

# The AMP Superannuation Adequacy Index report

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Produced by Access Economics Pty Limited for AMP



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## EXECUTIVE SUMMARY

In this first issue of the **AMP Superannuation Adequacy Index**, the true extent of how well Australians are prepared for their retirement has been revealed.

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

It finds that, while Australians are better prepared for retirement than previously thought, current savings are falling short of the expectations of millions of workers.

**The good news is that 7 million Australians (or around two thirds of the workforce) are on track for an adequate retirement** thanks to the large capital gains of recent years and a recent surge in voluntary superannuation contributions.

Indeed, figures for December 2006 show that average workers are on track to meet the relative benchmark for retirement incomes adequacy applied here.

**The bad news is that 3.5 million Australians (or around one third of the workforce) will need to improve their savings performance over time** if they hope to maintain the targeted standard of living in their retirement.

- More than 1.9 million Australians under the age of 40 are already falling behind when it comes to retirement savings. Even if they contribute more to super later in life, some 35% will not meet the target for a comfortable retirement.
- Among those falling behind, average retirement incomes are expected to fall short of the target by 13.5% (or \$97 a week in today's terms).

**Australians are contributing on average 12.6% of their salaries to superannuation, rather than the compulsory 9% minimum.**

- Voluntary contributions rise significantly by age group.
- Those aged 60-65 are contributing more than a quarter of their income to superannuation, at 25.5%.

Australians will draw on a range of assets in their retirement. This report provides a comprehensive coverage of those, but a unique focus here is provided by the real world information which underlies the analysis of super – the primary retirement savings vehicle for most Australians.

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

This analysis draws on the information from so many AMP clients that it ranks among the largest surveys ever taken of the Australian population. Such a large dataset means the results for super shown here are accurate to within  $\pm 0.6\%$  for Australia's 10.5 million workers (see Chart 8).

As well as providing measures of the adequacy of retirement incomes, the report includes detailed tables showing how average individuals are faring when it comes to super in



particular. These tables show average account balances, as well as targets designed to show where those balances should be for workers to be on track to meet the targeted retirement goals.

As new retirement savings trends emerge, including the introduction of the Federal Government's *Simplified Superannuation* package on 1 July 2007, the *AMP Superannuation Adequacy Index* offers – for the first time – the ability to measure the success of workers in planning for a comfortable future in retirement.

**TABLE 1: WORKERS ABOVE AND BELOW THE ADEQUACY ‘TARGET’– DECEMBER 2006**

	9% Superannuation Guarantee			With voluntary super savings		
	%	000s of workers	% shortfall	%	000s of workers	% shortfall
<b>Above target</b>	54.0%	5,648	na	66.9%	7,003	na
<b>Below target</b>	46.0%	4,818	18.6%	33.1%	3,463	17.3%

## **THERE'S GOOD NEWS....**

**The first issue of the AMP Superannuation Adequacy Index finds that the large capital gains of recent years mean that Australian workers are better prepared for retirement than ever before.** Indeed, figures for December 2006 show that 7 million workers – including the ‘average’ worker – are on track to meet the relative benchmark for retirement incomes adequacy applied here.

Adequacy has been on the rise thanks to excellent capital gains across a range of assets in recent years. These results also suggest that strong investment returns combined with the improved incentives and reduced complexity offered by the Government's *Simplified Superannuation* reforms have encouraged Australians to voluntarily save more in super.

## **....AND THERE'S BAD NEWS....**

**If savings behaviour is unchanged, around 3.5 million of today's workers will fall short of their retirement income goals.** Around one third of all workers are falling behind the targeted benchmark required to maintain an adequate standard of living in retirement.

And that shortfall is significant. **Among those currently in the workforce without expected sufficient retirement savings, average retirement incomes will fall short of the relative benchmark applied here by 13.5%, or \$97 a week in today's terms.**

More than half of these, or more than 1.9 million Australians, are under the age of 40. Current savings patterns mean that, *even if younger workers follow in the footsteps of their parent's generation by contributing more to super as they near retirement*, some 35% will still not achieve the savings they need for a comfortable retirement.



### ....WITH LITTLE ROOM FOR COMPLACENCY

While many Australians expect to support themselves in retirement without reliance on the pension, in practice Federal Treasury's own projections suggest that **only about a quarter of retirees will have enough super to enjoy a self-funded retirement without government support.**

The projections here show that, if Australia's super system is to meet the challenge of an ageing population, **today's younger workers will need to at least match the significant voluntary contributions being made to super by the boomers.**

As Table 1 shows, the 9% SG is not enough to secure adequate retirement incomes for all Australians. The need for voluntary super savings is clear – particularly for the youngest workers, with voluntary super savings projected to contribute around 22% of the income today's 20-24 year olds will rely on in retirement.

## Access Economics July 2007



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

This 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 will be 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 will track changes retirement incomes adequacy over time.

It is important to note that the report is focused on measuring the implications of current superannuation data for future retirement incomes. Many of the 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

It uses data from more than 320,000 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 aged 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 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.

In the past, making this connection between current super savings and future retirement income has been difficult at best, leaving many Australians confused as to how much super they need for a comfortable retirement.

Now, for the first time, the *AMP Superannuation Adequacy Index* will provide 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 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 will expect to maintain that relative advantage in retirement, and avoids the need to define a ‘one size fits all’ standard.

