Submission to Treasury in response to the Federal Budget 06/07 Proposal

"A Plan to Simplify and Streamline Superannuation"

Max Super Pty Ltd

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INTRODUCTION

max Super was launched in September 2005, following the introduction of Super Choice. We are one of Australia's newest (and fastest growing) retail super funds, designed to engage younger Australians in their retirement savings.

max Super shares the aims of the Government's proposals in the 2006 Federal Budget to simplify superannuation, and further wishes to address the adequacy issues affecting the younger generations' ability to realise a self-funded retirement. **max Super** has made considerable efforts to offer a fund that engages people under 40 in thinking about retirement savings. We have done this by providing;

- a low cost fund with a simple fee structure
- an easy to understand index investment strategy
- assistance in locating lost super and consolidating accounts
- an online focus for educational tools and member communications
- 'jargon busting' plain language communications

As the only fund specifically targeted to the under 40 demographic, we have based this response on our in-depth knowledge of the market gained through continuous research into the behaviours, attitudes and values of our demographic, and further consultation and research on commercial and economic impacts.

From its inception, our company has developed a keen interest in government initiatives affecting both the superannuation industry and its customers, in particular we have scrutinised legislation and policy that impacts on the ability of younger Australians to plan for a secure, self funded retirement.

We are pleased to be provided with the opportunity to respond to the 2006 Federal Government Budget. Our response provides a review of the Budget proposals and their ability to address the Government's stated objectives below, as well as exploring the broader impacts of the reforms on retirement savings behaviours and superannuation adequacy models.

The Government's proposed plan aims to:

- simplify superannuation arrangements for retirees, making it easier to understand;
- improve incentives to work and save; and
- introduce greater flexibility in how superannuation savings can be drawn down in retirement.

RESPONSE TO 2006 FEDERAL BUDGET PROPOSALS

Taxation on benefit payments

Benefits

max Super welcomes the proposed 2006 Budget reforms to the complex and confusing tax structure currently existing within superannuation. As a single sweeping reform we see the proposed changes as visionary and necessary, in order that ordinary Australians can take a more active interest in managing their retirement savings. The history of successive changes to superannuation law have served to make superannuation an obscure system for all but professionals and the most dedicated of individuals, and in this light the budget proposals bring a refreshing spring clean to the area of greatest complexity – benefit taxation and the grandfathering provisions surrounding them.

We believe that the removal of tax on benefit payments after the age of 60 and the abolition of Reasonable Benefits Limits will improve the retirement incomes of older Australians and also encourage those who currently have inadequate retirement funding to remain in the workforce longer, so as to maintain active superannuation accounts through continued contributions.

Limitations

In a recent **max Super** online survey of under 40's (August 2006), 81% of respondents nominated 'up front' incentives (removal of contributions tax 36%, soft-compulsion salary sacrifice 25%, access for 1st home 21%) as being the type of government initiative most likely to succeed in motivating them to personally contribute to their super funds, compared to 19% who saw the currently proposed 'exit' tax cuts as an incentive to save more. Of the 19% who *liked the idea* of removing 'exit' taxes, approximately half indicated it wouldn't change their immediate savings behaviours, while almost 4 in 5 of those preferring 'up front' incentives indicated they were likely to begin making additional contributions to their super if such an initiative were implemented. The clear implication of these findings is that while we can applaud the budget proposals' simplification aims, *and we do*, they do not in any significant way address what **max Super** believes to be the single most important issue in superannuation – closing the retirement savings gap.

Apart from lacking the required incentives to motivate higher savings behaviours in superannuants earlier, the proposed initiatives have the potential to impact negatively on Generations X and Y in the nearer future, in two specific ways. Firstly we believe that the removal of Reasonable

Benefits Limits has the capacity to decrease the probability of retirees buying annuities. If this were to prove true, once any lump sum benefits have been spent or (mis)invested elsewhere, those otherwise self-funded retirees will need to resort to living off the government age pension. In this scenario, upcoming generations will be left to support those retirees through the taxation system. Secondly, we believe that retirees may spend significant amounts of their non-taxed retirement funds on upgrading and extending principle residences (potentially to gain eligibility to the age pension, potentially to supplement income with a reverse mortgage), or buying investment property, either way fueling property markets. Any such property inflation would restrict Generations X and Y's ability to enter the increasingly out of reach housing market, the significance of which cannot be overstated given the core assumption that exists in all retirement savings adequacy models – that retirees own their home. Will a similar proportion of Generations X and Y own their home by the time they retire, as do the current Boomer generation? The very current discussions about 40 and 50 year mortgages coming into the marketplace seem to indicate not. The additional living expenses associated with paying for housing in retirement make the retirement savings gap for these generations wider.

