MERCER

2015 FEDERAL BUDGET

IMPLICATIONS FOR SUPERANNUATION FUNDS, EMPLOYERS AND INDIVIDUALS

MAKE TOMORROW, TODAY

CONTENTS

THE BUDGET IN REVIEW

As widely anticipated, the Government's second Budget is much less ambitious than their first. The Treasurer said the Budget was about jobs, families and small business. From the perspectives of superannuation and retirement; careers and the workforce; health and investment, the key initiatives announced were:

- greater targeting of the Age Pension assets test from 1 January 2017, resulting in cuts to part-pensions for wealthier retirees and a boost for some part-pensioners with lower assets;
- scrapping of last year's proposal to restrict pension increases to the CPI;
- a revamped child care package aimed at encouraging more parents back into the workforce, along with a tightening of the eligibility conditions for the Government Parental Leave Pay scheme;
- the new and amended listings on the Pharmaceutical Benefits Scheme; and
- the tightening of the Fringe Benefit Tax exemption for employees in the not for profit and health sectors.

The promise of "no new taxes on super" during this Government's term in office remains intact.

Economic Overview

The Government has retreated from an earlier budget strategy of deficit reduction built on restraining growth in the major social service portfolios. In the absence of also addressing the deteriorating revenue base and generous tax expenditures, this strategy proved extremely unpopular within the broader community, and several measures failed to pass the Senate.

The forthcoming reviews of Australia's taxation system and Federal-State Government financial arrangements were two further reasons to expect that the 2015/16 Budget would skirt a significant new approach to Commonwealth fiscal consolidation. Rather, this Budget seeks to maintain a gradual (although lengthier) path towards fiscal surplus through:

- savings from a wide range of 'integrity' and 'smaller government' measures impacting multinational corporations, the GST base, foreign investors in residential real estate, welfare payment systems, the Commonwealth Public Service and wealthier retirees claiming a part-pension;
- abandoning expensive 'signature' programs such as the previous Parental Leave Pay Scheme and Commonwealth Funding for Victoria's East-West Link, while resisting major new infrastructure programs apart from a new Northern Australia Infrastructure Fund; and
- the usual reliance on stronger economic growth in the outyears of the forward estimates period and the accompanying cyclical improvement in revenues and expenses.

The reviews of the taxation system and the funding of the Federation may yet yield additional measures to improve the structural position of the budget. However, any measures are unlikely to be implemented before the next election (due by late 2016).

In the meantime, the 2014/15 deficit is now estimated at $41.1 billion (2.6% of GDP), little changed from MYEFO ($40.3billion or 2.5% of GDP), and providing some hope the long period of negative variations may be drawing to a close (as the price of iron ore and the unemployment rate hopefully begin to stabilise). This represents an improvement on 2013/14 (in which the deficit was equal to 3.1% of GDP).

The deficit is forecast to shrink by an average of 0.5% of GDP annually over the next four years. Correspondingly, the deficit is forecast at just 0.4% of GDP in 2018/19.

Mercer broadly concurs with the Government's approach in the short-term of declining to chase the lost revenues, and allowing the budget automatic stabilisers to cushion the broader economic impact of the declines in the terms of trade and in mining investment. However, while there may be growing reasons to believe the periods of big budget revenue write-downs could be behind us, at the same time there must be some doubt over the projected shrinkage in the deficit. As in previous years (and quite separate from the impact of bracket creep), both revenue and expense projections could yet turn out too optimistic.

Real GDP growth is forecast to jump to over 3.0% in 2016/17 and beyond, helping to drive revenue from 23.5% of GDP in the current year to 25.2% in 2018/19. Nominal GDP, after expected growth of just 1.5% in the current year, is forecast at over 5% in 2016/17 and beyond. We believe the risks to these forecasts remain.

Superannuation and Retirement

With the Government having just commenced its holistic review of Australia's tax system – which is to culminate in a Tax White Paper setting out its preferred reforms to be released in 2016 and taken to the next election – it was not expected there would be any changes to superannuation taxation in this Budget. Nevertheless it was pleasing to see that the Government resisted the temptation to tinker with super yet again.

While there were no tax changes to superannuation, the proposed changes to the Age Pension assets test will have a significant impact on the retirement plans of many better-funded retirees who are currently receiving a part-pension, as well as those pre-retirees who will now need to factor a lower part-pension into their plans.

In Mercer's view, the proposed doubling of the assets test taper rate reduces the Age Pension too quickly as assets increase, creating a major risk that:

- current part-pensioners may be tempted to spend their savings more quickly given that the increase in their part pension (from having lower assets) will likely be much greater than the income they could generate on those assets. They will then be in a more vulnerable position should substantial unanticipated expenses arise, particularly in their later years; and
- some fund members in the accumulation phase may conclude there is not enough reward for them to make additional super contributions in the future, condemning them to a poorer financial situation in retirement and leading to a greater strain on the Age Pension in the future.

As the Treasurer is fond of saying, you have to be careful when you pull one policy lever that it doesn't have unwanted negative implications in another area. Whilst there is an argument that wealthier retirees should be expected to draw on some of their own savings to meet their income needs, the system needs to retain enough incentive to encourage those with capacity to save to do so. Otherwise future pension costs will go up, not down.

We will only improve our retirement savings system and therefore the retirement of Australians if we approach the system with a holistic review. It is critical superannuation tax arrangements be considered in combination with the age pension arrangements, rather than the continuation of piecemeal changes to the different elements of Australia's retirement income system in response to budget cycle pressures.

