Submission

Legislating the objective of superannuation

August 2023

A submission made in response to the Treasury consultation in respect of the Superannuation (Objective) Bill 2023 and Superannuation (Objective) (Consequential and Transitional Provisions) Bill 2023

Via email: SuperannuationObjective@treasury.gov.au

Written by:

Harry Chemay

Independent Superannuation & Wealth Consultant

About the author:

Harry Chemay has over 25 years of experience across financial planning, wealth management, asset consulting, financial technology and superannuation product design. He has previously worked for KPMG (Financial Services), Howarth Financial Services, Colonial/State Bank of New South Wales/CBA and Mercer. Harry was also a co-founder of Clover, a FinTech startup seeking to assist younger Australians in building wealth. He consults primarily in the APRA-regulated superannuation space, with a focus on the decumulation phase and designing innovative retirement solutions.

Harry holds a Bachelor of Business (Banking and Finance) from Monash University, a Graduate Diploma in Applied Finance and Investments (Finsia) and a Grad Certificate in SMSFs (University of Adelaide). He has previously held the Certified Financial Planner (CFP) and Certified Investment Management Analyst (CIMA) designations.

Preliminary Remarks

The exposure draft Explanatory Memorandum for the ***Superannuation (Objective) Bill 2023*** and ***Superannuation (Objective) (Consequential and Transitional Provisions) Bill 2023*** (collectively '*the Objective Bills 2023*') refer appropriately to the 2014 Financial System Inquiry's (the Murray FSI) recommendation (Recommendation 9) to:

"Seek broad political agreement for, and enshrine in legislation, the objectives of the superannuation system and report publically on how policy proposals are consistent with achieving these objectives over the long term."

Further, the Murray FSI suggested that one such objective for the superannuation system might be:

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

That form of wording was incorporated into a ***Superannuation (Objective) Bill 2016***, which was not agreed to by the then-sitting Parliament, the issue of an objective for the system instead being revisited in Treasury's 2020 *Retirement Income Review* (hereafter 'RIR').

As noted in the Explanatory Memorandum for the Objective Bills 2023, the RIR suggested that an objective for the retirement income system was required to *"anchor the direction of policy settings, help ensure the purpose of the system is understood, and provide a framework for assessing the performance of the system"*.

It is therefore a positive step that Recommendation 9 of the Murray FSI is now being revisited, having not been codified in legislation in 2016. As was noted in the final report of the Murray FSI:

"Clearly defining the objectives of the superannuation system is a prerequisite to achieving the objectives efficiently. Consistent policy settings across the accumulation and retirement phases would meet the retirement income needs of Australians more efficiently and effectively. It would also assist Government in implementing policy settings that are well targeted and sustainable over the long term."[1]

Having been involved in the superannuation space in various capacities since 1997, and having contributed to a submission to the Murray FSI, and several subsequent Treasury submissions thereafter in respect of the recommended Comprehensive Income Product for Retirement (CIPR) and related matters, I respectfully submit below my thoughts in relation to the proposed objective for the superannuation system as contained in the Objective Bills 2023.

[1] The Treasury, Financial System Inquiry – Final Report, November 2014, page 97

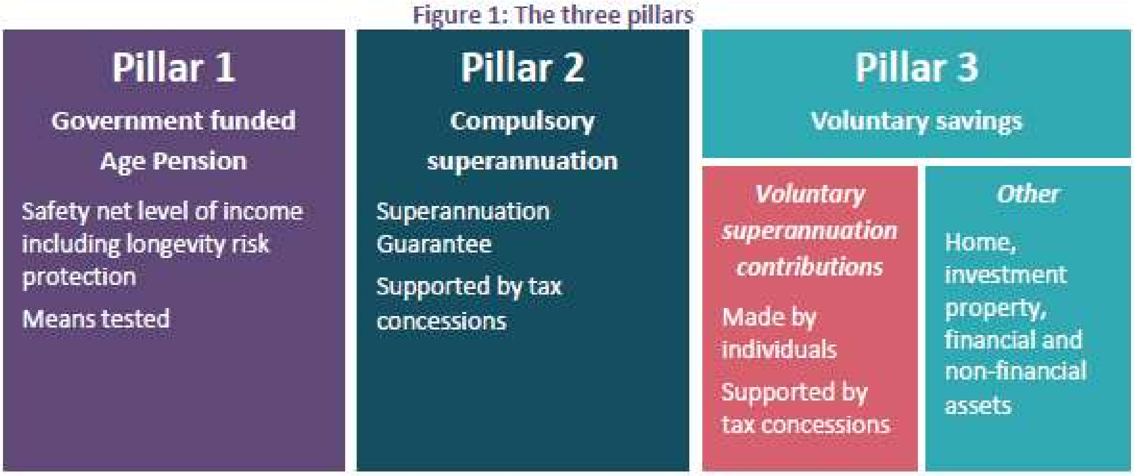
The Three Pillars Model of Retirement Income Policy

