AUSTRALIAN BANKERS' ASSOCIATION INC.

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Dr Ken Henry
Chair, Review Panel
Australia's Future Tax System
The Treasury
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Dear Dr Henry,

Retirement Income Consultation Paper

The Australian Bankers' Association (ABA) is pleased to have the opportunity to comment on the Government's *Australia's Future Tax System: Retirement Income Consultation Paper*.

The ABA would be happy to discuss further any of the matters raised in its submission. The banking industry looks forward to participating further in the Government's review process.

Yours sincerely

David Bell

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Submission on the Australia's Future Tax System: Retirement Income Consultation Paper

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Submission on the Australia's Future Tax System: Retirement Income Consultation Paper

1. Introduction

The Australian Bankers' Association (ABA) welcomes the opportunity to provide comments on the Government's *Australia's Future Tax System: Retirement Income Consultation Paper*.

The ABA acknowledges the recent changes to superannuation, taxation and social security policy. These changes will have a long-term positive impact on the retirement incomes of many Australians. However, despite these changes, we believe that generally Australians are still not planning early enough, or saving enough, for their retirement. It is vital that sustainable public policies provide incentives as well as address disincentives for superannuation and other private savings, to ensure optimum standards of living in retirement.

The ABA commends the Government for conducting this review into Australia's retirement income system. Given the global financial crisis, it is timely to be reflecting on the policy objectives, structure and operation of Australia's retirement income system. The global financial crisis has had a substantial impact on confidence in the superannuation system and financial markets with many members of superannuation funds dealing with negative returns (even though the preceding years have seen strongly positive returns).

However, the ABA does not believe that fundamental changes to the underpinnings of Australia's retirement income system are warranted. While the current market conditions present challenges for Australia and Australians, this review should seek to identify targeted reforms that position our retirement income system to respond to future conditions. We believe that additional measures which integrate the retirement income system and social security system; enhance private savings and risk strategies; and promote individual's taking an active interest in their retirement provision are needed. Furthermore, we believe that implementing structural changes without understanding the motivations and expectations of Australians towards their workforce participation and retirement is unlikely to engender sustainable behavioural change.

Factors impacting lifecycle stages and individuals' decisions impacting lifestyle choices will result in Australians having different dependencies on government welfare, superannuation and other private savings as well as having different responses to savings messages. Measures to improve superannuation and private savings will have different degrees of effectiveness due to the different savings capacities and other investment priorities, ideas around consumer consumption, and attitudes towards retirement.

Therefore, in addition to the above measures, the ABA believes that better research into consumer behaviour and better understanding of the motivations and expectations of Australians towards their workforce participation and retirement is needed. Understanding how Australians think about their retirement lifestyle and income, superannuation, and private savings will assist in identifying real incentives and removing disincentives for greater superannuation savings as well as devising strategies for lifting household savings.

1.1 Background

1.1.1 'Three pillars policy'

The three basic pillars of Australia's retirement income system are:

- Age pension funded by Government revenue;
- Compulsory superannuation contributions (9% of earnings); and
- Incentives to encourage private saving for retirement.

It is important for Australians to have confidence in the retirement income system, including the continuance of the age pension as part of the overall retirement income system as well as the continuance of rules surrounding superannuation (including tax concessions). The World Bank continues to affirm multi-pillar retirement income systems as sound policy.

The ABA supports Australia's sustainable three pillars retirement income system. In addition, we support enhancements to other pillars that promote discretionary saving and robust support services and programs (such as health and aged-care).

1.1.2 Incentives to save and plan

The ABA believes that Australians should have incentives to save and plan for their future. Reducing complexity and increasing flexibility with superannuation and other private savings and investments will go a long way to removing barriers to early saving and retirement planning. Reducing complexity and increasing flexibility will also lead to greater confidence in the retirement income system, which in turn will lead to greater interest and commitment in saving and planning early for retirement. Encouraging those with the capacity to meet their own retirement income provision has not only benefits for lifting individuals' standard of living in retirement, but also more broadly for Australia's national savings. While superannuation is a vital part of Australia's retirement income system, other private savings are also important. Self-provision in retirement should be the aim of strategies for enhancing financial independence and retirement income adequacy.

The ABA considers that as part of improving retirement income adequacy, incentives for superannuation and private savings should promote long-term savings and address current inequities between particular financial products and investments. Encouraging diversified pre-retirement savings and post-retirement incomes will supplement superannuation savings and reduce fiscal pressure on the age pension by enabling greater choice, financial independence and a higher standard of living in retirement.

It is well known that compared to other countries the level of deposits in Australia is low. Some evidence as to why this may be the case was given in the report *International Comparison of Australia's Taxes* – it showed that Australia has the highest top marginal tax rate on interest income amongst OECD countries[1]. Currently term deposits have no tax incentives at all. Interest income earned by an individual through a term deposit is taxed at the person's full marginal tax rate. This contrasts with the concessional tax treatment on the earnings of superannuation funds and the full tax deductibility of expenses of other investment earnings, where the return is not taxed in full due to the levy of the capital gains tax (CGT) only on disposal of assets and the CGT discount. It is important that anomalies are addressed so that incentives are equitable and allow people to ensure their superannuation and other investments are diversified.

