

15 June 2018

Manager, CIPRs  
Retirement Income Policy Division  
The Treasury

Via Email: [superannuation@treasury.gov.au](mailto:superannuation@treasury.gov.au)

Dear Madam/Sir,

**Re: Retirement Income Covenant Position Paper**

AustralianSuper is pleased to take the opportunity to make a submission in response to the consultation paper on the proposed Retirement Income Covenant.

AustralianSuper generally supports the overarching objectives behind a Retirement Income Covenant, particularly the focus on how RSE licensees should prioritise the provision of retirement income to members. However we have concerns about the rather prescriptive nature of the proposed solution, which reduces the scope to innovate and may not be appropriate for all members.

**About AustralianSuper**

AustralianSuper is Australia's largest superannuation fund and is run only to benefit its members. The fund has over 2.2 million members and manages over \$130 billion of members' assets. Our sole focus is to provide the best possible retirement outcomes for our members.

AustralianSuper is responsible for investing the superannuation savings of more than 10% of Australia's workforce, and we take seriously our responsibility to act in the best interests of our members as they move through their working phase to their retirement.

**Members' best interest**

There is a lot of focus in the paper regarding product solutions, design and requirements, but much less so on member outcomes and how the product solutions seek to satisfy these. The objective behind the supporting principles (CIPR design) needs to be clearer. Reference to a "broad agreement on the importance of what the CIPRs policy is seeking to achieve" in the introduction (p2) does not articulate what that is, including how long a stable income is required.

AustralianSuper would like to see a value proposition for members. Without rigorous application of a consumer lens, we fear CIPR products may fail. Members will not want to take up a new product if they are not satisfied that:

**1) They will be demonstrably better off**

Not all members will be better off with a CIPR, in particular those with lower balances. AustralianSuper does not agree with the \$50,000 minimum balance. Our modelling suggests that the minimum balance for a CIPR should be \$200,000-\$300,000. Those who will rely on the full Age Pension will receive little benefit from a CIPR because:

- a. the Age Pension provides the longevity protection for members with low assets and income;
- b. the modest additional lifetime income from (say) 20% of the account balance at retirement would be so low (likely less than \$100 a fortnight) that it would not justify the costs of the products administration (and therefore provide very low value for money). Indeed the UK has moved away from compulsory annuitisation as low interest rates and low balances have led to extremely low payment amounts, and proportionately high costs; and
- c. the low payments would have a high opportunity cost for a cohort who place a higher value on capital accessibility than those with higher savings levels and a need to self-insure.

The proposed income test concessions provide for smoothing between capital and income components, but compares unfavourably with the assumed earnings rates under the deemed income levels for account Based Pensions. The smoothing approach may result in members selecting such products to receive some Age Pension, the Pensioner Concession Card or to minimise tax.

This can result in suboptimal outcomes for members should 'gaming' arise if products are commuted for differential social security treatment. Alternatively remaining members may be disadvantaged under the social security tests when the need for a government safety-net is arguably higher.

**2) They are able to make reasonable changes**

The Productivity Commission has recently highlighted the concerns of members remaining in high cost, low net return products, and is looking at means to improve member outcomes. From an investment perspective, lack of portability (strict commutation provisions and a lack of a roll-over framework) results in the risk of locking members into sub-standard products, and a proliferation of legacy products. It is important that these matters are addressed prior to the offering of these products, to avoid a cohort of members being restricted for life.

**3) The product provider will be relied upon for the long term (up to 40 years)**

We must ensure that members have rights to consumer protections in the event of a product or provider failing, or changing terms and conditions (such as fees) to a product from which a member cannot exit. Further clarification on the treatment of legacy products is required.

**4) The flagship offer is the most appropriate option**

Not all members have access to nor can afford financial advice, and may be better off with an alternative solution to the flagship (such as an Account Based Pension with a 'Smart Default').

**5) They will receive value for money**

The current design principles appear to favour established product providers and may give rise to a concentrated and anti-competitive market (and may lead to legacy products). This is particularly the case given the short timeframes to implement. CIPRs offered to members with balances under \$250,000 are unlikely to receive value for money.

For the reasons above, we emphasise the importance of a timely resolution to certification of CIPRs. Furthermore, the principles and guidelines to solution development should not be so prescriptive as to stifle innovative and creative product/service solutions that will best serve members' interests over the short and long term.

