and Financial Services Association Limited

Retirement Incomes & Long Term Savings Policy Options

2006



## Policy Partnership



Over the last two decades successive Australian governments have faced the demographic issues that arise with an ageing population. Initiatives taken in the last few years have improved the prospects of retiring Australians, and materially lightened the burden on younger Australians from having to finance the retirement of preceding generations.

The retirement savings gap has been reduced by some \$16,500 per person between 2003 and 2005 – a 15% reduction in real terms. This improvement is reflected in the 43% growth of the superannuation pool, from \$518 billion to \$742 billion over the same period. By September 2005 the pool of superannuation assets had grown to \$791 billion.

Australia's retired population is increasing in number. Australia had 1.3 million people over the age of 65 years in 1976, or nine per cent of the population. By 2002, this was twelve per cent or 2.2 million people, and by 2042 it will be twenty-four per cent or 6.2 million people. The cost of funding the safety-net Age Pension is currently expected to reach around five per cent of Australia's annual national income (GDP) by 2042.

Australians are fortunate that they have an established system that combines voluntary and compulsory savings for retirement with an Age Pension safety net. On this sound base, further reform is needed to encourage Australians to save more for their retirement and to ensure that the funds that they have accumulated for retirement will provide an adequate income stream to match their increasing longevity.

IFSA represents Australia's leading investment managers and life insurance companies who are the custodians on behalf of more than nine million Australians of over \$920 billion in superannuation and managed funds. IFSA has used this wide perspective to shape its vision and policy principles in the areas of superannuation, retirement incomes and long term savings. IFSA believes that it will be industry, working in partnership with government, which will help Australians fund the retirement they aspire to. IFSA is a strong supporter of financial sector reform, which we believe will improve Australians' savings and investment decisions by delivering better quality financial advice and product disclosure.

On behalf of IFSA's one hundred and twenty member companies, I encourage you to read and consider the issues and options in this document.

Richard Gilbert  
Chief Executive Officer

# Retirement Incomes – Policy Options

Australia's retirement income system is substantially mature and its basic structure is sound. It faces twin challenges – the demographic funding challenge to fund income support, health and community care for an ageing population; and the adequacy challenge to see retired Australians have adequate living standards.

Some further improvements are needed to meet the adequacy challenge, and this document sets out a number of these. The most significant policy options are aimed at encouraging additional voluntary saving for retirement and reducing tax leakages from funds as they are being accumulated. IFSA's ongoing research and analysis shows there is a significant gain to be realised as Australians respond positively to lower tax on superannuation. We have modelled this gain in the research that backs this document.

The demographic funding challenge can be faced, in part, through improving national income. Key elements in improving national income are improved productivity and increased participation – and there have been calls to reduce marginal tax rates to address these issues. It is important to recognise the relationship between personal tax rates and incentive to save for retirement, and the need to ensure that superannuation saving retains incentive if personal tax rates fall.

Australia's retirement income system also depends upon effective information, education and advice to enable people to find their way through complex decisions. Consumer sovereignty in choice over superannuation, supported by effective disclosure, is also important. Efficient and competitive products translate policy potential into reality, and improved regulation is adding to consumer confidence.

IFSA member companies provide both superannuation savings and retirement income products, as well as financial advice, and we are vitally engaged in the development of Australia's retirement income system. IFSA suggests these policy options to continue the progress towards adequate living standards in retirement.

## Adequacy (Page 7)

1. Lower contributions tax and ensure that contributions tax maintains or improves relativity to personal income tax rates.
2. Extend the 'co-contributions' scheme to encourage middle income earners and baby boomers to save more for their retirement. (If contributions tax is fully removed, this extension should be fiscally neutral.)
3. Review and simplify Reasonable Benefit Limits and ensure that Australians are offered equitable tax incentives regardless of employment status.

## Sustainability (Page 14)

4. Allow non-superannuation money to be paid into retirement income streams after retirement.
5. Develop further incentives for Australians to take income streams rather than lump sums at retirement, and review incentives for the participation in income streams.

## Control, Ownership and Portability (Page 17)

6. Ensure that 'choice' is available to all working Australians.

## Promote Education, Information and Advice (Page 18)

7. Industry and Government to partner to develop initiatives which will encourage many more Australians to access quality education information, and advice about their retirement planning.

## Accelerate Industry Efficiency (Page 20)

8. Ensure that Australian industry competitors are able to offer a 'best in class' retirement system.

## IFSA'S Vision for 2036



Greater financial security and a better lifestyle in retirement for Australians through:

- A progressive increase in the degree of financial independence of the Australian population in retirement.
- Improving the superannuation system to enable individuals and families to meet their expectations of an adequate standard of living in retirement.
- A strong and viable social safety net, with a minimum level of Age Pension that maintains the living standards of Australians relying on government support.

Changes in policy and in the community's attitude to saving in general, and superannuation in particular, have improved significantly. More needs to be done if this vision is to be realised.

In its December 2002 report on living standards in retirement, the Senate Select Committee on Superannuation found that:

- "The available evidence demonstrates that the current arrangements for superannuation may not provide an adequate income in retirement for most people and that strategies need to be identified to address the shortfall;
- The current taxation treatment produces some inequities which need to be addressed;
- The relationship between the superannuation and the Age Pension and other social security measures could be better integrated; and
- The superannuation system in Australia is very complex and requires simplification."

