HESTA

HESTA Submission- Retirement Income Covenant Position Paper, May 2018

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Retirement Income Covenant Position Paper

HESTA welcomes the opportunity to submit a response to the Retirement Income Covenant Position Paper distributed in May 2018. We also support the submissions of our peak industry bodies – Industry Super Australia (ISA) and Australian Institute of Superannuation Trustees (AIST).

About HESTA

HESTA is an industry superannuation fund, established in 1987 to provide retirement benefits for workers in the Health and Community Services Sector, and we operate only to benefit members. We have approximately 850,000 members and manage over $44 billion of members' assets. Over 80% of our members are female.

The typical HESTA member is aged 43, is female and has a balance of approx. $19,000 in superannuation.

Because of our traditional industry base our members are:

1. More likely to live for five years longer than an average Australian male
2. More likely to suffer the inconsistencies and discrimination of the gender pay gap
3. More likely to take time out of the workforce on periods of unpaid leave
4. More likely to be at risk of poverty in retirement.

Our purpose is to make a real difference to the financial future of every member. The needs of our members in retirement are not unique, but the needs are common to many low paid workers particularly women.

We note that this paper seeks to explore ways of engendering a more sophisticated approach to the retirement landscape – we support the conversation. We note however that this conversation is best done comprehensively with the consideration of the social pillar and the interplay between this pillar and the private savings regime. It is regrettable that a covenant has been developed with a product in mind, which may be unaffordable for the majority of our members and that the broader considerations of the needs of low paid workers were not specifically taken into consideration.

We have made some brief comments on the proposed principles.

We welcome the opportunity to discuss the submission further. Should you have any queries please contact Mary Delahunty, Head of Impact on 03 8660 1673, or mdelahunty@hesta.com.au

Upholding the industrial default model

The industrial default model is a critical component of the superannuation system and works in the best interests of members.

HESTA, along with other industry superannuation funds, are strong supporters of the workplace distribution of super by means of modern awards and enterprise bargaining, because it has a proven record of connecting millions of employees to good funds that can be trusted to act in their best interests. This is a key part of the compulsory super safety net. We have made several public statements in support of this system.

The proposed retirement income covenant is part of a framework that is fundamentally inconsistent with the industrial default system. In fact it seeks to sidestep workplace distribution and the industrial system safety net in favour of retail distribution. Under the proposal:

- CIPRs will not be subject to a quality filter reviewed by the Fair Work Commission;
- CIPRs will not be distributed through the workplace, instead sold directly by funds to members; and
- Members will still be required to make an active choice from what will eventually be a wider (than now) range of more complex retirement income products – offered by their existing and competing funds.

This submission makes comments on the detail of the proposed covenant, but those comments on detail should not be interpreted as support for the broader initiative.

The retirement income framework

We strongly support the premise that longevity risk has not been addressed well by the current system.

Issues of longevity are felt acutely by our members; not only do they enter the retirement phase with less money than their male counterparts, they must also manage that money for longer. HESTA has a unique role to play in ensuring any policy intervention in this space correctly recognises the challenges faced by the typical health and community services worker.

The covenant paper suggests that the retirement phase of the current system is under developed and does not align well with the overall objective of super. It is noted that the objective of super as "providing income in retirement to substitute or supplement the Age Pension" is a proposed objective, it has not been written into legislation. In its current form, this objective does not have the support of the industry peak bodies. It is premature to therefore base an entire line of enquiry and proposed framework into an unlegislated objective.

Notwithstanding this, we agree that there could certainly be more comprehensive thought given to the operation of the system in the retirement phase to better serve all participants, including our members.

HESTA agrees that Australians deserve good retirement solutions; we consider it our duty as trustees to offer a preferred retirement strategy to our members for their consideration, but we do not support a mandated strategy based on a product solution.

Trustees are best placed to determine the right offering for their members. The conversation of policy-makers should be concentrated on the protection of member's money throughout their working life, predatory behaviour in the system and beyond, and the interplay of the social pillar to address longevity needs.

