FSC FINANCIAL SERVICES COUNCIL

28 November 2012

The Executive Director
Australian Law Reform Commission
GPO Box 3708
Sydney NSW 2001
Email: age_barriers_to_work@alrc.gov.au

Dear Ms Wynn

RE: Australian Law Reform Commission's Discussion Paper – *Grey matters – age barriers to work in Commonwealth laws*

The Financial Services Council (FSC) welcomes the opportunity to make this submission in response to the Australian Law Reform Commission's Discussion Paper – *Grey matters – age barriers to work in Commonwealth laws* (***DP78***).

The FSC represents Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advisory networks. The FSC has over 130 members who are responsible for investing $1.8 trillion on behalf of more than 11 million Australians.

The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Stock Exchange and is the fourth largest pool of managed funds in the world. The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

This submission provides the FSC's response to areas covered in DP78 which are relevant to the FSC's life insurance and superannuation members.

Please contact me or my colleague Blake Briggs, Senior Policy Manager, Superannuation, on (02) 9299 3022 should you wish to discuss any aspect of this submission.

Yours Sincerely

Holly Dorber
Senior Policy Manager, Life Insurance

Chapter 4. Insurance

Background and current experience

Life insurance products play an important role in the community as they protect consumers (and their dependents) against the financial risks of premature death, disability (both permanent and temporary), trauma and in the case of annuity products, longevity. Given 95% of Australian families do not have adequate levels of life and income protection insurance[1] and the devastating social and economic consequences caused by such high levels of underinsurance, prudent underwriting and risk assessment of applicants by life insurers is essential to ensure life insurance products remain affordable and accessible for consumers and the industry remains sustainable.

Individual life insurance in Australia is voluntary and is risk-rated through the insurance underwriting process and importantly, the majority of policies issued are guaranteed renewable[2]. Evidence-based underwriting that takes into account an individual's risk profile ensures that the premiums paid by each policyholder reflect their risk relative to the whole pool. This is a fundamental principle of voluntary insurance and means that insurers necessarily assess an individual's application for life insurance on the basis of a range of criteria, of which age is one important factor, but others may include their current state of health, health history, family medical history, habits, travel, residence, occupation and pastime activities etc.

Research has consistently shown that life insurance products are typically products that consumers engage with at particular life stages, for example, when taking on higher levels of debt, marriage, having children etc. as they provide a 'peace of mind' in relation to financial security and a safety net should something unforeseen occur that impacts their ability to earn or provide an income for themselves or their family. As a result insurers tailor their products to meet the needs of those different groups of consumers who are at those relevant life stages. The FSC is committed to ensuring that life insurance products, including income protection insurance, are accessible to and meet the changing needs of consumers.

In the development of insurance products and imposing an underwriting process within which to assess an individual's risk profile, life insurers also guard against the adverse impact of anti-selection. Anti-selection is the impact when there is a higher chance of loss than originally contemplated when the insurer sets its insurance rates. Anti-selection leads to a disparity where the purpose is to maintain equity between policy holders and has the potential to significantly impact the viability of the insurer's statutory fund. As anti-selection occurs when conditions or relevant history are known to an applicant for insurance and the insurer is not able to properly evaluate those conditions or history, it is fundamental to the life insurer's business that its underwriting rules are sound and not constricted to a point where the life insurer is not able to properly assess the risks.

[1] Lifewise/NATSEM 2010 Underinsurance Report: Understanding the Social and Economic Impact of Underinsurance

[2] Policies are issued as guaranteed renewable meaning that the insurer must renew cover up to the end of the term of the policy, regardless of any change in the insured's risk profile.

Additionally, the life insurance industry in Australia is highly competitive and as a result, it is the strong view of the FSC that competitive market forces combined with the changing demographics of the Australian community, in particular an ageing population that is now working longer, will lead life insurers to continue to innovate and develop products that best meet the needs and market demands of the potential consumers of their products including extending the terms of cover in respect of income protection insurance to older ages.

The focus of DP78 in relation to life insurance relates specifically to income protection insurance products. Income Protection (or Salary Continuance Insurance) is a form of personal insurance which provides an income stream should an individual become unable to work due to illness or injury. Depending on the level of cover, income protection insurance can pay up to 75-80% of an individual's income. Income protection insurance benefit periods vary with some benefits payable for 2 years and others until the normally expected retirement age.

