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### **RETIREMENT INCOME COVENANT**

The Financial Services Council (FSC) welcomes the opportunity to make a submission to Treasury's consultation on the Retirement Income Covenant Position Paper.

The FSC has over 100 members representing Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. The industry is responsible for investing more than \$2.7 trillion on behalf of 13 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange and is the fourth largest pool of managed funds in the world.

The FSC promotes best practice for the financial services industry by setting mandatory Standards for its members and providing Guidance Notes to assist in operational efficiency.

We welcome Treasury's consultation and support the proposed policy position and Retirement Income Framework. We request some clarification on certain aspects of the Covenant, particularly around flexibility, timing and advice issues and note that some elements of the framework require further consultation so that potential concerns can be addressed. We also provide some practical recommendations in our submission that, in our view, will improve the operation of the proposals.

Please contact me with any questions in relation to this submission on (02) 9299 3022.

Yours sincerely,

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## INTRODUCTION

The FSC and its members support the proposed policy position and retirement income framework. The need for a wider range of retirement income solutions is a long-standing issue and was first recommended in 2010 by the Super System Review. Since then it has been recognised by subsequent governments with work on the early-stage elements of the retirement phase having been progressed steadily.

The proposed retirement income covenant will strengthen the system by providing better outcomes for retirees to manage longevity and other risks that become heightened in retirement. It is an important element in providing strong governance of Trustees in the retirement system and ensuring that they appropriately consider the retirement needs of members.

We support the phased approach to the framework's development – i.e. developing the covenant ahead of the supporting regulations as this will help to frame and inform how the detailed regulations and guidance should be constructed. We note, however, that we would like to see the safe harbour provision specifically developed in line with the covenant.

The framework should be built in a way that allows for future innovation – that is, keep it simple and principles-based.

The introduction of comprehensive income products in retirement (CIPRs) as optional for the member to take up is a good approach. It will create valuable options for retirees to manage retirement risks, without removing any of the benefits of the current system.

The FSC supports greater prominence for retirement in the *Superannuation Industry (Supervision) Act 1993* (SIS Act) and associated regulations, and therefore consideration by the trustee of a retirement solution for members, however, we caution against a high level of prescription being incorporated into the Covenant.

We also have some reservations about the intersection with advice and what may constitute personal advice. This will need further clarification specifically in the legislation including on scaled advice and what Trustees can offer and how they interact with retirees in relation to advice requirements.

We have some concerns in relation to CIPRs that may require further consultation to be worked through. These include portability of products, cooling off periods and legacy products. CIPRs are complex products that will require detailed development and look forward to working through some of the issues through future consultation.

One consideration from some of our members is that the trustee considers what product/solution might constitute a CIPR based on its own membership, rather than a prescriptive approach.

We recommend the timing is reconsidered as developing these complex products in the timeframe proposed may not produce desirable outcomes.

As a general comment, retirees need certainty that their retirement decisions are based on rules that will not substantially change. For this reason we seek stability in the Government's retirement income policies.

## SUMMARY OF RECOMMENDATIONS

### GENERAL

1. Consideration should be given on the timing of the stages of the framework. Industry should be given until 1 July 2021 to mandatorily offer a CIPR. Certain elements of the regulatory framework will need to be finalised prior to, or in line with, the covenant
2. Further consultation is required to clarify what product innovation is required by the framework.
3. Treasury should consider the technical limitations of portability and comparability and address these in future documents.
4. More clarity and consideration is required in relation to the intersection of the framework with financial advice. This should be articulated in the relevant legislative frameworks to provide clarity to industry.

### RETIREMENT COVENANT

5. Ensure the Covenant is principles-based and clarify and refine the criteria list that a Trustee must consider.
6. We recommend the Government undertakes further consultation in relation to the expectation for trustees to provide information, guidance and/or advice to assist members to make choices about their retirement income products offered.

