



# Objective of superannuation

6 April 2016

AIST Submission

## AIST

**The Australian Institute of Superannuation Trustees** is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$650 billion not-for-profit superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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## 1 Executive summary

### In brief:

AIST supports this primary objective for the superannuation system:

*To provide retirement income for all Australians that, when combined with or in replacement of any public pension, ensures a reasonably comfortable living standard, in the spirit of fairness within and between generations.*

This primary objective should be supported by:

- Guiding principles addressing adequacy, sustainability, and fairness.
- A retirement incomes framework to ensure the system's transparency and accountability. No further changes to superannuation should be made until such a framework is in place.

AIST welcomes the opportunity to respond to the Government's *Objective of Superannuation Discussion Paper*.

The Australian compulsory superannuation system, established in 1992 and now worth over \$2 trillion, is internationally well recognised. Given that the system now has the fourth largest pool of retirement moneys in the world, and that therefore the maturity of the system is at a tipping point, the days of small tweaks to the system on Federal Budget night without a system framework being in place should be over. One of the well-known comments about the superannuation system is that constant tinkering erodes public confidence. This concern is regularly voiced in superannuation fund member surveys, and within the media.

The Government's response to the Financial System Inquiry (FSI) to enshrine the objective of the superannuation system is therefore welcomed. This is a great opportunity for the Government to bring greater certainty and transparency to policy development underpinning the retirement savings of Australians and the delivery of public pensions.

However, setting an objective (which by its very nature is broadly stated) is insufficient. This needs to be properly backed up and governed through an evidence-based framework. Otherwise, the piecemeal approach taken to the development of superannuation policy will remain a bugbear for Australians.

AIST has consistently advocated for the enshrinement of a superannuation system objective and a robust retirement incomes system framework before any further changes to superannuation are made. We mention a 'retirement incomes system' as it is important to recognise (and to help people understand) how the public pension and the superannuation system work together to produce an adequate retirement income. Our consistent advocacy may be witnessed through our submissions to the various recent inquiries, including the Financial Systems Inquiry, Taxation *Re:Think*, Retirement Incomes Review, Senate

Economics review of economic security in retirement for women, and Willing to Work: National Inquiry into Employment Discrimination Against Older Australians and Australians with Disability.

Indeed, the importance, number and range of these inquiries underpins the need for a robust and transparent retirement incomes system framework.

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## 2 Recommendations

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### 2.1 Retirement incomes framework is needed

#### *Reasons*

- Greater transparency and accountability regarding retirement income for all Australians.
- Would alleviate commentators 'leaping' to recommend policy changes without there being clarity about the impact on the costs and benefits of the system.
- Better enables bundling of policies so that a more cohesive, long-term approach is taken.
- Establishes an evidence-based framework within which to make decisions.
- Through developing quantifiable goals to underpin a broad system objective identifies those areas, which need policy attention. A good example is the need to track the impact of proposed policies on the gender gap. Setting of a gender gap tracker and quantifiable goal would help address the gap.

#### *What the framework could include - six key elements:*

1. Primary objective.
2. Guiding principles.
3. Quantifiable goals. (Whether the objective is being met e.g. what is 'adequate').
4. Track whether the quantifiable goals have been met.
5. Evidence-based decision-making: A method to road test proposed policies to gauge how they might impact the system.
6. A governance mechanism to:
  - a. Review and assess the quantifiable goals.
  - b. Assess whether the goals being met.
  - c. Road-test policies.

### 2.2 Basic tenets

The following underpin our following suggested primary objective and guiding principles:

- Adequacy of retirement income is needed for all Australians.
- Adequacy, sustainability and fairness are critical.
- The three pillars of Australia's retirement income system need recognition.
- Private savings need to be taken into account through, e.g. means-testing.
- A gender lens needs to be applied to retirement income and employment policies to help address the superannuation gender gap.
- Proposed policies should be road-tested within a retirement incomes framework:
- Guiding principles should not detract from the primary objective.

We now turn to the 6 key elements of the retirement incomes framework.

