Objective of Superannuation

Consultation process
KPMG Submission

6 April 2016

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6 April 2016

Dear Ms Dowdell,

Objective of Superannuation – Consultation paper

KPMG strives to contribute in a meaningful way to the debate that is shaping the future of the industries we serve. To this end we welcome the opportunity to make a submission on the proposed objective of superannuation and the manner in which to enshrine the objective in legislation.

KPMG supports the primary objective of the superannuation system as recommended by the Financial System Inquiry and agrees that clarity of purpose will aid consistent policy delivery and ultimately efficiency.

We also support the adoption of the overarching principles of adequacy, sustainability, certainty and fairness. We support the objective being legislated and recommend that the objective of superannuation would be best placed in the preamble of the *Superannuation Industry (Supervision) Act 1993*. Enshrining the objective of superannuation in the Act will serve to guide future policy makers.

KPMG would be pleased to provide further information to assist you with your deliberations. Should you require further information or have any questions please do not hesitate to contact Manish Prasad on +61 2 9346 6334 or at mprasad4@kpmg.com.au.

Yours sincerely,

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Partner, National Sector Leader
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Executive summary

KPMG welcomes the opportunity to make a submission concerning the Government's '*Objective of Superannuation*' discussion paper. As Australia's superannuation system matures it is appropriate that the focus shifts towards ensuring superannuation plays its part in providing all Australians with access to an adequate retirement income. The shift in focus is more profound than immediately evident. A statutory statement of the objective of superannuation will drive change in the industry; change that should see a much needed focus on the comprehensive retirement income needs of Australians.

Support for proposed objective of superannuation

KPMG supports the primary objective of the superannuation system as recommended by the Financial System Inquiry and agrees that clarity of purpose will aid consistent policy delivery and ultimately efficiency. We also support the adoption of the overarching principles of adequacy, sustainability, certainty and fairness.

We support the objective being legislated and recommend that the objective of superannuation would be best placed in the preamble of the *Superannuation Industry (Supervision) Act 1993*. Enshrining the objective of superannuation in the Act will serve to guide future policy makers.

Focus on retirement incomes

The recommended objective of the superannuation system recognises that the focus of the system is changing. This refocusing on retirement incomes is entirely appropriate and much needed. Importantly, the objective challenges policy makers to squarely focus on incomes from superannuation savings; other income; the Age Pension, and their interrelationship.

Adequacy

Whilst we support the Association of Superannuation Funds of Australia (ASFA) retirement income adequacy standard, we believe the standard should be revisited to consider other key factors beyond single and couple units. This could include home ownership and aged care cost considerations.

If the objective of the superannuation system is to provide income in retirement to substitute or supplement the Age Pension; then it follows that to achieve this goal the drivers of superannuation balances sufficient to generate adequate income must be addressed. This requires consideration of measures to boost the contributions of those Australian's who, due to their circumstances, have insufficient retirement incomes.

Women and low income earners

KPMG recommends the introduction of limited exemptions from concessional and non-concessional capping arrangements to allow women and low income earners to boost their superannuation contributions to compensate for broken employment patterns, changed family circumstances, including divorce and financial separation and reduced contributions generally.

Small and medium sized enterprises

Existing capping limitations make it difficult when an enterprise operator is investing in their enterprise, to also invest in their own retirement and limits subsequent catch up contributions when the business is established.

Measures to provide greater flexibility regarding contributions to personal retirement savings for small and medium sized enterprise owners are required.

Fiscal sustainability

KPMG proposes a number of specific changes to superannuation arrangements which would aid the sustainability of the retirement system and promote confidence and fairness in the system. These include reducing concessional and non-concessional capping arrangements and introducing life-time limits to the amounts individuals can maintain within the superannuation system.

KPMG recommends reducing the annual income threshold at which the 15 percent tax rate applies to concessional superannuation contributions to more effectively distribute the tax benefits associated with concessional contributions across the Australian workforce.

We also recommend reducing the existing annual non-concessional contribution cap from the existing $180,000 and restricting the ability to bring forward three years-worth of non-concessional contributions.

Flexibility

There should be sufficient regulatory flexibility to ensure superannuation trustees have the ability to create innovative comprehensive retirement products that are consistent with the objective, such as annuities.

We recommend a review of any legislative impediments to the offering of comprehensive income products for retirement and measures which would encourage product rationalisation and innovation, including mechanisms which facilitate the carrying forward of losses.

