

**Submission to Treasury on the
Objective of Superannuation
Discussion Paper
March 2016**

**Prepared by Tony McFadyen
Director**

INCOME IS THE GOAL™

April 2016

Tony McFadyen is Director, Campbell Lochbuie Pty Ltd in Australia. He operates the business name 'Income is the Goal™'. This business consults to financial services firms and fiduciaries that seek to help super fund members build an inflation-protected income stream for life when they retire.

The Income is the Goal logo is a trademark of Anthony L McFadyen.

Copyright © Campbell Lochbuie Pty Ltd (ACN 133 220 103) 2015. All rights reserved. This material is delivered on an "as is" basis without warranty.

Introduction

The definition and statement of objectives of superannuation in Australia is an important, indeed critical, issue for the welfare of Australians and the sustainability of government services to Australians. Income Is The Goal (IITG) is a business created by Tony McFadyen in June 2014. The business was created to help fiduciaries move fund strategy from wealth accumulation to focussing on retirement income for individuals.

As the name suggests the right goal for superannuation funds is to provide their members with an adequate income for all their retirement years. Income should always have been the goal for the superannuation system, and it is pleasing to note public debate in the last year has supported the premise that retirement income is the real target that funds should aim for.

IITG is pleased to submit its views on framing the objectives for superannuation and strongly supports Treasury's efforts to include the objective holistically in legislation and in the way successive Governments will consider the wide impact of any changes to policy in this area.

Questions for Consultation

The Treasury Discussion Paper released on 6 March 2016 asked industry the following questions:-

- Do you agree with the objectives recommended by the FSI? Why?
- If you do not agree with the FSI recommendation, what do you think should be the objective of superannuation? Why? What are the implications of this objective?
- In which piece of legislation should the objective be legislated and why?

Income Is The Goal Comments on the Questions

The Financial System Inquiry proposed the following as the objective of superannuation:-

To provide income in retirement to substitute or supplement the Age Pension.

IITG agrees with this objective but believes we can do a better job of defining the objective of superannuation, to ensure it is inclusive of all Australians, and to ensure that other factors can be taken into account.

We will therefore propose a different objective statement, and will discuss below other opinions that have been mentioned in the press or in other position papers on this important topic.

We strongly support the notion that the objective be inserted in legislation. However the purpose of the objective statement is to guide policy. Policy should only be created when all the impacts of one policy are mapped out on other areas of public governance. Superannuation impacts, or is impacted by, taxation, social welfare schemes and payments, the age pension, the rules about pension eligibility, individual longevity, societal morbidity rates, insurance rules and products, insurance company capital adequacy to name just a few. Government departments such as Treasury, Human Services, Finance, and Veterans Affairs

all administer policy that can influence the outcome or provision of superannuation savings and pension payments from those savings.

The idea that inserting the objective of superannuation in just one piece of legislation will ensure that current and future governments will create policy in all these areas with reference to the objective of superannuation is unrealistic. It is better that the objective of superannuation and any supporting objectives be placed in a ‘charter of government’ style document as well as in the *Superannuation Industry (Supervision) Act 1993*. In addition the objective should be reported on in the Intergenerational Report, which has an appropriate long-term focus on the state of the economy and nation.

Other factors discussed in the FSI report included two important issues. The first is that the funds in accumulation and decumulation be invested in the best interest of members. This has always been the mantra of superannuation and should remain a key tenet of the system. The second issue we wanted to mention was ‘increasing national saving’. The mandatory nature of superannuation ensures that the stock of savings should increase, at least until we reach a point where contributions are less than pensions paid to retirees. There should be no mention of directing those savings to any particular cause or investment category in policy, especially as per the operation of the ‘member best interest’ factor above.

Therefore to answer the questions put in the Discussion Paper:-

1. We broadly agree with the FSI recommendation, but believe it is not sufficient.
2. We will propose new wording for the objective of superannuation
3. At the least the objective of superannuation should be inserted in *Superannuation Industry (Supervision) Act 1993*, but should also be reported on in the Intergenerational Report, required every five years.

Other Opinions about the Purpose of Superannuation

There are many opinions being expressed by industry participants about the objective for superannuation. In essence the industry welcomes the initiative and wants it to be a robust statement that will guide the direction of industry providers, in the wholesale retail or self managed sectors. The statements have contributed loudly to the real purpose of superannuation that of providing income for people in retirement.

We believe that there some very strong contributions made by The Committee for Sustainable Retirement Incomes (CRSI), Mercer, the Financial Services Council (FSC), The Association of Superannuation Funds of Australia (ASFA) and individuals including David Bell and Michael Pascoe.

