

[CATEGORY]

ISN RESPONSE TO DISCUSSION  
PAPER: CHARTER OF  
SUPERANNUATION ADEQUACY AND  
SUSTAINABILITY AND COUNCIL OF  
SUPERANNUATION CUSTODIANS

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[KEYWORDS]



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# | INTRODUCTION

ISN is supportive of the development of a Superannuation Charter and the establishment of a Council of Superannuation Custodians.

Super is an important and growing sector within the economy and has a considerable direct and indirect impact on Australians. ISN supports the core superannuation principles proposed and suggests a number of others, including that the system operate in the best interests of beneficiaries.

The establishment of a Council of Custodians operating under a Charter would assist to provide certainty and build confidence within the system which is much needed following a period of significant change.

There is a high degree of agreement amongst stakeholders in the superannuation sector regarding possible Charter core principles and ISN is continuing discussions within the industry with a view to obtaining a level of consensus regarding the principles that will drive a Charter.

ISN's submissions offer a practical means by which the Council operating under a clear legislative mandate can provide a positive contribution to the work of government and the industry to provide a decent retirement income for all working Australians.

# 1. Response to Questions

## Question 1: What is your view of the core principles outlined [above]?

The core principles as detailed in the discussion paper - certainty, adequacy, fairness and sustainability are supported by ISN.

The broad high level core principles proposed and consequently are unlikely to be opposed by superannuation stakeholders or engaged consumers. During the past five years of superannuation reform there has been significant debate regarding the fundamental role of superannuation. Some participants in the recent debates have argued superannuation is an integral pillar of Australia's retirement system and a key social policy tool; others have portrayed superannuation as a financial product. Whilst fundamental differences emerged during these debates, most parties involved called for certainty, adequacy, fairness and sustainability, a clear indication that these terms mean different things to the debate participants.

As an example, some will argue that to be fair the system should operate in a progressive manner that ensures that those with higher incomes contribute more to the system, say via progressive tax treatment. Others argue that this is unfair treatment.

The principles will be shaped through the means by which the superannuation system deals with conflicts between principles.

## Question 2: Are there any additional principles that are important in setting retirement income policy?

### **In the best interests of beneficiaries**

A core principle, often assumed but not stated, is that the system is run for the benefit of fund members. The "In best interests of beneficiaries." should be explicitly stated. Although they have a valid interest in its operation, the system has not been established and funded to operate for the benefit of government, service providers, funds and their shareholders or other vested interests. The Stronger Super reforms have elevated the "best interests" principle to an explicit legislative requirement imposed upon trustees. It would be inappropriate if there was a lack of consistency between the stated core principle of the legislative and regulatory regime and the charter. Accordingly the 'In the best interests of beneficiaries' principle should be included in the Charter.

### **In the best interests of the nation**

The superannuation system can and should be operated in a manner that it delivers positive outcomes for both beneficiaries and the nation as a whole. Clearly the nation benefits if the system operates a sustainable, fair manner that ensures that as the system matures less people need to rely on the safety net pension.

It is also important to recognise the critical role superannuation plays in the conduct of financial markets, both in ensuring capital is allocated efficiently and effectively, and avoiding or minimising systemic risks for fund members as investors. The system also plays a key role in providing investment funds for the economic growth of the nation and its long-term prosperity. Superannuation investment is particularly important where a patient long-term approach to capital investment is required.

## National Savings impacts and flow on investment

Superannuation funds have a strong positive impact on the level of National Savings in the economy, increasing the economy's resilience to external shocks and increasing the pool of funds available for productive investment.

Research undertaken by the Reserve Bank of Australia (RBA)<sup>1</sup> has found the SG is an effective mechanism to boost national savings as there is only a small offset to private savings. Analysis by RBA researchers shows that up to 90 cents in each additional dollar of SG contributions flows through directly to increased net household savings.