### SUPPORTING PRINCIPLES

7. Ensure definition and usage of pooled lifetime products is consistent with that of 'innovative income stream'.
8. Further consideration of the ability to provide access to capital is required.
9. Increase the allowable expected income limit or variability range to allow for appropriate product flexibility.
10. We recommend changing the term 'flagship' to 'primary'.
11. Clarify when a Trustee must offer a CIPR in terms of interaction with eligibility for the age pension.
12. Clarify how CIPRs will work for members who are transitioning to retirement.
13. Clarify whether Trustees can satisfy Covenant principles for a flagship CIPR by having a defined list of questions they ask all members, which would ensure understanding of large cohorts of their funds members, without the need for tailoring via scaled advice.
14. Consider a cooling-off period and the technical issues that this may impose.
15. Clarify what flexibility will be given to Trustees in the use of third party providers or products.
16. Provide further information on 'consent'.
17. Increase the exemption limit to \$100,000, however more modelling is required.

### FUTURE CONSIDERATIONS

18. An appropriate approach should be developed for managing legacy retirement income products forming part of the retirement income framework.
19. Safe harbour provisions should be finalised along with the retirement income covenant.

## RETIREMENT INCOME COVENANT

### General Comments

#### *Covenant*

The FSC and our members support the Government's policy position on the Retirement Income Framework and overall support the themes put forward in the position paper.

We believe that legislative and regulatory certainty regarding the SIS Retirement Covenant and CIPR framework is critical to the successful development of a retirement incomes market in Australia.

We are supportive of a retirement income covenant being included in the SIS Act and agree with the statement on page 3 of the paper, that *"introducing a retirement income covenant will require trustees to consider the retirement income needs and preferences of their members"*, provided that the covenant is principles-based like the other SIS covenants and not overly prescriptive.

We believe that a principles-based covenant should be finalised and implemented via legislation as the first step. Following this, industry should be consulted on further detail on CIPR products.

The list of details that a Trustee must consider is quite prescriptive and needs further clarification. We understand that these are 'cohort' characteristics a Trustee must consider and are not individual level information requirements.

Areas where we foresee further consultation on product innovation include:

- ) whether longevity protection can be purchased through an ongoing payment of premiums rather than lump sum premium payment (e.g. for the acquisition of a deferred lifetime annuity);
- ) the satisfaction of the longevity protection component for CIPRs by utilising non-superannuation savings vehicles; and
- ) the flexibility for variable investment returns from capital supporting a lifetime retirement income stream.

#### *Broader framework*

FSC supports the broader retirement incomes framework but do have some concerns about certain aspects as currently outlined in the paper. We also have a divergence of views within our membership on whether offering a CIPR should be mandatory and how they will and the interact with financial advice.

We understand that the Government intends that offering a CIPR does not constitute advice and will clarify this position more fully in future iterations of the framework. Industry will require this clarity to progress with development of products and member engagement strategies.

We continue to be concerned that members will view the offering of a CIPR as a personal recommendation, which will have taken into account their full personal circumstances.

Given the complexity of retirement considerations (cash flow, investment allocations, Centrelink, succession planning), retirement decisions should be accompanied by quality financial advice in some circumstances or for some members.

We also make the point that this framework and the CIPR market will need scale to be successful – for the market to be sustainable and develop adequately, the products would need to be adopted at a large scale.

The position paper (on page 2) refers to facilitating trustees to provide retirement income projections during accumulation phase. While we agree this could be helpful for members, it is also worth exploring the value the ATO can add in this area considering it now holds account balance data for all of an individual's super holdings. Based on earlier consultation regarding the development of ATO Online screens accessed via MyGov, we understand the ATO has considered developing a retirement calculator and/or provide retirement projections based on data held. This should be explored at a later stage.

### **Dependencies on other legislation**

We would like to highlight that the objective of Super, as discussed on page 2 of the position paper, has not entered into law as yet and therefore we caution basing proposals on this objective pending passage of that objective into law.

A question posed by the FSC previously was whether the super rules would be an alternative to compliance with the pension standards currently embodied in the SIS Regulations. We understand that Treasury intends that the Retirement Incomes framework would “trump” the pension standards. We ask Treasury to clarify this issue explicitly. If this is the case, then it would seem to take away the concerns about certain CIPR product designs failing to meet minimum drawdown levels.

The retirement income covenant appears to operate in isolation of, and does not contemplate the current draft Design and Distribution obligations (DDO) which are designed to ensure that products are suitable for customer/member segments.