[1] http://comparativetaxation.treasury.gov.au/content/default.asp

It is also well understood that the level of insurance protection in Australia is low. Financial difficulty can be caused by a number of factors including unhealthy financial ways of thinking, circumstances out of the individual's control (e.g. divorce/break up, job loss, health, pregnancy, business failure, death of a family member providing supporting income, etc) and lack of skills and knowledge[2]. One of the simplest means to protect against unforeseen circumstances is to encourage people to have a savings buffer and/or protect themselves against such unforeseen circumstances. Currently there are anomalies in tax treatment and availability of rebates for people that invest in life insurance or other risk products. It is important that disincentives are removed so that Australians have an incentive to save and put in place risk strategies that will help them better manage their finances now and into the future.

The ABA suggests that Government should consider strategies for improving incentives for private savings and supporting development of risk products for increasing national savings, addressing the retirement savings gap and insurance protection gap, sustaining retirement incomes and managing health and age-related expenditure.

2. Specific comments

2.1 Retirement income system—Overview

The ABA believes that Australia's retirement income system is among the best in the world. However, Australia faces many socio-economic challenges – some newly emerging over recent years and others that have been emerging over recent decades – in terms of ageing population, shifting demographics, increasing globalisation and integration of markets, slowing economic growth, shifting to a lower carbon economy, changing expectations about workforce participation and retirement lifestyles and increasing individual responsibility for retirement provision (and subsequent financial and investment decisions).

Therefore, the ABA believes that Australia's retirement income system must be assessed against a number of broad principles and policy objectives:

- *Broad and adequate*: Does the retirement income system provide a basic safety net as well as encourage greater superannuation and private savings? Does the retirement income system promote adequate retirement incomes?
- *Acceptance*: Do Australians have confidence in the retirement income system to enable them to achieve the living standards they expect in retirement? Do Australians believe that the retirement income system provides fair and equitable treatment? Can Australians determine and select what savings and investment choices best suit their needs and circumstances pre and post-retirement? Can retirees select and use financial products and investment strategies to meet their changing needs and circumstances across retirement?
- *Robust*: Do Australians believe that the mix of public and private funding is appropriate for retirement provision? Do Australians believe the superannuation and social security rules are appropriate? Are taxes distributed equitably across income cohorts? Is the retirement income system robust enough to endure the fiscal pressures of an ageing population and increasing life expectancies?

[2] http://www.anz.com.au/aus/aboutanz/Community/Programs/pdf/ANZ_UPD_fin_difficulty.pdf

- *Simple and approachable*: Is the retirement income system simple for consumers and financial service providers? Do the rules limit complexity and lower administrative burden?

- *Sustainable*: Is the retirement income system appropriate given Australians increasing life expectancies and Australia's ageing population? Can Australians access information and advice that will assist them better understand how to get the best out of their superannuation and other private savings as well as better understand how external factors may impact on their retirement incomes?

The ABA believes that additional measures must be implemented so that the current system is well positioned to meet these policy objectives now and into the future, including:

- <u>Better integration of superannuation, social security and taxation policy</u>.

  If Australians are to take advantage of existing incentives and assistance available to them, then they must be able to easily understand their options pre and post-retirement. Currently there are significant structural barriers that hinder consumer comprehension and engagement – that is, interaction between the age pension and other assistance programs, superannuation, and private savings is extremely complicated. Complexity is further exacerbated by frequent changes to superannuation and taxation rules. Government strategies should concentrate on aligning the policy objectives of the retirement income system and social security system, simplifying the rules and streamlining the three pillars. In addition, the Government must be cognisant of the need to minimise changes to the rules, as this undermines confidence in the retirement income system.

- <u>Better incentives which enhance superannuation and private savings and support the development of risk products for increasing national savings, sustaining retirement incomes and managing health and age-related expenditure</u>.

  If Australians are to have greater confidence in the retirement income system, thereby increasing their own retirement provision voluntarily, then they must also have greater certainty and greater flexibility with their savings and investments. With greater investment choice, but also greater pressure on private savings, Australians must have the ability to budget, save and invest. Government strategies should recognise the need for individuals to have greater flexibility in their savings plans and investment strategies pre and post-retirement. In addition, Government strategies should address fiscal pressures of an ageing population by putting in place incentives for product development.

- <u>Better promotion of the importance of taking an active role in retirement income provision through improved financial education and financial literacy programs and better targeted messages about the importance of saving and planning early for retirement</u>.

  If Australians are to understand the implications of their decisions about pre-retirement consumption and savings, then they must have access to information at the right times and the skills to use that information. Government strategies should seek to encourage individuals to take more responsibility with managing their superannuation and other private savings. While superannuation is a substantial part of many Australians wealth accumulation, it should be considered as part of an individual's long-term savings strategy. Undertaking a regular "Financial Check" should be seen as just as important as having a regular health check. Government strategies should seek to promote the accessibility of professional financial advice.

- Better research into consumer behaviour and better understanding of the motivations and expectations of Australians towards their workforce participation and retirement.

  If Government is to devise strategies which provide real incentives and remove disincentives for greater superannuation and private savings it is important to understand how Australians think about their retirement lifestyle and income. Lifestyle choices and pre-retirement consumption and income will mean individuals will have different dependencies on government welfare, superannuation and other private savings as well as have different responses to savings messages. The Government must conduct thorough analysis of the retirement savings gap by giving consideration to the variety of needs and circumstances of individuals.

- Strong domestic financial institutions to promote Australia as a financial services centre with expertise in banking, wealth creation and risk management.

