
TREASURY LAWS AMENDMENT (MEASURES FOR A LATER SITTING) BILL
2021: RETIREMENT INCOME COVENANT

EXPOSURE DRAFT EXPLANATORY MATERIALS

Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
Exposure Draft Bill	Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Retirement income covenant
RSE	Registrable superannuation entity
SIS Act	Superannuation Industry (Supervision) Act 1993
SIS Regulations	Superannuation Industry (Supervision) Regulations 1994

Chapter 1

Retirement income covenant

Outline of chapter

1.1 Schedule 1 to the Exposure Draft Bill inserts a new covenant in the SIS Act that requires trustees of a RSE to develop a retirement income strategy for beneficiaries who are retired or are approaching retirement.

1.2 The retirement income covenant will require trustees to have a strategy to assist beneficiaries to achieve and balance three objectives:

- maximizing their expected retirement income;
- managing expected risks to the sustainability and stability of their expected retirement income; and
- having flexible access to expected funds during retirement.

1.3 This covenant does not apply to trustees of self managed superannuation funds.

1.4 All legislative references in this Chapter are to the SIS Act unless otherwise stated.

Context of amendments

1.5 In the 2018-19 Budget, the Government committed to introducing a retirement income covenant with the intention of improving retirement outcomes of individuals, while enabling choice and competition in the retirement phase.

1.6 Current legal obligations of superannuation trustees have a focus primarily on the accumulation phase and there are no specific obligations to consider the needs of beneficiaries in retirement. The retirement income covenant is intended to address this gap.

1.7 It is intended that member outcomes in retirement will improve by encouraging trustees to focus on and implement strategies for beneficiaries in retirement or approaching retirement.

Summary of new law

1.8 Schedule 1 to the Exposure Draft Bill amends the SIS Act to introduce a covenant to require trustees to formulate, review regularly and

give effect to a retirement income strategy for beneficiaries who are retired or approaching retirement.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<p>Implement a new covenant that requires trustees of an RSE to prepare a retirement income strategy to assist beneficiaries achieve and balance three objectives:</p> <ol style="list-style-type: none">1. maximizing their expected retirement income;2. managing expected risks to the sustainability and stability of their expected retirement income; and3. having flexible access to expected funds during retirement. <p>This includes obligations to:</p> <ul style="list-style-type: none">- take reasonable steps to gather the information necessary to inform the formulation and review of the strategy;- record the strategy in writing;- record a range of matters as part of the strategy; and- make a summary of the strategy publicly available on the website of the RSE.	<p>No equivalent.</p>

Detailed explanation of new law

Obligations applying to trustees of an RSE

1.9 Trustees of an RSE are required to formulate, review regularly, and give effect to a retirement income strategy for beneficiaries who are approaching or are in retirement. The strategy formulated must meet

certain requirements, such as covering relevant beneficiaries and addressing how a trustee will assist beneficiaries to achieve and balance certain objectives. It will be considered a contravention of a covenant for a trustee to fail to comply with this requirement. *[Schedule 1, item 1, sections 52(8A) and 52AA(1)]*

1.10 The retirement income covenant will also require the trustee to:

- take reasonable steps to gather the information necessary to inform the formulation and review of the strategy;
- record as part of the strategy, each determination made by the trustee for the purposes of the strategy, the steps taken to gather information, each decision the trustee considers to be significant in the process of formulating, reviewing or giving effect to the strategy, and the reasons for those determinations, decisions and steps; and
- make a summary of the strategy publicly available on the RSE's website. *[Schedule 1, item 1, section 52(8A)]*

1.11 In formulating the strategy trustees must prepare a governance document that outlines in generality how the trustee intends to assist beneficiaries covered by the strategy to achieve and balance the following objectives:

- maximize their expected 'retirement income';
- manage expected risks (including longevity risks, investment risks and inflation risks) to the sustainability and stability of their expected retirement income; and
- have flexible access to expected funds during retirement.

