**Submission to Treasury on the**

**Retirement Income Covenant**

**Position Paper**

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# Response to Retirement Income Covenant Position Paper

Income Is The Goal™ (IITG) fully supports the introduction of a retirement income covenant into the SIS Act. It will sit alongside the other covenants and principles of the SIS Act and will therefore link the accumulation processes that have worked well for Australian superannuants, with the new retirement principles being defined.

In previous submissions IITG has extolled the virtues of mass customisation, and the benefits it would bring to members of superannuation funds. We understand the need to create a simple and realistic strategy for members as the whole of a fund or large cohorts within a fund, but we still believe that funds have access to significant member data that would allow a fund to introduce a CIPR that is customised to each member.

The Position Paper states that a CIPR should “comprise set product components and proportions and drawdown rates”[[1]](#footnote-1). IITG agrees that product components should be stated by the Trustee in their CIPR. This will ensure the best internal and external products can be combined by a fund to benefit members. However, IITG does not agree that the proportions of the components should be set for every individual member or even for broad cohorts of members. We believe that funds should offer members a CIPR that best meets their individual or family needs. To keep a level of customisation available for funds IITG proposes that a funds CIPR would not have a set proportion of component parts, rather a set of range bound component parts.

IITG believes that there are many valid ways to find out more about a member, and for a fund to store that data for use in tailoring products to member needs. There are CRM systems and education tools that help members work their way through a fund’s services, and these systems provide a rich area for funds to improve their knowledge of members circumstances and needs. Some of these systems are electronic (robo), therefore not requiring a fund to have face to face contact through their own or external financial planning services. IITG is concerned that some of the points made in the Position Paper suggest that improvements in understanding members may be classified as financial advice, when in fact the knowledge is simply better record keeping about the member and use of reasonable heuristic rules.

Offering a customisable (i.e. with range bound component parts) CIPR would not be as a result of financial advice if the fund is simply using its systems to improve its knowledge of the member’s circumstances and therefore offering a certain CIPR as a result.

We look forward to this consultation and further work by Treasury continuing to support the creation of a vibrant retirement income product market where funds and their expert third party providers provide innovative retirement income streams to fund members.

# Discussion on Principles

### Retirement Income Strategy

IITG fully supports the introduction of a retirement income covenant into the SIS Act. It will sit alongside the other covenants and principles of the SIS Act and will therefore link the accumulation processes that have worked well for Australian superannuants, with the new retirement principles being defined.

In previous submissions IITG has extolled the virtues of mass customisation, and the benefits it would bring to members of superannuation funds. We understand the need to create a simple and realistic strategy for members as the whole of a fund or large cohorts within a fund, but we still believe that funds have access to significant member data that would allow a fund to introduce a CIPR that is customised to each member. We believe that this could be allowable in the current Covenant Paper, as discussed below.

The factors detailed for creating an income strategy in the Position Paper are

* maximising income for life for members;
* the potential life spans of members and the costs and benefits of managing longevity risk for members as a whole;
* managing risks that affect the stability of income, including inflation;
* providing members with access to capital;
* member needs and preferences for the factors above;
* the costs and benefits to members of developing a CIPR in-house compared with offering a CIPR developed and managed by a third party or a combination of both in-house and a third party;
* expected member eligibility for the Age Pension; and
* whether and how cognitive decline may affect outcomes[[2]](#footnote-2).

This list will provide Trustees with a checklist for their future compliance needs. However, it points to a number of issues and assumptions that will be made by Trustees in the process of creating their CIPR framework. For instance, member lifespan could be well known in funds and of great use to the actuaries creating annuity, GSA or DLA components. They may differ from population wide mortality rates by margins that may be significant enough to change pricing of CIPR components and may differ across cohorts in a fund. For this reason alone, we feel that customisation should be allowed in the development of flagship CIPRs.

In a similar vein, the second last factor – eligibility for the Age Pension – would have a dramatic impact on the proposed CIPR for any individual. There are a number of assumptions that need to be made or calculated in order for a fund to suggest that a member might be eligible for the Age Pension. Once these are made, then any proposed CIPR would be able to be customised for any individual member to a greater degree than if the calculations were not made. Indeed, IITG believes that this type of data would form a crucial reason for allowing CIPRs to be customisable at a member level.

IITG agrees that funds should make a decision on what should be managed in-house or provided by third parties in their CIPR strategy.

IITG agrees that cognitive decline as age advances is an important issue and may be satisfied in this instance with minimum drawdown schedules. The recognition of independent financial advice would also be prudent for older members and their protection. These provisions may however exceed the scope of SIS Act, and as such might be difficult to include in the Covenant provisions.