DDO does carve out MySuper but there is no suggestion that the concept of a CIPR is excluded from these obligations. We would like Treasury to consider the following questions:

- ) How will this interact with having to make a target market determination? Will it be solely based on using account balances as proxy for age pension eligibility, or will the requirements be broader?
- ) DDO also requires the target market determination to hold that the product “would generally meet the likely objectives, financial situations and needs of persons in the target market”. Would DDO carve out CIPRs where super funds meet the relevant disclosure requirements?
- ) Is it possible to carve out CIPRs from DDO altogether?

### **Advice**

We understand Treasury may clarify the interaction with this framework and the advice regime in the legislation to provide further certainty.

The proposed treatment of trustees under advice regulations creates some concerns in a broader policy context. We would like to flag some concerns generally and require more clarifications from Treasury regarding the interaction with financial advice – personal and general.

The paper states at p 10: *“To support trustees guiding members into products that are better suited to the member’s circumstances, regulations would clarify a limited range of factors that are classified as scaled personal advice or intra-fund advice. Trustees would be able to recommend an alternative retirement income product to a member or cohort of members based on these factors”*. This suggests trustee have enough information to make this decision, which they may not.

Clearly industry desires greater certainty and clarity around factual advice/general advice/personal advice. If carve outs are created under the CIPR framework, it would possibly be creating two tiers of advice delivery. This runs the risk of producing an uneven playing field through the creation of a policy distortion and we would suggest this is undesirable for broader financial services policy direction.

We suggest that there be greater clarity provided on what can be defined as some form of ‘scaled advice’, in absence of a Trustee taking measures to ensure the member obtains full personal financial advice. This should be explored in the legislation.

To ensure fair evaluation of CIPRs, we also suggest ASIC review RG 175 to ensure advice appropriately considers longevity risk and that evaluation of longevity products is done on an appropriate basis.

### **Portability**

There is no consideration given in the paper to portability and comparability. It is not clear what should happen if a member chooses to change CIPRs and whether the pooled lifetime product needs to be portable or have certain takeover terms.

It would not be a desirable outcome if a member is locked into a fund that provides bad service, increases its fees or otherwise, and the member could not change products without losing out.

At the same time, there are technical issues with providing portability on lifetime products and Treasury should consider these, including whether a product that is ported is treated as a new or a continuing product for the pension means test.

### **Timing and stages of the framework**

The commencement of the framework has been proposed for 1 July 2020 including introduction of CIPR products, with the legislated covenant introduced at 1 July 2019.

Some of our members believe that this timeframe is too short and that the industry should be given longer (e.g. until 1 July 2021) to offer a CIPR. We note however that if a fund wishes to implement a CIPR prior to this 1 July 2021 date, they should be allowed the flexibility to offer a CIPR voluntarily before then.

There is a lack of diversity in pooled lifetime products in the marketplace, particularly around non-guaranteed pooled products. The development of CIPRs require an unprecedented level of product innovation that will require time to achieve.

Treasury notes that the development of pooled lifetime products market has been held back by barriers, and while we congratulate the Government that these barriers have been removed, there is still likely a long time before the market develops scale. While it is expected that the certainty in rules will create new entrants and the market will form and mature overtime, it will take some time a truly competitive and healthy marketplace to exist.

The timeline on page 2 of the position paper indicates that the regulatory framework will be developed in the final phase of the retirement income framework. Further detail for some elements of the regulatory framework, including the safe harbour and an approach for managing legacy products, is required before the covenant is finalised.

**Recommendations:**

- ) Consideration should be given on the timing of the stages of the framework. Industry should be given until 1 July 2021 to mandatorily offer a CIPR. Certain elements of the regulatory framework will need to be finalised prior to, or in line with, the covenant
- ) Further consultation is required to clarify what product innovation is required by the framework.
- ) Treasury should consider the technical limitations of portability and comparability and address these in future documents.
- ) More clarity and consideration is required in relation to the intersection of the framework with financial advice. This should be articulated in the relevant legislative frameworks to provide clarity to industry.

## COVENANT PRINCIPLES

### 1. Retirement Income Strategy:

We support the principle that Trustees should develop a Retirement Income Strategy for their members. However we outline some key issues to consider below as well as requiring clarification on some points.

The required factors listed are too prescriptive. The retirement income covenant should be principles-based in line with the existing covenants in the SIS Act and should not require trustees to consider specific member preferences.

