Your money
Your future

Financial Planning Newsletter - Edition 1, 2012

The Super Guarantee turns 20

This year marks the twentieth birthday of the Superannuation Guarantee, Australia's unique system of compulsory retirement savings funded by employers. What was once a privilege extended to professionals and public servants is now the right of all employees who earn more than $450 a month.

As a result, Australians now have more than $1.2 trillion invested in super, up from $230 billion in 1995[1]. In the process, the Superannuation Guarantee, or SG as it is known, has changed the investment landscape in ways that few people could have imagined back in 1991.

For many individuals, super is their largest financial asset outside the family home and this provides a compelling incentive to take more interest in their investments. At a national level, the SG is designed to create a financial buffer to support our rapidly ageing population in retirement.

But the SG has turned super into more than just a retirement savings vehicle. During the 2008/09 financial crisis, Australia's superannuation system provided a pool of money to help cushion the economy from the worst of the financial shocks[2]. Super funds have invested about $50 billion in new infrastructure projects, and provided up to half of new capital raised by Australian companies to repay debts[3].

The Three Pillars

Governments in many countries, including our own, are grappling with the social and financial challenges of increasing longevity. Most developed nations have some form of government age pension supplemented by private pension schemes.

Australia has developed a 'Three Pillars' retirement income system which relies on a combination of government age pension, employer-funded superannuation, and private savings.

Like Australia, countries such as the Netherlands and Sweden, widely regarded as having excellent pension systems, have some form of compulsory private pension, whereas private pensions in the US and UK – although widespread – are voluntary.

A global comparison of retirement income systems in 14 developed nations ranks Australia fourth behind the Netherlands, Switzerland and Sweden. The verdict of the Melbourne Mercer Global Pension Index[4] is that Australia is doing well, but could do better. Suggested improvements are increasing the SG to 12 per cent, reducing the costs of super, increasing the workforce participation of people aged over 55, and making it compulsory for people to take at least part of their super payout as a pension. Some of these reforms are already in the pipeline.

1 ATO.

2 The Weekend Australian, 17-18 September, 2011.

3 ASFA, The Allen Consulting Group, Better living standards and a stronger economy: the role of superannuation in Australia, September 2009.

4 Melbourne Mercer Global Pension Index 2010.

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The Super Guarantee turns 20 continued

Building Australia's super scheme

The SG was originally set at 3 per cent of pre-tax income, rising to 9 per cent by 2002. In last year's budget the Federal Government announced a proposal to increase it from 9 to 12 per cent by July 2019. It also plans to raise the age limit for eligibility to 75 by July 2013[5]. At the same time, eligibility for the age pension is being lifted gradually from 65 to age 67 in 2024.

During your working years you and/or your employer contribute money into super. If you are aged between 18 and 70, earn more than $450 a month, and are regarded as an employee for tax purposes, then your employer must make contributions to your super fund on your behalf[6]. However, you cannot access that money until you satisfy a condition of release or reach age 65.

The reward for locking your money away for 40 years or more is two-fold: investment earnings inside super are taxed at concessional rates, and withdrawals from your savings are tax free after age 60[7].

The restrictions placed around access to your super savings may be strict, but they provide a rare win–win for government and investors. The longer you leave your money invested in super, the longer compound interest has to weave its magic and create a substantial nest egg for your retirement. Therefore, the government needs to spend less money on the age pension and other welfare benefits in the future.

A brighter future

The compulsory nature of these employer-funded payments takes the pain out of saving for many Australians, but there is no cause for complacency.

The average super payout in 2009/10 was $198,000 for men and just $112,600 for women. The current generation of retirees has had the benefit of the SG for only 20 years and many women have had time out of the workforce. But as the superannuation system matures, retirement benefits should increase substantially.

For example, someone on a modest income of $50,000 with 40 years in the workforce could expect to retire with a lump sum of around $466,000 based on 9 per cent SG and no voluntary contributions. This would provide annual retirement income of around $30,000, which is better than the pension but would only afford a modest lifestyle[8].

If you would like to discuss ways to boost your retirement savings, perhaps with an increase in voluntary contributions to super, then call us so we can help you realise your goals.

5 ATO.

6 ASFA, The Allen Consulting Group, Better living standards and a stronger economy: the role of superannuation in Australia, September 2009.

7 Assuming retirement is at age 60, note super payments between 55 and 59 may not be tax free.

8 ASFA, The Allen Consulting Group, Better living standards and a stronger economy: the role of superannuation in Australia, September 2009.

Women and money

Against a backdrop of global debt woes and financial market uncertainty, Australian women are more worried than men about their financial wellbeing and less optimistic about the economic outlook.

According to recent surveys by Million Dollar Woman, only 30 per cent of working women are confident that Australia will avoid an economic downturn, compared with 47 per cent of men[1]. What's more, nearly twice as many women (18 per cent) are pessimistic about the economy's future than men (10 per cent)[2].

It is not clear from the research why women are more concerned about their finances than men, but there are a number of possible reasons.

In most families, women have primary responsibility for household shopping so they may be more sensitive to rises in the cost of living.

Debt could also be an issue. Research by Million Dollar Woman found that women owe $2.60 for every $1 they earn, compared to $2.10 for men[3]. Debt can be good when it is used to build wealth, but it causes problems when it is used for everyday spending and not managed wisely. The less income you have, the more difficult it is to support a significant amount of debt.

Not only do women earn less than men on average, they are more likely to take time out of the workforce to raise children, leaving them with less money saved for retirement. The average superannuation balance in 2009/10 was just $40,475 for women compared with $71,654 for men[4].

Knowledge is power

There is another possible explanation for women's lack of optimism; perhaps they are just more realistic than men. The most famous study of gender differences in investing, by academics at the University of California, found that male investors tend to be overconfident and this leads them to trade their share investments more often than women and take greater risks[5]. But men were no more skilful or successful than women. Could it be that women are more willing to own up to the fact that they do not know everything?

While women may have good reasons to be less optimistic than men, it does not mean they are powerless to act.

The best way for women – and men – to take control of their financial destiny is to increase their knowledge.

Your financial adviser can help keep your finances on track but the more you learn about investment and sound money management the brighter your future will be.

1 Million Dollar Woman, Australia's financial outlook 'worries' women, 19 August, 2011

2 Allianz Future Optimism Index, 23 August, 2011

3 Million Dollar Woman, ibid.

4 ASFA, based on ABS Survey of Income and Housing 2009/10 (released 19 September 11)

5 Brad Barber and Terrance Odean, 'Boys will be boys: Gender, overconfidence and Common Stock Investment', Quarterly Journal of Economics, February 2001.