

POLICY OPTIONS RETIREMENT INCOMES AND LONG-TERM SAVINGS

Thursday 9 March 2006

Good afternoon.

While Australia can be justifiably proud of its policy foresight in retirement incomes – its true to say we are world leaders in this endeavour – our system still falls short of its goal: that is, to provide adequate living standards for retired Australians.

In August 2003, IFSA launched its first policy document addressing the issue of Australia's retirement income and specifically its significant Retirement Savings Gap.

As most of us know, the Gap is the difference between our reasonable expectations for living standards in retirement, and our final retirement income, which is a combination of our current rate of saving and the Age Pension.

IFSA rightly characterised the Gap as “a call to action for policy makers and the superannuation community to boost retirement savings”.

The response has been two years of outstanding improvements to policy and to the system. These include the:

- significant extension of the co contributions scheme – and we have seen co-contributions of just under \$700 million paid in the last six months;
- abolition of the superannuation surcharge;
- abolition of the work test up until age 65 and the introduction of a simpler test after age 65;
- introduction of term allocated pensions;
- consent of income stream payments for part-time workers;
- establishment of the Financial Literacy Foundation;
- introduction of fund choice for many Australians;
- refinements to the Financial Services Reform Act; and
- division of contributions (contributions splitting) between spouses

The result is a 15 per cent, or a \$16,500 per person, reduction in the Gap. When we consider that some improvements like the extension of the co-contribution scheme are still working their way into the numbers, this reduction is a very significant start to securing adequate retirement income.

While these figures are impressive, we are not yet home. The Gap still stands at \$452 billion or around \$93,000 per person and we must seriously examine other ways to reduce it to an acceptable level.

Australia's retirement income system is built on three pillars: the Age Pension safety net; compulsory saving through the Superannuation Guarantee; and voluntary saving.

Voluntary saving is about the savings behaviour of ordinary Australians and any 'heavy lifting' in this area to close the Gap will only be achieved through education, information and specifically the introduction of incentives.

IFSA research has found that Australians focus strongly on the issue of contributions tax and that lowering front-end tax would improve retirement income levels and provide a very big boost to voluntary super.

Most encouraging was the projected response to the complete removal of the tax so that over the next 70 years, superannuation savings would increase by \$2.51 for each dollar of tax foregone and reduce the Gap to less than half its current size.

Conversely, any reduction in personal tax rates but not to the contributions tax would diminish the relative attractiveness of superannuation. IFSA's research suggests that superannuation contributions could perhaps even fall. If this were to happen without any increase to personal savings, the Retirement Savings Gap would increase and the goal of adequate retirement income would move further away.

Today, I am pleased to be launching *Policy Options for Retirement incomes and Long Term Savings* on behalf of the investment and financial services industry. To the extent that changes in the tax rates and mix affect retirement saving in both a positive and negative way, IFSA must contribute to the current debate on the contributions tax and we suggest a number of policy options in this document.

The co-contributions scheme is an obvious success. Currently, the co-contributions scheme incentives start to wind down as incomes rise into the \$50,000 bracket. This occurs before the tax incentive for salary sacrifice winds up – the 42 per cent marginal rate, which now commences at \$62,500.

We are suggesting that it be extended to middle income earners at an affordable cost. Our research shows that middle income families will respond significantly at lower 'matching rates'. That is, where the government co-contribution is as low as 50 cents for each dollar contributed. We have used this response level to draw up an example of an expanded scheme, which is reasonably affordable.

We are also suggesting a more flexible transition to retirement by allowing "ordinary" money – that is any money not yet made extra-ordinary in superannuation - into retirement income streams.

All these projects are relevant to building retirement incomes.

Australia's retirement system is a long-term partnership between government and industry. Government has acted to place a benchmark under the Age Pension and to require a base level of compulsory superannuation. Australia relies on the superannuation and investment industry to deliver returns to compound superannuation savings until retirement. It also increasingly depends on industry to maximise the living standards of retired Australians by delivering income stream products that help them draw sensibly on their savings. Industry also provides the administration systems to manage superannuation. In this endeavour, we are vital partners with government. It is our role to ensure that regulation and other requirements do not choke the system. Otherwise, we will ultimately all bear the costs.

Australia, like its peers, faces the twin challenge of funding an ageing population and ensuring that our retirees live well in retirement. It is clear that the Government's initiatives to date have been very successful in addressing these challenges and we are assured that we now find ourselves advanced beyond other developed countries in addressing the retirement savings gap. Government and industry must now work together to see this task through to completion.

In our policy options, we address the twin challenges of inter-generational funding and adequacy. We are placing them on the table as a responsible contribution to the policy debate, backed by our continuing commitment to fund research and modelling to increase our national understanding.

In the end, the question of balance will be resolved by government. With this document, we offer useful options for consideration. These proposals should be regarded seriously, and if they are adopted, they will significantly improve Australia's retirement income system.

Thank you.