  If banks and other financial institutions are to continue to offer competitive products to consumers, it is important that banking and financial services regulation does not impose unnecessary compliance burdens. Regulation should strike the right balance between consumer protection in relatively straightforward financial situations while at the same time reducing costs and complexity for both consumers and industry. Furthermore, Government policies should support innovation in the financial services industry and promote competition and choice for the benefit of consumers as well as expertise in banking, wealth creation and risk management within Australia's banks and other financial institutions for the benefit of our economy.

The ABA believes that Australia's retirement income system needs to be improved to enable Australians to better take control of their retirement income decisions and assist in closing the retirement savings gap. Ultimately, this will require:

- Better integration between superannuation, social security and taxation policy;
- Better and more accessible incentives to encourage greater superannuation contributions, support voluntary and private savings and support the development of life risk insurance products;
- Better and more targeted messages about the importance of saving and planning early and the role of superannuation, private savings and investments in retirement planning;
- Better research into consumer behaviour and better understanding of the motivations and expectations of Australians towards their workforce participation and retirement lifestyle and income; and
- Strong domestic financial institutions to promote Australia as a financial services centre with expertise in banking, wealth creation and risk management.

2.2 Retirement income system—Broad and adequate

Broad and adequate: Does the retirement income system provide a basic safety net as well as encourage greater superannuation and private savings? Does the retirement income system promote adequate retirement incomes?

Unfortunately for many Australians there is disparity between their retirement income expectations and aspirations and what their current levels of superannuation and other private savings will actually achieve. As the superannuation system matures, we will have a better idea of "superannuation adequacy"[3]. In the meantime, the age pension and private savings will continue to supplement superannuation for many Australians. Notwithstanding, signals indicate that even with the benefit of a mature superannuation system, other pillars of the retirement income system will continue to be an important part of the retirement incomes of many Australians.

According to ABS data, the main source of retirement income for men is 'Government pension or allowance' (52%) followed by 'Superannuation or annuity' (22%); and for women 'Partner's income' (47%) followed by 'Government pension or allowance' (33%) and 'Superannuation or annuity' (7%). Furthermore, the main source of income during retirement will change, with many people becoming more reliant on a 'Government pension or allowance' and many people pre retirement underestimating their reliance on a 'Government pension or allowance' in retirement[4].

Currently for many Australians a combination of public and private savings will be needed to fund retirement incomes. However, the mix of public and private funding for retirement provision will depend on a number of factors including an individual's retirement lifestyle choice, longevity and health, and pre-retirement consumption as well as Australia's demographic, social, economic and financial trends.

What an adequate level of superannuation savings is can really only be answered by considering these questions:

- What should be the aspiration of the Australian community for standards of living in retirement – as reflected in retirement incomes policy?
- What superannuation contribution levels does this imply, given the compulsory nature of the superannuation system?
- Are current levels of provision adequate?

Each individual will have his or her own ideas on what is going to be an adequate pre-retirement and retirement income. Determining what savings and investment products best suit the needs and circumstances of an individual pre and post-retirement will depend on a number of factors including income, job security, taxation, access to credit, levels of debt, spending patterns, financial goals, liquidity of products, flexibility, and expectations regarding standard of living.

According to ABS population projections, in 2030 Australia's population is expected to be 28.5 million, with around 62.6% of working age (age 15 – age 64) and 19.7% older than age 65. In 2050, Australia's population is expected to be 34.0 million, with around 61.2% of working age and 22.2% older than age 65[5]. So we know that Australia's population is ageing. Changing demographics and longevity and life expectancies makes it very difficult

[3] In 1992, the Federal Government introduced the Superannuation Guarantee (SG). Between 1992 and 2002, compulsory employer contributions were increased progressively from 3% to 9%. An individual that commenced continuous full time employment at age 25 in 2002 will reach age 65 in 2032 and have received the full SG for the period of their employment.

[4] ABS (2008). *Retirement and Retirement Intentions, Australia, Jul 2006 to Jun 2007*. Catalogue No. 6238.0. January 2008. http://www.abs.gov.au/

[5] http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/3222.0Main+Features12004%20to%202101?OpenDocument

for there to be absolute certainty regarding estimates for retirement income adequacy. In addition, other social and economic variables will also impact on assumptions regarding retirement income adequacy.

Furthermore, each individual will face different retirement income issues based on a number of factors including wealth accumulation, level of financial assets and home ownership. According to the HILDA data, households that own their home tend to be much better off prior to and in retirement than households that do not own their home. Households that do not own their home also tend to have little financial assets and rely almost entirely on the age pension[6]. There is a strong tendency for Australians to concentrate on saving a deposit for a home before shifting their attention to other private savings. With increasing asset values, many young Australians may be required to save longer and delay home ownership. Some Australians may never own their home. Changing home ownership patterns pre and post-retirement will have an impact on assumptions regarding wealth accumulation and retirement income adequacy.

Adequacy for people with very low to low personal income concerns not so much "superannuation adequacy", but more importantly, "age pension adequacy" – as those on very low incomes, even if only temporarily, fall outside the compulsory contributions regime and thereby may rely entirely on a government pension or assistance and then the age pension as a safety net to alleviate poverty. Whereas for people with low personal incomes that have superannuation contributions made by their employer, superannuation co-contribution offers the ability to maximise their superannuation contributions, and therefore superannuation is becoming an increasingly important supplement to the age pension. According to Treasury's Retirement Income Modelling (RIM) Unit, projected higher wealth and income of retirees overtime will lead to a decline in those eligible for a full age pension. Nevertheless, the age pension will continue to be an integral part of most retirement incomes[7].

