

# Objective of Superannuation

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## Introduction

EY welcomes the Government's consultation on the Objective of Superannuation. We support the objective being enshrined within legislation to serve as a point of reference against which to assess proposed superannuation reforms.

This submission contains our responses to the focus questions raised in the Discussion Paper dated 9 March 2016.

As a leading global professional services organisation, we have drawn on our vast experience within the superannuation sector in preparing our submission. Our perspective has also been informed from our broader footprint as advisors across other sectors of the financial services industry and the economy in general.

We believe the Government's work to enshrine the Objective of Superannuation to be of significant national importance, both today but even moreso into the future as the system continues its exponential growth.

We hope our submission is a valuable contribution to the ongoing deliberations in this critical policy area.

**Maree Pallisco**  
National Superannuation Leader

# EY Response to focus questions

*Focus question 1 – Do you agree with the objectives recommended by the FSI? Why?*

We broadly agree with the FSI objective of the superannuation system being “to provide income in retirement to substitute or supplement the Age Pension”. In particular, we consider that such a clear and concise objective is desirable, both to guide policymakers and also to instill greater understanding of and confidence in the system by stakeholders and the community at large.

We also agree with the remark in the Discussion Paper that, “...the purpose of superannuation is not to allow for unlimited wealth accumulation and estate planning”. In fact, to avoid any doubt on this point, we consider it prudent that the objective of superannuation makes specific reference to activities that are not objectives of superannuation. These activities might include wealth accumulation and estate planning, or even other purposes, such as purchasing housing or paying education.

We also believe some other aspects of the proposed objective should be refined – as discussed in the following section.

*Focus question 2 – If you do not agree with the FSI recommendation, what do you think should be the objective of superannuation? Why? What are the implications of this objective?*

## Primary objective

We consider that a more equitable primary objective of superannuation would be:

To promote the creation of wealth to be used solely to provide a “comfortable” standard of living throughout retirement, with or without Age Pension support, for all Australians.

With the proviso that determining what constitutes a “comfortable” standard of living should be against an agreed benchmark, such as proportionate replacement of pre-retirement income (perhaps with certain caps). It should also contemplate funding expenditure on health care and aged care needs, which clearly increase during the retirement years.

Four key implications stem from this suggested primary objective:

- ▶ **Creation of wealth:** By focussing on wealth to provide income streams in retirement, this opens up opportunities for the Government to encourage the private sector to develop innovative solutions. For example, demand for home equity release products could be created by changing Age Pension means testing settings for such products.
- ▶ **Standard of living:** We favour an emphasis within the primary objective on providing an adequate standard of living in retirement rather than a retirement income. In this regard, although we accept the FSI’s observations around there needing to be a change in mindset away from account balances and lump sum withdrawals towards retirement incomes, this can be incorporated into the subsidiary objectives. Our rationale is that the cash flow needs in retirement are clearly not linear, particularly as a result of unforeseen health care and aged care expenditure (as discussed further below). In our view the superannuation system should specifically accommodate these costs, along with basic living expenses towards which an income stream in retirement might be directed.



- ▶ **Throughout retirement:** Income throughout retirement, however long that lasts, needs to be considered. This supports the FSI's recommendation for the private sector to develop comprehensive income products for retirement that provide some longevity protection for retirees. Research conducted by EY and Colonial First State in the 2015 Actuaries Institute paper, *The Optimal Solution to the Retirement Riddle*,<sup>1</sup> shows that the benefits of such products to retirees who live beyond life expectancy can be quite significant. We believe that such products have the potential to radically shift the provision of longevity protection from the public to the private sector. Supporting their development is therefore vital to improving the fiscal sustainability of the system.
- ▶ **Age Pension:** The Age Pension is critical to assisting many retirees to obtain an adequate, if not comfortable, level of income. However, it also places a financial burden on the Government. Thus, all proposed reforms clearly need to take into account realistic projections of Age Pensions likely to be provided to retirees.

Our suggested primary objective removes the emphasis on the Age Pension as a starting aspirational position for superannuation. This is because:

- ▶ It might infer that the superannuation system should not be accessible to Australians who are not likely to receive Age Pension support. In our view, all Australians should have the fundamental right to access the superannuation system. But safeguards (such as via contribution caps and taxation measures) are necessary to ensure the level of that access, and any tax concessions that follow, remain appropriate. Again, the objective should be to facilitate a comfortable standard of living throughout retirement.
- ▶ The objectives of the Age Pension itself are not clearly defined and enshrined. Directly linking the superannuation system with the Age Pension raises questions as to the resultant impact of future policy changes to the Age Pension. Because the Age Pension eligibility rules (i.e. the income and assets tests) take superannuation interests into account, a circular reference is in play. Both the Age Pension and superannuation systems are broadly directed towards a common underlying objective, which we consider should be clearly articulated i.e. to provide an adequate or comfortable standard of living.