IFSA recommends that the following benchmarks be attained by 2036, and maintained:

- More retirees will have privately funded an adequate retirement income, compared with their pre-retirement living standards:
  - the desirable replacement rate is of the order of 75%-80% of pre-retirement consumption expenditure or its equivalent, 60%-65% of pre-retirement earnings; and
  - one quarter of retirees will be fully self-funded (currently around one fifth).
- The cost to the community of the Age Pension system, and related benefits, will be affordable:
  - no more than one-third of retirees will receive the full Age Pension (currently around half);
  - the Age Pension cost should be no greater than 5% of GDP (currently 3%).
- The safety net will meet community standards:
  - the full means-tested Age Pension will provide an income of no less than one quarter of the average weekly earnings (as now).

## The Way Ahead

Australia's basic retirement system is sound. It stands well in any international comparison. Government and industry initiatives in recent years have made good progress to address the demographic funding challenge of an ageing population which will live significantly longer.

Australia's retirement savings system is built on three pillars:

- the Age Pension safety net;
- the Superannuation Guarantee; and
- voluntary contributions to superannuation.

The demographic funding challenge – to meet the income support and other needs of an ageing population – requires action on two fronts: improving national income, and improving saving. On Australia's strong foundation, further refinements are needed to encourage Australians to save more for their retirement, to ensure that they enjoy it in line with their expectations - without a heavy reliance on intergenerational public funding.

A large number of Australians will be disappointed when they reach retirement, unless they do more than rely on current levels of compulsory superannuation. Some sections of the community are more exposed than others, including: those who spend time away from paid employment, often women for family support reasons; the increasing number of families in small businesses who do not fully participate in the superannuation guarantee system; and those that are unable to contribute because of substantial periods of ill health.

The retirement savings gap is now estimated to be \$452 billion, or \$93,523 per person. The adoption of IFSA's policy options will maximise value and stem leakages from compulsory superannuation (the second pillar) and improve incentives for voluntary saving (the third pillar).

In retirement, Australians can elect to take their accumulated savings in the form of a cash payout, or preferably an income stream. Many Australians will take a combination of the above and also be eligible for a full or part-rate Age Pension. IFSA believes there should be appropriate incentives to encourage better use of income streams, with appropriate flexibility, and that post retirement savings should be able to go into income streams. The Age Pension, combined with the system of associated health and other benefits, is a critical component of living standards for most retirees.

The central message of the Intergenerational Report 2002-03, is not being, and cannot be, ignored. Demographic changes will significantly pressure government expenditure over the next few decades. Substantial increases in longevity to date, and anticipated further increases, heighten this challenge.

Improvements to retirement incomes policy and regulation should be considered in the context of key objectives.

- The most important goal is to increase the level of national savings, both public and private. Furthermore, it is critical that funds are used efficiently in investment markets to maximise returns to investors.

- The encouragement of self-provision for retirement is vital - private saving and other forms of self-provision are the keys to financial independence. Improved private financing of retirement will reduce calls on public income support and thus provide greater capacity for improved community benefits.
- Private retirement income must be sustainable. This requires both efficient investment and the means to manage capital so it is not exhausted prematurely.
- An appropriate balance must be struck between the cost of incentives and concessions to promote retirement saving, and equitable limits on these concessions.
- For system integrity, superannuation and Age Pension concessions should be limited to retirement incomes objectives. Prevention of tax deferral and/or avoidance from these concessions is appropriate.
- Education, information and quality advice are critical to the achievement of Australians' expectations of their retirement incomes.
- Over-regulation is a continuing risk in this complex policy field, and ongoing efforts are needed to ensure it does not result in dead weight costs which consumers ultimately bear.

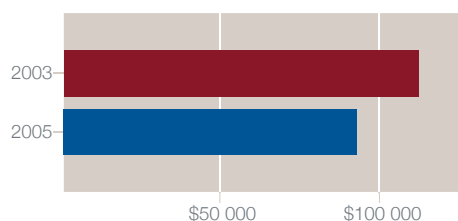
## Measuring the retirement savings gap

The Retirement Savings Gap has reduced by \$16,500 per person (15%) in real terms since our first estimate in 2003.

The Retirement Savings Gap is the difference between Australians' expectations for their standard of living in retirement, and the standard of living their current saving will achieve.

IFSA commissioned research to quantify this gap in 2003, and again in 2005. In that time, the Retirement Savings Gap has reduced by \$16,500 per person in real terms. Policy changes and improved markets have contributed to this reduction.

Retirement Savings Gap, Per Person



- 2003 Retirement Savings Gap, Per Person \$110 088
- 2005 Retirement Gap, Per Person \$93 523

Source: Rice Walker Actuaries 2005

Note: 2003 Retirement Savings Gap is \$110,088 in 2005 dollars – see calculation below

The Retirement Savings Gap stands at \$452 billion and shows current superannuation still falls well short of the benchmark needed to fund adequate living standards in retirement.