The CSRI have presented a paper “Clarifying the Purpose of the Retirement Income System” 9 February¹ giving their views of the appropriate wording of the objectives. They also provide a useful summary of other objective statements from the European Union, The Superannuation Charter Group (2013), The Financial System Inquiry (2014), ACOSS, and the Henry Review – Australia’s Future Tax System 2008.

¹ Clarifying the Purpose of The Retirement Income System – CSRI Position Paper 9 February 2016,

The CSRI proposal comes in two parts – an overarching objective and supporting objectives, and the paper gives detail on the reasoning behind the approach. IITG supports this definition and the details provided.

“CSRI Overarching Objective :-

- *Provide adequate income through all the years of retirement for all Australians.*

Supporting Objectives:-

- *Is fair and equitable*
- *Helps individuals manage financial risks*
- *Provide certainty with necessary safeguards*
- *Contributes to the sustainability of government expenditures”*

The FSC provides a slightly different purpose statement². Their objective of superannuation is :-

To provide adequate retirement incomes for Australians in order to:

- 1. improve their quality of life in retirement; and*
- 2. reduce their reliance on the age pension and other age related transfer payments to minimise the fiscal impact of retirement.*

IITG questions whether the objective statement should refer to an improvement in the quality of life in retirement as this would require an individual assessment of adequacy and improvement. That would be a very difficult matter to judge.

The FSC also recommends “that the Intergenerational Report (IGR) becomes the evidentiary basis for the measurement of the effectiveness of the superannuation system and examination of proposed reforms to the system. The natural relationship between the IGR, which examines the Government’s fiscal position forty years into the future, and the superannuation system, which is intended to address the intergenerational cost of an ageing population, is clear.”

David Bell, chief investment officer of Mine Wealth + Wellbeing, suggested an improvement to the government-backed Financial System Inquiry (FSI) definition would be³ xx:

“To provide *household* income in retirement to substitute or supplement the age pension.”

He says this simple modification puts the focus on the household (couple or single) rather than just the individual. His rationale for the amendments are that:

- System-wide efficiency gains can be derived from focusing on the outcomes of couples (where a couple makes up the household) rather than two singles individually
- Policy around the complex interaction of tax, superannuation and the age pension can be better integrated through the lens of the household rather than treating all as individuals
- Better projections of household outcomes can occur if there is a focus on the household projection rather than the aggregated projections of two individuals.

² Response to the Financial System Inquiry, FSC, Mar 2015, P66.

³ <http://investmentmagazine.com.au/2016/03/super-industry-nuanced-reactions-to-objective-consultation/>

IITG agrees with Mr Bell's rationale, recognises that the age pension also focuses on couple's assets and income streams, but feels that the change from an individual tax system to a household tax system may be hard to achieve.

The Association of Superannuation Funds of Australia (ASFA) believes that the following principles should underpin any retirement income policy decisions⁴:

- **Adequacy:** as many people as reasonably possible should have an adequate income in retirement
- **Universality:** the retirement income system must be comprehensive in its coverage and inclusive of people in different types of employment structures, stages in the employment lifecycle and levels of income
- **Equity:** outcomes must have both intra-generational and intergenerational equity and taxation must reflect the principles of a progressive tax system
- **Simplicity:** it must be easy to understand and implement
- **Sustainability:** it must deliver on its intended objectives within the fiscal constraints of the government and taking into account demographic factors that contribute to fiscal outcomes
- **Three-pillar:** it should retain the three existing pillars of the retirement system: the safety net of the age pension; mandatory Superannuation Guarantee contributions; and voluntary savings, both inside and outside superannuation
- **Sole purpose:** the system is about replacement income in retirement, and opportunities for accumulating excessive superannuation balances in a concessionally taxed environment (for example, with a view to generational transfer) should be minimised
- **Prudentially regulated:** given the mandatory nature of superannuation, systemic risks within the superannuation industry, as well as individual entities that manage other peoples' money, must be supervised by a prudential regulator.

ASFA also believes that the superannuation system has an extended purpose: to enable all Australians to be financially confident in retirement, with the measure of success being that the majority of retirees are not reliant on any (*public*) pension, and that their superannuation balance provides them with enough (*income*) to have a comfortable standard of living. (IITG emphasis in italics).

