



**Melbourne**  
Casselden  
Level 39, 2 Lonsdale Street  
Melbourne VIC 3000

**Canberra**  
Level 3,  
39 Brisbane Ave  
Barton, ACT 2600

4 April 2016

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

By email: [superannuationobjective@treasury.gov.au](mailto:superannuationobjective@treasury.gov.au)

**Re: Comments on Objective of Superannuation Discussion Paper**

Dear Ms Wilkinson,

Industry Super Australia appreciates the opportunity to comment on the Treasury's Discussion Paper in respect of the Objective of Superannuation.

The Discussion Paper is intended to facilitate the development and crystallisation in legislation of the objective of the superannuation system. As observed by the Discussion Paper, this could provide guidance not just to "policy makers," but also to "regulators, industry and the community."

This is a potentially beneficial undertaking and ISA supports the endeavour. Superannuation is an important component of the retirement security system. The delivery of superannuation public policy involves government, private sector providers, and members of the community. A greater clarity of mission for all could be helpful.

We recommend that the objective of the superannuation system should be:

***To deliver financial security and dignity in retirement to all Australians by providing regular income that is, when combined with any public pension and other sources of income, sufficient to secure a comfortable standard of living by reasonable community standards.***

This is a clear and measurable objective focused on securing retirement wellbeing consistent with community expectations. It locates superannuation as an integral pillar of the retirement security system. It specifies a living standard outcome that the community can embrace and policy makers and industry can work toward. Because the objective provides a clear picture of what a successful superannuation system would achieve, policy makers, regulators, industry and the community can determine whether proposed policy or conduct is consistent with the objective. Where there is a range of policy or conduct options, stakeholders can test the degree to which options efficiently advance (or do not) the superannuation system toward the objective.

Supplementing this objective would be a range of factors that policy makers, regulators, the industry and the community should consider in developing policy proposals or changes to business conduct. There are important government and community interests regarding the superannuation system – beyond retirement living standards – which do arise from the nature of the system. Most pertinently is the funded nature of the system, which gives rise to a public interest in national savings, an interest in the investment potential of

superannuation, and in financial stability. It would be unwise for government and the community, in particular, to fail to give regard to these matters when considering superannuation policy and private conduct, particularly as superannuation system assets continue to grow strongly to several trillion dollars and beyond.

Legislating the objective of superannuation, if it is to be done and done well, could reasonably require a lengthy process. Superannuation is a major system, with substantial effects on the vast majority of Australians across generations, and involves a broad number of stakeholders. There is a long history leading up to the Superannuation Guarantee in the early 1990s, and since that time the system has continued to evolve through the efforts of a number of governments, as well as community and industry behaviour. As a result, there are likely to be a range of views. Some of these views may not be easy to harmonise, especially in a short period of time. Some policy makers and opinion leaders disapprove of the superannuation system in principle. Some members of the community and private providers may have entered into arrangements or practices that they would not want to be declared inconsistent with a legislated objective of superannuation.

#### Why legislate the objective of superannuation?

A well-drafted objective of the superannuation system could help improve:

- The stability of policy settings,
- The consistency of policy settings and business conduct with the objective of the system,
- The design of policy and business conduct, including in terms of efficiency,
- Pre-emptive exclusion of policy change by government and conduct by industry and the community that is inconsistent with the objective, and
- Greater confidence in superannuation and retirement security among the community (in part because of the foregoing).

To be successful, however, the legislated objective will need certain threshold qualities. These include:

- *Broad support* to ensure that the objective is not at risk of frequent changes.
- *Clarity* regarding the improvement to retirement living standards that superannuation should achieve, so that policy makers, industry, and the community can (i) determine whether the current system is on track, (ii) determine whether or not changes to policy or business conduct would help or hinder superannuation to achieve its objective, and (iii) for the relative merits of different options to be assessed. The statement must make clear “what success looks like.”
- *Measurable* sought-for outcomes that enable policy proposals and business conduct to be compared.

#### Structure and mechanics of legislation

The mechanics of legislating the objective of superannuation involves at least four issues, regardless of its substance.

First, where should the statement of the objective be legislated?

Options include in a new piece of legislation or as an amendment to existing legislation. And if in an existing piece of legislation, should the statement be in a preamble or a new section. We have no firm view on this issue. There are benefits and drawbacks to any approach. Stand-alone legislation could require Government to provide a statement of compatibility with the objective and subsidiary factors when proposing or amending any relevant legislation. Alternatively, locating the objective in an existing substantive piece of superannuation law such as the Superannuation Industry Supervision (SIS) Act 1993 could increase the onus for legislation to be internally consistent with it when interpreting existing provisions or when future changes are proposed.

Second, what is the legal effect of legislating the objective?

We question the Discussion Paper's claim that "Notwithstanding where the objective is legislated, the purpose of stating the objectives of the superannuation system in legislation is only to guide the policy-making process. It will not affect the interpretation or application of superannuation legislation by the courts." We would recommend making this view express and publishing legal advice to Treasury or the Government explaining why courts would not use the statement.<sup>1</sup>

Third, how are the various considerations relevant to superannuation, but not directly related to the primary objective, given regard?

As observed in the Discussion Paper, the Murray Inquiry formulation provides a "primary" objective and a number of "subsidiary objectives."

Rather than characterising these subsidiary matters as "subsidiary objectives," describing them as "factors" may be more appropriate.

Referring to these matters as "factors" will remove any doubt about what the objective is while enabling important state and community interests in the superannuation system to be given appropriate regard even if they are not clearly related to the primary objective.

Fourth, how is accountability expected to be achieved?

The Discussion Paper (and the Government's response to the Final Report of the Murray Inquiry) is silent on whether, and if so how, policy makers, regulators, industry and the community would seek to embrace the legislated objective of superannuation in their activities.

The Murray Inquiry recommended that Government "Establish a publicly funded independent body to assess the superannuation system's performance and report on superannuation policy changes," and that "Government should report publicly on how policy proposals are consistent with achieving the objectives in the long term."<sup>2</sup>

<sup>1</sup> We also note that the quoted passage – that legislating the purpose of superannuation is "only to guide the policy-making process" – is inappropriately narrow. The Discussion Paper begins by stating that legislating the objective of superannuation is to guide "policy makers, regulators, industry and the community."