### Engagement

Fund engagement with members will be essential at the point of retirement in the transition from accumulation to retirement income services. The funds will need to provide a substantial amount of support to members, in the form of choice tools, comparison charts and intra-fund advice. We would expect these tools to be as sophisticated as any provided by the fund, whilst still being accessible to all members.

The sophistication of the tools would be understood by members as long as the fund has engaged with members for a significant period. As suggested in the Future Considerations[[3]](#footnote-3) section of the Treasury Paper, Trustees should engage early and consistently about retirement. This will be essential for members to understand what decisions they need to make at the point of, and in retirement, and why they are important.

# Discussion on Supporting Principles

### Definition of a CIPR

The definition of a CIPR will provide funds with sufficient clarity to create their retirement income framework.

The Position Paper states that a CIPR should “comprise set product components and proportions and drawdown rates”[[4]](#footnote-4). IITG agrees that product components should be stated by the Trustee in their CIPR. However, IITG does not agree that the proportions of the components should be set for every individual member or even for broad cohorts of members. At worst, and if the flexibility of the Flagship CIPR in (4) below is accepted (such that 3 CIPRS are allowed based on full, part or no Age Pension being received by the member), then a range for each CIPR component should be allowed. Stating a range for each of the CIPR components for a cohort of members would allow flexibility and some level of customisation, based on the factors described in later section 7.

IITG agrees that an objective for a CIPR should be that the expected income be efficient. It will be more problematic for the income to be broadly constant in either real or nominal terms, but the Position Paper appears to indicate a level of regulatory flexibility in this requirement. However, the Paper appears to point to a process of smoothing and or reserving within the product to maintain a broadly constant income stream. This will add substantial complexity and risk for the Trustee which they might not want to accept. It would also add operational risk to the members decision in accepting a CIPR structure from that fund.

It is absolutely appropriate for any CIPR structure to provide income for life, and crucial to the member that they have confidence that the CIPR will take away their own longevity risk.

Flexibility to access capital will be an important part of the CIPR structure, either in a separate component or part of a DLA/GSA/Annuity product.

Certification will be an interesting future debate.

### Offering a Flagship CIPR

As can be seen above IITG supports the ability to customise CIPR structures for members. As such IITG fully supports the suggestion to allow funds to offer up to 3 CIPR’s, based on full, part or no Age Pension payments. However, we do not believe that restricting a fund to just 3 structures with set proportions of components will provide enough flexibility to suit all members in a fund. Any fund will know a member’s age, marital status, income prior to retirement and could calculate a members Age Pension eligibility. Given a requirement to engage before a CIPR can be entered, these other factors will help a trustee customise a CIPR for a member.

If The Act allows a fund to offer 3 different CIPRs AND allows for there to be ranges of components of a CIPR in each structure, then a fund could probably customise each CIPR to the members needs more effectively.

IITG supports the ability of the trustee to offer a reversionary benefit and it not constituting a different CIPR.

### Third Party Products

IITG agrees that a fund should be able to offer third party products and must do so if it will be in the best interests of their members.

### Consent

IITG agrees that a CIPR must be offered to a member at retirement, but that it is an opt-in situation, not an opt-out.

### Offering an Alternative Through Advice

IITG believes that there are many valid ways to find out more about a member, and for a fund to store that data for use in tailoring products. There are CRM systems and education tools that help members work their way through a fund’s services, and these systems provide a rich area for funds to improve their knowledge of members circumstances and needs. Some of these systems are electronic (robo), therefore not requiring a fund to have face to face contact through their own or external financial planning services. IITG is concerned that these improvements in understanding members may be classified as financial advice, when in fact the knowledge is simply better record keeping about the member and use of reasonable heuristic rules. Offering a customisable (i.e. with range bound component parts) CIPR would not be as a result of financial advice if the fund is simply using its systems to improve its knowledge of the member’s circumstances and therefore offering a certain CIPR as a result.

### Exception for Individuals

It would be appropriate for a fund not to offer a CIPR to a person who has a known terminal illness or does not have sufficient assets to supplement the full age pension in any material way.

# Future Considerations

IITG looks forward to working with Treasury on the issues identified in this section, but in particular a requirement for funds to deliver retirement income projections to members and engage with members about retirement as soon as they enter a fund.

1. The Australian Government Treasury – *Retirement Income Covenant Position Paper* *– May 2018* Page 6 [↑](#footnote-ref-1)
2. The Australian Government Treasury – *Retirement Income Covenant Position Paper* *– May 2018* Page 4 [↑](#footnote-ref-2)
3. The Australian Government Treasury – *Retirement Income Covenant Position Paper* *– May 2018* Page 11 [↑](#footnote-ref-3)
4. The Australian Government Treasury – *Retirement Income Covenant Position Paper* *– May 2018* Page 6 [↑](#footnote-ref-4)