22 December 2016

Committee Secretary
Senate Economics Legislation Committee
PO Box 6100
Parliament House
Canberra ACT 2600

Email: economics.sen@aph.gov.au

Dear Mr Mark Fitt

INQUIRY INTO THE SUPERANNUATION (OBJECTIVE) BILL 2016 [*PROVISIONS*]

The SMSF Association welcomes the opportunity to make a submission to the Senate Economics Legislation Committee Inquiry into the Superannuation (Objective) Bill 2016 [Provisions].

The Association has been a vocal supporter of the Financial System Inquiry's (FSI) recommendation to enshrine the objective of superannuation in legislation and we are pleased that the Government has proceeded 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.

In our original submissions on the Government's draft legislation (see attached), we highlighted the importance of including adequacy in the objective of superannuation. We believe that it is essential that the concept of adequacy is included in the objective so that people can have a secure and dignified retirement.

We believe the best option going forward is to include a concept of adequacy in the subsidiary objectives (possibly to replace "Facilitate consumption smoothing over the course of an individual's life") and ensuring that legislative changes are made so that the subsidiary objectives are assessed in the required compatibility statement by a member of Parliament introducing a superannuation related Bill.

As we have stated in our previous submission, we believe that adequacy must be included in the objectives of the superannuation system so that the system aims to provide people with adequate retirement savings to deliver a "financially secure and dignified retirement". This maintains an aspirational element to superannuation and encourages people to save during their working life to fund a self-sufficient retirement.

SMSF Association
ABN 67 103 739 617

SMSF House
Level 1, 366 King William Street
Adelaide SA 5000

PO Box 6540
Halifax Street
Adelaide SA 5000

Tel 1300 779 096
enquiries@smsfassociation.com
www.smsfassociation.com

We are aware of the issues regarding including the concept of adequacy in the objectives of superannuation such as not having an accepted defined value of 'adequate retirement savings' and that Government's may feel pressured to apply adequacy to other policy areas, such as social security payments. While we cited that these issues should not be impediments to including adequacy in our previous submission, we believe that these issues could be circumvented by including a subsidiary objective of "*Providing a secure and dignified retirement*" rather than referencing adequacy.

Subsidiary Objectives

Including "*providing a secure and dignified retirement*" as a subsidiary objective supports the notion that superannuation fund members should be able to save to provide an income greater than the age pension to ensure they have a comfortable standard of living in retirement. This should also encourage self-sufficiency amongst people saving for retirement but does not herald open ended concessions for saving through superannuation.

Following on from our original submission on the draft Bill we believe that the subsidiary objectives to be regulated should then be:

1. *Providing a secure and dignified retirement*
2. *Managing risks in retirement*
3. *<u>Be invested in the best interest of members</u>*
4. *Alleviate fiscal pressures on Government from the retirement income system*
5. *Equity*
6. *Maintain a pool of national savings*
7. *Be simple, efficient and provide safeguards.*

While we prefer the subsidiary objectives to be part of the Superannuation (Objective) Bill, creating regulations for this purpose is acceptable. Most important is the requirement for future policymakers to evaluate a superannuation Bill against all of the superannuation's objectives, including subsidiary objectives so that all facets of the superannuation system are appropriately accounted for. This will help deliver more certainty for superannuation fund members and provide more transparency on future government policy and its effect on superannuation.

In summary, we believe the concept of adequacy can best be captured in the objective of superannuation by the Government undertaking the following:

- Including the concept of superannuation <u>providing a secure and dignified retirement</u> as a subsidiary objective.

Primary Objective

The original three pillar design of the Australian retirement system consists of the following:

- Pillar 1 – Age Pension
- Pillar 2 – Compulsory Superannuation Guarantee Contributions
- Pillar 3 – Voluntary Contributions

Superannuation is Australia's primary savings vehicle and comprises Pillar 2 and 3. It is a savings where Australians are encouraged through tax incentives to forgo current consumption to allow income to be saved and later accessed in retirement certain conditions are met. The age pension, Pillar 1, is the safety net for Australians who are unable to provide for themselves through superannuation or other private savings and require Government income support. The Age Pension has never been or intended to be a universal entitlement for all Australians and should not be treated by legislative design to as a universal entitlement.

In addition to including a concept of adequacy in the subsidiary objectives we believe that the primary objective could be improved. We are aware that a number of stakeholders are interpreting the primary objective's statement that superannuation should provide income to "substitute" the age pension as meaning superannuation should not provide tax concessions beyond replacement of the age pension through superannuation savings. This interpretation of the primary objective in this manner implies that the age pension is an entitlement for all Australians. This interpretation of the current drafting, would significantly undermine the success of the superannuation system delivering higher standards of living in retirement for Australians.