<sup>2</sup> Financial System Inquiry, Final Report, at 98.

The Murray Inquiry recommendations emerged from a concern that policy makers (and others) appear to be under pressure to act to achieve certain short term results, without giving due regard to the long term policy objectives of superannuation. The Murray Inquiry's recommendation to establish an independent public body to assess the superannuation system's performance (i.e., private conduct) and superannuation policy changes (i.e., government and regulatory conduct) would operate to provide some external discipline or review.

The Murray Inquiry's recommendation resembles in important respects recommendations by a range of parties for an independent "board of guardians" for superannuation, akin to the Reserve Bank.

#### Proposed primary objective

The Murray Inquiry was wise to recommend seeking broad political agreement for the objectives of the superannuation system.

However, the Murray Inquiry canvassed a range of issues across the financial system in a relatively brief period of time, and it would be unreasonable to expect the Inquiry to have not only started the process of developing a crystallised statement of the objective, but to have finished it.

Indeed, the Murray Inquiry did not formally consult on an objective.

A focused consultation, such as that being undertaken through the Discussion Paper, is necessary to advance this recommendation.

The Murray Inquiry's suggested primary objective for the superannuation system was "To provide income in retirement to substitute or supplement the Age Pension." The Discussion Paper indicates that the Government has accepted this recommendation.

Unfortunately, this formulation cannot achieve the stated rationale for legislating the objective of superannuation: it does not provide "a way in which competing superannuation proposals can be measured."<sup>3</sup>

The Discussion Paper did not seek to apply the proposed objective to recent policy debates and business conduct to determine whether the proposed objective would be able to provide useful guidance. Doing so would be instructive not only for purposes of determining whether the proposed objective would be capable of achieving the purpose of enabling "comparison of competing policy proposals," but also would provide commentators with some insight into how the proposed objective would be applied in practice, which would doubtless inspire more informed responses.

By not specifying a clear benchmark outcome for living standards in retirement that superannuation is supposed to achieve, the Murray formulation cannot provide useful guidance on the important questions relating to superannuation.

---

<sup>3</sup> Discussion Paper at 1.

There appears to be no upper limit on the degree to which superannuation can substitute for the Age Pension, and there appears to be no minimum sought-for income standard that informs the level and targeting of tax expenditures, or the level of the Superannuation Guarantee. It also is not possible to appropriately calibrate the interaction of the Age Pension and the superannuation system without anchoring such interaction in a combined adequacy benchmark that has community support.

In fact, the proposed language would be unable to provide useful guidance on recent policy debates, and would do little if anything to enhance the quality and stability of policy settings or business conduct. It is instructive to seek to apply the proposed objective to relevant policy debates of the day (and a similar endeavour could be made to private conduct). How would the proposed objective inform the following debates in any useful way?

- The decision to delay increasing the superannuation guarantee to 12%.
- The proposal to reduce the Division 293 threshold to \$250,000.
- The proposal to limit concessional superannuation contributions to \$11,000 per year and non-concessional contributions to an aggregate lifetime amount of \$250,000.

The proposed objective provides no useful guidance on any of these actual or proposed policies because under each of them superannuation would provide income in retirement to supplement or substitute for the Age Pension, and therefore each policy is consistent with the objective. The objective also doesn't assist in assessing the policies because there is no firm benchmark for adequacy against which to test the utility of each.

The proposed language also does not enable comparisons of competing proposals: recently, commentators have suggested taxing superannuation concessional contributions at marginal rates with a 15% discount, a 20% discount, and a 25% discount. Each of these proposals would be consistent with the Discussion Paper's proposed primary objective of the superannuation system (whereas they could be compared by reference to an adequacy benchmark).

The proposed language fails to be a useful guide because its only substantive content is about the *means* rather than the *ends* of the superannuation system. Moreover, the means are only delimited in terms of the form of benefits (namely, "income") and the timing of benefits (namely, "in retirement."). Limiting the benefits to "income" is not a material substantive limit because any financial benefit from superannuation would be considered "income" for purposes of Australian tax law. In addition, the phrase "substitute or supplement the Age Pension" has no substance because all financial benefits received by any retiree would either supplement their Age Pension, or replace it.

As a result, perhaps the only recent policy proposals in respect of which the proposed objective would provide relevant guidance are proposals to use superannuation savings for a deposit on a house, because such a benefit would not be "income in retirement."

Some might argue that the secondary objectives would enable guidance on some of the above questions. However, this argument fails where (as will often be the case) secondary objectives are in tension with each other. (It also seems highly incongruous that secondary objectives would be the source of guidance.)

The fatal shortcomings of the proposed language would be shared by most formulations that do not provide a measurable benchmark for adequacy outcomes.<sup>4</sup>

It is not clear why the proposed objective provides no guidance about the adequacy outcome sought. We note the Discussion Paper claims that “there is no consensus of what adequacy means.”<sup>5</sup> While it is true that different benchmarks for adequacy (e.g., budget standards and replacement rates) are used for different purposes, this does not mean that the deliberative process for crystallising the objective of superannuation cannot identify an appropriate approach for measuring adequacy for purposes of the superannuation system. Indeed, clarifying the sought-for living standard outcomes in terms of adequacy would appear to be a threshold task.

While further work would be needed to achieve consensus on a specific benchmark, we are not aware of any parties who would not share the view that adequacy could be grounded by reference to reasonable community expectations or standards.

Treasury and Government have reasons to be optimistic that well-intentioned stakeholders can come to a harmony of views:

- The academy in Australia has tended to use budget benchmarks for the purpose of assessing superannuation adequacy.<sup>6</sup> ASFA’s budget-standard benchmarks have been found to correspond to mean incomes of retirees in HILDA surveys.<sup>7</sup>

---

<sup>4</sup> There are some possible formulations that do not include a measurable adequacy benchmark that nonetheless are able to be used to compare policy options and business conduct options. For example, a statement that the objective of superannuation is to “reduce reliance on the Age Pension.” This objective could be operationalized, and enable competing policy proposals to be assessed based on the dollars of age pension reduced for different policy changes. Although such an objective would meet the requirements of being clear for stakeholders, providing guidance, and enabling comparison of policy options, it would be rejected by the community on other grounds (e.g., it would tend to rule out government support to individuals who are not eligible for the Age Pension, and would tend to result in living standards in retirement that we expect would be viewed as unsatisfactory and poor value for money by the public).

