

# The AMP Superannuation Adequacy Report

July – December 2007

Produced by Access Economics Pty Limited for AMP



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## EXECUTIVE SUMMARY

The *AMP Superannuation Adequacy Index* compares the savings of Australians with benchmark targets for an adequate retirement – based on 65% of individuals' own pre-retirement living standards.

It uses data from more than 320,000 AMP members, and supplements that with estimates of the age pension (for those who qualify) and 'other investments' (excluding the family home), to illustrate whether Australians are on track for an adequate retirement.

This issue of the *Index* draws on data for the six months from July to December of 2007 – a unique opportunity to measure the response to the new incentives in super **after** the one-off surge ahead of the introduction of *Simpler Super*, but **before** the recent volatility in market returns had a chance to affect members' super returns or savings behaviour.

### CONTRIBUTIONS REMAINED STRONG AFTER THE 30 JUNE DEADLINE ...

The overall boost to super contributions in the first half of 2007 was impressive, but much of it proved to be short-lived. As the one-off factors behind that result faded following the introduction of the *Simpler Super* reforms, the surge in contribution rates has fallen away in the second half of 2007 to reveal a more modest – and more sustainable – ongoing lift in super savings.

Data in this latest release of the *AMP Superannuation Adequacy Index* show that average contribution rates in the December quarter fell just short of the predictions made in the June 2007 *Index*. That is, 'ongoing' contributions, at 13.0% of member salaries, are 0.4 percentage points higher than a year ago.

### ... MEANING MEMBERS HAVE BUILT ON EARLIER ADEQUACY GAINS

CHART 1: THE AMP SUPERANNUATION ADEQUACY INDEX – DEC-06 TO DEC-07

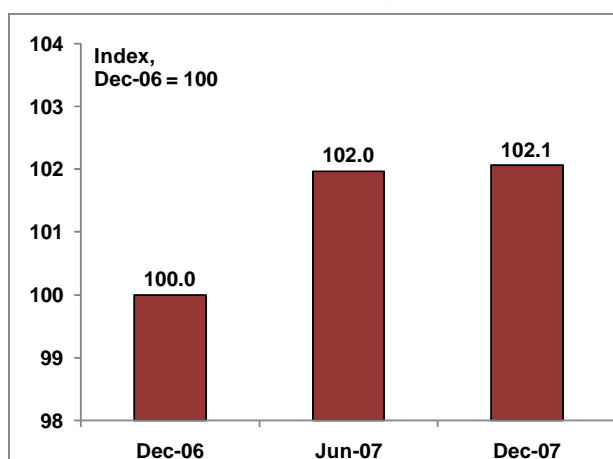


Chart 1 shows the movements in retirement incomes adequacy for the average Australian worker. The *AMP Superannuation Adequacy Index* measures retirement incomes adequacy using a measure of net retirement income as a share of pre-retirement living standards.



The June 2007 issue of the *AMP Superannuation Adequacy Index* showed that average adequacy levels rose relatively fast as members responded to recent improvements in incentives. This current *Index* shows that average adequacy levels recorded a further modest rise in the second half of 2007, building on the rapid adequacy gains in the lead up to the introduction of the *Simpler Super* reforms.

That is because retirement incomes rose further in the second half of 2007. The average worker can expect an extra \$1,091 a year in retirement income (or around \$21 a week in today's money) over and above the estimates in the last release of the *Index*.

That is a solid result coming after an even larger lift in the first half of 2007, meaning that a further 185,000 Australian workers now appear on track to achieve an adequate income in retirement, relative to their final year in the workforce.

Yet while adequacy levels continue to improve for 'the average worker', current super savings are still falling short for 3.2 million Australian workers. Current trends will see this latter group of workers face a greater relative shortfall of 11.4% against a desired benchmark for their retirement incomes, or some \$3,646 a year in today's terms.

### ... BUT MUCH DEPENDS ON MEMBERS' REACTIONS TO RECENT MARKET JITTERS

The further lift in projected retirement incomes above, while welcome, has been estimated based on data to December 2007, and has therefore been little affected by the weaker 2008 results in many of the markets in which superannuation funds are held.

Members' voluntary contributions in the six months to December 2007 represent a solid foundation, but there is risk short term market turmoil may outweigh the long term incentives offered by the super system and discourage super savings.

While weaker markets may have a short term impact on super balances and investment returns through 2008, particularly for those nearing retirement, it is the potential for a lingering impact on members' savings behaviour which presents the greatest challenge for future retirement incomes.

### ... AND THE APPROACH TO NEW RETIREMENT PATHWAYS

While average retirement ages for those retiring from the workforce (and leaving the super system) appear to be rising, new 'transition to retirement' options show a different trend.

The analysis in this *Index* is based on an average retirement age of 61 years and 6 months – little changed from that of the December 2006 and June 2007 editions of the *Index*.

However, more flexible retirement options for members mean that understanding recent trends in retirement age will take time, as the length of time members take to 'transition' into retirement will become an important driver of average retirement ages in the future.

As these new pathways to retirement become clearer, the average retirement age used in the modelling here may yet prove to be a conservative estimate.

**Access Economics**  
**May 2008**



## ABOUT THE ANALYSIS

The *AMP Superannuation Adequacy Index* is aimed at comparing current levels of saving in superannuation with the living standards that Australians can reasonably expect to aim for in their retirement years.

The report measures the impact of changes Australians are making today to secure an adequate standard of retirement living in the future.

The measures here project final retirement outcomes for today's members, and then compare them with a widely accepted adequacy benchmark based on 65% of pre-retirement living standards.

That benchmark is a relative one, comparing retirement income to the income that members enjoy in the final years of their working life.

In other words, the measure indicates the success of members' retirement savings efforts against the living standards they will enjoy, rather than a 'one-size-fits-all' standard such as average weekly earnings.

The *AMP Superannuation Adequacy Index* has important features which set it apart from other sources of information on super savings:

- ❑ **Accuracy.** It is based on real world data, rather than survey or sampling. This is the first ongoing analysis to use such data in Australia's debate on retirement incomes.
- ❑ **Relevance.** By using relative measures and including detailed information, the report provides measures which are relevant to the superannuation experience of individual members. This provides a welcome contrast to existing figures which focus on overall assets under management and contribution flows.
- ❑ **Consistency.** Released twice a year to allow like-for-like comparisons of savings performance, the report tracks changes in retirement incomes adequacy over time.

The report is focused on measuring the implications of current superannuation data for future retirement incomes. Many members examined as part of this analysis are a long way from retirement, and changes in their savings behaviour, investment returns and retirement ages can significantly alter outcomes for members over time.

The *Index* highlights the effect of members' savings today on their living standards in the future. In effect, this provides a 'report card' which gives new insights into the retirement savings performance of Australians.

## THE DATA

The *Index* uses data from more than 322,000 of AMP's 550,000 corporate superannuation members whose salary details are known. Data from retail superannuation members have not been analysed. Access Economics supplements this raw data with estimates of the age pension (for those who qualify) and 'other investments' (excluding the family home), to illustrate whether Australians are on track for an adequate retirement.



By drawing directly from client records, the analysis is able to measure contributions and balances to a high degree of accuracy. **In effect, the *Index* can be thought of as a combined account 'statement' for Australian super fund members.**

The data set examined includes account balance, age, gender, State of residence and salary. However, no individual member details are identified and all member information remains confidential.

## THE MEASURES

Superannuation, like other forms of retirement savings, is designed to accumulate assets during one's working life in order to provide income after retirement. However, retirement assets are simply a means to an end – achieving a higher standard of living in retirement.

Making this connection between current super savings and future retirement income is difficult, leaving many Australians (and policymakers) confused as to how much super they need for a comfortable retirement. However, the *AMP Superannuation Adequacy Index* provides a regular 'snapshot' of the nation's super savings, comparing them against a retirement income 'target' to show how super is performing for Australian workers.

The *Index* measures the living standards that retirees can expect to achieve with their super by predicting average outcomes for members based on current super savings. These outcomes are then adjusted to account for taxes<sup>1</sup> and savings, and compared with a benchmark based on 65% of pre-retirement living standards.

This 'target' is a relative one, measuring retirement living standards against members' own incomes in their final year of work. It makes the implicit assumption that individuals on higher incomes during their working lives expect to maintain that relative advantage in retirement, and avoids the need to define a 'one size fits all' standard.

## THE MODELLING

To assess the likely outcomes for tomorrow's retirees, the analysis presented in these reports projects future retirement incomes based on current superannuation and other data.

A comprehensive projection model of the retirement savings of Australian workers allows the impact of today's savings and retirement behaviour on future outcomes from super to be identified and assessed against the adequacy benchmark. Both the modelling approach and the adequacy measures used are broadly consistent with the Federal Treasury's preferred approach to assessing retirement incomes.

While the modelling allows alternative assumptions about taxes, savings rates, investment returns, retirement ages and government benefits to be explored, the results reflect a reasonable central case for the future of retirement incomes.<sup>2</sup>

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<sup>1</sup> Note that the analysis in this Index uses current personal income tax rates and thresholds (for the 2007-08 financial year), but allows for the latter to rise with inflation over time (to avoid 'bracket creep' into higher average rates of tax). The analysis therefore assumes that future taxes simply hand back such 'bracket creep', rather than being ahead of or behind it).

<sup>2</sup> For more information on the assumptions used in the analysis, and the treatment of tax and savings, see Appendix B.



## 1. LATEST DEVELOPMENTS IN SUPER ADEQUACY

In this issue of the *AMP Superannuation Adequacy Index*, we examine trends in members' savings and retirement behaviour **after** the one-off surge ahead of the introduction of *Simpler Super*, but **before** the recent volatility in market returns had a significant impact on the super system.

**Average super balances rose further in the second half of 2007**, despite a fall in average balances among some older age groups as those with larger super balances took early advantage of the removal of benefits taxes.

**The overall boost to super contributions in the first half of 2007 was impressive but, as expected, it proved to be short-lived.** As the one-off factors behind that result faded following the introduction of the reforms, the surge in contribution rates has fallen away to reveal a more modest (and more sustainable) lift in super savings.

