Legislating the objectives of superannuation: Traps and Trojan horses

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6 April 2016

I see no benefit in having a legislated objective for the superannuation system. If we must, care should be taken as to the unintended consequences – especially where the industry is lobbying for changes that will increase the size of the system. In particular, objectives should be limited to facilitating consumption smoothing over members' lifetimes. They should also say nothing about tax concessions or restrictions on other uses such as insurance and housing.

If we must have an objective, I suggest:

To facilitate consumption smoothing for families/households over the course of life.

If we must have a subsidiary objective that considers fiscal costs, it should also be more balanced.

Integrate with other Government programmes to address special needs, and to achieve inter-generational equity.

Even if it obtains bipartisan support, it should not be legislated as each new proposal for change needs to be evaluated on its merits. It is almost impossible to foresee in advance what the merits will be.

My Reasons

In one of his purple and perspicacious passages, which should be prominent on every policy paper produced, Adam Smith says:

"The interest of the dealers, however, in any particular branch of trade or manufactures, is always in some respect different from, and even opposite to, that of the public. … The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined, not only with the most scrupulous but the most suspicious attention. It comes from an order of men, whose interest is never exactly the same as the public, who have a general interest to deceive and even oppress the public, and who accordingly have, upon many occasions, both deceived and oppressed it."

It may therefore be wise to approach, with some suspicion, the proposal to enshrine the objective of superannuation in legislation. It is based on recommendations of the Financial Systems Inquiry (FSI). This was necessarily staffed by people with a strong financial background – Smith's dealers even if turned regulators. As John Kay says, their background, means that they may things "through the eyes of market participants rather than the end users they exist to serve" and are thus subject to "intellectual capture". The submissions they received also tend to reflect an industry perspective. My research with Sue Taylor suggests that such capture is evident in the Australian superannuation system more widely.

It is not obvious that there should be any "fundamental purpose". The Treasury paper says "a legislated objective will provide a way in which competing superannuation proposals can be measured". But how many Trojan horses will be released to subvert the regulatory review process and provide arguments against proposals that otherwise have merit? We do not have objectives for the education and health systems, for instance.

The SIS Act already has "a sole purpose test" in section 62. Like much of the Act, the section is complex, clumsy and lacks clarity. Its purpose appears to be to prevent SMSFs from investing in the family home. However, it takes over 900 words to say that a superannuation fund must be set up to provide benefits on the death, disability or retirement of a member. It would seem that the lobbyists in this debate want to ensure that superannuation is not used for either housing or insurance.

The absence of reference to insurance benefits in the Treasury paper is possibly an oversight. It is unfortunate however, because life and disability insurance are intimately connected with retirement planning and should not be lost to superannuation:

- A significant number of people are forced to retire for health reasons. Integrating retirement and disability benefits allows for higher benefits and a seamless transition.
- Death benefits should decline as superannuation balances increase. Spouses should also make provision for each other if one has lower superannuation benefits as a consequence of time out of the workforce (particularly if it was to care for the children of both).

While the case is not made vociferously, the industry seems to resent insurance premiums being taken out of superannuation. It reduces the balances on which they charge fees – and the market for retail insurance at three times the price.

The failure of most superannuation funds to provide lifelong annuity benefits received prominence in the FSI report, and is the ostensible driver of the discussion on objectives. The FSI recommendation in the Treasury paper, is "to provide income in retirement to substitute or supplement the Age Pension." Set as a subsidiary objective, is to "facilitate consumption smoothing over the course of an individual's life." I prefer the "facilitate" in both places.

- "Facilitate" implies no compulsion; "to provide" suggests compulsion perhaps after as well as before retirement. Superannuation funds, of course, love compulsion in any form as it increases their funds under management. The majority of the public seem to agree, but majority approval does not justify interference in people's lives without good reasons. It has long been known that young families are liquidity constrained and this is aggravated by mandatory superannuation contributions. If we must have a legislated purpose, it should avoid any suggestion that compulsion should be part of it.
- I would not even like to replace "provide" with "encourage the provision". This would suggest greater tax advantages and reduced means tests. Representatives of the industry are, unsurprisingly, indefatigable in their pursuit of tax concessions, but less vociferous on issues of means testing. One explanation is that they are personally less involved in the latter. Tax concessions, particularly the egregiously regressive no tax over 60, are all generous and perhaps unnecessary. Industry lobbying against tax changes is largely self-interested, although it would be much better to change the rate of tax rather than introduce new ones. Superannuation is a lifelong investment, and smallish changes to taxes on

contributions and investment income barely affect consumption. Short term changes to superannuation tax rates can therefore provide a useful way of raising taxes without discouraging consumption when appropriate in the cycle.

- "Substitute or supplement the Age Pension" might seem an acceptable objective for the individual, but the question is broader and deeper. I would be concerned that "substituting the Age Pension" could be used to justify reduction in the Age Pension as some might have it, or the introduction of even more inappropriate means tests. The Australia Institute makes the point that a higher universal pension with no tax concessions for superannuation would be cheaper, easier and fairer. I agree that the means tests in their current form are unfair and represent an unwarranted interference in the lives of pensioners – and do need reform. (The major problem is that they do not differentiate by age, falling heavily on younger retirees and lightly on the very old.) A legislated objective should not prevent changes here.
- "Consumption smoothing over the life time" and "an acceptable standard of living in retirement" are not the same. My research with Adam Butt, Gaurav Khemka and Ujwal Kayande, on financial planning for retirement, assumes as self-evident that the aim of planning is for relatively level consumption for a family over the lifetime – after adjusting for the costs of children and for mortgage repayments. Most of the calculators currently available, however, ignore the costs of children and housing and can suggest that users reduce themselves to penury in order to meet unrealistic retirement objectives. Objectives such as 65% of pre-retirement income or the ASFA comfortable standard are seldom right. The first is almost always too high – the latter appropriate for someone slightly above middle income, but too high for some, and low for others.