<sup>5</sup> Discussion Paper at 3.

<sup>6</sup> See, e.g., Burnett, et al, *Measuring Adequacy of Retirement Savings*, Melbourne Institute Working Paper No. 5/14, March 2014 (stating that “A key issue is the specification of target retirement income levels. For the purposes of this article we use a benchmark widely used in Australia for retirement income provided by the Association of Superannuation Funds of Australia (ASFA) (2012).”).

See also, Saunders, *Updating budget standards estimates for Australian Working Families in September 2003*, Social Policy Research Centre, February 2004 (explaining that “The principal advantage of a budget standard is that the assumptions and judgments on which it is based are made explicit, and this transparency provides a valuable basis for informed debate on questions of the adequacy of living standards.”).

<sup>7</sup> See *id.*, which also rejected the use of replacement rates for assessing the adequacy outcomes of the superannuation system (“Our analyses also suggest that the income replacement ratio has some limitations as an indicator of retirement savings adequacy. Most importantly, the income replacement ratio tends to be higher for low-income groups and lower for high-income groups, despite the latter group having higher consumption levels. This suggests that the income replacement ratio should be supplemented by other measures of savings adequacy to obtain a more comprehensive view of income or consumption during retirement.”).

- Adequacy and living standard improvements have been a core focus for superannuation since inception. As observed by the Fifteenth Report of the Senate Select Committee on Superannuation: ‘Super Guarantee: Its Track Record’ (1995), the then Treasurer, the Hon John Dawkins, MP, outlined the reasons for superannuation, which included “to increase the level of superannuation savings per individual, in order to maintain a satisfactory living standard in retirement.”<sup>8</sup>

#### ISA recommended objective

As noted above, to be successful, the primary objective must be sufficiently clear and measurable that (i) the relative efficiency gains (if any) from proposed changes to policy or industry practice can be assessed, and (ii) policy makers and market participants can reasonably be expected to know whether or not changes to policy or business conduct being considered would be consistent with the objective.

The objective must specify the outcomes that public policy is seeking to achieve. This is important for policy makers and regulators, but it is also important to industry and the community, as these private parties are being relied upon to execute superannuation policy.

A clear statement of the objective of superannuation that sets forth measurable outcomes to enable comparison would be:

***Deliver financial security and dignity in retirement to all Australians by providing regular income that is, when combined with any public pension and other sources of income, sufficient to secure a comfortable standard of living by reasonable community standards.***

This formulation satisfies the necessary and sufficient conditions for a successful statement of the objective of superannuation:

- It provides a clear statement of the policy outcome sought: “financial security and dignity in retirement for all Australians.” This includes wellbeing outcomes (security and dignity) and coverage outcomes (all Australians).
- It specifies the means by which this is to be achieved, and places the superannuation system (and the outcomes it is to achieve) in the broader retirement security policy framework: “by providing regular income that is, when combined with any public pension and other sources of income, sufficient to secure a comfortable standard of living.” The retirement income framework has long placed primary importance on the Age Pension.<sup>9</sup>
- The standard of living outcomes that would achieve financial security and dignity are measurable: “by reasonable community standards.” These standards can and should change over time as Australian society changes, but they can be determined and therefore used to benchmark the adequacy of retirement incomes.

<sup>8</sup> Fifteenth Report of the Senate Select Committee on Superannuation: ‘Super Guarantee: Its Track Record’ (1995), page 3.

<sup>9</sup> See, e.g., Id. at 8 (stating that notwithstanding the introduction of the Superannuation Guarantee, “the age pension was retained as the centrepiece of its RIP [i.e., “the Government's retirement income policy”].”).

In addition to being clear and measurable, the ISA proposed objective has positive substantive content that would receive broad public support.

- Financial security and dignity,<sup>10</sup> consistent with reasonable community standards was the animating force behind superannuation decades ago and would continue to galvanise community support.
- ISA's formulation is universal, seeking to achieve adequacy for "all" Australians. Retirement security policy is generally applicable and is important to the wellbeing of all Australians. Universality involves not just universal coverage, but the broadest possible achievement of the living standard objectives, across all members of the community. Superannuation could do more to improve the retirement outcomes of lower income earners, including many women.

A technical aspect of the ISA language is that it refers to public pensions, rather than just the Age Pension. Retirement should cover at least four reasons for leaving the workforce – disability, caring, age and death. This is consistent with both the SIS Act and the Social Security Act (which has pensions to cover these forms of retirement).<sup>11</sup> By only referring to age retirement, the proposal in the Discussion Paper was overly narrow.<sup>12</sup>

The ISA statement of the objective of superannuation is able to provide guidance to policy makers. It would clearly indicate that delaying the increase in the SG to 12% was inconsistent with the objective. Importantly, although ISA sharply disagrees with the decision by the Government to delay the increase in the SG, the ISA proposed formulation of the objective doesn't mean Government could not enact this policy – it is entirely legitimate for Government to act in ways that are inconsistent with the objectives of superannuation policy if they have an objective in another area of policy that is, in the Government's judgment, more important. That is the prerogative of Government. Having a clear statement about the objective of the superannuation system simply makes analysing the consistency of a policy option more straightforward.

We believe the application of the proposed ISA formulation to the other policy options we identified earlier in this letter is straightforward, so do not include further analysis here. We are happy to provide such an analysis (and a more detailed analysis of the 12% delay) as a supplement if that would be helpful to the Government's or Treasury's deliberations.

It is possible that some may not agree with the ISA formulation. For example, they might believe the objective of superannuation is to achieve fiscal outcomes rather than wellbeing outcomes. Or that the superannuation system should be only for some Australians rather than all. Or that adequacy should be measured not by community standards but by subjective standards. Although these views are misguided in our opinion, they are at least clear and the substance of an objective for superannuation based on them can be evaluated (and probably rejected).