Data in this latest release of the *AMP Superannuation Adequacy Index* show that average contribution rates in the December quarter were just short of the predictions made in the last release of the *Index*. That is, 'ongoing' contributions, at 13.0% of member salaries, are 0.4 percentage points higher than a year ago.

The past year has seen interesting and potentially important shifts in average retirement ages among members. While average retirement ages for those retiring from the workforce (and leaving the super system) appear to be rising, new 'transition to retirement' options show a different trend.

The analysis in this *Index* treats those members who withdrew more than three-quarters of their super in the six months to December 2007 as retirees, and measures the average retirement age across both groups.

The results in this *Index* are therefore based on an average retirement age of 61 years and 6 months – little changed from that of late 2006 (which also underpinned the results of the June 2007 edition of the *Index*). However, that may well prove to be a conservative estimate.

Last year saw interest in super at unprecedented levels, spurred on by major changes to tax and administrative arrangements announced by the then Government in May 2006 as part of the *Simpler Super* package of reforms. Last year also marked the high point in a record run of capital gains across a whole range of assets, as fallout from the financial and economic woes of the US began to filter through to Australian markets in the closing weeks of the year.

Data for the six months from July to December of 2007 represent a unique opportunity to measure the response to the new incentives in super after the one-off surge ahead of the introduction of *Simpler Super*, but before the recent volatility in market returns had a chance to impact on members' super returns or savings behaviour.

In this issue of the *AMP Superannuation Adequacy Index*, we examine trends in members' savings and retirement behaviour before and after the introduction of recent reforms.



## 1.1 SUPER BALANCES

Average super balances saw strong gains across 2007, to stand 11% higher by year's end.

Excellent super earnings combined with the one-off surge in voluntary contributions to produce increased average super balances by \$2,563 per head across all age groups between end-December 2006 and end-June 2007.

**TABLE 1: AVERAGE SUPER BALANCES – ACTIVE MEMBERS, DEC-06 TO DEC-07**

Age	Balance (\$)		
	Dec-06	Jun-07	Dec-07
20-24	\$5,246	\$5,110	\$5,277
25-29	\$13,131	\$13,052	\$13,573
30-34	\$24,076	\$24,799	\$26,352
35-39	\$34,486	\$35,829	\$38,850
40-44	\$44,233	\$46,621	\$51,319
45-49	\$54,991	\$57,507	\$63,314
50-54	\$69,025	\$75,247	\$79,534
55-59	\$81,257	\$90,244	\$91,638
60-64	\$93,331	\$96,494	\$88,684
65-69	\$86,927	\$98,160	\$83,767
<b>Average</b>	<b>\$39,663</b>	<b>\$42,226</b>	<b>\$44,013</b>

In the six months to end-2007, average super balances saw a further, more modest increase of \$1,787 per member. That increase was led by solid gains for members aged in their 30s and 40s. It occurred despite a fall in average balances among older age groups (as some members with larger super balances took early advantage of the removal of benefits taxes for the over 60s).

## 1.2 CONTRIBUTION BEHAVIOUR

In the months leading up to 30 June 2007, strong investment returns, increased government incentives and the short term deadline created by the one-off opportunity to contribute up to \$1 million combined to encourage a record surge in voluntary contributions from members.

Contributions in the first half of 2007 were set against a backdrop of widespread publicity and relaxed contribution limits. Aggregate measures of the boost to super in the first half of 2007 were impressive, but as the June 2007 issue of the *AMP Superannuation Adequacy Index* revealed, the overwhelming majority of the increase in voluntary contributions in the June quarter 2007 came from those groups who were already doing more to save for their retirement – older members and those on higher incomes.

As these one-off factors faded in the six months following the introduction of the reforms, the surge in contribution rates has fallen away to reveal a more modest lift in super savings.

In the June 2007 release of the Index – that based on the data through to June 2007 – Access Economics assessed the 'ongoing' component of the increase in voluntary super contributions in the six months to June 2007 at 0.4%.



Table 2 below shows that average contribution rates in the December quarter of 2007 were in line with that assessment. That leaves average contribution rates substantially lower than the record highs seen in the June quarter, but 0.4 percentage points higher than a year earlier.

**TABLE 2: CONTRIBUTION RATES BY AGE, DECEMBER 2006 TO DECEMBER 2007**

Age	Dec-06	Jun-07	Dec-07
<b>20-24</b>	10.1%	11.0%	10.1%
<b>25-29</b>	10.2%	11.0%	10.2%
<b>30-34</b>	10.7%	11.4%	10.6%
<b>35-39</b>	10.8%	12.4%	10.9%
<b>40-44</b>	11.3%	16.7%	11.6%
<b>45-49</b>	13.7%	17.7%	12.8%
<b>50-54</b>	14.4%	21.5%	16.0%
<b>55-59</b>	18.1%	28.4%	19.4%
<b>60-64</b>	21.6%	40.0%	25.0%
<b>65-69</b>	25.5%	56.5%	24.4%
<b>All workers</b>	<b>12.6%</b>	<b>17.2%</b>	<b>13.0%</b>

That increase in contribution rates is a key measure of the change in savings behaviour of Australian workers in response to the new incentives offered by the super system. It also forms a key component of the projections of adequacy presented later in this report.

Table 3 shows contribution rates by age in the three main categories of super contribution.

**TABLE 3: CONTRIBUTION RATES BY AGE, DECEMBER 2007**

Age	Super Guarantee (SG)/Award	Salary sacrifice	After-tax	Total
<b>20-24</b>	9.4%	0.5%	0.2%	10.1%
<b>25-29</b>	9.5%	0.6%	0.2%	10.2%
<b>30-34</b>	9.5%	0.9%	0.2%	10.6%
<b>35-39</b>	9.5%	1.1%	0.3%	10.9%
<b>40-44</b>	9.5%	1.7%	0.5%	11.6%
<b>45-49</b>	9.5%	2.7%	0.7%	12.8%
<b>50-54</b>	9.5%	5.1%	1.4%	16.0%
<b>55-59</b>	9.5%	7.6%	2.3%	19.4%
<b>60-64</b>	9.5%	10.9%	4.6%	25.0%
<b>65-69</b>	9.5%	10.1%	4.9%	24.4%
<b>All workers</b>	<b>9.5%</b>	<b>0.8%</b>	<b>2.6%</b>	<b>13.0%</b>

Importantly, increases in contributions broadly matching those seen in the June 2007 issue of the Index implies that the picture of average retirement incomes adequacy is also similar to that seen in the June 2007 analysis.



That therefore confirms the earlier good result, showing that Australians are prepared to maintain part of the record lift in contributions ahead of *Simpler Super* in response to the new super incentives that package entailed.

### 1.3 RETIREMENT PATTERNS

**Emerging retirement trends will be crucial to the overall adequacy of future retirement incomes. They have therefore been of particular importance to policymakers, and are similarly central to the forward planning of superannuation funds.**

Changes in retirement decisions can have a major impact on the adequacy of retirement savings, as delayed retirement allows a longer period to accumulate assets in the super system, while reducing the length of time those assets will be required to support members in their retirement.

Increasing average retirement ages was a key aim of the *Simpler Super* reforms, which encouraged older workers to delay retirement by creating separate tax arrangements for benefits withdrawn before the age of 60. These new arrangements strongly encourage members to leave assets in super until they can be withdrawn tax free.

With the introduction of the *Simpler Super* reforms, members are now able to withdraw some of their superannuation benefits while still working and making further contributions. Such members are referred to as those in 'transition to retirement'. Data from the six months to December 2007 show many members withdrew significant amounts from super, while still working and making regular contributions through their employer.

The introduction of new incentives and options has seen potentially important shifts in average retirement ages among members<sup>3</sup>:

- ❑ In December 2006, before the changes were introduced, the average retirement age evident in the data underlying the *Index* was 61 years and 8 months.
- ❑ By December 2007, average retirement ages had increased to 63 years, a rise of around 16 months. That lift came as many members delayed their retirement to take advantage of the new benefits tax regime.
- ❑ However, the latest figures also show average ages among those members starting 'transition to retirement' payments in the first six months of the new system was 60 years and 8 months, or 12 months younger than the average retirement age using the December 2006 data.

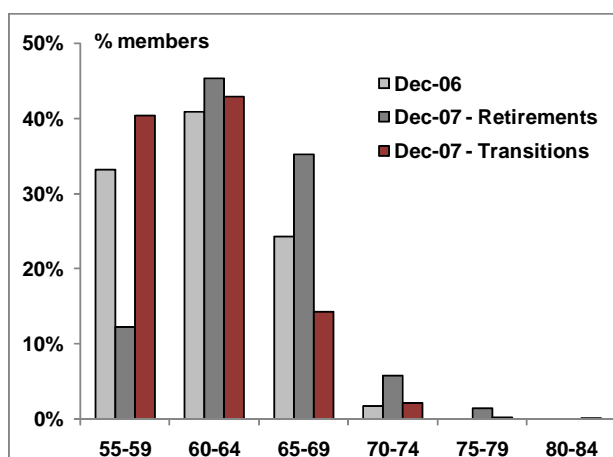
Or, in other words, **while average retirement ages for those retiring from the workforce (and leaving the super system) appear to be rising, new options for retirees show a different trend.**

Chart 1 below shows recent changes in retirement patterns, both for members making a full retirement ('Retirements') and those starting a 'transition to retirement' ('Transitions').

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<sup>3</sup> Measures of retirement age can be volatile, particularly those taken over short periods of time, as seen here. When combined with a small sample of retirees among AMP members in the six months to December 2007, there is reason to be cautious about the long-run implications of changes in estimated retirement ages.

**CHART 2: RETIREMENT PATTERNS – DEC-06 TO DEC-07**



The analysis in this *Index* treats those members who withdrew more than three-quarters of their super in the six months to December 2007 as retirees, and then measures the weighted average retirement age across both groups.

The results in this *Index* are therefore based on an average retirement age of 61 years and 6 months – little changed from that of the December 2006 and June 2007 editions of the *Index*.

That said, the average length of time members take to ‘transition’ into retirement will be an important driver of average retirement ages in future.

Many ‘transition to retirement’ members may continue to work and earn at the same rate for years to come. Indeed, it is possible that these members have the same retirement intentions as their older counterparts who leave the super system entirely.

