

Cost of Delay:

Critical factors in achieving retirement income adequacy

ASFA has in the past calculated estimates of replacement income in retirement that would be achieved by contributions over 30 or 40 years at the maximum SG rate of 9% of wages. These calculations have taken existing taxation and social security arrangements as given, and have applied an estimated rate for the investment earnings of superannuation funds in the future. The Age Pension is included in the estimate of retirement income.

The attached tables take this process further by calculating the rate of contributions (discretionary saving) over and above the 9% SG that would be necessary to generate specific levels of replacement income in retirement.

The scenarios show the sensitivity of outcomes to: employment patterns and the number of years over which the contributions are made; the level of contributions tax and the rate of investment returns within the fund.

In brief, the scenarios show that:

- Achieving 40% of gross pre-retirement income is achievable for those on around AWE if SG contributions were not taxed and were made for more than 15 years. But under current tax arrangements contributions would be needed for 25 or more years at higher income levels to achieve even the very modest 40% replacement rate.
- Shortening the period of contributions and savings by even 5 years generally lifts the required saving task by 3% or more of salary a year. Delay is costly.
- Getting rid of the current contributions tax would be equivalent to a 2 or 3 percentage point increase in the SG.
- Achieving 8% per annum fund earnings rather than 6% earnings can knock several percentage points off the proportion of wages required to be saved or 5 years or more off the required savings period, depending on the target income. Sound investment choice utilising growth assets is crucial.
- Achieving a gross income in retirement of 60% of pre-retirement income requires contributions for at least 40 years, with contributions above the SG needed for higher income earners, or where full time employment amounts to less than 40 years.
- Achieving a gross income in retirement of 80% of pre-retirement income requires both 40 years of contributions and total contributions of 12% at low-income levels and 15% or more at higher income levels.

Action Plans

A range of action plans are possible, involving both individuals and government, to close the likely gap between expectations (the retirement income goals) and the current level of saving.

We have stepped through one such action plan for people with the opportunity of 30 years employment and a retirement income goal of 60% of pre-retirement income.

It highlights the positive impact of the government removing the 15% contribution tax and of funds achieving higher earnings.

Bridging the savings gap will be more difficult with shorter employment opportunities or higher retirement income aspirations.

Possible Action Plans and The Cost of Delaying Change

Table 1 shows the extra contributions (over and above the 9% SG due to be implemented next year) needed by individuals to achieve a retirement income of 60% of pre-retirement salary.

Final salary	Retirement income goal (60% of pre-retirement)	Extra contributions (over 9% SG) needed		
		30 years	25 years	20 years
\$35,000	\$21,000	8%	13%	20%
\$50,000	\$30,000	13%	19%	29%
\$75,000	\$45,000	17%	24%	35%

The table assumes:

- 9% SG already paid by employer
- Includes value of age pension (which helps lower income groups more)
- 20 year annuity purchased
- nominal fund earnings of 6% (erring on the conservative side)

If Government removed the 15% contributions tax – helps goal of adequacy.

Table 2 shows the **lower additional** contributions required if Government removed the 15% contributions tax.

Final salary	Retirement income goal (60% of pre-retirement)	Extra contributions (over 9% SG) needed	
		30 years	20 years
\$35,000	\$21,000	6%	16%
\$50,000	\$30,000	10%	23%
\$75,000	\$45,000	13%	28%

Table 3 shows the result if the economy remains stable, enabling funds to achieve higher earnings (8% rather than 6%). However, it is also dependent on **no** increased administrative burden to funds.

Assume 8% nominal returns (and no contributions tax)

Final salary	Retirement income goal (60% of pre-retirement)	Extra contributions (over 9% SG) needed	
		30 years	20 years
\$35,000	\$21,000	2%	11%
\$50,000	\$30,000	5%	17%
\$75,000	\$45,000	7%	22%

Scenario 1

Some assumptions:

- 9% SG already paid by employer
- Includes value of age pension (which helps lower income groups more)
- nominal fund earnings of 6% after fees and taxes
- Nil contributions tax

Table 1: Percentage of income to be saved for 40% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$14000)	\$50000 (\$20000)	\$75000 (\$30000)
5	32%	65%	92%
10	10%	26%	39%
15	3%	13%	21%
20		7%	12%
25		3%	7%
30		0%	4%
35			1%
40			