---

<sup>10</sup> "Dignity" refers to economic and social participation that is reasonable compared to the community as a whole and keeps pace with changes to community standards over time.

<sup>11</sup> This broader understanding of retirement also is consistent with inclusion of group life and TPD insurance in superannuation.

<sup>12</sup> We would also note that even age retirees may be in receipt of service, disability and carer pensions subject to their personal circumstances.

### *Consistency with historical views of the objective of superannuation*

It would be unwise to radically disrupt settled community views about the objective of superannuation. Although superannuation has evolved to a degree from the early 1980s, and particularly through the early 1990s, the fundamentals of the policy have not changed. We can see this by reference to the extensive debate around the introduction of the Superannuation Guarantee. This was a major policy, and it was also tested in the 1993 election.

Some original views of the purposes of superannuation which are shared with the ISA formulation include:

- Superannuation was meant to provide “security and higher standards of living,”<sup>13</sup> consistent with “rising community expectations.”<sup>14</sup>
- It was meant for “all workers.”<sup>15</sup>
- Superannuation was not meant to replace the Age Pension, but to work with it to improve living standards.<sup>16</sup>
- Although the form in which superannuation benefits would be delivered was often described as retirement savings, these savings were viewed at the time as necessary to support retirement incomes.<sup>17</sup>

---

<sup>13</sup> See, e.g., Statement of Hon John Dawkins, MP, Hansard, 2 April 1992, page 1766 (stating that “The Government believes these measures represent a major step forward in the development of retirement incomes policy and will lay the foundation for income security and higher standards of living in retirement for virtually all workers.”)

See also, National Wage Case 1986, page 33 (noting that “The submissions of the ACTU were supported by the Commonwealth which claimed, inter alia, that distribution of a 3% wage equivalent in the form of occupational superannuation benefits would promote income security in retirement and assist in the removal of current anomalies and inequities in the provision of occupational superannuation.” (Emphasis added)).

<sup>14</sup> See, e.g., Fifteenth Report of the Senate Select Committee on Superannuation: ‘Super Guarantee: Its Track Record’ (1995), page 10 (quoting Statement Hon John Dawkins, MP, 30 June 1992 that “Our existing arrangements are no longer sustainable in the face of the community’s growing retirement aspirations, as well as demographic and other changes. These changes include the ageing of Australia’s population, the significant trend to earlier retirement and changing community views about what level of retirement income is adequate. None of these changes can be readily reversed by government policies... increasing aspirations for retirement are necessarily linked to increased living standards and improved health care.” (Emphasis added).)

<sup>15</sup> See Statement of Hon John Dawkins, *supra* note 13.

<sup>16</sup> See Fifteenth Report of the Senate Select Committee on Superannuation: ‘Super Guarantee: Its Track Record’ (1995), page 8.

<sup>17</sup> See, id (quoting Statement by Hon Brian Howe, MP, Minister for Social Security, *Better Incomes: Retirement Income Policy into the Next Century*, August 1989, p 2) that “the key to providing better income support for the growing number of older people is increased saving.”).

See also, National Wage Case 1986, page 33 (noting that “It was said by the ACTU that the superannuation proposal provided for a fundamental and necessary reform of retirement income arrangements in Australia. ... The submissions of the ACTU were supported by the Commonwealth which claimed, inter alia, that distribution of a 3% wage equivalent

### Secondary considerations or factors

The Discussion Paper, following the Murray Inquiry, included six subsidiary objectives. As noted earlier in this submission we believe these are more appropriately considered “factors.”

None of these factors seem so irrelevant to the objective of superannuation or the interests of the public that they should not be given regard by policy makers, regulators, industry and the community. However, the drafting of these factors and certain implications of such drafting are unsatisfactory.

More importantly, key considerations are not included in the secondary factors as prominently as they should be, if at all.

Superannuation is a funded system. This raises at least three legitimate state and community interests in the superannuation system beyond retirement living standards which arise from the nature of the system: an interest in investment and the allocation of capital, an interest in national savings, and an interest in the financial stability effects of superannuation. Whilst these are not the primary objective of the system they are certainly highly relevant factors which should be considered when assessing policy changes and participant conduct. It would be unwise for government and the community, in particular, to ignore these matters, particularly as system assets continue to grow strongly to several trillion dollars and beyond.

### *Investment*

Superannuation members have a clear interest in the manner in which the superannuation system invests, and how the decisions of policymakers, regulators, industry and the community influence this investment. The greater the long term net investment returns of superannuation, the greater the retirement benefits the system can deliver, which therefore increases the efficiency of the system in terms of its primary objective.<sup>18</sup> For this reason, operation of the superannuation system in the best interests of members is intrinsic to the primary objective.