More flexible options for members mean that understanding recent trends will take some time, as there are a range of possible outcomes for average retirement ages:

- ❑ If the workers starting out on a ‘transition to retirement’ path in the six months to December 2007 were in fact to retire immediately (as the modelling here assumes), then average retirement ages will settle at 61 years and 6 months.
- ❑ If those workers instead keep working until they reach the same age as members who fully retired in the six months to December 2007, then average retirement ages would settle at 63.

These estimates are based on a limited analysis of the early data available on transition to retirement arrangements. The *Index* calculations – as they have done previously – continue to assume that the bottom end of the range is where retirement behaviour is headed. The latter assumption highlights the conservative nature of the estimates presented in this report.

**That said, ‘conservative’ does not mean ‘unimportant’. As Federal Treasury has stressed, changes in retirement trends are vital to Australia’s economic future. They are even more vital to Australians’ retirement incomes. The data assessed for the AMP Superannuation Adequacy Index continue to provide an up-to-date source of tracking these trends. That said, it is necessarily based on relatively small numbers of new retirees, and it may be some time before fuller confidence may be placed on this part of the analysis underlying the *Index*.**



## 2. RETIREMENT INCOMES ADEQUACY

The last issue of the *AMP Superannuation Adequacy Index* showed that average adequacy levels were rising fast as members responded to recent improvements in incentives. This latest *Index* shows that average adequacy levels recorded a further modest rise in the second half of 2007, building on the rapid adequacy gains in the lead up to the introduction of the *Simpler Super* reforms.

That is because retirement incomes rose further in the second half of 2007. The average worker can expect an extra \$1,091 a year in retirement income (or around \$21 a week in today's money) over and above the estimates in the last release of the *Index*. That is a solid result coming after an even larger lift in the first half of 2007. It was driven by:

- Continuing good gains in markets in the six months to end-2007.
- Minor differences in estimated contribution rates.
- Later retirement among older workers (though not among all workers).
- Further gains in wages and salaries.
- Capital gains outside super.

In combination with a lift in average salaries, those factors have generated a solid lift in future retirement incomes, which are now 6.8% higher than estimated in the initial release of the *Index* based on December quarter 2006 data and 2.6% higher than in the *Index* based on June quarter 2007 data.

There is a key caveat here. That further lift in projected retirement incomes, while welcome, has been estimated based on data to December 2007, and has therefore been little affected by the weaker 2008 results in many of the markets in which superannuation funds are held.

Even so, the improvements in average adequacy levels to end-2007 have combined with a greater savings effort among upper-middle income earners in particular to make further inroads into the number of Australians falling below the retirement income adequacy benchmark.

Thanks to developments in the second half of 2007, a further 185,000 Australian workers now appear on track to achieve an adequate income in retirement, relative to their final year in the workforce.

Yet while adequacy levels continue to improve for 'the average worker', current super savings are still falling short for 3.2 million Australian workers. Current trends will see this latter group of workers face a greater relative shortfall of 11.4% against a desired benchmark for their retirement incomes, or some \$3,646 a year in today's terms.

## 2.1 PROJECTED RETIREMENT OUTCOMES

Estimates of future retirement incomes are crucial to assessing the adequacy of current retirement savings among Australian workers.

This section presents a 'no change' picture of the future for retirees, based on the trends outlined in the previous chapter. All results are shown in 'today's dollars' (that is, adjusted for the effects of inflation). In projecting future retirement incomes, the modelling assumes that:

- ❑ **Real wages grow over time**, reflecting gains in productivity. Younger generations will have higher incomes in 'today's dollars' when they retire in the future, and so need to aim for higher retirement spending to meet the relative benchmark applied here.
- ❑ **Retirement ages are unchanged in the future**. Retirement dates in the model are based on the current pattern of retirement evident in the AMP database, but do not allow for the effects of transition to retirement arrangements. As noted in the discussion above, the modelling assumes that members withdrawing more than three-quarters of their super balance are in fact retiring from the workforce immediately.

Since the June 2007 *AMP Superannuation Adequacy Index*, a combination of increased super savings and updated estimates of non-super savings from the ABS have boosted projected benefits for retirees across most age groups. Table 4 shows projected assets of Australian workers when they retire, if current savings trends continue.

**TABLE 4: AVERAGE ASSETS AT RETIREMENT – TODAY'S DOLLARS**

Age	Super	Other assets	Total
20-24	\$731,695	\$118,894	\$850,589
25-29	\$647,890	\$105,953	\$753,842
30-34	\$570,151	\$119,879	\$690,030
35-39	\$491,764	\$122,675	\$614,439
40-44	\$417,675	\$144,076	\$561,751
45-49	\$327,301	\$143,203	\$470,504
50-54	\$258,866	\$165,071	\$423,937
55-59	\$199,791	\$173,292	\$373,083
60-64	\$149,325	\$180,829	\$330,154
65-69	\$111,356	\$165,496	\$276,852
<b>All workers</b>	<b>\$469,008</b>	<b>\$136,169</b>	<b>\$605,176</b>

Retirement benefits for workers aged in their 30s and 40s have seen the largest gains, across both super and other assets. These workers will see the biggest gains from the recent lift in contributions, provided they are prepared to increase their contributions as they age to match the higher benchmark now set by today's older workers.

Contributions are less important than balances among older members, with projected assets among those in their 60s having fallen slightly. These falls mirror the slight reduction in average super balances among older members seen in Table 1 above. In part, that fall appears to be a result of members (who had accumulated substantial super balances after taking advantage of the opportunity to transfer assets into super ahead of 30 June 2007) retiring soon after the removal of benefits taxes.



Table 5 shows the income that today’s workers can expect in their retirement years. It takes average outcomes for workers across their time in retirement. Averages are shown across workers within each age group.

The value of the age pension is linked to changes in wages – leading to an increase in its real value over time. That has two effects on the results in Table 5:

- ❑ First, increases in the maximum rate of the pension are large enough to offset increased retirement incomes from super, resulting in higher average pensions among younger workers when they retire in the future.
- ❑ Second, because the age pension is included in taxable income, while income tax thresholds are assumed to rise only with inflation, retirees face a degree of ‘bracket creep’ as the real value of the age pension grows over time. This results in higher taxes for retirees in later years.

**TABLE 5: AVERAGE RETIREMENT INCOME – TODAY’S DOLLARS**

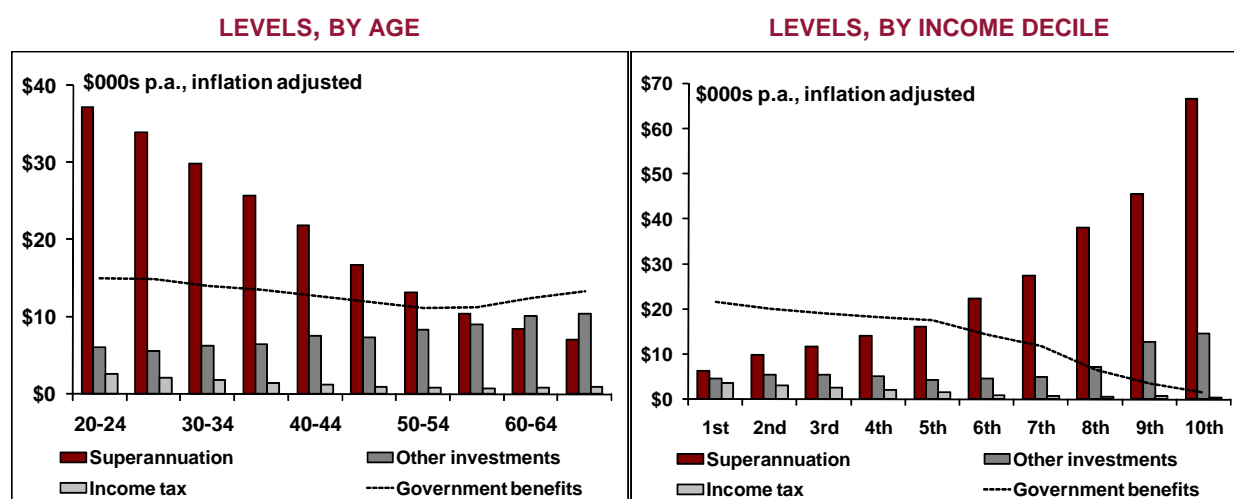
Age	Super income	Other investments	Aged Pension	Income tax	Net retirement income
20-24	\$37,159	\$6,028	\$14,982	\$2,578	\$55,590
25-29	\$33,859	\$5,523	\$14,872	\$2,064	\$52,190
30-34	\$29,799	\$6,249	\$13,976	\$1,729	\$48,294
35-39	\$25,706	\$6,395	\$13,455	\$1,393	\$44,162
40-44	\$21,794	\$7,496	\$12,666	\$1,191	\$40,764
45-49	\$16,675	\$7,275	\$11,930	\$858	\$35,022
50-54	\$13,116	\$8,335	\$11,123	\$756	\$31,818
55-59	\$10,398	\$8,970	\$11,175	\$683	\$29,859
60-64	\$8,374	\$10,078	\$12,441	\$818	\$30,075
65-69	\$6,995	\$10,352	\$13,272	\$844	\$29,774
<b>Average</b>	<b>\$24,392</b>	<b>\$7,111</b>	<b>\$13,321</b>	<b>\$1,512</b>	<b>\$43,310</b>

At current contribution rates, the average super benefit for those currently in the workforce will provide an income of \$24,392 a year in today’s dollars, or \$469 each week. Together with the age pension (for those who qualify) and other investments<sup>4</sup>, today’s workers will achieve average retirement incomes of \$43,310 a year, or \$833 per week in today’s dollars.

<sup>4</sup> This release of the *AMP Superannuation Adequacy Index* has been updated to account for new estimates of retirement savings outside the super system itself (such as financial assets other than super, as well as investment housing). See Appendix A for further details.



CHART 3: COMPONENTS OF RETIREMENT INCOME



The average worker can expect an extra \$1,091 a year in retirement income, or around \$21 a week in today's terms, over and above the assessment made in the June 2007 AMP Superannuation Adequacy Index.

Future retirement incomes are a function of market returns, and the willingness to contribute over and above compulsory rates. Both of these elements changed favourably in 2007 amid strong markets and changed saving behaviour and retirement patterns.

