6 April 2016

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

Email: superannuationobjective@treasury.gov.au

Dear Ms. Wilkinson,

ENSHRINING THE OBJECTIVE OF SUPERANNUATION IN LAW

The SMSF Association welcomes the opportunity to make a submission to the Government's consultation on enshrining the objective of the superannuation system in legislation. The Association has been a vocal supporter of the Financial System Inquiry's (FSI) recommendation and we are pleased that the Government is proceeding with this important step that will help provide stability for the superannuation system.

We believe that the objective for the superannuation system should be based around the provision of retirement income, as recommended by the FSI, and supported by a set of guiding principles that can be used to give context to the primary objective. It is essential that the objective not only has a focus on providing retirement income but also ensures that retirees are able to build adequate retirement savings through the superannuation system to manage financial risks of aging and retirement.

We believe that the primary objective for superannuation should be:

> ***"To provide income in retirement to substitute or supplement the age pension, delivering a financially secure and dignified retirement for Australians."***

In support of this primary objective we believe guiding principles are required in order to provide policy makers and superannuation system stakeholders context as to how the primary objective is to be interpreted and applied to retirement incomes policy.

The SMSF Association recommends that enshrining the objective of superannuation should occur in standalone legislation. The objectives of superannuation will influence a number of policy areas including superannuation, taxation, social security, health and aging. Accordingly, the objective should be legislated in a standalone Act rather than in existing superannuation or taxation legislation. Also, we believe that the explanatory memorandum to the legislation will be critically important for future policy makers and stakeholders to understand the intent of setting the objectives.

Also, we believe this is an appropriate opportunity to remove superannuation policy from the annual Budget cycle by limiting significant superannuation changes (i.e. changes to contribution caps,

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taxation of benefits or earnings, etc.) to be undertaken only as a result of a comprehensive periodic long-term review of superannuation. The Intergenerational Report (IGR) would be an appropriate vehicle for a regular periodic review of the superannuation system to be tied to. Having the IGR released once every five years will allow the Government, industry and consumers to take a "health check" on the superannuation system. Stakeholders can assess whether the system is achieving its goals and whether any adjustments/changes to policy settings are required. We strongly suggest that the Government consider this review process being implemented as part of the enshrining of the objective of superannuation.

Finally, we strongly encourage the Government to engage in further consultation on the wording of the objective and guiding principles before they are enshrined and also seek bipartisan support for the objective. We believe that enshrining the objectives for superannuation is an important step in delivering stability and certainty and stress that this important task should be undertaken in an orderly and unhurried fashion.

We have provided our detailed position on these matters in the **Attachment**.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

Andrea Slattery
Managing Director/CEO
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ATTACHMENT

PRIMARY OBJECTIVE

The SMSF Association supports the enshrinement of the FSI recommended primary objective with the addition of referencing a " a financially secure and dignified retirement" as part of the superannuation systems objective. This would read as:

> ***"To provide income in retirement to substitute or supplement the age pension, delivering a financially secure and dignified retirement for Australians."***

We have recommended the additional words to the FSI recommendation in order to ensure that the primary objective captures the idea that the superannuation system should be the primary savings vehicle to fund expenses in retirement, which is more aspirational than saving to merely replace the age pension. This links adequacy to the provision of retirement income which is crucial to the superannuation system delivering improved retirement outcomes for Australians.

However, we believe that if a succinct primary objective is adopted as we have recommended then it must be accompanied by a set of guiding principles. The guiding principles should provide context as to how the primary objective is to be interpreted and applied to future policy proposals and decisions.

We prefer a set of guiding principles instead of a number of subsidiary objectives to ensure that there are no conflicting objectives or priorities for the superannuation system.

GUIDING PRINCIPLES

We believe the guiding principles should be as follows:

Adequate retirement savings

A secure and dignified standard of life should be afforded to retirees through adequate retirement savings. We believe that adequate retirement savings should afford a dignified level of retirement income and flexibility to meet a broad range of needs.

The target level of income provided through the superannuation system should maintain an aspirational element and be greater than a standard of living provided by the age pension.

Adequate retirement savings should ensure that retirees are not only able to fund an income stream to rely on in retirement but should also ensure that they have sufficient capital to be able to flexibly manage expenses of aging and retirement. It is critical to provide flexibility to vary income drawdowns and access capital to manage financial risks and liabilities arising in retirement created by the myriad of life events, including health and aged care expenses. This can be balanced by a range of measures (including taxation, longevity risk pooling, retirement products, etc.) which rewards using superannuation savings for retirement and aging, not estate planning.