As superannuation contributions increase, particularly if the planned SG increase remains in place, the aggregate pool of superannuation assets will increase by at least half a trillion dollars over the next 25 years. A significant proportion of these funds will be available to finance nation building investment. Infrastructure is not highly correlated with the performance of equities so it is a prudent alternative investment within a balanced investment portfolio.

In the years ahead, the role of the superannuation sector in building and managing the infrastructure needed to keep the wheels of the economy moving will be critical. Industry funds have pioneered infrastructure investments across a diverse range of sectors including renewable energy, airports, roads, ports, and social infrastructure such as hospitals and schools. As well as financing and managing critical infrastructure and the employment and social benefits that flow from it, the investments have delivered exceptional returns to superannuation fund members.

## Effective and efficient

It is important that the system be both effective and efficient to maximise retirement incomes. The importance of this principle is reflected in the recognition that back office systems, outsourcing and related party arrangements can have a considerable impact on retirement savings over time.

To be effective and efficient the net tax cost of concessional tax arrangements must be reassessed to ensure appropriate targeting. Ongoing work in this important area is required.

### *Efficient taxation arrangements*

Over three million low and middle income earners currently obtain no tax concession on their mandatory super contributions with some of the lowest income earners paying more tax on their contributions than their ordinary income. More progressive contribution tax arrangements are needed to ensure low and middle income earners obtain more equitable superannuation tax concessions.

Individuals often face complex choices about whether their contributions are made from pre-tax or post tax income to maximise their concessions. For some employees particular choices may not be available depending on their employer (for instance the availability of salary sacrifice).

Existing contribution tax concessions are highly contingent on individual circumstances, but the broad outcome is such that the concession increases in line with the tax wedge between the contribution tax rate of 15 per cent and an individual's personal marginal tax rate. As a consequence the level of concession on an individual's SG component increases with income, although the outcome is not transparent or predictable due to the interaction of means tested tax offsets (such as the low-income tax offset) with the marginal tax rate schedule.

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<sup>1</sup> Connolly, Ellis (2007), The Effect of Saving Behaviour, RBA Research Discussion Paper.

For low income earners the concession on SG and any pre-tax contributions is can be negative as the contribution tax rate may be greater than their marginal tax rate. This impact is affecting more individuals every year as the effective tax-free threshold increases in line with the changes to the Low Income Tax Offset (LITO). Treasury has estimated there are in excess of 3 million tax payers who receive no benefit or a negative concession. These arrangements have a disproportionate impact on the retirement savings of women who comprise more than two-thirds of part-time workers which dominate workers on lower incomes.

### **Targeted contribution concessions required**

The cost of the current concessional arrangements to taxpayers is significant and growing. As this cost grows there is likely to be an associated increase in demands to reduce the concessional treatment of superannuation. There are a number of ways in which contribution concessions could be made more equitable and fairer and reduce the growth in the cost of concessions to the taxpayer.

In its submission to the Henry Review, ISN proposed comprehensive reform which would involve abolishing the contributions tax and making all contributions to super (including SG) from after tax income. The concession could then be provided by a tax offset (or Government Co-contribution) paid at a flat rate equal to at least 25 per cent of the gross contribution. This tax offset (or government contribution) would be paid directly in to the member's account.

The approach adopted by the government can be implemented relatively quickly through refunding the contributions tax paid by lower income earners. In effect lower income earners would pay zero contributions tax as a consequence. This relatively simple measure would go a long way towards making the contribution tax concessions more progressive and efficient. Such a change would also add up to \$66,000 to the retirement payout of a low income earner over their working life.

Under existing settings, the largest tax concessions typically accrue to the highest income earners who are likely to save in any case. The demographics and member balances of the SMSF sector see a disproportionate share of tax concessions provided to those holding greater wealth in their superannuation funds. The growth of the SMSF sector now sees it as the dominant sector in the industry. The billions in taxation concession provided to the sector are growing annually; these arrangements are not sustainable unless a more equitable arrangement is introduced.