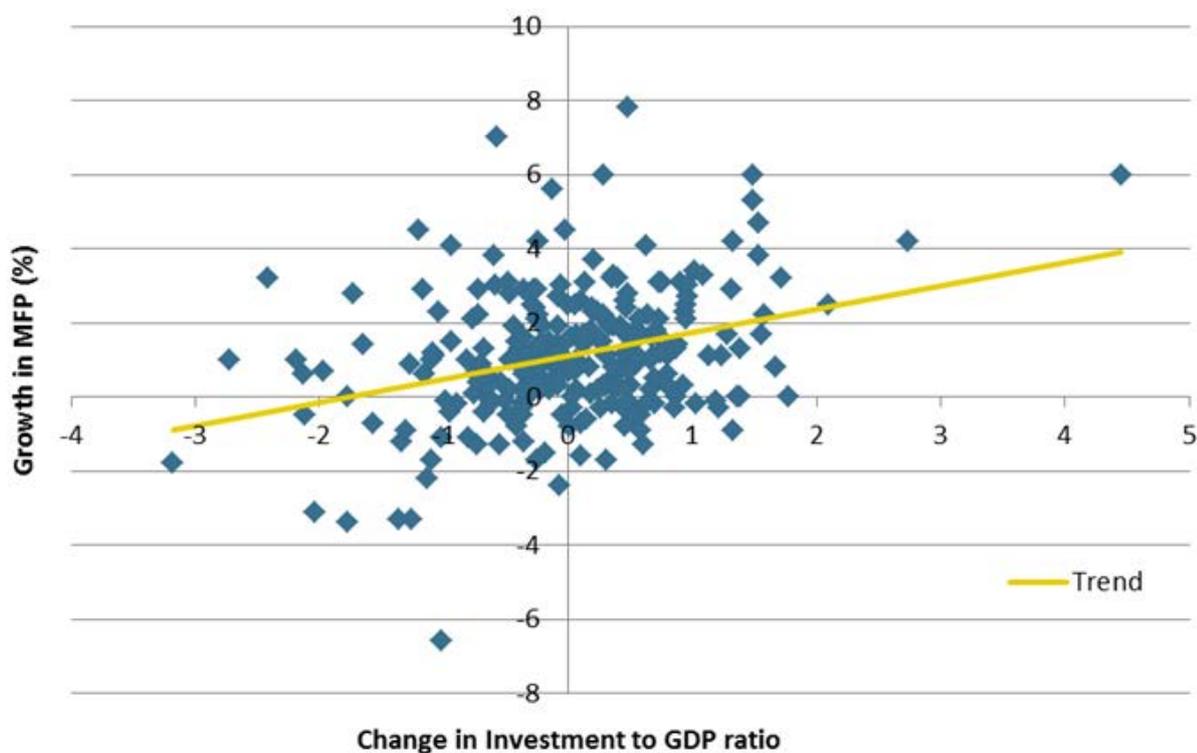
Government and the community also have an interest in how the superannuation system invests. There is strong evidence that efficient investment in fixed capital can lift living standards through productivity growth (Figure 1) (and thereby real wages growth).

---

in the form of occupational superannuation benefits would promote income security in retirement and assist in the removal of current anomalies and inequities in the provision of occupational superannuation.”)

<sup>18</sup> Key drivers of superannuation benefits include contributions by individuals and expenditures by government, long term net investment returns, and the efficiency of risk allocation and product structures.

Figure 1 – Capital formation and multifactor productivity growth, selected jurisdictions, 1985-2012



Source: OECD.Stat – Data extracts from the National Accounts Database and Productivity Database, ISA calculations

It is possible that the Discussion Paper assumes that the investment focus of superannuation funds will guarantee optimal outcomes, and that there is no need for government or the community to have an interest in whether superannuation is investing effectively: the Discussion Paper notes that the investment focus of superannuation funds “should be on maximising risk-adjusted returns, net of fees and taxes, over the lifetime of a member. This results in auxiliary benefits to the economy by creating a pool of savings to fund long-term investment.” The assumption that superannuation will invest optimally or even effectively should not be made without a rational, evidentiary basis that the system is actually doing so. Policy settings also may influence the incentives or affect the capacity of trustees to make certain investments. Particularly relevant here is whether or not trustees can appropriately match the investment horizon of superannuation to long lived assets, which the RBA has previously noted is a desirable outcome.<sup>19</sup>

Moreover, assuming that superannuation funds will invest optimally ignores that there are positive externalities or public goods to investment and other superannuation fund behaviour that a rational trustee might not include in their analyses.

<sup>19</sup> Remarks by Assistant Governor Financial Markets, Guy Debelle, 17 December 2013.

### *National savings*

Perspectives on national savings have evolved in their emphases since the 1980s and 1990s, but concerns about national savings remain important.

In the 1990s, the view on national savings could be fairly characterised by the following remarks of the Reserve Bank Governor:

[T]he problem is our vulnerability to possible adverse shifts in foreign sentiment about Australia which comes with such a heavy reliance on foreign investors to fill our saving gap. The best way to reduce that vulnerability, and avoid the potentially severe policy consequences which go with it, is to increase our national saving (rather than reduce national investment, which is the main source of improvements in productivity and living standards). Over time, as higher national saving comes to be reflected in lower average current account deficits, the risk premiums which Australian borrowers currently have to pay for funds would also tend to decline. For these reasons, the Reserve Bank and others have argued consistently that Australia must raise its national saving, through both private and public channels.<sup>20</sup>

This view, and its focus on the risk of foreign investor volatility, was vindicated by the experience of a number of economies who were affected by the behaviour of foreign portfolio investors in financial shocks, including the Asian Crisis.

As a result of the Asian Crisis among others, there is an established literature about the risks arising from foreign portfolio investors (as opposed to foreign direct investment by operating companies).<sup>21</sup> For example:

Foreign direct investment (FDI) has proved to be resilient during financial crises. For instance, in East Asian countries, such investment was remarkably stable during the global financial crises of 1997-98. In sharp contrast, other forms of private capital flows—portfolio equity and debt flows, and particularly short-term flows—were subject to large reversals during the same period (see Dadush, Dasgupta, and Ratha, 2000; and Lipsey, 2001).<sup>22</sup>

Analysis indicates that foreign shocks transmit to small open economies, even if they are advanced.<sup>23</sup>

Greater integration into the global financial system increases exposure to procyclical forces within the financial sector.<sup>24</sup>

<sup>20</sup> Remarks of then Reserve Bank Governor Bernie Fraser, Change and the Australian Economy, 5 September 1996.

<sup>21</sup> See, e.g., Dadush, Dasgupta, and Ratha “The Role of Short-Term Debt in Recent Crises,” *Finance & Development*, Vol. 37 (December 2000).