While much of the overall increase in retirement incomes seen here was due to higher estimates of existing average savings outside the super system, projected retirement incomes have also recorded an increase of 2.6% since the last *Index*.

Behind the further gains in projected super income seen in the second half of 2007 were:

- ❑ **Continuing good gains in markets in the six months to end-2007:** A gain of some 0.4% was generated by a further lift in **average super balances** between end-June 2007 and end-December 2007. Much of that increase was concentrated among members aged 40-54. Note that smaller average balances among older members play a less important role, as these age groups have a lower weighting in the final average.
- ❑ **Minor differences in estimated contribution rates:** Offsetting the lift in incomes from super, average **voluntary contribution rates** fell just short of those predicted by Access Economics' assessment of 'ongoing' contributions based on data for the June quarter of 2007 – reducing projected super income by around 0.1% for the average worker compared with the previous *Index* projections.
- ❑ **Later retirement among older workers (though not among all workers):** Changes in **retirement patterns** provided a minor boost to future retirement incomes (around 0.3% on average). While average retirement ages fell slightly, a small increase in the number of retirees in the 70-74 age group had a minor positive impact on average retirement incomes, particularly for those already aged over 65.
- ❑ **Further gains in wages and salaries:** A further 0.8% boost to estimates of future retirement incomes is due to rising salaries. The *Index* is calculated every six months. As such, the average future retirement incomes estimated in the production of this issue of the *Index* are six months further ahead in time than the last issue – meaning that wage and salary growth ahead of inflation will typically contribute to gains in the retirement incomes projected by the *Index*.



- ❑ **Capital gains outside super:** As part of this latest release, we have also updated the estimates of non-super retirement assets which form part of the retirement income modelling for the *Index*. That process brings the other asset data forward by two years to 2005-06 – while the *Index* itself has only advanced by six months. The result is an increase of 1.0% in projected retirement incomes from the good capital gains outside super since these were last benchmarked into the *Index*.<sup>5</sup>

In combination, members can look forward to a further lift in future expected retirement incomes. That is a solid result given it comes on the back of strong increases in projected retirement incomes in the last *Index*.

Indeed **projected retirement incomes are now 6.8% higher than estimated in the initial release of the *Index*** based on December 2006 data and 2.6% higher than in the *Index* based on June 2007 data. Over the 12 months to December 2007 projected retirement incomes increased by a total of \$2,743 a year, or \$53 a week.

## 2.2 ESTIMATES OF ADEQUACY

In assessing the adequacy of future retirement incomes, the *AMP Superannuation Adequacy Index* compares the living standards that retirees can expect to achieve in retirement with the consumer spending future retirees will undertake in their final years in the workforce. This 'target' is a relative one, making the implicit assumption that individuals on higher incomes during their working lives will expect to maintain that relative advantage in retirement.

The replacement rates used here measure the ratio of average consumption spending in retirement to average consumption spending in the final year in the workforce, adjusted to account for taxes and savings. The 'target' for that ratio is set at 65% of an individual's own pre-retirement living standards.

Chart 4 shows the average living standards future retirees will enjoy before and after they retire, and shows projected average replacement rates by age and income level.

Levels of pre-retirement consumption are higher among younger age cohorts, as they will receive the benefits of increased productivity (and hence rising incomes and savings) over a longer period of time remaining in the workforce. While workers aged over 55 may withdraw their super at any time, the average time to retirement for 20 year olds is around 45 years.

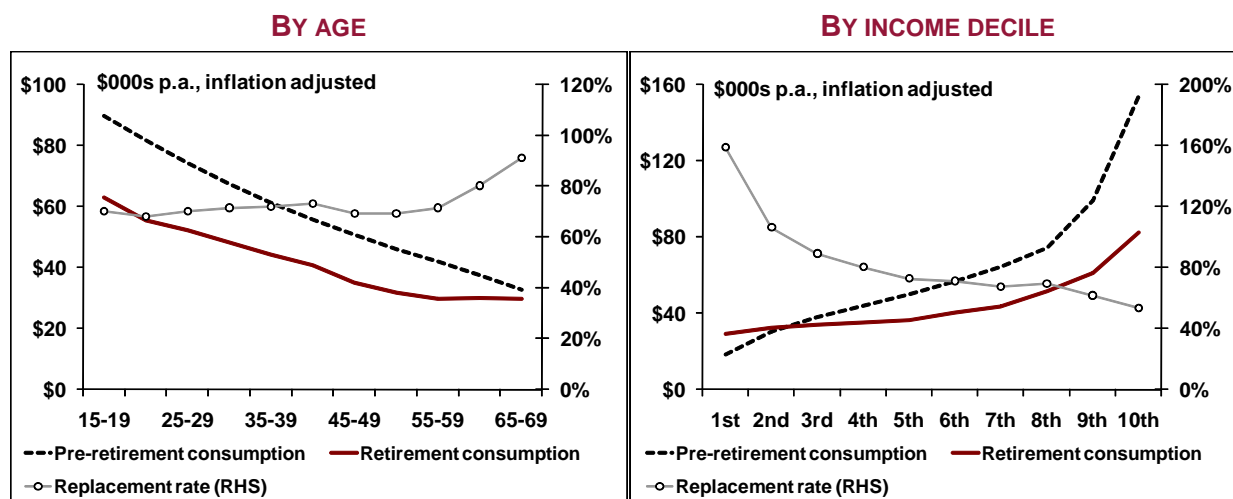
However, while older members will have lower levels of consumption in retirement, the relative 'drop' in consumption is lowest among older members. This is reflected in the higher replacement rates evident for these age groups in Chart 4 below.

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<sup>5</sup> The component parts do not exactly sum to relevant totals due to interactions between effects. (That is, the 'whole' may differ from the 'sum of the parts' if, for example, higher salaries interact with higher contribution rates to amplify increases in retirement savings over time.)



CHART 4: AVERAGE CONSUMPTION SPENDING AND REPLACEMENT RATES



**If current savings patterns are maintained, these results point to the ability of today's 'average' workers to retire on incomes above the benchmark for adequate retirement.**

Moreover, average adequacy levels continued to rise in the second half of 2007, as members maintained most of the estimated ongoing lift in contributions seen in the June quarter. Adequacy gains were greatest among workers aged in their 30s and 40s, who will benefit both from recent strong capital gains and increased contributions rates over time. In contrast, reductions in average super balances among older members saw replacement rates fall slightly for those aged in their 60s, consistent with some older members taking advantage of the new rules under *Simpler Super*.

Those on above average incomes managed a larger ongoing increase in voluntary contributions than expected at the time of the June 2007 *Index*, meaning they captured the largest share of the average adequacy gains.

The retirement adequacy benchmark is related to income in the final year of work, meaning that high income workers implicitly aim for higher average incomes in retirement.

By producing the biggest lift in contributions, it appears that **higher income workers have used the opportunities made available through the *Simpler Super* package to good effect – helping to address, at least in part, the relative shortfall in their retirement savings identified in the first release of the *Index*.**

Even so, higher income members will enjoy a greater level of retirement consumption than those on lower incomes, while low income members will have higher replacement rates. That is, the super system will promote broadly 'progressive' outcomes.

Indeed, for those members among the 10% with the lowest salaries, retirement may well mean an *increase* in consumption – with average replacement rates estimated at more than 100% for this group. In contrast, among higher income earners average replacement rates are as low as half of pre-retirement consumption. This result is due to the relative importance of the age pension to lower income retirees. Chart 5 highlights the importance of the age pension in supporting workers on lower incomes in their retirement years.



### WHAT MIGHT RETIREMENT TRANSITIONS MEAN FOR ADEQUACY?

With the 'transition to retirement' arrangements just six months old as of December 2007, very little information is available on the retirement behaviour of members who choose to withdraw some of their super while still saving for retirement.

The assumption used in the modelling – that members withdrawing most of their super play no further part in the system – provides a lower bound estimate of the increase in retirement ages prompted by the *Simpler Super* changes.

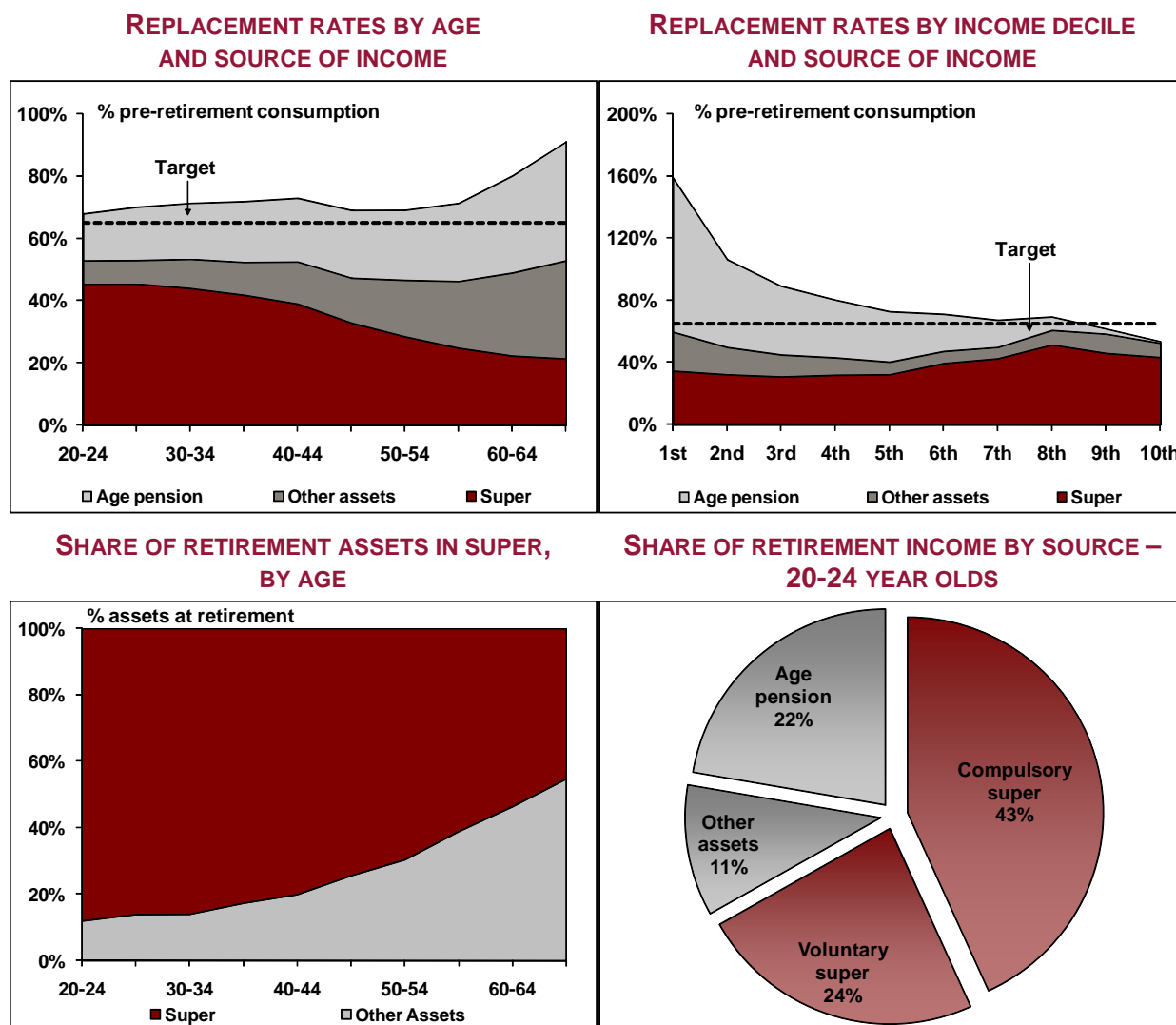
As a result, the **improvements to retirement income adequacy in the *Index* results are a conservative estimate of the gains from recent reforms.**