Retirement Savings Gap 2005 (\$billions)



- Total Savings Required
- Current Savings and Age Pension
- Retirement Savings Gap

Source: Rice Walker Actuaries 2005

### Policy Change has Improved the Retirement Savings Gap

The Government has taken significant steps to improve retirement income adequacy of Australians in recent years. These changes have contributed to a significant reduction in the Retirement Savings Gap per person. A stocktake of policy initiatives taken over the last few years includes:

- The extension of co-contributions to those earning up to \$58,000 with an increased incentive of a full \$1.50 for every \$1 contributed for those earning up to \$58,000.
- The abolition of the superannuation surcharge.
- The work test abolished up until age 65 and a simpler test after age 65.
- The introduction of term allocated pensions.
- Allowing income stream payments for part-time workers.
- The establishment of the Financial Literacy Foundation.
- The introduction of fund choice for many Australians.
- The Financial Services Reform Act refinements.
- Contribution splitting between spouses.

Improved financial markets have also had a positive effect on the Retirement Savings Gap. The 2005 Retirement Savings Gap shows that further improvements are needed.

## Calculating the Retirement Savings Gap

The Retirement Savings Gap was calculated for IFSA by Rice Walker Actuaries.

The Retirement Savings Gap estimates the value, in today's dollars, of the difference between the retirement people expect to have and the retirement that current compulsory and voluntary superannuation contributions, combined with the Age Pension, will eventually produce.

The Retirement Savings Gap is the sum of the retirement savings gaps calculated for each 5-year age group between 25 and 65 in 2005 earning 0.75 to 2.0 times Average Weekly Earnings. The retirement income expectation is set at 62.5% of pre-retirement earnings, equal to 75% to 80% of pre-retirement living standards. This replacement rate was a finding of the Senate Select Committee on Superannuation report Superannuation and standards of living in retirement, December 2002.

Assumptions selected tend to understate the Retirement Savings Gap.

The difference in Retirement Savings Gap between 2003 and 2005 per capita in nominal terms is:

$$\$100,811 - \$93,523 = \$7,300.$$

Allowing for 4.5% p.a. inflation, the difference per capita in real terms (rounded) is:

$$\begin{aligned} & \$100,811 \times 1.045^2 - \$93,523 \\ & = \$110,088 - \$93,523 = \$16,500 \end{aligned}$$

In percentage terms, the reduction is:

$$\begin{aligned} & \$93,523 / (\$100,811 \times 1.045^2) - 1 \\ & = 15\%. \end{aligned}$$

# Adequacy

## Policy objective: Encourage all Australians to save more to achieve an adequate retirement income.

Few Australians can be confident that they will have an adequate income in retirement. Recent initiatives have improved retirement income prospects significantly - the extension of co-contributions, the abolition of the superannuation surcharge, the introduction of choice of fund for many Australians, the transition to retirement initiatives and the introduction of term allocated pensions.

To build on these improvements, IFSA recommends two key options to help ensure adequate retirement incomes for more Australians. These two options will reduce the tax leakage from the 'second pillar' - compulsory superannuation - and will strengthen the 'third pillar' of voluntary saving by further encouraging Australians to save actively for their retirement.

These options should be seen in the context of the twin challenges facing retirement incomes - the demographic funding challenge and the adequacy challenge. Government has identified economic growth through improved productivity and increased participation as one key to meeting the demographic funding challenge.

Many commentators have suggested that reducing marginal tax rates will foster productivity and participation in the labour market and the economy generally, and there are widespread calls on government to use the current surplus to reduce personal tax. IFSA recognises that improving productivity and participation will improve retirement incomes by reducing the future deficit identified in the 2002-2003 Intergenerational Report.

IFSA suggests that reducing personal tax and winding back front-end tax in superannuation can and should be considered together.

## Wind Back Contributions Tax

Winding back contributions tax will help close the Retirement Savings Gap for all working Australians. IFSA's research shows that reducing front-end tax will also encourage people to increase their voluntary contributions, and thus provide overall benefits that exceed fiscal cost.

Reducing contributions tax is a responsible use of the current fiscal surplus. Unlike a reduction in personal tax rates, it will not over-stimulate consumption or place pressure on the current account by stimulating the demand for imports. It will preserve the value of the tax reduction in national saving and, in particular, it will stimulate long-term retirement saving. Australia's rate of tax on retirement saving is the third-highest in the OECD, and Australia is the only OECD country to tax retirement saving at the contribution, earning and benefits stages.

The case for reducing or removing tax on superannuation contributions is compelling:

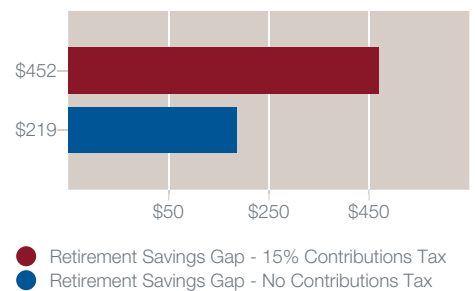
- Lower front-end tax will help many more Australians achieve an adequate retirement income.
- Lower front-end tax will encourage many more Australians to save more into superannuation themselves.
- The strong behavioural response (see below) will see a net positive outcome for government and the community.



## Improving Retirement Income

Reducing the contributions tax will help close the Retirement Savings Gap. To illustrate how much the Retirement Savings Gap can be closed, if the contributions tax was removed completely, the positive response below would see the Retirement Savings Gap fall from the current \$452 billion to an estimated \$219 billion. Obviously the smaller the reduction in the contributions tax, the smaller the reduction in the Retirement Savings Gap.

