Legislating the objective of superannuation

Submission

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About The Conexus Institute

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About David Bell

Dr David Bell is Executive Director of The Conexus Institute. Bell's career has been dedicated to the investment and retirement sector. He has worked with both commercial and profit-for-member firms, and ran his own consulting firm. Bell worked with APRA in the development of the APRA Heatmap. Academically, Bell taught for 12 years at Macquarie University and in 2020 completed his PhD at UNSW which focused on retirement investment problems. Full bio here.

About Geoff Warren

Dr Geoff Warren is an Associate Professor at the Australian National University and Research Director with the Consensus Institute, as well as a member of various investment and research advisory boards. Warren's research focuses on investment-related areas specially including superannuation and retirement, and is widely published in leading journals. He has a prior career in the investment industry spanning over 20 years. Full bio here.

Acknowledging Jeremy Cooper for his contribution to this submission.

***** The authors are willing and able to participate in further consultation. *****

1. Summary and recommendations

We support the legislation of an objective of superannuation. Beneficial outcomes could include more consistent policy formation and improved policy accountability. Noting the absence of specific consultation questions, we provide our general reflections on the draft legislation and explanatory materials.

We begin by reflecting that at least five important factors make legislating an objective of superannuation a difficult challenge, heightened by the fact that these factors interact:

1. The super system has been in place for decades without an objective, during which time various governments have contributed to the current policy settings.

2. Super is an important component of the wider retirement income system, for which a legislative objective has not been developed.

3. It is important to consider living experiences throughout the whole-of-life, not just the retirement phase in isolation. The direct exchange between working life experience and retirement income was well-established in the Retirement Income Review (RIR)[1] with the term *"consumption smoothing"* used in the Financial System Inquiry (2014, "FSI").

4. Super has become a heated topic in politics and the media, with a broad spectrum of strong ideologies brought to bear on an increasingly wide spectrum.

5. The need to adapt to the changing demands that the economy and society more broadly places on a retirement income system, including the superannuation industry.[2]

A common theme running through many of the above factors is that superannuation interacts with other components of individual welfare and the broader system. These interactions can be overlooked if an objective for super is established and pursued in isolation. The consequence could be that the objective for super is pursued with little regard for impact on other objectives.

Recommendations

We make a small number of suggestions, which we keep reasonably succinct. We frequently find ourselves referring to the five points raised above.

1. The Context of Amendments set out in the Explanatory Memorandum, perhaps inadvertently, sets out the case for creating an objective of the retirement income system. As it stands, the wording of the objective of superannuation appears to be trying to address some (government support) but not all (e.g. other savings) of the other elements of the retirement income system.

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[1] Retirement Income Review Final Report, pages 159 – 161.

[2] Cooper, Jeremy, Fiscal Issues and Super: Can There Ever Be Equilibrium? (August 26, 2016). Available at SSRN: <https://ssrn.com/abstract=2843370>

2. Consideration should be given to acknowledging (1) whole-of-life outcomes and (2) management of financial risks in retirement, either as primary or subsidiary objectives (discussed below).
3. Consideration be given to utilising subsidiary objectives to complement a primary objective. This can help facilitate a concise core objective while providing clarity on issues identified as non-core.
4. Design a robustness test whereby Treasury stress test their proposed objective of super through a range of scenarios to assess whether the proposed objective deals with those scenarios appropriately. See Section 4 for further details.
5. Through a narrow prism, the sole purpose test in section 62 of the *Superannuation Industry (Supervision) Industry Act 1993* (Cth) (SIS Act) might currently be the only legislated purpose of super. This creates potential for tension between an articulated objective contained in separate legislation and purpose of super as expressed through the sole purpose test. We suggest at least establishing a clear link or reconciliation between the two. It might also make sense for the legislated objective to be in the SIS Act itself. We acknowledge that the Explanatory Memorandum states that *"It is not intended to create any rights or obligations for participants in the superannuation industry (for example, it is not to be considered in assessing the conduct or liability of a trustee of a superannuation fund)"*. However, we wonder if this is sufficient to remove all ambiguity.

