Legislating the objective of superannuation

Consultation Paper – FSC Submission

March 2023

Contents

1. About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers and financial advice licensees. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing more than $3 trillion on behalf of over 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is one of the largest pools of managed funds in the world.

The FSC's mission is to assist our members achieve the following outcomes for Australians:

- to increase their financial security and wellbeing;
- to protect their livelihoods;
- to provide them with a comfortable retirement;
- to champion integrity, ethics and social responsibility in financial services; and
- to advocate for financial literacy and inclusion.

We do this by continuously engaging in advocacy concerning the development of the social, economic and regulatory framework in which our members operate, thereby helping them to better serve their clients and customers.

2. FSC Recommendations

1. Ensure the objective of superannuation is done in a way that reflects a long-term focus and does not dilute existing superannuation trustee obligations.

2. Maintain concise wording for the objective in legislation.

3. Incorporate the concept of individual ownership of superannuation into the wording for the objective of superannuation.

4. Remove explicit reference to 'equitable' and 'sustainable' in the wording for the objective of superannuation.

5. Use the explanatory memorandum to the bill to provide context to assist stakeholders in interpreting key concepts in the objective's wording with particular emphasis to:

    a. Providing an objective way of examining what constitutes a 'Dignified Retirement' such as the replacement rate measure and including reference to community expectations; and

    b. Should 'sustainable' be retained, making clear that 'sustainable' is interpreted from a fiscal perspective.

6. Enshrine the objective of superannuation through standalone legislation rather than through existing superannuation legislation.

3. General comments

3.1. Who this initiative is for

Consultation question

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

The objective of superannuation represents a commitment from the Government to underpin policy decision for the superannuation system with an agreed objective. Having a well understood and agreed objective provides substantial benefits for guiding policy for the superannuation system. However, to assist the Government's initiative, we outline below the key risks that should be mitigated in attempting to legislate an objective of Australia's superannuation system.

<u>1. The objective should be drafted with a long-term focus and not get clouded in the short-term policy debate</u>

Reflecting the nature of superannuation, the objective of superannuation should have a long-term focus and refrain from reactive policy driven by short-term interests and influences. A long-term focus would help ensure that the objective endures over time, thereby helping achieve its purpose of promoting more stability in superannuation policy settings.

The FSC therefore supports separating this consultation from the distorting effect of the current tax debate and indication from Government that it intends to build broad political consensus including the goal of obtaining parliamentary support.

<u>2. Legislating the objective should not have the effect of diluting existing superannuation trustee obligations</u>

The implementation of a legislated objective for superannuation should clearly be limited to guiding public policy decision making, and in no way impact industry practice and obligations with respect to the best financial interest duty and the sole purpose test. These should only be guided by relevant superannuation laws.

The Consultation Paper notes that the legislated objective would complement the long-standing legal and regulatory obligations of trustees of superannuation funds to have in place investment strategies that deliver the best outcomes for their members. This formulation is confused, as the objective is for policy makers and to inform all stakeholders on policy settings, not to impose additional obligations or distort existing obligations for superannuation trustees set in law.

As we set out in our response to Consultation Question 3, we consider there is a high risk that the objective will be used to interpret other relevant statutory obligations, such as the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS Act**) and might have the unintended effect of diluting existing superannuation trustee obligations. To avoid this, we recommend that the objective be enshrined in new standalone legislation with a clear statement that the objective does not override or interact with existing laws governing superannuation, including trustee obligations. Further, the stand-alone legislation should make clear the objective is to guide policy making and for evaluating superannuation policy settings.

Recommendation

1. Ensure the objective of superannuation is done in a way that reflects a long-term focus and does not dilute existing superannuation trustee obligations.

4. Detailed comments

4.1. Proposed Wording

Consultation question

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

<u>A clear and concise objective</u>

The objective proposed by Government is as follows:

> "*The objective of superannuation is to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way*."

Taken as a whole, we are supportive of the proposal to enact a clear and concise statement of the objective of superannuation as currently drafted. The FSC is of the view that a clear statement should not require the support of subsidiary objectives as a short statement of the system's objective can be more easily understood whilst still meaningfully informing debate between the public, policy makers and stakeholders.