1.12 In formulating the strategy trustees would be expected to identify the expected retirement income needs of beneficiaries and present a plan to build the fund's capacity and capability to service those needs.

1.13 In formulating and giving effect to a strategy for beneficiaries approaching retirement, trustees may consider assistance that could be provided during the accumulation phase.

1.14 A trustee's strategy could include providing a range of assistance, such as:

- developing and/or offering specific retirement income products;
- developing specific drawdown patterns that provide higher incomes throughout retirement;
- providing tools such as expenditure calculators to identify income and capital needs over time;

- providing factual information about key retirement topics, such as eligibility for the Age Pension, the concept of drawing down capital as a form of income, or the different types of income streams available; and
- providing guidance to beneficiaries early in accumulation about potential income in retirement through superannuation calculators or retirement estimates.

1.15 The trustee has discretion to determine the type and scope of assistance provided, noting that the assistance must also meet the sole purpose test and be in beneficiaries' best financial interests.

1.16 It is considered that the requirement to regularly review the strategy will entail reviewing both the outcomes from the strategy and the strategy itself at regular intervals. Treasury expects reviews would take place, similar to the investment covenant where reviews of the outcomes from the strategy are annual and reviews of the strategy itself occur every three years.

Consequences of failing to comply

1.17 The obligations form part of the section 52 covenants. Consistent with a contravention of other section 52 covenants, a contravention may incur a civil penalty. Where the contravention involves dishonesty or an intention to deceive or defraud, a criminal offence applies.

Beneficiaries covered by the strategy

1.18 Trustees are required to formulate a retirement income strategy for beneficiaries who are retired or approaching retirement. A trustee has discretion to determine the class of beneficiaries that the trustee considers meet this description. [*Schedule 1, item 2, section 52AA(3)*]

1.19 The legislation allows a trustee to approach this determination in any way the trustee considers appropriate. Some examples of factors that may assist a trustee to determine a class of beneficiaries that are retired or approaching retirement include:

- age which may take into consideration the preservation age or pension age;
- gender which may take into account differences in expected retirement ages, mortality and morbidity;
- employment status such as if beneficiaries are no longer employed or the trustee expects employment arrangements to end for beneficiaries;

- when the trustee expects beneficiaries to satisfy a condition of release requirement; and
- when the trustee expects beneficiaries to begin to plan for retirement and to retire.

1.20 Trustees do not have to formulate a strategy for certain defined benefit members. Where a beneficiary exclusively holds a defined benefit interest in the RSE and the beneficiary is not permitted to commute that benefit into a lump sum, then the trustee is exempt from developing a strategy for beneficiaries that fall under this category. [*Schedule 1, item 2, section 52AA(3)*]

1.21 Where beneficiaries of defined benefit schemes can commute their interest into a lump sum and the trustee considers that such beneficiaries are approaching retirement or retired then trustees should consider these beneficiaries when formulating the retirement income strategy. Beneficiaries who are permitted to commute their defined benefit pension have a choice as to how they access their expected retirement savings. This provides justification for why the trustee should consider how to assist these beneficiaries in their strategy.

1.22 Trustees have discretion to develop sub-classes of beneficiaries and differentiate the strategy for those sub-classes. [*Schedule 1, item 2, section 52AA(4)*]

1.23 Developing sub-classes allows trustees to formulate strategies that reflect their understanding of beneficiaries. This recognises that beneficiaries will have different circumstances and allows strategies to be more tailored to sub-classes. Trustees are best placed to provide distinct strategies to sub-classes based on similar characteristics and their understanding of beneficiaries.