Michael Pascoe of Business Day from the Fairfax press also contributes to the debate regularly. His analysis show how closely linked the tax system is to the superannuation system. As a result he suggests that⁵ :-

“The tax system should support and encourage superannuation savings up to the point of making people independent of the government age pension. Beyond that point, it's up to the individual how comfortable or uncomfortable a retirement they want to have and plan for it.”

⁴ The Future of Australia's Super: A New Framework for a Better System, ASFA, Nov 2014 P 8-11

⁵ <http://www.smh.com.au/business/the-economy/superannuation-ready-fire-aim-20160316-gn1056.html#ixzz43Zue4pT2>

In essence he says that the objective of the superannuation system is to make every individual save, such that their savings can support them to the level of the age pension.

A significant contributor to the debate has been the people of Mercer. “In its submission to the government's consultation on the objective of super, Mercer will propose a "long-term relationship between the age pension and superannuation", according to one of the firm's senior partners, David Knox⁶.

"To do this properly we have to define the objectives of both superannuation and the age pension simultaneously," Dr Knox said.

On the way the FSI describes the objective, Knox said “Nor is it enough to state that superannuation should substitute or supplement the age pension. We need a clear and sensible line in the sand as to when it should move from supplementing to becoming a substitute and some rationale and clarity around the rate of substitution. We firmly believe the objectives of superannuation must include a whole-of-life approach, including reference to how longevity risk may be managed.”

IITG strongly supports the enunciation of the relationship between the superannuation system and the provision of the age pension. We look forward to seeing how Knox makes these definitions.

The Objective of Superannuation

Given the opinions shared above, and IITG's comments, the principles that we would like to see in the Government's version of the objectives of superannuation are as follows:-

- The purpose of saving throughout your working life is to defer saving now so that you can spend in retirement. Therefore the goal of superannuation is to provide an income in retirement.
- There needs to be a determination of adequacy of the income stream that a person can achieve in retirement, and at income above a certain level, any tax advantages allowed to individuals should be progressively reduced to nil, such that the state is not funding excessive incomes well above adequacy.
- The system should work effectively for all Australians, including those who can't work for periods, and therefore have to rely on the age pension.
- The system has to allow people to manage longevity risk, or have structures that will allow it to be managed for them.
- The system should, in maturity, lead to a reduction in people relying on the age pension and therefore a reduction of the cost of superannuation to government.

Therefore IITG suggestion for the objective of superannuation is as follows:-

To provide adequate income for all Australians through their retirement years

Recognising that the system should

- *Work for all Australians fairly*
- *Allow Australians to manage the risks that face them in retirement*
- *Assist in the sustainable provision of the age pension to Australians in need.*

⁶ “Super objective must be 'whole of life': Mercer”, Tim Stewart, Investordaily.com.au, 17 Mar 2016.

Important definitional work will need to be included in the Objective of Superannuation to ensure the legislation remains relevant and concise in years to come. As mentioned above adequacy is a well-used term but has a different meaning (or more importantly income amount) for every Australian. Some may live on a fraction of their pre retirement income, which would make a 75% replacement ratio of past income not a useful definition. Others who have lived on small weekly income relative to AWOTE⁷ would most likely want to remain as close to their past income as they possibly can, and would see a 75% replacement ratio as the minimum. The series created by ASFA of modest or comfortable income levels will be useful in this definitional work.

The Objective states ‘for all Australians’ as the retirement system must take into account all those in the system, those who have been able to save and those who couldn’t, and ensure that we provide for them.

The Objective should also help policymakers by adding some other conditions. IITG’s suggestion is that the Objective should “recognise that the system should” do some essential things. In particular the system should be fair, and be fair in its application. This should recognise the need to help avoid poverty, but also ensure people do not receive unfair benefits above a certain level of adequate income.

The financial risks faced in retirement are not well understood, nor do we yet have a well-developed market for products that manage those risks. This has been the subject of other consultation but it is essential that the constraints identified in the Income Streams consultation be dealt with. Only then can people manage the longevity risk they face, probably best done through pooling, or in individual deferred annuity contracts.

Finally the Objective should recognise that there will always be age pensions paid by Government. There will always be less fortunate people who have not been able to save enough to provide for themselves throughout retirement. So it is important for the Objectives to say that the Government will provide for those people, and that Superannuation savings system will operate within policy settings that support and promote structures that help people provide for themselves in retirement. It is hoped that as the system moves to maturity (in say 2035), with the creation of suitable superannuation policy aimed at fulfilling the Objectives as set out above, that the burden of the age pension on Government will be declining.

⁷ <http://www.abs.gov.au/ausstats/abs@.nsf/Lookup/6302.0main+features8Nov%202014>