### Bridging the Retirement Savings Gap (\$billions)

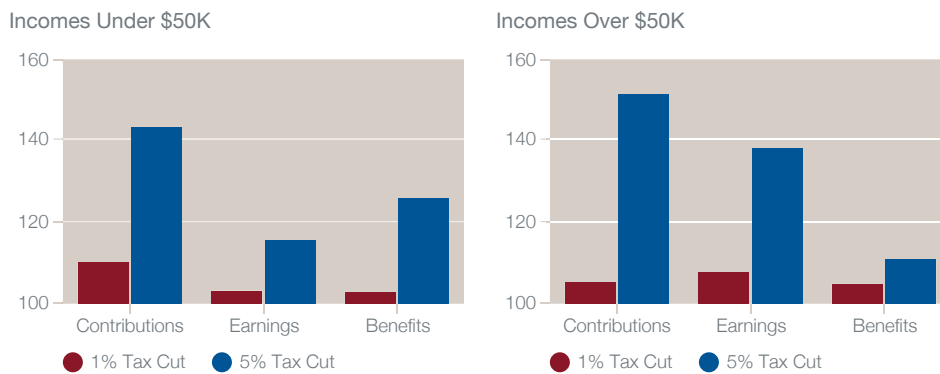


Source: Rice Walker Actuaries / Access Economics 2005, 2006. Note: Retirement Savings Gap without behavioural response would be \$378bn

## Positive Behavioural Response

IFSA research shows that voluntary superannuation saving would increase if the contributions tax is reduced. The research shows that a larger reduction in tax has a significantly higher behavioural response in increasing contributions than does a small reduction. It is also clear that Australians respond more strongly to a reduction in contributions tax than to reductions in earnings or benefits taxes. The higher impact of a large contributions tax reduction can be seen in both low and middle to high income groups. This behavioural response was used to estimate the reduction in the Retirement Savings Gap.

Intended Increase to Superannuation Contribution  
(100 = Current Contribution)



Source: Access Economics 2006

Note: this chart includes both after-tax and salary sacrifice contributions.



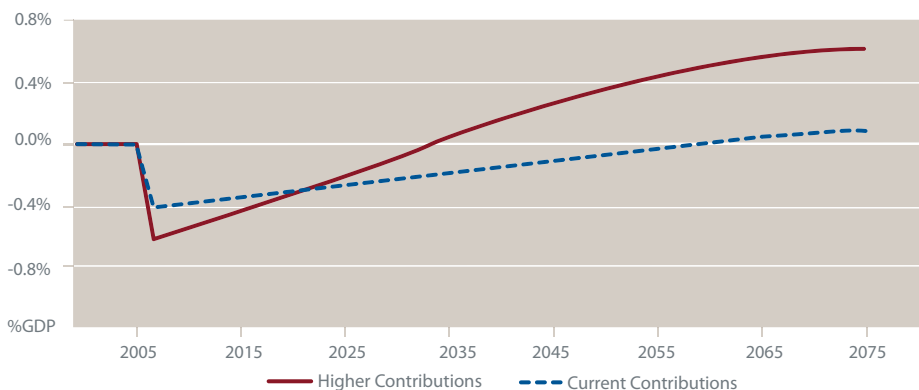
## Net Benefit to Community

Based on the illustrative example of removing the contributions tax, the following chart shows the net benefit to the community. This takes into account the increase in superannuation savings, less the tax revenue forgone. The chart shows that the fiscal cost would initially increase because of the strong behavioural response, while community benefits would exceed fiscal cost each year from about 2030. The positive benefit to the community would be much larger than the fiscal cost over the longer term: the net benefit would be approximately \$2.51 for each \$1 of contribution tax foregone over the 70 years to 2076-77. The “current contributions” line shows the impact of removing the contributions tax alone: the difference between the lines illustrates the considerable positive benefit from behavioural response.

Again, the smaller the reduction in the contributions tax the lower is the net benefit to the community and the lower is the fiscal cost.

The research presented here shows that reducing the contributions tax is a powerful tool that can be used to increase the retirement savings of Australians. Removing the contributions tax altogether brings about the largest reduction in the Retirement Savings Gap and provides the largest net benefit to the community. However, the size of any reduction to the contributions tax is a matter for the Government to decide, given the costs and benefits of the policy.

Net Effect - Retiree Incomes and Government Revenues



Source: Access Economics 2006

## Risk to Superannuation Contributions if Personal Tax Rates Fall

The converse of the positive behavioural response would be that the relative attractiveness of long term savings into superannuation would be reduced if personal tax rates fell without a corresponding reduction in superannuation taxes. If this occurs, Australia's already poor record of personal savings could suffer a further setback and the goal of improving adequacy could become more difficult to achieve. This means any reduction in personal tax needs to be considered hand in hand with winding back front-end superannuation tax.