Simplified Contribution Rules

Benefits

max Super is supportive of any effort by Government to make superannuation processes easier to understand and participate in. We are particularly pleased that changes to the Maximum Deductible Contributions limits have dropped the aged-based deductions in favour of a more equitable and streamlined approach.

Limitations

While **max Super** welcomes the opportunity provided to young Australians to invest more money into their superannuation accounts, we contest any proposition that the abolition of age based Maximum Deductible Contribution limits alone will encourage younger members to contribute more to their super. Our research shows that Generations X and Y contend with debt models that were not around when their parents were the same age and on comparative incomes. HECS, credit card debt, and the cost of modern communications place heavy burdens on weekly incomes even before families are started or attempts are made to buy a home. Given these factors, it is unrealistic to believe that this initiative will either provide an incentive to contribute more to their super, or that given their average annual incomes, many will be advantaged through Super Guarantee contributions alone. With the comparative reduction in MDC limits for over 50's and the introduction of new limits on undeducted contributions, we recognise that a significant structural change is being implemented to change the 'race to the finishing line' approach taken by current over 50's. **max Super's** concern is that without visionary changes that motivate younger Australians to contribute more into super we are likely to see many leaving their run too late, when larger top ups are affordable, but the ability to reap the benefit of concessionally taxed contributions has been lost.

Payment of benefits

Benefits
Providing Australians over 65 with the opportunity to maintain and continue to contribute to their superannuation funds until the age of 75 is a positive step towards encouraging older people to continue to work and save, and recognises the desire of older Australians to continue to contribute to Australian society. Furthermore, this initiative is of great benefit to older Australians who currently have minimal retirement funds, allowing them to hold and build their superannuation savings into their seventies. It may also relieve the taxation burden on Generations X and Y by decreasing the demand on Government pensions.

Limitations
A lack of restriction on the maximum amount that can be drawn annually leads us to repeat our concerns regarding investment into property, and its potential effect on inflating the housing market.

Changes for self-employed persons

Benefits
max Super strongly supports the proposed alignment of contribution deductibility for the self employed with those that exist for employees, and the extension of the co-contribution scheme to the self employed. It provides an excellent incentive for the self employed to participate in superannuation by creating equitable contribution process and practices.

Portability

Benefits

max Super has consistently called for the standardisation of portability practices throughout the superannuation industry and congratulates the Federal Government on its proposed changes to portability regulations. The efficient transfer of superannuation benefits between funds is critical to having effective Super Choice, where the current provisions have been clearly inadequate. We also applaud the proposal to use the ATO to assist with locating and moving lost superannuation accounts, and believe that despite the administrative burden on funds to know the tax file numbers of their members, that requirement will prove significant in reducing the amount of lost super.

Limitations

Our call for changes to superannuation portability is based on the frustrations experienced by our new fund members. We believe that Superannuation Choice has provided a solid base to enable young Australians to take an active interest in their retirement savings. Such active interest is quickly eroded when attempts to actually transfer super from one provider to another are made. Currently, if a member wishes to rollover their funds there is no structured way to go about it – every fund has different complicated forms, ID requirements and protocols which need to be met before funds are released.

The proposed timeframe reduction to 30 days we believe does not go far enough.

Recommendation

This is a key factor limiting people from taking an active interest and seizing control of their super. **max Super** believes urgent action needs to be taken to implement changes that simplify and standardise industry transfer protocols, including legislating:

- A standard rollover form to be accepted by all Trustees
- Standard ID protocols for rollovers to be accepted by all Trustees
- The timeframe for a Trustee to transfer funds be reduced to 14 days from the time of receipt of the completed rollover form and accompanying ID

SUMMARY (or how to address the elephant in the room)

max Super celebrate the wider reforms to superannuation contained in the 2006 Budget proposals. We believe that the Budget's objectives to simplify superannuation, provide incentives to continue working and saving and provide drawdown options for retirees has been well met within these reforms.

However, as a superannuation fund that largely represents the interests of young Australians, we believe that while these proposals create very significant structural change to superannuation, they take a 'back ended' focus on superannuation and do not address the problem of ensuring adequate retirement funding for Generations X and Y.

We believe that the Government must now focus on providing real incentives for young Australians to make voluntary super contributions, otherwise a great many Australians will continue to have needs in retirement that are exceeded by the outcomes generated by the current 9% superannuation guarantee. It has been widely recognised that around 15 % of annual earnings must be saved across a full working life of 30 years, to provide an income of 60 per cent of pre-retirement salary deemed necessary to sustain a reasonable lifestyle in retirement. A critical assumption in this figure is home ownership – it is assumed that retirees will own a house. The question of adequacy becomes far more problematic if this assumption is challenged. Savings levels would then need to be more like 22 per cent to cover housing costs in retirement. Given that all commentators agree that there is an adequacy issue looming, the proposals put forward in the 2006 Budget offer little to impact on adequacy and bridge the retirement savings gap. Rather we see these proposals simply replicating the investment behaviours of the previous generation, who were introduced to superannuation via the Super Guarantee late in life.