"Superannuation adequacy" concerns the very broad group of people that earn low to middle incomes. Most Australians are in this group, with many not likely to be eligible for the full age pension, but also likely to face retirement income inadequacy unless they contribute voluntarily to superannuation or other private savings. For those people on high incomes, the current superannuation system will provide an adequate retirement income. Australians in this group will not need to make voluntary contributions to superannuation.

The Government has historically been cautious about establishing or endorsing a particular retirement income goal or replacement rate to guide the retirement income system. However, a consensus view for an adequate standard of living in retirement is 60-65% of gross pre-retirement income (around 75-80% of pre-retirement consumption expenditure). For people earning low incomes, 65% will include contributions from the age pension. For people earning middle incomes, other private savings will need to supplement this level of retirement income.

However, the ABA recognises that most analyses of retirement income adequacy make projections based on future workforce participation rates, retirement ages, future returns of superannuation funds, future level of voluntary and other private savings, future tax rates, drawn down patterns in retirement and other variables of future cohorts of retirees, therefore it may be better to identify a budgetary measure rather than a replacement rate. A budgetary measure will accommodate the different needs and circumstances of individuals, as adjusted.

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[6] Headey, B, Warren, D and Wooden, M (2008). *The Structure and Distribution of Household Wealth in Australia: Cohort Differences and Retirement Issues*. Social Policy Research Paper No. 33. Melbourne Institute of Applied Economic and Social Research. University of Melbourne. P 20 http://www.facsia.gov.au/research/prp33/sprp33.pdf
[7] http://rim.treasury.gov.au/content/html/CP07_1_06.asp

According to the Westpac/ASFA *Retirement Living Standard* (September 2008), most Australians want and need more than the age pension will provide – that is, expenditure for a modest lifestyle for a single is $19,617 per year and a comfortable lifestyle for a single is $27,454 per year. A modest lifestyle for a couple is $37,829 and a comfortable lifestyle for a couple is $50,561[8].

Certainly identifying a target and analysing the assumptions behind the target will enable individuals to ascertain whether such a target is desirable and realistic, or not. Similarly, assessing what is an adequate retirement income and identifying the budgetary implications for the type of lifestyle that can be afforded will assist individuals to understand whether they need to forgo pre-retirement consumption to enable them to maintain or attain such a lifestyle and level of income in retirement.

In August 2008, Full-Time Adult Average Weekly Ordinary Time Earnings (AWOTE) was $1,145.10. Therefore, an individual with a $59,545 salary that receives superannuation contributions (9%) for an uninterrupted employment period (40 years) will be able to support a retirement income of around $27,450 until they are age 88[9]. While average life expectancy rates in Australia are currently 79 years for males and 84 years for females and it therefore appears that a mature superannuation system will deliver an adequate level of retirement income, the problem with this result is that it implies that an individual commences employment at age 25 on AWOTE or above salary and remains in continuous full-time employment until age 65. It also means that after age 88, this individual is reliant entirely on the age pension.

Many studies indicate that compulsory superannuation savings will still not be enough for many people to be able to maintain their standard of living in retirement. According to IFSA, the national retirement savings gap in 2006 was estimated to be $452 billion or $93,000 per person (a reduction on the previous calculation in 2003 of around 15% from $600 billion)[10]. So we know that there is retirement income inadequacy, especially for those people that have not had the benefit of compulsory superannuation over their whole working life, due to starting employment late, broken work patterns or early retirement, where the reduction in standards of living will be even more dramatic. For Australians to enjoy a reasonable, or even comfortable, standard of living in their retirement, they will have to take on the responsibility of contributing to their own retirement savings.

However, there is no simple answer as to what contribution level is needed to achieve retirement income adequacy. External factors and lifecycle patterns, such as workforce participation, will affect an individual's retirement income provision outcomes. Strategies to encourage greater superannuation and other private savings must recognise that there is a cost for saving for retirement; a reduction in disposable or discretionary income and lost consumption opportunities pre-retirement.

Additional superannuation contributions can be achieved in a number of ways, for example, increasing compulsory employer contributions, increasing voluntary after-tax contributions, providing optional access to additional pre-tax contributions and broadening access to the superannuation co-contribution scheme. Understanding that Australians will have different expenditure demands, savings capacities and lifecycle stages, it is important for any structural reforms to superannuation to enable individuals to tailor their superannuation contributions to best suit their needs and circumstances as they change pre and post-retirement and balance long-term savings accumulation with current consumption. For example, those people on low to middle incomes may have capacity to

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[8] *Westpac/ASFA Retirement Standard. Detailed Budget Breakdowns: Comfortable Lifestyle and Moderate Lifestyle*. September 2008. A modest lifestyle is very basic with restricted eating out and entertaining and no overseas travel. The shift to a comfortable lifestyle adds comfort and enjoyment, such as better clothes, improved household appliances and technology, better car, access to entertaining, purchase of magazines or CDs, purchase of alcohol/tobacco or gifts, occasional overseas travel, some eating out and entertaining, but importantly access to private health insurance. http://www.superannuation.asn.au/RS/default.aspx

[9] http://www.fido.asic.gov.au/fido/fido.nsf/byheadline/Retirement+planner?openDocument

[10] http://www.ifsa.com.au/

make additional voluntary contributions in earlier working years, however, with family and other household demands may seek to reduce voluntary contributions for a period of time. Whereas those people on high incomes may not need to make additional voluntary contributions to superannuation and may seek to invest in other private savings.