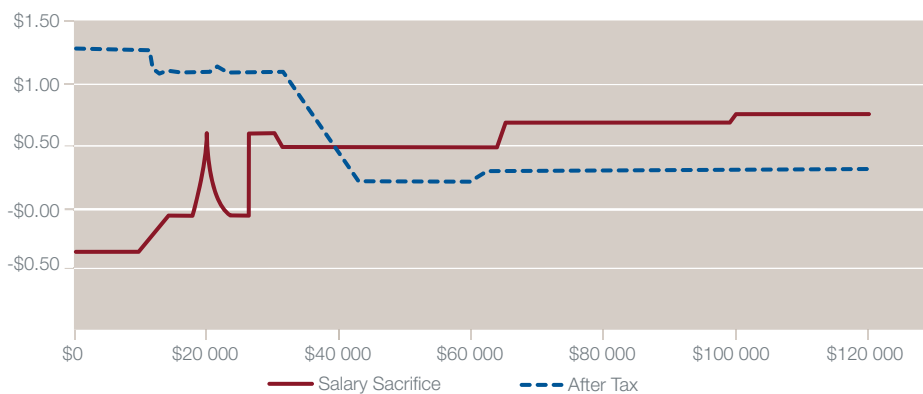
## Extend the Co-Contributions Scheme

The co-contributions scheme has proved a success with the very people it targeted. Australians have responded to the incentives provided by matching their own contributions at the levels predicted by IFSA community response research in 2002. The current scheme provides a generous matching level of \$1.50 for each \$1.00 of personal contributions.

IFSA's research showed that middle income groups would respond quite strongly to lower matching rates (for example a matching rate of \$0.50 for each \$1.00 of after tax contributions). This provides an opportunity to expand the scheme's reach at relatively low cost.

Currently, tax and co-contribution incentives for superannuation show a gap for middle income earners. This incentive gap commences at incomes of about \$50,000 a year, where the maximum co-contribution amount falls below \$400. It extends to incomes of \$62,500, where incentive arises from the difference between the 42 percent marginal tax rate and superannuation contributions tax (at 15 percent). This point will move up to \$70,000 from 1 July 2006. The next chart shows the value of tax incentives for each dollar contributed to superannuation – both after tax (co-contribution) and before tax ("salary sacrifice").

Value of current incentives



Source: Access Economics 2006. Note: Value Calculated on \$1 000 invested in superannuation over 30 years

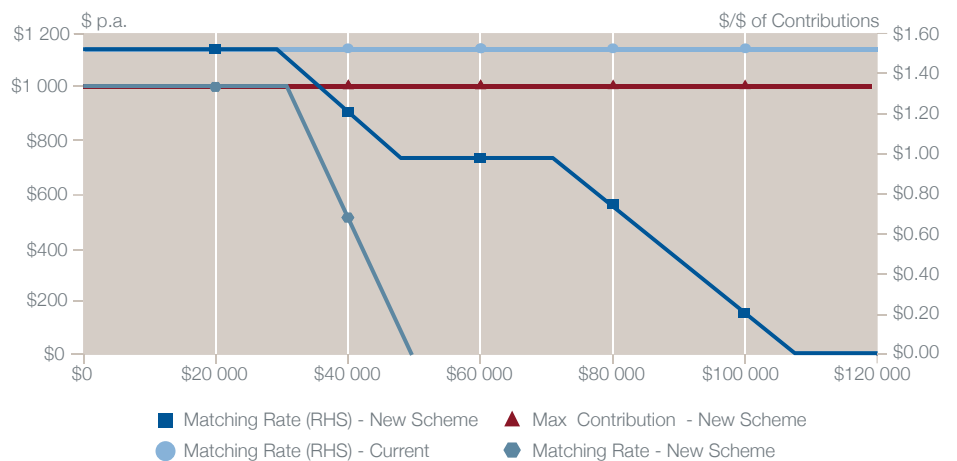


IFSA's example of an expanded scheme reduces the co-contribution matching rate at higher incomes.

- Below the existing income threshold of \$28,000 p.a. the current matching rate of \$1.50 per \$1 contributed should apply.
- Between \$28,000 and the current maximum income of \$48,000 the matching rate is reduced by 1.7 cents for each additional \$1,000 of income.
- Between \$48,000 and \$68,000 the matching rate is maintained at a dollar-for-dollar level.
- Above \$68,000 the matching rate is reduced by 2.5 cents for each additional \$1,000 of income.
- The matching rate reaches zero at an income of \$108,000 per year.

The expanded co-contributions scheme chart shows how the recommended extension to the co-contributions scheme will work for those on middle incomes. The left-hand scale shows the annual matching rate and the right-hand scale shows the matching rate for each \$1 contributed by the individual. In practice, the rate could be represented by a matching amount for \$1,000 in personal contributions.

Expanded Co-Contribution Scheme

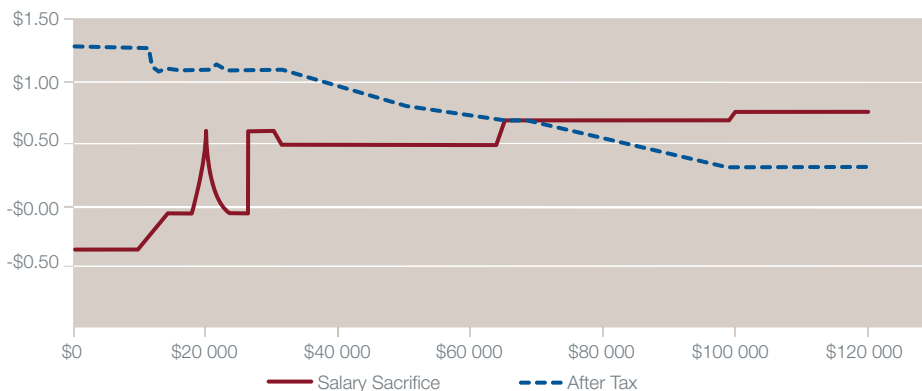


Source: Access Economics 2006

The *value of incentives – expanded co-contribution scheme* chart shows how the scheme will fill the incentive ‘gap’ for those on middle incomes. The extended co-contribution scheme provides after-tax incentives for those on a marginal rate of 30 cents that equal or exceed the incentive for salary sacrifice at a contributions tax rate of 15%.