TAX REVIEW

The chorus of calls for the Government to crack down on super tax breaks for the 'wealthy' appear to be getting to a point where it is almost inevitable that there will be changes to the super tax system following the coming tax review. However, the Treasurer reiterated the promise of "no new taxes on super" for this Government's current term of office.

Mercer believes there is room for improvement in the equity of super tax concession and our four point plan released last year set out a number of proposals for achieving this by fine-tuning the current system – rather than a drastic overhaul that is likely to be very costly to implement and involve substantial and complex transitional issues.

Mercer's four point tax and super plan includes the following recommendations:

1. Extend Division 293 tax to all those on the top marginal tax rate
2. Improve the Government Low Income Earners Superannuation Contribution
3. Introduce lifetime contribution caps but with a maximum contribution in any year
4. Limit the amount of assets that can exist in the tax exempt pension phase.

Mercer is currently preparing a submission in response to the Government's Tax White Paper Discussion Paper and will continue to participate in and influence this debate.

NEED FOR AGREED OBJECTIVES FOR SUPER

For any proposed super and pension changes to be properly assessed, Mercer believes it is critically important that the Government establish a set of objectives for the superannuation system, as most recently called for in the report on the Financial System Inquiry (FSI). Mercer strongly supported this recommendation in our recent submission in response to the FSI report.

Above all else, Mercer believes the objective of superannuation should be to provide an income for life, it should not be about wealth maximisation or just about reducing the cost of the Age Pension. The super system should be aimed at enabling and encouraging Australians to save enough for a comfortable retirement and defining what that means.

It is critical any future changes are based on evidence and measured against agreed objectives. Furthermore, until Australia develops relevant, specific and measurable retirement income objectives, it will be very difficult to determine, with any confidence, the strategies and products needed to meet those objectives.

If tested against an objective that the super system be aimed at enabling and encouraging Australians to save enough for a comfortable retirement, Mercer believes the proposed doubling of the assets test taper rate would receive a definite 'Fail', particularly for those who are adversely affected.

Tracking policy changes against objectives

The AIST-Mercer Super Tracker – launched earlier this year at the Conference of Major Superannuation Funds – was jointly developed by AIST and Mercer to provide an objective means of assessing super and road test new ideas and policies. The initial score for Australia's superannuation system from the Tracker is 64.9 out of a possible 100, confirming the system is strong in many areas, but more work is needed to ensure super is fair to all, particularly in terms of closing the gender gap in retirement savings.

The tracker brings evidence based views to the table on hotly debated issues such as the equity of government support and the gender gap in retirement savings. It provides a measure of where we are at and a tool to model how we can improve.

This model will allow us to analyse and assess potential changes and track Australia's super system regularly – are we getting better or worse and why? The real value will be in modelling the implications of policy changes in the future, such as changes to the Superannuation Guarantee rate, tax concessions, coverage of super, labour force participation rates, and even changes to the Age Pension.

Health

Essentially in the area of health, this Budget is a maintenance budget providing ongoing funding for some previously announced initiatives such as My Health Record and the Medical Research Future Fund. Unlike last year's Budget the Government has not included any initiatives that significantly shift the cost of health to individuals.

Careers and the Workforce

Against the background of a projected reduction in Australia's workforce participation rate from 64.6% in 2015 to 62.4% in 2055 due to the ageing of the Australian population, the 2015 Federal Budget measures provide a strong theme of increasing workforce participation.

The measures are aimed predominantly at increasing labour supply while looking to small businesses and start-ups to generate the jobs to be filled by increased participation.

The childcare measures seek to encourage parents to return to and remain in the workplace by improving access to flexible and affordable childcare. This is a positive development as improved childcare support plays an important role for many families in enabling both partners to participate in paid employment, and a critical role enabling single parents to return to paid employment.

The move to change the eligibility criteria for the Government's Parental Leave Pay scheme is more controversial.

While it may also have the impact of encouraging parents to return to work earlier, by effectively reducing the level of paid parental leave available, many female employees will view the changes to paid parental leave as the Government removing benefits. Corporate parental leave schemes are generally designed to supplement the public paid parental leave scheme and together provide income support for a greater proportion of the parental leave period. Restricting eligibility to either the corporate or the public parental leave scheme simply reduces the extent of income cover.

Changes to tighten eligibility for the Age Pension and the increases in the eligibility age that are already in place (to age 67 by 2023, with further increases likely in the future) could also encourage people to stay in the workforce longer to further build their private savings and bridge the gap between what the Government will provide and their desired income in retirement.

The challenge for employers is clear: to do their part to optimise increased participation and improve productivity by using initiatives designed to support women and older employees in the workforce.

1. SUPERANNUATION/ RETIREMENT

THERE WERE A NUMBER OF ANNOUNCEMENTS IN THIS YEAR'S FEDERAL BUDGET WHICH IMPACT AUSTRALIA'S RETIREMENT SAVINGS SYSTEM. THE FOLLOWING SECTION WILL COVER THEM IN DETAIL REFLECTING ON THE IMPACT THEY HAVE ON INDIVIDUALS, EMPLOYERS AND SUPER FUNDS.