## 2.3 Key elements

### 2.3.1 First key element: Primary objective

We recommend the following primary objective:

*To provide retirement income for all Australians that, when combined with or in replacement of any public pension, ensures a reasonably comfortable living standard, in the spirit of fairness within and between generations.*

#### 2.3.1.1 Comments on the FSI recommended primary objective

AIST agrees with the FSI recommended primary objective in so far as it goes, but believes the primary objective should also reflect:

- The concept of ‘adequacy’
  - ‘Adequacy’ is reflected in our reference to a ‘reasonably comfortable living standard’.
  - A key focus needs to be on a *reasonably comfortable retirement income* rather than a *replacement income*.
  - *Comfortable* because it is a step above the age pension.
  - *Retirement income* rather than *replacement income* as the focus as it is an objective measure of what one needs in retirement, rather than what one had prior to retirement. This aids fairness and also underpins that superannuation is not for wealth transfers.
  - Transition To Retirement involves a move to retirement income as a step towards full retirement, and so should be considered within the definition of retirement income.
- The concept of ‘sustainability’ – this is reflected in our reference to ‘spirit of fairness within and between generations’.
- The concept of ‘fairness’.

If the primary objective does not include a reference to ‘adequacy’, ‘fairness’, or ‘sustainability’, then the long-standing debates such as ‘is the system fair’, or ‘is the system delivering’ will continue.

#### 2.3.1.2 Where the primary objective should be housed

There are many pieces of legislation dealing with the ‘superannuation system’. This would make it difficult to enshrine the objective within existing legislation. Separate legislation would place prominence on the objective of the system and ensure there is an obligation on the Government of the day to make a Statement of Compatibility, similar to the process used with the *Charter of Human Rights and Responsibilities Act 2006*. Such a Statement of Compatibility should include an assessment of how any proposed policies may impact quantifiable goals that have been set. AIST strongly believes such a Statement of Compatibility is needed in order to publicly demonstrate that there is a consistent framework being applied to the superannuation system. Use of a Regulatory Impact Statement which is not developed

within a broader publicly transparent retirement incomes framework, will not adequately deliver a consistent and objective approach.

## 2.3.2 Second key element: Guiding principles

AIST supports the development of ‘guiding principles’ to underpin the primary objective of the retirement incomes system. While reference has sometimes been made to ‘secondary objectives’, AIST believes that this terminology would reduce the clarity and purpose of having a primary objective.

### 2.3.2.1 We recommend the following guiding principles

	Guiding principle	Why the principle is important
1	Adequacy	Adequacy should take into account superannuation, public pensions, and other sources of income through, e.g. means-testing.
2	Fairness	Delivery of fairer outcomes within the retirement incomes system through proper targeting of public pensions and superannuation concessions.
3	Sustainability	Ensuring adequacy and sustainability are suitably balanced taking into account current and future generations.
4	Intergenerational fairness	Ensuring the retirement incomes system takes generations (between and within) into account.
5	Superannuation is a savings, not a wealth creation vehicle	Ensuring the retirement incomes system does not unreasonably create intergenerational wealth transfer.
6	Gender lens is needed	Application of a gender lens to the retirement incomes system with a view to closing the gender gap.
7	Employment lens is needed	Application of a retirement incomes lens to employment policy development.
8	Structural change needs assessing	Demographic ageing and structural changes are to be taken into account.
9	Sole purpose test is key	Implementation of the primary objective of the retirement incomes system should be designed so as not to interfere with the operation of the sole purpose test, including the provision of insurance as part of superannuation benefits.

	Guiding principle	Why the principle is important
10	Transparency and accountability	Policy development should not be ad hoc, but should be developed within a transparent and accountable retirement incomes framework. The community needs to know how proposed policies will affect the adequacy, sustainability and fairness of the retirement incomes system prior to policies being tabled within Parliament. Statements of Compatibility should be used and include an assessment of how any proposed policies may impact quantifiable goals which have been set.
11	Superannuation has a role in national savings	Recognition of role of the superannuation system in national saving and funding economic activity, especially infrastructure.