In regards to defining adequacy, there are pitfalls in setting a definition by use of either a replacement rate of pre-retirement income or alternative methods such as setting a defined amount of income as a reasonable retirement income. Accordingly, we believe careful consideration needs to be afforded to developing an appropriate framework to define adequacy.

Replacement rates offer a simple solution to defining adequacy by linking adequate retirement incomes to a percentage of pre-retirement earnings. They embody income smoothing over a person's lifetime, which offers an appropriate approach to providing income in retirement. However, this approach can result in higher income earners being afforded overly generous support through the superannuation system to sustain a level of income not enjoyed by many taxpayers.

Also, replacement rates do not account for different working patterns that may occur throughout a person's career as they focus on income at the time of retirement. This inherently does not account for people with volatile incomes such as people with broken work patterns or small business owners. Historically, replacement rates have been set as a percentage of average male earnings, which has not adequately reflected the different working conditions faced by male and female workers throughout their careers. Additionally, replacement rates do not account for the need for capital to address costs of aging or longevity as they are a point in time measure. That is, they are not future looking and do not account for the different costs of aging that can be expected in retirement compared to during people's working lives.

An alternative to setting replacement rates of pre-retirement income is setting a defined level of income that is determined as "reasonable" or "comfortable" and should be supported by Government to be achieved through superannuation. This approach does not have the equity concerns that replacement rates have but is highly subjective as to how the level is constructed or set. This subjectivity can lead to uncertainty for savers if subsequent Governments are to change how the measure is constructed or set. Also, this approach is limited in accounting for future capital expenses that can arise during retirement.

Finally, another approach is to construct a replacement rate that can apply to an income level that applies to the whole population. For instance, a replacement rate of the average or median wage can be used to deliver a replacement rate that is applicable to the whole population and is more aspirational than merely replacing the age pension.

In conclusion, we are wary of defining adequacy through replacement rates or a measured level of income but believe that focusing on concepts of dignity, security and flexibility to manage financial risks should underpin the concept of adequate retirement savings.

Sustainability

We agree that superannuation should be fiscally sustainable over the long-term.

Sustainability must be viewed through a long-term lens that matches the long-term policy intent of superannuation. This should remove emphasis from short-term tax concession and Budget costs and focus more on the long-term savings that superannuation creates by decreasing the reliance on the age pension.

However, the current inadequate measurements of superannuation tax concessions and the lack of measurement of the long-term savings that superannuation brings to the budget (through reduced future Government expenditure) makes objectively evaluating this principle impossible. Accordingly, a guiding principle of sustainability must be accompanied by improved measurements of the costs and benefits of the superannuation system.

Evaluating sustainability also requires an integrated approach of viewing retirement income policy so that superannuation and social security outcomes are looked at together when evaluating sustainability. We strongly encourage current and future Governments and policymakers not to address retirement income issues from a siloed approach of dealing with taxation, age pension and social security means testing issues separately. We believe a holistic approach to retirement income is needed as each policy area affects each other and consequently has complex impacts on current and future retirees. This is especially relevant for middle income earners who may have an average or low superannuation balance and may need to rely on an entitlement to a part-pension in retirement.

Maintaining a pool of national savings

We believe that maintaining a healthy level of domestic savings should be an objective of superannuation. This objective should not be discarded on the basis that it has been achieved.

Continuing to maintain a large pool of domestic savings through superannuation will benefit Australia by providing an important capital buffer to international economic crises, reducing the cost of capital for domestic investment, enabling capital formation and providing ongoing funding for Australian investment (such as funding infrastructure and innovation).

While global capital markets and flows are more open than when compulsory superannuation was established, Australia is still dependent on importing capital to finance public and private investment as evidenced by Australia's continuing current account deficit. Accordingly, we believe it is important for the Australian economy to continue to maintain a healthy national savings pool to act as a buffer to international events that can affect global capital flows.

Three pillar approach to retirement income

We believe it is important that the objectives endorse and reiterate the original three pillar retirement system approach to retirement incomes of an age pension safety net, compulsory retirement savings and incentivised voluntary retirement savings. This approach has led to Australia's retirement income system being recognised as a world leader and should be safeguarded to ensure this continues.