This interpretation would mean that future governments would be burdened with increased fiscal commitments if the reliance on the full or part pension by Australians grows rather than decreases from the current predictions. The superannuation tax incentives must compensate Australians for the compulsory contributions and preservation of their current income as retirement savings, and, provide incentives further contributions to allow and encourage self-sufficiency in retirement where possible.

Accordingly, we recommend that the primary objective be amended so that it is not open to an interpretation that limits superannuation's support to merely replacing the age pension or that the objective implies a universal entitlement for all Australians to the age pension. We believe appropriate wording could be:

> *To provide income in retirement for a self-sufficient retirement or to supplement the age pension.*

Using a concept of a self-sufficient retirement instead of substitution of the age pension will clarify that superannuation can legitimately support a savings system providing a retirement income that significantly exceeds the age pension. Ensuring that this concept is understood by future governments, policy makers and the public is important to the future of superannuation policy and its stability.

If you have any questions on this issue please do not hesitate in contacting us.

Yours sincerely,

[redacted]

Andrea Slattery
Managing Director/CEO
SMSF Association

ATTACHMENT

Excerpt from SMSF Association Submission on trench 1 of draft superannuation legislation submitted on 19 September 2016

OBJECTIVE OF SUPERANNUATION

The SMSF Association is pleased that the Government is proceeding with legislating an objective for the superannuation system. We believe this is a significant step in ensuring that superannuation is more stable and that people saving for retirement can have confidence that the superannuation and related tax laws will not be constantly changing, especially in unexpected ways.

However, we are concerned by the Government's proposed primary objective, the proposed sub-objectives and the mechanism for ensuring future superannuation legislation is compatible with the objective. We believe that in the current draft form, these elements are not appropriately designed to deliver the policy stability needed for the superannuation system and long-term savers.

In addition, we view that due to the significance of legislating the objective for superannuation (and the issues outlined above) that the Government should consider extending the timeframe for consultation on the draft superannuation objective legislation to allow for further discussion and consideration of this important policy. We note that unlike the other tax and regulatory changes proposed in the 2016 Budget, legislating the objective for superannuation is not time sensitive and can be afforded more than one and a half weeks of consultation.

Primary Objective

The SMSF Association is disappointed that the primary objective for superannuation does not include the concept of adequacy. We believe the use of the Financial System Inquiry (FSI) recommended objective is an appropriate starting point but does not fully encapsulate the purpose of the superannuation system.

We strongly support the notion that at its core, superannuation should provide people with income in retirement to alleviate reliance on the age pension but believe that superannuation's purpose goes further than this. We believe that superannuation should aim to provide people with adequate retirement savings to deliver a "financially secure and dignified retirement."

Accordingly, we believe the primary objective should read:

> ***"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.

Including adequacy as part of the objective for 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.

Further, including the idea that superannuation should aim to deliver "a financially secure and dignified retirement" will reinforce the idea that the age pension should remain as Australia's safety net for retirement income and poverty alleviation rather than a central pillar of income in retirement. We believe that the proposed primary objective places an undue focus on the age pension being central to retirement income for Australians, rather than aspiring for a higher standard of living and self-sufficiency in retirement.

We believe the narrower objective currently proposed will allow future governments to justify eroding the taxation system support for superannuation until superannuation merely supports a savings amount which can generate income equivalent to the age pension. This would result in substantially lower standards of living in retirement for many Australians and lower the national savings rate.

We understand that there are two key concerns with including adequacy as part of the objective of superannuation:

1. That there is no broadly accepted definition of adequacy.
2. Applying a concept of adequacy to superannuation will pressure the Government to apply it in other areas such as to the age pension, New Start or disability pensions.

We do not believe that these issues should be impediments to including adequacy.

1. That there is no broadly accepted definition of adequacy.

While there is no broadly accepted definition of adequacy, we do not believe that this should preclude the concept of adequacy being included as part of the primary objective. The concept of adequate retirement savings or income is well understood to mean a level of savings that delivers people a comfortable standard of living in retirement with a sense of financial security. Having this concept included in the primary objective will ensure that superannuation continues to deliver higher standards of living in retirement.

Any further need to define adequacy to justify policy changes should be an exercise undertaken by policymakers at the time a policy is being proposed and assessed against the objective. That is, adequacy does not need to be a static or finite monetary figure defined in legislation (or by an EM) but a concept that policy makers should refer to in assessing future policy changes to superannuation. This would also ensure that adequacy remains a contemporary concept and is judged accordingly in the context of the era in which it is being assessed.

2. *Applying a concept of adequacy to superannuation will pressure the Government to apply it in other areas such as to the age pension, New Start or disability pensions.*

We do not believe that the Government will be forced to use the concept of adequacy in determining policy for income provided by government pensions. Adequacy is being included as part of the superannuation system's objective in reference to a level of savings that delivers a dignified and secure retirement. This is clearly distinct to the provision of income by government as a safety net for poverty alleviation.