Income protection insurance is a type of insurance for employed and self-employed individuals which is intended to provide an income replacement, generally on a temporary basis, until the individual is able to return to the workforce. Consequently, the longer the duration of the claim, the higher the cost of that claim to an insurer and hence, the increased cost of premiums where an insurer determines as a result of the underwriting process an increased risk of longer duration claims. Industry data clearly shows the increased incidence and duration of claims on disability income insurance at older age groups[3] and anecdotally, insurers advise that those claims at older ages tend not to result in a return to work.

Paragraph 4.19 of DP78 states that, "Significantly, with some exceptions, income protection insurance is unavailable to persons aged over 65". The FSC disagrees with this premise and we do not believe that access to income protection for older workers is in fact at present a significant barrier to workforce participation. This is supported by the results of a member survey conducted in February 2012 which showed that of the eleven life insurance members that responded, ten currently had products in the market that offering income protection policies with benefits beyond age 65 (with the majority offering cover to age 70 with one insurer indicating it offered a product with benefits to age 76)[4]. However, the feedback from insurers was that take up of such policies was low. ABS workforce data also reveals this showing that in the 20 years to March 2008 the participation rate of people aged 45 years and over increased from 40% to 50% while the participation rate for those aged 15-44 changed very little.[5]

In relation to group disability income or salary continuance insurance offered through superannuation, benefits have traditionally been designed to align to the retirement age (i.e. age 65) however, as the age pension eligibility age increases, trustees may determine coverage should continue beyond age 65. FSC life insurance members active in this market have indicated a willingness to offer coverage on this basis where requested by the trustee. However, it is important

[3] 2009 KPMG/FSC Disability Income Experience Investigation preliminary data analysis

[4] Note: Some additional conditions may be applied to these types of policies – for example, in some cases, benefits are available up to 70 but the product must be taken out prior to age 60 or in some cases 65.

[5] ABS, Health of Mature Age Workers in Australia: A Snapshot, 2004 to 2005.

to note, that in these cases, younger members of a fund would often effectively be cross-subsidising the higher premiums attributable to older members within the fund.

In light of this background and current consumer experience in relation to the accessibility to income protection for older Australians, the FSC makes the following comments in relation to the specific proposals outlined in DP78.

Proposal 4–1 In April 2011, the Australian Government established an Insurance Reform Advisory Group. The group should examine:

- **a. options for the development of a central information portal or source in order to provide mature age persons with clear and simple information about available insurance products;**

- **e. training of insurance distributers in order to facilitate the provision of clear and simple information about available insurance products.**

The FSC is supportive of initiatives to improve consumer awareness and accessibility of life insurance products offered by its members. We submit that it is important to ensure that any proposals with respect to the centralisation of product-specific information are balanced with the appropriate consumer protection in light of regulatory requirements for product issuers in regard to obligations that limit the provision of personal versus general advice. For example, while the age-related features of a product may be an important consideration for an individual, it is likely that there will be multiple other factors of equal importance (e.g. product terms and conditions) that may need to be considered by that individual when considering which product is right for them.

Approximately 60 percent of the life insurance products sold in Australia are acquired through an intermediary, i.e. a financial adviser or broker. There are around 16,000 financial advisers operating in Australia of which 14,000, or 87.5%, provide advice in relation to life insurance products. Of the 14,000 around 4,500 provide advice purely in relation to life insurance/risk. Financial advisers are skilled and trained to assist consumers in identifying and accessing the insurance products that are most suitable to an individual's needs and circumstances.

It is in the commercial interests of life insurers to ensure the particular and where applicable, differentiating, features of the products they offer are well understood and widely communicated to advisers as intermediaries and consumers more broadly.

We acknowledge that it is likely that awareness of the range of products that are presently available for older Australians may be low and would welcome the opportunity to engage further with consumer advocates to raise awareness of existing products.