1.1 Age Pension assets test changes

In a measure it describes as providing fairer access to more sustainable pensions, the Government proposes to:

- increase the amount of assets pensioners can have before their pension starts to be reduced (see Table 1) ; and
- double the 'taper rate' (i.e. the rate at which the Age Pension is reduced for each $1,000 of relevant assets in excess of the 'free' level), so that part-pensions reduce more quickly as assets increase and cut out entirely at significantly lower levels than currently (see Table 2).

Table 1: Assets test threshold for full pension

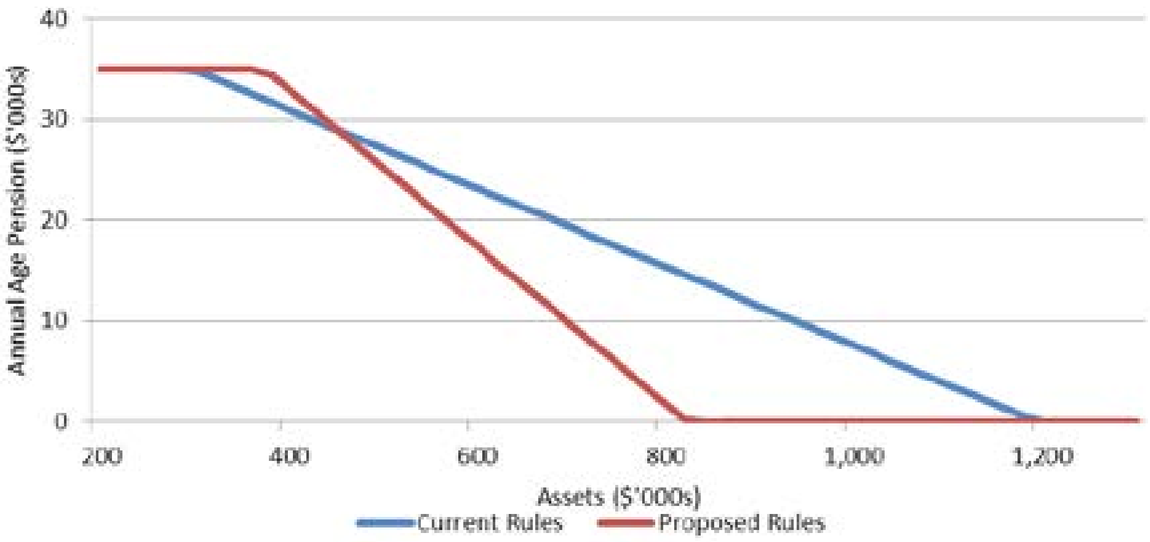
Family situation	Homeowners – for full pension assets must be less than		Non-homeowners – for full pension assets must be less than	
	Current	**Proposed**	**Current**	**Proposed**
Single	$202,000	$250,000	$348,500	$450,000
Couple combined	$286,500	$375,000	$433,000	$575,000

Table 2: Assets test limits for part pensions

Family situation	Homeowners – for part pension assets must be less than		Non-homeowners – for part pension assets must be less than	
	Current	**Proposed**	**Current**	**Proposed**
Single	$775,500	$547,000	$922,000	$747,000
Couple combined	$1,151,500	$823,000	$1,298,000	$1,023,000

Note: The proposed limits are based on projected pensions from 1 January 2017, not today. Also, special limits may apply for illness-separated couples or where only one partner is eligible.

Chart 1: 2017 Age Pension vs asset level for homeowner couples



Note: Chart 1 compares the annual Age Pension payable for different asset levels under the current rules as compared with the proposed rules for a homeowner couple. (The patterns for other categories are similar.) Note that this illustration does not take into account the impact of the income test. In practice many of those in the 'better off under the new rules' upper triangle for modest balances may gain less (or nothing) when the income test is applied, particularly if the deeming rates applicable for the income test increase from the current historically low levels.

The Government estimates these changes would result in:

- around 50,000 current part pensioners with lower asset levels becoming eligible for the full pension;
- higher part pensions for around 120,000 current part pensioners with lower asset levels;
- lower part pensions for around 235,000 current part pensioners with higher asset levels; and
- cessation of any Age Pension for around 91,000 current part pensioners with assets above the new cut-off levels (though these people will be eligible for the Commonwealth Seniors Health Card).

Based on Government modelling, the asset holdings levels above which part-pensioners will be worse off under the rebalanced asset tests are:

- $289,500 for single home owners;
- $451,500 for home owner couples (the crossover point in Chart 1);
- $537,000 for single non-home owners; and
- $699,000 for non-home owner couples.

