

Response to the Financial System Inquiry Interim Report

Summary

August 2014

Association of Superannuation Funds of Australia (ASFA)

ASFA's response to the Financial System Inquiry Interim Report provides discussion around clarifying the objectives of the superannuation and retirement income systems, as well as providing a detailed response to the observations and questions raised in the Report.

1. Meeting the objectives of superannuation

1.1 The need for clear and measurable objectives for the superannuation industry

The ASFA submission calls for clear and measurable objectives for the superannuation industry, which would be used as a basis for all future policy initiatives. ASFA describes the high-level objectives as two-fold:

- **a fiscal imperative:** reducing the call on the public purse of retirement income for older Australians for future generations, and
- **a social imperative:** to ensure that all Australians are given the opportunity of having a dignified retirement.

The indirect benefit of these twin objectives of superannuation is a pool of national savings that will ultimately benefit the Australian economy.

To enable accountability against these objectives, we must have clearly defined measures of success. ASFA believes that there must be long-term goals and has proposed four goals, which reflect both the social objective and fiscal objective of the system.

Superannuation and retirement system goals for 2050:

- Age Pension expenditure and tax expenditure on super (properly measured) of less than six per cent of GDP
- less than 20 per cent of retired Australians over Age Pension qualifying age relying solely or almost exclusively on the Age Pension
- Australians retiring with an income replacement rate in excess of 65 per cent (on average)
- at least 50 per cent of Australians able to cover their expenditure in retirement and at least have a 'comfortable' lifestyle in retirement, as described in the ASFA Retirement Standard.

1.2 Regulatory settings – do they match the objectives of superannuation?

In considering the regulatory setting for superannuation system, ASFA has recommended that:

- the regulatory framework is designed more flexibly, and/or re-assessed more frequently, with the objectives of the superannuation system front of mind, to ensure that it matches the way in which the system is evolving. This should be reflected in the mission statements of the regulators
- the prudential promise or regulatory commitment given to all superannuation members be reviewed given the development of self-managed superannuation funds (SMSF) arrangements and other areas of member choice, and that superannuation trustee obligations are clarified and revised to be consistent with these.

The ASFA submission highlights the need for consistency across the regulatory system as the market evolves and as retirement income products are developed to meet market demand. We note that the change in the system over the past decades has introduced many other ways to manage superannuation assets, and many service providers to help in this process. The regulatory perimeters need to be reassessed and redefined as a result.

1.3 Does the superannuation industry demonstrate competitiveness?

While there is no doubt that there are structural factors that work against ‘perfect competition’ in the superannuation market, we are observing continual improvements in industry competitiveness and efficiency, aided by policies that are promoting greater comparability of products for consumers and trustees. In particular, we note:

- significant competition at the institutional level in fees paid to fund managers
- improvement in member retention
- more account consolidation
- competition in the development of MySuper offerings
- better member engagement – particularly through easier access to accounts
- more members choosing to stay in their own fund when they change jobs
- sector competition between industry funds, retail funds and SMSFs
- the development of retirement and income stream options.

We are also seeing evidence of fees being reduced and recent policy reforms – MySuper, Future of Financial Advice (FoFA) and SuperStream, in particular – should generate cost savings over the next few years. Superannuation trustees must ensure these are passed through to members. And, contrary to the observation in the Interim Report, ASFA research shows that, on a like-for-like basis, the Australian defined contribution (DC) member is actually paying less in fees than most of their OECD counterparts. This research is provided as an Appendix in the submission.

Critically, ASFA reiterates the need for the industry and public policymakers to focus on net-of-fee returns, rather than absolute fee levels, as it is this measure that will ultimately determine the level of income available in retirement.

ASFA recommends that:

- the recent initiatives of MySuper, Stronger Super, the publication of APRA data, FoFA and SuperStream are given time to demonstrate effectiveness as initiatives that will drive greater efficiency in the superannuation industry
- a review of the cost efficiency of the industry is undertaken after a period of, say, three or four years.

In its submission, ASFA also reiterates the unique benefits that the Australian superannuation system provides members, most particularly cost-efficient access to insurance and advice products. Using specially commissioned analysis from Rice Warner, the submission quantifies the benefit this brings the economy in terms of reducing the problem of underinsurance and related social security costs, and also estimates the additional costs this creates for funds. The Rice Warner material is provided as an Appendix in the submission.

2. Meeting the objectives of retirement

ASFA believes that the retirement income system needs to be designed in line with the high-level goals we have identified for Australians in retirement.

Specifically, ASFA recommends:

- learning from our experience with superannuation system design and developing a simple framework that is assessed on a holistic basis
- linking retirement outcomes with other government responsibilities for older Australians such as the Age Pension and health care
- higher educational standards and other measures that raise the quality and consistency of financial advice and thereby safeguard the trust of customers
- a principles-based approach to the regulation of new retirement income products to facilitate innovation and avoid unnecessarily complex regulation.

The submission describes the current retirement income system as one in development, and notes that the issue of optimal system design for income in retirement system is being dealt with around the globe. To date, there is not an effective, mature system that can be used as a benchmark. However, we can point to some useful analysis and theoretical benchmarks to guide us in developing the Australian system.

The submission describes ASFA's approach to framing the right policies to deliver on retirement income. It notes that the interests of fund members must be paramount. This implies that a good system for providing retirement incomes should:

- deal with the financial needs associated with longevity
- be simple to understand
- inspire consumer confidence through being stable and fair
- allow products to be easily compared
- support competition between providers in order to foster product innovation and fee reductions
- deal with investment volatility, in particular lowering that volatility when fund members are risk adverse and/or are unable to recover from past investment losses
- provide flexibility in terms of access to capital to meet unexpected or unpredictable needs such as aged care or health costs or accommodation bonds
- deal with both those highly engaged and exercising choices, and those who cannot make or do not want to make a choice.

The system should be all about the provision of retirement income. It should not be about opening up opportunities for estate planning, wealth accumulation or tax planning. It should not be about the accumulation of assets for purposes other than supporting income in retirement. Nor should it allow regulatory or tax arbitrage through choice of superannuation structure or retirement income product.

That said, the submission also notes the differing promises made in respect of different retirement income products and the differing level of involvement of fund members in making choices about their retirement income requires some variations in approach by superannuation fund trustees and other product providers.

3. Responses to questions in the Interim Report relevant to the superannuation and retirement industry

In the submission, ASFA provides a detailed response to all questions that related to superannuation and retirement in the Interim Report. These responses were collated through the ASFA policy councils, in the context of ASFA's mandate of representing the best interests of the members of Australian superannuation funds.