The RIR of 2020, commissioned as a recommendation of the Productivity Commission in its 2018 report *Superannuation: Assessing Efficiency and Competitiveness*[2], acknowledged (per its Terms of Reference) that Australia's retirement income system is based on three pillars, these being:

- A means tested Age Pension
- Compulsory superannuation (i.e. the Superannuation Guarantee); and
- Voluntary savings; including additional super contributions, home ownership and other financial assets.

The RIR depicted the operation of these three pillars[3] in providing Australians with support in their retirement years thusly:

Figure 1: The three pillars



Source: Retirement Income Review Consultation Paper, 2019

It is relevant to any discussion about the objective of the superannuation system that super be placed in its proper context relative to the total assets that Australians may accrue over their working lives, and the benefits they may be entitled to, from which to fund their retirement years.

At this point it should be acknowledged that the needs and preferences of individuals in retirement may differ. People will differ in their capacity to build retirement assets over their working years, and some of these differences will be discussed later in comments on the 'equity' component of the proposed superannuation objective.

It is however to be expected that there will be a distribution of outcomes in respect of financial resources capable of funding retirement. Broadly, individuals with higher lifetime incomes will have relatively more of their household wealth in Pillars 2 and 3 above, while those with lower lifetime incomes may be more reliant on Pillar 1 to anchor their income in retirement.

For the purposes of creating an objective for the entirety of the superannuation system, it is therefore necessary to put less weight on the outliers of the distribution (those either with extreme wealth or in relative poverty) and consider instead the circumstances of 'middle Australia', which one could broadly encapsulate within the 20th and 80th percentiles.

---

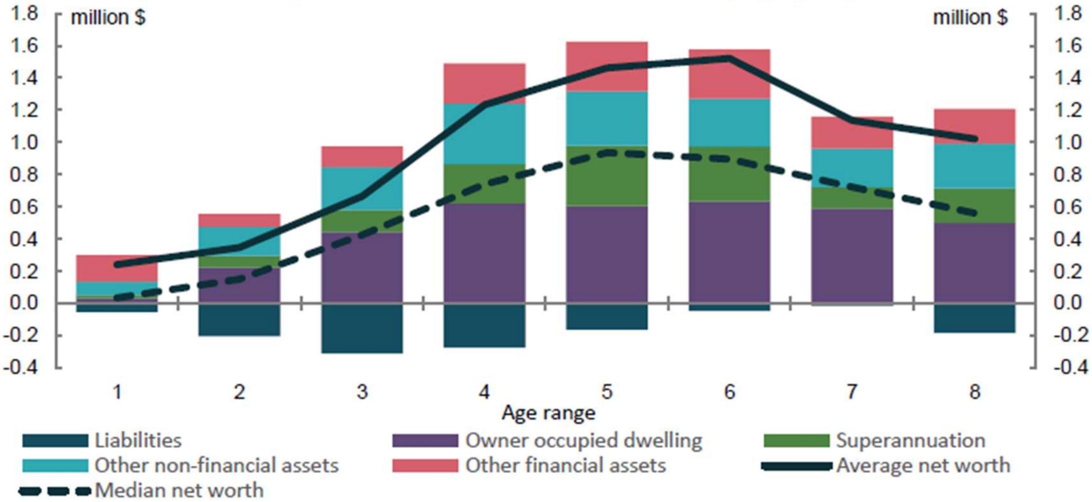
[2] Productivity Commission Inquiry Report, Superannuation Efficiency and Competitiveness, No.91, 21 December 2018

[3] Retirement Income Review, Consultation Paper, November 2019

Turning thus to ‘averages’ to assist in framing an appropriate objective for the super system, it is instructive to consider the average household wealth of Australians, and its composition.