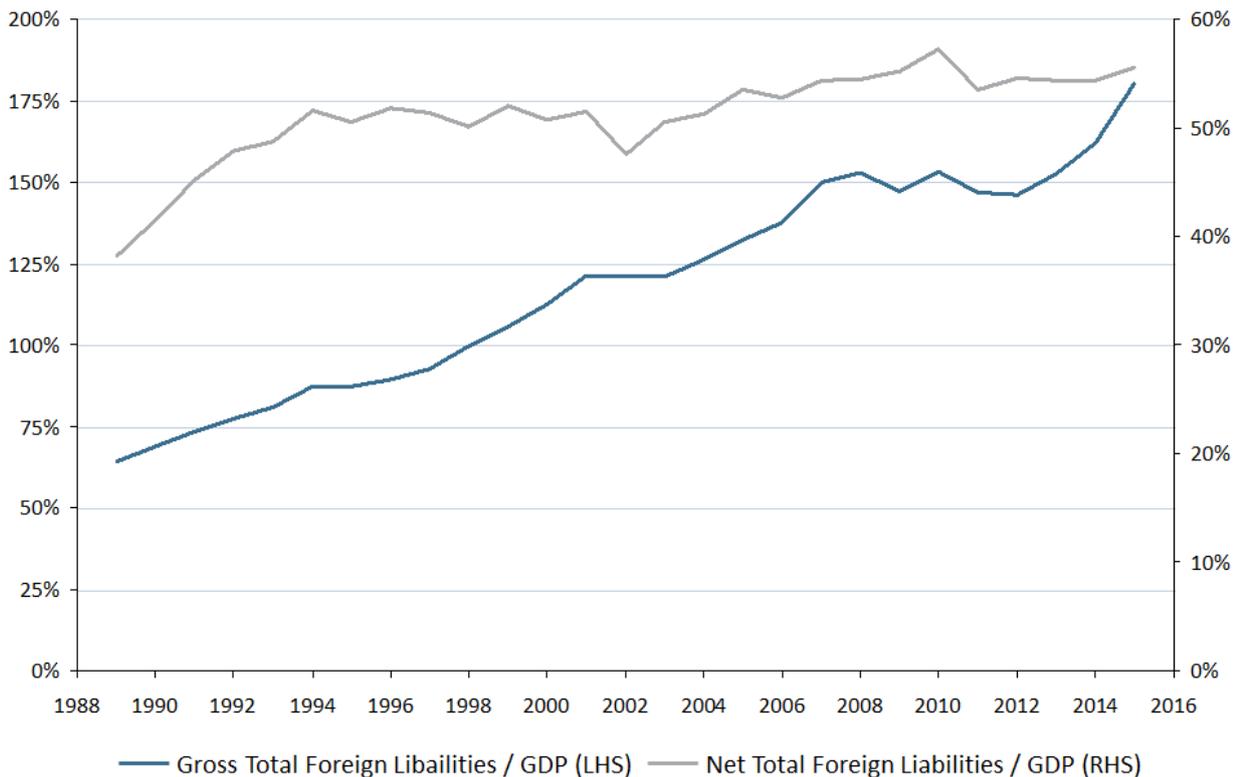
<sup>22</sup> Loungani and Razin, “How Beneficial Is Foreign Direct Investment for Developing Countries?” *Finance & Development*, Vol. 38 (June 2001).

<sup>23</sup> Kamber, Karagedikli, Ryan, and Vehbi, International spill-overs of uncertainty shocks: Evidence from a FAVAR, Reserve Bank of Australia, Quantitative Macroeconomics Workshop paper, 2013 (assessing whether shocks originating in the United States affect New Zealand).

<sup>24</sup> See, e.g., Panetta et al., Financial Sector Pro-Cyclicality: Lessons from the Crisis, Bank of Italy Occasional Paper No 44 (2009) (stating that “What are the implications of financial integration for financial sector pro-cyclicality? One view is that financial integration provides better opportunities for countries to diversify idiosyncratic risk, which should weaken the correlations between consumption and GDP at the national level and strengthen those between consumption in

Treasury analysis has shown superannuation has a positive effect on national savings.<sup>25</sup> However, with Australia's foreign liabilities rising and around historical highs (Figure 2), there is no clear basis to move away from an economic strategy that looks to reduce the risks arising from this position.

Figure 2 – Foreign liabilities are rising and around historical highs



Source: ABS 5302.0 Balance of Payments and International Investment Position and ABS 5206.0 Australian National Accounts: National Income, Expenditure and Product, December 2015

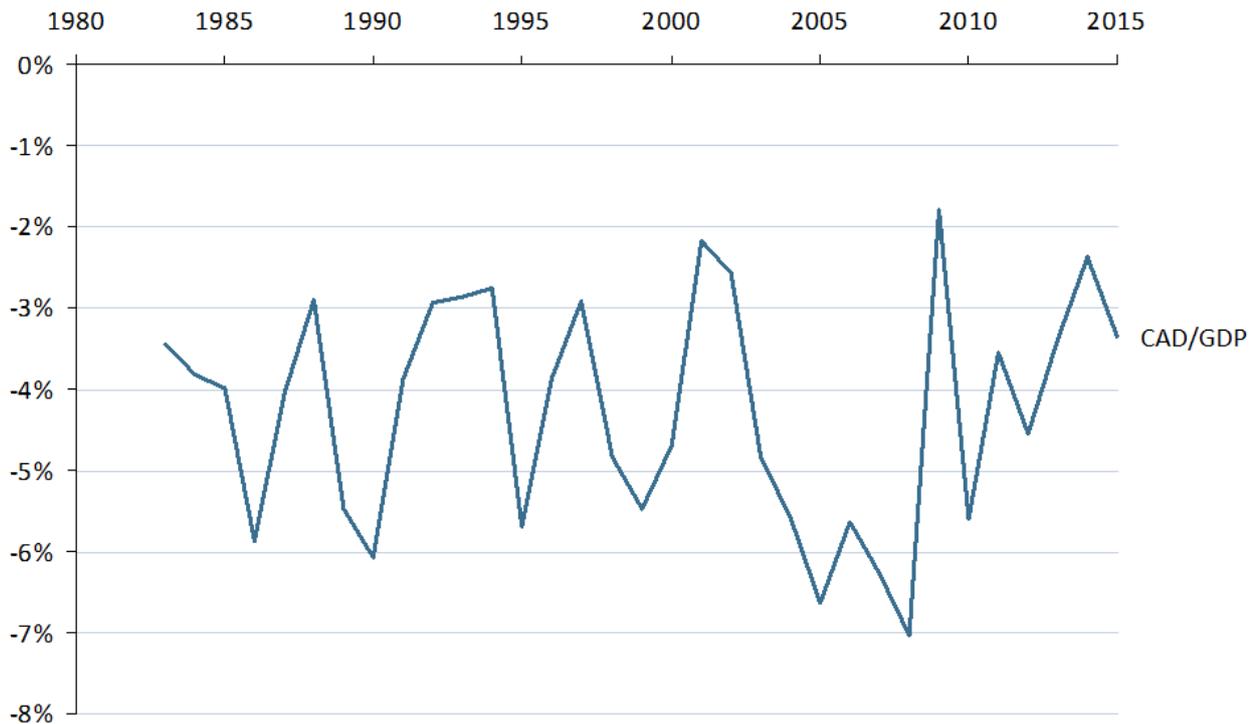
These large foreign liabilities are a source of risk. History demonstrates that Australia is not immune to sentiment-driven volatility and procyclical foreign investment shocks. Figure 3 shows the current account deficit as a proportion of GDP since financial market deregulation. As one would expect, there are sharp changes in the current account around the time of external shocks, representing flight by foreign investors,