- **b. the design and redesign of comprehensive and affordable insurance products tailored to the needs and circumstances of mature age persons;**

The FSC does not generally support legislative or regulatory intervention in relation to commercial product design. As discussed earlier, the FSC strongly believes that the competitive marketplace and increasing market demand is the most powerful driver of product innovation. As the population ages

and people remain in the workforce longer we submit that products have, and will continue, to be developed to meet the needs of older workers.

c. **mechanisms for reviewing age-based insurance pricing and underwriting across the industry;**
d. **mechanisms for ensuring that the insurance industry utilises relevant and appropriate actuarial and statistical data upon which to make decisions about insurance offerings, based on age; and**

The FSC strongly opposes these proposals.

The underwriting process for insurance product offerings is the foundation of each insurer's business operations and is the basis on which insurers compete in the market place. Therefore, an insurer's underwriting processes are highly commercially sensitive and as such, those processes should be afforded due commercial protection.

Therefore, we do not support any obligation for insurers to publish commercially sensitive information used in the pricing and underwriting process that is in fact an insurer's intellectual property.

In relation to comments made in DP78 and in subsequent consultation with the ALRC proposing the possible publication of data used by insurers in making underwriting and pricing decisions, we do not object to the principle of disclosing publicly available information used. However, we caution against such publication in absence of a strong disclaimer recognising that there are many other factors (as discussed further below) that must be considered in establishing the final price, including adjustments to the experience to reflect the particular product, how it is sold and managed, and recent trends in experience not reflected in public information.

We note that with respect to mechanisms for reviewing pricing and underwriting decisions, such mechanisms exist today and consumers are able to challenge an insurer's decision through the insurer's internal dispute resolution process and, if unsatisfied with that outcome, are able to pursue additional avenues of recourse through an external dispute resolution mechanism such as the Financial Ombudsman Service or the Australian Human Rights Commission. We believe these existing avenues are sufficient as they provide comprehensive consumer protections.

Background information

In the pricing and underwriting process, life insurers utilise a range of data sources including actuarial tables as an input to premiums, in addition to other sources - some of which are publicly available, others which are proprietary. Locally sourced data from the Australian Government Actuary, Australian Bureau of Statistics and other relevant data(for example, Australian Institute of Health and Welfare) including international data sources together with an insurer's own experience or the reinsurer's experience may also be used and may reflect varied experience across ages.

Underlying claims assumptions will also reflect expectations about anti-selection through the targeted channel, taking into account the underwriting approach adopted, but this is unlikely to be

age-based. For example, underlying rate tables may be loaded with a less stringent underwriting approach, or discounted for a channel where insurance is a secondary sale (as lower anti-selection will be expected).

In regards to overall pricing models, an allowance is made for the profit margin to compensate for the risk taken by the insurer. Competitive pressures are also taken into consideration and different insurers may target different age segments through their pricing models.

Most insurers will rely on various reinsurance manuals in order to assess any additional risks that an individual may present. Where a condition exceeds the risk appetite of the insurer, the only way to manage the additional risk will be exclude particular disorders or events, or decline cover altogether.

In relation to different ratings that may alter with age, this is dependent on the impairment and the prognosis of that impairment, in combination with any other risk factors that may be present in an individual. The age of an applicant will improve some ratings, or in some instances incur a higher rating. These decisions must be supported by appropriate evidence sourced via data referred to above.

As noted, reinsurance is a key component of the life risk contract although the consumer has no visibility of reinsurance arrangements. Each of the six reinsurers operating in the Australian market is a subsidiary/local branch of a large global reinsurer.

In setting reinsurance terms, conditions and prices for insurers, reinsurers use a combination of:

- The rates charged by direct insurers;
- Industry experience studies (where available);
- Individual reinsurer experience studies (at portfolio and individual treaty level);
- Information about the detailed design of the product that is being reinsured in addition to the insurer's relevant experience; and
- Other data (e.g. medical or workplace/population statistical data, overseas data), where the experience information is not sufficient, for example new benefit type - this may be particularly relevant in relation to the potential for further products to be designed to cover older ages. This would typically be publicly available information, apart from overseas data supplied from the reinsurer's parent company internal studies.

When the reinsurer and the insurer enter into a reinsurance agreement, the terms of the insurance policies are crucial as they detail the conditions upon which the reinsurer would pay the insurer's losses. The transference of the financial risk from the insurer to the reinsurer is dependent on an understanding of the policies that fall within that insurance arrangement and the terms of those policies, particularly what may or may not be excluded from benefit payments.