Issues such as adequacy, sustainability and fairness need definition so that a benchmark may be set and proposed policies road-tested against these benchmarks. The AIST-Mercer Super Tracker<sup>1</sup> is an example of a robust methodology. Comments on the FSI recommended subsidiary objectives

AIST agrees with the following FSI recommended subsidiary objectives:

- Facilitation of consumption smoothing, provided that flexibility is still available (as FSI mentions).
- Be invested in the best interests of superannuation fund members (this is already a legislated and common law requirement).
- Alleviate fiscal pressures – although AIST strongly believes the need for sustainability should be stated in terms of requiring balancing against the need for adequacy of retirement income.
- Be simple, efficient and provide safeguards – although AIST notes that ‘simplicity’ is a difficult goal given the interactions of the three pillars. Accordingly, ‘transparency and accountability’ would be more meaningful subsidiary objectives.

AIST has concerns with the following FSI recommended subsidiary objectives:

1. Helping the management of financial risks which includes a reference to pooling of products. AIST believes that subsidiary objectives should not make reference to particular product types because funds need to be able to meet the members’ best interests test through addressing member demographic needs.
2. Be fully funded from savings. While AIST strongly agrees that funding as opposed to unfunded schemes are highly desirable, AIST queries whether the suggested wording places an emphasis on one pillar of retirement income – people’s savings.

<sup>1</sup> AIST and Mercer, (2016). *AIST-Mercer Super Tracker: How the Super System stacks up on fairness, adequacy and sustainability March 2016*. [online] AIST and Mercer. Available at: <http://tinyurl.com/h6lyg2e> [Accessed 30 Mar. 2016].



Strengthening of the FSI recommended subsidiary objectives could be achieved through:

- Examining what is meant by ‘adequacy’ and ‘fairness’.
- Acknowledging that adequacy and sustainability need to be balanced against each other.
- The application of a gender lens.
- Recognising that employment policies also have a big impact on retirement incomes.

### **2.3.3 Third and fourth key elements: Quantifiable goals; and tracking whether the quantifiable goals have been met**

Setting an objective (which by its very nature is broadly stated) needs to be properly backed up and governed through an evidence-based framework. Otherwise, the piecemeal approach taken to the development of superannuation policy will remain a bugbear for Australians.

AIST notes the comments made by the Financial System Inquiry<sup>2</sup> that ‘increased transparency around the objectives of policy proposals would help frame parliamentary and public debate’, and that this could occur through regulatory impact statements. AIST strongly recommends that this is insufficient, and that the evidence-based framework as outlined in this submission is needed. Key issues which have arisen through Government, media, and superannuation system commentators include whether the system is ‘fair’, whether the system is ‘sustainable’, and whether the system is delivering ‘adequate’ benefits. These are key questions which need to be answered through an evidence-based framework.

In 2015, AIST and Mercer developed a methodology for tracking the costs and benefits of the Australian superannuation system. The result – AIST-Mercer Super Tracker – was launched at the 2015 Conference of Major Superannuation Funds (CMSF). The AIST-Mercer Super Tracker (the ‘Tracker’) provides ten robust suggested KPIs for the Australian superannuation system. The Tracker includes ten Key Performance Indicators, which (while not ‘goals’ of the superannuation system) we have settled on as being reasonable in the circumstances.

The Tracker highlights which areas in the superannuation system may require more attention and potential policy development.

Our aim with developing the Tracker was to:

- Develop a robust tool to provide a consistent way to examine Australian superannuation at system level.

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<sup>2</sup> Commonwealth of Australia, (2015). *Financial System Inquiry Final Report*. [online] Commonwealth of Australia, p. page 101. Available at: <http://tinyurl.com/nx768z8> [Accessed 12 Mar. 2015].

- Track adequacy and sustainability of the superannuation system.
- Identify which areas of the superannuation system may need attention.
- Road test the impact of policy changes on a series of metrics. AIST believes that proposed superannuation policies should be road-tested on the grounds of key drivers such as adequacy, fairness, gender impacts on retirement savings, and sustainability.

The Tracker is one methodology for measuring the costs and benefits of the superannuation system. Such a tool- or indeed any form of metrics – can work best only where the key objectives of the system (which the tool is examining) are known, accepted, and applied.