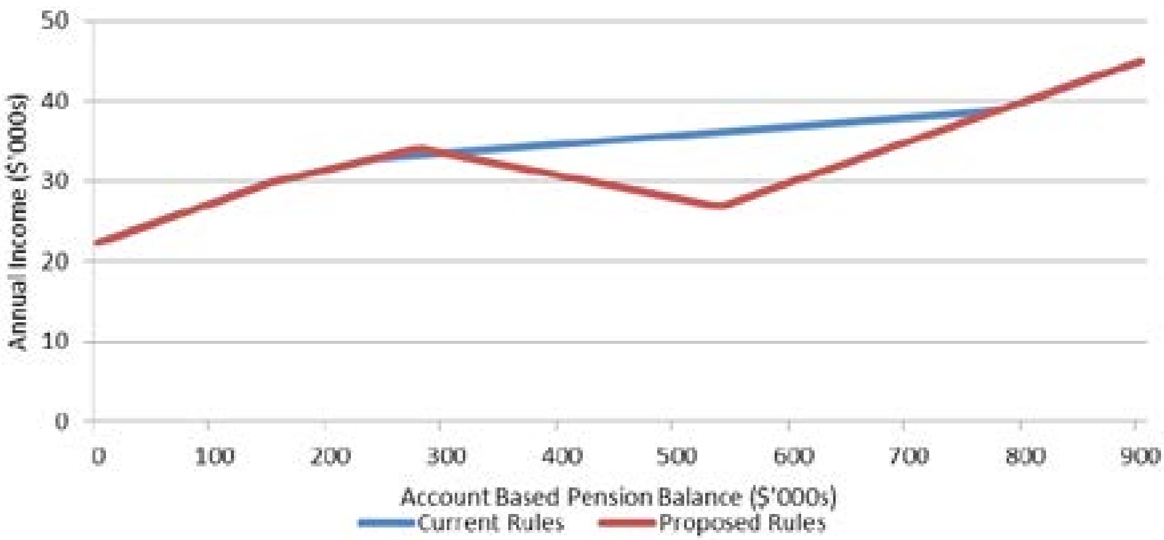
The changes are proposed to take effect from 1 January 2017 and are projected to produce savings of $2.4 billion over the 4 year forward estimates period.

MERCER'S VIEW

Whilst the reductions are highly targeted at those who can best afford it, the increase in the taper rate from $1.50 to $3.00 per fortnight means part pensioners will need to earn 7.8% pa on their savings to offset the reduction in the part Pension. This is clearly high in today's investment environment, meaning most will need to use part of their savings to replace the lost pension income. Whilst the savings drawdown required will be relatively small as a percentage of overall assets, this could encourage dissipation of savings by pensioners and/or increase the use of untested assets (principally the family home). It may also act as a disincentive to additional saving for retirement.

For example, consider a single homeowner who is planning to retire at 65 and live on retirement income based on drawdowns from an account-based pension (ABP) plus a part Age Pension. The individual was considering a strategy of making the minimum drawdown from his ABP to make his super last as long as possible. However Chart 2 shows that, under the proposed asset test rules (and assuming the ABP balance is his only assessable asset), this member will receive a lower starting income (from his ABP and part Age Pension combined) if he has an ABP balance of $500,000 than if he had $300,000. Whilst this picture will change over time, it does not send a good message to encourage or retain savings. (Similar issues also apply for other categories of pensioners.)

Chart 2: Retirement income (single homeowner)



A comprehensive income test (rather than having both income and asset tests), as recommended by the Henry Review, would be simpler and could be designed to provide fairer outcomes.

IMPACT ON INDIVIDUALS

Based on Government modelling, the impact on current pensioners ranges from an increase in Age Pension of up to around $1,500 pa (singles) or $3,900 pa (couples) for those with assets around the relevant new assets test free threshold to a reduction of up to around $10,000 pa (singles) or $14,500 pa (couples) for those with assets around the new assets test cut-off limits.

Those with significant reductions will need to review the impact on their cash flow and may need to consult with their financial advisers as to whether they should re-structure their investments, adjust their budget or take any other action.

Those who are approaching retirement who have factored a part pension in to their retirement income will need to reassess taking into account the proposed changes.

As Chart 2 shows, a strategy of making the minimum drawdown from your ABP to make your super last as long as possible may no longer provide adequate income. More sophisticated approaches may need to be considered, including using a longevity product to protect against the risk of outliving your savings, rather than just tightening your belt.

IMPACT ON EMPLOYERS

No direct impact.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

Changes such as these reinforce the need for funds to provide members with good retirement planning tools, including a retirement income calculator that takes into account estimated Age Pension entitlements. Such a calculator can assist members understand the amount of superannuation they will need in retirement and how the changes to the Age Pension will impact on their position.

Clearly calculators will need to be updated (if and) when the proposed changes become law. Providers will also need to consider whether to take any action in the meantime e.g. the incorporation of warnings regarding potential changes or adding the option to look at illustrations assuming the changes go ahead.

1.2 2014 Budget Age Pension changes not proceeding

The Government has confirmed that it will not proceed with three changes to the Age Pension arrangements that were announced in last year's Budget:

- The proposed pause in the indexation of the income test free areas for the Age Pension for three years from July 2017
- The proposed reductions in the deeming thresholds from $46,600 to $30,000 for single pensioners and from $77,400 to $50,000 for pensioner couples from September 2017
- The proposal that pension increases be linked only to the Consumer Price Index (CPI) from September 2017.

MERCER'S VIEW

The decision not to proceed with the first three changes mentioned is welcome from a retirement incomes viewpoint, particularly the proposal to restrict pension increases to the CPI indefinitely which would, over time, have led to very significant falls in the value of pensions as compared with wages. However the replacement measure – the changes to the assets test – could result in lower savings and hence raises the question of whether further changes will be needed to make the ongoing costs of providing Age Pensions more affordable.

The eligibility age for the Age Pension is already being increased gradually from age 65 to age 67 by 2023 in increments of six months each two years. It appears that the further increase in eligibility age to age 70 has been put on the back burner. However, unless the Age Pension eligibility age is increased as pensioner longevity improves, the Age Pension will, on average, be paid for longer and longer periods, leading to greater and greater strain on the Federal Budget.