Furthermore, while the ABA considers that the superannuation co-contribution scheme will provide incentives for improved savings, individuals' capacity to make a contribution may be reduced or limited during different lifecycle stages, debt/equity exposures and economic cycles. For example, those medium income earners that do not have access to the superannuation co-contribution scheme or salary sacrifice may not necessarily have an incentive to forego current consumption and lock away savings in superannuation until preservation age. Therefore, strategies need to provide Australians with incentives that are flexible and can be used by individuals as relevant to their lifecycle stages. Lifting the level of national savings and household savings is important not just for Australia's economic prosperity, but for individual's economic and social retirement provision.

The Government's recent reforms to superannuation and transition to retirement will enhance overall retirement incomes as well as give retirees more options to improve their retirement income from other sources, including employment. However, we believe that further structural reforms to superannuation, social security and taxation policy are necessary to assist in closing the retirement savings gap and promoting more flexible long-term savings incentives for Australians and more flexible workforce participation and transition to retirement for older Australians. Strategies that are flexible are better able to be tailored to the different needs and circumstances of different people.

Furthermore, given that retirement incomes are based on three pillars (age pension, compulsory superannuation and voluntary superannuation and other private savings), retirement income inadequacy must be addressed through measures that provide certainties and incentives regarding the entire retirement income system – that is, incentives to lift private savings should not simply focus on voluntary contributions to superannuation, but also on other forms of private savings and investment.

Measures for addressing retirement incomes inadequacy should include:

- A viable and sustainable age pension that is better integrated into the retirement income system as well as enhanced support services (such as health and aged-care);
- Greater superannuation contributions through a multi-dimensional approach that increases compulsory employer contributions and voluntary employee contributions to superannuation, but provides flexibility for individuals to tailor their retirement incomes planning to best suit their needs and circumstances; and
- Greater participation of Australians in the financial services industry and enhanced private savings.

The ABA supports further consideration being given to the following:

Age pension

- Conducting thorough analysis of the social security system in relation to projected future fiscal balances, including assessing future age pension costs and projections of population eligible for full or partial age pension using varying assumptions[11]. Furthermore, consideration should be given to issues such as the intergenerational

[11] For example, Treasury's Retirement Income Modelling (RIM) Unit should build on research contained in the Second Intergenerational Report as relative to changing circumstances, such as shifting demographics and changing market conditions (i.e. global financial crisis). The ABA notes that analyses of retirement incomes adequacy tends to differ due to the significance placed on contribution of the age pension and emphasis on investment returns of superannuation funds. Testing different scenarios and identifying the assumptions that underlie each scenario should provide greater validity to the analysis.

impacts of the age pension, how to simplify the eligibility rules (including income and asset tests) for the age pension, how to further promote the pension bonus scheme as a way to lift workforce participation of older workers, whether the current level of the age pension provides an adequate safety net, what age individuals should have access to the age pension and whether the age pension rules discourage workforce participation (i.e. high taper rates with the income test) and penalise private savings (i.e. high taper rates with the assets test).

Superannuation

- Raising the SG by increasing compulsory employer contributions from 9% to 12%. (The ABA recognises that the global financial crisis has placed pressure on increasing the SG at this time, however, a phased approach could be pursued over the medium-term.)

- Introducing an 'opt-out' voluntary savings component on top of the SG, meaning individuals could increase their superannuation contributions from the SG level or 'opt-out' of the initiative. (The ABA notes that an 'opt-out' mechanism could adopt a phased approach whereby individuals are able to make pre-tax contributions to their superannuation fund, initially 1% and up to 3%. We also note that there could be opportunities for employers to match the additional contribution made by their employees as a way of promoting themselves as 'employers of choice'. An 'opt-out' mechanism would seek to enable individuals the flexibility to tailor their superannuation contributions to best suit their needs and circumstances[12].)

- Providing a tax rebate for superannuation contributions of individuals on very low and low income levels (i.e. individuals with a 15% marginal tax rate or below), meaning tax concessionality is more equitable across income levels and these individuals are provided with an incentive to make additional personal superannuation contributions. (The ABA notes that utilising the superannuation co-contribution scheme system will minimise administrative burden and compliance costs for both the Government and superannuation funds.)

- Improving awareness and access to salary sacrifice and allowing all individuals, not just those self-employed, to claim a tax deduction on personal superannuation contributions, encouraging individuals to make additional contributions up to the contribution limit and ensuring tax concessionality is more equitable across income levels.

- Increasing access to the superannuation co-contribution scheme, lifting maximum thresholds and re-scaling phasing out, meaning those individuals on medium incomes have greater access to matched savings incentives.

- Enabling more flexible spouse contributions by aligning the age limit on spouse contributions with the age limit on personal contributions, meaning that partners are able to supplement each others superannuation contributions when one may be temporarily out of the workforce (this is particularly important for women and carers). In addition, tax concessionality arrangements may need to be reconsidered to simplify the rules and provide greater opportunities for lifting superannuation contributions.