Recommendation

2. Maintain concise wording for the objective in legislation.

<u>Recommended changes to the proposed wording</u>

To inform the conversation around the potential wording for the objective, the FSC commissioned consumer research which found strong support for legislating an objective for superannuation, providing it focuses on delivering retirement income for all Australians.[1]

In particular, key findings from participants included:

- legislating an objective for superannuation would serve Australians better;
- while the objective should focus on delivering income in retirement, they also wanted to have a say in where and how their money is invested; and
- when a list of possible wording for the objective was provided to participants, all preferred wording specific to achieving a certain standard of living in retirement

As outlined in the consultation paper, one of the benefits of legislating an objective of superannuation is to provide a shared understanding among members and funds of the role

[1] Financial Services Council, Media Release, *Australians want superannuation to be about their retirement* (2023).

and purpose of superannuation throughout both the accumulation and retirement phases.[2] For a system that manages the retirement savings of around 16 million Australians, it is critical that the final wording is commonly understood and reflects the general expectations of individual Australians.

The notion of individual ownership of superannuation is not recognised in the wording as currently proposed. Explicitly including this concept in the final drafting is more reflective of community expectations and would better orientate the objective towards the outcome the system is designed to achieve – providing individuals with capacity to save for their own retirement.

Recognising that it is individuals self-provisioning for their retirement is also consistent with the foundation of compulsory superannuation as articulated by then-Treasurer The Honorable John Dawkins in the second reading speech of the enacting legislation[3]:

> *"[The superannuation guarantee levy] will ensure that, by the beginning of the next century, virtually all employees will be accumulating substantial superannuation savings to help fund their retirement income."*

Additionally, we note that the proposed wording for the objective recognises that superannuation should be equitable and sustainable. The consultation paper seeks to further elaborate that this is in the context of fiscal settings. The principles of equity and sustainability are not unique to the superannuation system and should instead be enshrined in the Government's broader fiscal strategy for all programs.

In our view, including the concepts of 'equitable and sustainable' detracts from this primary objective and goes to broader Government goals, not the objective of the system itself. It would signal to consumers that the Government will continue to focus on superannuation taxation settings as an avenue to raise revenue. The FSC therefore recommends removing the terms 'equitable and sustainable' to reduce the risk of policy changes that detract from the primary objective and undermine public confidence in the superannuation system.

To address these points, an alternative wording could be achieved via minimal adjustments as follows:

> "*The objective of superannuation is to preserve* ***individual*** *savings to deliver income for a dignified retirement, alongside government support*~~***, in an equitable and sustainable way***~~."

Removing the words at the end would be consistent with the approach advocated earlier to ensure the objective is concise.

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[2] Treasury Consultation Paper, *Legislating the objective of Superannuation* (2023), Page 4.
[3] Superannuation Guarantee (Administration) Bill 1992.

Recommendations

3. Incorporate the concept of individual ownership of superannuation into the wording for the objective of superannuation.
4. Remove explicit reference to ‘equitable’ and ‘sustainable’ in the wording for the objective of superannuation.

Providing additional context to a concisely worded objective

There may be scope for elements of the proposed objective to contradict each other. If there is no explicit priority given to the elements, it may be open to the Government of the day to determine the priority (which risks diluting the overall effectiveness of the objective).

To increase the durability of the legislated objective over time, we support context being provided to assist interpretation of the statement in the explanatory memorandum to the enacting legislation.

We outline below the concepts that should feature in the Explanatory Memorandum (**EM**) to assist future governments and stakeholders with interpreting the objective.

‘Preserve Savings’

We are supportive of the concept to ‘preserve savings’ to capture the principle of preservation, and support clarity in the EM that appropriately recognises the existing rules around early access to superannuation.

