



**Australian Government**

# Objective of Superannuation

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Discussion Paper

9 March 2016

## **Notes to participants**

The principles outlined in this paper have not received Government approval and are obviously not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

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## CONSULTATION PROCESS

### Request for feedback and comments

The Australian Government (the Government) welcomes feedback from all interested stakeholders on the issues outlined in this consultation paper.

The consultation paper includes focus questions. Stakeholders are invited to address any issue raised in this paper and should not feel obliged to address every question. The information obtained through this process will inform the Government's approach on the way forward. Comments in submissions that are substantiated with reasons and evidence will carry the most weight.

### Closing date for submissions: Wednesday 6<sup>th</sup> April 2016

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# OBJECTIVE OF SUPERANNUATION

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## PURPOSE

This paper provides background and questions for consultation on the objective of the superannuation system. This consultation will help guide the final decision on the objective to be legislated.

## CONTEXT

The Government agreed, as part of its Financial System Program and in response to the Financial System Inquiry (FSI), to develop and introduce legislation to enshrine the objective of the superannuation system.

As the FSI noted, a legislated objective will serve as a guide to policy-makers, regulators, industry and the community about superannuation's fundamental purpose.

The objective will provide a way in which competing superannuation proposals can be measured and a framework for evaluating the fairness, adequacy and sustainability of the superannuation system.

Superannuation is important to improving the retirement income of Australians and is one pillar of the Australian retirement income system, together with the Age Pension and voluntary savings. Over 80 per cent of working age Australians have superannuation savings. Superannuation is also the second largest savings vehicle, making up around 22 per cent of all assets held by Australian households. Only owner occupied housing is larger, constituting 38 per cent of all assets held by Australian households.

Superannuation is also a key component of the financial services industry and the economy more broadly. Superannuation assets have increased from \$245 billion in 1996 to over \$2 trillion today – representing well over 100 per cent of Gross Domestic Product and the second-largest sector in the financial system. Going forward, superannuation assets are projected to increase to \$9 trillion by 2040, by which time they may exceed the size of the entire banking sector.

## EARLY OBJECTIVES OF SUPERANNUATION

In 1992 universal superannuation was introduced through the Superannuation Guarantee (SG). This was expected to expand superannuation coverage to more than 90 per cent of the workforce. Reflecting on the objective of superannuation, Treasurer Dawkins said in introducing the SG legislation:

*The increased self-provision for retirement will permit a **higher standard of living** in retirement than if we continued to **rely on the Age Pension alone**. It would also enable future governments to improve the retirement conditions for those Australians unable to fund their own retirement adequately. Lastly, self-provision will increase the flexibility in the Commonwealth's Budget in future years, especially as our population ages, and will increase our **national savings** overall, thus reducing our reliance on the savings of foreigners to fund our development. (emphasis added)*

Various other statements on the objective have been made, and as the superannuation system continues to mature and grow, it is important to ensure that a legislated objective of superannuation reflects the expectations of society.

## WHAT DID THE FSI RECOMMEND?

The FSI recommended the following primary objective:

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

The Government accepts this recommendation and proposes to enshrine this objective in legislation.

The FSI also recommended the consideration of a number of other factors in supporting the primary objective.

Subsidiary objective	Why the objective is important
Facilitate consumption smoothing over the course of an individual's life	Superannuation is a vehicle for individuals to fund consumption in retirement largely from working life income. The system should facilitate consumption smoothing while providing choice and flexibility to meet individual needs and preferences.
Help people manage financial risks in retirement	Risk management is important as retirees generally have limited opportunities to replenish losses. The retirement income system should help individuals manage longevity risk, investment risk and inflation risk. Products with risk pooling would help people to manage longevity risk efficiently.
Be fully funded from savings	A fully funded system, as opposed to an unfunded system, is important for sustainability and stability. The system is designed to be predominantly funded by savings from working life income and investment earnings, where superannuation fund members in general have claims on all assets in the fund.
Be invested in the best interests of superannuation fund members	Superannuation funds are managed for the sole benefit of members, which means the investment focus should be on maximising risk-adjusted returns, net of fees and taxes, over the lifetime of a member. This results in auxiliary benefits to the economy by creating a pool of savings to fund long-term investment.
Alleviate fiscal pressures on Government from the retirement income system	Government's total contribution to the retirement income system, through both the Age Pension and superannuation tax concessions, needs to be sustainable and targeted. Higher private provisioning for retirement should reduce the burden on public finances.
Be simple and efficient, and provide safeguards	The system should achieve its objectives at the minimum cost to individuals and taxpayers. Complexity is less appropriate for a compulsory system, as it tends to add to costs and to favour sophisticated and well-informed investors. Given the compulsory nature of SG contributions, the system needs prudential oversight and should provide good outcomes in both the accumulation and retirement phases for disengaged fund members.

Source: Financial System Inquiry Final Report

## POINTS TO CONSIDER FOR DISCUSSION

A single primary objective cannot possibly encompass all aspects of the purpose and attributes of the superannuation system.

The subsidiary objectives recommended by the FSI raise a number of useful points for considering the legislated objective of the superannuation system. For example, the purpose of superannuation is not to allow for unlimited wealth accumulation and estate planning – a notion that is not explicit in the primary objective.

Issue	Points to consider
Retirement income <i>or</i> standard of living in retirement	While retirement income will provide resources to help a person meet their costs of living in retirement, standard of living is broader as it includes the use of both income and assets. Both also clarify that superannuation is meant to help fund a person's retirement, it is not for unlimited wealth accumulation or bequests.
Adequacy	While adequacy provides a sense of targeting superannuation and is consistent with fiscal sustainability, there is no consensus of what adequacy means. While the OECD defines it through the use of replacement rates, implying people have different levels of adequate retirement incomes according to their wages, others may conceive of a single level of income applicable to all.
Fiscal sustainability	The superannuation system should also be fiscally sustainable - through reducing reliance on the Age Pension and providing tax concessions that are targeted. While the objective of the system is to improve retirement incomes, balancing the need for fiscal sustainability may mean there is a limit to the support that can be given.
Increasing national saving	While this was an important motivation for establishment of the superannuation system, as perceptions and the economy have evolved the need for prominence in the objective may have reduced.

## LOCATION OF OBJECTIVE

There are a number of ways in which the objective of the superannuation system could be enshrined in legislation. This could be in the preamble to a major piece of superannuation legislation, for example the *Superannuation Industry (Supervision) Act 1993*, or in a stand-alone Act.

Notwithstanding where the objective is legislated, the purpose of stating the objectives of the superannuation system in legislation is only to guide the policy-making process. It will not affect the interpretation or application of superannuation legislation by the courts.

**Questions for consultation**

- Do you agree with the objectives recommended by the FSI? Why?
- If you do not agree with the FSI recommendation, what do you think should be the objective of superannuation? Why? What are the implications of this objective?
- In which piece of legislation should the objective be legislated and why?