Insurance arrangements need to reflect the changing face of Australia's workforce.

Reasons for change

Why superannuation is important

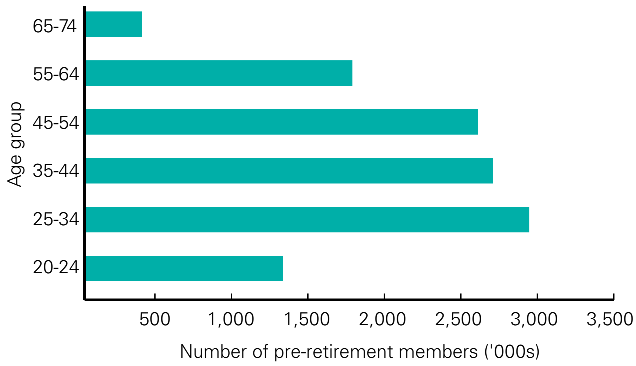
Superannuation is a central pillar within Australia's retirement incomes system. If not for the deferment of wages into compulsory retirement savings, meeting the challenges faced by an ageing population would be almost impossible. Since its introduction, compulsory contribution levels have increased and other changes to the superannuation system have seen a significant growth in funds under management to an estimated $2.0 trillion[1] or 125 percent of GDP.[2] The superannuation pool is growing and is expected to exceed $3 trillion by 2025.[3]

System matures

Australia's superannuation system has three interconnected pillars, compulsory savings, voluntary savings (in and out of the superannuation system), and the aged pension.

The superannuation component of the system is maturing as more Australians are receiving compulsory superannuation contributions for longer periods of their working lives, and encouraged by taxation incentives, are choosing to make voluntary contributions to their retirement savings. On aggregate the retirement savings of Australians are increasing and as a consequence there is a reduced, but still significant, reliance on the age pension.

Figure 1: Members in accumulation phase by age



Source: Australian Bureau of Statistics.
4125.0 Gender Indicators Australia, August 2015

The superannuation pool is growing and is expected to exceed $3 trillion by 2025.

1 APRA: Annual Superannuation Bulletin, 30 June 2015. Estimating total superannuation assets were $2.0 trillion as at 30 June 2015. December quarter 2015 ($2.046T at the end of December 2015).

2 Australian Bureau of Statistics: Australian National Accounts Time Series to 30 June 2015. Estimation of GDP at $1.6 trillion.

3 KPMG: Supertrends: The trends shaping Australia's superannuation industry, May 2015.

Ageing population

Australia's ageing population places significant pressure on the adequacy of the retirement incomes system. The 2015 Intergenerational Report[4] projected that the number of Australians over 65 will double by 2054-55. In 1974-75 less than 1 percent of Australians lived to 85 and over. It is projected that by 2054-55 nearly 5 percent or two million Australians will be aged 85 and over.

As a consequence, the cost of aged care and health services is increasing, placing a growing burden on individual savings, as a greater portion of disposable income is required to fund health and care expenses, and the Government.

'*Government aged-care expenditure is projected to rise from 0.9 percent of gross domestic product (GDP) in 2014/2015 to 1.7 percent of GDP in 2054/2055 ($220.2bn, or $80bn in today's dollars) among other things, governments can be expected to seek higher contributions from individuals to help meet these increased costs.*'[5]

The Intergenerational Report estimates that the existing trend of a reduction in working age population will continue, with the number of people aged between 15 and 64 for every person aged 65 and over falling from 7.3 people in 1974-75 to an estimated 4.5 people and nearly half again to 2.7 people by 2054-55.[6]

Shift to retirement phase

In its April 2015 submission to the Financial System Inquiry, ASIC noted that:

'*The overarching aim of the superannuation system is to provide members with an adequate income in retirement. However, the focus of public awareness of superannuation currently revolves around the pre-retirement phase*.'[7]

Given the ageing of Australia's population, ASIC was of the view that superannuation funds and financial advisers will need to adapt business models and products from the current limited product offering to products that appropriately address longevity risk for retirees.

We agree, however there are regulatory barriers to the development of innovative products. These barriers, combined with the uncertainty generated by continual change in the superannuation sector is not a conducive environment for innovative change. Particularly change that requires long-term investment.

The overarching aim of the superannuation system is to provide members with an adequate income in retirement.

4 Treasury: Commonwealth of Australia 2015; 2015 Intergenerational Report.

5 Discussion paper: the future interaction of superannuation with aged care and health care, released at the ASFA 2015 National Conference, page 4.