In particular, the phrase 'needs and preferences' should be replaced with 'reasonable assumptions about needs and preferences' from the fifth factor ('member needs and preferences'). Assessing member needs implies an objective and possibly thorough investigation of the circumstances of each member – something the trustee is going to find difficult to do, given that it will have incomplete information.

The last two factors should also be redrafted to better reflect the intention of these factors (age pension eligibility and cognitive decline).

We understand that Treasury has indicated that a fund does not need to know the information referred to in the last two factors for each member but rather a strategy can be designed to address these factors structurally. For example, a strategy can address cognitive decline in general by providing a simple income stream for life with no need for significant financial decisions. This is not



clear based on the current drafting which refers to how cognitive decline may affect (retirement) outcomes as opposed to considering cognitive decline in the product design.

We note that retirement outcomes are not solely dependent on how much one has in super. In fact, some members may have more assets/income outside super than they have in their super fund (e.g. investment income and assets, employment income, overseas pension, rental properties, age pension if eligible etc.).

The paper refers to the requirement for trustees to assist members to 'meet their retirement objectives throughout retirement'. Does this mean that the trustee will have to check in with members on a regular basis to see if this is achieved? Would the trustee have to give regard to a whole range of factors 'outside the super fund' to determine if this requirement is being met?

The first 4 key factors - providing income for life, managing longevity risk, and providing some access to capital, will require:

- ) Managing the mix of account based versus pooled lifetime products
- ) Managing the investment mix (defensive versus growth)
- ) Restricting the level of income drawdowns/commutations in any ABP which forms part of the CIPR, so as for the ABP to last to a certain age, and to ensure some access to capital at all times.

Some of the remaining 4 factors to consider in developing the retirement strategy may require the trustee to offer personal advice. Some questions to consider include:

- ) How is 'member needs and preferences' defined? Is it at retirement, or over the full retirement period? Would a member understand/know what their needs and preferences will be for their whole retirement?
- ) How much income do they need now? How much later?
- ) Can they increase their income to meet health costs and/or pay for aged care fees?
- ) Will they need access to capital down the track for entry to aged care?

The unintended consequence here is that members may end up in a CIPR that may not fully meet their needs in retirement, or conversely, decide not enter into a CIPR which is actually in their best interests.

The paper seems to suggest that the member's account balance could be used as a 'proxy' for whether a person may be eligible for any age pension. Unfortunately, this is not that simple to determine as it must consider the following:

- ) Age – may not be eligible for age pension at retirement as under age pension age
- ) Marital status (single or couple)
- ) Home ownership status (homeowner or non-homeowner)
- ) Assets and income outside super

Under current advice requirements, once any of personal details above are considered (of the member, and in the case of a couple, of the non-member spouse), then the line is crossed and personal advice must be provided under a full AFSL. Scaled advice/intra-fund advice would not suffice especially when the details of the non-member are considered.

Age pension eligibility is also not 'set and forget'. Eligibility can change as asset/income levels change (e.g. downsizing and having a surplus, receiving an inheritance etc.) or as the couple's status changes to single following death, illness or divorce.

Furthermore, the CIPR selected at retirement may potentially impact the age pension payable once the person qualifies for age pension.

We appreciate that the trustee could leave the age pension eligibility to the member and provide different CIPRs based on the member declaring/choosing whether they are eligible for full/part age pension or no age pension. However, without the member receiving advice we question whether the member would fully understand the implications of locking their money for life in a CIPR.

**Recommendation:** Ensure the Covenant is principles-based and clarify/refine the criteria list that a Trustee must consider.

## 2. Engagement:

A key focus of engagement should be about how to communicate and educate super fund members – members currently take either a lump sum or an ABP with full access at any time, the concept of pooled income streams that have limited flexibility is obviously very different.

Based on the information provided in the paper, as discussed above the expectations or obligations of trustees with respect to engagement are not clear. The distinction between information, guidance, intra-fund advice tools and personal advice is not clear. The paper indicates that the *“tools should assist members in making the most appropriate choice, given their needs and preferences”*.