## THE MODELLING

In order to assess the likely outcomes for tomorrow’s retirees, the analysis presented in this report 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 below reflect a reasonable central case for the future of retirement incomes.<sup>1</sup>

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<sup>1</sup> For more information on the assumptions used in the analysis, and the treatment of tax and savings, see Appendix B.



## 1. 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 chapter, superannuation, other savings and government benefits are each considered in turn. The average retirement incomes from each are presented in Chapter 2.

### 1.1 SUPERANNUATION

Australia's superannuation system lies at the heart of private saving for retirement. It enjoys significant tax advantage 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 2 shows the average super account balance for members who made SG contributions in the December quarter of 2006.

**TABLE 2: AVERAGE SUPER BALANCE – ACTIVE MEMBERS, DECEMBER 2006**

Age	Balance (\$)		
	Males	Females	Average
20-24	\$5,828	\$4,528	\$5,246
25-29	\$13,886	\$12,142	\$13,131
30-34	\$25,567	\$21,754	\$24,076
35-39	\$37,999	\$28,259	\$34,486
40-44	\$52,471	\$30,116	\$44,233
45-49	\$67,113	\$35,083	\$54,991
50-54	\$86,298	\$42,020	\$69,025
55-59	\$97,533	\$53,749	\$81,257
60-64	\$108,096	\$61,630	\$93,331
65-69	\$96,336	\$59,622	\$86,927
<b>Average</b>	<b>\$46,663</b>	<b>\$27,642</b>	<b>\$39,663</b>



2006 was an excellent year for investors – and it followed on from several excellent years.

Moreover, not only were superannuation fund returns very good, but unprecedented interest in super was sparked by the May 2006 Federal Budget, which saw the announcement of significant reforms to tax and contribution arrangements.

Against this backdrop of strong returns, simpler rules and improved incentives, a significant increase in average contributions is evident in the AMP database in the final quarter of 2006.

That increase appears across both SG/award and voluntary contributions (which include 'salary sacrifice' arrangements and after tax contributions). As a share of income, average contributions to super were 0.3% higher in the final quarter of 2006.

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

**TABLE 3: CONTRIBUTION RATES BY AGE, DECEMBER 2006**

Age	SG/Award	Salary sacrifice	After tax	Total
20-24	9.4%	0.5%	0.1%	10.1%
25-29	9.5%	0.6%	0.1%	10.2%
30-34	9.5%	1.0%	0.2%	10.7%
35-39	9.5%	1.0%	0.3%	10.8%
40-44	9.5%	1.5%	0.4%	11.3%
45-49	9.5%	3.5%	0.7%	13.7%
50-54	9.5%	3.7%	1.2%	14.4%
55-59	9.5%	6.2%	2.4%	18.1%
60-64	9.5%	8.0%	4.1%	21.6%
65-69	9.4%	8.4%	7.7%	25.5%
<b>All workers</b>	<b>9.5%</b>	<b>2.3%</b>	<b>0.8%</b>	<b>12.6%</b>

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 which are higher than 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.

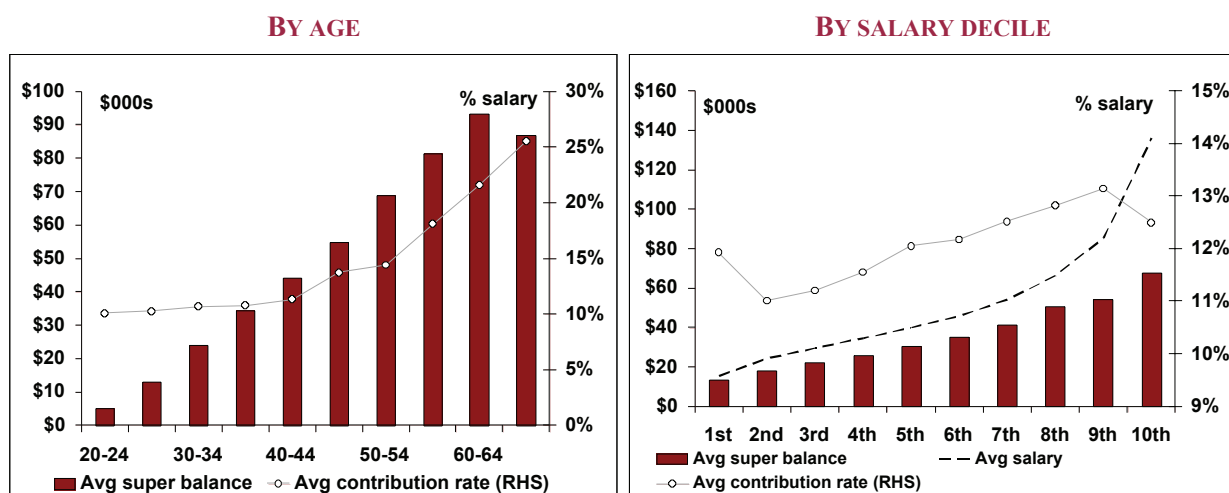
For example, in 10 years time, today's 20 year old will have the salary level and savings behaviour of a 30 year old with similar relative income today.

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.

Chart 1 shows the average super balances and contribution rates underlying the projections later in this report.

