

31 March 2023

Director
Superannuation Insurance and Governance Unit
Member Outcomes and Governance Branch
Retirement, Advice and Investment Division
The Treasury
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By email: superannuationobjective@treasury.gov.au

Dear Sir/Madam,

Thank you for the opportunity to submit Challenger's view on the Government's proposal for the objective of superannuation (the Objective), specifically by addressing the questions in the consultation paper and highlighting additional matters that will impact the effectiveness of the Objective.

Challenger is an investment management firm focused on providing customers with financial security for a better retirement. Challenger operates a fiduciary Funds Management division, an APRA-regulated Life division and an APRA-regulated authorised deposit-taking institution. Challenger Life Company Limited (Challenger Life) is Australia's largest provider of annuities.

Challenger for many years has been an advocate of retirement income reforms that will significantly enhance the lives of older Australians. Legislating the Objective is an appropriate step in clearly establishing superannuation's role in helping Australians enjoy a retirement they work towards over their entire working lives. The emphasis on retirement income within the Objective can help provide the financial security for retirement to support the lifestyle everyone deserves.

The following pages address the specific questions raised in the consultation paper.

Question 1

What do you see as the practical benefits or risks associated with legislating an objective of Australia's superannuation system?

Challenger fully supports legislating an objective of Australia's superannuation system and in particular, its focus on the delivery of retirement income. A clear objective of superannuation is critical to provide focus for policy makers, participants in the superannuation industry, individual members of superannuation funds and retirees.

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The following benefits should be noted.

1. The Objective sets out the singular purpose of superannuation as providing retirement income. It gives guidance to policy makers to prioritise the provision of retirement income and highlights participants in the superannuation system cannot expect it to support intergenerational wealth transfer.
2. The focus on retirement income should help super funds and members move away from the view of account balances as the key measure of success. Account balances are only an interim step to producing retirement income and must be matched with strategies for delivering cash flow to members over the course of their retirement.
3. Ultimately, the Objective should contribute to the financial wellbeing and sustainability of retirement incomes for the growing number of retirees in Australia, creating significant economic and social policy benefits impacting the health, social security and aged care systems.

Challenger does not believe legislating an objective of superannuation creates any material risks if it is clearly focussed on the delivery of retirement income. Of greater concern are the risks to achieving the Objective if other critical components of the retirement income system are out of sync or ineffective such as the Retirement Income Covenant (RIC) and delivery of financial advice and guidance.

If the Objective is to deliver income for retirement, then we must avoid the risk of the RIC and the advice system compromising the outcomes of the Objective (i.e. to maximise retirement income).

Periodic reviews should be conducted by the Australian Prudential Regulation Authority (APRA) to understand the effectiveness of the RIC and other critical parts of the superannuation system in contributing to the Objective.

RIC needs to support the Objective

The RIC requires superannuation fund trustees to prepare a retirement income strategy that will maximise the expected retirement income of beneficiaries. It does this by specifying the need for such strategies to be designed to help retirees to manage inflation risk, longevity risk and market risk.

Inflation risk is particularly concerning when you consider inflation has eroded the value of retirees' nominal incomes and asset returns, with cumulative inflation over the last two years being approximately 12% compared to an expected 2.5% for this period.

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This is a huge difference, with approximately 10% of purchasing power eroded over this time. At a high level, the RIC is strongly aligned to the Objective, given both emphasise the need for retirement income. However, it should be noted that the requirement for super funds to publish retirement income strategies needs to translate into meaningful retirement income outcomes for retirees otherwise it will undermine the Objective.

By legislating the Objective, APRA will have a base to review the way super funds are meeting the RIC and whether its implementation by funds is aligned with the legislated Objective. APRA should develop a Prudential Standard to direct the industry as to the form and substance of the Retirement Income Strategy. For example, APRA might set prudential requirements so that the strategy:

- details how the strategy supports the legislated Objective;
- details how the trustee has constructed one or more cohorts in retirement;
- explains how the trustee has balanced the key objectives, while also managing the key risks in retirement such as inflation, longevity and market risks;
- is transparent about what risks in retirement cannot be managed with a Fund's products and plans to mitigate this with options outside of the Fund;
- reflects the results of balancing the objectives in determining the trustee's retirement product offering;
- specifies an appropriate selection process for, and due diligence of, third party product providers (if they are to be used) and explains how the trustee will monitor the relationship with those providers on an ongoing basis;
- sets out investment and drawdown strategies for each product offering; and
- provides a mechanism for monitoring, reviewing, and revising the strategy over time.