Hence further increases to the eligibility age will need to come back on to the political agenda at some point and a long lead time is needed to allow appropriate retirement planning.

In Mercer's view, it would make sense to put in place a legislative mechanism by which the future Age Pension eligibility age (e.g. in 10, 15 or 20 years' time) is linked to pensioner life expectancy, with an automatic review and update say every 5 years. This could help to take the political heat out of adjustments to the pension age and help contain the cost of the Age Pension.

IMPACT ON INDIVIDUALS

The decision not to proceed with the first three changes mentioned and to continue with the current pension indexation arrangements is good news for current and future recipients of the Age Pension.

Whilst there is not much clarity regarding future changes in the eligibility age for the Age Pension, younger people should factor into their retirement planning the likelihood that there will be further increases to the eligibility age if, as expected, life expectancies continue to improve.

IMPACT ON EMPLOYERS

Increases in the Age Pension eligibility age, along with the tightening of means tests, will add to the trend for employees to work to older ages. Employers will need to factor this trend into their workforce planning, as discussed in Section 3.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

The decision not to proceed with the proposal to restrict pension increases to the CPI is also welcome from a retirement planning tool viewpoint. Trustees would have been placed in a very difficult position with regard to the indexation assumptions for retirement calculators, as to assume pension indexation to the CPI only for 20, 30 and 40 years plus would be arguably unrealistic as the value of pensions would fall to such low levels compared with wages that it would be politically unacceptable.

1.3 Defined benefit pensions income test treatment

From 1 January 2016, the proportion of defined benefit superannuation income that an individual can exclude for the purposes of the social security income test (the deductible amount) will be capped at ten percent. Under current rules, the deductible amount can be a much higher proportion for some defined benefit pensions.

This will reduce the amount of Age Pension some individuals would otherwise receive as a larger proportion of the actual defined benefit income will be taken into account. The Minister for Social Security said around 48,000 superannuants in mainly public sector and large corporate defined benefit plans will be affected.

The change will not apply to defined benefit pensions payable from self-managed super funds or from small APRA funds. Recipients of Veterans' Affairs pensions and/or defined benefit income streams paid by military superannuation funds will also be exempt from this measure.

MERCER'S VIEW

The Budget material does not provide much detail about this change. It appears that it is to apply to assets-test exempt defined benefit pensions and the Government has decided to tighten the application of the incomes test for recipients.

IMPACT ON INDIVIDUALS

Affected individuals will see a reduction in their age pension entitlements and will need to review the impact on their cash flow. Those facing significant reductions may need to consult with their financial advisers as to whether they should re-structure their other investments, adjust their budget or take any other action.

IMPACT ON EMPLOYERS

No impact.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

Affected funds will need to consider communicating with their defined benefit pensioners about this change and whether there is a need to amend any existing communications material.

1.4 Other changes

There were a number of other measures announced which impact on superannuation funds:

- **Revised criteria for release of superannuation for terminal medical condition**

From 1 July 2015, as announced just prior to the Budget, the Government will extend the tax free access to super for people with a terminal medical condition, to include a person whose life expectancy is less than two years – currently it must be less than one year to qualify for the relevant concessional tax treatment and early benefit access.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

The proposed change is certainly a good one from a member viewpoint but there are some significant implementation issues. Most super funds now have terminal medical conditions included in their insured benefit arrangements. The effective date of the change does not give sufficient time for Trustees to negotiate changes to the group life policy so that it is appropriately aligned with the changes. Insurers will need to give consideration to the new amendment and whether it would result in an increase in premiums – if so the trustees would need to consider whether the increase was good value as well as flow on issues such as notice to member requirements.

Hence while the change will clear the way for more members to be eligible to be paid their accumulated balances as a result of a terminal medical condition from 1 July 2015, the situation for insured benefits may remain unclear for some time and trustees will need to be careful that any member communications on this issue are clear as to any difference in treatment between accumulated balances and insured benefits.

- **APRA levy increases**

The APRA levy was originally intended to cover the cost of APRA supervision of industry participants. The Government has now extended that concept of "cost recovery" to include certain superannuation activities of the ATO and the Department of Human Services performed in respect of APRA regulated entities. The changes are not trivial and are expected to raise additional revenue of $46.9m over the next 4 years.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

Funds will need to factor in the higher levies in to their anticipated cost recoveries.

- **Serious Financial Crime Taskforce**

The Government has allocated $127.6m in funds over the next four years to a dedicated taskforce of current agencies (including the ATO; Australian Federal Police, Australian Crime Commission , AUSTRAC, ASIC , DPP) for investigations and prosecutions to address superannuation and investment fraud, identity crime and tax evasion.

It is also intended to be net revenue positive to the Budget through the recovery of stolen funds. Despite the obvious uncertainties in estimating such activities and the extent of recoveries that are likely to be achieved, this measure is optimistically estimated to contribute net $288.9m to the Budget over the forward estimates period.

MERCER'S VIEW

Co-ordinated initiatives of government enforcement agencies to support the security of our retirement savings system from external criminal threats (including presumably from cyber risk) are to be applauded.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

The initiative also acts as a clear marker to the importance that funds need to place on measures to address, manage and mitigate the ever present risks of criminal activities and fraud particularly with the advent of the digital age where these risks and the potential losses have been amplified.