Consideration of members' needs and preferences could be considered personal advice, however the paper indicates there is no expectation for trustees to provide personal advice as it is based on a cohort. It is our view that trustees cannot provide personal advice, nor provide guidance, without an appropriate safe harbour. At present, the concept of a safe harbour has been included in the position paper as an item in the Regulatory Framework/Future Considerations that will be consulted on at a later stage - we believe that the safe-harbour is fundamental to the feature of the CIPR being offered to members by the Trustee, which includes guidance and perhaps implicit advice to members, and should therefore be consulted on earlier as part of the CIPR design.

It is critical that retirees be provided with information about both the CIPR offer and any alternative retirement income product offered before making a decision to purchase a retirement income product. There is no 'one-size-fits-all' solution to retirement needs and CIPRs may not be appropriate for all members. There is significant risk members could accept a CIPR offered to them that does not meet their needs in retirement, or conversely, decide not enter into a CIPR which is actually in their best interests.

We recommend the Government undertakes further consultation in relation to the expectation for trustees to provide information, guidance and/or advice to assist members to understand and make choices about their retirement income products offered. This is particularly relevant in the current regulatory environment with draft legislation for Design & Distribution Obligations and where the Productivity Commission has recommended in draft recommendation 12.1 of its Draft Report on Competition in the Australian Financial System that *“General Advice”* be renamed, removing reference to the term *“advice”* so as not to confuse it with *“Personal Advice”*.

Allowing an extended cooling off period of 6-12 months, particularly for longevity products, would assist in mitigating to some extent the risk that members could accept a CIPR offered to them that does not meet their needs.

However, the cooling off period will have implications on pricing. In general, it may inhibit product innovation. This needs to be explored further.

**Recommendation:** We recommend the Government undertakes further consultation in relation to the expectation for trustees to provide information, guidance and/or advice to assist members to understand and make choices about their retirement income products offered.

## SUPPORTING PRINCIPLES

### 3. Definition of a Comprehensive Income Product for Retirement (CIPR) including CIPR features

#### What is a CIPR?

The framework requires some further clarification about whether a CIPR is to be a product in its own right under the SIS regulations or rather it will be considered the combination of an Account Based Pension (ABP) and a longevity product, or both.

Further, should the Trustee be required to diversify or provide choice, what processes and requirements would a trustee need to undertake before appointing one or more pooled lifetime product issuers. It would make most sense for members to be able to access a solution from trustees which delivers an account based pension from one provider and a longevity product from another. This lends heavily towards the CIPR being a 'solution' rather than a 'product', however, the paper seems to confine a trustee's thinking on this.

#### CIPR features

Some of our members feel that the features of a CIPR as described in the paper are prescriptive and it should be up to the trustee to consider what product/solution might constitute a CIPR based on its own membership.

#### *Efficient and broadly constant income*

The trustee will be required, at the **time of offer**, after considering average investment returns and longevity outcomes, to inform the member of the annual income payable from the CIPR.

A small buffer of approx. +/- 2.5% from the real or nominal income in the **first year** will be permitted over time. There is no requirement to provide either a full or partial guarantee of income payments. If the trustee offers to pay the income in real terms, then the nominal income would be expected to rise by 2.5% p.a. for inflation (note: there is no requirement to eliminate all inflation risk).

The trustee can also choose to incorporate any age pension income when determining the 'broadly constant income'. Given the difficulties in this, and the many variables present, we would not think that this advisable.

The need to provide 'broadly constant income' would require the trustee to effectively set their own ABP drawdown rates, preventing the member from choosing their own drawdown level (potentially even conflicting with minimum drawdown levels). This is also implied in the 'certification' section of

the paper on page 7 with the reference to ‘any implications for ABP minimum drawdown rates would be considered at that time (of certification)’.

The framework appears to disqualify CIPRs with expected return that grows over time, and allow CIPRs with extreme levels of (a posteriori) variability. Neither of these results seem appropriate. As such, we require clarification on the following:

- J The paper argues the expected income from a CIPR should be ‘broadly constant’. Does this mean that a Group Self Annuity (GSA) with significant exposure to equities would be disqualified – because the expected return would grow over time (as equity returns are expected to grow at a faster rate than CPI)? If so this doesn’t seem to be meeting the policy goal.
- J Could this be addressed by saying that the returns in expectation could be constant or grow at a constant rate in expectation?
- J Almost all random variables have an expected value, even if they have extremely large variance; hence a CIPR with almost any type of return will have an expected value even if it is subject to extreme variability around this return. So the expected return of a CIPR could be constant and remain within an extremely narrow band, but on realisation the return could vary enormously, by much more than 2.5%. This does not seem consistent with the policy intent.