The upper end of such an expanded co-contributions scheme is likely to have little fiscal impact because the incentives provided by the co-contribution more or less equal those available for salary sacrifice. If the phase-out of co-contributions occurs largely where individuals face a marginal tax rate of 42 cents, then a \$0.50 for \$1.00 co-contribution has roughly the same tax effect at the time of contribution as does a salary sacrifice contribution taxed at 15%. If the contributions tax is removed, then at a marginal tax rate of 30 cents, a \$0.50 co-contribution and salary sacrifice are roughly equivalent. At marginal rates above 30 cents, salary sacrifice is more tax effective than a \$0.50 co-contribution rate.

Value of incentives - expanded co-contribution scheme



Source: Access Economics 2006. Note: Value Calculated on \$1 000 invested in superannuation over 30 years



## Reasonable Benefits Limits

IFSA has long supported a fair lifetime limit on superannuation tax concessions. Some of the superannuation rules have become increasingly complex and may be counter-productive. It is now widely accepted that the actual rules and processes for the lifetime limits on concessional tax in superannuation, the Reasonable Benefit Limits, are cumbersome. IFSA wholeheartedly supports the 2005 announcements by the government to simplify the RBL system. At the same time it may be opportune to review the limits to ensure that they do not act as a deterrent to retirement savings.

When the RBL system is simplified, the current age-based contribution limit system could be reviewed. The goal of this RBL review would be to remove unnecessary rigidities at little or no fiscal cost. The benefits of a simplified system are twofold:

- limits at retirement would not impede savings; and
- a simplified system would reduce administrative cost in retirement.

## Tax Neutrality on Superannuation Contributions

Self-employed Australians can have quite different tax concessions on superannuation than other Australians. To achieve tax neutrality and equitable treatment, the rules for tax deductibility of superannuation contributions for the self-employed should be relaxed. Specifically, self-employed people could be entitled to a deduction on the same basis as employees. That is, a contribution for a self-employed person should be deductible up to the age based limit, rather than being restricted to 75 per cent of any amount over \$5,000 (as is currently prescribed in section 82AAT of the Income Tax Assessment Act 1936). In addition, the 10 per cent rule could be softened so that substantially self-employed people with low proportions of paid employment (yet above 10%) would also receive equitable tax treatment.

## Policy Options

1. Lower contributions tax and ensure that contributions tax maintains or improves relativity to personal income tax rates.
2. Extend the 'co-contributions' scheme to encourage middle income earners and baby boomers to save more for their retirement. (If contributions tax is fully removed, this extension should be fiscally neutral.)
3. Review and simplify Reasonable Benefit Limits and ensure that Australians are offered equitable tax incentives regardless of employment status.

# Sustainability

## **Policy objective: To encourage retirees to use their retirement savings optimally to provide income across their retirement.**

Australians who have accumulated savings for their retirement must invest wisely if those savings are to maintain their desired standard of living throughout their retirement.

### Longevity Risk

Australians are now living longer in retirement. As life expectancy continues to increase, there is additional strain on private retirement income streams and on the publicly funded Age Pension. The Treasury's Retirement Income Modeling task force has estimated the impact of increased longevity will add about 0.5% of GDP to the cost of retirement income support by about 2050 (*ceteris paribus*).

A key problem in longevity risk in the private superannuation market is that future life expectancy is difficult to quantify. This is particularly so because of likely, but unquantifiable, future advances in medical science and specific therapies. The longevity of a given age group could well increase quite significantly, and the size or timing of such an increase is not predictable.

The challenge for private lifetime income stream products is to match the premium charged for the benefit of guaranteeing an income for the purchasers' lifetime against the potential costs and risks the provider must bear. Problems such as uncertain future longevity mean reinsurance is not currently available in Australia to spread risk. Consequently providers carry longevity risk on their balance sheets - and there are limits on their capacity to do so.

Given the level of uncertainty, answers are not likely to appear quickly. Dialogue about the respective roles of the private market and government in income stream provision could help answer questions about who can or should bear this risk. The World Bank has shown interest in the impacts of increased life expectancy, and Australia is well placed to consider how market-linked income stream products can deal with longevity risk.

### Encourage Participation in Retirement Income Streams

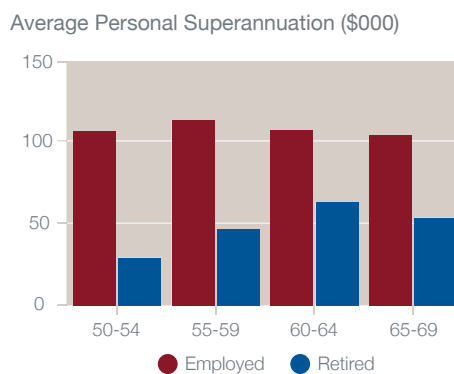
Retirement income streams are critical to the delivery of adequate retirement income. They provide a simple vehicle to assist retirees to use their capital evenly across their retirement. Retirement income streams can afford significant tax advantages to retirees, and receive concessional treatment under the Age Pension means tests.