As noted by Terry McCrann in relation to the proposed super changes:

> *"The best way to take advantage of it is to turn it into a shorter-term investment, back-end loading contributions as you get closer to 60."*
> *(Herald Sun 9 July, 2006)*

Enticing young Australians to invest in superannuation is no small task. Significantly, however the Federal Government has shown its concern over Generations X and Y's lack of engagement with superannuation by establishing a House of Representatives parliamentary inquiry into "Improving the Superannuation Savings of People under 40", and specifically looking at the barriers and disincentives faced by this cohort. We wish to take the opportunity to reiterate some of the points we made in our submission to that inquiry, and highlight certain recommendations proposed in the committees report, for consideration in future Federal Budget initiatives.

RECOMMENDATIONS

When it comes to making voluntary contributions to super the younger generation are clearly more responsive to policy proposals that support building retirement wealth throughout the investment lifecycle. In research undertaken by **max Super** 81% of respondents supported 'up front' incentives.

At this stage of your life which of the following proposals would be MOST likely to get you personally contributing to your Super?	
No tax on my money going in	36%
No tax on my money coming out	19%
Enforced 3% salary sacrifice	25%
Access my Super for a 1st home deposit	21%

max Super Online Survey August 2006

Amongst this group there was a strong commitment to contributing funds now, if the proposals were implemented.

Based on your answer to the previous question, if your preferred proposal were implemented, what level of additional super savings are you MOST likely to make? (81% 'upfront incentive' respondents)	
Lock it in, I like enforced savings programs	34%
I'd immediately start a regular contribution plan	22%
I've got other pressing needs for my spare cash right now	22%
I'll start right away piling savings into super for a first home deposit then ease off the super and focus on paying off my mortgage	7%
I'd salary sacrifice to build a house deposit then continue building more into my super	14%

Only 19% indicated that the Governments proposal to remove the end benefit tax was the more attractive of the options. Nearly half of this group also indicated that under this strategy they were unlikely to be motivated to contribute to their super in the near term.

Based on your answer to the previous question, if your preferred proposal were implemented, what level of additional super savings are you MOST likely to make? (19% 'exit tax' respondents)	
Lock it in, I like enforced savings programs	11%
I'd immediately start a regular contribution plan	36%
I've got other pressing needs for my spare cash right now	48%
I'll start right away piling savings into super for a first home deposit then ease off the super and focus on paying off my mortgage	2%
I'd salary sacrifice to build a house deposit then continue building more into my super	2%

max Super Online Survey August 2006

The following expands our thinking on the various proposals to incentivise the younger generations to commence early savings for retirement.

Removal of the 15% Contributions tax

36% of participants surveyed in August 2006 indicated that abolishing the 15% contributions tax is the number one incentive for young Australians to make voluntary contributions to their super fund.

This tax was introduced as a temporary measure during a period when the national budget was in deficit. The abolition of this tax would effectively raise the Super Guarantee to its full 9%, increasing member savings and further encouraging voluntary contributions. Significantly, this proposal benefits from the compounding growth throughout the investment lifecycle.

This 'upfront' focus on superannuation would demonstrate the Government's commitment to investing in the future through superannuation, and remind Australians that superannuation is not 'just for retirees'. Currently, income tax cuts and Government grants stand to stimulate inflation, whereas a redirection of these funds into superannuation through the abolition of the contribution tax would be more fiscally responsible. We encourage the Government to revisit this proposal in future Budgets.

Enforced 3% Salary Sacrifice

Adopt the 'soft-compulsion' 3% salary sacrifice option recommended by the committee report following the Government's Inquiry into Improving the Superannuation Savings of people Under 40.

max Super's August 2006 survey indicates that 25% of participants under 40 were open to an enforced superannuation savings plan through salary sacrifice as an incentive to make further voluntary contribution, if they had the ability to stop contributions when they chose to. We encourage the Government to revisit this proposal in future Budgets.

Partial access to Super for 1st home deposit

max Super recommends providing partial access to voluntary (non super guarantee) contributions for first home deposits.

26% of those who participated in **max Super's** August 2006 survey and whom were not currently in the housing market selected this incentive as being the most likely to get them to personally contribute to their superannuation fund.

Spiraling house prices and rising interest rates have made entry into the housing market difficult for young Australians, as larger home deposits are required to offset the amounts needing to be borrowed. A decrease in home ownership bought about by a lack of affordability has serious implications for future Australian economies.