**CHART 1: AVERAGE SUPER BALANCE AND CONTRIBUTION RATE**



The right hand panel of Chart 1 highlights two key income groups:

- ❑ Among low income earners, there are significant contributions to super by high wealth individuals who are taking a break from the labour force, particularly later in life.
- ❑ Among the highest income earners, voluntary contributions to super are not keeping pace with salary levels, resulting in lower super contribution rates than might be expected from this group.

## 1.2 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 have been riding a recent 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.

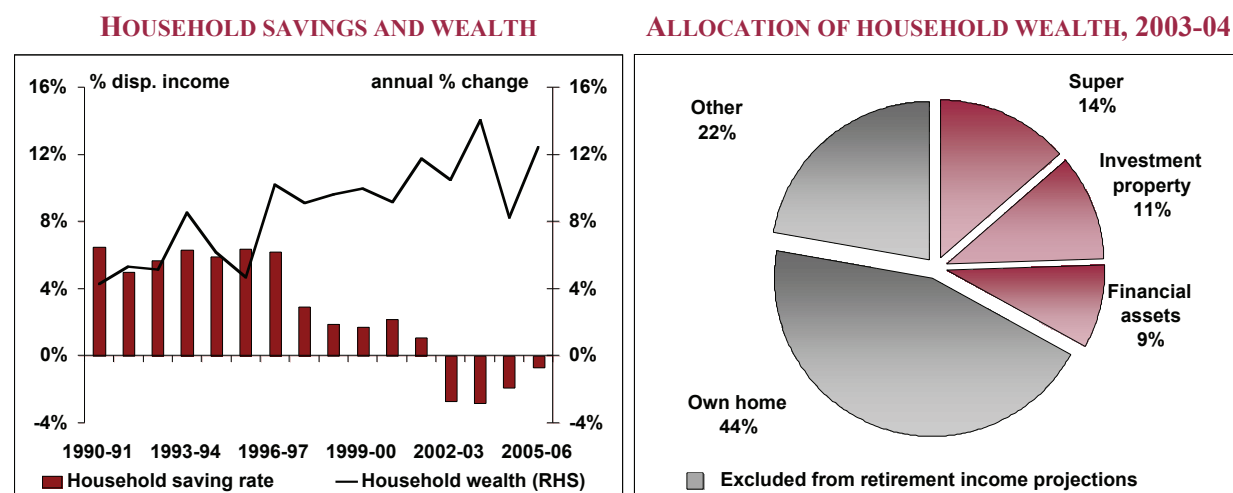
In assessing the retirement income potential of non-super assets, it is important to identify:

- ❑ 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 2 shows, recent gains in private wealth in Australia have been stunning. On the back of five consecutive years of strong investment returns, household wealth has been rising strongly, despite negative saving rates.

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 2: 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, 2003-04* (Cat. No. 6554.0).

The right-hand panel of Chart 2 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 of super**, which include savings 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:



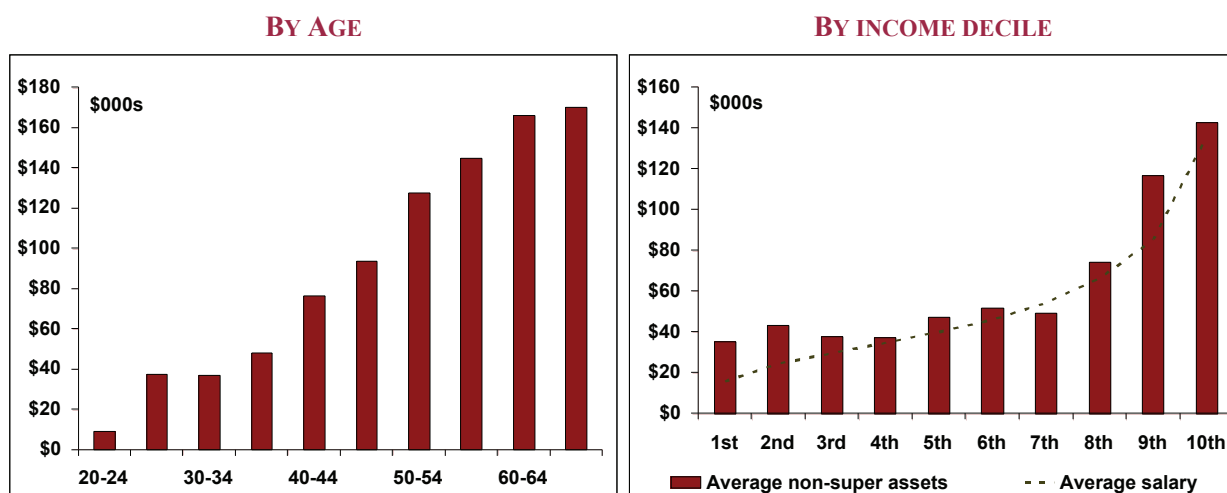
- ← *Own enterprise assets and liabilities.* AMP members are wage and salary earners, who are less likely than other members of the community to have significant holdings of such assets and liabilities.
- ← *Consumer durables,* such as cars, furniture and whitegoods. These assets provide for basic household needs, rather long term saving for retirement.

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 3 shows the average wealth estimates underlying the retirement income results below. These estimates are based on ABS data for 2003-04, adjusted on the basis of long run investment returns.<sup>2</sup>

**CHART 3: ESTIMATED NON-SUPER WEALTH – DECEMBER 2006**



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

As Chart 3 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.

