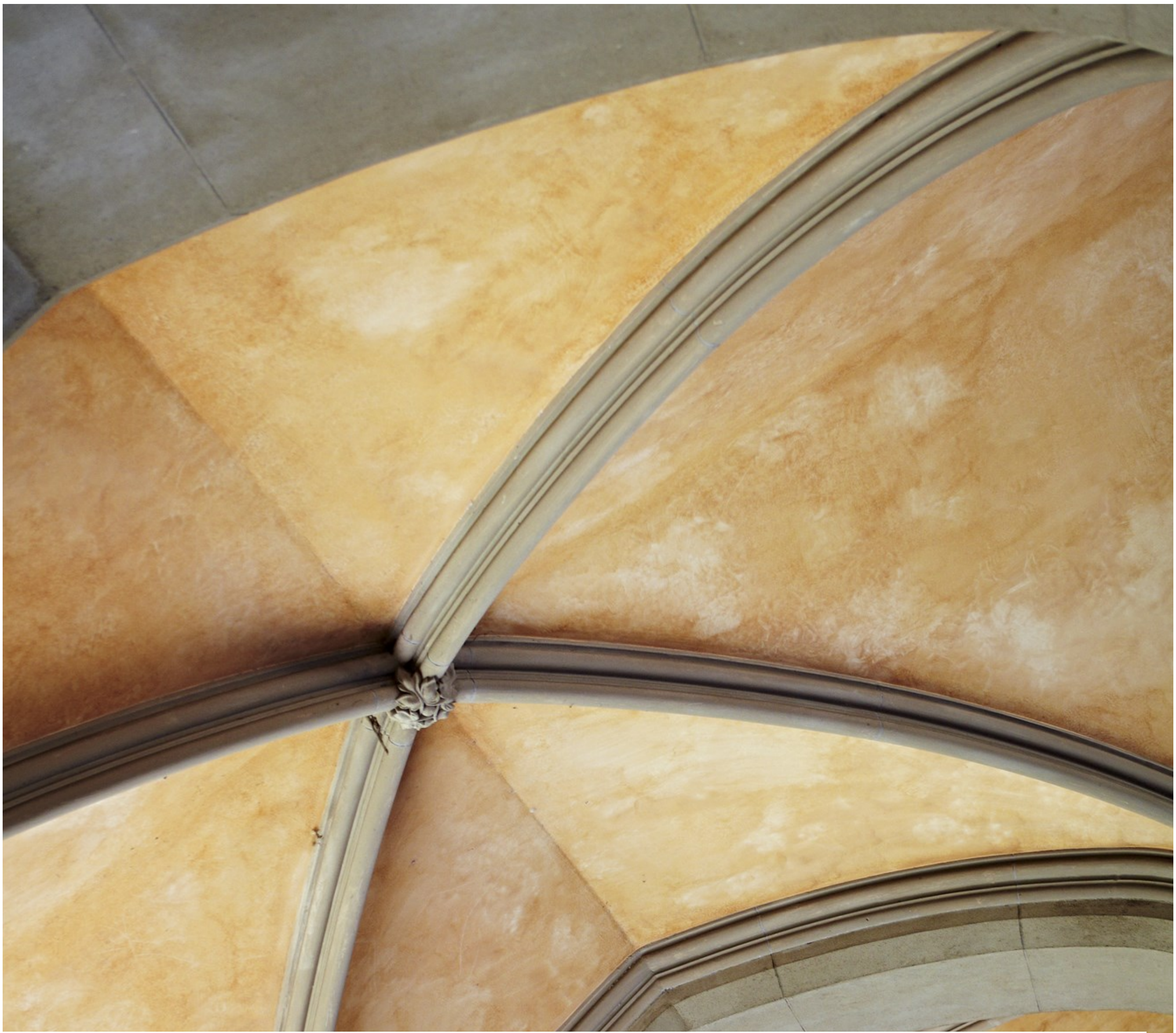

Superannuation (Objective) Bill 2016

Submission by UniSuper

23 December 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 $55 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 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).

Overview

- We are broadly supportive of this Bill, however, we believe that the proposed primary Objective of superannuation is more suited as an objective of the *overall* retirement incomes system i.e. the combined pillars under the World Bank's multi-pillared framework.

- In its place, we would prefer to see an objective that focusses on the role that superannuation funds can and do play in delivering income in retirement:

  "*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"*

- An objective along these lines would help create a climate for the development of innovative retirement income streams which we think would be a positive outcome for retirees and the industry more broadly.

- We strongly believe that the concept of income replacement rates needs to be brought to the fore in these discussions. Replacement rates have a key role to play in the evaluation of our retirement income system. Target replacement rates should include income from a combination of sources including superannuation and the means-tested Age Pension.

- Rather than a flat dollar or fixed percentage replacement rate, we suggest a sliding scale income replacement rate 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.

- UniSuper sees great value in the concept of replacement rates and uses different replacement rates in our retirement adequacy projections to better understand how our members are likely to fare in retirement.

UniSuper supports an Objective with a stronger focus on super

We believe that the current proposed objective of superannuation, with its focus on substituting or supplementing the Age Pension, is an objective more suited for the *overall* retirement incomes system i.e. the combined pillars under the World Bank's multi-pillared framework.[2]

We would prefer to see an objective that focusses on the role that superannuation funds can play in delivering income in retirement to their members. This approach, along with focussing more on income replacement rates, would help create a climate for the development of innovative retirement income streams which we think would be a positive outcome for retirees and the overall industry.