6 Intergenerational Report OpCit.

7 Financial System Inquiry: Submission by the Australian Securities and Investments Commission April 2015, Page 20.

Objectives of the superannuation system

The Murray Review (Financial System Inquiry)[8] recommended that the Government:

'*Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publicly on how policy proposals are consistent with achieving these objectives over the long term'.*

The inquiry recommended that the Government seek broad agreement on a primary and related subsidiary objectives for the superannuation system.

Primary objective

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

Subsidiary objectives

The inquiry's six recommended subsidiary objectives are contained in the discussion paper and are found at Appendix 1; and are summarised as:

- The facilitation of consumption smoothing over life;
- Managing financial risks in retirement;
- Be fully funded from savings;
- Be invested in the best interests of superannuation fund members;
- The alleviation of fiscal pressures on Government from the retirement income system; and
- That the system be simple, efficient and provide safeguards.

The inquiry was of the view that an agreed policy framework and objectives would improve system efficiency, long-term planning and assist in meeting the retirement needs of Australians more efficiently and effectively.[9]

8 Financial System Inquiry – Final Report December 2014; Recommendation 9.

9 Financial Systems Inquiry; Final Report: Chapter 2.

Support for proposed objective

KPMG supports the primary objective of the superannuation system as recommended by the Financial System Inquiry and agrees that clarity of purpose will aid consistent policy delivery and ultimately efficiency.

We also support the adoption of the overarching principles of adequacy, sustainability, certainty and fairness which were identified by the Charter Group in its May 2013 report to the Treasurer and the Minister Assisting for Financial Services and Superannuation.[10]

The principles identified by the Charter Group should be adopted as the headline secondary objectives within which the discussion paper's recommended secondary, and more granular, objectives fall.

Focus on retirement incomes

Policy makers must focus on incomes from superannuation savings; other income; the aged pension and their interrelationship.

A renewed focus on retirement incomes should be considered in conjunction with a superannuation fund trustees' obligation to act in their member's best interests. This best interest obligation rightly requires a consideration of accumulation and post-accumulation solutions.

We believe the proposed objective is clear and unambiguous. Its enshrinement in legislation will aid in the development of a more balanced approach as it encourages a greater focus on retirement.

We also support the introduction of a new obligation relating to comprehensive income products (CIP) which, combined with a legislative definition outlining the objective of superannuation, will shift the focus towards retirement incomes and products.

It is noted that smaller funds may not have the internal capacity to develop and deliver retirement products which could drive further consolidation in the superannuation industry.

10 A Super Charter: Fewer Changes, Better Outcomes. Charter Group; The Australian Government the Treasury. May 2013.

Policy makers must focus on incomes from superannuation savings; other income; the Age Pension and their interrelationship.

Issues and points for further consideration

Retirement income or standard of living in retirement

If the primary objective of the superannuation system is to provide income in retirement, this focus should not be distracted by wealth accumulation or transfer considerations beyond those required to support adequate retirement incomes.

Super concessions should be limited to the level required to ensure an adequate retirement income. Changing the capping arrangements around concessional taxation treatment of superannuation contributions and income can achieve this aim. We believe that restrictions on concessional arrangements should not be so restrictive that the objective of superannuation is potentially hindered.

Any changes to concessional taxation arrangements should be equitable and sufficiently flexible to accommodate the primary objective of superannuation. Concessional capping arrangements should be flexible enough to allow for catch-up contributions.

Adequacy

If the objective of the superannuation system is to provide income in retirement to substitute or supplement the Age Pension; then it follows that the drivers of superannuation balances sufficient to generate adequate income must be addressed.

There are five key drivers which affect income from superannuation retirement incomes:

1. The wage or salary of the superannuation fund member;
2. The consistency of their participation in the workforce;
3. The level of the compulsory Superannuation Guarantee payments made;
4. The extent of voluntary contributions made by the superannuation fund members; and
5. The efficiency of the superannuation system.

It is also important to recognise that the level of confidence in the system will ultimately impact on adequacy levels. Reductions in confidence in the system will reduce voluntary inputs into the system. Accordingly, any changes to the system should have a long-term focus, be cautious and consistent with the designated objective of the system.

The four drivers of adequacy outlined above should be considered when determining superannuation policy consistent with the primary objective of superannuation.

Whilst we support the ASFA retirement income adequacy standard, we believe the standard should be revisited to consider other key factors such as home ownership and aged care costs.