<sup>2</sup> Long run returns in the modelling are related to economic growth, and are therefore lower than the returns implied by recent gains in wealth. Accordingly, the non-super wealth estimates here represent a conservative estimate.



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.

### 1.3 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.

From March 2007, a single age pensioner received \$13,652.60 per year, plus pharmaceutical, telephone and utilities allowances totalling \$342.40 per year.<sup>3</sup>

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 aged pension has grown over time, as pensioners share in improvements in living standards. That increase will continue, with the buying power of the aged 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 is being halved from \$3 to \$1.50 per \$1,000 of assets over the threshold.

Official projections contained in the second *Intergenerational Report* 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 4).

Indeed, projections of increased spending on age pensions are higher than predicted by the first *Intergeneration Report* in 2002-03.

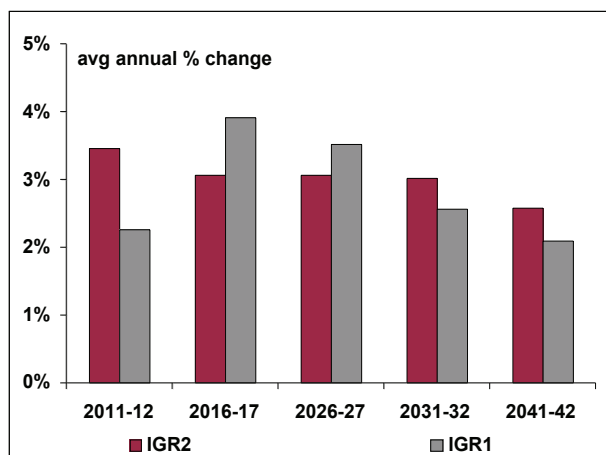
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<sup>3</sup> These allowances are paid to all pensioners, and are included throughout the analysis presented here. Other pensioner concessions (such as discounts on PBS medicines) and rent assistance are not included in estimates of retirement expenditure.

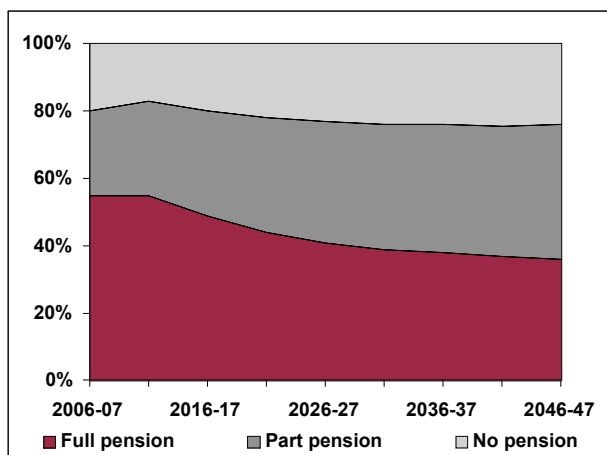


CHART 4: TREASURY IGR PROJECTIONS OF AGED PENSION SPENDING

GROWTH IN REAL AGED PENSION OUTLAYS



SHARE OF AGE PENSION AGE ELIGIBLE



Sources: Federal Treasury, *Intergenerational Report 2002-03* (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 aged 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.

### 1.4 PROJECTED RETIREMENT OUTCOMES

#### 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 aged 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 much more can be done to reduce the burden of the aged pension on government finances in the future.

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 therefore have higher incomes in 'today's dollars' when they retire in the future, and will also need to aim for a higher level of retirement spending to meet the relative benchmark applied here.
- ❑ **Retirement ages are unchanged<sup>4</sup>** in the future. Retirement dates in the model are based on the current pattern of retirement evident in the AMP database, which shows workers retiring between the ages of 55 and 74.

Table 4 shows the projected assets of Australian workers when they retire, if current savings trends continue.

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

<b>Age</b>	<b>Super</b>	<b>Other assets</b>	<b>Total</b>
<b>20-24</b>	\$646,104	\$106,065	\$752,168
<b>25-29</b>	\$571,855	\$128,670	\$700,524
<b>30-34</b>	\$499,740	\$100,047	\$599,787
<b>35-39</b>	\$425,323	\$96,692	\$522,014
<b>40-44</b>	\$353,499	\$117,059	\$470,558
<b>45-49</b>	\$276,069	\$120,325	\$396,395
<b>50-54</b>	\$220,722	\$148,255	\$368,977
<b>55-59</b>	\$177,167	\$161,496	\$338,664
<b>60-64</b>	\$155,429	\$182,857	\$338,286
<b>65-69</b>	\$121,307	\$189,498	\$310,805
<b>All workers</b>	<b>\$409,839</b>	<b>\$125,197</b>	<b>\$535,036</b>

These results indicate that benefits from the super system will become the dominant source of assets to fund retirement in coming decades, providing a more solid foundation for future generations. Younger workers will retire with more assets than their older counterparts, as rising living standards combine with a mature super system to deliver greater lifetime savings.

Older workers will retire with less in super, but capital gains in their other assets have often offset much of the shortfall, particularly among those who have already delayed retirement.

However, the latter may be cause for some concern. Assets outside the super system are less flexible when it comes to providing retirement income, may be subject to greater investment risk, and will not benefit from the changes to taxation made on 1 July 2007.

<sup>4</sup> While it is possible to model the effects of delayed retirement in the modelling underlying these results, this assumption ensures that the results shown here are measured on a like-for-like basis with today's retirees.



