

16 September 2016

Manager
Superannuation Tax Reform
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

Attn: Ms Michelle Dowdell

Lodged via online portal

Dear Ms Dowdell,

Re: Superannuation reform package – Objective of superannuation

In brief:

In conjunction with other industry associations, AIST seeks that the Government consult further prior to introduction of the Bill. We seek the amendment of the primary objective to include reference to providing an adequate income that delivers a comfortable retirement.

AIST also seeks an additional subsidiary objective of increasing national savings; recognition of insurance as key part of the 'sole purpose test'; Parliamentary committee review of statements of compatibility; and the development of tools to assess compatibility.

This submission responds to the Exposure Drafts and the Explanatory Material to the Exposure Drafts for the *Superannuation (Objective) Bill 2016*.

We have responded in a separate submission to the Exposure Draft of the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Bill 2016* and the *Treasury Laws Amendment (Fair and Sustainable Superannuation) Regulation 2016*.

Superannuation (Objective) Bill 2016

Chapter 1 - The primary objective of the superannuation system

AIST supports the creation of a stand-alone Act relating to the primary objective of the superannuation system, and the identification of subsidiary objectives in the Explanatory Material.

The critical importance of the objective requires careful consideration. Consultation in response to the Government's discussion paper of 9 March 2016 on the Objective of superannuation was

limited and left important issues unresolved. Given the importance of superannuation to the Australian economy and society, and in meeting the retirement income goals of Australians, AIST calls on the Government to undertake further consultation on the primary objective prior to the introduction of this Bill to Parliament. In doing so, we do not seek that other legislation arising from the superannuation reform package be in any way delayed.

Adequacy

AIST maintains our support for a version of the primary objective that differs from that proposed in the Bill.

AIST and some other industry associations support a legislated objective that reflects the core purpose of the system in providing adequate retirement outcomes, in the terms and on the basis articulated in the letter sent to the Minister for Revenue and Financial Services dated 3 August 2016. This submission is to be read in conjunction with that letter, and is attached with this submission on a confidential basis.

It is our view that the primary objective proposed by the Financial System Inquiry and now reflected in the draft Bill, is a sound starting point for the development of a more holistic objective. It recognises that the superannuation system must provide income to retirees in conjunction with the Age Pension.

However, it fails to articulate the goal of the system to maximise the number of Australians living in comfort and dignity in retirement. In our view, the core purpose of the superannuation system is to deliver income which affords a comfortable standard of living in retirement, over and above what the Age Pension delivers.

Incorporating these elements will establish a primary objective aligned with the core purpose of the system. This, in turn, will ensure that the superannuation system is working towards a clear goal of providing Australians adequate retirement incomes and a comfortable standard of living, now and into the future.

A definition for the primary objective that addresses these elements has been agreed upon by the industry associations as signatories to the letter of 3 August 2016. The agreed definition is:

To provide an adequate income to ensure all Australians achieve a comfortable standard of living in retirement, supplementing or substituting the Age Pension.

The definition in the draft Bill omits adequacy, and AIST proposes the above definition its place.

Without in any way in derogating from this preferred and strongly held position, AIST also makes comments in relation to adequacy on our response to the subsidiary objective of smoothing consumption later in this submission.

Context of amendments

- **Increase national savings**

In addition to improving retirement incomes, in the *Context of amendments* the Explanatory Material recognises superannuation as a key component of the financial services industry and the economy more broadly (paragraph 1.3). However, the Explanatory Material subsequently asserts that “increasing national savings should not itself guide the superannuation system” and categorises this as an “auxiliary benefit” (rather than a subsidiary purpose; paragraph 1.24).

AIST submits that, notwithstanding its omission in both the Bill and in the recommendations of the Financial System Inquiry, the subsidiary objectives should include recognition of the role of the superannuation system in increasing national savings and funding economic activity, especially infrastructure, and in providing certainty and stability.

This is consistent with the position advocated by AIST in response to the Government’s Discussion Paper of 9 March 2016 on the Objective of Superannuation.

This purpose is achieved to an extent by the recognition of “increasing national savings” (in paragraph 1.24) as an auxiliary benefit.

The Explanatory Material (but not the Bill) identifies both “subsidiary objectives” and “auxiliary benefits”. Comparing the meaning of “auxiliary” and “subsidiary”, it is clear that auxiliary objectives have greater standing than subsidiary objectives.