An alternative assumption would be to represent the upper bound of estimates based on the available data by allowing these members to continue to accumulate super until they reach the average age of those members who did fully retire in December 2007.

**Such an assumption would see the average transition to retirement last around 18 months, and result in average retirement incomes for today's workers some 4.7% higher than those presented here.**

It is early days yet, and the full impact of transition to retirement arrangements will emerge as those who entered the transition in 2007 retire completely over the coming years.

**CHART 5: PROJECTED SOURCES OF RETIREMENT INCOME**



While the age pension will remain a major source of income for most retirees, the lower-right hand panel of Chart 5 shows the dramatic impact voluntary super savings can make over time. Small changes in behaviour now can have large impacts with the passing of time.

If today's 20-24 year old workers contribute as much to super in the future as older generations are now, then they will enjoy 24% more income in retirement than they could with compulsory super contributions alone.

Chart 5 also highlights a further increase in the relative importance of super in providing long term savings to support future Australian retirees. If the greater focus on super seen throughout 2007 is maintained to the extent assumed in the modelling here, retirees will see a larger share of their retirement assets coming from super in the future. That in turn will reduce the reliance of future retirees on the age pension, particularly among middle income earners, who are most likely to fall into the means test 'taper range'.

## 2.3 WHO IS FALLING SHORT?

While *average adequacy levels are tracking well, millions of people are below that average – indeed, 3.2 million Australians are falling behind when it comes to providing for a comfortable retirement.* Table 6 shows where each age group is headed, relative to the target for a comfortable retirement. Based on current levels of retirement saving, these figures show the number of workers who are well placed to achieve or exceed the target, as well as the number who will fall shy of the benchmark.

**TABLE 6: WORKERS ABOVE AND BELOW THE ADEQUACY ‘TARGET’**

Age	Above target		Below target		
	% of workers	Number (000s)	% of workers	Number (000s)	% shortfall against target
<b>20-24</b>	65.3%	759.0	34.7%	403.8	10.5%
<b>25-29</b>	70.1%	790.8	29.9%	337.7	10.6%
<b>30-34</b>	71.6%	813.7	28.4%	322.0	9.7%
<b>35-39</b>	72.1%	875.5	27.9%	339.2	9.4%
<b>40-44</b>	73.0%	901.7	27.0%	332.6	8.5%
<b>45-49</b>	65.0%	804.1	35.0%	432.6	11.3%
<b>50-54</b>	64.1%	675.3	35.9%	378.9	11.6%
<b>55-59</b>	68.5%	580.4	31.5%	267.1	14.2%
<b>60-64</b>	77.1%	345.3	22.9%	102.8	15.7%
<b>65-69</b>	83.8%	130.9	16.2%	25.3	12.8%
<b>All workers<sup>6</sup></b>	<b>69.5%</b>	<b>7,270.8</b>	<b>30.5%</b>	<b>3,194.6</b>	<b>11.4%</b>

More than two-thirds of workers, or 7.3 million Australians, are on track to achieve an adequate lifestyle in retirement. Thanks to developments in the second half of 2007, a further 185,000 Australian workers now appear on track to achieve an adequate income in retirement, relative to their final year in the workforce.

Average adequacy levels have continued to improve thanks to increased super balances, particularly for those on upper-middle incomes. Recent increases in voluntary contribution rates from those on upper-middle incomes has seen a greater reduction in the number of workers below the target than the previous *Index*.

However, while improvements in average adequacy levels are making inroads into the number of Australians falling below the benchmark, the average shortfall among those left behind has increased since the last *Index*. On average, the 31% of workers below the benchmark face a relative shortfall of 11.4%, or \$3,646 a year in today's terms.

Despite recent increases in super savings, around 1.6 million of these Australians are under the age of 40. Even if younger workers can match the strong super savings of 2007 in the future (as these projections assume), some 30% of those aged 40 and under will not achieve the savings they need for a comfortable retirement.

<sup>6</sup> Note that, as with all tables in this report, the 'all workers' total includes some workers under the age of 20, and some aged 70 and over. It is therefore not the sum of the identified age groups. For example, there are more than 200,000 workers aged under 20 who are below the adequacy target (and therefore included in relevant totals – such as 3.2 million Australians falling below the adequacy target, of whom 1.6 million are aged under 40).

## APPENDIX A: PROJECTING RETIREMENT SAVINGS

Retirement incomes policy has only one central aim – to ensure that Australians maintain a reasonable standard of living after they choose to retire from paid work. To assess our performance against that aim, it is crucial to identify the outcomes facing future retirees.

Australia's retirement income policy is currently designed around three key policies known as the 'three pillars'. They are:

- ❑ **Pillar one:** Providing a safety net through the Commonwealth aged pension.
- ❑ **Pillar two:** Increasing private provision for retirement through the compulsory 9% Superannuation Guarantee (SG).
- ❑ **Pillar three:** Encouraging voluntary contributions to super by offering tax concessions and co-contributions to those who choose to save more for their retirement.

While superannuation is the primary vehicle for retirement savings in Australia, each of these three types of retirement income is important to ensuring adequate standards of living for Australia's retirees. In this Appendix, super, other savings and government benefits are each considered in turn. The average retirement incomes from each are presented earlier in Chapter 2.

### SUPERANNUATION

Australia's superannuation system lies at the heart of private saving for retirement. It enjoys significant (and recently enhanced) tax advantages over other investments, and is preserved solely for retirement. For most workers, super represents both the largest and the most effective pool of retirement savings.

Table 7 shows the average super account balance for members who made SG contributions in the December quarter of 2007, detailed by age and gender.

**TABLE 7: AVERAGE SUPER BALANCE – ACTIVE MEMBERS, DECEMBER QUARTER 2007**

Age	Balance (\$)		
	Males	Females	Average
20-24	\$5,917	\$4,487	\$5,277
25-29	\$14,294	\$12,598	\$13,573
30-34	\$27,867	\$23,941	\$26,352
35-39	\$42,701	\$32,010	\$38,850
40-44	\$60,455	\$35,557	\$51,319
45-49	\$77,271	\$39,989	\$63,314
50-54	\$98,722	\$48,491	\$79,534
55-59	\$110,391	\$60,555	\$91,638
60-64	\$99,705	\$65,318	\$88,684
65-69	\$93,465	\$55,536	\$83,767
<b>Average</b>	<b>\$51,639</b>	<b>\$30,887</b>	<b>\$44,013</b>



Table 8 further breaks those balances down by State.

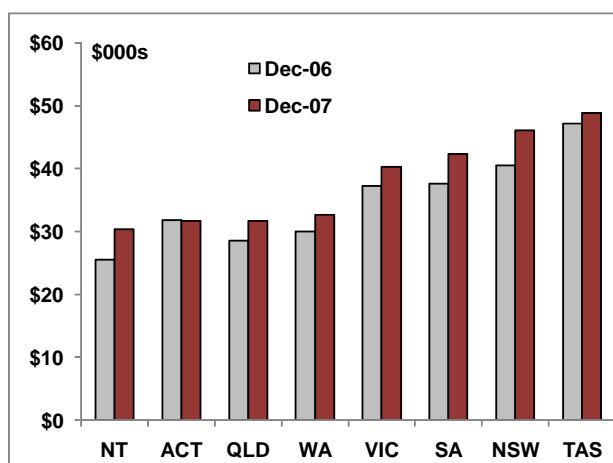
**TABLE 8: AVERAGE BALANCES OF ACTIVE AMP MEMBERS – STATE-BY-STATE BREAKDOWN<sup>7</sup>**

	NSW	VIC	QLD	SA	WA	TAS	ACT	NT	Average
<b>20-24</b>	\$5,691	\$5,009	\$4,801	\$5,950	\$5,163	\$5,997	\$4,452	\$4,506	\$5,277
<b>25-29</b>	\$14,996	\$12,712	\$11,630	\$14,820	\$13,057	\$14,483	\$11,550	\$9,408	\$13,573
<b>30-34</b>	\$29,084	\$26,629	\$21,560	\$26,859	\$22,478	\$27,458	\$22,800	\$16,853	\$26,352
<b>35-39</b>	\$44,556	\$40,587	\$29,399	\$36,773	\$31,890	\$38,944	\$36,788	\$24,779	\$38,850
<b>40-44</b>	\$59,480	\$52,829	\$40,278	\$47,516	\$40,670	\$54,693	\$51,492	\$46,945	\$51,319
<b>45-49</b>	\$75,918	\$63,609	\$48,091	\$58,345	\$49,583	\$67,467	\$55,687	\$52,682	\$63,314
<b>50-54</b>	\$94,888	\$80,153	\$62,605	\$71,910	\$65,369	\$90,305	\$73,739	\$59,134	\$79,534
<b>55-59</b>	\$109,155	\$93,502	\$72,051	\$88,157	\$74,699	\$107,592	\$89,315	\$72,751	\$91,638
<b>60-64</b>	\$107,989	\$89,636	\$71,155	\$88,380	\$73,705	\$128,200	\$100,896	\$59,531	\$88,684
<b>Average</b>	<b>\$46,046</b>	<b>\$40,257</b>	<b>\$31,676</b>	<b>\$42,307</b>	<b>\$32,671</b>	<b>\$48,915</b>	<b>\$31,674</b>	<b>\$30,354</b>	<b>\$39,512</b>

As the first edition of the *Index* showed, average balances vary considerably between the States, with much of that variation due to differences in the average age of AMP members.