Reforms to financial advice will strengthen the outcomes of the Objective

There is little point trying to build a better retirement income system by defining an Objective and setting a Covenant if people have little idea how to navigate the complexities of the superannuation system. Unfortunately, the financial advice system is currently unaffordable for many Australians and overly bureaucratic. Moreover, low financial literacy and a misunderstanding of the intent of superannuation have meant people are not adequately planning for their retirement and are limiting the value they can generate from their assets when in retirement.

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The Retirement Income Review found retirees were reluctant to draw down their savings in retirement mostly due to complexity, and a reluctance to consume funds driven by concerns about outliving savings¹. Adding to complexity is the interaction with other systems, such as aged care and tax.

People need better information, guidance and good, affordable advice tailored to their needs, otherwise the effectiveness of the Objective will be greatly diminished. Michelle Levy's proposal to allow super funds to provide personal advice to their customers without all the obligations that currently apply is central to simplifying the system and making advice more affordable and accessible to everyone.

The proposed advice reforms are positive, but they need to ensure proposals such as the "good advice" test are tied to the Objective and deliver retirement income outcomes that are maximised through the strategies developed by funds when implementing the Covenant requirements. It should be stipulated through any future changes to the advice laws that financial advice provided by advisors, trustees or issuers is aligned to the Objective and the RIC. Advisers should be required to disclose what retirement risks (e.g. inflation, market, longevity) cannot be managed within a particular fund (where relevant) and provide options outside of those funds to manage such risks.

Financial advice should play a pivotal role in contributing to, and strengthening, the Objective as well as other parts of the retirement income system such as the Covenant.

Question 2

Does the proposed objective meet your understanding of the objective of the superannuation system in Australia?

The core objective of superannuation is to provide people with a source of income in retirement. There will be some debate over whether that income needs to be significant or the lifestyle it supports dignified; but that should not distract from the fact superannuation's role is to provide income in retirement.

Concepts such as "equitable" and "sustainable" talk to how the superannuation system works rather than why it exists and should not be defined as an outcome. The Objective should align to the lifecycle hypothesis² in that people aim for the same lifestyle in retirement as they have while working.

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Superannuation is there to give people the confidence they will have income available to them in retirement in a way that will sustain their lifestyle for as long as possible, ideally as long as they live.

A key element of success for superannuation is to generate investment returns high enough to ensure it can meet this objective. There are broader macro-economic benefits from having the pool of superannuation savings, but that should not be the objective. If it does deliver a large pool of savings as a consequence, that is positive but the Objective should be focused on retirement income as proposed.

Question 3

Is the proposed approach to enshrining the objective in legislation appropriate? Are there alternative ways the objective should be enshrined?

Challenger believes that it is appropriate to enshrine the Objective in legislation, and it should be forward-looking. There are different benefits with locating the legislation in the existing Superannuation Industry (Supervision) Act 1993 legislation or a new stand-alone Act. Either can work as long as the Objective is enshrined. Further, it would be prudent that trustees be required to cross reference the Objective with the Members Outcome Assessment and Retirement Income Strategy.

Question 4

What are the practical costs and benefits of any alternative accountability mechanisms to the one proposed?

The basis of superannuation is the requirement for Australians to put aside some of their earnings while working to have money to support their lifestyle in retirement. While there are good reasons for the compulsory nature of superannuation, there is also a tax incentive for people who would otherwise choose to spend their money now. Ultimately, superannuation is accountable to all Australians and the parliamentary process proposed should meet the requirements. What is needed is stability in the rules so that people can utilise superannuation appropriately in order to have their own income in retirement.

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Conclusion

The importance of focussing the Objective on retirement income cannot be overstated, considering Australians are living longer today and it is much harder to absorb macro-economic changes like inflation when employment is no longer the primary source of income.

Our own research at Challenger shows just how much longer retirees have to make their money last; retirees today will spend, on average, around 24 years in retirement compared to 13 years in the 1970s, when Australia's last major inflation crisis occurred, because we are living longer.

The proposed Objective is a welcome step towards ensuring the superannuation system works as well for retirees as it does for working Australians so long as other critical components of the superannuation system – namely the RIC and the financial advice regime – are properly enabled to support the delivery of income over the retirement phase.

We commend the Government on putting forward such a critical reform. If you have any further questions regarding our submission, please do not hesitate to contact me at skingham@challenger.com.au.

Yours sincerely



Stuart Kingham
Chief Commercial Officer
Challenger Limited

¹Retirement Income Review- Final Report July 2020, Box 5A-1 p415

²Based on Franco Modigliani. "Life cycle, individual thrift, and the wealth of nations." American Economic Review, 1986, Vol. 76, Issue 3, Pages 297-313.

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