Women and low income earners

On average superannuation balances for women are 50 percent[11] lower than men because women:

- Are more likely to be employed on a part-time and/or casual basis and earn less than men in similar occupations;
- Are more likely to have broken work patterns due to primary carer responsibilities; and
- Are more likely to work in lower paying occupations.

Retirement income parity for women with men can only be substantially addressed by addressing the wider socio-economic inequities that result in women earning less income than men. Notwithstanding this disparity of income, measures can and should be taken that will work towards women having adequate retirement incomes.

The measures to address adequacy of retirement incomes for women are consistent with measures that boost the contribution levels of low income workers such as the Low Income Superannuation Contribution; the level of the Superannuation Guarantee and the income threshold when superannuation is paid.

There are a number of additional measures which would boost the retirement incomes of women.

These could include, but not be limited to, applying the superannuation guarantee to income replacement payments such as paid parental leave and worker's compensation payments.

We suggest that there is a strong case for the introduction of limited exemptions from concessional and non-concessional capping arrangements to allow women and low income earners to boost their superannuation contributions to compensate for periods out of the workforce, changed family circumstances, including divorce and financial separation and reduced contributions generally.

Small and medium sized enterprises

Small and medium sized enterprise owners are often not in a position to be engaged with their own superannuation arrangements. Their personal superannuation arrangements are often complicated by the business structure adopted. Profits or distributions may often be deferred to accommodate investment in the enterprise leaving little capacity to invest in retirement savings.

Changes to business and family arrangements and business changes; including failures, often leave the owners of small and medium sized enterprises with little personal superannuation. For those operating in regional and rural communities, including farm based enterprises, it is often difficult for these former owners of enterprises to generate sufficient retirement savings for an adequate retirement income.

Existing capping limitations make it difficult when an enterprise operator is investing in the enterprise to also invest in their own retirement and limit subsequent catch up contributions when the business is established. Measures to provide greater flexibility regarding contributions to personal retirement savings for small and medium sized enterprise owners are required.

KPMG RECOMMENDATIONS

- Introducing measures to promote catch-up contributions for those with broken employment patterns and low income earners, including limited exemptions from concessional and non-concessional capping arrangements.
- Sufficient flexibility for small and medium sized business operators to allow them to make personal superannuation contributions to ensure they have an adequate retirement income.

11 ANZ Women's Report, July 2015 p64.

Also see: ASFA, ASFA and State Street Global Advisors: The future of retirement income, March 2015 Page 4. Relying on 2011-12 data finding on average male retirement superannuation balances of $197,000 and $105,000 for women.

Fiscal sustainability

Australia's retirement system as it is currently structured is not capable of meeting the challenges imposed by its ageing population. In the longer-term Australia's retirement incomes system should be capable of providing a dignified, largely self-funded, retirement for most working Australians. However, this can only be achieved if the system is capable of being sustained by successive governments.

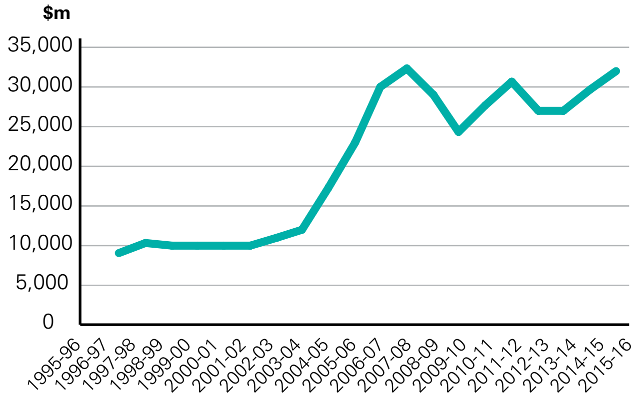
Demographic change will continue to place pressure on the ability to deliver an adequate aged pension, this gap must be filled by compulsory and voluntary retirement savings. Concessional tax treatment within superannuation recognises the fact that Australians forego wages which are invested in the system. These incentives play an important role in ensuring there are sufficient savings to meet Australian's retirement needs. As the system grows, so does the contribution to the system by the taxpayer.

There has been much discussion regarding the current concessional arrangements. It is generally recognised that, as currently structured, they are not sustainable or fair.

Increasing national saving

Australia's superannuation system has served to provide long-term patient capital, an important economic factor that differentiates Australia from many other nations. The system has matured sufficiently that the goal of increasing national savings no longer need be a primary motivation driving decision making.[12] However, the drivers of the system's maturity should not be undermined, in particular the compulsory nature of superannuation contributions and their exclusive use towards the provision of retirement income for Australians.