All current retirement adequacy models assume home ownership. As previously stated, if homeownership is not as widely attained in the future, the annual savings required in adequacy models rises to something like 22%. So how do we ensure that the fundamental assumption of home ownership in retirement – the increasingly elusive 'Australian Dream' – is secure?

max Super proposes that federal legislation governing the early release of superannuation be amended to allow first home buyers to access part of their accumulated non Super Guarantee contributions for this specific purpose. We put this proposition forward in the belief that it will motivate young Australians to make voluntary contributions to their superannuation funds, as it offers a more attractive investment vehicle than online savings accounts used to save for a 1st home deposit (Appendix 2). It also assists young Australians to relate to superannuation as something other than a scheme 'just for retirees', and thereby is more likely to stimulate ongoing contributions post the draw-down for a home deposit.

Our **case study** demonstrates how the effect of compounding interest on earlier contributions, coupled with ongoing savings behaviours would in fact build greater wealth in retirement.

Accumulated Super at Age 60 Retirement	Base Case SGC Only	Level of continued salary sacrifice after drawdown		
		0%	3%	6%
Cont. Tax = 15%	227,735	244,839	288,779	332,718
Cont. Tax = 0%	259,117	277,966	328,377	378,788
Growth on Base Case		7%	27%	46%

(See case study: Appendix 1)

We encourage the Government to revisit this proposal in future Budgets.

CONCLUSION

With the current Budget proposals "A Plan to Simplify and Streamline Superannuation" the Government has demonstrated an extremely visionary set of reforms to superannuation largely focused at the 'back end' of the investment cycle.

If the Government expects Generations X & Y to be mostly self funded in retirement, they will be required to be equally visionary in dealing with the issue of adequacy of retirement savings for this demographic.

max Super believes that motivating the under 40's to make ongoing voluntary superannuation contributions won't prove a difficult undertaking if the Government gives consideration to the reforms outlined in this submission, and closely examines the committee report on the Inquiry into Improving the Superannuation Savings of People under 40.

APPENDICES

Appendix 1: Early Contribution to Super Case Study

In the following example, it is assumed that an individual commences work at age 20 on a salary of $30,000 and is encouraged to make salary sacrifice contributions of 6% in addition to the 9% SGC contributions paid by the employer. After 10 years, the individual draws down 75% of salary sacrifice contributions for use towards a first home deposit, leaving the remaining 25% of salary sacrifice and 100% of the earnings on all contributions within the fund.

Following the drawdown at age 30 we have looked at 3 scenarios for continuing salary sacrifice contributions moving forward:

1. No further salary sacrifice contributions
2. Continue with 3% salary sacrifice contributions until age 60
3. Continue with 6% salary sacrifice contributions until age 60

The table below shows the amount an individual would currently accumulate in super by relying solely on employer SG contributions (base case) as well as the resulting outcomes of the 3 scenarios above after drawdown has occurred in year 10.

Accumulated Super at Age 60 Retirement	Base Case SGC Only	Level of continued salary sacrifice after drawdown		
		0%	3%	6%
Cont. Tax = 15%	227,735	244,839	288,779	332,718
Cont. Tax = 0%	259,117	277,966	328,377	378,788
Growth on Base Case		7%	27%	46%

<u>Assumptions</u>

Start Age	20
Retirement Age	60
Start Salary	30,000
Real Wages Growth	1.00%
Earning Rate	8.50%
Total Fees	1.00%

(Based on superannuation calculator, FIDO website, ASIC)

These results show that *even if salary sacrifice arrangements are stopped* after drawdown at year 10, the higher balance remaining within the fund will build a retirement balance that is 7% higher than if no salary sacrifice contributions were made. Given individuals would have experienced the positive value creation from saving within super, it would be reasonable to expect most would maintain some level of salary sacrifice contribution post drawdown.

If they were to maintain a 3% contribution moving forward, a 27% higher balance would be available at retirement, or if they were to maintain a 6% contribution, a 46% higher balance would be available at retirement than if an individual relied solely on the SG contribution.

Appendix 2: Saving via Super versus on-line bank account

Under 40's are currently likely to use a traditional or high interest online bank account to save for their first home deposit. In order to test the attractiveness of our proposal it is necessary to consider the typical outcome of this competing savings strategy.

Assuming the same individual above was to direct 6% of their pre-tax income (now in post tax dollars) to a savings account bearing interest of 5.5%, after paying tax at the marginal rate of 30% on earnings they would have a balance of $16,272 available after 10 years.
In the earlier scenario, by making a 6% pre tax contribution to super the individual would have balance of $21,258 attributable to the salary sacrifice contributions and related earnings after 10 years. With 75% of only the salary sacrifice contributions available to be withdrawn, the amount available would be $14,124.

Although the amount of funds available to put toward a home deposit would be $2,148 less, we believe that the ongoing value of the savings created within super would be sufficient to encourage its widespread use as a viable saving scheme for first home buyers.