Objective of superannuation

Submission by UniSuper

9 April 2016

About UniSuper

UniSuper[1] is the superannuation fund dedicated to people working in Australia's higher education and research sector. With approximately 400,000 members and around $50 billion in net assets under management, UniSuper is one of Australia's largest superannuation funds and has one of the very few open defined benefit schemes.

UniSuper is proud to be recognised as one of Australia's most awarded super funds. Over the years we have received a string of awards and high ratings from independent ratings and research agencies. We recently received the prestigious honour of being named 'Super Fund of the Year' and 'Default Fund of the Year' at the 2016 Conexus Financial Superannuation awards. In 2015, in what was an industry first, UniSuper was named 'Super Fund of the Year' and 'Best Fund: Investments,' by Chant West – two of the most coveted awards in the superannuation industry. We received 5 apples ratings for our Accumulation 1 and Accumulation 2 products and our Accumulation products were also awarded a 10-year Platinum Performance rating by SuperRatings.

These awards reflect our ongoing commitment to deliver greater retirement outcomes for our members, by providing them with the best products and services, along with strong investment returns.

UniSuper Management Pty Ltd would welcome the opportunity to discuss the submission further and to provide additional information in respect of the comments made in this submission. Should you have further queries, please contact Benedict Davies on (03) 8831 6670 or benedict.davies@unisuper.com.au

[1] This submission has been prepared by UniSuper Management Pty Ltd (ABN 91 006 961 799), which acts as the administrator of the Trustee, UniSuper Limited (ABN 54 006 027 121).

UniSuper

Executive Summary

- UniSuper supports a primary Objective of superannuation to provide retirement income which substitutes or supplements the Age Pension, provided that it is not an exhaustive statement of what superannuation is for. This is to avoid a "present day mindset" trap.

- We do, however, suggest a more flexible phraseology for the Objective:

  > "*To encourage Australians to take retirement benefits predominantly in the form of income streams, with those income streams targeting a percentage of pre-retirement income which varies depending on the level of their pre-retirement income"*

- We believe that an Objective along these lines would help create a climate for the development of innovative retirement income streams, which would be a positive outcome.

- We do believe that replacement rates have a role to play in analysing the success of the retirement income system and that the rate should include a combination of the means-tested Age Pension and superannuation. Rather than a flat dollar or fixed percentage replacement rate, we suggest a sliding scale between 60% and 100% as follows:

  - Up to 100% for those retirees who rely fully on the Age Pension;
  - Around 85% for those retirees who receive a part Age Pension as well as a superannuation income stream;
  - Between 60% and 85% for those retirees who have been able to make full provision for their retirement and receive income in retirement solely from their superannuation.

- We have no objection to the subsidiary objectives proposed in the consultation paper. We could be concerned, however, if the subsidiary objective of building national savings were to be interpreted as compelling trustees to invest in infrastructure or indeed in any other asset.

- If appropriately drafted, the objectives could be drafted into existing or stand-alone legislation. We suggest considering a regime whereby all future reforms would be assessed for compatibility with the objectives and, in this regard, the *Human Rights Act 2011* is an example of a model that has worked effectively.

Initial comments

In our view, superannuation's primary purpose is to smooth consumption[2] over a person's life by replacing income from employment with income from retirement savings. This is typically achieved with an income stream that facilitates an orderly drawdown of a person's retirement savings while, if possible, maintaining some access to capital in retirement to pay for miscellaneous expenses.[3]

UniSuper has a long history of providing retirement incomes to our members, and we currently offer the "full-suite" of pension products allowed by law. We are strongly committed to developing new retirement income stream products and we have undertaken considerable research of pooled-risk schemes.

One of the challenges faced by retirees (and those designing retirement income products) is working out exactly how long retirees will live. Effective longevity risk management is essential to planning an orderly decumulation of assets - and the concomitant challenge of drawing against those savings at a sustainable rate. This is something that is almost impossible for an individual to know with any sense of certainty. Consequently, we believe that many retirees will continue to see benefits from pooling their retirement savings in defined benefit schemes, superannuation pensions and annuities. We also believe that there will be significant member interest in newer yet-to-be-developed retirement income products such as comprehensive income products for retirement (CIPRs) including group-self annuities (GSAs) and collective defined contribution schemes (CDCs).