1.24 As part of meeting obligations relating to member outcomes assessments, trustees are required to conduct cohort analysis. Identifying sub-classes for the purposes of formulating a retirement income strategy is expected to involve similar analysis. Examples of factors that trustees can use to determine sub-classes include:

- superannuation balance amount;
- expected eligibility for the Age Pension at retirement;
- whether a beneficiary is partnered or single;
- home ownership status, whether the property is owned outright, with a mortgage, or the beneficiary is likely to be or is renting at retirement;
- gender which may take into account differences in expected retirement ages, mortality and morbidity;
- expected retirement age; and

- age that drawdowns from superannuation are expected to begin.

1.25 Trustee flexibility in determining sub-classes of beneficiaries allows trustees to develop appropriate and tailored strategies for their membership base.

Objectives of the strategy

1.26 Trustees need to consider how to balance the three key objectives in retirement of maximizing expected retirement income, managing expected risks, and having flexible access to expected funds. Trustees have discretion to consider additional objectives they consider relevant.

1.27 Trustees have discretion on how these objectives are to be balanced using their understanding of the needs and preferences of beneficiaries when formulating the strategy.

1.28 Where these objectives compete, a trustee should identify in the strategy how it is intended to assist beneficiaries balance these objectives. For example, if a trustee is aware that a sub-class of beneficiaries would likely hold a mortgage at retirement, that information can be used to inform the assistance they provide to those members in balancing flexible access to capital over the other objectives.

Maximizing expected retirement income

1.29 Trustees are expected to assist beneficiaries to maximize expected retirement income throughout the period of retirement. [*Schedule 1, item 2, section 52AA(2)(a)*]

1.30 ‘Retirement income’ for the purpose of the strategy is after-tax income that is received during the period of retirement. This expected retirement income includes superannuation drawdowns from the entity or fund, Age Pension payments made under the *Social Security Act 1991* and any other income the trustee determines is appropriate. [*Schedule 1, item 2, section 52AA(5)*]

1.31 Other income that may be appropriate to include as retirement income can be from other non-superannuation assets, income from a partner, other income support payments under the *Social Security Act 1991* or the *Veterans’ Entitlements Act 1986* or superannuation interests held outside the fund if the trustee considers it suitable.

1.32 For the purposes of the strategy (including for working out what is included as ‘retirement income’), a trustee must determine the meaning of ‘period of retirement’. [*Schedule 1, item 2, section 52AA(6)*]

1.33 The ‘period of retirement’ can differ for different sub-classes of beneficiaries. It is expected that a trustee may wish to consider the retirement patterns of their members when working out the start of that period and consider the distribution of life expectancies of their members in forming views about the end of the period.

1.34 While trustees are required to maximize expected retirement income, this requirement needs to be balanced with the other objectives of the strategy. The objective of maximizing expected retirement income reflects the role of superannuation in providing income in retirement and that trustees should assist beneficiaries to drawdown superannuation balances.

1.35 It is expected that determining what assistance is required to ‘maximize’ retirement income should involve considering:

- current and expected member behaviour (for example, regular drawdown behaviour or the size and frequency of lump sum withdrawals);
- potential volatility (including situations of varying investment returns, inflation scenarios and mortality outcomes); and
- appropriate modelling and analysis, including modelling of expected Age Pension entitlement.

1.36 These considerations are relevant to the trustee’s assessment of the objectives of managing expected risks and providing flexible access to expected funds, as explained below.

Sustainability and stability of expected retirement income

1.37 Trustees are required to balance maximizing expected retirement income with managing expected risks to the sustainability and stability of retirement income and the other objectives of the strategy.

1.38 Sustainable retirement income is income that is reliable, durable and lasting for a beneficiary’s entire period of retirement. Stable retirement income is income that is broadly constant and predictable year on year over a beneficiary’s period of retirement. *[Schedule 1, item 2, section 52AA(2)(b)]*

Managing risks

1.39 The retirement income strategy requires a trustee to consider how the trustee will assist beneficiaries to manage the impact of expected risks to expected retirement income throughout a beneficiary’s period of retirement. The risks that impact the sustainability and stability of expected retirement income include investment risks, longevity risks, inflation risks and any other risks the trustee deems as relevant. *[Schedule 1, item 2, section 52AA(2)(b)]*

1.40 A trustee has discretion to determine if their beneficiaries need assistance managing investment, inflation and longevity risks, and how trustees provide that assistance. In exercising their discretion, a trustee needs to consider each of the risks in turn.