Key objectives for income streams should be to:

- provide a simple means for retirees to spread income and capital across retirement;
- provide appropriate incentives to retirees to use income streams;
- promote efficient investment;
- allow flexibility to adjust to individual and changing circumstances; and
- ensure simple administration.



Conversion of superannuation savings into an income stream is largely voluntary in the Australian retirement incomes system. Currently, older workers and young retirees do not have large amounts in superannuation, so for many an investment in a superannuation retirement income stream may not appear to make practical sense. Nonetheless, 2002-3 data analysed by NATSEM for AMP showed that the average personal superannuation was significantly lower among retirees, suggesting expenditure of lump sums may be a significant issue.



Source: AMP - Natsem 2005

IFSA undertook research in 2001, which found that consumers showed a strong preference for the ability to control their capital. We also found that consumers preferred features such as a defined account balance, the ability to choose investments and the ability to switch providers. A significant group showed definite preferences for incomes that were predictable, stable or guaranteed. Our research also showed Australians do not intend to build estates at a cost to their retirement living standards.

IFSA's guiding principles for income streams are to:

- seek incentives that encourage use of income streams by reflecting community values and preferences;
- balance responsible fiscal outcomes with effective incentives and concessions; and
- promote economic efficiency in investment by ensuring that regulations do not distort choices.

The current treatment of income stream types under the Age Pension means tests does not align ideally with consumer preferences. Consequently it does not provide as much incentive for income streams as it should. An effective set of policy incentives and a range of product features would further encourage consumers to use retirement income streams. If the means tests and tax concessions were reviewed, including the offsets for non-commutable income streams, better incentives could be developed for a range of income streams to suit retiree needs and preferences.



## Allow Australians to contribute to retirement income streams after retirement

People aged over 65 who are no longer working cannot put 'ordinary money' into superannuation income streams (including complying and allocated annuities: ordinary money can go into other annuities). After age 75, no additional money can be moved into superannuation income streams.

Since some of this money would be from intergenerational transfers and from assets held outside the superannuation system, increasing longevity means an increasing proportion of retirees will receive these lump sums after they are able to place them into superannuation income streams under current rules. Much or all of this money will be after-tax money, that is, there would be no tax deduction available were it able to be contributed to superannuation.

Allowing money into superannuation income streams after retirement would produce both economic and fiscal benefits. Economic benefits will arise as more capital is consumed rather than passively held, thereby raising GDP. Capital held is also likely to be invested in more efficient investments like balanced portfolios through allocated income streams. Fiscal benefits will arise as deductible amounts under tax and social security law fall in real terms compared to annual payments, thereby creating higher assessable income for both tax and means tests than would have occurred were investments held passively and capital not drawn down.

## Policy Options

4. Allow non-superannuation money to be paid into retirement income streams after retirement.
5. Develop further incentives for Australians to take income streams, rather than lump sums at retirement, and review incentives for the participation in income streams.

## Control, Ownership and Portability

**Policy objective: Give the benefits of ownership, control and portability to more Australians regardless of the nature of their employment arrangements.**

The Australian superannuation industry includes a large range of customer segments, industry providers and product choices, varying in their complexity and their suitability for different individual circumstances. All consumers should be able to choose which of these products are most appropriate for them.

IFSA strongly supports the principle that Australians should be able to choose their superannuation fund, provided that funds comply with retirement incomes policy and prudential regulation.

On the 1st July 2005, approximately half of Australia's workforce were given the opportunity to take greater ownership and control of their superannuation and retirement planning through the Choice of Fund legislation. IFSA believes that this right should be extended to all working Australians.

### Policy Option

6. Ensure that 'choice' is available to all working Australians.

## Promote Education, Information and Advice

Required additional contribution above superannuation guarantee to close 'retirement savings gap' (after Age Pension)

Age	Males	Females
	Above SG	Above SG
25-29	8.8%	9.5%
30-34	9.5%	9.3%
35-39	10.1%	9.3%
40-44	11.4%	10.8%
45-49	12.9%	12.8%
50-54	15.3%	14.1%

SOURCE: Rice Walker Actuaries 2005.

**Policy objective: To ensure that all Australians grow in competence and confidence when making decisions about long-term savings and retirement provisions through access to information and advice on superannuation and income streams.**

IFSA's 2001 research into the drivers of retirement savings found that the perception of a retirement savings 'gap' did not appear to be a major driver of retirement saving. Setting retirement income targets for individuals and families, while essential, will not be sufficient to foster a stronger savings culture. Education, information and advice must combine to equip people to plan for and realise a range of short term and long term financial goals.

The Retirement Savings Gap demonstrates the need to inform and educate each generation of Australians of the need to save additional superannuation above the basic Superannuation Guarantee. For example, an average 38 year old female (a member of Generation X) would need to make additional contributions of 9.3% of salary above the basic Superannuation Guarantee (i.e. a total contribution rate of 18.3%), to achieve adequate income in retirement. This message is particularly important for younger age groups if they are less likely to receive additional employer superannuation support above the basic Superannuation Guarantee.



IFSA's qualitative research has continued to identify very low levels of planning for the financial aspects of retirement among younger Australians. The main reasons for this included other commitments, poor savings habits and lack of disposable income. Those people who did pre-plan shared a number of characteristics including the realisation that they had an asset, through superannuation or other means, which commanded their attention.