In particular, the voluntary retirement savings pillar is critical in ensuring superannuation reaches not only a more comprehensive coverage of the workforce but also ensures that the level of coverage is adequate in cases where it would not otherwise be, notably amongst Australians who have been self-employed (approximately 16.7% of all employed Australians in 2014)[1], out of the workforce or having broken work patterns (e.g. due to parenting responsibilities which was the reason for 25.6% of women who were out of the labour force in 2014 not seeking work)[2], or subject to fluctuating levels of their income from year to year.

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[1] ABS 6105.0 Australian Labour Market Statistics
http://www.abs.gov.au/AUSSTATS/abs@.nsf/Lookup/6105.0Main+Features1July%202014?OpenDocument
[2] ABS 6220.0 - Persons Not in the Labour Force, Australia
http://www.abs.gov.au/AUSSTATS/abs@.nsf/productsbyCatalogue/352EF7B94ED636D3CA25741200192D8E?OpenDocument

Also, it is important that the age pension is viewed as targeted safety net, not a right that Australians are entitled to use in retirement. Superannuation savings should be promoted as the key source of retirement income with the age pension playing its role as a safety net to alleviate poverty in retirement.

Equity

The superannuation system should be equitable so that it is accepted by the public which will help maintain stability for superannuation policy.

The development and maintenance of an equitable system should include focus on four areas of equity:

1. **Horizontal equity** so that taxpayers in the same position are treated equally. This should cover type of superannuation fund that they are member of as well as income/superannuation balance.
2. **Vertical equity** so that there is fairness between fund members with lower balances and lower income and those with higher balances and higher incomes.
3. **Intergenerational equity** so that the burden of financing the current cohort of retirees retirement income is spread fairly between different generations of savers.
4. **Gender equity** so that the superannuation system is appropriately structured to support saving for retirement for both men and women, noting the disadvantages for women under the current superannuation system.

As with all other guiding principles, equity should be a guiding principle which is balanced with others such as the need to achieve adequate retirement savings and maintaining a simple superannuation system.

Simplicity

The superannuation system should be as simple as possible in order to ensure that superannuation fund members are able to understand the system and engage with it. Additionally, a less complex system will be more cost efficient for all superannuation fund members as administration costs should be kept as low as possible.

LOCATION OF THE OBJECTIVE

The SMSF Association recommends that enshrining the objective of superannuation should occur in standalone legislation. The objectives of superannuation will influence a number of policy areas including superannuation, taxation, social security, health and aging. Accordingly, the objective should be legislated in a standalone Act rather than in existing superannuation or taxation legislation. Also, we believe that the explanatory memorandum to the legislation will be critically important for future policy makers and stakeholders to understand the intent of setting the objectives.

APPLYING THE OBJECTIVE AND GUIDING PRINCIPLES

In order for the primary and objective and guiding principles to effectively guide retirement income policy, there needs to be a direct link between new policy and the enshrined objective and principles. We believe that any new legislation that affects retirement income policy (e.g. superannuation, taxation, age pension, etc.) should be reviewed against the objective and principles similar to *Regulatory Impact Statements* or *Statement of Compatibility with Human Rights* that are carried out in conjunction with introducing new legislation currently. This review process should also be included in consultation on new legislation.

REMOVING SUPERANNUATION POLICY FROM THE ANNUAL BUDGET CYCLE

To promote policy stability the SMSF Association recommends that significant changes to the superannuation system (e.g. changes to contribution caps, changes on taxation of benefits or earnings) be removed from the budget decision making process and instead only be undertaken as a result of a review of superannuation settings linked to the IGR.

The IGR is required under the *Charter of Budget Honesty Act 1998* to be completed every five years and released by the Treasurer at the time. As the IGR assesses the long term sustainability of current Government policies over the 40 years following the release of the report, with a focus on demographic change, it is a sensible vehicle on which to base superannuation policy changes.

Having the IGR released once every five years will allow the Government, industry and consumers to take a "health check" on the superannuation system to see whether it is achieving its goals and whether any adjustments/changes to policy settings are required. The process should allow Government and key stakeholders to evaluate whether structural changes are needed to ensure the fulfilment of the goals of the superannuation system. In-built with this process should be orderly and timely consultation with appropriate superannuation system stakeholders.

This would allow the superannuation industry and consumers to have confidence that changes to superannuation will only be made with a long-term focus rather than in an arbitrary manner or with short-term Federal Budget goals as a key motivation.