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Superannuation – Efficiency and Competitiveness

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Australian
Chamber of Commerce
and Industry

Australian Chamber of Commerce and Industry

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Australian Chamber of Commerce and Industry

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Executive summary

For the purposes of this inquiry, the Productivity Commission (PC) has defined the objective of the superannuation system as delivering the best outcomes for members and retirees.[1] Within the context of this objective, the criteria that the Issues Paper set out are clear and sensible. However, the objective that the March 2016 Issues Paper entitled *Superannuation Efficiency and Competitiveness* (Issues Paper) sets out is different to the superannuation objective recommended by the Financial System Inquiry (FSI), which is currently being considered by Government through a parallel process, and the relationship between these objectives is unclear.

The PC states that the inquiry is about the superannuation system not the superannuation industry, but the objective the PC sets out appears to make most sense in assessing the performance of superannuation funds. Similarly, the criteria the PC sets out largely relate to the performance of the superannuation industry.

A particular concern is that the Issues Paper does not consider the costs that the system imposes on key stakeholders, such as employers and the government. The terms of reference emphasise that costs to employers should be taken into account in the PC's proposed fund selection mechanism. Similarly, current superannuation guarantee (SG) charge arrangements impose excessive costs on employers and lead to higher levels of unpaid contributions. However, these issues are not reflected in the PC approach as expressed in the Issues Paper.

Although the scope of the Inquiry is not clearly defined, the Australian Chamber's reading of the terms of reference is that the PC has been asked to assess the administration of superannuation savings, including the performance of funds and rules that govern how contributions are made, managed and disbursed. This is distinct from the rules that govern when money enters and exits the superannuation system, including contribution rates, taxation arrangements and the preservation age.

A critical question is how the administration of superannuation savings should be assessed in the context of the overall superannuation objectives being considered by government. The Australian Chamber's view is that the fiscal costs to government are best addressed through the rules that govern when money enters and exits the superannuation system. The objective and criteria set out by the PC largely capture other features of the objectives being considered by government, including managing the financial risks of retirement and funds being invested in the best interests of members. The objective that does not appear to have been captured in the approach the PC has outlined is the need for the superannuation system to be simple and efficient.

On this basis the Australian Chamber suggests that the PC amend the working objective it has adopted for the purposes of this inquiry so that it is defined as delivering the best outcomes for members and retirees, taking into account administrative costs to employers and government.

This should be reflected in changes to the specific criteria, including adding a 'contributions stage' to the accumulation, de-accumulation and all stages referred to the PC's illustrative criteria.[2]

[1] Issues Paper http://www.pc.gov.au/inquiries/current/superannuation/competitiveness-efficiency/issues/superannuation-competitiveness-efficiency-issues.pdf , p. 3.
[2] Ibid, p 21.

1 Introduction

The Australian Chamber of Commerce and Industry (Australian Chamber) welcomes the opportunity to make this submission in response to the PC's Issues Paper.[3]

As set out in the Issues Paper, the PC has been asked to develop criteria to assess whether, and the extent to which, the superannuation system is efficient and competitive and delivers the best outcomes for members and retirees, including whether it optimises risk-adjusted after-fee returns. While the considerations involved in determining an appropriate retirement incomes policy are complex, this is a worthwhile inquiry. It is a first step along the path of a review of the efficiency and competitiveness of the superannuation system following the full implementation of the MySuper reforms (that is, after 1 July 2017). As the PC has made plain in the Issues Paper,[4] its task is not to evaluate the current performance of the superannuation system. Rather the PC should consider how current policy settings impede or constrain the competitiveness and efficiency of the system when determining the criteria to propose. This submission sets out a number of matters critical to employers in the conduct of the initial stages of the PC's consideration of this complex subject.

2 Main Objective of the Superannuation System

The Australian Chamber agrees with the PC that an overarching objective will help to ensure that retirement incomes policies are developed and designed to achieve appropriate long term objectives. As the Issues Paper makes clear, what is efficient ultimately depends on what is sought to be achieved: the system objective(s). Clear objectives are essential for the development of assessment criteria. That is why the Australian Chamber endorses the main objective of the system as:

To provide income in retirement to substitute or supplement the age pension.