These are important matters that the Guardians should address as a priority.

### **Concessional contribution caps**

The capacity for individuals to save varies considerably throughout their life time in line with income and consumption preferences. Younger workers are often on lower incomes and use any available discretionary income for leisure activities or to save for a deposit on a home. Typically the next phase involves an increase in income but additional responsibilities such as costs associated with raising children and servicing a mortgage. Often it is only as these responsibilities taper off that individuals have sufficient discretionary income to consider additional superannuation contributions.

Recent changes introducing a higher contribution cap for over-50s is an essential equity measure to enable older workers to make catch up contributions as their circumstances allow. A range of more flexible options for contribution caps should be considered in time. The principles of equity and fairness should be extended to those who have had broken patterns of employment due to family responsibilities or extended periods of casual, seasonal or part-time employment.

## Certainty

It is in the interests of fund members, service and product providers and the government to provide a high level of certainty in the superannuation industry. Certainty encourages a long-term approach to decision making which ultimately operates to the benefit of all stakeholders.

Continual change and the discussion regarding possible change, has the inevitable impact of undermining confidence in the system which reduces inputs into the system which is ultimately reflected in greater cost to the taxpayer via higher pension payments than would otherwise occur if confidence was not undermined.

A significant means by which certainty is undermined is government decisions which have a retrospective impact on superannuation decision making. Retrospective decision making should be avoided. Policy and taxation settings should be designed in the interests of both existing and future retirees. A long-term and bi-partisan approach to taxation settings delivers certainty and confidence.

Short-term bench marks do not assist certainty. Superannuation is a long-term investment and the long-term reporting of superannuation returns adds to certainty.

### Question 3: What safeguards can be placed on changes in the superannuation system to promote certainty?

&

### Question 4: How should the Charter reflect procedural fairness, including providing adequate notice of future changes and an open and transparent consultation process?

The charter needs to find a balance between the mandate of sovereign government and ability to promote core principles. It is not in public interest to frustrate representative government and it should be acknowledged that superannuation is a key and growing component of a wider taxation and social security system and policy platform.

Decisions relating to superannuation have a considerable impact on significant areas of government activity. It is also true that non-superannuation decisions can have a significant impact on retirement savings and the super system. Whilst pension and taxation arrangements have the most obvious impact; family law, social security and other changes can also have an impact on superannuation.

ISN does not propose a mechanism which unduly limits the ability of a government to make changes which directly or indirectly impact on superannuation arrangements. Rather, we suggest that it would be desirable to have in place mechanisms which encourage consultation with the industry and community to avoid surprises as far as is possible. In addition there should be imposed an expectation that the government would be required to fully explain any proposed changes, the grounds for the change and the likely impacts of the change.

Superannuation is a component of the social contract between government and the community. This is reinforced as superannuation payments are a form of deferred wages.

A requirement that superannuation changes be placed on notice, explained and costed will allow for informed feedback and analysis and encourage greater engagement on superannuation and related issues.

### Statement of Compatibility with Superannuation Charter

ISN suggests that it would be appropriate that Explanatory Memorandums to legislation should provide a statement of compatibility with the superannuation charter. This would reflect the existing requirement imposed by Part 3 of the *Human Rights (Parliamentary Scrutiny) Act 2011* which requires a statement from

the relevant Minister that the legislation is compatible with human rights and does not raise any human rights issues.

We suggest that a similar process should be adopted so that the relevant Minister provides a statement that the proposed Bill is or is not relevant to the Superannuation Charter and where it is relevant that it is compatible with the Superannuation Charter. In addition we would suggest that, in circumstances where the subject of the Bill is relevant to the Superannuation Charter that there is a statement that the superannuation custodians have been consulted and their views sought.

The office of the guardians once established should be adequately resourced to allow a timely examination of proposed Bills.