Chart 6 compares average balances by State with those from the December 2006 edition of the *Index*.

**CHART 6: AVERAGE BALANCE OF ACTIVE AMP MEMBERS BY STATE – DEC-06 TO DEC-07**



In the year to December 2007:

- ❑ The Northern Territory saw the largest relative increase in average balances, but remains behind the other States due to its younger member base.
- ❑ New South Wales recorded the largest increase in average balances, while South Australia also saw solid gains.

<sup>7</sup> Note that the numbers in Table 8 above are weighted by AMP membership, whereas those in Table 7 and in Table 1 in the body of the main report are weighted by shares of the labour force survey done by the Bureau of Statistics. That can lead to minor differences in reported averages. For example, Table 8 shows an average balance of \$39,512, whereas both Table 1 and Table 7 show an average balance of \$44,013, with that difference attributable to the greater representation of younger workers in AMP membership.



- ❑ While Tasmania has the largest average balance, increases in the year to December were below the national average – although this could be due to the small sample size in that State.

### WILL SUPER BE ENOUGH?

Many working Australians have taken the mantra of self-responsibility to heart when it comes to super, and hope to retire with enough to support themselves without relying on the government's age pension.

However, the projections below show that **current super savings will not be enough for most Australians to rely on their super assets alone to generate adequate incomes in their retirement.**

In fact, the projections indicate that the average worker will receive close to a third of their retirement income from the pension.

For some, particularly those on lower incomes, that is a sensible outcome. After all, the pension is there as an income safety net.

Others, including taxpayers, may see reduced pensions as a key aim of retirement saving in general, and the super system in particular. Current super savings show that more can be done to reduce the burden of the age pension on government finances in the future.

Importantly, current super savings indicate that:

- ❑ **A degree of 'soft compulsion' may already be a feature of the super system.** Many workers appear to be receiving contributions from their employer through award arrangements above the minimum 9% mandated by the SG. Indeed, the average value of employer contributions over and above the 9% SG is 0.5% – close to the average level of voluntary after-tax contributions made by members themselves.
- ❑ **Older members are making significant voluntary contributions to super**, helping to boost their own retirement income prospects. Indeed, contribution rates among workers over 50 are significantly higher than the minimum 9%, revealing a widespread 'catch-up' among those who were working before the introduction of compulsory super.

When projecting outcomes for members, the modelling for this project uses current savings behaviour to predict future contributions. In particular, the modelling assumes that:

- ❑ As individual members age, their circumstances and behaviour change to match the current experience among older age groups.
- ❑ Workforce participation rates and average salary levels are also maintained in relative terms throughout the life-cycle.
- ❑ There is no allowance for members to 'shift' their relative income level over time. Members with incomes in the bottom 10% of their group at age 20 will continue to be in the bottom 10% throughout their working life.

For example, in 10 years time, today's 20 year old will have the salary level and savings behaviour of a 30 year old with similar relative income today.

In effect, this creates a **'no change' picture of the future** for the system as a whole, with individual members progressing along the same income and savings path implied by current data for older age groups.



That 'no change' projection implicitly assumes that award contributions remain higher than the minimum 9% over time, and that today's younger members are prepared to make significant voluntary contributions to super later in life.

## OTHER ASSETS

While super is the main vehicle for private retirement savings, assets outside of super will be an important source of retirement income for future retirees. That is particularly true for the 'baby boomers', who until recently have been riding a surge in capital gains, and have fewer savings within the super system.

Unlike super assets, which are aimed squarely at retirement, other savings and investments are made for many reasons and can take many forms. With the notable exception of the family home, savings outside the super system are not tax advantaged, and are not specifically reserved for the purpose of retirement.

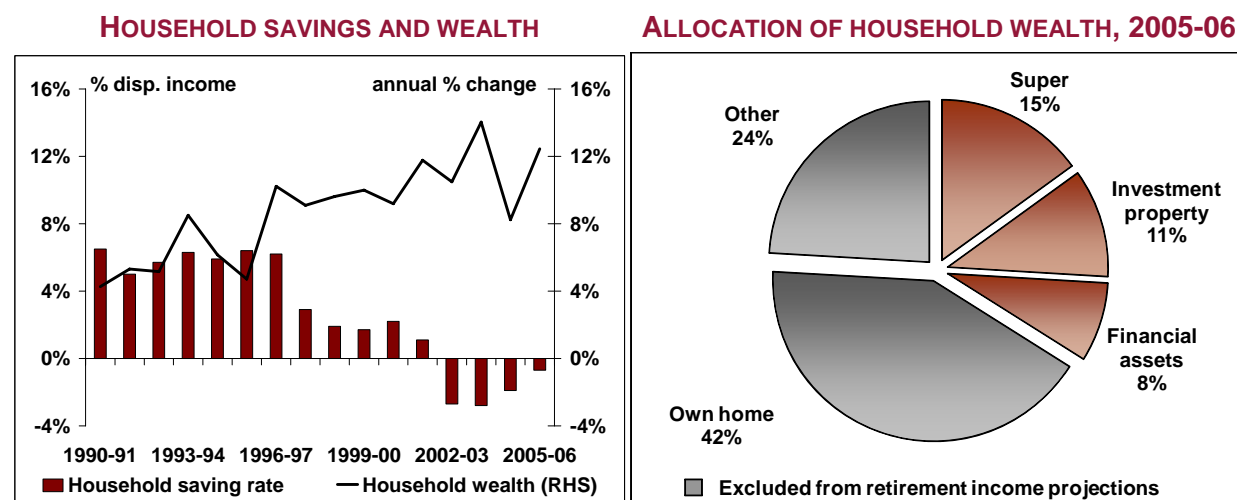
In assessing the retirement income potential of non-super assets, it is important to identify:

- ❑ The extent to which non-super assets are available to fund retirement income, rather than short term spending needs during working life.
- ❑ The asset types which are of greatest importance to workers' retirement prospects.

As the left-hand panel of Chart 7 shows, gains in private wealth in Australia through to end-2007 were substantial. The next release of the *Index* will pick up the weaker markets of recent times. However, the five consecutive years of strong investment returns to end-2007 saw household wealth rising strongly despite negative saving rates from cash incomes.

Capital gains have been the key driver of that surge in wealth, with asset values increasing in response to record lows in long term interest rates. Accordingly, the gains have been greatest among those with high levels of existing wealth, notably baby boomers who have lower levels of super savings.

**CHART 7: AGGREGATE PRIVATE WEALTH**



Sources: Reserve Bank of Australia, *Bulletin Statistical Tables*.  
ABS, *Australian System of National Accounts, 2005-06* (Cat. No. 5204.0) and  
*Household Wealth and Wealth Distribution, Australia, 2005-06* (Cat. No. 6554.0).



The right-hand panel of Chart 7 shows the allocation of household assets into five classes. In the projections presented in this report, two types of non-super assets are considered:

- ❑ **Investment property**, which includes all property other than the family home.
- ❑ **Financial assets outside super**, including saving accounts, shares, bonds and trusts.

Specifically excluded from projections of retirement incomes are the remaining asset types:

- ❑ **Owner-occupied housing assets and liabilities**. With the focus on salary income, this project excludes income and saving from and to the family home.
- ❑ **Other wealth**, including:
  - *Own enterprise assets and liabilities*. Although AMP members are a good proxy for the wider workforce, they are more likely to be wage and salary earners, who are less likely than other members of the community (such as small business owners) to have significant holdings of such assets and liabilities.
  - *Consumer durables*, such as cars, furniture and whitegoods. These assets provide for basic household needs, rather than long term saving for retirement.

Outstanding debts are also a factor in retirement planning for many households, and must be included in the analysis. In estimating asset holdings outside of super, the value of any outstanding liabilities is subtracted to create a measure of net wealth.

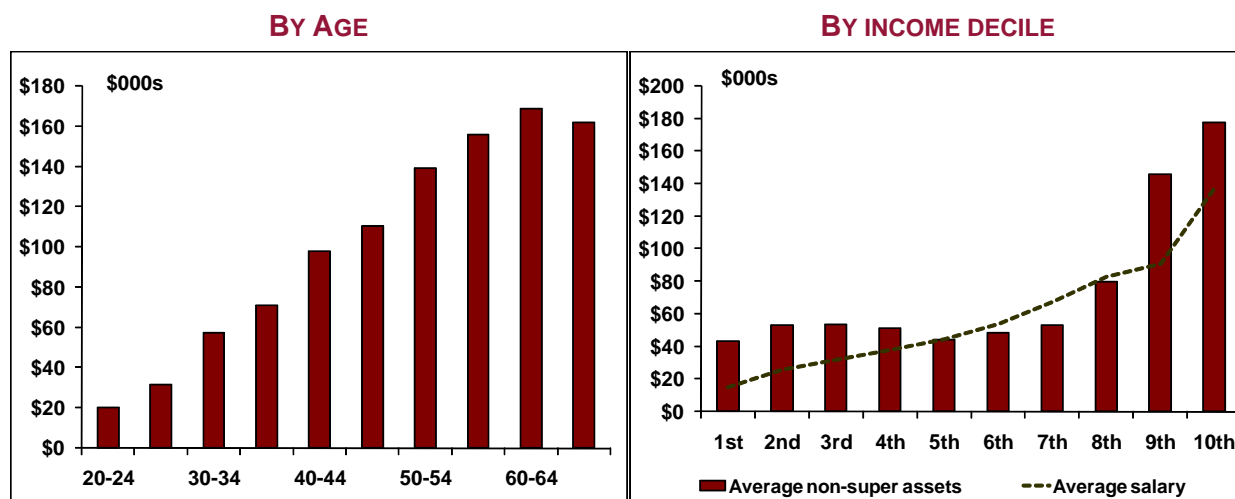
It should be noted that measures of household wealth are problematic. Survey respondents have shown a tendency to under-report some items, while for others alternative sources and methodologies provide conflicting estimates.