The Tracker examines a number of areas that affect the sustainability and adequacy of Australia's superannuation system. Currently, the Tracker rates the Australian superannuation system as having a rating of 67.5 out of a possible 100. This recognises that Australia's retirement income system has many attractive features. However, the Tracker identifies a number of areas where we believe improvements could be made (refer [Appendix A](#)).

The assumptions underlying the Tracker are attached, and may also be found at:

<http://tinyurl.com/h6lyg2e>

### **2.3.3.1 AIST-Mercer Super Tracker methodology similar to EU**

In 2012, the EU issued a White Paper<sup>3</sup> examining an agenda for adequate, safe and sustainable pensions. This paper examines a number of initiatives, including examining the sustainability of public pensions, supporting longer working life, and measuring the gender gap in savings.

The White Paper forms part of a series examined by the EU, with three further reports being of particular interest:

*The Pension Adequacy Report*<sup>4</sup> sets out the commonly agreed objectives for pensions, which are:

- 'Adequate retirement income for all and access to pensions which allow people to maintain, to a reasonable degree their living standard after retirement, in the spirit of solidarity and fairness between and within generations;
- The financial sustainability of private and public pension schemes, bearing in mind pressures on public finances and the ageing of the populations, and in the context of the three-pronged strategy for tackling the budgetary implications of ageing, notably by:
  - supporting longer working lives and active ageing;

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<sup>3</sup> European Commission, (2012). *White Paper: An Agenda for Adequate, Safe and Sustainable Pensions*. Brussels: European Commission. Available at: <http://tinyurl.com/mmvnk26> [Accessed 5 April 2016]

<sup>4</sup> European Commission, (2012). *Pension Adequacy in the European Union 2010-2050*. European Commission.

- by balancing contributions and benefits in an appropriate and socially fair manner; and
- by promoting the affordability and the security of funded and private schemes;
- That pension systems are transparent, well adapted to the needs and aspirations of women and men and the requirements of modern societies, **demographic ageing** (emphasis added) and structural change; that people receive the information they need to plan their retirement and that reforms are conducted on the basis of the broadest possible consensus.’

*Adequacy and Sustainability of Pensions Report*<sup>5</sup>, which gives a concise overview of the KPIs of pension adequacy and sustainability in the EU. These indicators relate to adequacy of retirement benefits, the employment rate of older workers, and the sustainability challenge (the long term growth in pension expenditure as a per-cent of GDP).

*Implementation of the Pensions White Paper*<sup>6</sup> report, a process for reviewing the outcomes of progress, including the KPIs.

By way of comparison, the Tracker, while using a similar approach of Key Performance Indicators, is also used to road-test proposed Australian superannuation policies.

### 2.3.4 Fifth key element: Evidence-based decision-making

As mentioned above, the Tracker was also developed as one methodology to road test the impact of potential policy changes that may affect the ongoing development of the system. The Tracker provides a methodology for evidence-based decision making within a consistent fashion. This type of methodology would provide greater transparency and accountability regarding proposed superannuation policies.

Over 20 policies which have been discussed over the past year or so have been road-tested via the Tracker. The outcomes may be found at Annexure B.

### 2.3.5 Sixth key element: governance of the framework

Governance of the retirement incomes framework is needed. A periodic assessment by governments, as suggested in the Financial Systems Inquiry Final Report, runs the risk of the process being captured by short term considerations and is open to tinkering. Therefore, this approach is not supported by AIST.

The Inquiry considered but dismissed the establishment of an independent publicly funded body to assess the superannuation system’s performance and report on superannuation policy changes. It did so largely on the basis of concern about appropriate accountability mechanisms. AIST supports the establishment of

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<sup>5</sup> European Commission, (2013). *Adequacy and Sustainability of Pensions*. [online] European Commission. Available at: <http://tinyurl.com/o9efgrl> [Accessed 5 April 2016].