Table 2: Percentage of income to be saved for 60% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$21000)	\$50000 (\$30000)	\$75000 (\$45000)
5	108%	142%	168%
10	47%	62%	75%
15	26%	36%	44%
20	16%	23%	28%
25	10%	15%	19%
30	6%	10%	13%
35	3%	6%	9%
40	1%	4%	6%

Table 3: Percentage of income to be saved for 80% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$28000)	\$50000 (\$40000)	\$75000 (\$60000)
5	185%	219%	245%
10	83%	99%	111%
15	49%	59%	67%
20	32%	39%	45%
25	22%	27%	32%
30	15%	20%	23%
35	11%	14%	17%
40	7%	10%	12%

Scenario 2

Some assumptions:

- 9% SG already paid by employer
- Includes value of age pension (which helps lower income groups more)
- nominal fund earnings of 6% after fees and taxes
- 15% contributions tax

Table 1: Percentage of income to be saved for 40% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$14000)	\$50000 (\$20000)	\$75000 (\$30000)
5	39%	79%	109%
10	14%	32%	47%
15	5%	17%	26%
20	1%	10%	16%
25		5%	10%
30		2%	6%
35			3%
40			1%

Table 2: Percentage of income to be saved for 60% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$21000)	\$50000 (\$30000)	\$75000 (\$45000)
5	129%	169%	200%
10	56%	75%	90%
15	32%	44%	53%
20	20%	29%	35%
25	13%	19%	24%
30	8%	13%	17%
35	5%	9%	12%
40	3%	6%	8%

Table 3: Percentage of income to be saved for 80% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$28000)	\$50000 (\$40000)	\$75000 (\$60000)
5	219%	259%	290%
10	99%	118%	132%
15	59%	71%	80%
20	39%	48%	54%
25	27%	34%	39%
30	20%	25%	28%
35	14%	18%	21%
40	10%	13%	16%

Scenario 3

Some assumptions:

- 9% SG already paid by employer
- Includes value of age pension (which helps lower income groups more)
- nominal fund earnings of 8% after fees and taxes
- Nil contributions tax

Table 1: Percentage of income to be saved for 40% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$14000)	\$50000 (\$20000)	\$75000 (\$30000)
5	30%	63%	88%
10	9%	23%	35%
15	2%	10%	17%
20		4%	8%
25		0%	3%
30			0%
35			
40			

Table 2: Percentage of income to be saved for 60% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$21000)	\$50000 (\$30000)	\$75000 (\$45000)
5	104%	136%	162%
10	42%	56%	68%
15	21%	30%	37%
20	11%	17%	22%
25	6%	10%	13%
30	2%	5%	7%
35		2%	3%
40			1%

Table 3: Percentage of income to be saved for 80% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$28000)	\$50000 (\$40000)	\$75000 (\$60000)
5	178%	210%	235%
10	75%	90%	101%
15	41%	50%	57%
20	25%	31%	35%
25	15%	19%	22%
30	9%	12%	14%
35	4%	7%	9%
40	1%	3%	5%

Scenario 4

Some assumptions:

- 9% SG already paid by employer
- Includes value of age pension (which helps lower income groups more)
- nominal fund earnings of 8% after fees and taxes
- 15% contributions tax

Table 1: Percentage of income to be saved for 40% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$14000)	\$50000 (\$20000)	\$75000 (\$30000)
5	37%	75%	105%
10	12%	29%	42%
15	3%	14%	22%
20		6%	12%
25		2%	6%
30			2%
35			
40			

Table 2: Percentage of income to be saved for 60% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$21000)	\$50000 (\$30000)	\$75000 (\$45000)
5	124%	162%	192%
10	51%	68%	81%
15	27%	37%	45%
20	15%	22%	27%
25	8%	13%	17%
30	4%	7%	10%
35	1%	3%	6%
40		1%	2%

Table 3: Percentage of income to be saved for 80% of pre-retirement income

Years to retirement	Final Income (Retirement income sought)		
	\$35000 (\$28000)	\$50000 (\$40000)	\$75000 (\$60000)
5	211%	249%	278%
10	90%	107%	120%
15	50%	60%	68%
20	31%	38%	43%
25	19%	24%	28%
30	12%	16%	18%
35	7%	10%	12%
40	3%	5%	7%