The Oxford Dictionary defines auxiliary¹ as “*Providing supplementary or additional help and support*”, while subsidiary² is defined as “*less important than but related or supplementary to something*.” Therefore an auxiliary benefit can have equal but different standing with the primary objective, while a subsidiary objective has a lesser standing. Given the size and importance of superannuation to the national saving pool, and the recognition of this in the Explanatory Material (paragraph 1.3), this is appropriate.

In comparing objectives and benefits, the differences between the two are more readily identified. The Oxford Dictionary defines an objective³ as “a thing aimed at or sought; a goal”

¹ Oxford Dictionaries | English. (2016). *auxiliary - definition of auxiliary in English | Oxford Dictionaries*. [online] Available at: <http://tinyurl.com/zm9ehgb> [Accessed 16 Sep. 2016].

² Oxford Dictionaries | English. (2016). *subsidiary - definition of subsidiary in English | Oxford Dictionaries*. [online] Available at: <http://tinyurl.com/juqunya> [Accessed 16 Sep. 2016].

³ Oxford Dictionaries | English. (2016). *objective - definition of objective in English | Oxford Dictionaries*. [online] Available at: <http://tinyurl.com/jvakedx> [Accessed 16 Sep. 2016].

while a benefit⁴ is “an advantage or profit gained from something.” A benefit therefore does not need to be the intended outcome.

Increasing national savings is not just a benefit of the superannuation system; it is an intended benefit, and should be more clearly identified as such in the Explanatory Material.

When the Superannuation Guarantee legislation was introduced into Federal Parliament by the then Treasurer John Dawkins in 1992 he identified a number of purposes for the provision of universal superannuation including to⁵:

...increase our national savings overall, thus reducing our reliance on the savings of foreigners to fund our development.

When an expanded version of this quote was included in the earlier Discussion Paper on the Objective of Superannuation, it was noted that the Government gave this purpose increased emphasis by placing “**national savings**” in bold. However, the discussion paper commented (at page 3) a point to consider that “*While this was an important motivation for the establishment of the superannuation system, as perceptions and the economy have evolved the need for prominence in the objective may have reduced.*” (page 3)

The document does not support this assertion, and neither do other documents produced by Treasury. In fact, the opposite applies and superannuation indisputably has become a more important element of the Australian economy. Its role and benefits cannot be easily separated from the objective of the system and it is unreasonable to attempt to do so.

This interconnectedness is evident in paragraph 1.5 of the Explanatory Material where the maturing superannuation system with growing *assets*, are given as a reason why “*new proposals be considered in light of the objective of the system.*” Even the drafters of the Explanatory Material are unable to separate increasing national savings from the objectives of the superannuation system.

Largely as consequence of the compulsory superannuation, Australia has a higher than average savings rate compared to other OECD countries. Treasury has estimated⁶ in 2011 that

⁴ Oxford Dictionaries | English. (2016). *benefit - definition of benefit in English | Oxford Dictionaries.* [online] Available at: <http://tinyurl.com/hdtn6e5> [Accessed 16 Sep. 2016].

⁵ Dawkins, J. (1992). *Second reading speech - Superannuation Guarantee (Administration) Bill 1992*, Speech by the Hon. John Dawkins MP, House of Representatives, Parliament House, Canberra 2 April 1992. Available at <http://tinyurl.com/zbmjaz9> [accessed 16 September 2016].

⁶ Gruen, D. (2011). *Compulsory Superannuation and National Saving*. Speech by David Gruen (with Leigh Soding) to the Melbourne Institute/The Australian 2011 Economic and Social Outlook Conference *Compulsory Superannuation and National Saving* Australian Treasury. 1 July 2011. Available at <http://tinyurl.com/zbe9wk3> [accessed 14 September 2016].

superannuation contributes between 1.5 to 2 percentage points to the national saving rate, and that this is projected to rise to 3 percentage points by 2050.

In making this submission, AIST does not in any way suggest that increasing national savings should be subsidiary to or at the expense of the primary objective, or investing in the best interests of superannuation fund members.