- **Lost and unclaimed super – simplified reporting and administrative arrangements**

Redundant fund reporting obligations for lost and unclaimed super are to be removed and the reporting and administrative arrangements are to be streamlined.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

Funds will welcome removal and simplification rather than additional disclosure reporting obligations being imposed. However this is only a small component of the overall regulator reporting and disclosure saturation for superannuation funds – with substantial ongoing compliance costs borne by members' retirement savings.

1.5 Tax Review (White Paper) Process and Timeline

As commented earlier, while there were no super tax changes announced in the Budget, super tax arrangements will definitely be under consideration as part of the Government's Tax White Paper process which formally commenced with the release of a Discussion Paper on 30 March 2015.

The Treasurer said the purpose of the Discussion Paper is to start a national conversation on tax. No particular options or solutions were presented.

Only a few pages of the 196 page Discussion Paper directly cover superannuation. Consistent with the aim of focussing on ideas, the superannuation questions raised in the Discussion Paper are very broad:

How appropriate are the tax arrangements for superannuation in terms of their fairness and complexity? How could they be improved?

Submissions on the Discussion Paper are due by 1 June 2015.

Following the national conversation and consideration of submissions and issues raised, an options (green) paper will be developed and published in mid to late 2015.

The Government will then consider responses to the options (green) paper and release a White Paper setting out its plan on how to improve the tax system before the next election.

As a leading thinker in retirement savings systems the world over, Mercer will participate in this national conversation and help shape the adequacy and sustainability of our retirement savings system for today and tomorrow. In Australia, we are one of the few providers in the superannuation industry whose expertise and solutions span the entirety of the industry and understand retirement savings from an administrator, employer, fund, member, and investments perspective.

2. HEALTH

IN THE AREA OF HEALTH THIS BUDGET IS A MAINTENANCE BUDGET PROVIDING ONGOING FUNDING FOR SOME PREVIOUSLY ANNOUNCED INITIATIVES SUCH AS MY HEALTH RECORDS AND THE MEDICAL RESEARCH FUTURE FUND.

Unlike last year's Budget the government has not included any initiatives that significantly shift the cost of health to individuals.

While not impacting employers a number of announcements will impact some individuals and Australian families.

2.1 New and amended listings on the Pharmaceutical Benefits Scheme

The Government will provide $1.6 billion over five years for a number of new and amended listings on the Pharmaceutical Benefits Scheme and the Repatriation Pharmaceutical Benefits Scheme. These new listings include drugs for the treatment of melanoma, relapsing remitting multiple sclerosis, asthma and metastatic breast cancer. This addition to the PBS will make these new drugs readily accessible, which were previously unaffordable to most Australians.

2.2 Medical Research Future Fund

The Medical Research Future Fund (MRFF) had been announced in the previous Budget with funding to be provided, in part, by the now scrapped GP co-payment scheme. In this year's Budget the Government recommitted to the establishment of the MRFF from August 2015 with a reduced initial allocation of $3.4 billion sourced from a range of other saving measures. The MRFF is still expected to grow to $20 billion by 2019-20.

2.3 National Drugs Campaign — renewal

The Government will provide $20.0 million over two years from 2015–16 to renew the National Drugs Campaign. This will include a media campaign to promote the avoidance and cessation of illicit drug use. In 2015–16 and 2016/17 the campaign will focus on young people and their parents and seek to raise awareness of the harm of, in particular the form of methamphetamine known as 'ice'.

2.4 Improving immunisation coverage rates

$26.4 million will be provided over four years for activities designed to improve immunisation coverage and further reduce the incidence of vaccine preventable diseases in the Australian community.

2.5 Pharmaceutical Benefits Scheme safety net

The Government will save an additional $5.1 million in 2018-19 by extending increases to the Pharmaceutical Benefits Scheme (PBS) safety net thresholds by one additional year in 2019.

3. CAREERS/WORKFORCE

WITH THE AGEING OF THE AUSTRALIAN POPULATION, THE WORKFORCE PARTICIPATION RATE IN AUSTRALIA IS PROJECTED TO FALL FROM 64.6% IN 2015 TO 62.4% IN 2055. WHILE THIS MIGHT SEEM LIKE A SMALL REDUCTION IT WILL HAVE A MATERIAL IMPACT ON PRODUCTIVITY AND THEREFORE THE ECONOMY UNLESS MEASURES TO IMPROVE BOTH ARE PUT IN PLACE.

The 2015 Budget provides a strong theme of increasing workforce participation. The measures are aimed predominantly at increasing labour supply while looking to small businesses and start-ups to generate the jobs to be filled by increased participation.

The Budget appeals to small business, while leveraging the fact that small business that employs approximately 4.5 million people or 43% of private sector employment. Introducing measures that are aimed at reducing business costs (such as lowering the tax rate, scrapping FBT for mobile devices) suggest that the Government hopes that small business is able to redirect resources to generating employment through a mix of investment, job creation and/or growth.

3.1 Taxation changes for small business

Measures that impact taxation of small business in the 2015 Budget include:

- the introduction of tax cuts for Australian businesses with annual turnover below $2 million. Specifically, for small corporations, a 1.5% reduction in company tax rate from 30% to 28.5% will be introduced. For unincorporated businesses, a 5% tax discount up to $1,000 per year will apply;
- all small businesses will be able to get an immediate tax deduction for purchasing a range of business assets. An immediate tax deduction will be available for every individual asset costing less than $20,000, compared to the current threshold of $1,000. Costs above over $20,000 per purchase can be pooled and depreciated at the same tax rate of 15% for the first income year and 30% per year thereafter;
- for start-ups, professional expenses incurred when the business is set-up will be immediately deductible. In addition, from 1 July 2015, expanded tax concessions for Employee Share Schemes will enable employees to share in, and benefit from, the future growth and success of the business. Employees will not be required to pay tax on their shares until they actually receive a financial benefit from those shares; and
- the removal of Fringe Benefits Tax for all small business work-related portable electronic devices.