The Financial System Inquiry Report (FSI Report) acknowledged that:

> *Objectives that guide policy making and frame community and industry debate would help build confidence in the system by providing a framework for considered and cohesive change. Greater clarity around objectives can help reduce complexity and costs in the system.*[5]

The FSI Report suggested that:

> *The Inquiry's single primary objective prioritises the provision of retirement incomes and precludes the pursuit of other objectives at the expense of retirement incomes. It will help reorient the community mindset around superannuation, away from account balances and towards the provision of retirement incomes.*[6]

The Australian Chamber recently submitted to the Commonwealth Government that the objective set out above is relatively consistent with government objectives at the time that the

[3] Above n 1.
[4] Ibid, p 2
[5] Australian Government The Treasury, *Financial System Inquiry Final Report,* 2014, p. 97.
[6] Australian Government The Treasury, *Financial System Inquiry Final Report,* 2014, p. 98.

Superannuation Guarantee (Administration) Act 1992 was enacted in order to establish and administer the superannuation guarantee system. The bill's second reading speech envisaged increased superannuation holdings as supplementing the age pension and allowing a higher level of benefit because fewer retirees would be reliant on the full pension.[7] Then Treasurer Dawkins explained:

> *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. The increased self-provision will also enable future Commonwealth governments to improve the retirement conditions for those Australians who were unable to fund adequately their own retirement incomes.*
>
> *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.*[8]

However the FSI Report identified a number of deficiencies in the system when considered against the desired system objectives including "the lack of focus on retirement incomes over other objectives; the lack of operational efficiency in the system, the lack of risk management in retirement, the inefficiency in converting wealth to retirement income, the ability of superannuation funds to borrow rather than be fully funded from savings, poorly targeted tax concessions, and safeguards that could be strengthened to assist members".[9]

Many changes made since the inception of the system have been piecemeal and ad hoc. An overarching objective enshrined in legislation should help to remedy this unsatisfactory approach.

For the purposes of this inquiry, the PC has defined the objective of the superannuation system as delivering the best outcomes for members and retirees.[10] Within the context of this objective, the criteria that the PC set out are clear and sensible. However, the objective that the PC sets out is different to the superannuation objective recommended by the Financial System Inquiry (FSI), which is currently being considered by Government through a parallel process, and the relationship between these objectives is unclear.

Different parts of the superannuation system serve different functions in achieving the overall objective, so this inconsistency is not necessarily a problem. The problem is that the Issues Paper does not explain which parts of the system the PC is concerned with assessing, or how the PC's proposed objective fits with the broader superannuation objective.

The PC states that the inquiry is about the superannuation system not the superannuation industry, but the objective the PC sets out appears to make most sense for assessing the performance of superannuation funds. Similarly, the criteria the PC sets out largely relate to the performance of the superannuation industry.

The apparent focus on funds is also reflected in the failure of the Issues Paper to consider the costs that the system imposes on key stakeholders, such as employers and the government. The

[7] P 1764, Hansard, 2 April 1992.
[8] Ibid.
[9] Australian Government The Treasury, *Financial System Inquiry Final Report,* 2014, p. 98.
[10] P. 3.

terms of reference emphasise that costs to employers should be taken into account in the PC's proposed fund selection mechanism. Similarly, current superannuation guarantee (SG) charge arrangements, discussed in more detail below, impose excessive costs on employers and lead to higher levels of unpaid contributions.

The Australian Chamber's reading of the terms of reference is that the PC has been asked to assess the administration of superannuation savings, including the performance of funds and rules that govern how contributions are made, managed and disbursed. This is distinct from the rules that govern when money enters and exits the superannuation system, including contribution rates, taxation arrangements and the preservation age.

A critical question is how the administration of superannuation savings should be assessed in the context of the overall superannuation objectives being considered by government.

The Australian Chamber's view is that the fiscal costs to government are best addressed through the rules that govern when money enters and exits the superannuation system, rather than in the context of the administration of superannuation savings.

For example, a person with a low superannuation balance may be fully reliant on the pension if they only receive the rate of return provided by a balanced investment option. However, they may drop to a part pension if they elect to utilise a high growth investment option instead. From the individual's perspective, the high growth option may be inferior because of the additional risk involved, but it would be superior when measured against the objective of reducing pension reliance. Nevertheless, it is not clear that anyone would support funds being required to select member investment strategies with reference to pension costs.

The objective and criteria set out by the PC largely capture other features of the objectives being considered by government, including managing the financial risks of retirement and funds being invested in the best interests of members. The objective that does not appear to have been sufficiently captured in the approach the PC has outlined is the need for the superannuation system to be simple and efficient.

On this basis, the Australian Chamber suggests that the PC amend the working objective it has adopted for the purposes of this inquiry so that it is defined as delivering the best outcomes for members and retirees, taking into account administrative costs to employers and government.