Chart 8 shows the average wealth estimates underlying the retirement income modelling for the *AMP Superannuation Adequacy Index*. These estimates are based on the latest ABS data for 2005-06, and are adjusted on the basis of long run investment returns.<sup>8</sup>

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<sup>8</sup> Long run returns in the modelling are related to nominal economic growth, and are therefore lower than the returns implied by the gains in wealth to end-2007. Accordingly, the non-super wealth estimates here represent a conservative estimate.

**CHART 8: ESTIMATED NON-SUPER WEALTH – DECEMBER 2007**



Note: Excludes owner-occupied housing assets, own enterprise assets and consumer durables. Values are net of outstanding debts.

As Chart 8 shows, age groups currently nearing retirement have significant levels of non-super wealth. That wealth is highest among the top 20% of income earners, where these estimates suggest that savings outside super are large enough to have a significant impact on the adequacy of future retirement incomes.

### ARE HIGHER INCOME EARNERS MAKING THE MOST OF SUPER?

For higher income earners, superannuation has a significant tax advantage over other investments, both before and after retirement.

Despite this, the estimates show higher levels of saving outside of super among high income earners, who have relatively less invested in super. **That represents a missed opportunity for higher income earners to take advantage of the benefits of the super system.**

In the past, the super surcharge and uncertainty surrounding reasonable benefit limits and other complex benefits tax arrangements may have played a role in discouraging super savings among these workers.

As reforms remove these impediments, super may play a larger role in helping to improve retirement outcomes among higher income earners. Indeed, as discussed elsewhere in this report, the early evidence suggests that the response to *Simpler Super* is already seeing behaviour adjust.

## THE ROLE OF THE AGED PENSION

The age pension is designed to provide a safety net for Australians who are unable to support themselves in retirement.

The rate of the age pension is adjusted every March and September in line with movements in inflation, with the maximum single rate of the age pension maintained at (at least) 25 per cent of Male Total Average Weekly Earnings (MTAWE). As a result, the real value of the



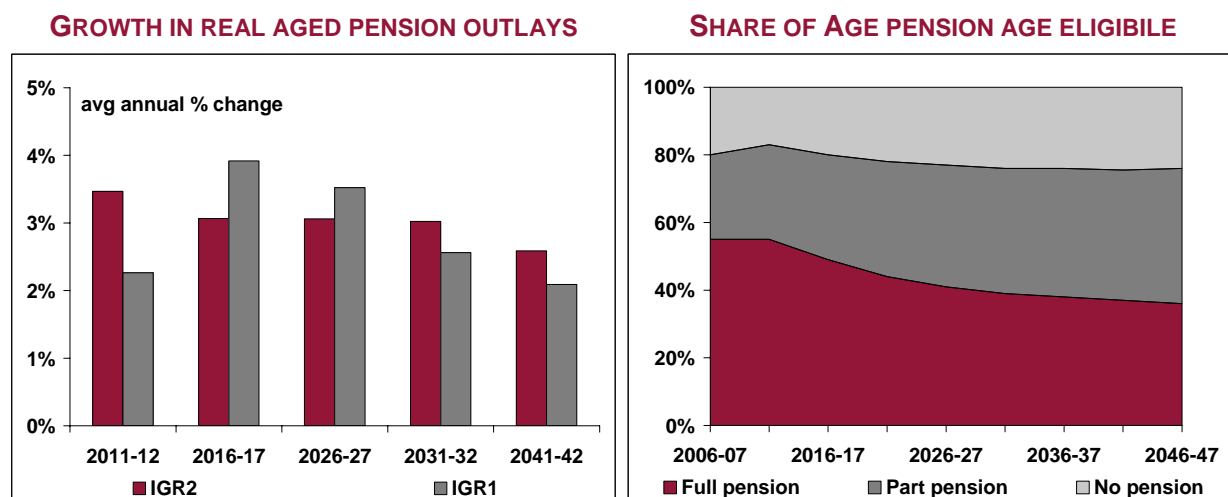
age pension has grown over time, as pensioners share in improvements in living standards. That increase will continue, with the buying power of the age pension projected to double over the next 40 years under current rules.

The relationship between private savings and the government safety net is a complex one, aiming to strike a balance between incentives to save through super and individual responsibility.

In recent years a number of changes have shifted the balance toward more generous means testing of the pension. As part of the *Simpler Super* package, the asset test taper rate was halved from \$3 to \$1.50 per \$1,000 of assets over the threshold.

Official projections contained in the second *Intergenerational Report* released in 2007 show that, even after the SG system is mature, around three quarters of retirees will continue to receive government support through the age pension (see Chart 9). Indeed, projections of increased spending on age pensions are higher than predicted by the first *Intergeneration Report* in 2002.

**CHART 9: TREASURY IGR PROJECTIONS OF AGED PENSION SPENDING**



Sources: Federal Treasury, *Intergenerational Report 2002* (IGR1) and *Intergenerational Report 2007* (IGR2).

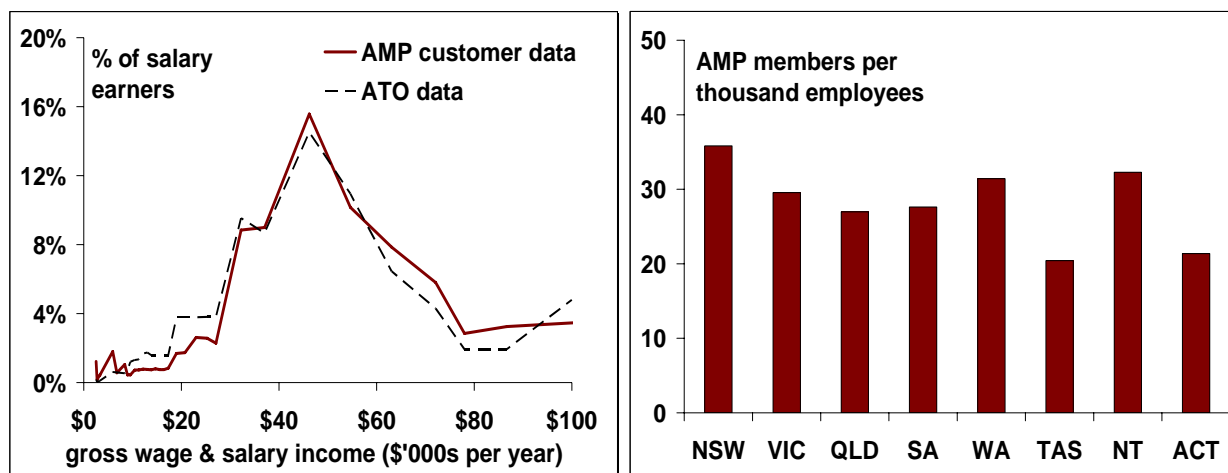
At a time when access to government income support is being expanded for retirees, these official projections sound a note of warning. Even with the super system providing significant private savings, future Australian taxpayers will be supporting a growing number of pensioners at a time when government finances are tight.

That said, the sustainability of the Australian age pension should be viewed in a broader context. When compared with other OECD nations, Australia's future pension payments are relatively small as a proportion of GDP.

## APPENDIX B: SUPERANNUATION DATA

The foundation for this report is a comprehensive dataset derived from AMP's corporate super client records. This unique dataset covers the period from July 2006 to December 2007, and includes some 322,000 members with combined super balances of \$10.93 billion. As Australia's largest provider of superannuation, AMP is in a unique position to provide detailed data on the operation of the Australian superannuation system. As Chart 10 shows, the AMP client base shows similar wage and salary income characteristics to the wider Australian workforce, and is fairly well spread across States and Territories.

**CHART 10: SALARY AND STATE DISTRIBUTION OF AMP CUSTOMERS VS ALL EMPLOYEES**



Sources: AMP Financial Services, Access Economics, ATO *Australian Taxation Statistics* 2003-04. Australian Bureau of Statistics, *Labour Force, Australia* – Jan 2007 (Cat. No. 6202.0).

Included in the data underlying this report are details of each individual member's:

- Gender, date of birth and State or Territory of residence.
- Annual salary.
- Superannuation account balance.
- Detailed information on super contributions, including:
  - employer contributions under the Super Guarantee and/or award arrangements.
  - salary sacrifice contributions.
  - after-tax member contributions.
  - rollovers and transfers from other super funds.

However, no individual member's details are revealed and these remain confidential.

Unlike other data sources, the client records underlying the report link together contributions, account balances and incomes at the individual level. This allows detailed analysis to be conducted, providing a comprehensive view of the retirement savings position of members.

However, it should be noted that there is an important weakness in account-based data when measuring super savings. Care must be taken to ensure that the data accurately reflects the true retirement savings position of members with additional accounts with other super funds, and those making contributions on behalf of others (such as a spouse). Accordingly, Access Economics has performed adjustments to the raw data provided by AMP, with the aim of ensuring that contribution and salary information are consistent and appropriate for measuring the adequacy of future retirement incomes.



## APPENDIX C: ASSUMPTIONS USED

When projecting outcomes for members, the modelling for the report uses current savings behaviour to predict future contributions. In particular, the modelling assumes that:

- ❑ As individual members age, they continue to contribute the same share of their wages or salary to super over time as those of older age groups do today.
- ❑ Workforce participation rates and salaries are also unchanged as members age (although salaries are adjusted for wage growth over time).
- ❑ Finally, there is no allowance for members to 'shift' their relative income level over time. Members with incomes in the bottom 10% of their group at age 20 are assumed to continue to fall in the bottom 10% throughout their working life.

