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Ms Jenny Wilkinson
Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Dear Ms Wilkinson

Re: Consultation on the Objective of Superannuation

Challenger Limited is an ASX 100 listed company specialising in the delivery of retirement incomes. It is Australia's largest provider of annuities and seventh largest fund manager.

Challenger provides the following response to Treasury's consultation on the objective of superannuation.

Question 1
Do you agree with the objectives recommended by the FSI? Why?

Challenger agrees with the FSI recommendation that the primary objective of superannuation is;

"To provide income in retirement to supplement and replace the Age Pension."

A clear objective of superannuation is critical to provide focus for policy makers, participants in the superannuation industry, individual members of superannuation funds and retirees. It is the first logical step in the sequence of coming reforms including the Review of Retirement Income Streams, the development of Comprehensive Income Products for Retirement and any adjustment to superannuation tax arrangements.

This reform process is critical to prepare Australia for one of the greatest social and economic challenges of our time, the ageing of Australia's population. Making clear the purpose of superannuation provides government and industry the framework to tackle this challenge. Establishing the objective of superannuation to provide income in retirement will make a meaningful difference to the financial well being and sustainability of retirement incomes for the growing number of retirees in Australia, many of whom are concerned they will run out of funds. According to a December 2015 National Seniors Australia survey, only 45 per cent of over-50s are confident that their superannuation savings will be adequate for retirement.

This Financial System Inquiry definition of the objective of superannuation, which has been adopted by the Government:

1. Sets out the singular purpose of superannuation as providing retirement income. It gives guidance to policy makers to prioritise the provision of retirement income and highlights that participants in the superannuation system cannot expect the superannuation system to support unlimited wealth creation and bequests.

2. Provides policy makers with guidance for targeting superannuation tax concessions to supplement and replace the Age Pension, this will:
   - alleviate aged poverty;
   - assist in raising living standards in retirement up to a community standard which is both fair and fiscally sustainable; and
   - improve the fiscal sustainability of both the Age Pension and the superannuation system.
3. Integrates policy for the superannuation and Age Pension systems.

Question 2
If you do not agree with the FSI recommended, what do you think should be the objective?

Challenger also supports the subsidiary objectives proposed by the FSI. We offer some further comments that could reinforce and improve the statements why each of the subsidiary objectives are important if these statements are to be incorporated in the legislation.

Facilitate consumption smoothing over the course of an individual's life.

Consumption smoothing has three aspects:

1. Deferring income from wages, salaries, or an individual's income from their own business to provide retirement income.
2. Providing a predictable and reliable income in retirement.
3. In a society that enjoys significant and continuing improvements in life expectancy, income needs to last for the whole of retirement. This requires an appropriate level of protection from longevity risk.

Help people manage financial risks in retirement.

The Final Report of the Financial System Inquiry at page 120 noted that; "at least 94% of pension assets are in account based pensions." The Final Report of Australia's Future Tax System said at page 118; "an allocated pension cannot ensure security of income on its own." These two statements underline the importance of this subsidiary objective.

The principal risks in retirement are longevity risk, inflation risk and market risk. Retirement outcomes are particularly vulnerable to market volatility in the period immediately before and after retirement when an individual's superannuation assets are close to or at their maximum. This is called sequencing risk and has major implications for retirement outcomes so there is a strong argument for it being included explicitly in any list of retirement risks.

Longevity protection on a retiree's own-funded component of their retirement income is important to ensure they will not become totally dependent on the Age Pension.

Be fully funded by savings.

State and Federal governments have significant unfunded superannuation liabilities held on behalf of current and former employees. Funding for these schemes will be achieved with ultimate resort to taxpayers. Some private defined benefit schemes are less than fully funded exposing their members to some risk.

Account based pensions are by definition fully funded. Life offices are fully funded because they are required to hold capital and are regulated by APRA to ensure they will meet the promises they have made to policyholders.

The Financial System Inquiry and the Review of Retirement Income Streams proposed GSAs (group self annuities). These will involve the pooling of longevity risk within a fund without a guarantee. At page 188 the Final Report of Australia's Future Tax System said;

"The government should also consider removing other legislation constraints that may inhibit the development of longevity products. However, this should not be at the cost of necessary prudential or

consumer protection. Given the nature of these products, they should only be provided by prudentially regulated entities. Products that provide a guaranteed income should follow consistent prudential requirements to reduce the risk that a provider is unable to meet their obligations as they fall due."

To meet the subsidiary objective of being fully funded GSAs need to operate using an account balance that may include mortality credits.

Be invested in the best interests of superannuation fund members.

The statement accompanying this subsidiary objective focuses on the investment concept risk adjusted returns. Longevity insurance is an efficient, low cost, low risk means of providing retirement income over the latter years of retirement. Use of superannuation to purchase longevity insurance meets the test of being in the best interests of retirees.

Alleviate fiscal pressures on government from the retirement income system.

This is a critical subsidiary objective to ensure the sustainability of the retirement income system. Governments already carry a significant amount of longevity risk on their balance sheets due to government employee pension entitlements and expected Age Pension and aged care outlays. Means tests provide a mechanism by which individuals' private longevity risk is transferred to government as individual private pension assets deplete. Wider use of longevity insurance within private superannuation pensions will have the reverse effect transferring longevity risk from the government to private balance sheets where it will be better managed. There is no public finance or equity case for government to take additional longevity risk on to its own balance sheet in addition to the means tested Age Pension. Governments should not become providers of financial products other than government bonds.

Be simple and efficient, and provide safeguards.

The first sentence of the statement on why this subsidiary objective is important should include a reference to risk, ie. "The system should achieve its objectives at the minimum cost and risk to individuals and taxpayers."

Question 3
In which piece of legislation should the objective be legislated and why?

Challenger believes the objective of superannuation should be in its own act because it has ramifications for policy across a range of areas including the SIS pension rules, tax and social security.

The objective of superannuation is a guide for policy makers and participants in the superannuation industry and will not affect the interpretation or application of superannuation legislation by the courts. However the superannuation objective could affect the consideration of legislation by parliament before it is made. This would be achieved if the objective of superannuation act required that a statement of compatibility with the objective of superannuation be included in the explanatory memorandum of any bill that could affect the superannuation system.

We hope that these suggestions are useful in finalisation of Government policy on the objective of superannuation.

Yours faithfully

D. A. Cox

David Cox
Head of Government Relations