### **Procedural fairness, notice and consultation**

The appointment of superannuation guardians would facilitate a process by which government could on a confidential basis, where required, pass matters through the office of the custodians to ensure they are consistent with the principles.

Except in cases where there are commercial or budgetary implications, it would be preferable if the government held a public discussion regarding proposed change. The Stronger Super consultation process is an example of such a process. The recent Stronger Super reforms have been enacted after a lengthy consultation process. A process that builds on these initiatives that requires the provision of information to the office of the custodians for independent assessment and genuine consultation within the context of the core principles would be welcomed.

ISN does not suggest that superannuation decisions should be the subject of procedural fairness, the government is elected to govern. The emphasis should be on consultation and openness that removes any perception that decisions are being made as a result of bias or in the interests of those other than beneficiaries. The second limb of natural justice goes to bias, real and apprehended, the most relevant context of this principle will be on the appointment of custodians to uphold the charter.

## **Adequacy**

Central to the success of Australia's superannuation system is the trade-off between compulsion and tax concessions. However, a large proportion of the Australian workforce does not receive their fair share of the tax concessions. When lifting the compulsory SG, it must be ensured that all employees receive tax concessions and for older workers, the flexibility to adjust their contributions as circumstances permit.

The above comments on an efficient and fair system detail what ISN believes would be an appropriate treatment of concessional tax arrangements and contribution caps.

### **Lifting the SG to 12 per cent**

A phased increase in the SG from 9 to 12 per cent is the most efficient and comprehensive means to raise retirement incomes, with little offset in other private savings. Combined with efficiency and equity measures it will be sufficient to raise retirement accumulations by between 50 and 75 per cent. A combination of increases in the SG, efficiency and equity measures have the potential to increase the pool of savings available to be invested in the economy by around half a trillion dollars over the next 25 years.

## **Question 5: What would be appropriate benchmarks for measuring the adequacy of the superannuation system?**

ISN is generally supportive of the discussion paper's expressed aspiration for adequacy being a superannuation balance large enough to provide an income stream (including capital drawdown) of around



70 per cent of pre-retirement income over a 25-30 year period. The most recent national figures released for the ASFA Retirement Standard show that, in general, a single person looking to achieve modest retirement needs to spend \$22,641 a year, while those seeking a 'comfortable' retirement lifestyle need to spend \$41,169 a year. This methodology is a good basis for assessing adequacy.

In the 1907 Harvester case<sup>2</sup> Justice Higgins began the process of determining the adequacy of a living wage, including a decent retirement. We do not intend to take on this task as part of these submissions. However, we believe it would be appropriate and timely for an independent body guided by core principles to assess the adequacy and measurement of retirement incomes and attempt to set long-term adequacy goals. Any assessment, in the first instance, should focus on the adequacy of retirement incomes at the bottom quartile of retirement incomes.

There should be a holistic assessment of the adequacy of the superannuation system. Any assessment should be focused on the adequacy of retirement incomes for Australians. A more restricted view of the superannuation system are likely to focus on final quantum (output) which will be determined by contributions (input) and earnings (less costs).

The size and treatment of superannuation contributions will be the largest factor in the determination of the adequacy of retirement incomes. With an average superannuation account balance of under \$30,000, most working Australians will continue to rely heavily on the pension and social security system at retirement. The adequacy of retirement incomes, of which the superannuation system is a key and growing component, will be affected by many factors.

Retirement adequacy will be heavily impacted by future medical and housing expenses

### Question 6: What principles would support fairness in the distribution of government assistance in the retirement income system and how should they be incorporated into the Charter?

The key principle should be that the system is operated in the interests of beneficiaries.

The principle of sustainability requires the establishment of priorities. Whilst it is ultimately it is a matter for government to set priorities, the Charter should ensure that principles of sustainability, fairness and certainty are dealt with and in turn examined by the council of superannuation custodians. The most vulnerable should be specifically considered

### Question 7: What limits could be placed on government assistance and how should this be measured?

Government assistance is clearly limited by principle of sustainability and should be guided by the principle of fairness. As assistance will always be limited, progressive principles should be applied when considering taxation and a progressive means test applied.

