Objectives of Superannuation

NAB WEALTH (MLC), April 2016

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http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Economic_security_for_women_in_retirement/Terms_of_Reference

About us

MLC (NAB Wealth) is National Australia Bank's wealth management arm and provides investment, superannuation, insurance and financial advice to our corporate, institutional and retail customers.

MLC has 1.7 million customers, 5,000 employees and 1,800 in the adviser network.

For over 125 years MLC has been helping our customers. Our wealth management expertise, coupled with the strength of being within the NAB Group, enables us to provide holistic financial solutions for our customers.

Our multi-asset investment portfolios are structured to deliver reliable returns in many market environments, evolving to manage new risks and capture new opportunities. We have specialist in-house investment managers, with intimate knowledge of their asset classes, as well as the resources to access some of the best managers from around the world.

We have one of the largest financial planning networks in Australia, providing quality financial advice, insights and expertise. We are the wealth management partner of choice for more than 1,800 self-employed, aligned and salaried advisers, and have relationships with independently owned and licensed advisers across Australia.

Our retirement solutions can help Australians grow and protect their future through competitive investment returns, efficient income stream options and investment protection solutions that help create a smoother ride in different market conditions.

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Foreword

MLC appreciates the opportunity to provide feedback on enshrining the objectives of superannuation in law.

Below we have provided our views on an approach to construction of the provision along with a reiteration of our initial views for establishing measurable targets to assess progress towards fulfilling the objective(s).

We support enshrinement in separate statute to avoid confusion and issues with application given the multiple laws under which superannuation is operated.

Preliminary

As a preliminary comment, MLC confirms its continued support for the three pillar retirement system:

- Mandatory contributions (the Superannuation Guarantee (SG) currently 9.5% of ordinary earnings and rising to 12%),
- Voluntary savings, and
- The means-tested age pension (safety net).

The superannuation savings system is predicated on the [working] population foregoing income now in order to fund consumption in retirement, which is an opportunity cost. Tax concessions are a fundamental part of this covenant with the population and also assist in the capacity of private individuals to self-fund, in whole or part, their retirement needs. The Government and the populace both forego income now for a future benefit. This 'pay as you go approach' has the advantage over unfunded systems in that it reduces the impost on future generations.

MLC supports concessional taxation treatment of superannuation savings, with reasonable controls to moderate actual or perceived use for inordinate wealth accumulation and/or estate planning.

Recommendation

Consistent with NAB's submissions to the Financial System Inquiry (FSI) and the Tax Discussion paper, MLC submits that the objective(s) for superannuation should be structured in a manner that is clear, measurable and robust.

This should mitigate costly and de-stabilising interventions particularly with regards to policies other than the provision of retirement benefits to the individuals who have foregone current income to fund their retirement.

MLC supports the adoption of enduring principles or objectives which anchor future policy considerations specifically for super and retirement incomes policy.

Whether this is expressed as a single objective, with key and measurable targets, or as a 'bundle' of measurable principles or aims in service of an overarching objective is, at this juncture, more a matter of form than substance.

The FSI framing of the objective "to provide income in retirement to substitute or supplement the Age Pension" lacks sufficient clarity leaving it open to widely varying interpretation. That is, it would fail to provide a stable and robust approach against which policy and settings could be tested over time.

Critically, at the heart of any objective or set of objectives, is the concept of adequacy.

This was not expressly addressed in the FSI as was highlighted by the Treasurer, the Hon. Scott Morrison MP, in his address to the ASFA November 2015 Conference (bolding by author). While he also indicated issues with determining what is adequate it is clearly an important part of a system designed to help participants meet their retirement consumption needs:

"As I've already said, the Financial System Inquiry recommended that the primary objective of the superannuation system should be 'To provide income in retirement to substitute or supplement the Age Pension'.