It is not possible for the industry to produce insurance data in respect of business that it does not already write. Therefore, the industry has to look to other factors to assist in making product decisions that are prudent and sensible and do not endanger the viability of the statutory fund and the existing policyholders' future payments. Where an insurer would like to offer new products that are viable there are limitations as a result of obligations under Section 48 of t*he Life Insurance Act 1995* to ensure that policyholders as a group in a statutory fund receive the appropriate

consideration in any relevant decisions made by the Directors of the Company. Therefore, due consideration must be given to the predictability of the experience of any product that is to be written.

Proposal 4–2 The Insurance Reform Advisory Group should keep a watching brief on developments in the insurance industry in relation to age, both in Australia and overseas, with a view to reviewing Australian insurance practices as the need arises.

The FSC supports the role and work of the IRAG and has been an active contributor to its agenda in relation to life insurance industry issues.

The FSC also maintains a watching brief in relation to the developments taking place in the life insurance industry globally. With respect to recent international developments in the United Kingdom in particular, we submit that it is prudent to observe the impacts of changes restricting permitted risk rating factors, including age and gender, on the accessibility and affordability of life insurance products.

As noted earlier, Australia has a significant underinsurance challenge and legislative or regulatory reform that results in an outcome that reduces accessibility and affordability of insurance for all consumers should be avoided. Recent data indicates that Australia has one of the lowest life insurance penetration ratios (total premiums as percentage of GDP), ranking 19th for insurance penetration in industrialised countries ahead only of Canada and New Zealand.[6]

Question 4–1 In addition to the General Insurance Code of Practice, are there other industry standards or codes that should be reviewed in order to encourage insurers to consider the needs and circumstances of mature age persons? For example, the Financial Services Council Code of Ethics and Code of Conduct?

The life insurance industry is well regulated and has one of the world's leading legislative frameworks for insurance underpinned by the *Insurance Contracts Act 1984* and *Life Insurance Act 1995* supported by regulatory oversight by the Australian Prudential Regulatory Authority (APRA) and the Australian Securities and Investment Commission (ASIC).

The FSC represents the superannuation, financial advice, trustee company services, managed investments, funds management and life insurance industries.

FSC Standard Number 1 – *Code of Ethics and Code of Conduct* ("**Code**") is not life insurance specific. FSC's *Code of Ethics and Code of Conduct* sets out ethical principles to guide decision making, and specific rules regarding certain conduct by all FSC members (which include superannuation trustees, trustee companies, fund managers, financial advice licensees and life insurers). This Standard is not life insurance specific or tailored and binds all FSC Members, and is not relevant to the specific subject matter relating to insurers and mature age persons. Therefore it should not be reviewed in the context of insurers and mature age persons.

[6] Swiss Re Sigma – World Insurance 2011 (No 3 2012)

The intent of the FSC's *Code of Ethics and Code of Conduct* is to promote the highest integrity among the broad FSC membership. We do not believe it is appropriate to limit (or tailor) the operation of this Standard to a particular group or demographic.

Question 4–2 In the course of the consolidation of federal anti-discrimination legislation, the Australian Government is considering the operation of the insurance exemption under the *Age Discrimination Act 2004* (Cth). If the specific exemption is retained, what changes, if any, should be made? For example, should:

- **a. the application of the exemption be limited in some way;**
- **b. there be provision for an individual to request and receive the actuarial or statistical data on which the action or decision was based; or**
- **c. clarification be provided as to what are 'other relevant factors'?**

The FSC has advocated the continuation of the inclusion of a specific exemption in relation to the provision of insurance and superannuation in the Consolidated Anti-Discrimination Act to ensure that the regulatory certainty and clarity that currently exists and enables insurers to appropriately assess risk and make distinctions on the basis of disability, age or gender remains.

We have noted that the existing exemptions also provide significant consumer protection through the requirement that where an insurer does make a distinction on the basis of disability, gender or age they can only do so where the decision is supported by reasonable actuarial or statistical data or other relevant factors. The FSC supports the inclusion of these provisions in the Consolidated Act.