FSC is of the view that the existing early release rules are broadly appropriate and reflect the following notions underpinning preservation:

- Superannuation benefits is generally preserved to provide income in retirement. Early access to superannuation for other purposes is inconsistent with the preservation principle.
- There will be circumstances where the benefits of early access to superannuation for an individual will exceed the benefits of preserving balances until retirement, such as in cases of genuine financial hardship or under certain medical conditions where the individual is suffering a life-threatening condition or the treatment is required to alleviate acute/chronic pain.
- Early releases of superannuation benefits are generally used as a last resort where other sources of financial support have been exhausted.

One concept that the Treasury could consider useful in providing clarity in the EM is that the principle of preservation primarily applies to compulsory superannuation, that is payments required under the Superannuation Guarantee.

Providing this additional clarity in the explanatory memorandum would distinguish between superannuation for housing type policies. Proposals that dip into compulsory superannuation weaken the sole purpose of superannuation. In contrast, the existing First Home Super

Saver Scheme (**FHSSS**) allows people to make voluntary contributions into their superannuation fund that can be subsequently withdrawn to help fund the purchase of their first home. While the FHSSS is outside the strict purpose of delivering income in retirement, it is separate to the compulsory superannuation system.

<u>'Deliver income'</u>

We are supportive of the concept to 'deliver income' to highlight the system's shift to a drawdown focus as superannuation members transition to and move through their retirement phase.

We would suggest that the EM include wording to reflect existing features of the system:

- 'Delivering income' can also be achieved through people drawing down on their superannuation via a lump sum rather than purely as an income stream;
- Death benefits to beneficiaries, whether from an insurance payout or from excess superannuation savings left over on death, are an important feature of the current system and are consistent with the sole purpose test of a superannuation fund.
- Insurance benefits that are provided through superannuation, which help to address the well-documented issue of underinsurance.[4]

However, with respect to insurance benefits there is a need to review whether they are delivering benefits to consumers. We note a future review of group insurance settings in superannuation, as recommended by the Productivity Commission[5], will now benefit from the guidance of an objective of superannuation.

<u>'Dignified retirement'</u>

We are supportive of the concept of reaching a 'dignified retirement'.

In our view, 'dignified' has both an intrinsic and extrinsic element, which recognises that individuals have differing needs and circumstances and means the system needs to be customisable and retain flexibility. There is no "one size fits all" retirement goal.

While the consultation paper does recognise the qualitative measure of "dignified" in that it will require interpretation and may change over time to reflect society's standards, we recommend including in the EM an objective measure of what dignified is.

In our view, the most appropriate metric would be the **replacement rate**, which is retirement income expressed as a proportion of working age income.

The recent Retirement Income Review (**RIR**) focused on the replacement rate, making the following statements:

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[4] See, for example, NMG Consulting, *Australia's Life Underinsurance Gap: Research Report* (2022).
[5] See recommendation 18 of the Productivity's Commission's 2018 Inquiry Report into the efficiency and competitiveness of superannuation.

“Replacement rates are a preferred metric because they provide adequacy targets based on the income a person earned while they were working (Chart 2C-2). Since replacement rates are a proportion of working-life income, changes in working-life income and retirement income both affect the measure. They can account for the trade-off required between working-life and retirement income. For this reason, replacement rates align with the view that the appropriate objective for adequacy in the retirement income system is maintaining living standards in retirement.”[6]

“Replacement rates are the preferred tool for assessing the objective of maintaining living standards in retirement.”[7]

A replacement rate of 70 per cent has also been adopted by the OECD, and has been adopted or accepted by various commentators and analysts including those that have questioned increases to the Superannuation Guarantee rate.[8] Replacement rates have also been used to determine retirement income adequacy by the Henry Tax Review and previous recommendations of the Senate Select Committee inquiry into superannuation and living standards in retirement.

Further we note comments made by the Productivity Commission in their 2018 inquiry report into the efficiency and competitiveness of superannuation which did not support the use of alternative measure in relation to a retirement target as it does not link to actual income. In relation to the ASFA standard of comfortable retirement, it noted that “*[the ASFA standard] is no more than an arbitrary benchmark that should be ignored in policymaking*”.[9]

It would also be useful to include reference to **community expectations** that a dignified retirement is one where superannuation income supplements or replaces the age pension safety net. While the age pension will remain an important safety net for retirees and likely continue to form part of the retirement income of a majority of Australians for the medium term, the superannuation system should be aspiring to ensure as many people as possible achieve an adequate and self-funded retirement.