The above measures are aimed at improving cashflow and encouraging small businesses to redirect the savings towards value generating activities such as employment and investment.

The one item that has a direct impact on employees is the tax concession for equity remuneration provided in an eligible start-up. In an increasingly digital economy, this scheme is likely to be an attractive means for start-ups to motivate and retain employees, while ensuring that the costs to the business remain sustainable.

3.2 Child Care

Two key child care measures are expected to impact employees and employers:

- the Government proposes to introduce a simplified Child Care Subsidy to be implemented from 1 July 2017 which aims to replace the current Child Care Benefit, Child Care Rebate and Jobs, Education and Training Child Care Fee Assistance programmes. The Child Care Subsidy will be subject to means testing and activity testing. Families earning up to approximately $65,000 will receive a subsidy of 85% of the actual fee (subject to an hourly fee cap) and there will be no annual cap for families earning $185,000 or less. Families earning more than $185,000 will have a $10,000 annual cap on the total amount of assistance provided per child; and
- an Interim Home Based Carer Pilot Programme (Nannies Trial) will commence on 1 January 2016 and run until 31 December 2017. The measure is aimed at providing support to eligible families that experience difficulty in accessing mainstream child care services (such as shift workers in emergency services). The programme is only available to families with annual incomes below $250,000 and will provide a subsidy at a percentage of an hourly fee cap of $7 per child based on family income, similar to the Child Care Subsidy parameters.

Although the date of implementation for the Child Care Subsidy is two years away, the measures seek to encourage parents to remain in the workplace by improving access to flexible and affordable childcare. This is a positive development as improved childcare support plays an important role for many families in enabling both partners to participate in paid employment, and a critical role enabling single parents to return to paid employment.

For employers, this has the potential benefit of reduced employee turnover risk as employees feel supported by these measures and are able to return to their jobs. Employers are also able to continue to reap the benefits of having trained employees able to do their jobs on return, instead of having to provide training to replacements.

In terms of the Nannies Trial, this may create greater supply of shift workers to participate in the workforce whereas in the past their participation would be limited by the lack of access to child care.

3.3 Parental Leave

The Government will remove “double-dipping” in Paid Parental Leave (PPL) from 1 July 2016.

Currently, individuals are able to receive taxpayer funded PPL in addition to any employer-provided parental leave entitlements. Access to PPL will be limited to individuals whose employer does not provide parental leave entitlements. In cases where employers provide less generous entitlements, the Government will top up the amount paid to be equal to the full amount available under the current scheme.

The move to change the eligibility criteria for the Government’s paid parental leave scheme is more controversial. While it may also have the impact of encouraging parents to return to work earlier, by effectively reducing the level of paid parental leave available, many female employees will view the changes to paid parental leave as the Government reducing benefits.

Mercer research shows that a majority of companies already provide some form of company paid parental leave. The current government scheme enables corporate parental leave schemes to act as a supplement to the public paid scheme and together provide income support for a greater proportion of the parental leave period. Restricting eligibility to either the corporate or the public parental leave scheme simply reduces the extent of income support.

Effective public policy in this area needs to be aimed at boosting women’s participation in the workforce across the lifecycle. This means providing effective financial support for women having children during child-bearing (through parental leave) and upon return to work (through childcare support).

While some commentators have suggested that corporates will now reduce or abandon the level of corporate parental leave, effectively forcing all to rely on the public parental leave scheme, this would seem to be counter-productive for those organisations that have a significant proportion of female talent in their workforce as well as creating potential inequity for the more highly paid female employees. Some of the more generous corporate schemes (such as in financial services and the professions) exist where firms have made significant investments to develop female talent over a number of years, and are highly motivated to encourage female employees to return to work after having a child.

Mercer anticipates that employers are likely to retain their corporate parental leave pay schemes as part of their employee value proposition.

Table 3: Impact of the Paid Parental Leave (PPL) Policy Changes

Income Level	Corporate PPL Median (1)	Commonwealth PPL Scheme (2)	Combined PPL	Income Cover during PPL as % of Income
Existing Provision				
$200,000	$46,154		$46,154	23%
$150,000	$34,615	$11,539	$46,154	31%
$100,000	$23,077	$11,539	$34,616	35%
$50,000	$11,538	$11,539	$23,078	46%
Probable Impact of Budget Proposal				
$200,000	$46,154		$46,154	23%
$150,000	$34,615		$34,615	23%
$100,000	$23,077		$23,077	23%
$50,000		$11,539	$11,539	23%

Notes:
1. Corporate median paid parental leave is 12 weeks full-time earnings [source Mercer, Australian Benefits Review (2014)]
2. Commonwealth PPL Scheme provides up to 18 weeks at National Minimum Wage

3.4 Changes to benefits for Employees of Not-For-Profit and Public Health Organisations

Currently, employees in the not-for-profit and public health sector are able to access generous uncapped “meal entertainment” benefits which include holidays, cruises, weddings and meals and alcohol in restaurants. Additionally, these benefits are not reportable for FBT purposes. The Government proposes to introduce a new reportable grossed-up exemption cap of $5,000.