HESTA has made several public statements on the structural reform required to comprehensively address longevity and income outcomes. Women are not as well served as they could be from the retirement system. This is not due to a lack of products available to them, it is due to a lack of policy responses to the drivers of inequity including the gender pay gap, uncompensated time out of the workforce, threshold settings, etc. Longevity risk requires more than just the development of a product for true risk mitigation.

Furthermore, we believe that if Trustees are to start redesigning their approach to the retirement phase, the timeline proposed is too short.

HESTA is also strongly of the opinion that if CIPRs are to be a mandated product, a safe harbour is a minimum requirement. It should be properly constructed and further consultation would be required on this.

The Covenant principles

1. Retirement income strategy

   Trustees should assist members to meet their retirement income objectives throughout retirement by developing a retirement income strategy for members.

HESTA has developed a comprehensive strategy for member's retirement that we believe to be suitable for the majority of our members, we support this principle.

However, the principle proposes that a comprehensive strategy for the majority of members in retirement is related to the number of products that can be offered.

The consideration of a retirement strategy for the majority of our members cannot be done absent of a discussion about their social security entitlements.

We are concerned that an implementation date of 2020 is unrealistic and would urge a reconsideration of this timeframe.

2. Engagement

   Trustees should assist members to meet their retirement income objectives by providing guidance to help members understand and make choices about the retirement income products offered by the fund.

The "engagement" principle is troublingly under developed. Where does the concept of guidance fit in the current financial advice regime? When does the concept of guidance become advice? It is overly simplistic to suggest that members can be provided with side by side comparisons and cohort guidance.

3. Definition of a comprehensive income product for retirement

   A CIPR is a retirement income product which is designed to provide:

   - Efficient, broadly constant income, in expectation;
   - Longevity risk management (income for life); and

- Some access to capital

A 100 per cent allocation to an ABP alone would not meet the definition of a CIPR.

We believe that if such a system is to be imagined, the goal of maintaining a "real" income is mostly the right goal.

However, the definition of "broadly constant income" is vague and difficult to interpret.

We recommend Treasury make themselves familiar with all recent relevant research on the spending patterns of retirees. Allowing retirees some access to capital is an important consideration, however, the operation of this is difficult for the fund – because delivery of "broadly constant income" becomes at the whim of the retiree.

4. Offering a flagship CIPR

   All Trustees should offer a flagship CIPR to members at retirement, subject to limited exceptions.

HESTA is concerned this principle will lead to the naming of products that confuses members as they are trying to determine their retirement choices.

We concur with the finding of the Productivity Commission detailed in their most recent Draft Report (2018) that finds a *MyRetirement* default to not be warranted.

This has been a constant principle throughout the consultation phases and we have consistently said that requiring Trustees to design a mass-customised product, which we then name to be held high above other retirement options as our preferred option is not favored by us.

We are concerned about the member's exit rights. Beyond their ability to draw down capital, what is their ability to exit the product all together? This cannot be easily catered for within a CIPR.

We strongly recommend against the CIPR as a default, although acknowledge that further innovative thought could be given to the retirement phase by the development of a default system in retirement that builds on the current default arrangements in the accumulation phase

5. Third party products

   Trustees can fulfil their obligation in part or in full by using a third party.

We support the involvement of third parties and new providers with alignment to a profit-for-members ethos.

We recommend more work be done on disclosure obligations that are fair and effective.

6. Consent

   Consent should be required for a CIPR to commence.

This principle imagines a system of uninformed consent which we do not support.

7. Offering an alternative retirement income product through advice.

> Trustees may offer an alternate CIPR or another retirement income product to a particular person or cohort of people through any form of personal financial advice, including scaled personal advice, intra-fund advice, or full financial planning.

We are supportive of members choosing complex retirement products and strategies with the assistance of advice. However, further thought needs to be given to the possibility of how this may fit into intra-fund advice structures.