The preliminary report of the RIR illustrated the average household wealth by age group during 2017-18, and reported the outcomes per the below chart:

Figure 2: Average net Australian household wealth by age group, 2017-18[2]



Source: ABS 2019a, cat. no. 6523.0.

At every age range from the 40s onward, owner occupied dwelling assets dominate superannuation assets in respect of average net household wealth.

This dynamic continues to hold constant, with Treasury’s most recent Intergenerational Report (IGR) noting that the largest asset held by Australian households has historically been the family home, and that in 2019-20 it made up 37 per cent of net household wealth, followed by superannuation at 22 per cent[4].

Thus for those who attain home ownership during the course of their working lives, and remain home-owners at the point of retirement, the family home is itself a key asset in determining one’s retirement standard of living.

This is because, in addition to the ‘imputed rent’ of home ownership (lowering the effective cost of housing in retirement), outright home ownership, as the RIR noted *“supports retirement income by reducing ongoing expenses and acts as a store of wealth that can be accessed in retirement”*.

Updating the concept of ‘average net household wealth’ for the latest available statistics, it is instructive to review the just-released Australian Bureau of Statistics data on household wealth[5] (to 30 June 2023).

The balance sheet for Australian households in aggregate shows total accrued superannuation assets (in both accumulation and decumulation mode) of some $3.59 trillion as at 30 June 2023. That however should be seen in the context of the value of land and dwellings (housing) of some $10.3 trillion, some 2.9 times the size of the entire superannuation system.

[4] Treasury Intergenerational Report 2023, Australia’s future to 2063, at page 169
[5] ABS, Australian National Accounts: Finance and Wealth (released 28 September 2023)

The relevant table from the ABS release is provided below, and shows an aggregate level of wealth for Australian households, at at 30 June 2023, of some $15.1 trillion dollars, of which housing (land and dwellings) comprises some 68 per cent.

Household balance sheet, $b

	Amounts outstanding, Mar-23	Transactions, Jun-23	Other changes(a), Jun-23	Holding gains/losses, Jun-23	Amounts outstanding, Jun-23
Non-financial assets					
Land and dwellings	9,975.3	11.1	10.2	314.6	10,311.2
Other non-financial assets	827.0	-2.1	-	16.2	841.1
Financial assets					
Superannuation reserves	3,541.3	36.5	-	10.3	3,588.2
Shares and other equity	1,297.0	2.1	-	14.9	1,314.0
Currency and deposits	1,615.2	-6.4	-	0.2	1,608.9
Other financial assets	385.6	6.5	-	0.4	392.5
Liabilities					
Loans	2,765.8	37.9	-	1.4	2,805.0
Other liabilities	154.3	-3.3	-	-	151.1
Wealth (Net worth)	14,721.3	13.0	10.2	355.3	15,099.8
Memorandum item					
Consumer durables (b)	528.7	3.4	-	-	540.0

- nil or rounded to zero

(a) Not all other changes in volume are separately identifiable. Some have been shown as holding gains.

(b) Consumer durables are not included in net worth.

Source: ABS – Australian National Accounts: Finance and Wealth (Reference period June 2023)

It should also be noted that non-superannuation assets (as allocated, alongside housing, to Pillar 3 in the RIR framework) accounted for some $2.9 trillion in aggregate household wealth, not too far off the aggregate amount held in superannuation.

Thus it is important to acknowledge the size, and role of, household assets that make up Pillar 3 within the RIR framework, and particularly the role of the asset that dominates household wealth, and is likely to continue to do so; wealth held in 'land and other dwellings', i.e. housing.

In essence, a robust objective for the superannuation system would be one that recognises all key sources from which the average Australian might derive a dignified retirement across all three pillars of the retirement income system.

A failure to acknowledge the importance of housing, or more specifically *secure shelter* (incorporating those who may not attain property ownership prior to or during retirement) is to ignore the asset that dominates the household balance sheet for the majority of Australians.

The Assumption of Consumption Smoothing

Before considering the specific form of words contained in the Objective Bills 2023, it is also necessary to consider the purpose of a retirement income system in the context of the economic affairs of the population.

