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Retirement income covenant: exposure draft legislation

Industry Super Australia (ISA) is a research and advocacy body for Industry SuperFunds. ISA manages collective projects on behalf of several industry super funds with the objective of maximising the retirement savings of nearly five million industry super members.

Executive summary

ISA broadly supports the retirement income covenant in the exposure draft legislation. We particularly welcome:

- the flexible principles-based approach to the covenant, which will allow funds to tailor a retirement income strategy that best suits the needs of their membership base, and
- the inclusion of spending flexibility as an objective that funds must address in the strategy, as this will support members to choose how they use their savings in retirement.

However, to improve the covenant and retirement outcomes for members more broadly, ISA makes the following recommendations.

- **Inclusion of self-managed super funds**: Self-managed super funds should be subject to the covenant. There is no strong policy rationale for their exclusion.
- **Application of the covenant**: The government should clarify when some of the obligations that form part of the covenant (such as the obligation to give effect to a retirement income strategy) commence.
- **Interaction with the design and distribution obligations**: The government should consider ways to minimise the overlapping regulatory burden for funds in complying with the covenant and the design and distribution obligations.
- **Classes of members**: The government should share with funds de-identified data held by government agencies on the relevant characteristics of members of the fund. This will assist funds to divide their members into appropriate subclasses for the purposes of the strategy (if the fund chooses to do so) and formulate a suitable strategy for each subclass.
- **Appropriate guidance**: The government should ensure funds can provide trusted, efficient, and cost-effective advice to members to assist them to meet their retirement objectives.

- **Meeting the needs of disengaged members**: The government should consider the role of carefully designed default retirement income products to cater for members who are unlikely to make an active choice about a retirement income product.

Self-managed super funds should be included

The exposure draft explanatory materials indicate that the retirement income covenant will not apply to self-managed super funds.

Self-managed super funds are often used for wealth preservation and estate planning - with provision of retirement income a secondary aim. Their exclusion from the covenant means that these practices will likely continue.

The policy shift to exclude self-managed super funds from the covenant is therefore inconsistent with the broader objective of the covenant, which is to improve a retirees' standard of living by focusing on increasing their use of superannuation assets in retirement.

Excluding self-managed super funds from the covenant also means there will be a gap in the super system, as self-managed super funds will be the only funds that are not required to have either an express or implicit retirement income strategy. This also appears to be at odds with the policy shift to require funds to consider, as part of their strategy, members with a defined benefit interest that may be commuted.

In ISA's view, the flexible principles-based approach to the covenant in the exposure draft legislation means that it can be broadly applied to self-managed super funds. In particular, the covenant as drafted allows funds to comply with the relevant obligations in a way that considers the nature, scale and complexity of the fund, including its membership base. For self-managed super funds, this means the fund could determine the class of members who are retired or are approaching retirement for the purposes of the strategy (which is required under the covenant), but given the small number of members, it may not be appropriate to further divide this class of members into sub-classes (which is optional under the covenant).

Additionally, this flexibility means the associated regulatory burden for self-managed super funds in complying with the covenant would likely be reasonable and proportionate. This reflects the small number of members in these funds and the information needed to inform the strategy is likely to be more readily available compared to other funds.

There is no rationale for self-managed super funds to be excluded from this positive obligation. They receive considerable taxpayer support via tax concessions and should be subject to broadly equivalent obligations as APRA-regulated funds. Accordingly, ISA recommends that self-managed super funds are subject to the new covenant.

Application of the covenant

The application provisions in the exposure draft legislation indicate that funds are not required to formulate a retirement income strategy or publish a summary of a retirement income strategy before 1 July 2022. In other words, on 1 July 2022, funds are required to have formulated a retirement income strategy and published a summary of that strategy.

However, it is unclear on the face of the law what the application date is for the other obligations that form part of the covenant, such as the obligations to give effect to the retirement income strategy and to record decisions made by the fund to inform the strategy.

ISA understands the policy intention is that funds are not required to have given effect to all the components of their strategy on 1 July 2022; instead, the intention is that funds have a reasonable period after 1 July 2022 to do so. We support this position as it would otherwise be difficult for many funds to meet this timeframe and could result in the formulation of more generic strategies that are easier to implement but may be less beneficial for members.

To give certainty to funds, the application date for these other obligations should be expressly clarified, at least in the explanatory materials.

Interaction with the design and distribution obligations

There is likely to be a significant overlap for funds in complying with the covenant and the design and distribution obligations, which commenced on 5 October 2021.

While the retirement income strategy under the covenant is intended to be more general, for many funds it will involve setting out how the fund will design, market, and distribute retirement income products that are appropriately suited to the objectives, financial situation and needs of their members who are in retirement or close to retirement.

As a result, ISA anticipates there will be significant similarities between a fund's retirement income strategy and the target market determination that a fund is required to make and review for its retirement income products under the design and distribution obligations.

These overlaps will result in an increased regulatory burden for funds without any additional benefit to members.

ISA recommends that the government consider ways to ensure that parallel processes undertaken by funds to comply with these obligations are not duplicated. For example, it may be appropriate for the regulators to provide specific guidance to funds about how they can streamline compliance with these obligations to reduce the associated regulatory burden and cost to members. This could be like the guidance provided to funds about the interaction between the member outcomes obligations and design and distribution obligations.[1]

Previously raised issues

We have set out below a summary of the issues that were raised in our submission on the position paper[2], which do not appear to have been addressed by the government.

Classes of members

ISA recommends that the government share with funds relevant data it holds about members on a de-identified basis. This data, in addition to publicly available data and data collected

[1] https://www.apra.gov.au/sites/default/files/2020-12/Member%20Outcomes%20and%20design%20and%20distribution%20obligations.pdf
[2] https://www.industrysuper.com/assets/Retirement-Income-Covenant-submission.pdf

from surveys, would assist funds to appropriately determine classes or sub-classes of members and formulate a suitable strategy for the class or sub-class.

In addition to the points raised in our previous submission, we consider that de-identified data on the following matters would be of assistance to funds:

- the employment income of members, to allow funds to set or target replacement rates as part of their strategy if they choose to do so, and
- the relationship status of members, as whether a member is single or partnered has implications for their expected retirement income.

ISA understands the ATO already holds this data and notes the task of the government analysing and de-identifying that data to share with funds would be more effective and accurate compared to funds relying on member surveys and analysis of publicly available data. Therefore, the ATO should be directed to release this data to funds, noting the sharing of de-identified data is also unlikely to contravene privacy laws or secrecy provisions in the tax law.

Appropriate guidance

To ensure members can receive efficient, cost-effective, and trusted advice to assist them to meet their retirement objectives, ISA recommends that intra-fund advice be expanded to include advice about retirement income products:

- which takes into account Age Pension eligibility, Centrelink payments, non-super assets, and non-super income, and
- which covers the members household, i.e., spouse/partner of the member and, if applicable, dependant/s of the member.

ISA also encourages the government to explore the benefits of free, subsidised, or low-cost advice on retirement planning as part of the *Quality of Advice Review* in 2022.

Meeting the needs of disengaged members

ISA encourages the government to consider the role of carefully designed default retirement income products to cater for those members who, for a range of reasons, are unlikely to make an active choice about a retirement income product.

If you would like to discuss this submission, please contact me at anguyen@industrysuper.com.

Yours sincerely

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