1.41 Investment risks include market risk, which is the risk of variable or negative investment returns and sequencing risk, which is the risk of converting assets to income at a disadvantageous time.

1.42 Inflation risk is a key risk to the stability of retirement incomes in real terms. It is the risk that a person's income does not maintain its purchasing power over time.

1.43 Longevity risk must also be considered by a trustee. This is the risk that a beneficiary's retirement savings will not extend for the entire life of a beneficiary.

1.44 Due to the varying levels of exposure to risks for each member, trustees may develop different approaches to managing risks between funds or even between classes of beneficiaries. The Age Pension provides a minimum amount of investment, inflation and longevity risk management. Depending on the beneficiary's circumstances the Age Pension may be sufficient without additional sources of investment, inflation and longevity risk protection.

1.45 The risks that are listed in the legislation are not exhaustive of the types of risk that could be considered and managed. Other potential risks could include risks associated with beneficiaries' disengagement with, or lack of access to, the fund. There is also the risk to the appropriate management of the sustainability and stability of expected retirement income posed by issues associated with beneficiaries' potential cognitive decline over time.

Flexible access to expected funds

1.46 The retirement income strategy must address how trustees will assist beneficiaries covered by the strategy to have flexible access to expected funds available over the period of retirement and balance this against the other objectives of the strategy. [*Schedule 1, item 2, section 52AA(2)(c)*]

1.47 Trustees are expected to consider situations where it is anticipated that beneficiaries will need access to funds over retirement. Trustees may wish to consider the life stage of beneficiaries and likely consumption needs. It would be prudent for a trustee to consider financial and in-kind support offered by state/territory and federal governments to offset health and aged care when determining the needs of beneficiaries to have flexible access to expected funds.

1.48 The concept of having flexible access to available expected funds is intended to have a broad meaning, which includes private savings, liquid assets and consideration as to the extent to which non-liquid assets can be drawn upon to meet beneficiary needs. Trustees should make informed assumptions about investment arrangements and use this information to assist beneficiaries to have flexible access to funds in retirement.

1.49 For example, trustee assistance to their beneficiaries could be in the form of factoring in these needs in the design of retirement income products offered by the fund.

Strategy to be general in nature and its relationship with financial advice and other laws

1.50 The retirement income strategy outlines a trustee's plan to assist beneficiaries covered by the strategy, in generality. It is expected that trustees will consider the broad needs of the beneficiaries covered by the strategy to determine what assistance may best meet those needs. This does not preclude the trustee from assisting their members to meet their individual needs through tailored guidance or advice.

1.51 Trustees must operate within the existing financial advice framework. Trustees can fulfill the requirements of the covenant and create effective retirement income strategies without providing personal advice.

1.52 The retirement income strategy is to express the general actions the trustee will take to assist their members to balance key retirement income objectives. It also does not need to consider the specific circumstances of individual members.

1.53 Collecting information on beneficiaries in and of itself, would not result in the provision of personal financial advice (which relates to making statements of opinion or recommendations about financial products).

1.54 The covenant obligations are also consistent with anti-hawking laws, which permits a trustee to contact a member who is approaching retirement with information about different retirement income products offered by the fund, provided that the trustee does not make an offer, or request an invitation to a beneficiary during an unsolicited telephone call, face-to-face meeting or other real time interaction that creates an expectation of an immediate response.

Information gathering requirements

1.55 A trustee must take reasonable steps to gather general information about their beneficiaries necessary to inform the formulation and review of their strategy. *[Schedule 1, item 1, section 52(8A)(b)]*

1.56 Given the general nature of the strategy, reasonable steps should only involve gathering information to the extent necessary to form a broad understanding of beneficiaries as a group in order to identify the types of assistance that could be offered to beneficiaries to achieve and balance the three objectives. Trustees currently make similar judgements about their membership when developing products or considering communication with their beneficiaries.