Primary purpose of superannuation is to supplement pension to ensure retirees can meet normal needs of a human being living in a civilised society.

For the foreseeable future the focus of the system needs to be on supplementing the pension to ensure a decent and dignified retirement income. The focus should be steered away from taxation considerations. We agree with the observation on page 6 of the discussion paper that the 'system is not intended to be an open-ended tax concession for capital income'.

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<sup>2</sup> *Ex Parte H V McKay* (1907) – [The Harvester Case] Commonwealth Arbitration Court.

## Sustainability

The principles of sustainability, certainty and fairness must be considered together. Preceding paragraphs go to these issues

### Question 8: How should the costs and benefits of the superannuation system be measured?

It is important to note that the direct cost of the system, via the cost of contributions, the cost of operating the system and the cost of tax concessions, must be aligned against the direct and indirect benefits provided by the system. Any cost benefit analysis of the system should be holistic and incorporate the broader purpose of the system – to have retirees at a minimum, to live in frugal comfort.

### Question 9: How should the Charter take into account the goal of administrative simplicity and balance this against other objectives such as fairness and sustainability?

### Question 10: What weight should be given in the Charter to the considerations below?

- *Recognising the inherent trade-offs involved in retirement income policy.*
- *Considering the interactions between the superannuation system and other elements of Australia's retirement income system, for example, other savings vehicles and government support such as the Age Pension.*
- *Recognising the intergenerational costs and benefits of superannuation savings and tax concessions.*

Superannuation is not an end in itself and should be considered in a broader social context. As stated previously, the superannuation system is a large and growing part of a holistic retirement system and a wider social contract. The inevitable conflict between principles will always be difficult and any approach should interpret the conflicting principles in a way that recognises the system needs to offer proportionately more support for those of limited level of income / accumulation.

The effectiveness of Charter and custodians will be limited if a narrow view is adopted.

Considerations identified in the three dot points of question 10 are properly identified as matters for the Council's consideration.

### Question 11: How would the Charter reflect the impact of superannuation changes on the broader economic environment?

Our earlier comments under the heading "In the best interests of the nation" are relevant to this question. Changes will be identified in the application of the identified principles, in particular the sustainability and fairness principles.

### Question 12: Should the Charter be a policy document, or be enshrined in legislation?

It should be enshrined in legislation so that clarity of role and purpose is widely understood.

## 2. Council of Superannuation Custodians

ISN is supportive of the establishment of an independent Council of Superannuation Custodians.

It is not suggested that Council be given a mandate to make policy but rather assess Government policy options or proposals against articulated principles. In function it is close to a Scrutiny of Acts and Regulations Committee (SARC)<sup>3</sup>, and similar to the role of the Australian Productivity Commission. The Council should be, and seen to be, independent of Government so that it will make an independent assessment.

Achieving the required level of independence is best served by creating the Council through legislation with a clearly articulated purpose and objects

For the Council to be effective it needs to be seen as a voice outside Treasury, (or other central agency), independent of revenue imperatives of Government.

The independence should not extend to a lack of accountability for responsiveness or the quality of analysis. It is envisaged the Council would report to Parliament on its performance and presumably be subject to review by the auditor general.

**Question 13: Should the Council also be able to examine and report on issues on its own initiative?**

**Question 14: What powers should the Council be given in order to effectively carry out its role?**

**Question 15: Should the Council have the capacity to recommend policy changes?**

**Question 19: What structure and supporting legislation is necessary to ensure the Council operates at arms-length from Government?**

ISN suggests that the Council should have legislative backing as an independent body. We suggest the best arrangement would be one which is similar to the Australian Productivity Commission which is an independent research and advisory body to government.