different countries, leaving GDP-based measures of business cycle synchronization unchanged, or even reduced, if financial linkages stimulated product specialization. An alternative view is that large-scale geographical financial diversification accentuates and hastens the transmission of regional shocks to other areas, turning them into global shocks. For example, a bank run in one country might lead to a run in connected banking systems, fostering the transmission of crises and ultimately producing more closely correlated GDP-based measures of business cycles. ... The ever-closer correlations among financial variables in industrial economies over the last ten years (Figure 2.2) suggest that financial shocks are becoming truly global. And there is indirect evidence that capital inflows influence the business cycle in emerging economies via their effect on the national monetary policy stance. From 2001 to 2007 growth in net foreign assets of the monetary authorities has been strongly correlated with growth in reserve money, M2, and credit to the private sector.” (Emphasis added, footnotes omitted.)

<sup>25</sup> See, Gruen and Soding, Compulsory Superannuation and National Saving, July 2011.

which has adverse effects on GDP. In addition, the size of the changes to the current account deficit may have widened. Superannuation has buffered these shocks, acting as an important stabiliser, and it is important that policy and community behaviour continue to support a national savings pool that can do so.

Figure 3 – Changes in foreign investment often coincide with shocks



Source: ABS 5302.0 Balance of Payments and International Investment Position and ABS 5206.0 Australian National Accounts: National Income, Expenditure and Product, December 2015

Australia's experience has been moderated however, due in part to superannuation's positive contribution to savings and to national stability.

Some recent Treasury analysis has expressed remarkable confidence in Australia's capacity to manage large and volatile current account deficits because Australia "came through" the GFC "stress test."<sup>26</sup>

Australia's ability to manage exposure to foreign investor volatility in the GFC is perhaps not such a strong basis to shift away from a focus on national savings. The country's success through the GFC could be seen as substantially tied to 'at risk' policy settings, such as the country's self-conscious efforts to improve national savings via superannuation and other policies,<sup>27</sup> and to one-off factors, such as an historic boom in mining investment now reversing. The country also deployed extraordinary fiscal and monetary policy.

<sup>26</sup> See, Australia's current account deficit in a global imbalances context, Economic Roundup Issue 1, 2010 (Stating that "Reliance on external borrowing — particularly short-term borrowing — does entail risks; particularly, in the event of disruption to global financial markets. Nevertheless, the fact that Australia has come through the demanding stress test posed by the global financial crisis provides grounds for confidence that the risks are manageable." (Emphasis added.))

<sup>27</sup> See, e.g., Economic Roundup Summer 2006 (reflecting the remarks of David Gruen, Perspectives on Australia's current account deficit, 13 December 2005).

### *Financial stability*

As observed by the Reserve Bank, superannuation has contributed to financial stability.<sup>28</sup> But whether this continues to be the case depends on public policy and on the behaviour of industry and the community. As a result, the Reserve Bank has recommended that the superannuation system's role in stability should be "carefully monitored."<sup>29</sup>

### *Comments on Discussion Paper secondary objectives*

As noted above, we would not object if policy makers, regulators, industry and the community gave regard to the concepts raised in the Discussion Paper subsidiary objectives, because they are not irrelevant.

However, the drafting by which these concepts are expressed in the Discussion Paper raises concerns, largely because the language that purports to explain why the subsidiary objectives or factors are important too often instead states what superannuation is or is intended to do in ways that differ from the primary objective, or that inappropriately prioritise matters.

For example, in explaining why consumption smoothing should be considered, the Discussion Paper says "Superannuation is a vehicle for individuals to fund consumption in retirement largely from working life income. The system should facilitate consumption smoothing while providing choice and flexibility to meet individual needs and preferences." This is problematic on a number of grounds: (i) it expresses what superannuation is in a manner that is different from the primary objective, (ii) it mandates that choice and flexibility be provided to meet individual needs and preferences, even though the weight of empirical evidence indicates choice and flexibility undermine consumption smoothing and efficiency, and (iii) it does not clearly indicate that the consumption smoothing sought is between working and retirement.

Other concerns include:

- In discussing why being fully funded from savings is important, the Discussion Paper suggests that "superannuation fund members in general have claims on all assets in the fund." The meaning and relevance of this detail is not clear, and it might intrude on future innovations in design.
- In discussing investment in the best interests of members, the Discussion Paper expresses a view on how that should be operationalised (i.e., seeking to maximising risk-adjusted returns, net of fees and taxes,

<sup>28</sup> Reserve Bank of Australia, Submission to the Financial System Inquiry, 2014, page 7. (stating that "The rise of superannuation has transformed the Australian financial system... the growth in superannuation has been in many ways conducive to financial stability, by adding depth to financial markets, and providing a stable, more or less unleveraged, source of finance for other sectors.")

<sup>29</sup> Id at 185 (stating that "Despite the above factors [i.e., leverage, size, interconnectedness, and correlation], the fact that the pool of superannuation savings is large and provides a source of funding for other sectors in the economy means that the system should continue to be carefully monitored. ... In particular, superannuation funds can be exposed to liquidity risk, although potentially to a lesser extent than the banking sector, which could have implications for financial system stability in some circumstances.")

See also, Assistant Governor Guy Debelle, Remarks on Liquidity, 17 December 2013.

over the lifetime of a member),<sup>30</sup> rather than explaining why investing in the best interests of members is important to the objective. In part this could be because the objective doesn't include an outcome benchmark. In addition, the Discussion Papers asserts that focusing on long-term risk adjusted returns will result in auxiliary benefits to the economy. As noted above, that is only true if strong assumptions are made.