Leaving this point aside, note the +/- 2.5% return is very narrow. For a product providing 2.5% return per year, this means the return could vary from 2.43% to 2.56%.

**Recommendation:** increase the allowable expected income limit or variability range to allow for appropriate product flexibility.

### *Income for life*

The CIPR must provide this broadly constant income for life, even if the person were to live well beyond 100 years old.

We now have a concept of an “innovative income stream”, being one that meets the standards in Regulation 1.06A of the SIS Regulations. This concept is product neutral in the sense that it can be a superannuation pension or an annuity and therefore seeks to accommodate group annuitisation products as well as classical annuities offered by life offices.

The concept of an innovative income stream is highly flexible. Importantly, there is a requirement for the benefit to be payable “throughout the life of the beneficiary (primary or reversionary)” and commutation values reduce on a straight line basis over the primary beneficiary’s life expectancy. As this is now a “known” concept in these regulations, we assume that this is the same concept that will be used in the proposed new regulation.

**Recommendation:** Ensure that the definition and usage of pooled lifetime products is consistent with that of ‘innovative income stream’.

### *Should have flexibility to provide access to capital*

The paper discusses the ability for the member to access some capital for health costs, home maintenance, unexpected events etc. This could be drawn from the ABP, however once the DLA is

commenced, it may be harder to achieve if the DLA is complying with the ‘declining capital access schedule’ requirement, and/or provider limitations on commutation.

The paper suggests that the most common way to provide access to capital would be to incorporate an account-based pension. Access to capital is often required later in life e.g. for residential aged care and at this time the account-based pension is likely to have been depleted with income payments being supported by a longevity product such as a DLA. Care needs to be taken to ensure CIPR design requirements consider the trade-off between the two types of products.

**Recommendation:** Further consideration of the ability to provide access to capital is required.

### Certification

We would like confirmation that a CIPR would be able to be certified if it:

- ) allows for changes in returns if there is an unexpected change in life expectancy (a Group Self Annuitisation (GSA) product would likely achieve this but not all products would);
- ) involves the delayed purchase of a lifetime annuity (this is not the purchase on retirement of a DLA, instead it is the decision to delay the purchase an annuity (immediate or deferred) for several years and then purchase the annuity if the member survives to that date).

#### **4. Offering a flagship CIPR:**

Trustees should have appropriate flexibility to consider which members it offers CIPRs. Trustees also need further clarity on how the development and offering of a flagship CIPR would work relative to a more tailored CIPR.

The extent of the required/allowed tailoring of the flagship CIPR(s) is unclear. Trustees can provide three CIPRs tailored to different cohorts of members; but in the example there is much more extensive tailoring, much more than three types of CIPR (plus the requirement to offer reversionary benefits).

More consideration is required in relation to how Trustees determine a CIPR is not appropriate for members (one example may be a terminal illness), and how they will satisfy the requirements accordingly.

**Recommendation:** Provide further clarity on how a flagship CIPR would be developed and offered relative to a more tailored CIPR.

We are also not sure the term ‘flagship’ is a useful one and suggest ‘primary’ instead.

**Recommendation:** change the term ‘flagship’ to ‘primary’.

We include some key questions below for Treasury’s consideration.

#### **When does the trustee have to offer a CIPR?**

The paper refers to trustees having to offer a ‘flagship CIPR’ to members at retirement, with the CIPR being the starting point for retirement income products (i.e. it must be offered before the trustee can offer any other retirement income product (including an ABP)).

We assume that this means when the member is ready to move into the ‘retirement phase’, i.e. retired on or after preservation age, or attaining age 65. This will often be before a person may qualify for any age pension (considering age pension age is rising to age 67). The paper refers to ‘eligibility for the age pension’ as a factor to consider when determining the retirement strategy and offering the CIPR to members or a cohort of members. However, members do not often proactively inform Trustees that they have retired from the workforce so it will be difficult to comply with this obligation if this is the requirement.

We assume the makeup of the CIPR will vary based on the age at which the member retires (e.g. higher ABP/lower DLA in under age 65, lower ABP/higher DLA if over 65).