3 The System is Dynamic

Policy that enhances the capacity of employees to adequately plan for their retirement will require enhanced employee and employer engagement with the system. As the PC points out at page 6 of the Issues Paper, there currently exists a great deal of disengagement with the superannuation system by superannuation fund members. There are a number of ways in which higher levels of engagement may be supported and which warrant further debate and consideration. For example, the FSI Report suggested that "funds should provide retirement income projections on member statements to improve member engagement".[11]

[11] Australian Government The Treasury, *Financial System Inquiry Final Report,* 2014, p. 92.

The Cooper Report suggested that "individual choices for members should be available and respected, but members must recognise and accept the increased responsibility that comes with making those choices".[12] The Cooper Review Panel, on which the Australian Chamber was represented, suggested that the system needs to be able to cater for different degrees of engagement[13] and made a number of recommendations with this principle in mind. These recommendations were designed to "re-cast the architecture of the superannuation industry to a member-oriented, rather than an industry-oriented, perspective".[14] That recommendation accords with the PC approach set out in the Issues Paper.

Superannuation has historically been seen as something for which employers are responsible and from which employees are merely beneficiaries. This has resulted in sub-optimal levels of member engagement with the system. The system's complexity has no doubt contributed to this deficiency, a matter taken up further below. Continuing the pursuit of policy to get a shift in thinking is appropriate to help employees take ownership of their future in retirement. This policy needs to be linked to the relevant trend identified by the PC which is that the total size of superannuation balances will continue to grow as the system matures, with broader implications for the financial sector and further elevation of superannuation's relative importance in the financial system. The elevation of importance for the individual fund member will be a necessary concomitant of this trend. One of the benchmarks that might be adopted (discussed further below) is the extent of member engagement.

As the PC notes, contributing to dynamism of the system is the fact that policy changes (including tax changes) are frequently considered, and re-considered, by government, making it likely that architectural features of the system will continue to change. It is this level of change which obviously adds to the disconnection of many fund members from the superannuation system. As stated, these changes add to complexity which makes engagement more difficult. The stability of the superannuation system is therefore suggested as a benchmark that could be utilised by the PC.

4 The Recommended Approach

The PC at pages 9-10 of the Issues Paper indicates that benchmarking could be an appropriate tool in identifying and encouraging best practice with respect to particular performance criteria. The Australian Chamber supports benchmarks which reference performance of the superannuation system against its own objectives, as is highlighted in the discussion in section 3 of this submission. These objectives have been touched on in this submission and are the subject of separate government consultation at this time.[15] Whilst of critical concern to employers, the question of adequacy and the related level of employer contribution is outside the scope of this

[12] Super System Review Final Report, p. 4.
[13] Ibid, p. 9.
[14] Ibid.
[15] http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Objective-of-superannuation - submissions to this inquiry closed on 11 April 2016.

benchmarking exercise. The Australian Chamber agrees with this approach however we foreshadow re-visiting those issues at a later point in the PC's inquiry.

The idea of using an assessment via market barriers to competition and efficient outcomes is more problematic. The rules which govern superannuation funds and which govern employers in their interaction with the superannuation system should be set with reference to the best interests of superannuation fund members. But the overall policy framework should be directed towards the self-provision for retirement as expressed in the objective discussed in section 2 of this submission. The idea is that having superannuation funds which act in the best interests of their members achieves this latter goal but is not necessarily consonant with examining competition between funds.

At page 14 of the Issues Paper the PC asks: "Do you agree with the broad approach of combining performance benchmarks with a test of barriers to efficient or competitive outcomes in the superannuation system?" The Australian Chamber prefers an approach where performance indicators can be expressed as outcomes that are linked to the overall objectives of the system, with the main objective being that which prioritises the substituting or supplementing the age pension without overly burdening employers. That latter consideration must qualify the main objective.

5 Effectiveness of Regulation

On page 18 of the Issues Paper one of the questions posed is: "How would you measure the effectiveness of regulation in promoting competition within the superannuation system?" One of the measures of effective regulation is that compliance is simple and that failure to comply is proportionate to the harm caused by non-compliance. That is far from the case with the superannuation system. Indeed, competitiveness may be distorted by the issue of non-compliance.

From the perspective of employers, contributions non-compliance continues to be a significant area of focus and is a major barrier to the system having efficient outcomes. The Australian Taxation Office (ATO) is investigating ways of better identifying the level of non-compliance, identifying non-complying employers and increasing the amount of unpaid superannuation which is recovered. The Australian Chamber has been closely involved in consultations about how this might be achieved and how it might be communicated. The ATO work in this area is shaped by two drivers. The first is the growing focus on contributions non-compliance and the relatively poor collection levels of unpaid contributions. The ATO is moving from a high reliance on member complaint driven investigation to greater reliance on data matching to identify potential non-compliers. The ATO's data matching capacity will significantly improve over time. The second driver is the ATO's "Reinventing the ATO"[16] process by which the ATO seeks to improve client experience by focussing on them and the issues which are important to them – what does the client want, the need to comply and how best this can be done. Data matching will provide one of the ways that different client types and their needs will be identified.