Auxiliary benefits

As noted above, the Explanatory Material *introduces* the concept of auxiliary benefits, such as insurance, which do not appear in the Bill and which do not otherwise have legal meaning in the superannuation system. EMs should facilitate the understanding of a Bill rather than introduce new concepts. The Explanatory Material can assist in interpreting a law but it does not stand as law in its own right.

Overall, the Bill and Explanatory Material introduce the concepts of a primary objective, subsidiary objectives, auxiliary objectives and benefits. The SIS Act and Regulations already use the terminology of core purposes and ancillary purposes to describe in some cases, similar superannuation concepts. It might be desirable to align the language of the Bill, Explanatory Material and the existing sole purpose test definitions from the SIS Act, so that the objective of the superannuation system and the operation of the sole purpose test are more closely aligned.

The relationship between this Bill, the sole purpose test and insurance is addressed later in this submission.

Tax minimisation and estate planning

AIST agrees with the statement in the Explanatory Material that the purpose of superannuation *“is not to allow for tax minimisation or estate planning”* (paragraph 1.11).

Subsidiary objectives

- **Facilitate consumption smoothing over the course of an individual’s life**

AIST supports this subsidiary objective. Paragraph 1.19 implies that this objective incorporates adequacy in its explanation that it will *“increase self-reliance”*. By definition, self-reliance requires an adequate retirement income. Again referencing the comments of Treasurer Dawkins when the Superannuation Guarantee legislation was introduced:

The higher provision for retirement will permit a higher standard of living in retirement than if we continued to rely on the Age Pension alone.

This does not imply that the Age Pension is inadequate, and provides the basis for further consideration of adequacy through this objective.

However, this is unlikely to be a satisfactory mechanism for addressing such a critical aspect of the superannuation system. In any event, the Explanatory Material commentary about consumption smoothing is focused on encouraging member self-reliance and the limits to the level of Government support that can be provided. It is unlikely that this extends to the adequacy of member benefits and income.

Even if it does, the lack of an enforceable mechanism to require a statement of capability, and the lack of a requirement for the statement to address subsidiary objectives, means that this mechanism may be of limited value.

- **Manage risks in retirement**

AIST notes that this subsidiary objective differs from that recommended by the FSI (which was “*manage financial risks in retirement*”). AIST supports an amended version of subsidiary objective in the version included in the Bill, and supports a wider definition of risk (i.e., without reference to “*financial*”).

Risks exist throughout an individual’s participation in the superannuation system, and not just in retirement. AIST submits that this subsidiary objective should be amended to read:

Manage risk over the course of an individual’s life.

The increased range of risks under this objective could include mortality risk, and governance and integrity risks, and AIST submits these should be identified in the Explanatory Material.

Mortality risk, for example, could mean a superannuation fund member does not receive their optimal retirement income given the nature of their retirement product in circumstances when they die earlier than expected. While the provision of safeguards in another subsidiary objective also addresses governance and integrity, governance and integrity are nonetheless risks to be managed in retirement.

- **Be invested in the best interests of superannuation fund members**

AIST supports this subsidiary objective, subject to it being consistent with the sole purpose test in its entirety, including in relation to insurance.

AIST also submits that this objective, along with the primary objective, is consistent with and indeed supported by increasing national savings.

- **Alleviate fiscal pressures on Government from the retirement income system**

AIST supports this subsidiary objective. AIST supports the three pillar retirement income system, and recognises that the Government’s contribution to the system needs to be financially sustainable.

- **Be simple, efficient and provide safeguards**

AIST supports this subsidiary objective, especially it incorporates appropriate governance and integrity measures.

- **Be fully funded from savings**

A subsidiary objective of being fully funded from savings was recommended by the FSI, but has not been included in the Explanatory Material. AIST does not argue for its inclusion.

Insurance

Life and disability insurance is a core feature of pension systems. In a recent review of the global financial system, Davis, Lukomnik & Pitt-Watson noted⁷ that pensions contain two bedrock elements, savings and insurance. The Australian system is no exception.

Many people involuntarily retire for health reasons, and the integration of retirement and disability benefits allows for improved retirement incomes. It is noted that death benefits tend to decline as superannuation balances increase.

The “sole purpose test” in section 62 of the SIS Act provides that a superannuation fund must be set up to provide benefits on the death, disability or retirement of a member. Section 62 is not being amended by this Bill, and paragraph 1.22 identifies that the subsidiary objective of a members best interests is consistent with Section 62.