Statistics from the Australian Human Rights Commission highlight the effectiveness of the current exemptions in protecting consumers and supporting the insurance and superannuation industries. In 2010-11 of the 2,152 complaints received by the Commission under Anti-Discrimination legislation just 12 related to insurance or superannuation.[7] Eight complaints were made under the DDA, four were made under the ADA and there were no complaints made under the SDA in relation to life insurance or superannuation in 2010-11.

We note that section 39 of the exposure draft legislation, *Human Rights and Anti-Discrimination Bill 2012* released on Tuesday 20 November 2012 retains a specific insurance exception in respect of lawful discrimination on the basis of age. The FSC welcomes this exception.

We also note that the draft legislation retains in s39 (5), conditions that must be satisfied for exemption as follows,

> *(5) For the purpose of paragraphs (2)(c), (3)(c) and (4)(c), the condition is that either:*
>
> *(a) the following subparagraphs are satisfied:*
>
> *(i) the discrimination is based upon actuarial or statistical data on which it is reasonable for the first person to rely;*
>
> *(ii) the discrimination is reasonable, having regard to the data and other relevant factors;*

[7] Australian Human Rights Commission Annual Report 2010-11.

(iii) *if the other person has given the first person a written request for access to the data—the first person has, within a reasonable period after the request is made, provided the other person with a copy of the data, or with reasonable access to the data; or*

(b) *if no such actuarial or statistical data is available and cannot reasonably be obtained—the discrimination is reasonable having regard to any other relevant factors.*

These provisions include the ALRC's proposed additional provision allowing an individual to request and receive the actuarial or statistical data on which the action or decision was based.

The FSC does not support the inclusion of this provision as currently drafted. However, we would, in principle, be supportive of an amended provision that enables a court or other relevant body, i.e. the Australian Human Rights Commission, to request such information on a confidential basis and for use only in the matter under investigation.

The FSC will make a comprehensive submission to the Senate Standing Committee on Legal and Constitutional Affairs inquiry in relation to the draft consolidated anti-discrimination legislation including in relation to the matters discussed above.

Question 4–3 Is the power of the Australian Human Rights Commission under s 54 of the *Age Discrimination Act 2004* (Cth) sufficient, or should there be some other mechanism for requesting or requiring the actuarial or statistical information relied upon by insurers seeking to invoke the insurance exemption?

As above.

Proposal 4–4 The Australian Human Rights Commission, in consultation with the Insurance Council of Australia and the Financial Services Council, should develop guidance material about the application of any insurance exemption under the *Age Discrimination Act 2004* (Cth) or consolidated anti-discrimination legislation.

We note that the Australian Human Rights Commission has developed *Guidelines for Providers of Insurance and Superannuation* with respect to the insurance and superannuation exemptions under the Disability Discrimination Act, which were last revised in 2005. The guidelines are not binding but provide the AHRC's view on the interpretation of the exemption under the Act and relevant case law.

The FSC believes this guidance is helpful and would welcome the opportunity to contribute to the development or revision or similar guidance in the future.

Chapter 8. Superannuation

Superannuation tax settings

The FSC is concerned that in section 8 of the discussion paper the ALRC appears to question the integrity of Australia's superannuation system,[8] in spite of the system being widely regarded as one of the best in the world.

Whilst the discussion paper does not make proposals or raise questions in relation to the broader structure of the superannuation system, its explicit criticism of the system appears to underpin a number of recommendation around 'targeting' the tax concession within superannuation.

It is not immediately clear that the architecture of the taxation settings around superannuation are within the terms of reference of the review, except in the most general, expansive reading of the terms of reference.

In spite of this, the FSC argues that, if the ALRC is considering making recommendations in relation to the taxation settings for Australia's retirement system, that it would be necessary to conduct a thorough assessment with the relevant tax experts so that the interactions between the social security system, superannuation tax settings and other concessions such as the Senior Australians Tax Offset, can be fully understood. It is an area of tax law where minor changes can have significant unintended consequences.

The FSC seeks to correct the record in this submission so that the ALRC does not rely on the information contained in the Discussion Paper. The FSC also seeks to demonstrate that any recommendations relating to the taxation system would require a more comprehensive assessment of the overall system with the involvement of tax and superannuation law experts.