Subsidiary Objectives

The SMSF Association is concerned by some of the subsidiary objectives chosen and explained in the EM.

We support the inclusion of "managing risks in retirement", "alleviate fiscal pressures on Government from the retirement income system", and, "be simple efficient and provide safeguards."

We do not support the inclusion of "facilitate consumption smoothing over the course of an individual's life". We also note that "be invested in the best interest of members" is largely not relevant to the SMSF sector and already present in other legislation.

Further, we believe additional subsidiary objectives of "equity" and "continuing to build and maintain a pool of national savings" should be included in the objectives.

In addition, if the Government is not persuaded to include a concept of adequacy in the primary objective for superannuation, we believe that adequate retirement savings must be included as subsidiary objective in the EM to guide future policy maker's interpretations of the primary objective.

"Facilitate consumption smoothing over the course of an individual's life"

While we are not opposed to the concept of consumption smoothing and agree that this is an appropriate outcome of superannuation, we believe it does not warrant being identified as one of the principal goals for superannuation. We believe ensuring that people have an adequate level of savings to fund retirement income (which facilitates consumption smoothing) should be a higher order objective for the system to aim for.

Also, the commentary on sustainability under this subsidiary objective would be more appropriately included under the heading of "alleviate fiscal pressures on Government from the retirement income system".

"Be invested in the best interest of members"

As explained in the EM, this objective is already legislated as a legal requirement for trustees in the *Superannuation Industry (Supervision) Act 1993* and embodied by the sole purpose in section 62 of that Act.

In addition, we note that this objective is mostly relevant to Australian Prudential Regulation Authority regulated funds rather than SMSFs where trustees and members are the same people and principle-agent conflicts do not exist.

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 include ensuring that superannuation fund members are treated equally given the type of superannuation fund they are member of as well as their 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 subsidiary objectives, equity should be balanced with others such as the need to achieve adequate retirement savings and maintaining a simple superannuation system.

Maintaining a pool of national savings

We believe that maintaining a healthy level of domestic savings should be a subsidiary objective of superannuation. This objective should not be discarded on the basis that it is seem as having been achieved at a particular point in time. It is important to not view national savings as a "stock" variable, which can lead to the conclusion that an appropriate level of national savings has been achieved and "ticked off the list".

Continuing to maintain a large pool of domestic savings and a higher domestic savings rate 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.

Description of age pension

In addition to the broader issues discussed above, we believe that in paragraphs 1.25 and 1.26 of the EM it should be made clear that the age pension is a safety net and not a universal entitlement. We are concerned by language that places too high a reliance on the age pension as a source of retirement income rather than savings generated through superannuation. Without clarifying the role of the age pension appropriately, its role in the three pillar system may be distorted by future policy makers.

Ensuring Future Legislation is Compatible with the Objective

We support the draft legislation's requirement that a member of Parliament introducing a Bill related to superannuation must prepare a statement of compatibility to accompany the Bill.

However, we are disappointed that a member of Parliament undertaking this exercise will not be required to assess how the Bill is compatible with the subsidiary objectives in addition to the primary objective. We do not believe that the EM's description of evaluating a Bill against the subsidiary objective as "best practice" (as per paragraph 1.37) is strong enough to guarantee the stability of superannuation policy in the future. Assessing how a Bill affects the superannuation system will be more complex than evaluating it against the primary objective. Bills should be evaluated against the subsidiary objectives to ensure that the complexities of how legislation and policy changes affect superannuation are appropriately assessed.

The most appropriate solution would be to include the subsidiary objectives in the superannuation objective legislation with the relevant commentary being retained in the EM. This would ensure that when evaluating a Bill against superannuation's objectives, all facets of the superannuation system are appropriately accounted for. Without this mechanism, the subsidiary objectives in the EM have no "bite" in creating greater stability for superannuation and making future Government's more accountable and transparent in changing superannuation policy.

Alternatively, the legislation requiring the compatibility statement could require the relevant member of Parliament to make an assessment of whether a Bill is compatible with the primary objective **and** the subsidiary objectives included in the EM.

In addition, we believe that there would be a significant benefit in the superannuation system being reviewed against the primary and subsidiary objectives on a regular basis to assess how well current policy setting are contribution to achieving the system's goals. We believe that the Intergenerational Report (IGR) provides an appropriate vehicle for such a regular review to occur.

Removing Superannuation Policy from the Annual Budget Cycle

In addition to setting the objectives for the superannuation system we believe that the current exercise being undertaken by Government presents an opportunity to deliver even greater stability for superannuation by removing superannuation policy from the annual federal 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 policy settings linked to the IGR. This exercise should include an assessment of how the superannuation system is tracking in meeting its primary and subsidiary objectives.

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.

At a minimum we recommend that the IGR should assess how the superannuation system is tracking in meeting its legislated objectives and how any recent policy changes have affected the system's attainment of its goals.