Retirement systems exist as an acknowledgement of, and a response to, the diminution of human capital over time such that, in modern developed economies, it is the expectation that the vast majority of people will outlive their willingness or ability to exchange their labour for income, electing instead to remove their services from the labour market and thus 'retire'.

Underpinning retirement income policy is thus a notion of *consumption smoothing*; of individuals under-consuming during their working years, setting aside a portion of their income from personal exertion, either voluntarily or by compulsion, to help fund consumption in their retirement years.

In a consumption smoothing framework, the aim is to have a level of income in retirement that bears some relationship to one's pre-retirement income. Indeed this is the assumption used in the RIR, insofar as the modelling of income adequacy was based upon a suggested replacement rate of income of 65 – 75 per cent of one's pre-retirement equivalent. This is thought to be an appropriate rate of replacement income for most Australians (i.e. those that are not at the extremes of income distribution pre-retirement).

Consideration of consumption smoothing has relevance to any discussion of the objective of the superannuation system because, from a household economic efficiency point of view, getting the balance right between the 'delayed gratification' implicit in deferring consumption today and enjoying higher levels of consumption in retirement (than would be the case without retirement savings) has ramifications at the broader macroeconomic level.

Saving for retirement necessarily lowers one's consumption capability during one's working years (and thus arguable one's working-life living standard). The trade-off is a presumably higher consumption capability (and living standard) in one's retirement.

To the extent that individuals accrue superannuation assets and, once in retirement, under-consume these assets, either by design or due to insufficient knowledge or confidence to 'spend down', it tests the premise of consumption smoothing as the rationale for a properly functioning retirement income system and brings into consideration other possible motives, such as bequests.

In a system such as operates in Australia, the preferential tax treatment accorded to superannuation contributions and earnings exists to incentivise both compulsory and voluntary contributions, on the premise that these are preserved until needed for retirement (unless accessed prior in one of the limited available circumstances).

The cost of these tax concessions is not inconsequential, with the latest IGR forecasting the combined earnings tax and contributions tax concessions to continue growing steadily over the 40 year forecast period, increasing from 1.9 per cent of GDP in 2022-23 to 2.4 per cent in 2062-63[6]. The cost of these concessions is projected to overtake Age Pension expenditure in the 2040s.

It is therefore vital that any superannuation objective also highlight the importance of focussing on superannuants maximising their retirement standards of living by smoothing the consumption of their retirement assets.

[6] Treasury IGR 2023, at page 171

Objective as Proposed

The objective for Australia's superannuation system, as proposed in section 5(1) of the Superannuation (Objective) Bill 2023 is:

'to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.'

This is substantively different from the objective suggested by the Murray FSI, and taken into Parliament in 2016 as the Superannuation (Objective) Bill 2016.

Whereas the Murray FSI version focussed primarily on super's role in providing income to supplement, or substitute for, the Age Pension, the Objective Bills 2023 broaden the definition to incorporate aspects of accrual (saving), adequacy (dignified retirement), equity and system sustainability.

Insofar as the above additions add to depth to a holistic description of the purpose of Australia's superannuation system, they are to be welcomed, and I do not have any issue with the policy intent in the wording.

I would however suggest minor changes to the form of words to give greater clarity to the purpose of the system, and to take account of the issues I have outlined for special mention; these being the influence of secure shelter (whether as home owner or renter) and appropriate consumption smoothing as determinants of a dignified retirement.

Thus the amendments I suggest to the wording as currently drafted are as follows (amendments in bold italics below):

> 'to ***grow and subsequently consume*** savings ***purposefully accrued*** for a dignified retirement, alongside government support ***and secure shelter***, in an equitable and sustainable way.'

The remainder of this submission will involve an exploration of the key concepts of the proposed objective as outlined in the EM (preserve savings, deliver income, dignified, Government support, equitable, sustainable) together with my suggested amendments (a chronological focus on saving then consuming, and the importance of security of housing tenure).

'Preserve Savings' to 'Deliver Income'

It is noted in the EM that 'preserve savings' means superannuation savings should not be accessed for purposes outside of retirement income, apart from in exceptional circumstances (generally genuine financial hardship and related early release mechanisms).

In respect of the term 'preserve savings', there exists the possibility that this could be interpreted as focussing on accrued superannuation assets held in accumulation mode, i.e. the value of assets at a point in time, rather than the process of generating earnings on contributions, compounded over time, that creates a growing pool of superannuation assets across time.