The current proposals also don’t reference how CIPRs will work with individuals who are genuinely transitioning to retirement with part time or consulting work.

**Recommendation:**

- ) Clarify when a Trustee must offer a CIPR in terms of interaction with eligibility for the age pension.
- ) Clarify how CIPRs will work for members who are transitioning to retirement.

**What is the process for offering a Flagship CIPR and collecting member information?**

We would need to see the legislation/regulations but our interpretation is as follows – if the member wants to start a retirement income stream at retirement, the trustee will offer a CIPR in the first instance. The member would then need to decline the offer, and advise the trustee of their interest to start an ABP or another form of income stream.

There needs to be some form of a cooling off period, however the considerations for this are complex. The consent process must make it clear that the arrangement can be unwound within this period of time.

For the longevity component, the cooling off period will have implications on pricing. In general, it may inhibit product innovation.

Treasury should clarify that if a cooling off period is applied, how will death be treated in this period? Will a death benefit apply or will there be an entitlement to the same value under the cooling off rules?

The paper indicates that trustees can offer a single ‘flagship’ CIPR tailored to up to three different cohorts of members with different account balances. We propose that a trustee should be able to offer CIPRs based on a broader range of factors in addition to account balance, without it necessarily being a tailored CIPR as outlined as part of principle 7. To do this, it may be useful for a trustee to request details from the member via a shortlist of questions at the time of the offer to assist the trustee in determining the most appropriate CIPR is for that particular member.

The questions could form part of regulations, or associated APRA guidance. This should assist the trustee in deciding if a CIPR should or should not be offered to the member as well as the appropriate CIPR. At a minimum, questions should include health status (for example terminal illness), gender, home ownership, assets outside super, dependents, other super assets as well as

importantly advising the member that any balance left upon death remaining in the longevity/DLA portion of their balance cannot be bequeathed to beneficiaries.

However, we need clarity in the legislative framework as to the point where asking these questions may constitute a form of advice.

The requirement to offer a CIPR as the 'starting point' compared to any other retirement income products that may be offered at the same time could imply to a member that the CIPR is in the member's best interests or is more suitable than the other products. In the absence of financial advice, however, the trustee has no knowledge of the member's circumstances and has no basis for offering the CIPR as the 'starting point' over other retirement income products. Therefore, the shortlist idea above may be required. Obtaining this data for members should not be considered in the same way as traditionally obtaining information to provide personal advice, but rather under some form of 'scaled advice' provision.

A significant shift in member behaviour away from 'accumulation of a lump sum' towards 'purchasing an income stream for life' is required to create demand for CIPRs. At a time when the industry is being encouraged to rationalise, there is considerable risk that mandating trustees to develop products for which the demand is unknown, may result in proliferation of legacy products.

**Recommendation:**

- ) Clarify whether Trustees can satisfy Covenant principles for a flagship CIPR by having a defined list of questions they ask all members, which would ensure understanding of large cohorts of their funds members, without the need for tailoring via scaled advice.
- ) Consider a cooling-off period and the technical issues that this may impose.

**5. Third party products:**

We support this principle and agree with allowing trustees to fulfil their CIPR obligation in part or in full with a third party. We believe that this therefore means that the underlying products within a CIPR do not need to be all within the same superannuation fund.

Flexibility is required for trustees to structure the use of third party products both inside and outside the superannuation fund. There are advantages of either structure, products inside the fund are more easily able to provide a single income stream while products outside the fund provide greater portability for the member and are therefore less likely to result in the creation of further legacy products.

**Recommendation:** Clarify what flexibility will be given to Trustees in the use of third party providers or products.

**6. Consent:**

We strongly support the requirement for explicit consent however further detail on what this looks like is required.

Express consent required although should not simply be included in terms and conditions of super product. Risk must be adequately disclosed as part of the consent process.

**Recommendation:** Provide further information on 'consent'.

#### **7. Offering an alternative retirement income product through advice:**

A trustee should not be required to ensure that any other retirement income products offered are in the member's best interest compared to a flagship CIPR unless it is clear that personal advice is being provided.