- In discussing fiscal matters, the Discussion Paper prioritises “alleviating fiscal pressure” rather than maximising outcomes per dollar of Government fiscal support over time; in other words, the Discussion Paper pushes for “alleviation” or reduction of outlays, rather than maximising the efficiency of outlays toward some stated purpose.<sup>31</sup> Again, this flaw is perhaps an outgrowth of the flawed primary objective.
- In discussing fiscal matters, the Discussion Paper does not take into account the potential fiscal costs if the superannuation system does not deliver on its objective and community expectations for retirement are not met. Fiscal sustainability is a sensible consideration for the purposes of assessing the efficiency of Government support. However, sustainability is a broader concept than a simplistic view about reducing reliance on the Age Pension or even the cost of tax concessions. Fiscal sustainability must be grounded in understanding community expectations and competing priorities. If combined retirement security settings do not help the community achieve well-being in retirement – security and dignity – then this will give rise to its own fiscal pressures through community demands for a higher publicly funded pension. Thus, fiscal sustainability is actually about how the system can most efficiently deliver reasonable retirement outcomes that broadly satisfy community expectations.

---

<sup>30</sup> Indicating that risk-adjusted net returns should be maximised “over the lifetime of a member,” rather than through generations, could be an artificially constrained expression of investing in the best interests of members. Lifecycle investing, which is implied by the Discussion Paper, can deviate from the optimal portfolio of a persistent investor. There could be alternative ways of managing individual sequencing and market risk other than de-risking investment allocations as an individual moves through old age.

<sup>31</sup> The Discussion Paper also could be clearer that chimeric fiscal activity, which just shifts cost burdens over time, is not efficient.

We would suggest the secondary factors be set out as follows:

Subsidiary factors	Rationale
Best interests of members	<p>To most efficiently achieve the primary objective of the superannuation system, all participants need to act in the best interests of members consistent with that objective. Participants should always place members first and act ethically and fairly.</p> <p>A system that operates in the best interests of members also is important to confidence, trust and sustainability. No less can be demanded in a compulsory system.</p> <p>This commitment should extend across the activities undertaken by participants, from the manner in which savings are invested to the manner in which products are structured.</p>
Investment	<p>The manner in which superannuation savings are invested affects not only the financial wellbeing of beneficiaries, but also has important effects on the economy, including on an intergenerational basis.</p> <p>The superannuation system is a major source of funding for business investment in Australia.</p>
National savings	<p>Due to financial integration and other factors, a heavy reliance on foreign investors (particularly financial investors) can expose Australia to possible adverse shifts in foreign sentiment. Higher levels of national savings can mitigate these risks, and reduce borrowing costs.</p>
Financial stability	<p>The growth in superannuation has been in many ways conducive to financial stability. However, superannuation could present risks to financial system stability in some circumstances as a result of decisions by policy makers, regulators, industry and the community.</p>
Risk management	<p>Participants in superannuation face risks: agency risk, investment risk, sequencing risk, longevity risk, political risk, and others. Risk can be mitigated and risk can be managed.</p> <p>The superannuation system can help to mitigate some of these risks. Some risks are best managed other than by individuals. Sometimes government is best placed, and sometimes private institutions are best placed.</p> <p>The decisions of policy makers, regulators, industry and the community should be oriented toward allocating risks efficiently and to those best able to bear them.</p>

Consumption smoothing	Achieving broad adequacy consistent with reasonable community expectations for living standards does not necessarily mean that any given individual maintains a reasonably comparable level of consumption between working and retirement. Superannuation together with other sources of private retirement income should facilitate the ability of individuals to smooth consumption between working and retirement.
Fully funded from savings	Australia's three pillar approach to retirement security reflects a policy judgment in which the superannuation system is funded by member savings (as well as tax expenditure and direct expenditure by government).
Fiscal efficiency and sustainability	Government support for retirement incomes policy, including superannuation, should be efficiently targeted to achieve community expectations while leaving sufficient fiscal capacity for other public priorities. Failure to do so risks less efficient fiscal expenditure and reduced wellbeing.
Regulation and other safeguards	<p>Protecting the interests of beneficiaries and the community, and maintaining public confidence in superannuation, requires the system, individual firms, and member conduct to be well-regulated.</p> <p>Behavioural biases, cognitive limits and other factors require strong intervention by government and regulators. The compulsory savings underlying the Superannuation Guarantee is a reflection of this.</p> <p>Due to the compulsory nature of superannuation, among other reasons, complexity in system design and communication should be avoided, because complexity tends to add to costs and to favour sophisticated and well-informed participants.</p>

### Conclusion

Seeking to legislate an official statement of the objective of superannuation is a worthwhile endeavour.

The proposed primary objective suggested in the Discussion Paper will not achieve its stated purpose of enabling policy makers, regulators, industry and the community to assess their own behaviour against the objective, nor will it enable the efficiency and other merits of competing options for policy change or private conduct to be assessed. As outlined above, the proposed primary objective would provide no meaningful guidance in assessing several recent policy proposals. Adopting an objective that cannot be operationalised would be counterproductive.

The primary objective of the superannuation should be:

***Deliver financial security and dignity in retirement to all Australians by providing regular income that is, when combined with any public pension and other sources of income, sufficient to secure a comfortable standard of living by reasonable community standards.***

When considering whether policy change or behaviour is consistent with the objective, policy makers, regulators, industry and the community should also give regard to a handful of subsidiary factors, specifically the effect of such policy change or behaviour in terms of members' best interests, investment, national savings, financial stability, risk management, consumption smoothing, leverage, fiscal efficiency and sustainability, and consumer and public safeguards.

\* \* \* \* \*

We appreciate Government and Treasury's consideration of our comments on the proposed objective. We would be happy to discuss any of the concerns or suggestions described above or any other matters that would be helpful to your deliberations. Please do not hesitate to contact Matthew Linden, Director of Public Affairs, on 02 6173 1825 or me on 03 9657 4369 if ISA can be of any assistance.

Respectfully submitted,



Zachary May  
Director of Policy