Although recent data is not readily available, ABS data suggests that approximately 1 million people are employed in the NFP sector with close to 500,000 in the public health care and social assistance sector. Clearly, this measure is likely to impact a significant population of employees through reducing the benefit of working in the sector.

For employers, the lack of any change to the current FBT exemption arrangements and the introduction of this measure will lead to reduced competitiveness in their employee value proposition when it comes to attracting key talent.

3.5 Non-Resident tax treatment for working holiday makers

The Government will change the tax residency rules to treat most working holiday makers temporarily in Australia as non-residents for tax purposes, meaning that they are unable to access the tax-free threshold.

This measure is likely to affect casual workers in specific industries (namely agribusiness, retail, tourism). One of the implications for employers is a potential reduction in availability of the casual workforce as employees begin to weigh up the cost of the extra taxation. On the other hand, this may be balanced by greater workforce participation for Australian residents generated through other budget measures.

3.6 Assets Test for the Age Pension

One of the consequences of the proposed amendments to the assets test for the Age Pension (discussed in Section 1) may also be that people choose to stay in work longer to further their private savings and bridge the gap between their desired level of income in retirement and the available sources of income. This gap is further accentuated by the current low interest rate environment.

IMPACT ON EMPLOYERS

While these measures are designed to contribute to increasing workforce participation it is important that employers stand ready to do their part in optimising increased participation and improving productivity.

Evidence shows that companies around the world have a long way to go to harness the very real benefits that more women in their workforce can bring. Likewise many companies are yet to understand the challenges that will come when they have four generations of people at work.

The challenges for employers are real and complex – making flexibility at work, work; successfully enabling people to work remotely while contributing to the team; retaining key talent; transfer of business critical knowledge and skills; helping people to take the right steps to safeguard their financial and physical wellbeing; moving some older workers out of physical roles to more suitable positions.

Don't be denied the benefits of a silver talent pool

Research we released late last year revealed retirees will outlast savings by more than five years on average; one-time retirement will become history; and the silver talent pool double-edged sword.

The majority (73%) of Australians approaching retirement believe they will semi-retire, or gradually wind-down into full retirement. In contrast, only 27% of retired Australians actually semi-retired, 67% moved immediately to full retirement.

Only 36% of Australians retired because they had enough savings and less than one third (28%) of working Aussies aged 50-80 believe they will have enough savings to retire when they want. Its likely retirees will outlast their savings by more than five years on average, according to the research.

Expectations are disconnected to the reality of retirement, which presents a significant risk for individuals and employers. Individuals face longevity risk; employers risk losing the skills, experience and productivity of a valuable silver talent pool if not managed correctly.

With increasing life expectancies, retirement will no longer be a one-time event, as it once was for earlier generations. Continuing to work part-time or re-entering the workforce after a short break will become common – however, there are still a lot of barriers within many companies to do this.

For employers, retaining employees aged 60+ can be a double edged sword. It can boost economic output and allows companies to preserve years of acquired knowledge and valuable experience. But their presence can also be detrimental. Highly compensated senior workers who stay can put a drain on financial resources and block younger employees from possible promotion opportunities.

Managing an ageing workforce needs to be handled strategically and delicately. When talent management strategies get derailed, younger workers get discouraged, and a company's costs add up. Yet, on the other hand, older employees will find it frustrating to be encouraged to retire before they're ready – financially or professionally - after building a lifetime of experience.

The implications for employers are quite fascinating. How are you going to help retirees re-enter a changing workforce? How are you going to manage people in their second or third career, while engaging people who are in their first career at the same time?

Employers have the opportunity to maximise employee productivity and engagement while gaining a competitive edge by offering benefits to meet the full spectrum of an employee's needs, including approriate benefits and flexiblity.

4. INVESTMENTS

WITH THE GOVERNMENT STILL CONSIDERING THE RECOMMENDATIONS FROM THE FINANCIAL SYSTEM INQUIRY AND HAVING LAUNCHED THE TAX WHITE PAPER PROCESS, THE BUDGET CONTAINED FEW MEASURES DIRECTLY IMPACTING INVESTMENTS. MEASURES ANNOUNCED ESSENTIALLY MODIFY OR EXTEND EXISTING ARRANGEMENTS.

4.1 Managed investment trusts – transition period to apply the new tax system

A managed investment trust is a type of collective vehicle that is widely held. New taxation arrangements have previously been proposed and included a 12 month period transition period commencing 1 July 2015. However, in response to industry feedback that many trusts required additional time to amend trust deeds and IT systems, the Government has announced the new tax rules will apply from 1 July 2016. Trusts may still choose to apply the new rules from the earlier start date.

Trusts will continue to be allowed to disregard the trust streaming provisions for the 2015-16 income year. This will ensure these interim arrangements for managed investment trusts continue to apply until the commencement of the new rules.

MERCER'S VIEW

The measure follows the release of new draft legislation in April. Mercer welcomes the additional flexibility available to funds in moving to the new taxation arrangements, and which should also help remove any remaining uncertainty around the eventual implementation of the new legislation.

IMPACT ON SUPERANNUATION PROVIDERS (INCLUDING TRUSTEES)

Unlikely to have any major impact on super funds.

IMPORTANT INFORMATION

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