The proposed implementation date of July 2020, (combined with the social security provisions being active in July 2019), provides for a very restrictive timeframe to properly consider the members' interests in product design, and may lead to a rush to release substandard products as well as members making rushed, myopic purchase decisions to access greater Government Age Pension payments.

Lastly, the industrial default model is a critical component of the superannuation system and works in the best interests of members. The proposed retirement income covenant is part of a framework that is fundamentally inconsistent with the industrial default system. Under the proposal, CIPR's will not be subject to a quality filter reviewed by the Fair Work Commission and will be sold directly by funds to members requiring them to make an active choice. AustralianSuper favours that a member is defaulted into an income stream (currently an Account Based Pension), notwithstanding that policy settings regarding portability, opt-out, transparency and safe harbour will need to be adjusted.

### **Retirement Income Strategy**

AustralianSuper agrees that Trustees should consider the needs of members in retirement, and formulate and give effect to a retirement strategy alongside investment, insurance and risk management strategies.

Optimising the competing levers of high income, risk management and flexibility, means that none can be individually maximised. The priority for each objective will vary for different cohorts of members. The focus (and language) should not necessarily be biased to maximising income, it should be on sufficiency or sustainability of income.

## Engagement

Member engagement is something that funds already undertake and does not need to feature in such a covenant as a primary principle relevant only to retirement.

## Definition of a CIPR

It is important to have a definition in order for a trustee to meet its regulatory requirements in offering a CIPR, however it is important that it is not too prescriptive. It must be broad enough to foster innovation, yet articulated to allow comparison between products. AustralianSuper would like the certification requirements resolved quickly to enable timely product development.

The terms of the proposed Retirement Income Covenant is that a trustee must consider:

- a. Constant income;
- b. Longevity risk management
- c. Some access to capital.

In principle we agree with the concepts, although there are some questions as to how this may be applied in practice, and may be a matter for clarification.

### 1) Efficient, broadly constant income in expectation

There is concern that the paper does not expect this to be delivered in practice. This is not only contradictory, but does not allow for innovation in income delivery to account for changing spending patterns over time (other than the choice to index or not) or actual earnings/pooled longevity experience. Our preference would be change the first definition to "efficient, expected income over time" or similar.

Further, from the examples provided, this constant income level may take into account individual entitlements to income streams from the Government Age Pension (either throughout the individual's lifetime or after income streams are depleted). Industry discussion suggests that there is some confusion on this point.

### 2) Income For Life

Again, we understand that products need to provide for income for those who exceed projected life expectancy levels. We agree with this in principle, although note that:

- a. for some (in particular those with lower balances), Account Based Pensions which reduce Government Age Pension entitlements in earlier years, but provide greater entitlements in later years may be more attractive; and
- b. the focus on 'income for life' and longevity protection somewhat overlooks the importance on investment returns in providing sufficient and long-lasting income.

### 3) Access to capital

This is good as a concept, but the proposed maximum commutation values as set out in the draft explanatory memorandum are highly restrictive and may be punitive, rather than actuarially based. In order to maintain flexibility (for example to allow for unexpected medical needs) undue restriction should not be placed on products.

Whilst various scenarios may involve offering an Account Based Pension balance as the accessible portion, but there is no consideration to what happens when this balance runs out and the longevity solution takes over. Further, commutations from the Account Based Pension will change the level of the income and affect the 'constant income in expectation' concept.

## General observations

There is confusion as to what a "CIPR" product is and the certification criteria – i.e. where an Account Based Pension is combined with a deferred lifetime annuity, is the CIPR product a stapled format? This leads to confusion as to:

- a. The social security provisions / commutation restrictions, will they apply to both components?
- b. Who is responsible / liable for each of the components?
- c. Is portability by component possible?

That is, if commutation restrictions (per the draft explanatory memorandum) apply to Account Based Pensions components, CIPRS containing these are unlikely to be attractive.

With such confusion, only traditional lifetime annuity products provide *certain* compliance. However, these may not be in members' interests due to:

- a. Costs of insurance: guaranteed outcomes come at a significant margin over at-cost pooling arrangements; and
- b. Low investment returns: such products provide lower fixed returns which are "hedged" by investing in long-term fixed interest portfolios. This means that members are missing out on the potential benefits of higher investment earnings – which can provide greater income levels and/or address sufficiency and/or longevity by having funds last longer.