[12] An 'opt-out' mechanism would allow individuals to increase their voluntary superannuation contributions when their savings capacity enabled them to do so, and conversely, reduce their voluntary superannuation contributions to meet other expenditure demands. An 'opt-out' mechanism could be similar to the 'soft compulsion' model in New Zealand called "Kiwi-Saver".

- Building on the existing transition to retirement arrangements, encourage more flexible workforce participation by lifting the age that the SG is paid from age 70 to age 75, meaning older workers can tailor their transition to retirement to suit their needs and circumstances. In addition, the 'work test' criteria may need to be reconsidered in light of changing work patterns and community engagement, increasing life expectancies and other factors including economic conditions and decisions regarding other elements of the retirement income system.

- Removing the restriction on compulsory employer contributions only paid to those that earn $450 or more before tax in a month. (The ABA notes that practical measures will be needed to minimise the administrative burden for both employers and superannuation funds.)

- Adjusting requirements to draw down superannuation upon retirement, meaning individuals only access monies in their superannuation fund as needed. (The ABA recognises that relief recently provided regarding minimum draw down restrictions responded to the immediate concerns brought on by the current economic conditions, however, relief may need to be considered broadly in terms of allowing individuals the flexibility to tailor their superannuation to best suit their needs and circumstances.)

- Conducting thorough analysis of the superannuation system in relation to the social security system, including assessing the long-term impacts of exclusion from superannuation for recipients of government welfare, assistance and allowances and relevance of superannuation for Indigenous people, especially due to lower life expectancy rates. Furthermore, consideration should be given to issues such as what levels of superannuation is adequate for different people and their different needs and circumstances and how being self-employed may impact on retirement patterns.

<u>Private savings</u>

- Removing tax-based distortions between different classes of investments by increasing the after-tax benefit of investment in deposit products[13]. (The ABA believes that the low level of deposits in Australia is exacerbated by the anomalies created by differential tax treatment between term deposits and other classes of investments. Lifting the level of deposits will have substantial benefits for national and household savings.)

- Providing employers with incentives and/or assistance to retain and upgrade the skills of older workers (i.e. training programs for older low-skilled and non-regular workers).

- Supporting consumer understanding of retirement income provision by removing barriers to promoting information about replacement rate targets, budgetary measures, and retirement incomes tools to assist individuals manage their finances pre and post-retirement.

- Enhancing access to professional financial advice by providing a rebate for financial advice on superannuation and removing anomalies between access to superannuation and other investment planning, meaning that the Government recognises the long-term benefits for Australia and Australians with managing their finances and maintaining good financial habits.

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[13] The ABA provides commentary on funding and capital issues in our submission to the Government's *Australia's Future Tax System: Consultation Paper*.
http://taxreview.treasury.gov.au/content/submissions/Australian_Bankers_Association.pdf

- Supporting the financial services industry in developing alternative savings vehicles and enhancing life risk insurance products to assist build long-term savings for the purposes of sustaining retirement incomes and managing age-related expenditure. For example, expand tax deductibility of premiums across all life insurance products or provide a rebate for those people that invest in life insurance (i.e. death and disability cover) or other risk products (i.e. income protection cover), etc.

- Conducting thorough analysis of the inter-relationship between home ownership, superannuation and private savings, including assessing the long-term impacts of homeownership on wealth accumulation, the implications of renting on retirement incomes, the impediments to maximising savings for younger Australians and the basis of the 'sole purpose' test for superannuation.

Ultimately it is for the community to determine its expectations or aspirations for living standards in retirement. However, we believe that it is important for the Government to acknowledge a benchmark or retirement savings goal and identify long-term policies that more accurately reflect the community's needs and expectations in relation to retirement income adequacy. This will enable all Australians to consider whether their current superannuation contributions and other private savings and investments will deliver their anticipated retirement incomes, or whether they are likely to have a retirement savings gap.

The ABA believes it is important for the Government to ensure that restrictions placed on superannuation savings reflect contemporary expectations of living standards pre and post-retirement. Younger people should be provided with incentives to save and plan for retirement. Older people should be provided with choice and flexibility regarding their continuing participation in the workforce, transitional access to superannuation and transition to retirement. We also believe that it is important for the Government and financial services industry to promote the importance of a 'savings culture', so that Australians can improve their standard of living pre and post-retirement.

2.3 Retirement income system—Acceptance

Acceptance: Do Australians have confidence in the retirement income system to enable them to achieve the living standards they expect in retirement? Do Australians believe that the retirement income system provides fair and equitable treatment? Can Australians determine and select what savings and investment choices best suit their needs and circumstances pre and post-retirement? Can retirees select and use financial products and investment strategies to meet their changing needs and circumstances across retirement?

Retirement can extend over 30 years and retirees circumstances are certain to change over that time. Similarly, an individual may participate in the workforce for over 40 years and their needs and circumstances will change during that time. Therefore, the retirement income system needs to reflect the realities of pre and post-retirement for different people in different situations. For some people, control over their superannuation and other private savings and investments is extremely important. For other people, knowing their retirement incomes (including age pension) are secure is more important.

"Acceptance" of the retirement income system will mean different things to different people. For some people, confidence in the system will be based on whether they believe that the rules in place now will be the same rules in the future (and when they retire). For other people, fairness will drive their views and the actual and perceived equality of the system. However, a measure of acceptance is surely reflected by the level of engagement individuals demonstrate.