1.57 In particular, the information gathered should be used to inform elements of the strategy that are to be determined by the trustee.

1.58 If a trustee is considering whether it would be appropriate to include additional sources of income as ‘retirement income’ for the purposes of the strategy, it may also be considered reasonable steps to gather information about those elements not known to the fund. For example, trustees may consider information about whether beneficiaries are likely to have assets in other funds, other pensions or non-superannuation assets.

1.59 Information gathering may involve surveying beneficiaries or reviewing existing data. Trustees are permitted to use existing publicly available data where the trustee considers it appropriate and relevant in formulating a strategy.

1.60 Relevant publicly available demographic data may be accessed from government sources such as:

- the Australian Bureau of Statistics;
- the Australian Government Actuary;
- the Australian Prudential Regulatory Authority;
- the Australian Taxation Office;
- the Department of Social Services; and
- the Household Income and Labour Dynamics of Australia survey.

1.61 Trustees may also consider qualitative sources of information in developing their strategy, such as research reports by peak bodies or academic literature. For example, existing research on the preferences of Australian retirees or the effectiveness of various communication methods could inform the trustee’s strategy, whereas data tables on mortality and

morbidity could aid in managing longevity risk of the sub-classes chosen in a strategy for projected life expectancy.

1.62 Trustees are required to regularly review the appropriateness, effectiveness and adequacy of their retirement income strategy including the assumptions underpinning it. As part of reviewing their strategy, trustees are required to take reasonable steps to gather necessary information to inform this process. [*Schedule 1, item 1, section 52(8A)(b)*]

Publishing the strategy and written records forming part of the strategy

1.63 The retirement income strategy must be in writing. A trustee must record in writing as part of their strategy:

- each determination made by the trustee for the purposes of the strategy and the reasons for the determinations;
- all other decisions made by the trustee in formulating, reviewing or giving effect to the strategy, that the trustee considers to be significant, and the reasons for such decisions; and
- the steps taken to gather information about their beneficiaries that informed the formulation of the strategy, and the reasons for taking those steps. [*Schedule 1, item 1, section 52(8A)(d)*]

1.64 The amendments include the following determinations to be made by the trustee for the purpose of the strategy:

- a determination of the class of beneficiaries of the entity who are retired or who are approaching retirement;
- a determination of the meaning of retirement income, which may involve a determination that it is appropriate to include income from other sources in the concept; and
- a determination of the meaning of period of retirement.

1.65 Examples of decisions that the trustee may consider to be significant in formulating in their strategy include:

- decisions to divide beneficiaries into sub-classes and to make provision in relation to those sub-classes;
- how it was chosen to balance the objectives and the trade-offs that are present;
- the data sources relied on; and
- other relevant factors where appropriate, such as recording risks that are not listed.

1.66 Trustees may have two strategy documents, one detailed for internal use and a published summary of their strategy that is freely

available and easily accessible to the public. *[Schedule 1, item 1, section 52(8A)(e)]*

1.67 As part of the requirement to regularly review the retirement income strategy, trustees must maintain a current summary of the strategy that is available to the public at all times, even if the strategy is currently under review. The purpose of publishing the strategy is to provide equal information to the public so the opportunity exists to make informed choices about the superannuation entity that is most applicable to their circumstances.

Application and transitional provisions

1.68 The amendments commence on the day after Royal Assent. However, trustees will not be required to have their strategy formulated in writing and a summary publicly available before 1 July 2022. It is expected trustees complete these actions by this time. *[Clause 1 and Schedule 1, item 3]*

1.69 The amendments apply for RSEs in existence before the amendments commence and for RSEs established after commencement. *[Schedule 1, item 3]*