CSRI
COMMITTEE FOR SUSTAINABLE RETIREMENT INCOMES

# Retirement Income Covenant

Response to the Treasury Position Paper of May 2018

27 June 2018

# Purpose

The CSRI welcomes the opportunity to provide a submission on the Treasury Retirement Income Covenant Position Paper of May 2018.

The Committee for Sustainable Retirement Income (**CSRI**) is an independent, non-partisan, non-profit think tank whose mission is to promote "adequate incomes through all the years of retirement for all Australians on a fair and fiscally sustainable basis".

The CSRI supports the development of a regulatory framework that focusses the superannuation system on providing members with stable retirement incomes through all the years of retirement.

Treasury is to be commended for its highly consultative approach in progressing this significant area of public policy.

The CSRI has been actively involved in the development of the comprehensive income products in retirement (CIPR) regime over recent years and has fully documented its views in previous reports and submissions. This submission is limited to the what we see as the key issues associated with the retirement income covenant.

# Fundamental Principles

Given that the ultimate purpose of superannuation is to provide members with income in retirement, the CSRI supports the government's proposal to require trustees to develop a retirement income strategy to address the retirement income needs of their members. Fundamental to this approach are the following key features:

- Members Opt-In: Members' explicit consent should be required for the CIPR to commence, consistent with the aim of providing members with greater freedom and choice in retirement. This is important given the diversity of member needs in retirement and the fact that the trustees access to member information may be incomplete.
- Trustee obligation: Rather than leave it to the discretion of trustees as to whether to offer a CIPR, requiring trustees to do so is consistent with the fundamental purpose of superannuation and would ensure that all retirees receive the same opportunity regardless of fund.
- Engagement: We support the proposed requirement that trustees should engage with all members to assist with their retirement income planning. Such engagement should not be limited to retirees with a super balance above the limited threshold required for the offer of a CIPR.
- Household basis: The system must be capable of accommodating solutions on a household basis recognising that women have much lower superannuation balances than men with which they must finance higher life expectancy. The proposal to require trustees to give members the option to include a reversionary benefit in the CIPR is supported.
- Recognising that a CIPR will not be appropriate for all members, particularly those with a life threatening or terminal illness or with modest size super balance, it is important that trustees not be required to offer a CIPR in such cases. The definition of a modest super balance is discussed further below.

## Proposed Start Date

The CSRI supports the proposal to legislate the covenant by 1 July 2019 but to delay commencement until 1 July 2020.

We note that the proposed requirement for offering a CIPR outlined in the Position Paper provides considerable flexibility for trustees to determine how they will meet the retirement income needs of members. Trustees must only provide one flagship CIPR and flexibility is allowed in relation a wide range of variables (including no requirement for products to be fully or partially guaranteed, whether or not to incorporate the age pension income in determining broadly constant income) which we consider appropriate particularly at this stage of the development of the system.

If funds are allowed to offer one flagship CIPR by 1 July 2019, this may create an incentive for funds to go to market quickly in an effort to prevent the loss of member funds rather than take a more considered approach that is more beneficial for members in the long run.

This may not be in the best interests of members and carries a greater risk that people will be offered CIPRs that are unsuitable for their needs.

Allowing less than 12 months for the development of CIPRs allows insufficient time for a pooled product market to develop and limits the choices available to trustees to develop suitable solutions.

On this basis, a common start date of 1 July 2020 would help to ensure a level playing field in the pooled product market and permit a more reasonable timeframe for CIPRs to be launched in the best interests of members.

## Requirement to Offer a CIPR

At the same time, a number of funds have the governance and organisational capabilities to provide a greater degree of tailoring of solutions for members than is possible with CIPRs. Imposing an obligation on such funds to develop and offer up to three flagship CIPRs may constrain trustees' ability to implement solutions that meet the best interests of their members.

On this basis, trustees should not be required to provide CIPRs if they have implemented a superior, better tailored, solution for their members. The method for determining whether an alternative solution better meets the interests of members in retirement would need to be developed. Where the trustee chooses not to offer CIPRs to all or a cohort of members, the trustee would need to document in the retirement income strategy why the decision is in the interest of members.

## Minimum Account Balance

The question of minimum super account balance for the offer of a CIPR was put to delegates of the CSRI Leadership Forum on 31 May 2018.