### Financial Literacy Foundation

The Government is to be congratulated on the Financial Literacy Foundation initiative. IFSA is more confident that existing and future generations of Australian families will be better prepared to manage their financial affairs.

IFSA suggests that an initiative could be developed and sponsored by the Foundation that is focused on those in the workplace, building on the work already done by superannuation providers and through the Centrelink Financial Information Service. It should be aimed at rewarding those employers, industry participants and educators who deliver workplace education on long-term savings and superannuation through Foundation approved or endorsed education seminars and courses.

### Financial Planning Advice

With FSRA now in place, the importance of advice in the accumulation and benefit phases of superannuation should be better promoted. The cost of underinsurance and poor financial decision-making can be catastrophic for Australian families, and the complexity of decision-making, especially around retirement, means that few can make informed decisions without quality advice.

A 2002 report from the Association of British Insurers shows that 26% - 46% (dependent on income levels) of those surveyed would not have commenced saving without access to financial advice. Advice from financial planners, employers, family and friends was an important factor in the savings decision of 71% of those currently saving. Also, advice from a financial planner was especially important for the self employed.

Continuous improvements in the integrity and quality of advice is largely an industry challenge, but one that needs the support of all stakeholders. Continuous improvements made by industry and changes to the regulatory environment will further improve the quality and objectivity of financial advice. IFSA strongly supports these initiatives. Armed with quality advice, consumers can take responsibility for their financial planning, and make more informed decisions.

### Policy Option

7. Industry and Government to partner to develop initiatives which will encourage many more Australians to access quality education information, and advice about their retirement planning.

## Accelerate Industry Efficiency

### **Policy objective: To enable providers in the superannuation market to maximise the efficiency of their operations.**

The Australian market place for wealth management, and superannuation in particular, is one of the most transparent, contested and efficient markets in the world. Consumers can be confident of longer term outcomes and commitments. IFSA - commissioned studies over the last few years show continuing efficiency improvements. However, we must maintain a commitment to productivity and efficiency improvements to ensure that consumers benefit from innovation, technology advances and the increasing scale that now places Australia as the fourth largest investment pool in the world.

### Product Rationalisation

In 2006, the number of regulated superannuation funds in Australia will be significantly reduced. This will increase opportunity and demand for an improved plan, platform and product rationalisation regime.

The superannuation market has a long history of legislative change, tax change, industry innovation, and mergers and acquisitions. The legacy of these changes is a significant number of closed and subscale funds and products whose high cost maintenance is a drag on the industry – and ultimately on consumers who are saving for their retirement. Many closed superannuation products operate on old computer systems which suffer from technological obsolescence and design features that complied with legislation that has since changed many times.

While the superannuation and life insurance regimes do contain some mechanisms enabling product rationalisation, their cost and complexity inhibits product rationalisation. The successor fund provisions of superannuation legislation work well where the previous fund and trustee cease to exist, but do not function effectively where fund and/or trustee continue.

A single financial product rationalisation regime should apply to managed investments, superannuation and life insurance products. Consistent amendments are needed to reform and align the Corporations Act and the SIS and Life Acts.

### A Managed Investments Tax Regime

Tax on superannuation and its investment arrangements has considerable scope for improvement. In particular, a separate tax regime for managed investments, including superannuation, would reduce the considerable resource cost of managing tax issues in superannuation investments. Superannuation is overwhelmingly invested in managed investment schemes with dynamic, daily unit pricing. While superannuation funds themselves are largely taxed under their own regime, there remain many tax provisions which apply to trusts generally. This problem is worse in managed investment schemes and so has an impact on superannuation investment.

A managed investments tax regime could significantly improve the administration of superannuation investments by dealing with them directly rather than by exception from private and trading trusts. Tax law currently deals with all trusts more or less alike. It does not generally distinguish between a large, widely held investment trust and a private trading or family trust. Consequently, many of the integrity measures that are appropriate for non-arms length arrangements impact on highly regulated managed investment trusts, even though these trusts are subject to conduct and prudential regulation. What is more, this generalised tax treatment has not been conducive to solving some ongoing tax issues in managed investments such as the consequence of tax adjustments after a unit price has been set.

## Cost of Regulation

Legal compliance is a significant operational cost to operators in the financial services industry generally, and superannuation in particular. The volume and scope of legislation and regulation has created a compliance driven culture, which can foster risk aversion and dampen entrepreneurship. Industry also faces an apparent perception among policy-makers and regulators that industry has ample resources to implement substantive changes quickly.

IFSA's concern, which is shared by Government, is that the increasing volume of rules and black letter law has come at a financial cost to industry and our customers. While we have seen policy-makers take a simpler approach to new initiatives in retirement incomes policy, in the overall regulatory and prudential framework, a significant shift in regulatory design and process is an imperative. This is particularly important where consumer and policy outcomes are not at risk from simpler regulation – and indeed would benefit from less 'red tape'.



IFSA also remains concerned that the cost and burden of regulation should not inhibit the provision of appropriate, scaleable advice.

IFSA's approach is three-fold: greater reliance on the development of industry codes of practice and self enforcement; a more formal consultative process for proposed regulatory changes and reform proposals; and greater emphasis and reliance on the analysis of costs and consumer benefits of regulatory proposals. This approach could well see the cost of unnecessary regulation lifted from the financial services industry and its consumers.

## Policy Option

8. Ensure that Australian industry competitors are able to offer a 'best in class' retirement system.



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