The ABA believes that, for many reasons, the level of engagement in superannuation, estate and retirement planning in Australia is still low. The compulsory nature of superannuation means many Australians feel detached from their savings, and therefore do not take an active interest. Furthermore, typically Australians do not think about their retirement income or their estate until they are preparing for retirement. Strategies to encourage long-term savings must by underpinned by simple, flexible rules that recognise the needs, circumstances and preferences of different people.

Measures for addressing acceptance of the retirement incomes system should include:

- Greater awareness by Australians of the importance of early retirement planning;
- More simplified rules that enable individuals to understand the retirement income system and make contributions according to their earning and saving capacity;
- More targeted incentives that focus on income cohort and lifecycle distinctions (contribution phase, preparing for retirement phase and in retirement phase); and
- More flexible rules that enable individuals to take advantage of the retirement income system in a manner that best suits their needs, circumstances and preferences as they change throughout their lives.

The ABA believes it is important for the retirement income system to be structured so that it adopts a consumer-focused approach. Rules should impose only those limits on individual flexibility that are necessary to achieve the policy objectives, and to limit behaviour that would otherwise compromise the policy objectives. Furthermore, it is important for changes to the rules to strike the right balance between maintaining currency with evolving consumer expectations, market conditions and product innovations while at the same time minimising changes that destabilise the retirement income system.

2.4 Retirement income system—Robust

Robust: Do Australians believe that the mix of public and private funding is appropriate for retirement provision? Do Australians believe the superannuation and social security rules are appropriate? Are taxes distributed equitably across income cohorts? Is the retirement income system robust enough to endure the fiscal pressures of an ageing population and increasing life expectancies?

The ABA believes that public funding via the age pension and other government welfare and assistance is appropriate to ensure a basic standard of living for those individuals and families without capacity to provide for themselves in retirement. However, we do not support a universal age pension. A universal age pension would act as a disincentive for the other pillars of the retirement income system as well as exacerbate the fiscal pressures that will face Government in the future. For those individuals with capacity to meet their own retirement income provision, compulsory superannuation, voluntary contributions to superannuation and other private savings should be encouraged to reduce reliance on a partial age pension and other government assistance.

However, members of superannuation funds and investors face risks with regards to their monies including market risk – variability of returns and the possibility of poor market performance; investment risk – asset allocation and the possibility that the choice of asset class does not perform as well as compared to another over the same period of time; inflation risk – higher cost of living; longevity risk – outliving savings; and insurance risk – inadequate insurance to manage life, health and aged-care costs. In addition, consumer behaviour can be a risk in itself where an individual makes poor consumer decisions resulting in inappropriate spending patterns, adversely impacting on their savings and capacity to fund their retirement.

Generally, individuals want to maximise their returns and minimise their risks. However, currently the ABA believes there are several impediments to consumers being able to manage risk and return. Firstly, many Australians do not fully understand the risks involved in investing, whether that be superannuation or non-superannuation monies. Secondly, there are regulatory and tax issues that restrict the development of products that could be used by retirees to assist in managing the wide range of risks they face. The global financial crisis has acutely demonstrated the importance of making sure that individuals have the knowledge and capacity to manage consumer and financial risks.

The ABA considers that the best outcomes will be delivered for Australians where the market for retirement savings and income products is open and competitive. One of the disadvantages for consumers of a highly specific regulatory regime is that rules can impede competition and thereby consumer choice. The retirement income system should seek neutrality of rules. Lack of neutrality can arise in retirement savings and incomes products in a number of ways, including concessions in tax or social security law can directly favour one business model (or effectively exclude or disadvantage others), rules can apply different treatment to similar products, inadvertently or by misconception about the nature of products and/or the market, and onerous regulatory and compliance requirements can act as barriers to entry and restrict competition in a market. Strategies to ensure the retirement savings system does not impede competition must address over-regulation that may manifest in the rules that provide concessions or impose restrictions on certain products and services as well as the compliance obligations required of financial service providers.

Measures for addressing robustness of the retirement income system should include:

- Encouraging innovation in superannuation and retirement income products that recognise the different financial needs and circumstances and risk tolerances of different people, meaning that individuals have greater certainty regarding their ability to be self-sufficient in retirement and capacity to manage risk during the accumulation and drawing down phases.
- Simplifying and streamlining regulation that hinders product development and innovation in income stream products (i.e. remove anomalies between superannuation and some insurance and annuity products).
- Promoting financial instruments that assist product development, such as Government issued long-dated bonds.
- Conducting thorough analysis of the retirement income system in terms of the inherent risks that each pillar faces. Furthermore, consideration should be given to issues such as the compulsory nature of the superannuation system, the availability of choice in superannuation, and the implications of market-linked and capital guaranteed products on the level of retirement income, the availability of alternative financial instruments to fund retirement (e.g. reverse mortgages) and any shortcomings in data, methodologies and/or indices used to project retirement income stream products.

The ABA believes that the rules surrounding superannuation and retirement income products should promote competition and choice. Importantly, we note that competitive neutrality does not imply the same outcomes from different products – that is, a retiree with a strong preference for capital guaranteed investments would not expect to receive the same return overall as from a market-linked investment.

The ABA notes the commentary on retirement income stream products and the impediments in the current system to develop products to address longevity risk as provided by the Investment and Financial Services Association (IFSA).

