MySuper consultation working group

Issues paper on retirement income products

May 2011

PROPOSED REFORM

The Government's Stronger Super package considered reforms to post-retirement products and announced it will consult with relevant stakeholders on whether post-retirement products should be mandated for MySuper products at some time in the future (recommendation 7.1). The Government also announced it supported requiring a separate investment strategy for post-retirement members in MySuper and choice products which offer retirement income stream products (recommendation 7.4).

The Government's response to recommendations 7.2 and 7.3 of the Super System Review has been considered through a separate paper on advice.

OBJECTIVES

The reforms aim to ensure appropriate protection for members in the post-retirement phase by requiring trustees that offer retirement income stream products to explicitly consider relevant risks (for example, longevity, inflation and liquidity risks) when developing investment strategies for post-retirement members.

In addition, mandating MySuper products to offer post-retirement products at some time in the future may encourage the development of products when the superannuation system matures and post-retirement assets become substantial.

ISSUES

Issue 1 – Post-retirement products

The Super System Review recommended that MySuper products should be viewed as 'whole-of-life' products (recommendation 7.1). They will cover the accumulation phase and ultimately offer a post-retirement product, either on their own or in conjunction with another provider.

Requiring MySuper products to offer a post-retirement product would allow members to stay invested in a single MySuper product for their entire lives. It would ease the member's transition to retirement and reduce the burden and cost of searching and selecting a post-retirement product to invest in upon retirement.

However, the Government will not require trustees of MySuper products to offer post-retirement products (response to recommendation 1.7(j) and 7.1). Trustees of existing default superannuation funds which do not currently offer post-retirement products would need to develop new skills or more likely engage expertise to design new products to meet this requirement. Mandating that trustees of MySuper products must develop and offer post-retirement products, either on their own or in conjunction with another provider, may increase costs and complexities within the superannuation system.

Requiring trustees of MySuper products to offer post-retirement products may not be appropriate now as many members, particularly those in default investment options, currently have relatively small account balances and are more likely to take lump sums upon retirement.

It may be appropriate to mandate post-retirement products at some stage in the future when average account balances are higher and more members are likely to invest in a post-retirement product.

The Super System Review noted that particular focus should be considering what, if any, default arrangements should apply at any MySuper income stream products. The advantage of having a MySuper default income stream product is that it will smooth consumption. It will also allow disengaged members to rely on the trustee to provide an income stream which is value for money. That is, ensuring fees are not excessive and that investment returns are optimised.

However, the main concern with creating a MySuper default income stream product is that it may not be in the best interest for all members. The trustee may not be aware of a member's full financial affairs. For example, the member may require a lump sum to pay off debts, or a retirement income stream may have negative implications on a member's age pension entitlements. In addition, as an accumulation product is a separate product from a retirement income stream, legislation will need to be changed in order to allow an income stream to be offered as part of a 'whole of life' MySuper product.

Question 1.1 What are the advantages and disadvantages of trustees of MySuper products being required to offer post-retirement products at some time in the future?

Question 1.2 If this requirement was introduced, when should it be mandatory?

Question 1.3 Should there be default income stream arrangements for a MySuper product where a member is disengaged on retirement? If so, what legislative changes are required in order for there to be a 'whole of life' MySuper product?

Question 1.4 What are the costs involved in developing and maintaining a post-retirement product?

Question 1.4 What are the advantages and disadvantages of trustees of MySuper products being able to offer more than one post-retirement product to its members?

Question 1.6 What are the advantages and disadvantages of alternatives to a superannuation fund developing a post-retirement product on its own?

Issue 2 – Post-retirement investment strategy

The Government will require trustees of post-retirement products to have regard to the factors set out in paragraph 52(2)(f) of the *Superannuation Industry (Supervision) Act 1993* (SIS Act) as well as other relevant risks for post-retirement members in both MySuper and choice products in determining an appropriate investment strategy for those post-retirement products (response to recommendation 7.4).

Currently, the SIS legislation requires trustees to formulate and give effect to an investment strategy that has regard to the whole of the circumstances of the entity. This covers members in both the accumulation and post-retirement phases. In practice, most trustees offer multiple investment strategies, with it being open to members to choose those they consider most appropriate, whether they are in the accumulation or retirement phase.

The risk profile, tax treatment and liquidity needs of members in the post-retirement phase may be different from those of most members in the accumulation phase. Therefore, the Government considers it appropriate that trustees of MySuper and choice products, which offer post-retirement products, should separately consider the investment strategy for members in these products. Trustees are best placed to understand the particular demographics of their funds' membership bases, to communicate with those members about the risks and options involved and to mobilise their service providers to deliver the most appropriate retirement products.

Question 2.1 What are the advantages and disadvantages of requiring a separate investment strategy for post-retirement members?

Question 2.2 What relevant risks should trustees of post-retirement products have regard to when separately considering investment strategies? For example, inflation, longevity and liquidity risk.