It is important to note most forms of collectively-pooled superannuation - defined benefit schemes in particular - will target an income replacement rate as a percentage of income. Therefore, any primary or subsidiary objective for the system that addresses adequacy and sets system-wide target replacement rates will need to ensure that the policy is flexible enough to cater for existing retirement income streams as well as those yet-to-be developed.

In the next section, we suggest a broader phraseology which we believe adds more flexibility:

"*To encourage Australians to take retirement benefits predominantly in the form of income streams, with those income streams targeting a percentage of pre-retirement income which varies depending on the level of their pre-retirement income"*

We also believe that an Objective along these lines would help create a climate for the development of innovative retirement income streams, which would be a positive outcome for the system as a whole, as well as retirees who will benefit from an increased choice of retirement income options.

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[2] Friedman, M, 'The Permanent Income Hypothesis', *A Theory of the Consumption Function*, 1957 & Modigliani, F & Brumberg, R, 'Utility analysis of the consumption function: An interpretation of cross-section data' in *Post-Keynesian Economics*, 1954

[3] Superannuation can also augment a retiree's income with lump-sum withdrawals of capital to fund expenses such as home improvements or to cover things such as health and aged care costs (e.g. paying a refundable accommodation deposit) in later life.

Consultation questions

Do you agree with the objectives recommended by the FSI? Why?

We support a primary Objective of providing retirement income which substitutes or supplements the Age Pension, provided that it is not an exhaustive statement of what superannuation is for, and that the Objective would not restrict trustees from providing lump sums, commutations, death or disablement benefits or early access on grounds of financial hardship or compassionate grounds.[4] This is to avoid a "present day mindset" trap, so that future generations are not hamstrung by the limitations of what we know today.

We are comfortable with the combined statement that superannuation should "substitute or supplement" the Age Pension, provided that the focus remains the combined pillars of retirement incomes policy (viz the Age Pension and superannuation) rather than focussing on only one or the other.

We would be concerned if parts of the Objective were examined in isolation, particularly the second part of the primary Objective "*to substitute or supplement the Age Pension*". If examined in isolation, we suggest that the language is imprecise and uses potentially ambiguous concepts. For example, the Objective does not help to answer the question, by *how much* should superannuation substitute or supplement the Age Pension? The answer to that question will always be subjective because it is relative to the standard of living enjoyed by individual members prior to their retirement.

In light of the above, we would suggest broader phraseology which adds more flexibility:

"*To encourage Australians to take retirement benefits predominantly in the form of income streams, with those income streams targeting a percentage of pre-retirement income which varies depending on the level of their pre-retirement income"*

We do not think the objectives should comment specifically on the issue of the adequacy of retirement incomes, for example, by enshrining a specific system-wide replacement rate in law. We do, however, believe that replacement rates have a role to play in analysing the success of the broader retirement income system by recognising that for many people, their income in retirement will be a combination of the retirement incomes policy pillars viz the Age Pension and compulsory superannuation.

[4] Nor should the Objective restrict trustees from offering services to their members that meet the sole purpose requirements in section 63 of the SIS Act.

There are two main approaches to developing replacement rates – a dollar-based approach and a percentage-of-pre-retirement-income approach. While a dollar-based approach has some strengths, as it is currently conceived, it is likely to be a better measure for low income earners. International literature, on the other hand, offers a range of replacement rates for private pensions, typically between 60% and 85%[5] and is likely to be a better measure for middle to higher income earners to ensure that their standard of living in retirement is roughly equivalent to that enjoyed during their working lives.