#### **8. Exception for individuals for whom CIPRs are unsuitable:**

In the Position Paper, it is proposed that the trustee can make a decision not to offer a CIPR where the trustee has reliable information that a CIPR would not suit that particular person. Scenarios that are envisaged where such a rule would apply are where the trustee has knowledge that the person has less than \$50,000 in superannuation assets in that fund or a life-threatening or terminal illness.

We support the position with respect to life-threatening or terminal illness.

The exception limit of \$50,000 is too low. Given average super account balances at retirement today, it will need to be much higher, at least \$100,000, or the level of total assets where a member is eligible for the full age pension.

Time in the super system (e.g. whether for their full working life or not) and the Age Pension should be considered in modelling an appropriate minimum balance. It may be difficult to suggest a CIPR is in a member's best interest if they are entitled to a full Age Pension which would in itself provide sufficient longevity protection.

Our suggestion for a trustee to request details from the member via a shortlist of questions at the time of the offer would also be helpful here in relation to determining when a CIPR is unsuitable. However as discussed, the interaction with advice is an important element here.

**Recommendation:** Increase the exemption limit to \$100,000, however more modelling is required.

## FUTURE CONSIDERATIONS

#### **1. Lifetime engagement:**

We support the Government's proposal that engaging members on retirement is best done early to ensure that they have thought about their needs in retirement.

#### **2. Legacy products:**

There are significant long term costs involved for consumers, product providers and trustees with maintaining a product where take-up is limited. These costs and adverse impacts include (but are not limited to):



- J as there is a fixed cost to maintaining the required IT systems and processes for the administration of older products, over time this cost is borne by both product providers and consumers alike. This is particularly the case with respect to longer term products (such as lifetime) as the administration of the product could theoretically continue for many years beyond a normal financial product contract.
- J the ability to adequately service member needs over time can also be challenging as product disclosure documentation which may be compliant and relevant at the point of sale, may over time become out of step with community expectations and contemporary market offerings. This can become further exacerbated by product provider and trustee staff turnover with respect to legacy products and systems.

Accordingly, mitigating maintenance costs of CIPR products for trustees, product providers and consumers alike is an important objective.

One approach is to allow for the termination of such arrangement on notice to the policyholder for an agreed repayment (for example, a portion of residual capital). We believe this approach is feasible, noting the following high level points:

1. included in all relevant PDS documents would be the clear disclosure of the Trustees right to terminate the policy (or for the client to agree/consent), and how the commutation value will be calculated;
2. reasonable minimum and maximum commutation amounts for termination would have to be considered in the context of the current and proposed legislative framework; and
3. the minimum surrender value provisions and their interaction with the termination clause would have to be considered.

It is critical for the successful development of a retirement incomes market, that these legacy product termination provisions are clearly outlined and agreed under legislation or regulation prior to the offering of any CIPR products.

However, this needs to be balanced with providing customers with certainty. A potential implication of allowing the termination of legacy products is we may see participants enter the market knowing that they have the opportunity to simply terminate their products if they are not successful. Further consideration of this is required.

**Recommendation:** An appropriate approach should be developed for managing legacy retirement income products forming part of the retirement income framework.

### 3. Safe harbour:

There are two considerations for safe harbour requirements under this framework:

1. an ability for the trustee to provide guidance without being deemed to be giving personal financial product advice; and
2. protection for a trustee when offering a CIPR against a claim that, for a person with reduced life expectancy, offering the CIPR was not acting in the member's best interest.

In relation to a 'CIPR design safe harbour', there is no 'one-size-fits-all' solution to retirement needs and CIPRs may not be appropriate for all members. Despite best intentions and disclosure, there is a real risk to trustees of claims by individual members that the CIPR offered and accepted was not in their best interests. It is imperative that a 'safe harbour' defence is provided to trustees against such claims.

This is because it provides explicit protection to the trustee with respect to the task of seeking to reach a compromise for all members that may not be optimal for particular groups or particular members. Even where trustees are mandated to offer a CIPR, there is still some scope for a safe harbour to protect a trustee from claims where the product design of the CIPR turns out to be less favourable for particular members (or their dependants) relative to other available product design choices.

As a result the safe harbour cannot be considered and developed in the final phase of the development of the retirement income framework, and must be considered together as part of the development of the covenant.

**Recommendation:** Safe harbour provisions should be finalised along with the retirement income covenant.