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C/O Ms Michelle Dowdell
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The Treasury
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Dear Ms Dowdell

Objective of Superannuation

We broadly agree with the FSI recommendation and the governments' intent to legislate the purpose of superannuation being:

"To provide income in retirement to substitute or supplement the Age Pension."

It is important that the objective of superannuation is stated in a clear and unambiguous way that is not open to misinterpretation (or misrepresentation). This will then in turn provide clear guidance to Trustees who have a fiduciary responsibility to act in the interests of their members. By focussing on this purpose, Trustees will need to consider whether significant efficiency improvements can be achieved compared to current practices, in order to better provide acceptable incomes for members in retirement.

Trustee Tailored Superannuation (TTS) – Fully aligned with the objective of superannuation

TTS is a product specifically designed to address this fundamental objective of superannuation in its application to the approximately 80% of superannuation fund members who are disengaged and simply accept the current inefficient default (MySuper) investment option.

Generally, the current practice with default schemes is:

- One size fits all
- Age only lifecycle
- Focus on market performance
- Current balance is the focal point

TRUSTEE TTS TAILORED Super

The drawbacks of current default schemes are:

- No tailoring of options to members
- Potential lifetime earnings of members not optimised
- Inefficient use of investment horizons
- Personal retirement outcomes receive insufficient attention

In particular, the historic ‘one size fits all’ default option simply bundles 20 year old members entering the workforce, with 65 year olds leaving the workforce – without regard to investment horizons, preservation rules or retirement outcomes. Some funds are now providing lifecycle products in their default schemes, to provide different investment paths for members based on age. While this recognises the different investment horizons of a 20 year old compared with a 65 year old, it does not recognise that two 20 year olds may have different investment priorities due to differences in current income, current balances and hence projected retirement balance. Age only based life-cycling reduces average investment returns indiscriminately in order to reduce sequencing risk as members’ age and the size of their balance increases, regardless of retirement prospects.

Trustee Tailored Super (TTS) is a next generation lifecycle product, for the MySuper segment, during the accumulation phase. In simple terms, TTS allocates MySuper default fund members to Lifestyle Retirement Bands (LRBs) based on lifecycle factors of age, current income level and projected retirement balance. These LRBs are then used to more efficiently align the investment paths (“glide paths”) of a MySuper members balance to their retirement lifestyle prospects compared to current practices. It aligns the investments of 80% of Australians super balances to the Purpose of Super – Retirement.

The investment options can align with the existing investment choice options offered by a fund, or can be structured or tailored differently in accordance with the objectives of Trustees. In this regard, TTS is a trustee product, and in no way disturbs existing relationships with administrators or fund managers. Trustees set the LRB and glide path parameters as part of their required investment strategy.

Ultimately, TTS results in higher retirement balances which is the desired outcome from the perspectives of all stakeholders – members, trustees and the Federal Government (by reducing the call on the age pension system), while at the same time reducing average sequencing risks across the default fund as retirement approaches. Notably, the Australian Government has recognised the need for greater efficiency of default fund schemes. It has referred to the Productivity Commission several matters relating to the efficiency of the superannuation system, including a requirement to “**develop alternative models for allocating default fund members to products.”** (Emphasis added.) TTS meets this requirement, by offering a more efficient solution for trustees to apply to existing MySuper default fund schemes.

It is our intention that through implementing TTS broadly within the industry, MySuper will prove to be successful and the proposed default (fund selection) auction will not be warranted. Instead a robust dynamic industry with a broad range of funds, competing to provide the best retirement lifestyle possible for their default (MySuper) members, based on their funds demographics, will exist.