[16] http://reinventing.ato.gov.au/.

A consequence of the “Reinventing the ATO” initiative is that the ATO will distinguish between non-complying clients on the basis of the extent of their non-compliance, previous history and reasons for the present non-compliance. The ATO will allocate its resources to assisting “low risk”, non-serial non-compliers without multiple areas of non-compliance to help them become complying rather than directing resources to auditing them. High-risk significant non-compliers will be subject to audit and the penalty regime. Before approaching an identified likely non-complier the ATO will have formed a preliminary view about its risk category on the basis of its data matching and that client’s file. But this categorisation raises the issue of the system’s orientation to punishing those who are non-compliant well in excess of the consequences to the individual employee.

The superannuation guarantee charge is essentially a tax, albeit one intended to encourage employers to make superannuation guarantee contributions on behalf of eligible employees rather than paying the tax. For a number of reasons this arrangement does not give rise to a simple or effective compliance regime, and nor does it give rise to simple legislation. There is too much outstanding unpaid contribution and a significant proportion of unpaid contribution which is identified each year is unrecoverable. An unpaid contribution is a direct loss to the member but it is also a loss to the overall national retirement system and hence is relevant to the issue of the efficiency of the system and the system meeting the main objective identified in this submission.

A number of factors contribute to this state of affairs. These include the time taken for missed contributions to become visible, the complexity of the SG charge itself, and the dysfunctional penalty structure associated with the SG charge. None of this is assisted by the structure of the *Superannuation Guarantee (Administration) Act 1992*, which is structured around the idea of establishing the tax, making it unpleasant, and then with quite complex provisions providing a way out.

A SG charge arises when a complying contribution is not made by the due date. Identifying the SG charge basically relies on employer self-reporting. Where the ATO investigates a suspected failure to report, there is discretion as to penalty. Where the employer self-reports the existence of the SG charge, there is no discretion as to penalty. The whole charge must be paid and, although the member receives the collected charge as a contribution into his/her fund, for the employer a properly paid SG charge is not treated as a contribution.

The longer contributions remain unpaid the greater the likelihood that they will not be paid at all. One important factor discouraging late payment of a contribution, or payment of the SG charge the missed contribution creates, is that the penalty regime imposes an excessive and arbitrary cost on re-joining the system. The consequences are that many small businesses sit outside the system with unpaid contributions which they are unable to remedy. They simply cannot afford to re-join the system. These systemic issues are vitally important to employers and impact on the effectiveness of the system.

Costs to employers could be incorporated into the Productivity Commission’s framework by adding a ‘contributions’ stage to the accumulation, de-accumulation and all stages referred to in table 2 of the Issues Paper.[17] The objective might be to minimise transaction costs, broadly defined as including lost contributions, compliance costs, and penalties. Indicators might include estimates of levels of lost contributions, the results of surveys of compliance costs, and data on audit activity and penalties.

This discussion reinforces the Australian Chamber view that the system should be simple, tailored to the main objective identified earlier and provides sanctions proportionate to a failure to comply.

We look forward to commenting on the draft report.

About the Australian Chamber

he Australian Chamber of Commerce and Industry speaks on behalf of Australian business at home and abroad.

Our membership comprises all state and territory chambers of commerce and dozens of national industry associations. Individual businesses also get involved through our Business Leaders Council.

We represent more than 300,000 businesses of all sizes, across all industries and all parts of the country, making us Australia's most representative business organisation.

The Australian Chamber strives to make Australia a great place to do business in order to improve everyone's standard of living.

We seek to create an environment in which businesspeople, employees and independent contractors can achieve their potential as part of a dynamic private sector. We encourage entrepreneurship and innovation to achieve prosperity, economic growth and jobs.

We focus on issues that impact on business, including economics, trade, workplace relations, work health and safety, and employment, education and training.

We advocate for Australian business in public debate and to policy decision-makers, including ministers, shadow ministers, other members of parliament, ministerial policy advisors, public servants, regulators and other national agencies. We also represent Australian business in international forums.

We represent the broad interests of the private sector rather than individual clients or a narrow sectional interest.

[17] P. 21.

Australian Chamber of Commerce and Industry

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