RETIREMENT INCOME COVENANT
Position Paper
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Submission from

Robert Reid
Director, Yangunyah Pty Ltd
ATF Yangunyah Superannuation Fund

The Retirement Income Covenant sets out a requirement for superannuation fund trustees to develop retirement income strategies to assist members:

- Maximise retirement income
- Manage risks to stability and sustainability of income
- Have some flexible access to savings in retirement

COMMENTS

Drawing Down Savings

The covenant is critical of the slow rate at which retirees draw down their superannuation and other savings and states that 'People could have a higher standard of living in retirement if they had greater confidence to spend their superannuation.' This is a valid issue but ignores the point that a very significant barrier to higher expenditure for healthy retirees early in retirement can be uncertainty over life expectancy, and the costs and duration of the standard of age and health care that they aspire to in the latter stages of retirement. 'Lifetime guaranteed income' products can reduce this problem but retirees then believe that, if they die early in retirement, these options deny them the freedom to choose what happens to the balance of their funds.

Age care support services are means tested so, the greater the individual contribution, the less the government pays.

On balance, retirees with appreciable financial resources appear willing to carry the risks associated with longevity and funding age and health care in late retirement rather than transfer risks to a superannuation fund or an insurer.

Also, the covenant gives no evidence that retirees with superannuation balances greater that those needed to help support them for more than a few years aspire to higher standards of living than they currently choose. Account based pensions give retirees the ability to specify the income they desire from superannuation each year provided it is above the specified minimum.

Income Products – Industry and Retail Funds

The covenant indicates that superannuation funds need to review the characteristics of their members and may need to develop one or more retirement income products that assist members to balance the three objectives set out above.

Retail and industry funds usually have a range of investment options that would allow members to develop a mix of existing products to balance the above objectives for themselves. For example, QSuper members in or entering retirement can choose one or more investment options from a range including:

- Lifetime Pension
- Self Invest
- Diversified Moderate
- Diversified Balanced
- Diversified Socially Responsible
- Diversified Aggressive
- Single Sector Cash
- Single Sector Diversified Bonds
- Single Sector International Shares
- Single Sector Australian Shares

Many industry and retail fund members will require financial advice in choosing retirement investment options that best balance their needs to maximise retirement incomes, manage risks and have some flexibility in access to superannuation savings. The products are often there. The problem lies in convincing members to use those appropriate to their circumstances. Even dividing members into a number of cohorts for strategy development will not address the needs of members unless they are guided to the options that best suit their personal aspirations, superannuation balances, and financial resources outside superannuation.

The 'problem' appears to be that retail and industry superannuation members are not behaving in ways that conform to policy-makers expectations or desires, not that the funds are failing to provide appropriate products.

If there is a 'problem' it appears to be one of poor financial literacy and/or failure of individual members to seek professional advice. Mandating that funds develop retirement income strategies that may consider cohorts of members does nothing to address this.

Self Managed Superannuation funds

The covenant indicates that SMSFs will be required to develop retirement income strategies and, presumably, review fund performance under the strategy and periodically review the strategy.

The requirement for SMSFs with members drawing pensions to prepare then review a retirement income strategy is superfluous.

When undertaking the annual review of the fund's investment strategy the trustee(s) should, if necessary, be adjusting balances of investment types allowed for, and used, to reflect a balance between maximizing retirement income over time and managing risks to stability and sustainability of income. This includes consideration of longevity and investment risks.

Because SMSF Trustees are the fund members, they are best placed to manage the balance between the maximization of retirement income and income stability and sustainability risks through the fund's investment strategy. Also, SMSF members are well placed to decide on the appropriateness of rolling their balances into a lifetime pension or similar income stream with an industry or retail fund if the SMSF cannot meet their needs.

They are best placed to consider their financial resources outside superannuation and manage their pensions and balances in the fund as just one component of their retirement income strategy as well.

Flexible Access to Savings in Retirement

Current account based pension requirements where an age-based minimum pension is mandated, but no maximum pension is specified, gives flexible access to savings in retirement.

All that is required is for members to keep sufficient funds in an account based pension to cover any unforeseen requirements for additional funds if they decide to use a 'Lifetime Pension' type of product.

There are sufficient options available to give members flexible access to savings in retirement. Nevertheless, members may require professional advice to select the mix of investment options that best suits their needs.

Robert Reid