<sup>6</sup> European Commission, (2014). *Implementation of the EU White Paper on Pensions*. [online] European Commission Available at: <http://tinyurl.com/mmvnk26> [Accessed 5 April 2016].

an independent publicly funded body for this role and urges the Government to revisit this issue. The funding of such a body should be subject to regular review by Government, with the funding tied to a performance audit undertaken as part of a review.

The body should be chosen following a competitive evaluation or tender process. This body should use objective measures such as the AIST-Mercer Super Tracker to assess performance and policy against the key principles of fairness, adequacy and sustainability. While of itself this will not guarantee impartiality or consensus, it will nonetheless institutionalise a process that will add transparency, objectivity and stability.

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### 3 Concluding remarks

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AIST strongly believes that transparent objectives for the superannuation system, coupled with agreed quantifiable goals and a governance methodology for reviewing the outcomes – would provide a sound platform for reviewing any proposed taxation or other changes to the Australian superannuation system. Without this, the debate around the three cornerstones of the superannuation system (what is ‘adequate’, what is ‘sustainable’, and what is ‘fair’) will continue.

## 4 Appendix A: Adequacy and Sustainability measures from the AIST-Mercer Super Tracker

10 Indicators of the performance of the Australian Superannuation System					Currently	What would get 10/10
Adequacy		Objective	Score (/10)	Weighting		
A1	Net Retirement Income for median income earners (F/T and P/T, M & F)	ASFA Retirement Standard Comfortable	7.8	20%	FT Male: 98.0% of ASFA Comfortable FT Female: 91.8% PT Male: 89.2% PT Female: 74.2%	If the income following retirement is the ASFA Comfortable Standard for a single person, irrespective of age and career.
A2	Fairness of Government Support (tax concessions and age pension)	Level support across income deciles	5.0	15%	Wide differences in spread of concessions across income deciles – see page 7 of Tracker assumptions report.	Zero variance in the spread of concessions across income deciles.
A3	Gender gap at Retirement (modelling and actual)	Same benefit at retirement for M & F	6.6	10%	ABS data: Median female balance 65.2% of median male balances. Projected to age 67: Female balance 65.9% of male balances.	No difference in median super balance for male and female (current and projected).
A4	Coverage of superannuation	80% of working age population	8.1	2.5%	88.5% of working Australians covered by superannuation schemes.	>80% of working population is covered by superannuation schemes.
A5	Level of personal (voluntary contributions)	3% of GDP	6.4	2.5%	1.91% of GDP	3% of GDP for past 12 months as measured by APRA
Sustainability						
S1	Total cost of Government support including ((a) age pension (current and in 2050) and (b) tax concessions)	2% of GDP	8.3	15%	Cost of (a) is 3% (current and projected - amongst lowest of OECD countries) and (b) is 1.45%	Combined cost not > 2% of GDP (lower than all but 2 OECD countries)
S2	Super assets as a % of GDP	150% of GDP	8.2	10%	123% (4 <sup>th</sup> largest pool in the world)	150% of GDP
S3	Labour force participation rate at ages 55 and over	85% for 55-59; 65% for 60-64; 20% for 65 and over	6.2	10%	55-59: 74.0% 60-64: 58.8% 65 and >: 12.5%	55-59: 85% 60-64: 65% 65 and >: 20%
S4	Length of Retirement, today and in 20 years' time	15 years (today) 13 years (20 years)	6.1	10%	Current (at age 65): Males: 19.22 Females: 22.05 Projected average: 18.9 (85.9 less 67)	Life expectancy at pension age is 15 years; projected life expectancy at birth in 20 years time is 13 years more than pension age
S5	Age pensioner population, today and in 2050	25% on full pension	5.3	5%	Current: 65% (50% full, 30% part) Projected 2050: 55% (30% full, 50% part)	Aged population receiving full pension: 25% (half weighting for part pension)
Total Tracker Score			68.8	100%		

Tracker Assumptions Report available at [http://www.aist.asn.au/media/765530/21072-re-aist\\_mercer\\_super\\_tracker\\_2016\\_fin-sec\\_\\_00000002\\_.pdf](http://www.aist.asn.au/media/765530/21072-re-aist_mercer_super_tracker_2016_fin-sec__00000002_.pdf)

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