An August 2015, CIFR Research and Survey confirmed that the industry's attention has moved to life-cycling, member engagement and tailoring to default members. It concluded: *"**Smart defaults** – As improved member outcomes are likely to result from the capacity of funds to tailor products, regulators and policy makers might aim to foster the development of smart defaults by accommodating the evolution of lifecycle products beyond simple age-based strategies."*

TTS is an implementation ready solution that focusses on the Purpose of Superannuation and will make a significant dent in the pending intergenerational retirement shortfall. We are in active consultation with a range of superannuation trustees, have provided a full briefing to Treasury and will do the same for the Productivity Commissions 'Operational, Allocative and Dynamic Efficiency Study'.

Further Comments on Consultation Paper

The Consultation Paper makes the following four statements:

1. Treasury is undertaking this consultation to help guide the final decision on the objective.
2. The objective will provide a way in which competing superannuation proposals can be measured and a framework for evaluating the fairness, adequacy and sustainability of the superannuation system.
3. A single primary objective cannot possibly encompass all aspects of the purpose and attributes of the superannuation system.
4. Superannuation is important to improving the retirement income of Australians and is one pillar of the Australian retirement income system, together with the Age Pension and voluntary savings.

Firstly we commend you for the consultation process; however we do urge you to actively consider new players and innovative ideas. In this respect the FSI report made recommendations on five specific themes[1] one of which was to *"Drive economic growth and productivity through settings that promote innovation."* Continuing to predominately accept recommendations from established players that concentrate on the larger balance pre/post retirement phases is accepted practice, but unlikely to achieve required long term change. The TTS focus is not on these phases but rather on building better retirement outcomes over the whole accumulation period. The FSI Recommendation 9 *"Objectives of the superannuation system"* is the genesis of this consultation. It should be considered at least equally with FSI Recommendation 10 *"Improving efficiency during accumulation"* as with FSI Recommendation 11 *"The retirement phase of superannuation."*

We fundamentally agree with the second statement above that competing superannuation proposals must be measured (**clearly this consultation is not simply about wordsmithing the Purpose**). We also agree with point three that a single primary objective cannot achieve this outcome. As a result, while we agree with the recommended purpose, you must go further and we suggest a dual measurement via key performance indicators (KPI), one for the accumulation phase and one for the retirement phase. For the accumulation phase this should be **Projected Retirement Balances (Recommendation 1).**

The key attributes of this KPI are:

- It will already be required to be calculated annually, per member, as a result of FSI Recommendation 37 *"Publish retirement income projections on member statements from defined contribution superannuation schemes using Australian Securities and Investments*

[1] FSI Executive Summary Page xiii

Commission (ASIC) regulatory guidance." That is because in order to calculate a 'retirement income projection' the starting position/number (Projected Retirement Balance) has to be calculated.

- It should be expressed in 'today's dollars', and also be included on annual member statements. This approach allows members to understand the relative value now, is less complex and also avoids potentially different inflation related assumptions.
- Existing calculators on funds website can be used (consistent with ASIC guidance) on bulk facilitating consistency and accountability.
- Measurements of fund performance can then be assessed including:
    - For the MySuper option, how much did the average projected retirement balance change (last annual statement to this annual statement or over 3 or 5 annual statements)?
    - For those with a projected retirement balance that indicates, for example retirement on the Full Age Pension, how much did the average grow (refer to point 4 above – other pillars of the system)?
    - For individual members, how is my fund performing, what type of retirement can I expect, what impact did that wage increase/career break/maternity leave/ voluntary contributions last year, have on my retirement prospects and what action should I now take?

It is consistent with the stated objective and the other KPI – retirement incomes – in fact adds **significant extra complementary value and necessary rigor** to that element.

We leave it to other submissions to comment on the second 'retirement income' KPI.

Subsidiary Objectives

In addressing the subsidiary objectives, as outlined in the discussion paper and included in the numbered table below, we believe there is a more logical order and some clarity available, that will assist with this consultation.