<sup>1</sup> <http://www.actuaries.asn.au/Library/Events/SUM/2015/GardinerEtAlRetirementRiddlePaper.pdf>



In her address to the Association of Superannuation Funds of Australia on 9 March 2016 in Melbourne, the Hon Kelly O'Dwyer, Minister for Small Business and Assistant Treasurer, stated that "Australians deserve an A-grade system".<sup>2</sup>

In our view, OECD measures of current income levels for older Australians suggest that we still have a way to go. As the OECD report, *Pensions at a Glance 2015* (published on 1 December 2015)<sup>3</sup> showed, Australia's projected net replacement rate for workers on average incomes is 58%, which is below the OECD average of 63%. The OECD report also found that 36% of Australians aged over 65 live in income poverty, which is the second highest rate across OECD countries. Indeed, the Age Pension by itself is below the poverty line under the OECD definition of income poverty.

Our suggested objective will raise the bar for superannuation to provide a comfortable standard of living in retirement. Any policy reforms aligned with that objective should greatly enhanced the prospects of our system being "A-grade".

<sup>2</sup> <http://kmo.ministers.treasury.gov.au/speech/006-2016/>

<sup>3</sup> <http://www.oecd.org/pensions/oecd-pensions-at-a-glance-19991363.htm>

## Subsidiary objectives

In addition to the primary objective discussed above, we agree in principle with the list of FSI-proposed subsidiary objectives. However, we would expand this list to include:

- ▶ **Provision of replacement income during retirement:** As discussed above, the primary objective of the superannuation system should be based on providing access to funds required to maintain a comfortable standard of living in retirement, determined as a proportionate replacement of pre-retirement income subject to certain caps and also allowances for certain one-off expenditures. This default position should be articulated within the subsidiary objectives, subject to limited exceptions, such as for aged care and health care.
- ▶ **Aged care and health care considerations:** Although we agree with the subsidiary objective to “facilitate consumption smoothing over the course of an individual’s life”, a more specific reference should be made to aged care and health care needs in retirement as a stand-alone subsidiary objective.

As our recent *Public Health Expenditure and Distribution of Benefits* report to the South Australian government<sup>4</sup> illustrated, cost increases within the health care system are outpacing CPI and are being passed onto governments and individuals. The challenges of this will only become greater given our ageing demographics and increased demand for health care services. In our view, superannuation has a critical role to play in enabling older Australians to access the health care and aged care services they will need.

For example, if any liquidity constraints are introduced or encouraged to facilitate sustainable retirement incomes (for instance via longevity risk pooling products), perhaps these should be able to be relaxed in light of aged care or health care needs, which can often be substantial and unexpected. This is particularly relevant as the system shifts from lump sum superannuation withdrawals to developing retirement income products, as Australians will still need access to lump sum withdrawals for certain types of one-off expenditures.

When considered together with these subsidiary objectives, we believe our primary objective is equitable, not overly restrictive and allows for flexible calibration as our demographics and economy change.

<sup>4</sup> <http://www.federalcutshurt.com.au/wp-content/uploads/2015/03/EY-SA-Health-Expenditure-Final.pdf>

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### *Focus question 3 – In which piece of legislation should the objective be legislated and why?*

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In the absence of establishing a new independent body charged with responsibility around assessing superannuation and retirement income policy reform proposals, the preamble to the SIS Act would be the most appropriate location for the objective.

If such a body was to be established (although we note this was not favoured by the FSI), then incorporating the objectives into the relevant legislation for that body would be preferred.

As a final consideration, we are concerned that the following comment in the Discussion Paper may promote ambiguity as to the use of the objective:

**“Notwithstanding where the objective is legislated, the purpose of stating the objectives of the superannuation system in legislation is only to guide the policy-making process. It will not affect the interpretation or application of superannuation legislation by the courts.”**

To promote certainty and confidence in the system, the stated objectives must be strictly adhered to in developing and implementing superannuation policy reform, with comprehensive and transparent reporting as recommended by the FSI. To this end, where judicial interpretation of superannuation legislation does not align with the stated objectives, a mechanism will be needed to seek any necessary amendment to that legislation (subject to the consideration of any competing interests). We encourage the Government to give further thought to this issue.



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