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, and then averages across workers within each age group.

Recall that 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**

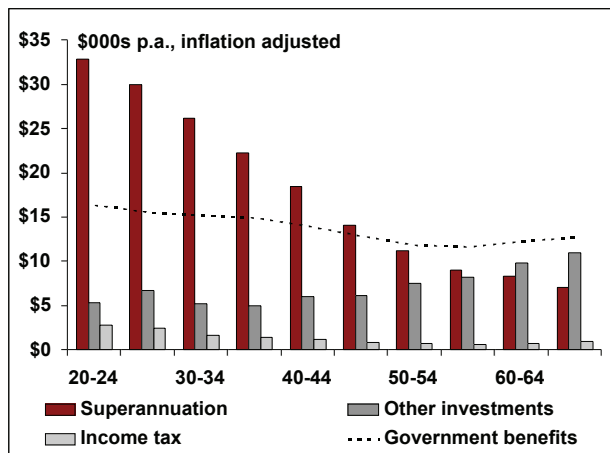
<b>Age</b>	<b>Super income</b>	<b>Other investments</b>	<b>Aged Pension</b>	<b>Income tax</b>	<b>Net retirement income</b>
<b>20-24</b>	\$32,907	\$5,392	\$16,371	\$2,768	\$51,901
<b>25-29</b>	\$29,977	\$6,726	\$15,595	\$2,418	\$49,880
<b>30-34</b>	\$26,200	\$5,230	\$15,286	\$1,716	\$44,999
<b>35-39</b>	\$22,302	\$5,054	\$14,938	\$1,410	\$40,884
<b>40-44</b>	\$18,453	\$6,091	\$14,004	\$1,192	\$37,356
<b>45-49</b>	\$14,054	\$6,105	\$12,897	\$813	\$32,243
<b>50-54</b>	\$11,223	\$7,508	\$11,852	\$767	\$29,815
<b>55-59</b>	\$9,075	\$8,222	\$11,649	\$654	\$28,291
<b>60-64</b>	\$8,376	\$9,793	\$12,271	\$748	\$29,692
<b>65-69</b>	\$7,064	\$10,989	\$12,728	\$1,001	\$29,780
<b>Average</b>	<b>\$21,336</b>	<b>\$6,516</b>	<b>\$14,316</b>	<b>\$1,601</b>	<b>\$40,567</b>

At current contribution rates, the average super benefit for those currently in the workforce will provide an income of \$21,336 a year in today’s dollars, or \$410 each week. Together with the aged pension (for those who qualify) and other investments, today’s workers will achieve average retirement incomes of \$40,567 a year, or \$780 per week in today’s dollars.

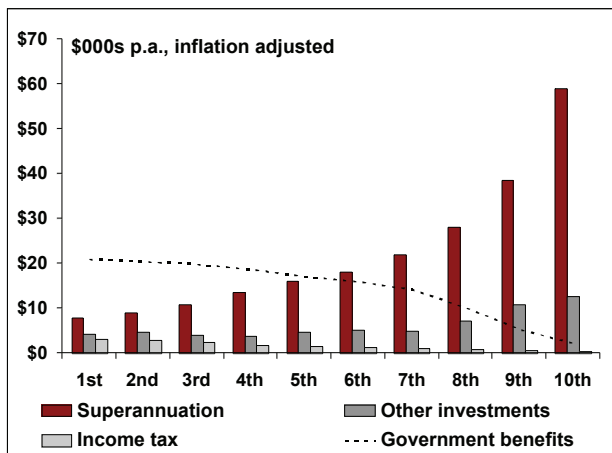


**CHART 5: COMPONENTS OF RETIREMENT INCOME**

**LEVELS, BY AGE**



**LEVELS, BY INCOME DECILE**





## 2. RETIREMENT INCOMES ADEQUACY

The first *AMP Superannuation Adequacy Index* shows that 7 million Australians – including the ‘average’ worker – are on track to achieve an adequate income in retirement, relative to their final year in the workforce.

Adequacy levels have been on the rise thanks to excellent capital gains across a range of assets in recent years and an increase in voluntary superannuation contributions over and above the compulsory 9% rate.

To stay on track, Australian workers will need to continue that solid record of voluntary contributions, as well as make the most of the opportunities offered by the super system.

However, current super savings are still falling short for 3.5 million Australian workers.

Current savings trends will see these workers face a relative shortfall of 13.5%, or \$5,036 a year in today’s terms.

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 achieve 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 6: AVERAGE CONSUMPTION SPENDING AND REPLACEMENT RATES