	Subsidiary objective	**Why the objective is important**
1	Facilitate consumption smoothing over the course of an individual's life	Superannuation is a vehicle for individuals to fund consumption in retirement largely from working life income. The system should facilitate consumption smoothing while providing choice and flexibility to meet individual needs and preferences.
2	Help people manage financial risks in retirement	Risk management is important as retirees generally have limited opportunities to replenish losses. The retirement income system should help individuals manage longevity risk, investment risk and inflation risk. Products with risk pooling would help people to manage longevity risk efficiently.
3	Be fully funded from savings	A fully funded system, as opposed to an unfunded system, is important for sustainability and stability. The system is designed to be predominantly funded by savings from working life income and investment earnings, where superannuation fund members in

		general have claims on all assets in the fund.
4	Be invested in the best interests of superannuation fund members	Superannuation funds are managed for the sole benefit of members, which means the investment focus should be on maximising risk-adjusted returns, net of fees and taxes, over the lifetime of a member. This results in auxiliary benefits to the economy by creating a pool of savings to fund long-term investment.
5	Alleviate fiscal pressures on Government from the retirement income system	Government's total contribution to the retirement income system, through both the Age Pension and superannuation tax concessions, needs to be sustainable and targeted. Higher private provisioning for retirement should reduce the burden on public finances.
6	Be simple and efficient, and provide safeguards	The system should achieve its objectives at the minimum cost to individuals and taxpayers. Complexity is less appropriate for a compulsory system, as it tends to add to costs and to favour sophisticated and well-informed investors. Given the compulsory nature of SG contributions, the system needs prudential oversight and should provide good outcomes in both the accumulation and retirement phases for disengaged fund members.

- Source: Financial System Inquiry Final Report

Starting with item 6, we obviously agree with 'good outcomes' in the accumulation phase for disengaged members – given this is what TTS improves for those circa 80% of MySuper members (FUM $428+B). These members are relying on their (sophisticated and well-informed) trustee hence **it is not correct to assume (some) complexity is less appropriate**.

Moving to item 4, it is maximising risk-adjusted returns, net of fees and taxes, over the lifetime of a member that is important, not lower fees or annual performance. This will (as the TTS research shows) result in auxiliary benefits to the economy by creating a pool of savings to fund long-term investment (including infrastructure).

Item 3, highlights the importance of being predominantly funded by savings from working life income and investment earnings. With 80% of members disengaged and this MySuper group accounting for vast majority of the future full/part age pension burden – it is this segment that provides the biggest opportunity for improvement. The remaining 20% are trying, they choose an investment option, they often have higher balances, and are as a result seen as a 'target for tax concession reductions'. However the 80% should (and can more effectively) do their bit – through their trustee. Trustees by simply dumping all members in a 'one size fits all' 70/30 balanced default are not carrying their 'full weight or responsibility' to society, taxpayers, the retirement or superannuation systems or to their members. Neither is simplistically reducing average returns as balances rise, which is what occurs within an age only based default resulting in lower average retirement balances. A more effective MySuper next generation product (Smart Default) is needed.

By targeting higher starting retirement balances throughout the accumulation phase for these MySuper members, '*Alleviating fiscal pressures on Government from the retirement income system*' (item 5) is far more likely to be achieved in a sustainable manner. It also reinforces (item 6) the system achieving its objectives at the minimum cost to (all Choice and MySuper) individuals and taxpayers.

Items 1 and 2 are subsequent to the preceding items. We agree that providing choice and flexibility to meet individual needs/preferences and that managing risk (including sequencing risk as retirement approaches) are important, both of which are major features of TTS. However these aspects are secondary to higher projected retirement balances and the broader retirement lifestyle outcome achieved by utilising all three (superannuation, Age Pension and voluntary savings) pillars.

Objective Location

In summary, the proposed purpose *"To provide income in retirement to substitute or supplement the Age Pension"* is appropriate. It will be how that is measured and regulated that really counts.

Placement of the Purpose within the SIS Act, under APRA's purview would be logical. It has the added advantage that measurement of KPI's (including Projected Retirement Balances) would be either included in the 'MySuper Dashboard' legislation, regulations or standards.

Please contact me should you wish to discuss this submission in further detail.

Yours sincerely

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