Centre for International Finance and Regulation

Towards Financial System Integrity

Objective of Superannuation

Submission by the Centre for International Finance and Regulation (CIFR)

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CIFR Submission

CIFR welcomes the move to formally state the objective of superannuation around the concept of providing income in retirement, and would like to take this opportunity to offer some suggestions in relation to how the statement might be framed.

We believe that stating the objective for superannuation in isolation is a second-best solution. Income in retirement is supported by the pillars of social security payments (including the age pension), superannuation drawdowns, and assets outside of superannuation (including, most notably, housing). Further, these pillars interact and should ideally be viewed holistically. Treating any one in isolation is undesirable. Accordingly, a more general statement around the objectives of the retirement system would have been preferable, although probably a bridge too far at the present time.

Nevertheless, establishing a clear objective for the superannuation system is worthwhile. CIFR believes the main advantage in doing so is to act as a shield against using the system for inappropriate purposes. Indeed, what is ruled out by the objective might be more important than what the objective explicitly permits. Given this, and the fact that an objective is being stated for just one component of a broader retirement system, we recommend the following:

1. A simple statement of objective that is consistent with the objectives of the broader retirement system.

2. A supplementary list that explicitly recognises some of the potential uses for superannuation that the statement of objectives is intended to rule out. This list might be indicative, and need not be comprehensive.

This would amount to something along the following lines:

Objective of superannuation: *To provide income in retirement*

Some uses for superannuation funds and/or their assets that might be considered *inconsistent* with this objective include:

- Funding asset purchases for the prime reason of supporting broader economic or social goals;
- Using superannuation as a vehicle to for tax-effective wealth accumulation; and
- Using superannuation as a mechanism for acquiring assets for personal enjoyment.

Comments

CIFR's recommended statement shortens the objective that appears in the discussion paper dated 9 March 2016, which was: "*To provide income in retirement to substitute or supplement the Age Pension*". There are a number of advantages to discarding the reference to the age pension, while retaining the central element of "income in retirement". A more straightforward statement can act as a readily recallable and recognisable ‘banner’ to be unfurled during discussions: it can become the mantra for the system. Further, tying the objective of superannuation to the age pension is not only unnecessary; but could be unhelpful by limiting the capacity to view the retirement system and all its pillars in a holistic manner going forward.

There are also advantages in making it patently clear what the system is NOT intended for by explicitly ruling out certain uses for superannuation. Given that one of the main benefits of a statement of objective is to deflect calls to use superannuation for extraneous purposes, there is considerable benefit in being explicit on this front. It removes ambiguity, and will have considerable impact. Exactly what might be on the list of exclusions could be made the subject of further consultation.

CIFR also acknowledges that there may be value in stating some of the subsidiary objectives of superannuation, for instance as listed in the Discussion Paper of 9 March 2016. In doing so, we implore that the superannuation system be considered at the household, rather than the individual, level. This simply reflects the living arrangements and needs of Australians. It makes sense for the superannuation system to recognise what is common practice in Australian society.

Note: This submission represents the views of CIFR, and not the official views or policies of any CIFR stakeholders, such as its funders, consortium members or industry partners.

Objective of Superannuation

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On 9 March the Australian Government released a Discussion Paper entitled *Objective of Superannuation*. The Paper repeatedly says “superannuation ... is not for unlimited wealth accumulation or bequests”. But legislating this exclusion could reinforce pre-existing policies that are literally counterproductive.

Taxes and regulations tempt Australian life-cycle savers away from super investments in industry and towards investments in a geared family home or investment property. Dwellings are both gearing-friendly and tax-benefit effective. Yet housing is a consumer durable rather than a productive asset.

Moreover, tempting people to borrow heavily puts financial stability at risk.

The Discussion Paper notes that owner-occupied housing makes up 38 per cent of assets owned by Australian households. It could have added that rental housing makes up another 17 per cent (approximately). By contrast, super assets make up just 22 per cent. So if you want to target ill-gotten gains from “unlimited wealth accumulation”, housing is a much better place to look. Why should super be singled out for this pejorative phrase?

The same goes for the Discussion Paper’s take on bequests, which loom large in the budgets of Australian retirees. In 2013 an international survey by the HKSB organisation found that the average estate planned by Australian retirees was US$501,919 - the highest of all the countries surveyed, and an amount suspiciously close to the average value of an Australian home around that time.

HKSB points out that the reason for our top ranking may be our low estate taxes. Indeed, estate taxes are nonexistent in the case of a family home sold within two years of inheritance.

One familiar strategy is to live frugally in retirement, relying mainly on the Age Pension, while reserving the family home - possibly a valuable one - for a tax-free estate. In this way, bequests financed by the family home are actually subsidised by our tax-benefit system.

By contrast, if concessional super contributions are left to someone other than a spouse or a dependent child then a tax of 15 per cent plus the Medicare levy applies. Again, why should bequests financed by super be singled out, given that bequests partly financed by Centrelink are not?

What, then, should be the objective of super? In 1972 Switzerland came up with the useful principle of organising discussions of retirement income policy under the heading of three pillars. Accordingly, the government's proposed statement on the objective of super should be a holistic one on the objective of retirement income policy as a whole.

Broadening out the statement in this way would recognise the substitutability between the three leading strategies for saving over the life cycle, each involving considerable support from the tax-benefit system.

Mentioned earlier was the traditional strategy whereby you first pay down the family home - and possibly trade up in the property market as well, in a quest for "unlimited wealth accumulation or bequests" - and then rely heavily on the Age Pension in retirement.

Next, and increasingly popular over the last 15 years or so, has been negative gearing.

Finally - albeit with growing trepidation - you might also consider voluntary contributions to super.

Unfortunately, the Discussion Paper disregards this three-way substitutability, thereby failing to achieve coherence in the context of retirement income policy as a whole, while reinforcing the pre-existing tilt of the savings playing field, i.e. away from ungeared super investments in industry and towards geared investments in property.

Here is a candidate list of objectives for retirement income policy:

1. Social safety net.

2. Compulsory occupational super, to reduce free riding on the first pillar by affluent households, help ensure a decent proportion of wage income is replaced in retirement, and boost national savings.

3. Incentives for voluntary super contributions by people funding a comfortable retirement or a significant estate.

Since 1992 Australia has of course had a version of the three pillars. Equally obvious is that each one needs radical re-sculpting. But that topic is best left for another occasion.