Key economic assumptions include:

- ❑ Price inflation – 2.5% a year.
- ❑ Productivity growth per worker – 1.75% a year.
- ❑ Employment growth – 0.9% a year.
- ❑ Nominal return on investment – 5.2% a year (that is, the product of the above).

Current personal income tax arrangements for retirees are modelled explicitly, including the Senior Australians' Tax Offset (SATO) and Medicare Levy arrangements applying to those aged 60 and over. Income tax thresholds are linked to price inflation.

### ACCUMULATION PHASE

During the accumulation phase of the modelling, current account balances and contribution rates are used to construct estimates of future account balances.

Initial superannuation contribution rates are calculated from the AMP customer database. These rates then follow the age profile evident in the current cross-sectional data. Super contributions from a deductible source are subjected to the 15% contributions tax, while all other savings are untaxed upon contribution.

To estimate holdings of assets outside super, the analysis uses information on the distribution of household wealth by age and gross income from Australian Bureau of Statistics (ABS) data published in *Household Wealth and Wealth Distribution, Australia, 2005-06* (Cat. No. 6554.0).

This data also informs implied rates of saving into non-super assets, forming the basis for projections similar to those developed for super assets. In particular, information on non-super assets helps to inform:

- ❑ Non-superannuation income in retirement, both through investment returns and capital draw-downs.
- ❑ Age pension entitlements under the assets test and income deeming rules.

Note that the available survey based data on household wealth is less detailed and less reliable than the information supplied by AMP on superannuation assets and savings.



## RETIREMENT PHASE

The current distribution of retirement benefits by age forms the basis of the retirement age applied to age groups in the model, with each retirement age treated separately for the purposes of estimating retirement incomes and then later combined to estimate average consumption levels for the cohort as a whole.

As noted elsewhere in this report, those members who withdraw more than three-quarters of their super are considered to be retirees for the purpose of the modelling.

All retirees are assumed to convert any assets they hold at retirement into two allocated pension products:

- A superannuation allocated pension, with tax free earnings and distributions.
- An allocated pension for all other assets, which is subject to income tax.

In each period, a proportion of the capital value of each pension is withdrawn, with retirees assumed to run down capital values over their remaining life expectancy. **The modelling does not allow for capital withdrawals from owner-occupied housing.** In other words no 'reverse mortgage' style arrangements are assumed to apply to the family home.

Current age pension arrangements are modelled explicitly, with income and assets tests applied to assessable assets, incomes and deemed incomes. In all cases, members are treated as single, and they are assumed to own a house for the purposes of means tests.

All current supplements and allowances are included in the estimates of government benefits. This includes the seniors' concession allowance which is paid to self-funded retirees with incomes below a fixed cut-off. Age pension payment rates increase with wages, whereas allowance rates and means test thresholds increase with CPI.

## SUPERANNUATION 'TARGETS'

The benchmark used for the *AMP Superannuation Adequacy Index* is based on 65% of pre-retirement living standards<sup>9</sup>, measured in the final year in the workforce.

This benchmark is preferred by Access Economics. It is similar to that recommended by the 2002 Senate Select Committee on Superannuation, which found a range of 60-65% of pre-retirement income was an appropriate measure. The results shown focus on incomes in retirement averaged over remaining life expectancy.

Targets shown in the detailed tables are based on projected average retirement benefits. As in the modelling for the headline figures, all members contribute to super at current average rates over the remainder of their working life. However all members are assumed to retire at age 65 for the purposes of calculating target balances, which differs slightly from the retirement profile underlying the main modelling.

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<sup>9</sup> Measured as consumer spending in the final year in the workforce.



## DEFINITIONS

**Adequacy** refers to a level of income which allows retirees to achieve an "acceptable" standard of living in retirement. In the Australian debate, 'adequacy' is often referred to as an aggregate concept, though it is in fact an individual one. It is by nature subjective.

The benchmark used to assess adequacy in this report is 65% of pre-retirement consumption, where consumption is defined as pre-retirement income less tax and savings.

**After-tax contributions** are contributions made with after-tax money, such as take-home pay. These are also called 'non-concessional', 'personal' or 'undeducted' contributions.

The **age pension** is an Australian Government payment to seniors who are unable to support themselves in their retirement.

An **allocated pension** is a form of regular income provided by a superannuation fund or other financial institution from an initial pool of assets. It allows the recipient to supplement investment earnings with capital drawdowns, which combine to make up a regular income.

The **assets test taper rate** is the rate at which some Centrelink payments are reduced by the value of a person's assets, and in some cases, by their partner's assets. For the age pension, this rate is \$1.50 per fortnight for each \$1,000 in assets over the threshold.

**Average retirement incomes** measure the expected average income flow from the date of retirement until death. They are calculated by multiplying the level of income in each period after the date of retirement by the probability that an individual is still alive in that period.

**Average Weekly Earnings (AWE)** measures the average wage of employees in Australia, and is published by the Australian Bureau of Statistics.

**Before-tax contributions** are contributions to super that are made before tax is taken out of a worker's wage. These can be made by employers for superannuation guarantee and also include salary sacrifice contributions. May also be called 'concessional', 'taxable' or 'deducted' contributions.

The **benefit**, or assets at retirement, is the value of assets released at date of retirement either from super, or from other assets. In many cases it can then be converted to be paid as an income stream, lump sum or some combination of the two.

**Contributions tax.** The 15% tax payable on some amounts paid into a superannuation fund and the earnings and investments held in the fund. The super fund usually reduces a member's superannuation account by their share of this tax.

**Consumer Price Index (CPI).** The CPI is produced by the Australian Bureau of Statistics, and tracks the growth in prices of a basket of goods and services over time.

**Employer contributions.** Payments made by an employer (or someone associated with an employer) to an employee's super fund. These can include superannuation guarantee obligations, plus any salary sacrifice amounts.



**Final salary** refers to a worker's salary in the year before they retire. In the modelling above, this is approximated using averages among a worker's five-year age cohort, and used to calculate pre-retirement consumption spending.

The **income test** is one of the tests used to work out whether a person is entitled to receive government benefits. It calculates the amount of assessable income that the person earns, which can affect their payment rate.

**Living standards** refer to the general economic wellbeing of individuals. In the context of this report, living standards are more narrowly defined as the level of *consumption spending* that is enjoyed by individuals.

**Member contributions.** Personal contributions to a superannuation fund. These can be undeducted personal contributions or deductible personal contributions.

**Net wealth**, also called net worth, is the value of assets less any outstanding debts.

**Net retirement income** measures the income received by retirees after accounting for the effects of income tax.

**Non-concessional contributions.** These are amounts that count toward a person's non-concessional contributions cap, i.e. personal contributions which are not claimed as an income tax deduction. These include contributions made by a person's spouse to their superannuation account.

**Other assets**, or non-super assets, are assets which have not been invested in the super system. Other assets included in this analysis include:

- *Investment property*, which includes all property other than the family home.
- *Financial assets outside of super*, which include savings accounts, shares, bonds and trusts.

Other assets which have not been included in this analysis include:

- *Owner-occupied housing assets and liabilities.* With the focus on salary income, this project excludes income and saving from and to the family home.
- *Own enterprise assets and liabilities.* AMP members are wage and salary earners, who are much less likely than other members of the community to have significant holdings of such assets and liabilities.
- *Consumer durables*, such as cars, furniture and whitegoods. These assets provide for basic household needs, rather long term saving for retirement.

Estimates of asset holdings outside of super are net of the value of any outstanding liabilities, creating a measure of *net wealth*.

The **age pension age** is 65 for men and 63.5 for women, rising to 65 for women by 2014.

**Personal contributions** are contributions a person makes to their superannuation account including from money they have paid tax on, such as their take-home pay and contributions for which they don't claim a tax deduction.

**Pre-retirement consumption spending** is a measure of workers' living standards while they are still in the paid workforce. It is calculated as total income less taxes and savings



(including the 9% SG). In the modelling above, pre-retirement consumption is measured as the average among a five-year cohort to which an individual belongs when they retire.

**Preservation age** is the age when you can access your superannuation benefits. Preservation age will rise from 55 to 60 between 2015 and 2024. This will mean that for someone born before 1 July 1960, their preservation age is 55 years, while for someone born after 30 June 1964, their preservation age will be 60.

Preserved benefits are most commonly paid when a member has reached their preservation age and retired. Members who have reached their preservation age can access their preserved benefits while they continue working.

**Replacement rates** measure the proportion of a worker's income that is 'replaced' by income from other sources (such as super benefits) when they retire. This report uses an expenditure replacement rate concept, which is an after-tax measure taking account of the drawdown of capital during retirement

**Retirement consumption spending** is a measure of living standards of retirees. It is calculated as total retirement income, plus drawdowns on retirement assets, less taxes.

**Retirement savings** include all forms of savings to meet long term retirement planning needs. In Australia, most retirement savings are made through superannuation, though other investments can also form part of a retirement saving plan.

**Salary sacrifice contributions** are when you arrange for your employer to put a part of your before-tax salary into your superannuation account for you.

The **Senior Australian's Tax Offset** is a reduction in the amount of income tax paid by people over the age of 65. The tax offset allows older people to earn more income before they pay tax and the Medicare levy. It is means tested, with singles earning more than \$42,707 in 2006-07 receiving no benefit from the offset.

**Superannuation** is a system where money is placed in a fund which is preserved to provide for a person's retirement. In the context of this report, superannuation refers to private, defined contribution funds. Often simply referred to as 'super'.

**Superannuation benefit** is the amount you are paid either as a superannuation income stream, lump sum or a combination.

**Super co-contributions** are a payment made by the government into your super fund if you are a low income earner. The government pays \$1.50 for every \$1 you make in personal contributions for which you have not claimed a tax deduction, up to a maximum of \$1,500. This maximum is reduced by 5 cents for every dollar you earn over \$28,000, with no co-contributions available for members earning more than \$58,000 in 2006-07. The value of government co-contributions is included throughout the analysis in this report.

**Super Guarantee (SG) contributions** are the before-tax minimum level of superannuation contributions an employer must contribute for eligible employees. The rate is currently 9%.

**'Transition to retirement'** is a term used to describe a new retirement option available to members under the Simpler Super system. Under this arrangement, members are able to 'top up' a reduced salary with a regular income stream purchased with some or all of their super savings.