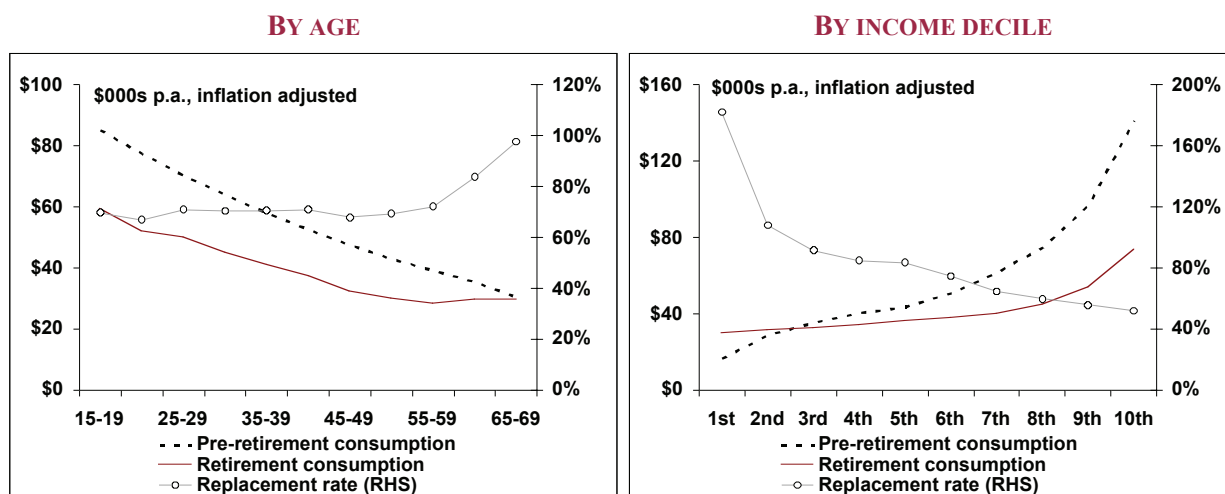


Chart 6 shows the average living standards future retirees will enjoy before and after they retire, and shows projected average replacement rates by age and income level.



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

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 just over 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 6 above, though that is partly due to lower final salaries among members who have already passed preservation age.

#### **YOUNGER MEMBERS AND 'CATCH-UP CONTRIBUTIONS'**

The projections seen here assume that younger members follow in the footsteps of their parents' generation by saving relatively more in super in later years.

But can younger members be expected to make 'catch-up' contributions in the same way as today's older members? In one sense, they shouldn't have to.

After all, unlike the boomer generation, they have had the full benefit of the 9% SG, now have access to the opportunities offered by the government's co-contribution scheme, and have been aware of the need to provide for their own retirement for most of their working lives.

However, the first *AMP Superannuation Adequacy Index* shows that despite this head start, they are still falling behind retirement targets.

That will involve some sacrifices, either sooner or later. For most, sooner would be better, making the most of the co-contributions scheme and the power of long term compounding returns.

If today's younger members avoid or delay these hard decisions, then the results here show they may face disappointment when they retire.

Workers on lower incomes will lean heavily on the aged pension to provide an adequate retirement income. In contrast, workers on higher salaries will need to rely on super and other investments to fund a comfortable retirement.

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. Projections show that **it is these higher income workers who face the greatest relative shortfall in their retirement savings.**

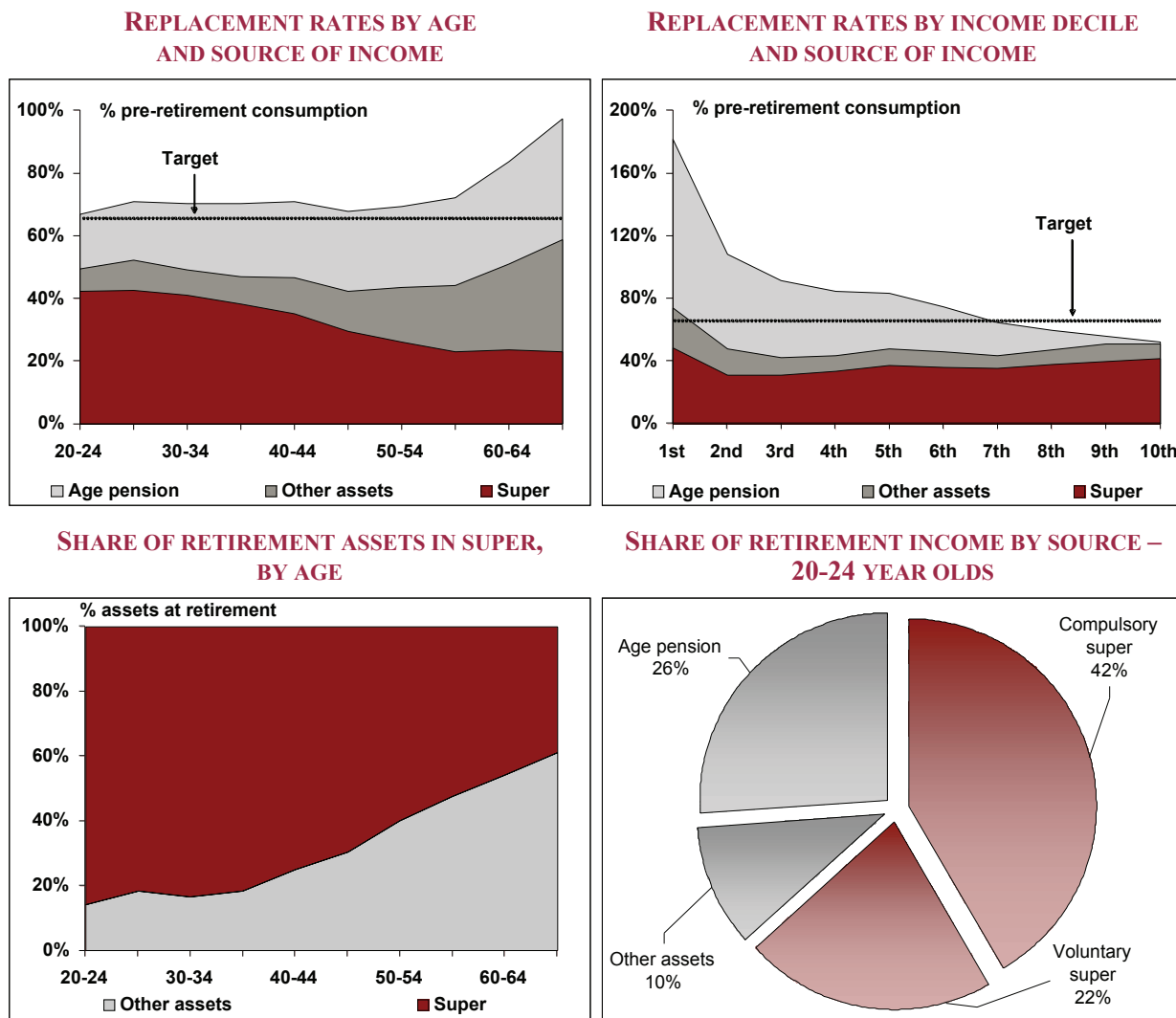
Higher income members will enjoy a greater level of retirement consumption than those on lower incomes, but low income members will have higher replacement rates. That is, the super system will promote broadly 'progressive' outcomes.