The health of Australia's retirement system

The *2012 Mercer Global Pension Index* (Mercer Report) ranks Australia's pension system, which is underpinned by the superannuation system, private savings and a means-test age pension, as the third best system in the world.[9]

The Mercer Report broadly endorses the Australian system, and where it recommends changes, it is to increase the scope of the system, including by improving labour market participation amongst older workers and increasing the minimum access age before individuals are able to access benefits from their superannuation savings.[10]

The report does not does not make any recommendation in relation to the taxation settings, expect to note that the scoring of the Australian system has *increased* due to the legislated increase to the contribution rate to 12% - an increase in the concessional taxation of contributions designed to bolster retirement savings.

FSC commissioned research has repeatedly demonstrated that the overwhelming majority of Australians have a retirement savings shortfall and will not have sufficient savings to enjoy an adequate income in retirement. The latest FSC Rice Warner *Retirement Savings Gap* report identified

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[8] Grey Areas—Age Barriers to Work in Commonwealth Laws, paragraphs 8.13 and 8.15

[9] 2012 Mercer Global Pension Index - http://globalpensionindex.com/pdf/melbourne-mercer-global-pension-index-2012-report.pdf

[10] 2012 Mercer Global Pension Index at p23

a cumulative, national shortfall of $836 billion for the current working population that earns between $30 000 and $120 000 per annum.[11]

The shortfall indicates the magnitude of the issue that faces Government finances in the future, as more people are eligible for, and reliant on, the full or part age pension and advocate for ongoing increases to the pension rate. It also reflects the lower quality of life for retired Australians who are not able to maintain their living standards, however modest, into retirement.

Australia Institute criticism of the superannuation system

The discussion paper appears to rely on the Australia Institute's report *Can the Taxpayer Afford Self-Funded Retirement?* (AI Report) for its criticism of the tax settings of the superannuation system. The FSC notes that the AI Report is deeply flawed in its methodology and should be disregarded for the purposes of the ALRC's deliberations.

The AI Report argues that the tax concessions are not equitable and the long standing concessional rates should be wound back. However, the AI Report overlooks three significant elements of the system that skew the taxation benefits of the super system towards low income Australians.

Firstly, it does not calculate the benefit to low income earners that will be generated by the Government's Low Income Super Contribution, a measure introduced at the 2012 Federal Budget and currently in operation. This measure was specifically designed to support the super balances of low income Australians by providing an annual payment of up to $500 for low income earners.

The payment amount is 15% of concessional contributions made for individuals with a taxable income of up to $37,000. This reduces the tax rate for those earning below $37,000 to zero per cent. As a result, low income earners pay no tax on their super contributions.

Secondly, the AI Report ignores the recent tax increase for individuals with incomes over $300,000 also announced in the 2012 Federal Budget. The concession has been changed so that the tax rate for this cohort is now 30%, a measure that is expected to raise $1 billion for the Government over the next three years.

The AI Report does not take these two measures into consideration, in spite of the fact that both the measures had been announced and implemented by the Government before the report was published.

Thirdly, the AI Report ignores the tax receipts the Government receives from the 15% earnings tax levied on the $1.4 trillion held by super funds. By definition, you pay more earnings tax if you have more money in super, and so this tax is overwhelmingly directed at wealthier fund members. Earnings tax receipts makes up a significant, but not quantified, share of the $8 billion in tax forecast to be collected from super funds in the 2012-13 financial year and will increase significantly as the pool of retirement savings grows to $3 trillion by 2020.

The AI Report also has a broader structural flaw in its methodology that calls into question its reliability. The AI Report argues that the 'tax concession' that superannuation earnings receive is a concession directed towards wealthier Australians. However, the very reason we have a superannuation system is because Australians would not otherwise save for their retirement, and hence there would not be any savings to tax.

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[11] FSC *Retirement Savings Gap* - www.fsc.org.au/downloads/file/ResearchReportsFile/FINAL_FSCSuperannuationSavingsGapReport2011.pdf

The touted $30 billion headline figure in the AI Report would be cut by $15.1 billion if the earnings tax concession was discounted, as it should be.

Even if this money was not saved in super and spent elsewhere, it is likely that the Government would not collect much tax from these monies. The bulk of this money would likely end up in the tax-free family home, a negatively geared investment property, or spent on the 40% of good and services that escape the GST, such as health and owner occupied housing.