2.5 Retirement income system—Simple and approachable

Simple and approachable: Is the retirement income system simple for consumers and financial service providers? Do the rules limit complexity and lower administrative burden?

While supporting the basic design and vision of Australia's retirement income system, the ABA has in the past criticised the complexity of the system. The Government's recent reforms to simplify the superannuation system were an important step in removing unnecessary complexity, making our retirement income system more approachable and in part addressing the retirement savings gap – but more can be done.

Retirement income decisions are strongly influenced by tax and social security incentives and penalties. However, the lack of integration between the social security and retirement income systems distorts and undermines the policy objectives and amounts to over-regulation.

The ABA believes that the goals of the retirement income system should be simple and clear, such as:

- Strategies, tools and products should be able to be tailored to individual circumstances pre and post-retirement.
- Strategies, tools and products should help retirees spread their available income across retirement – subject to their needs and preferences.
- Strategies, tools and products should be flexible to adapt to the inevitable changes retirees will face.

The ABA also believes that in order to achieve these simple goals, the rules need to limit administrative complexities and costs for consumers and financial service providers. Strategies to simplify the retirement income system must seek to lift levels of engagement as well as reduce unnecessary compliance costs for financial service providers. In addition, the rules should not inhibit product innovation or create anomalies that restrict individuals being able to make financial decisions that best suit their needs and circumstances and strategy for wealth accumulation.

2.6 Retirement income system—Sustainable

Sustainable: Is the retirement income system appropriate given Australians increasing life expectancies and Australia's ageing population? Can Australians access information and advice that will assist them better understand how to get the best out of their superannuation and other private savings as well as better understand how external factors may impact on their retirement incomes?

Lifting private savings and workforce participation rates is critical to the sustainability of Australia's retirement income system. However, community awareness and understanding are also critical factors in ensuring that the retirement income system is sustainable. Currently, it is difficult, if not impossible, for many Australians to understand the technical details and implications of the social security and superannuation systems and how they interact.

The ABA and its member banks have demonstrated a long-term commitment to promoting consumer understanding and financial literacy. For example, the ABA has published a number of financial literacy materials to assist consumers better manage their finances[14]. However, even as recently as at the ABA's Financial Literacy Summit "Broadening Financial Understanding" held in July 2008, commentators pointed out that superannuation and retirement incomes policy had become so complex that basic messages are difficult to get across to consumers. In addition, many consumers do not feel confident in making decisions about their finances or managing their savings, including superannuation.

Much material already exists about superannuation and retirement incomes. However, there is a need for information to be consolidated and simplified and delivered in a manner that is accessible and meaningful to different people. We consider that it is important for the public and private sector to work together to better promote savings messages as well as better inform consumers of options available to them to assist them take responsibility for their superannuation and private savings.

While retirement income projections and realistic life expectancy tables are invaluable tools for individuals in understanding the implications of the impact of their savings and investment decisions on their standard of living in retirement, it is also important for individuals to have the skills to understand their pre-retirement lifestyle choices, attitudes to debt, savings capacities and access to other investments, so that they can plan earlier and better for their retirement. Strategies for improving financial literacy should target those sectors of the community with the lowest levels of financial literacy, as improvements in financial literacy can result in lifestyle gains for individuals of all ages across the community.

The benefits of improved financial literacy are well-informed consumers, greater personal savings and investment opportunities, improved management of household debt and a reduction in the likelihood of periods of financial stress, decreased need for welfare or other government assistance, greater national savings, more efficient markets and increased personal economic security. Strategies to improve community awareness and understanding must seek to assist Australians make better retirement savings and income decisions.

Measures for addressing sustainability of the retirement income system should include:

- Developing a national financial literacy strategy that provides a framework for better coordination across stakeholder groups (government, banking and finance, and community sector);
- Encouraging Australians to access education, information and financial advice about money management, savings, retirement and estate planning;
- Publishing information developed around 'information seeking opportunities' – that is, life events where people need to make consumer and financial decisions;
- Measuring levels of financial literacy and behavioural change to ensure that the importance of planning for retirement has been made and translated into behaviour; and
- Improving disclosure documents provided to retail investors by targeting information and applying obligations suitable to various types of financial products and investments.

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[14] The ABA's financial literacy booklet series includes: Smarter Banking: Make the most of your money; Smarter Credit: Make credit work for you; Smarter Super: Invest in your future and make the most of your retirement; Smarter Money: Take control and stay on top of your finances; Smarter Insurance: Protect your assets and secure your future; Smarter Investing: Build wealth and secure your future; Planning for Homeownership; and Planning for Retirement. http://www.bankers.asn.au/financialliteracy

- Enhancing Centrelink's Financial Information Service and increasing support for financial counselling services, meaning all Australians can have access to information on financial issues, especially on how the social security and superannuation system interacts. Government should provide additional funding and resources so that FIS officers and financial counsellors can assist consumers and retirees with basic information about debt management, financial products and services, contracts, retirement options, support services, etc.

3. Conclusion

The ABA believes financial independence, financial security and a better lifestyle in retirement should be attainable for Australians. It will take a multi-dimensional approach from the Government, financial services industry and the community to ensure that all Australians take responsibility for their savings early so they are well prepared for retirement. Such a multi-dimensional approach should involve strategies to promote confidence in the retirement incomes system as well as deliver other economic and social benefits. The efficiency and equity of Australia's tax and transfer arrangements will shape the economic wellbeing of Australia and Australians.

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