2. Further reflections

We make the following reflections:

1. In our previous submission, we commented that the task of developing an objective of super is challenged by the absence of an objective for the retirement income system. Super is recognised as only one of three pillars of the retirement system. A specific objective of super could be more concisely stated if there was an objective for retirement income policy. In absence of such an objective, we note the inconsistency of referencing the Age Pension in the proposed objective while not referencing the third pillar of voluntary savings including home ownership.
2. The "deliver income" aspect of the objective is important, but we also note the increasing number of people retiring with mortgage debt[3] (which likely increase in a higher interest rate environment). It is anticipated that super will be used to pay down outstanding debt, as the RIR assumed in their modelling. We question whether an objective of super should more realistically reflect this use of retirement savings. This issue is nuanced. For instance, the action of paying down mortgage debt at the point of retirement could be viewed as part of income management (i.e. boosting available income through removing an outgoing). Thus we could satisfy ourselves that "deliver income" is appropriate. However, we consider it unlikely that most consumers would form a similar interpretation without further guidance.

[3] See Retirement Income Review Final Report Chart 1D-16.

3. We reiterate our concerns expressed earlier that the proposed objective does not appropriately balance whole-of-life outcomes. As a (fundamental, in our view) test case, consider further increases in the Superannuation Guarantee (SG) rate. While this would appear broadly consistent with the proposed objective of super, it also reduces consumption prior to pre-retirement and could be detrimental to the whole-of-life experience. One possible solution would be to broaden the explanation of 'equitable and sustainable' to include consideration of whole-of-life outcomes. The use of subsidiary objectives (discussed below) could also work.
4. In a similar vein, preservation is referenced in the proposed objective, and is generally recognised as an important design principle of a defined contribution pension system. However, we believe it is important that preservation is matched by a focus on the appropriate contribution level that is cognisant of whole-of-life outcomes. For instance, if the current SG level is too high (as suggested by the RIR) then the principle of preservation will always face tension. This might undermine acceptance of any legislated objective of super.

3. Primary and secondary objectives

The FSI urged the Government to not only adopt its proposed purpose of super, but also to seek broad agreement on six subsidiary objectives of the super system. This framework warrants consideration. Secondary objectives would add value to the primary objective that has been put forward for legislation. Additionally, the framework could enable a more concise primary objective.

A framework of primary and secondary objectives could facilitate a list of what super should *not* be used for. Some examples of uses that might be excluded appear below:

- Early access, e.g. housing deposits, medical procedures, economic disruptions, etc.;
- Measures that are largely tax gimmicks such as downsizer concessions; small business concessions, and so on;
- Reducing minimum drawdown requirements whenever there is an apparent market disruption;
- Other changes such as significantly opening up super to be used for housing or making part of super voluntary.

  .. etc.

Stating secondary objectives would also be a way to help connect superannuation to other components of the retirement system and related objectives. For instance, among the secondary objectives suggested by the FSI, the first referred to whole-of-life outcomes while the second raised the issue of managing risk in retirement:

1. *"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.*

2. *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."*

We refer to (1) throughout this submission while we believe that (2) warrants consideration as a subsidiary objective. Even though it is central to trustees' duties under the Retirement Income Covenant (RIC) it warrants strong consideration as an objective of super (within which the RIC directs responsibility).

4. Stress testing a proposed objective of superannuation

We think it would be a healthy exercise to stress test any proposed objective of super through a range of scenarios, to ensure that pursing the objective does not give rise to any unintended consequences thereby improving its robustness. We suggest a range of scenarios could be considered including the following:

1. Proposed change in the level of superannuation guarantee;
2. Increasing trend in mortgage indebtedness at the point of retirement, such a rising proportion of population or size of outstanding debt;
3. Decreased level of home ownership at the point of retirement, noting it is currently trending downwards;
4. Increase in cost-of-living pressures;
5. Material changes to tax treatment of super either in accumulation or retirement (or both);
6. Extreme case for nation building, e.g. accelerated transition to net zero carbon emissions;
7. Material increase/decrease in mortality experience or retiree life expectancies;
8. Research that reveals working life experiences are below those projected for retired life (i.e. explores lifetime consumption smoothing).