FSC response to questions and proposals

Question 8 - 1

The FSC supports the removal of the work test for fund members who wish to make a voluntary contribution to their superannuation fund. The FSC also supports retaining the current definition of the work test, that is, the relatively 'low' threshold of a minimum of 40 hours over a consecutive 30-day period.

The FSC does not support a change to the definition of the work test. Doing so would risk disenfranchising individuals who genuinely have a tenuous link to the workforce, often lower income workers.

A work test with a 'higher' threshold may inadvertently penalise individuals who are continuing to be engaged in the workforce in order to increase their superannuation savings out of a realisation they have inadequate retirement savings to support their retirement. An older worker would only have certain employment opportunities available to them, and may have less physical capacity for work with longer hours, requiring their work arrangements to be closer to the current work test definition.

Furthermore, it is logical that most individuals who choose to work over 65 years of age do so because they either genuinely wish to work, or have inadequate retirement savings and therefore have a financial need to continue working.

It is unlikely that wealthier individuals would continue to engage with the workforce in order to be able to contribute to their superannuation balances, and receive the corresponding tax concessions, especially where the concessional contributions caps are set at only $25 000 per annum (which creates a marginal tax benefit of only $3750).

Proposals 8 – 1, 2, 3, 4, 5 and 6

The FSC supports these proposals as they would remove barriers to mature age workforce participation as a result of provisions that discriminate on grounds of an individual's age.

The FSC is also of the view that any proposals that encourage a worker to stay engaged with the workforce in order to bolster the adequacy of their retirement savings would have a positive impact on the decision of an older individual consider whether or not to continue working.

Removing these barriers would also have the beneficial effect of reducing unnecessary complexity from the superannuation system, making it more efficient and cheaper to administer and easier for consumers to understand.

Proposal 8 – 7

The FSC strongly supports the retention of the existing transitional to retirement (TTR) rules and opposes the proposal as a review is neither appropriate or necessary.

The TTR rules are specifically designed to promote mature age employment. For this reason the FSC considers it unusual that the Discussion Paper appears to be suggesting that the TTR rules should be reviewed with a view to abolishing the capacity to enter into a TTR arrangement, or to require that a mature worker should work *less* in order to be eligible to establish a TTR arrangement.

Importantly, the only evidence in the Discussion Paper used to argue against the retention of the current rules is the 2010 DEEWR report.[12] The FSC observes that this report studies HILDA data between 2001-2008; the strongest years of the mining, asset price and share market booms in Australia. The FSC contends that the booms distorted Australian's views about their wealth, and in particular, the current and future value of their retirement savings. As a result individuals did not have accurate information to make assessments about their capacity to retire with adequate retirement savings, potentially distorting the results of the research by recording an inordinately earlier rate of retirement than would now be the case.

The FSC also notes that the retention of the current TTR rules is supported by the superannuation industry, employer organisations and trade unions. It appears that the organisations opposing the retention of the TTR rules have argued that the tax concessions could *better* be directed at low income cohorts for social equity reasons, regardless of the employment participation outcome and contrary to the objectives of the ALRC review.

The FSC submits that TTR arrangements create a financial reward that encourages individuals to continue in the workforce, and as such can only have a positive impact on mature age employment. As previously mentioned, FSC research has demonstrated that the overwhelming majority of Australians have a significant retirement savings shortfall, which many first identify as they commence planning for retirement in their fifties.

The TTR rules assist in addressing this shortfall by encouraging Australians to continue working in order to bolster their retirement savings through making it more financially rewarding to do so. Regardless of whether it was the original intent of the policy to allow people to reduce their workforce engagement through a TTR, it is entirely appropriate for individuals to continue working full-time (or their equivalent pre-TTR hours) to take advantage of the tax concession in order to maximise their retirement savings. Such a strategy would result in a net tax gain for the Government, through higher income tax payments, a more productive worker, as a result of the higher output by the worker, and a greater contribution by the mature worker to national GDP.

To the extent that retention of pre-TTR hours of work is an unintended consequence, it is a positive one with benefits for the individual, the Government and the nation.