The objective of self-provision is outlined further in the second reading speech of the legislation enacting compulsory superannuation:

“The increased self-provision for retirement will permit a higher standard of living in retirement than if we continued to rely on the age pension alone.”

Self-reliance in retirement has continued to be explored in some detail in recent Government reports including the Intergenerational Report. Projections from the most recent

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6 The Australian Government the Treasury, *Retirement Income Review Final Report* (2020), Pages 161–162.
7 Ibid, Page 163.
8 See for example Daley, Coates, Wiltshire, Emslie, Nolan & Chen, *Money in retirement: More than enough* (2018).
9 The Productivity Commission, *Inquiry Report into the efficiency and competitiveness of superannuation* (2018), page 228.

intergenerational report show that Australia is moving in the right direction against this objective, which found that in the 40-year period to 2060-61 that the proportion of retirees which are self-funded (not reliant on the Age Pension) will increase from 26 per cent to 40 per cent and the proportion that are partially reliant on the Age Pension will increase from 26 per cent to 35 per cent.[10]

<u>'Alongside government support'</u>

We are supportive of the concept of 'alongside government support', which recognises that superannuation is part of our retirement income system and the need for cohesion of our retirement system more broadly.

Compared to alternative wording formulations like specifically referencing the Age Pension, the proposed wording recognises the role that other sources of Government support such as in aged care, health care, Commonwealth Rent Assistance and the Home Equity Access Scheme need to play alongside superannuation in a cohesive manner to improve outcomes for Australians in retirement.

We note the RIR conducted substantial analysis on the 'cohesion' of the retirement system as a whole and the extent of integration between the system's three pillars. Alongside the high degree of complexity in the system, lack of financial literacy and issues with accessing financial advice by Australians, the RIR found that this complexity and the lack of cohesion in the retirement income system prevents people from optimising their retirement income, suggesting this may lead to lower standards of living in retirement. It would be useful for Treasury to expand further on the importance of cohesion in describing the concept of 'alongside government support' in the EM.

<u>'Equitable'</u>

As recommended above, we do not support including explicit reference to 'equitable' in the wording for the objective of superannuation. This should be covered in the EM.

We are broadly supportive for the concept of 'equitable' to adopt the interpretation as used in the Retirement Income Review, namely that:

- the system should deliver similar outcomes to people in similar situations; and
- the system should target support to those most in need.

We also believe that 'equitable' should recognise the element of ensuring intergenerational equity. Incorporating a broader view around long-term equity of the system acknowledges that superannuation is conditional on the system maintaining broad public confidence and support. Maintaining broad public confidence and support implies the system needs to treat, and be perceived to treat, individual people and different generational cohorts equitably over time.

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[10] The Australian Government the Treasury, *2021 Intergenerational Report* (2021), Chart 7.41.

'Sustainable'

As recommended above, we do not support including explicit reference to 'sustainable' in the wording for the objective of superannuation. However, should this concept be retained in the wording, we strongly recommend further detail be included to assist policymakers and stakeholders understand this is a narrow definition of sustainability focused on fiscal considerations.

'Sustainable' is a word with a variety of meanings depending on the perspective of different groups and will require robust and specific commentary in explanatory material to clearly set its parameters.

We would support additional wording in the EM that clear defines that sustainability is meant from a fiscal perspective. This should recognise that superannuation tax settings are provided as an incentive and compensation for people to save for their retirement.

It should also be made clear that sustainability should not be interpreted with reference to 'sustainable' investments that adhere to environmental, social and governance (**ESG**) norms and expectations. Not doing so would risk conflating system sustainability with sustainability in investment and business practices.