The Retirement Income Covenant Paper contains very little discussion on pooling versus guaranteed products, and is silent as to the impact of investment risk or investment returns. In contrast to traditional (clearly complying) products, a higher-risk investment proposition with pooling of longevity, may provide somewhat volatile income outcomes at the very long-tail end of longevity experience, but better income outcomes for the vast majority of members. Accordingly, clarification will be helpful as to whether such alternative products will comply with the "income for life" and "constant income" criteria.

### **Offering a flagship CIPR**

It makes sense that trustees should offer a CIPR product designed for a majority of members, with simple features and guidance without personal advice. It is reasonable that differentiators should be able to apply to ensure appropriateness to different cohorts of members, however, it seems anomalous that the only differentiator required between different types of CIPRs is account balance, as this does not have regard to any other member needs.

### **Third Party Products**

Trustees have the ability to assess the quality of third party providers themselves and do not need to be compelled to use third party providers in the absence of quality. Such a supporting principle should not be required.

### **Consent**

We agree that member consent is required. As it stands, CIPRs should not be the default, nor opt-out option for retirement. AustralianSuper favours a default income stream and at present this should be the Account Based Pension. Once CIPRs are settled and working in practice as the most appropriate vehicles for members' retirement income, we are open to examining whether CIPRs should be the default option in the future.

### **Offering an alternative product through advice**

As is currently the case, a fund may offer alternative retirement income products, such as a Term Allocated Pension, Account Based Pension or IRISP. These are not encumbered with a requirement to provide personal financial advice.

It is important that the requirements to provide advice for alternative retirement products are clarified and align with financial advice regulations. For example, will personal financial advice only be required if the product locks away a member's capital for life, with restrictions on access, but is not a 'flagship CIPR'?

It is not feasible for individual advice to be provided to all members. A clear framework must be provided to enable trustees to offer products based on general advice (with specifications as to the circumstances under

which products may generally be appropriate for different cohorts of members). It must take into account the intersection of general advice and guidance, and the different levels of personal advice.

It is important that safe harbour provisions are considered now and not as a 'future consideration'.

### **Exceptions for unsuitability**

As previously addressed, AustralianSuper does not agree with the \$50,000 minimum balance. There will be a conflict if trustees do not believe it is in the best interest of their members to be offered a CIPR when their balance is over \$50,000 but under \$250,000 (the upper threshold being dependent on the member demographics of each fund).

An Account Based Pension is likely to be more appropriate for this member cohort. AustralianSuper has addressed the concern that members tend to draw the minimum amount, by designing a Smart Default (with an initial 6% drawdown and tailored investment mix). Other funds have also addressed this segment with through 'ready-made' default settings, and is an innovative way to appropriately address this segment.

### **Lifetime Engagement**

AustralianSuper agrees with framing retirement benefits as income throughout the life of a membership.

### **Legacy Products**

It is important that this issue is addressed quickly to ensure products continue to best meet member needs.

As previously addressed, there needs to be provision for portability between providers or for the right of consumers to change their mind further in the future, otherwise this may be against consumer's interests as well as their wishes.

Rushing into producing CIPR products to be launched by July 2020 (or indeed by July 2019 to take advantage of the social security means test changes) may result in unintended legacy products as funds supersede such products after further time and consideration.

### **Safe Harbour**

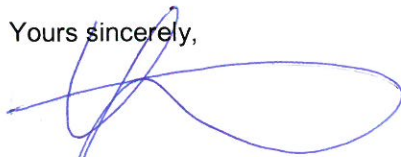
Further detail is required and must be resolved quickly in order to allow trustees time to develop products. At what point will safe harbour be granted to a CIPR, and under what circumstances / offered to whom etc?

If a safe harbour is to apply in respect of CIPRs, it should apply to the entire offer made to all relevant members as a mass customised product offering, rather than restricting the application of the safe harbour to certain members only. The safe harbour should apply to the initial offer of a CIPR only and not follow up advice interactions with the customer.

The safe harbour should not apply to a personal advice situation facilitating CIPR uptake. Once a member/prospective member has engaged with the fund and their personal financial circumstances have been determined (in all or in part) by the trustee of the CIPR, then a safe harbour that applies due to lack of knowledge of personal financial circumstances should not apply.

If you have any further queries please do not hesitate to contact Tom Garcia on 03 8648 3742, [tagarcia@australiansuper.com](mailto:tagarcia@australiansuper.com) or Louise du Pre-Alba on 03 9864 3847, [lduprealba@australiansuper.com](mailto:lduprealba@australiansuper.com) in the first instance.

Yours sincerely,



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