Furthermore, in a post-global financial crisis world, where capital growth is subdued and superannuation balances have, on average, only recently returned to pre-GFC levels, it is important to provide additional incentive for individuals approaching retirement to remain in the workforce and contribute to their retirement savings. The alternative is a higher number of mature workers resigning themselves to lower retirement incomes and greater reliance on the age pension. To the extent that the TTR rules prevent this eventuality from occurring, they have a positive impact on mature age employment participation.

[12] *Grey* areas, at 8.119 on p184

Conjecture that individuals utilise TTR rules as a tax minimisation strategy are misguided. It is important to note that the concessional contributions cap is set at $25 000, causing the marginal tax benefit that a 'high income' individual can receive by entering into a TTR arrangement to be minimal as a portion of their income, and certainly not large enough to substantiate views that the policy allows structural abuse by wealthier individuals.

TTR rules provide the greatest benefit to middle income workers, as the tax concession they receive is a greater proportion of their total income and therefore contributes more towards their personal measure of an adequate post-retirement income.[13]

To the extent that the ALRC may recommend that TTR arrangement can be better targeted to encourage mature age workers to stay in the workforce when they would not otherwise do so, be it either part time or full time, the FSC is of the view that this can be better addressed through the current, and potential future increase to the preservation age, which is discussed in more detail below.

There is a low incidence of voluntary retirement between the ages of 55 and 60 years. Those that leave the workforce at this age are more likely to do so as a result of health issues, often as a result of working in occupations requiring manual labour. It is those over the age of 60 years who may be persuaded to remain in the workforce for longer than they otherwise would and who can be influenced by the availability to TTR arrangements after they have passed the preservation age.

Question 8 – 2

The FSC supports an increase of the preservation age to 62 years in order to increase mature age workforce participation, to better target existing TTR rules and to increase retirement savings and the adequacy of retirement incomes.

As previously indicated, an increase to the preservation age would interact with existing TTR rules to target TTR arrangements at those people actively considering the option of retirement. This is because is available to individuals currently over the preservation, which is currently set at 55 years of age and transitioning to 60 years. As indicated, there is a low level of voluntary retirement under the age of 60 years, and as such the low preservation age dilutes the targeting of TTR arrangements.

If the preservation age were raised to 62 years, the TTR arrangements would be targeted at approximately the average age of retirement. Whilst the impact would obviously vary by industry, it is logical that the biggest benefit would be felt by making the TTR arrangements available at the point that individuals are making their retirement decisions.

The FSC also supports an increase in the preservation age as a method of addressing the $836 billion shortfall in retirement savings. FSC research into potential policy responses to the longevity savings gap showed that for every year the preservation age is increase, the savings gap is closed by almost $200 billion.[14] This is by far the most powerful lever available to the Government to address inadequate retirement savings.

The significant effect arising from the increase in the preservation age is a result of:

- Two additional years of growth on entire accumulated balances;

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[13] Defined by the Senate Select Committee for Superannuation and Financial Services as 60-65% of immediate pre-retirement income.

[14] FSC *Longevity Savings Gap*, 2012

- Two less years of draw down of retirement savings, especially before the age pension becomes available; and
- Two additional years of contributions to superannuation accounts.

An increase to the preservation age would mandate higher levels of employment participation, and would clearly be better managed by employees in less labour intensive industries. However, labour intensive sections of the workforce make up a declining portion of the total workforce, and should not be afforded a disproportionate level of emphasis.

Furthermore, appropriate phasing arrangements, such as the higher preservation age applying to those born after 1 July 1976 (a date consistent with the current phasing of the preservation age), would minimise the impact on current workers and those who are currently planning for their retirement.

At this stage raising the preservation age to 62 years is appropriate as it restores the historical 5 year gap between the preservation age and the age pension age, which has currently blown out to 7 years. A larger gap has serious negative consequences as it provides a longer period in which a retiree consumes their superannuation savings without being eligible for the age pension, therefore reducing the length of time that their personal savings can provide an adequate retirement income.

Question 8 – 3

The FSC does not see a causal relationship between the tax-free access age to superannuation benefits and employment participation.

The FSC would support, however, an increase in the tax-free access age to align with the preservation age, if the preservation age were to be increased, to improve the simplicity of the system.