It should also be noted that the preservation aspect of 'preserve savings' is already captured, adequately so, by the Sole Purpose Test provision contained in section 62 of the Superannuation Industry (Supervision) Act 1993.

Thus rather than using the term 'preserve savings', it is recommended that a form of words be used to clarify the intent of the superannuation system to help Australians grow savings for the express purpose of creating a substitute to income from personal exertion in retirement.

Hence my suggested reference to both sides of the superannuation journey; the accumulation side (to grow savings purposefully accrued for a dignified retirement) and the decumulation side (to subsequently consume said savings for a dignified retirement).

In addition to making explicit the duality of the journey (growing assets and subsequently consuming them), my definition reduces the ambiguity that surrounds the ordinary language usage of the words 'savings' and 'income'.

These terms have come to take on many, often conflicting, meanings and thus it would be prudent to make clear the context in which they are being used.

The term 'preserve savings' in the context of the proposed objective is meant to take in the sum total of contributions plus accrued earnings thereupon (net of relevant taxes).

In practice, the value of these accrued savings, whilst in accumulation mode, can vary with fluctuating investment returns, and so using the phrase 'preserve savings' may be misconstrued by laypersons to be some reference to holding steady the value of accrued balances where no such warranty exists.

It is because of the potential for miscommunication and confusion in the minds of super members (as compared to those in the policy space), my preference would be to remove any possible ambiguity by electing not to use the phrase 'preserve savings'.

My suggested alternative:

"to grow and subsequently consume savings purposefully accrued…"

removes the ambiguity and introduces, I believe, a higher level of clarity of the purpose for contributions to the superannuation system.

In a similar vein, removing the phrase 'deliver income' removes ambiguity over the multiple possible meanings of 'income' in the context of retirement.

It is noted in the EM that 'deliver income' means superannuation savings should be drawn down to provide individuals with a source of income during their retirement years.

It has however become apparent, through the RIR final report and subsequent Treasury work (particularly in the development of the Retirement Income Covenant requirement) that many super member take 'income' to be the income yield on superannuation assets transferred into pension mode.

Many retirees, particularly those higher up the wealth and income distribution, appear to manage their retirement affairs to live off the income generated from their pension assets (subject to minimum withdrawal standards for certain income stream products such as account-based pensions).

As outlined in the RIR final report, for highly superannuated retirees this may result in net super balances increasing rather than decreasing into retirement, where returns on assets in retirement mode exceed any minimum (or required) drawdown level. It also results in retirees under-consuming in retirement, thereby experiencing a lower standard of living than might otherwise be accessible.

The way to negate ambiguity, in respect of drawing from pension assets to fund retirement, is to substitute the word 'income' with a reference instead to consumption, which denotes no preference for whether that consumption of retirement assets should come from investment income or capital.

For this reason I suggest that the phrase 'deliver income' be substituted with 'consume savings' in the phrase 'to grow and subsequently ***consume savings*** purposefully accrued for a dignified retirement,…'.

These two suggestions are interconnected, and work together to help clarify the objective of superannuation as purposefully growing assets (savings) to be later consumed in retirement.

Dignified

It is noted in the EM that in the context of the objective of superannuation, 'dignified' denotes a standard of financial security and wellbeing in retirement which allows a person to participate economically and socially in their community.

I concur that the term 'dignified' is an appropriate descriptor, being left as a relative construct to be determined by individuals, given their lifetime income trajectory, historical standard of living, societal reference group(s) and personal health, social and economic circumstances.

It is noted that the concept of what is 'dignified' may change over time with societal expectations, and that such changes can be reflected in policy-makers' assessment of this concept from time to time.