We therefore encourage consideration of a more nuanced approach which can take into account the best features of both approaches. We suggest that if there were to have a replacement rate as a subsidiary objective, a flexible sliding scale should be considered along the following lines:

- For some retirees, the Age Pension will fully replace their pre-retirement income, providing a replacement rate of 100%[6];
- For others, a combination of superannuation and the means tested Age Pension will replace some but not all of their income, providing a replacement rate of around 85%[7];
- While for others, who are able to fully self-fund their retirement and receive their income solely from superannuation, a target replacement rate of somewhere between 60% and 85%.

[5] There is a wide range of replacement rates which often vary with income. For a variety of commentary, see for example AON Hewitt, *The Real Deal: 2012 Retirement Income Adequacy at large companies*, 2012; Scholz Jk & Seshardi A, *What replacement rates should households use*?, Michigan Retirement Research Center Working Paper, September 2009; Lee MI, *The Retirement Income Equation*: *Understanding how to arrive at a target replacement rate*, June 2013
[6] Or even increase it in some instances, for example, Newstart recipients moving the Age Pension
[7] This might be typical for those with income and assets below the “free areas” and some part pensioners.

Subsidiary objectives

While we have no objection to the subsidiary objectives proposed in the consultation paper, our view would likely be changed if they were altered. For example, we would be concerned if the subsidiary objective of building national savings were to be interpreted as compelling trustees to invest in public infrastructure or indeed in any other asset class.

Subsidiary objective	UniSuper's view
Facilitate consumption smoothing over the course of an individual's life	UniSuper strongly supports the idea that 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. In light of this, superannuation funds should be able to develop a wide variety of income stream products to assist their members and regulatory impediments to their development should be removed.
Help people manage financial risks in retirement	UniSuper strongly supports the idea that 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. These products include, but are not limited to, defined benefit pensions, purchased superannuation income streams, annuities from a life office or friendly society and other collectively pooled arrangements such as GSAs and CDCs. We also believe that death, disability and salary continuance insurance continues to have an important role to play in a fund's superannuation offering to its members. Insurances play a key role in replacing income that would otherwise have been earned and can offer significant protection against important financial risks. An additional source of difficulty in managing financial risks in retirement is the risks associated with policy and tax changes. While the objective is designed to ameliorate these risks, we suggest that this should be recognised as a specific subsidiary objective – for example, "to help people manage financial risks in retirement *with confidence and certainty about how their retirement savings will be able to be accessed and taxed*".
Be fully funded from savings	This subsidiary objective has particular meaning for public sector pensions. Private sector pensions, on the other hand - whether defined benefit or defined contribution – are fully vested and do not have the benefit of a government guarantee,

	consequently, we make no comment on this objective.
Be invested in the best interests of superannuation fund members	UniSuper strongly supports an objective that would focus the system on members, which means the investment focus should be on maximising risk-adjusted returns, net of fees and taxes, over the lifetime of a member. While it is important to state this as a policy objective, a best interest duty is already codified in enforceable terms in the SIS Act and we do not believe this additional legislative change is required.
Alleviate fiscal pressures on Government from the retirement income system	A successful superannuation system twinned with a means-tested Age Pension will by design alleviate fiscal pressure. However, this is a benefit of a well-functioning system rather than an end in its own right. As such, we do not believe there should be a specific objective of the superannuation system.
Be simple and efficient, and provide safeguards	This is an important regulatory objective and it should be incorporated into the objectives as well as into the broader regulatory framework.

In which piece of legislation should the objective be legislated and why?

If appropriately drafted, the objectives could be drafted into existing or stand-alone legislation. We suggest considering a regime whereby all future reforms would be assessed for compatibility with the objectives and, in this regard, the *Human Rights (Parliamentary Scrutiny) Act 2011* is an example of a model that has worked effectively. If a similar approach were to be adopted, this might be a reason to enact separate legislation (as in the human rights context).

We would also like to see the purpose of the Objective and subsidiary objectives clearly stated in any Explanatory Memorandum confirming that the objective:

- only applies when assessing proposed reforms;
- would not affect the interpretation of existing legislation;
- in particular, does not alter character of the sole purpose test or a trustee's ability to offer both core and ancillary services; and
- would not be binding on trustees.