While Section 62 is not being amended and cannot be amended in consequence of this Bill, the Explanatory Material must nonetheless be amended to clarify that the status of insurance in superannuation is in no way changed or diminished by this Bill.

The APRA Superannuation Circular No.III.A.4⁸ summarises the sole purpose test as follows, and the Explanatory Material should be amended to provide explicit recognition of this:

7. Essentially the “core purposes” are the provision of benefits on or after the member’s retirement, reaching age 65 or earlier death. Similarly, the “ancillary purposes” are the provision of employment termination insurance, salary continuance (on a member’s cessation of work because of ill health), reversionary benefits and other approved benefits on or after an appropriate condition has been met.

⁷ Davis, S., Lukomnik, J. and Pitt-Watson, D. (2016). *What They Do with Your Money*. New Haven: Yale University Press, p.201.

⁸ APRA, (2001). *The Sole Purpose Test*. Superannuation Circular No.III.A.4. [online] Canberra: Australian Prudential Regulation Authority. Available at: <http://tinyurl.com/ja2vwvd> [Accessed 14 Sep. 2016].

AIST also submits that that, for increased clarity and to maintain consistency with Section 62, the Explanatory Material should also be amended to identify other features of a superannuation fund that are appropriate, including in relation to the objective of superannuation. This text could also be sourced from the APRA Circular cited above:

41. It is open to trustees to develop features of their fund which add value to, or differentiate it from, other funds. For example, fund sponsored member awareness, education and financial advice programs, targeted at fund specific issues such as benefit features (including insurance options, the making of binding death benefit nominations etc) or investment choices offered in the fund, may be appropriate.

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It is also noted that the provision of minimum levels of death and TPD insurance are also required benefits of default MySuper products, and submit that this further supports more specific alignment of the objective of superannuation with the sole purpose test.

Statements of compatibility

The Bill requires statements of compatibility to be prepared for Bills relating to superannuation but does not refer to the subsidiary objectives or contain any mechanism for their consideration. The Explanatory Material states that addressing the subsidiary objectives in the statement of compatibility (with the primary objective) is considered to be “best practice”, rather than a prescribed step. In other words, consideration of the subsidiary objectives is not a requirement.

Notwithstanding this however, a failure to prepare a statement of compatibility does not appear to affect the validity of any given Bill or Regulation.

The requirement to prepare a Statement of Compatibility does not extend beyond Bills and Regulations, and does not cover legislative instruments that are not regulations.

It is understood that the requirements for a statement of capability have been modelled on the Human Right Statements of Compatibility. AIST submits that changes be made to the Bill and Explanatory Material to bring it closer to the Human Rights Statement:

AIST submits that the Bill be amended to provide that a statement of compatibility must:

- Be provided for all disallowable legislative instruments relating to superannuation;
- Address each of the subsidiary objectives; and
- Be reviewed (along with the Bill or other instrument) by either the House of Representatives or Senate Economics Committees.

Assessing compatibility with the objectives

Clause 6(3) of the Bill requires that:

A statement of compatibility must include an assessment of whether the Bill is compatible with the primary objective of the 26 superannuation system.

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AIST submits that appropriate and robust measurement tools are necessary to support the assessment process. The framework being developed by the Productivity Commission to assess the competitiveness and efficiency of the superannuation system will also assist with this process.

The measurement of proposals affecting the superannuation system should consider both macro-economic effects and the impact at the personal (or micro) level. Both are important. Hence, tools such as the AIST-Mercer Super Tracker can be used to consider the movement in certain macro-economic measures, such as the value and fairness of tax concessions and the level of assets within the economy, as well as measures that affect individuals, such as net retirement income and the gender gap.

AIST recommends the establishment of an independent publicly-funded body to assess the superannuation policy changes, to develop and refine tools to be used in this process, and to be available to Parliamentarians intending to propose superannuation changes.

AIST would welcome the opportunity to discuss our submission of these applications with you. Please contact David Haynes, Executive Manager Policy & Research on 03 8677 3800 or at dhaynes@aist.asn.au.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Tom Garcia', is written over a white background.

Tom Garcia
Chief Executive Officer

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 \$700 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.