Due to the close interaction between the many arms of government policy, ISN is not supportive of the Council commencing reviews on its own initiative. We suggest that the ability to do so would reduce the effectiveness of the Council and potentially put the Council at odds with the government of the day.

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<sup>3</sup> SARC's major areas of responsibility include the scrutiny of bills introduced into Parliament, the scrutiny of regulations and the review of redundant, unclear or ambiguous legislation. SARC also receives references from Parliament or by Governor-in-Council Order. These references typically require SARC to review an Act or issue concerning an Act and to report to Parliament.

SARC's functions are set out in section 17 of the [Victorian] *Parliamentary Committees Act 2003*

### 3. Functions of Council

ISN suggests that the Council would have four main ongoing functions:

1. To undertake research relevant to the Superannuation Charter;
2. To consult with industry, stakeholders, regulators and government and participate when requested in government consultation processes;
3. To provide an annual report to Parliament; and
4. Following a Ministerial request, to undertake reviews and provide reports to the Minister in accordance with the terms of reference.

#### **Research Role**

ISN does not suggest that the Council have a large secretariat. However, it should have the capacity to undertake research, including the funds to outsource relevant research.

#### **Consultation Role**

It is suggested that consultation will be an important component of the Council's work. The Council should not take on the role of advocate for specific change, rather the guardians of the principles contained in the Superannuation Charter. Part of this role would be consulting and providing advice to government regarding the potential impact of legislation on the Superannuation Charter.

#### **Annual Report to Parliament**

The Council's annual report to Parliament would, in addition to a annual report's normal functions, provide the Council with the opportunity to make recommendations for change and suggested areas of further action in advancement of the Superannuation Charter.

#### **Reviews**

The Council should be empowered to undertake reviews in much the same way as the Australian Productivity Commission. Restricted by the terms of reference, but with the flexibility of moving outside the scope where required to properly fulfil the request provided.

Any final report produced by the Council should be provided to the Minister. It is suggested that the Minister should be required to table the Council's report no more than 90 days after receipt. This time frame would allow for a considered and coordinated response from government.

### Question 16: How should the Council be assembled to adequately reflect the wide range of community views on superannuation?

The composition of the Council is important. ISN does not have a firm view on the composition other than to state the following should be considered:

There should be a balance between:

- technical experts and 'community' representatives ;
- those currently engaged in the industry and those with past knowledge.

It is important that Council has relevance and is not dominated by vested interests. Excluding the involvement of persons with current relevant knowledge is likely to hinder the operations of the Council. If Custodians are appointed on a part-time basis there will be a need to manage real or perceived conflicts.

## Question 17: How would the work of the Council relate to the activities of existing bodies?

It is important to ensure that the work of the Council is aligned to the Inter-Generational Report (IGR) four yearly cycles.

The IGR takes current economic and demographic trends, current government policies and policy settings and projects forward the implications of a continuation of those trends, policies and settings. Its work is highly relevant to the work of the council.

In addition the Council will need to liaise and work closely with regulators and Treasury. There may be economies of scale gained by the incorporation of the Council within an existing body. This should

## Question 18: Will the establishment of the Council require changes to the role or structure of existing superannuation oversight bodies?

It is not envisaged that the Council would subsume any of the existing functions of superannuation oversight bodies. It would be appropriate for the Council to take on the role of facilitator of any superannuation round table activities.

## 4. Conclusion

ISN welcomes the opportunity to make these submissions and is supportive of the development of a Superannuation Charter and the establishment of a Council of Superannuation Custodians.

ISN recognises that decisions relating to superannuation have an impact on other key policy areas and the economy as a whole. ISN has approached the questions posed in the discussion paper with this in mind. An appropriately resourced Council operating within a clear mandate will play a central role in ensuring the system is operated in the best interests of beneficiaries, is fair and sustainable, competitive and responsible and is stable over the long-term and continues to benefit the nation.