Indeed, for those members among the 10% with the lowest salaries, retirement will 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 aged pension to lower income retirees. Chart 7 highlights the importance of the aged pension in supporting workers on lower incomes in their retirement years.

**CHART 7: PROJECTED SOURCES OF RETIREMENT INCOME**



While the aged pension will remain a major source of income for Australian retirees, the lower-right hand panel of Chart 7 shows the dramatic impact voluntary super savings can make over time. Assuming today's 20-24 year old workers contribute as much to super in the future as older generations are now, they will enjoy 22% more income in retirement than they could with the 9% SG alone.

Chart 7 also highlights the drivers of the strong showing among the 'pre-boomer' generation:

- ❑ Lower levels of super benefits among this group will lead to a greater reliance on the aged pension to fund retirement living standards.
- ❑ Older age groups have also enjoyed the lion's share of the leap in asset values evident in recent years, leading to stronger prospects in retirement from non-super savings.

Put another way, while retirement living standards appear more secure for these retirees, it is future taxpayers and past capital gains in other assets which will support them, rather than



their own accumulated superannuation savings. If these workers hope to maximise the benefits of recent changes to super benefits taxes, they will need to act quickly to save more in super.

**While average adequacy levels are tracking well, millions of people are below that average – indeed, 3.5 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		
	%	000s	%	000s	% shortfall
<b>20-24</b>	61.6%	716.8	38.4%	446.0	12.7%
<b>25-29</b>	66.8%	754.3	33.2%	374.2	9.5%
<b>30-34</b>	66.1%	750.8	33.9%	384.9	13.0%
<b>35-39</b>	66.9%	812.5	33.1%	402.2	13.1%
<b>40-44</b>	67.3%	830.7	32.7%	403.6	13.2%
<b>45-49</b>	63.2%	781.2	36.8%	455.5	18.8%
<b>50-54</b>	65.4%	689.6	34.6%	364.6	14.5%
<b>55-59</b>	69.3%	587.4	30.7%	260.1	14.7%
<b>60-64</b>	81.5%	365.1	18.5%	83.0	13.1%
<b>65-69</b>	89.7%	140.0	10.3%	16.2	14.3%
<b>All workers<sup>5</sup></b>	<b>66.9%</b>	<b>7,002.8</b>	<b>33.1%</b>	<b>3,462.6</b>	<b>13.5%</b>

Around two thirds of workers, or 7 million Australians, are on track to achieve an adequate lifestyle in retirement. The remaining third appear likely to fall short of their retirement goals. On average, this group will face a relative shortfall of 13.5%, or \$5,036 a year in today’s terms.

Half of these, or around 1.9 million Australians, are under the age of 40 and already falling behind in their saving for retirement. Current savings patterns mean that, even if younger workers follow in the footsteps of their parent’s generation by contributing more to super as they near retirement (as these projections assume), some 35% of those aged 40 and under will not achieve the savings they need for a comfortable retirement.

<sup>5</sup> Note that, as is true 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 close to 265,000 workers aged under 20 who are below the adequacy target (and therefore included in relevant totals – such as 3.5 million Australians falling below the adequacy target, of whom 1.9 million are aged under 40).