As indicated in our response to the Murray Inquiry, ***this is an excellent starting point*** *for enshrining an objective in legislation....*

But let me go broader than that..... we want to be very sure that superannuation tax concessions are appropriately targeted so that they secure an ***adequate retirement income for Australians****.*

But just what is adequate?

One way to approach this is by using replacement rates, where retirement income is given as a proportion of pre-retirement earnings.

...So while governments deliver policy solutions to such issues as best they can, we need to recognise that there is no straightforward answer to the question of adequacy".

In focusing on strengthening the superannuation system the final FSI report did recommend an objective of providing an income in retirement. This was on the basis that, amongst other things, a lack of conversion of assets to income lowers living standards in retirement, while economic growth benefits where retirees can sustain higher levels of consumption in retirement. [1]

A more robust single objective, which conflates those in our previous submissions and, critically, includes an adequacy target for the broader population, could be framed as follows:

"The [primary] objective of concessionally taxed superannuation savings is to provide dignity and independence in retirement in the following way:

- Generating savings over a working life sufficient to provide an adequate replacement income of 65%-70% of pre-retirement income ;
- Subject to a reasonable limit of up to twice average weekly full time earnings;
- Provided within an efficient, open, competitive and strongly prudentially regulated, system".

NOTE: The reasonable limit could be a lump sum similar to the earlier pension RBL. However, in keeping with the FSI recommendation focusing on income, we believe the limit is better framed as a post retirement replacement income subject to a cap of twice average weekly full time earnings.

[1] November 2014, Final Report Financial System Inquiry, Ch 2

We believe this objective addresses adequacy, issues of 'excessive' accumulation of wealth beyond reasonable community standards, will limit its use as an estate planning vehicle (rather than one for retirement consumption) and recognises the need for appropriate regulatory oversight given the mandatory limb of the 3 pillar system.

A retirement system should seek to encourage a wide section of the working community to save sufficiently to support a standard of living reasonably proximate to their pre-retirement circumstances. A three-tiered retirement system should be capable of delivering much better and more adequate outcomes than the replacement of a safety net tax-transfer system with a simple supplement.

A matter that should be subject to further clarification is the capacity of the system to provide benefits to members, or their dependant family members, in the event of their earlier disablement or death. This could simply be referring to the objective above as the primary objective perhaps with a clarification of the use of the term 'retirement'. However, it may warrant inclusion as a subsidiary objective.

We do not believe the objective should interfere with or substitute for the Superannuation Industry (Supervision) Act (SISA) covenants expressed in section 52.

Targets/measures of progress towards the objective

Our previous submissions suggested some specific measures or targets against which our progress towards the objective(s), conflated above, could be assessed. Broadly these included:

- The encouragement, and **increase in take up** of, income streams at retirement over lump sum withdrawals;
- In combination and over a transition period:
  - o The base of the headline target (of a 70% replacement rate) comprising the age pension and private earnings (the age pension continuing to act as the safety net to alleviate old age poverty).
  - o Increasing years of self-provision at a minimum of the age pension rate;

  NOTE: This was expressed as an assessment of progress over specific time periods from 10-30 years (intentionally within the projection period of 40 years adopted for the Intergenerational Report). So, roughly from the 2050s, the system should be targeting a significant number of the superannuation population[2] saving to independently fund the level needed to provide the headline target of 60%-70% pre-retirement earnings for full retirement and a majority achieving this from the 2060s.

  System maturity is still some decades away. This will not eventuate until the 2060s with a 12% Superannuation Guarantee (SG) rate due to commence from July 2025 (under current settings).
- Boosting the pool of national private savings in absolute terms and as a percentage of GDP;
- A market that provides a range of solutions to meet differing retirement needs which remains contestable, innovative and competitively priced; and
- Lower losses as a percentage of assets resulting from fraud or fund/product failure.

[2] This should be based on a reasonable assessment of workforce participation rates and full/part-time status profiles over 'working life'. In effect, the age pension would continue as an important safety net with superannuation supplementing this income for those who have variable rates of participation and associated lower overall incomes over time.