A greater proportion of respondents judged that $100,000 was the preferred threshold for the offer of CIPRs rather than $50,000 as proposed in the position paper. More specifically:

- $100,000 was the most frequent point response (33% of respondents).
- $50,000 was the second most frequent point response (27% of respondents)
- $50,000 to $100,000 (60% of respondents)
- $150,000 to $200,000 (only 40% of respondents)

These results are particularly telling given that the respondents are dominated by industry participants who are very close to the issues. In many cases, they have an interest in the development of the retirement market and therefore would be expected to favour a lower balance threshold.

These results should not be interpreted as implying that engagement of members with low superannuation balances is unimportant. On the contrary, 49% of respondents considered that *"consumers should be empowered to make better retirement income decisions".* In this context, empowering consumers was understood as not requiring turning consumers into financial experts. Rather it meant giving them the practical tools, meaningful choices and appropriate nudges to make the right decisions.

This support for member empowerment compared with only 39% who considered that "*trustees should provide a default retirement option for consumers who do not choose*" (the second most popular option) and 14% "*Consumers need broader access to financial advice*".

These results support the need for government, industry and community groups to work together to help to empower consumers to look after their interests, while at the same time supporting them to make smart choices.

# Disclosure and Advice

We note that more work and consultation between government and industry will be needed to determine the most appropriate form that trustee guidance should take, including the requirements for intra-fund advice, disclosure requirements for CIPRs and the design requirements for certifying CIPRs. These are significant issues that will determine the success or otherwise of the framework in achieving its objectives and meeting member needs.

# Monitoring arrangements

History has shown that policy changes that go barely noticed by the people they are designed to serve can ultimately have profound impacts once you fast forward 10 or 20 years. The growth of super from basically a niche market in the early 1990s to an over 2 trillion-dollar industry today is a case in point. The retirement income framework could potentially have a dramatic effect on income distribution, intergenerational wealth, market structure and the flow of funds in the pension market.

The announced new means test rules for income streams would seem innocuous to many given that such products do not exist currently. However, they take on a whole new significance once trustees are obliged to offer CIPRs and nudge members to take them up. The distributional impacts of these measures need to be monitored carefully to ensure they improve incomes and reduce reliance on the age pension.

Given normal human inertia, we need to be mindful of the license given to trustees to guide consumer choices. If we are going to institutionalise nudging at retirement, where the consequences can be significant and potentially irreversible, we need the checks and balances in place to protect the consumer interest. The same applies to financial advice particularly given the significant problems in the industry as highlighted by the current Royal Commission.

It is critical that these are not measures are not implemented with a 'set and forget' mind set. Their impact on consumers needs to be monitored closely to ensure they are meeting their policy objectives without negative consequences. There is no one body in Australia charged with responsibility for monitoring the effectiveness of retirement income policies as there are in other jurisdictions such as New Zealand. That monitoring role is conducted on an ad hoc basis which seems inadequate and in need of strengthening.

Against this background it is important to clarify the basis and process for monitoring the development of the post retirement market to ensure that it develops in accordance with its objectives.

# Supportive CSRI Initiatives

Adopting a compliance mentality in developing a retirement benefit strategy could severely limit the ability of the funds industry to make the most of an opportunity to create not only value for "members" but ensure sustainable benefits for all current and future consumers.

Bearing in mind the industry transformation that needs to take place, the CSRI has launced a new initiative to support funds in implementing a retirement income focus, benchmark fund performance and shine light on consumer outcomes. This initiative will examine what constitutes good practice, what innovative approaches are being developed, and will identify organisations that are at the forefront of those developments.

As a first stage we have identified good practice principles around five core consumer focus capabilities. They relate to governance; understanding consumer needs; financial advice; investments and products; and consumer outcomes as outlined in the attached Discussion Paper.

Further work is needed to develop and socialise the scorecard capabilities and principles which we plan to do on a collaborative basis. The plan is to develop these principles into a balanced scorecard assessment tool that will assist funds to benchmark their own performance. The process will involve "judgement with independence and objectivity". While this will not satisfy those who seek an objective measure, we are mindful that the use of metrics in the absence of judgement may result in unintended consequences.

In the initial beta testing stages, the Scorecard will be developed as a tool for super funds to benchmark themselves against peers. In the longer term, the intention is to create a tool that is available for consumers.

# About the CSRI

The Committee for Sustainable Retirement Income is an independent, non-partisan, non-profit think tank focused on developing policies that support adequate incomes through all the years of retirement for all Australians on a fair and fiscally sustainable basis.

CSRI has an integrated view of financing retirement – including aged pension, superannuation benefits, home equity and the costs of health and aged care.

Its perspective on policy formulation is long term and multi-disciplinary, building consensus for reform by drawing on input from academics, investment managers, life companies, financial planners, governments, consumer and community groups.

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