Also, we note that the Consultation Paper states:

> "Beyond a certain level of income, additional Government support through tax concessions is not necessary or appropriate".[11]

To maintain ongoing public confidence in the system, the FSC is strongly of the view that the objective of the superannuation should not, in any manner, limit or discourage retirement savings that are in excess of what is necessary to end age pension reliance. The superannuation system is not solely limited to replacing the cost of the age pension to the Commonwealth as it assists retirees with managing other costs that arise in retirement, such as aged care and health costs in later life.

It would be helpful to clarify whether Government support should recognise that some level of tax concessions is warranted to reflect the view that savings should be taxed at a lower rate (as advocated in the Henry Tax Review).

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[11] Australian Government the Treasury, *Legislating the objective of Superannuation* (2023), Page 11.

Recommendation

5. Use the explanatory memorandum to the bill to provide context to assist stakeholders in interpreting key concepts in the objective's wording with particular emphasis to:
   a. Providing an objective way of examining what constitutes a 'Dignified Retirement' such as the replacement rate measure and including reference to community expectations; and
   b. Should 'sustainable' be retained, making clear that 'sustainable' is interpreted from a fiscal perspective.

4.2. Practical application

Consultation question

3. Is the proposed approach to enshrining the objective in legislation appropriate? Are there any alternative ways the objective could be enshrined?

Care will be required to ensure that the proposed objective as legislated will not inadvertently interfere or add layers of complexity and costs to regulators and superannuation trustees' existing obligations as these costs will ultimately be borne by superannuation members.

It is critical that this initiative does not impact upon the currently legislated best financial interest duty or sole purpose test provided for in the SIS Act. Both obligations are already enshrined in law and their meanings are established and well understood by superannuation trustees.

Notwithstanding commentary in the consultation paper that the intent is not to guide the regulation of trustees' conduct and it would not change trustee obligations, we are concerned based on legal advice provided to the FSC and attached to this submission that legislating the objective, even as a preamble, within existing legislation would carry this risk.

We recognise that others may hold a different view on this question, but believe this only highlights the legal uncertainty and risk from adopting an approach that would embed the objective within existing legislation. To avoid this uncertainty and the attendant court costs that might end up being required to settle this question, we strongly recommend that the objective of superannuation should be enshrined in stand-alone legislation – the 'Objective of Superannuation Act' with a clear statement that this does not affect other legislation.

Enshrining the objective through standalone legislation would also carry the practical benefit of providing a single reference point for relevant future changes to superannuation, tax or social security policy.[12] We note that the SIS Act does not cover all of the superannuation system as there exists constitutionally protected funds which are governed by separate laws.

Recommendation

6. Enshrine the objective of superannuation through standalone legislation rather than through existing superannuation legislation.

4.3. Accountability

Consultation question

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

We note the proposal that legislating an objective of superannuation would not look to alter existing policy development and parliamentary scrutiny processes.

We briefly consider one additional accountability mechanism that could be included: introducing a requirement for a statement of compatibility for new policy against the objective of superannuation.

Statement of compatibility

Stand-alone legislation could place an obligation on the relevant Minister to make a 'statement of compatibility' with the objective of the system when legislation is introduced that impacts on the superannuation system. The Act would not prescribe what information is necessary for a statement of compatibility, but leave this for the Minister to determine. This places the onus on external stakeholders to assess the robustness of a statement of compatibility and publicly hold the Government to account for unpersuasive statements.

The *Human Rights (Parliamentary Scrutiny) Act 2011 (Cth)* (**HR Act**) provides precedent for this approach. The HR Act requires MPs and Senators to make statements of compatibility regarding legislation introduced to parliament that may impact on human rights. A statement of compatibility is not enforceable through the judicial system, but demonstrates that human rights issues have been considered. The HR Act also establishes a parliamentary committee with authority to scrutinise bills for human rights implications.

While there may be some doubt as to the outcomes these additional accountability measures might achieve, our view on balance is that introducing an additional accountability mechanism would enhance accountability and transparency in the development of superannuation policy.

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[12] For example, 'Superannuation law' also includes the *Superannuation Guarantee Administration Act 1992* (Cth), Part 7.9 of the *Corporations Act 2001* (Cth) and the *Income Tax Assessment Act 1997* (Cth).