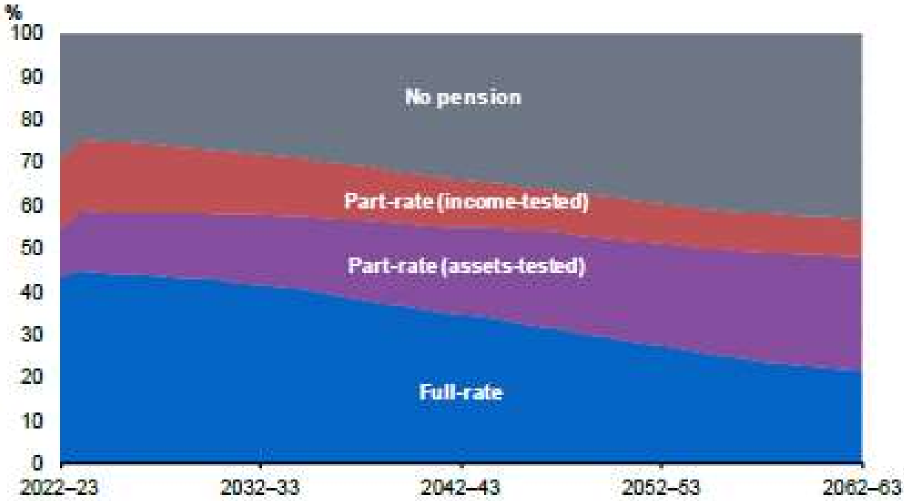
'Government support' (and 'secure shelter' recommendation)

The EM correctly notes that many Australians will continue to rely on Government support to substitute or complement their accrued superannuation to achieve a dignified retirement.

The latest IGR very much confirms that this will be the case, for at least the next 40 years, noting that around 64 per cent of Australians of eligibility age received the Age Pension during 2022-23, and nearly 70 per cent received some form of Government pension or other income support payment (including Disability Support Pension, Carers Payment and Service Pension).

With the maturity of the superannuation system, it is expected that total cost of Government supports for the aged will flatten, such that spending on Australian Government Age and Service Pensions is projected to fall from around 2.3 per cent of GDP in 2022-23 to 2 per cent of GDP by 2062-63.

The IGR projects that those in receipt of some form of age related support payment will however continue to be in the majority, relative to fully self-funded retirees, as the following chart depicts:



Note: The increase in 2023–24 is due to the Age Pension eligibility age increasing from 66.5 to 67 years old, which affects the measure of 'person of Age Pension age'.
Source: Treasury.

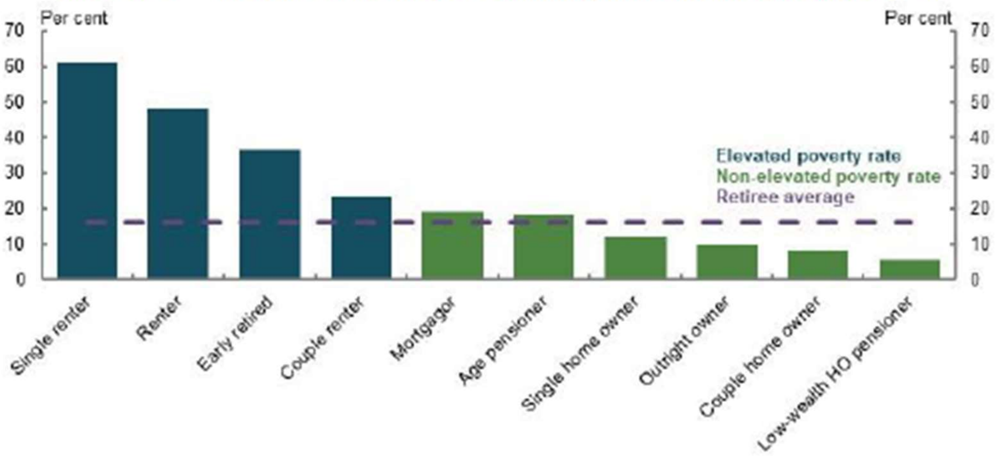
The inclusion of the phrase 'alongside Government support' within the proposed superannuation objective is therefore warranted and valid.

What I do believe is missing, alongside Government support, is an acknowledgement of the importance of shelter in creating a dignified retirement.

There is a robust body of evidence that those who are home owners at the point of, and through, retirement tend to have higher levels of subjective wellbeing and lower levels of financial stress compared to retirees who renters.

The RIR final report, in assessing levels of retirement income poverty, noted that the highest levels were experienced by single renters, while the lowest levels were experienced by home owning retirees, as the below RIR chart illustrates.

Chart 2A-10 Incidence of income poverty among different retiree groups, 2017-18



Source: Retirement Income Review Final Report, 2020

As previously alluded, home ownership forms part of Pillar 3 of the 3 Pillar model of the Australian retirement income system, and its attainment (particularly where unencumbered at the point of retirement) provides both a store of wealth and a high degree of optionality in funding both retirement living (such as use of the HEAS) and, if needed, residential aged care costs.