The Objective – as currently proposed – is likely to be useful for evaluating the overall retirement incomes policy settings, particularly for targeting the Age Pension under a means test. However, the second part of the Objective ("*to substitute or supplement the Age Pension*") relies on imprecise and 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 a broader phraseology (below) that 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.

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[2] World Bank (2008), *The World Bank Pension Conceptual Framework*, http://siteresources.worldbank.org/INTPENSIONS/Resources/395443-1121194657824/PRPNoteConcept_Sept2008.pdf

A key objective in retirement is to maintain a standard of living relative to that enjoyed while working

Replacement rate: the value of a pension as a proportion of a worker's wage during some base period, such as the last year or two before retirement or the entire lifetime average wage.

World Bank (1994)[3]

The concept of replacement rates has a well-established place in international literature, where replacement rates are central to the evaluation of retirement income systems. We strongly encourage focussing on replacement rates and bringing them to the fore when setting the Objective.

The concept behind replacement rates is itself based on theories of consumption and saving and, in particular, the concepts of lifetime income and consumption smoothing.[4] Following this approach, saving is undertaken in order to replace income from work with income from savings in retirement.

Most modern retirement income systems are, however, multi-pillared and retirement income has numerous sources. According to the Intergenerational Report[5], the means-tested Age Pension will remain a significant component of the retirement income of many, and those with lower lifetime incomes are likely to be more reliant on the Age Pension compared to those with higher lifetime incomes.

Regardless of the source of income in retirement, a key objective of the overall system should be to help retirees maintain a standard of living in retirement *at least equivalent to* that which they enjoyed while working.

The World Bank, for example, believes replacement rates are partly a matter of personal choice and some people might wish to replace 75% of their income in retirement, while others might prefer a lower replacement rate so that they can consume more while young.[6] Replacement rates can also reflect personal choices and sacrifices made and the "right" target replacement rate varies greatly.[7]

The World Bank report recommended replacement rates that vary with income from low to middle to higher. Under this approach, those with lower lifetime incomes would need a higher replacement rate target compared to higher income earners. Higher income earners, however, would still target a comfortable standard of living albeit with a lower replacement rate.

[3] World Bank (1994), *Averting the Old Age Crisis*, xxiii
[4] 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
[5] Australian Government (2015), *Intergenerational Report*, p. 65
[6] *Op cit* p. 75
[7] *Ibid* p. 294

In Australia, there are two main approaches to developing income replacement rate targets – 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 lower income earners. The alternative approach (i.e. "proportion of a worker's wage…[or] lifetime average wage"[8]) is likely to offer a broader range of replacement rates from private pensions, typically anywhere between 60% and 85%[9]. This approach 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 the standard enjoyed during their working lives.

We therefore encourage consideration of a replacement rate as a subsidiary objective, based on a flexible sliding-scale along the following lines:

- for some retirees, the Age Pension will fully replace their pre-retirement income, providing a replacement rate of 100%[10]
- 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%[11]
- 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%.

[8] *Ibid* p. 75

[9] 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

[10] Or even increase it in some instances, for example, Newstart recipients moving the Age Pension

[11] This might be typical for those with income and assets below the "free areas" and some part pensioners.

UniSuper's use of replacement rates and plans for innovative retirement income streams

Replacement rates are also a helpful heuristic for retirement planning. In fact, UniSuper uses replacement rates in our retirement adequacy modelling. To understand better how our members are likely to fare in retirement, we projected all members' benefits to a retirement age of 67 to enable calculation of both:

- retirement adequacy: a measure of whether a member is "on track" to achieve an adequate level of retirement income, and
- Age Pension dependency: a measure of the proportion of total projected retirement income sourced from the Age Pension.

In undertaking this modelling, we recognised the diversity of our membership and made use of different adequacy targets based on the membership of our defined benefit division or accumulation division(s) and their differing contribution rates.

This modelling is also particularly useful in understanding our members' needs and to develop retirement income products to meet those needs. We have a long history of providing retirement incomes to our members, and we currently offer the "full-suite" of pension products allowed by law.

We continue to believe that many retirees benefit from pooling their retirement savings in defined benefit schemes, superannuation pensions and annuities. We are also strongly committed to developing new retirement income stream products and we have undertaken considerable research into pooled-risk schemes, such as those adopted in Canada, the Netherlands and Denmark. We believe that there will be significant member interest in these 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, therefore, that any Objective enshrined in law allows superannuation funds to develop collectively-pooled superannuation products which target income replacement rates. Therefore, any primary or subsidiary Objective for the system will need to ensure that the policy is flexible enough to cater for existing retirement income streams, including existing defined benefit schemes, as well as those yet-to-be developed.

We believe that an Objective that specifically mentions both replacement rates and retirement income streams 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.

Subsidiary objectives

While we had no objection to the subsidiary objectives proposed when Treasury released its consultation paper, we stated that our view might change if the subsidiary objectives were altered. For example, we would be concerned if there were a subsidiary objective of building national savings that were 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, investment and inflation risks. 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	This subsidiary objective has particular meaning for public sector pensions. Private sector pensions, on the other hand -

savings	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 this 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.