Figure 2: Estimated cost of superannuation tax concessions



KPMG RECOMMENDATIONS

Reduce concessional contribution arrangements

- Reduce the annual income threshold at which the 15 percent tax rate applies to concessional superannuation contributions.

Reduce non-concessional caps

- Reducing the existing annual non-concessional contribution cap from the existing $180,000; and
- Restricting the ability to bring forward three years-worth of non-concessional contributions.

Introduce life-time limits to contributions

- The introduction of life-time limit to the amounts individuals can maintain within the superannuation system, including self-managed funds.

12 ASFA, Superannuation and the economy, June 2015, page 12 notes that 'Compared to other OECD countries, Australia has an above average savings rate. Superannuation makes a major contribution to the relatively high saving rate. Australian Treasury estimates indicate that the superannuation system currently contributes about 1.5 to 2 percentage points to the national saving rate, rising to 3 percentage points by 2050'.

Three additional considerations

We believe that there are three other key factors that should be included when considering the objectives of the superannuation system; certainty, fairness and flexibility.

Certainty

There should be a high level of certainty in the superannuation system. Certainty provides system participants confidence to engage and make long-term investment decisions. Changes to the superannuation system should be flagged well in advance, not be retrospective and be consistent with the objectives of superannuation.

Fairness

Fairness should be a key objective of the superannuation system as it encourages support for and confidence in the system.

To be fair the superannuation system must, when striving towards its objective of providing an adequate retirement income, ensure those with different experiences are treated equally.

Flexibility

There should be sufficient regulatory flexibility to ensure superannuation trustees have the ability to create innovative retirement products that are consistent with the objective, such as annuities.

Tax settings are the root cause of many fund members consciously drawing minimal income from their superannuation entitlements, for fear that the monies may not last. The lack of tax-free treatment for deferred annuities further compounds the issue and should be addressed.

Insurance arrangements need to reflect the demographic change and be consistent with the objective of superannuation. It is no longer appropriate that life and disability insurance cover ceases or becomes prohibitively expensive at age 65. Insurance barriers regarding income protection and workers compensation coverage for older Australians restrict access to or continuance in the workforce. These issues must be addressed to enable those Australians who wish to, and are able to, work longer.

KPMG RECOMMENDATIONS

- Review and remove any legislative impediments to the offering of comprehensive income products for retirement.
- Encourage product rationalisation and innovation through mechanisms which facilitate the carrying forward of losses.
- Remove barriers to insurance coverage which may restrict workforce participation by older Australians.

Location of objective

We support the objective of superannuation being placed in the preamble of the *Superannuation Industry (Supervision) Act 1993*. Enshrining the objective of superannuation in the Act will serve to guide future policy makers. At a minimum the insertion of an objectives clause will be a reminder that proposed changes should be consistent with the stated objective.

Appendix 1

Table 3: Subsidiary objectives of the superannuation system[13]

Subsidiary objective	Why the objective is important
Facilitate consumption smoothing over the course of an individual's life	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.
Help people manage financial risks in retirement	Risk management is important as retirees generally have limited opportunities to replenish losses. The retirement income system should help individuals manage longevity risk, investment risk and inflation risk. Products with risk pooling would help people to manage longevity risk efficiently.
Be fully funded from savings	A fully funded system, as opposed to an unfunded system, is important for sustainability and stability. The system is designed to be predominantly funded by savings from working life income and investment earnings, where superannuation fund members in general have claims on all assets in the fund.
Be invested in the best interests of superannuation fund members	Superannuation funds are managed for the sole benefit of members, which means the investment focus 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.
Alleviate fiscal pressures on Government from the retirement income system	Government's total contribution to the retirement income system, through both the Age Pension and superannuation tax concessions, needs to be sustainable and targeted. Higher private provisioning for retirement should reduce the burden on public finances.
Be simple and efficient, and provide safeguards	The system should achieve its objectives at the minimum cost to individuals and taxpayers. Complexity is less appropriate for a compulsory system, as it tends to add to costs and to favour sophisticated and well-informed investors. Given the compulsory nature of SG contributions, the system needs prudential oversight and should provide good outcomes in both the accumulation and retirement phases for disengaged fund members.

13 *Source: Financial System Inquiry Final Report, Chapter 2*

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