Reponses to Treasury points to consider for discussion

Based on the discussion paper:

Issue	Points to consider	Response
Retirement income *or* standard of living in retirement	While retirement income will provide resources to help a person meet their costs of living in retirement, standard of living is broader as it includes the use of both income and assets. Both also clarify that superannuation is meant to help fund a person's retirement, it is not for unlimited wealth accumulation or bequests.	Based on the FSI, we support framing the objective in the context of a replacement income (although believe flexibility is required to meet once-off or unpredictable expenses particularly related to health). An adequacy target based on income orients the Australian population to drawing down their superannuation assets in a similar way to earning regular salary/wages rather than as a single lump sum. As a comparative approach to pre-retirement earnings it is more familiar and more likely to sustain standards of living provided sufficient flexibility is retained to meet differing needs and circumstances over longer retirement timeframes than has traditionally been the case. As highlighted in the Discussion Paper, most Australians' primary assets comprise their home and superannuation. The home is often used to fund later aged care accommodation needs particularly by those who have not benefitted from a fully mature system (although changing demographics and household structures can mean that the principal residence is home to others apart from the retiree(s)).
Adequacy	While adequacy provides a sense of targeting superannuation and is consistent with fiscal sustainability, there is no consensus of what adequacy means. While the OECD defines it through the use of replacement rates, implying people have different levels of adequate retirement incomes according to their wages, others may conceive of a single level of income applicable to all.	We acknowledge there is still some debate about how to describe what is adequate. This should not preclude legislating an objective which includes an adequacy target. To omit this altogether would, we believe, create a vacuum in which policy debate and decisions could continue to be compromised in the context of a robust privately funded retirement. The population overall does not operate on a single level of income. A cohort of the population, in this case retirees, will also have varying needs, expectations and obligations which have been serviced relative to pre-retirement income. A target replacement rate based on pre-retirement earnings is more likely to be understood and as a result more likely to be embraced by the community. So, whilst it may not capture all of the factors that might be considered in determining what is 'adequate' (including, as noted in the Discussion paper, well-being measures) it is, in the overall scheme of the system, a clear and readily understood metric.
Fiscal sustainability	The superannuation system should also be fiscally sustainable - through	Determination of fiscal sustainability has itself been divisive due to competing claims, lack of clear data and criteria in assessing costs and long term benefits.

Issue	Points to consider	Response
	reducing reliance on the Age Pension and providing tax concessions that are targeted. While the objective of the system is to improve retirement incomes, balancing the need for fiscal sustainability may mean there is a limit to the support that can be given.	In Australia public expenditure on pensions at 3.5% of Gross Domestic Product (GDP) is lower than the OECD average in 2011 at 7.9 per cent.[3] Even at what is viewed as an excessively high $30billion expenditure estimate on super tax concessions (which ignores budget savings to the age pension amongst other things), that would still be less than the OECD average overall assuming a GDP at 2015 of approximately AUD1.75trillion.[4] That is, the combined cost of concessions (approximately 2% of GDP) and pension outlays would be 5.5% which is 2.4 percentage points less than the OECD average. It is our view that a reasonable cap could be applied equivalent to a maximum replacement rate of 65-70% of up to twice average earnings. In the longer term, ensuring retirees maintain relative purchasing power is important to the overall economy.
Increasing national saving	While this was an important motivation for establishment of the superannuation system, as perceptions and the economy have evolved the need for prominence in the objective may have reduced.	We agree with this sentiment, but believe increased national saving remains an important metric in assessing the effectiveness of the system and its target aim for more adequate retirement incomes. The FSI, amongst others, identified the growing (and enduring) size of Australia's retiree population relative to the past as a key determinant of economic growth. Sustained consumption over working and retirement life is important for economic stability. As one cohort consumes another must also be saving.

[3] 2015, OECD, Pensions at a Glance.
[4] 2015 IMF estimate $1.2trillion US