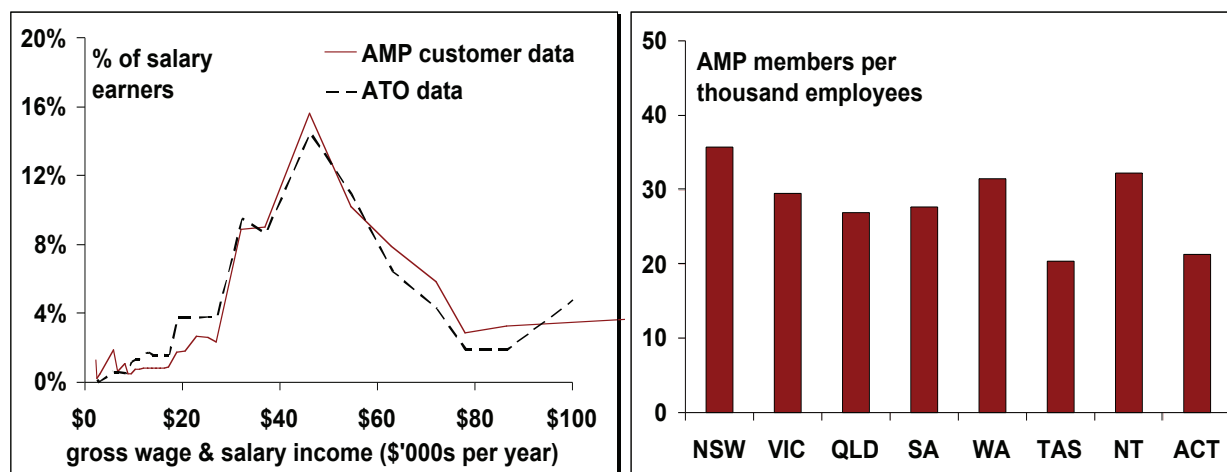


## APPENDIX A: SUPERANNUATION DATA

The foundation for this report is a comprehensive dataset derived from AMP's corporate superannuation client records. This unique dataset covers the period from July to December 2006, and includes around 320,000 members with combined super balances of \$9.57 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 8 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. As can be seen, Tasmanian employees are underrepresented. The number of AMP member per thousand employees is also lower in the ACT, which is to be expected, due to the large number of public sector employees in the Territory.

**CHART 8: 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 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.

The table below shows the average balances of active AMP members by State.

**TABLE 7: AVERAGE BALANCES OF ACTIVE AMP MEMBERS – STATE-BY-STATE BREAKDOWN<sup>6</sup>**

	<b>NSW</b>	<b>VIC</b>	<b>QLD</b>	<b>SA</b>	<b>WA</b>	<b>TAS</b>	<b>ACT</b>	<b>NT</b>	<b>Average</b>
<b>20-24</b>	\$5,443	\$5,462	\$4,467	\$5,907	\$5,086	\$5,648	\$4,541	\$4,282	\$5,228
<b>25-29</b>	\$13,967	\$13,303	\$10,944	\$14,266	\$12,218	\$13,650	\$10,491	\$9,621	\$13,073
<b>30-34</b>	\$25,857	\$24,785	\$19,453	\$24,175	\$21,262	\$24,766	\$21,191	\$17,065	\$23,935
<b>35-39</b>	\$38,695	\$36,118	\$26,060	\$32,019	\$28,229	\$34,561	\$28,021	\$25,101	\$34,304
<b>40-44</b>	\$50,181	\$44,819	\$34,336	\$40,892	\$36,448	\$47,314	\$45,316	\$42,208	\$43,923
<b>45-49</b>	\$64,222	\$54,794	\$41,661	\$51,056	\$44,105	\$60,127	\$46,647	\$47,563	\$54,556
<b>50-54</b>	\$81,119	\$70,117	\$54,175	\$61,641	\$56,364	\$83,019	\$53,980	\$56,923	\$69,238
<b>55-59</b>	\$93,048	\$81,067	\$65,546	\$75,968	\$62,854	\$110,621	\$73,197	\$75,805	\$80,588
<b>60-64</b>	\$114,733	\$96,813	\$71,846	\$83,803	\$73,725	\$160,917	\$90,540	\$83,060	\$95,468
<b>Average</b>	\$40,548	\$37,301	\$28,580	\$37,571	\$30,040	\$47,203	\$31,874	\$25,535	\$36,348

Tasmania appears to have the largest average balance – although this could be due to the small sample size in that State. The Northern Territory has the lowest balance – perhaps due to its young and transitory labour force. Queensland has the second lowest balance, probably due to the large number of retirees in that State who are currently drawing down on their super.

<sup>6</sup> Note that the numbers in Table 7 above are weighted by AMP membership, whereas those in Table 2 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 7 shows an average balance of \$36,348, whereas Table 2 shows an average balance of \$39,663, with that difference attributable to the greater representation of younger workers in AMP membership.



## APPENDIX B: 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.
- ❑ 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).

The 1 July 2007 changes to the taxation of super benefits and the age pension assets test announced as part of the *Plan to Simplify and Streamline Superannuation* are included in these projections.

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, 2003-04 (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.

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 aged 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>7</sup>, measured in the final year in the workforce.

This benchmark is that 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>7</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 will be \$1.50 per fortnight for each \$1,000 in assets over the threshold from 1 July 2007.

**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.

**Benefits tax** is the tax paid on benefits taken from superannuation, either by way of a lump sum or a pension. From 1 July 2007, for retirees aged 60 or over, benefits received from a 'taxed source' will be tax free and not subject to this tax.

**Contributions tax.** The 15% tax payable on some amounts paid into a superannuation fund and the earnings and investments held in the fund. Your super fund usually reduces your superannuation account by your 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 your employer (or someone associated with your employer) to your 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 your non-concessional contributions cap, i.e. personal contributions which are not claimed as an income tax deduction. These include contributions made by your spouse to your 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 than 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 you make to your superannuation account including from money you have paid tax on, such as your take-home pay and contributions which you don't claim a tax deduction for.



**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 workers 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 those earning more than \$39,808 in 2005-06 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.

**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 \$1,000. This maximum is reduced by 5 cents for every dollar you earn over \$28,000, with no co-contributions available for members earning a \$58,000 in 2005-06. 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%.