For this reason, and given that homeownership rates still are north of 75 per cent for most Australians aged 65 and beyond, it is recommended that the centrality of 'secure shelter' be recognised alongside 'Government support' as key allied structures to the superannuation system.

This also allows for policy-makers to give consideration to those retirees who are not homeowners at the point of, or during, retirement. Many such retirees find themselves disconnected from home ownership late in life (often through relationship breakdowns, ill health or an inability to work) and expressly including an element of 'secure shelter', allows for consideration of the property rental markets (private and other) and how they impact on a dignified retirement for non-home owners.

Equitable

It is noted in the EM that the concept of 'equitable' is a subjective one, seeking to capture the importance of a system that delivers similar outcomes to people in similar situations and targets support in the superannuation system to those most in need.

In general, I support the inclusion of the term 'equitable' in the proposed superannuation objective, as it is important that policy-makers, current and future, take account of the fairness of the superannuation system, and the potential redistribution effects it may have, both from the present to the future and from any one cohort of individuals to another.

Equity issues in superannuation often have their root in income inequity, which magnify over time due to the effect of compounding returns and the long timeframes involved in accumulating superannuation assets.

Key amongst these are gender equity considerations, with super balances as between males and females of the same age still disproportionately favouring males. The latest IGR noted that the average super balance is some $190,000 for males and only $150,000 for females, suggesting that underlying factors, such as employment participation rates and the wage gender gap, residing outside of the superannuation system continue to flow through to the super system.

Sustainable

It is noted in the EM that 'sustainable' signifies that the superannuation system should be robust to demographic and economic change and cost-effective in achieving its objectives.

It is further noted in the EM that tax concessions have a role in incentivising Australians to save for retirement but come at a significant cost to the revenue required to fund services, so need to be targeted at where they are needed most.

Policy-makers will therefore need to consider the effects on system sustainability in any future amendment to superannuation laws (other than those specifically excluded by the operation of the consequential amendments).

As alluded to earlier, superannuation tax concessions exist because it is assumed that individuals would be reticent to trade-off more current consumption today for less current consumption and more future consumption in their retirement, and so tax incentives are needed to motivate individuals to do so.

There is a degree of uncertainty as to how individuals with a high marginal propensity to save (i.e. high income individuals) might save for retirement in the absence of the current superannuation system, but it is safe to assume that these individuals would still save some, not inconsequential, amount for their later years, via alternative mechanisms and investment vehicles.

Thus in terms of sustainability, the policy-setting for the superannuation system, in aggregate, needs to be constantly visited to ensure that the right balance is maintained between the benefit of tax incentives (flowing as they do to generally to individuals who can make the fullest use of them) and the cost to taxation revenue forgone.

Overall, I consider it just and appropriate that a reference to system sustainability be captured within the proposed objective of superannuation.

Concluding comments

The objective of superannuation, as proposed in the Superannuation (Objective) Bill 2023, is an improvement on the version first suggested by the Murray FSI in 2014, and thereafter brought before Parliament in 2016.

This version seeks not just to focus on income replacement, via accrued superannuation assets and/or the Age Pension, but broadens the focus to systemic issues of equity and sustainability. These changes should assist policy-makers, now and in the future, to balance the system's needs versus its costs, and that is to be welcomed.

My suggestions are primarily in clarifying the intent and use of contributions and their accrued earnings.

I believe the phrase *'to preserve savings to deliver income…'* creates unnecessary ambiguity as to what constitutes 'savings' and how to appropriately define 'income' in the context of one's retirement assets.

My key recommendation therefore seek to clarify savings as the sum of contributions and accrued earnings, by reframing the objective using a consumption perspective, rather than a savings-to-income perspective. I believe that a retirement system with a mandatory savings element, such as exists in Australia, should seek to give as many individuals as possible the smoothest lifetime consumption as possible, thereby ensuring that they do not inadvertently consume less than they otherwise would have.

My other recommendation is to incorporate 'secure shelter' into the objective, as it is difficult to conceive of a 'dignified retirement' in the absence of such security, whether that is as a home owner or a tenant in one's retirement years. The evidence base bears out the primacy of security of shelter to retirement wellbeing.