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**Submission in response to Treasury ‘Retirement Income Covenant’ position paper**

June 2018

1. **Submission participants**

This submission is made by:

* QIEC Super – a profit for members industry fund, established specifically for the benefit of all participants in the non-Government education sector, child and other care and community services in Queensland;
* Club Super - a profit for members industry fund, established specifically for the benefit of employees in the sporting and recreational clubs and associated industries in Queensland;

1. **Introduction**

The Treasury position paper outlines the Government’s intention to develop a retirement income framework.

The key elements of the proposed retirement income framework include the introduction of a retirement covenant requiring Trustees to assist members to meet their retirement income objectives:

* throughout retirement by developing a retirement income strategy for members;
* by providing guidance to help members understand and make choices about the retirement income products offered by the fund.

A key component of the retirement income framework would be the compulsory offering of a Comprehensive Income Product for Retirement (CIPR) by all superannuation Trustees.

The position paper states that the introduction of a retirement income framework is to better align the retirement phase of superannuation with the Government’s proposed objective for the superannuation system, which is to provide income in retirement to substitute or supplement the age pension. While it is recognised that the Government has an interest in promoting the take up of CIPRS’s, this paper queries whether CIPR’s will actually be in the best interests of the majority of members.

We consider that the current income stream structure has worked well, as Account Based Pensions (ABP) offer a simple, flexible and easy to manage solution for members in retirement. ABP’s allow members to adapt their income stream to their evolving needs, by allowing them to change their level and frequency of payments, or provide access to a lump sum, to deal with emergencies and other needs. The reduced flexibility offered by a CIPR would adversely impact the lifestyle of many retirees.

In addition to an ABP, many superannuation members also access a full or part age pension, which provides a fixed and secure source of income. When considered together, this provides members with the security of a fixed income source, combined with the flexibility offered by ABP’s. Introduction of CIPR’s would create two sources of fixed income, reducing income diversification and flexibility. Additionally, having only fixed income sources (age pension and CIPR) would place members at the mercy of interest rates. For the reasons outlined above, we consider CIPR’s may not be in the best interests of many members.

1. **Executive summary**

We generally support the concept of Trustees having to comply with a retirement income covenant. However, this submission raises a number of concerns with the CIPR’s proposal, including:

* compulsory offering of CIPR’s by Trustees ;
* disincentives for members to invest in CIPR’s, and likely demand ;
* whether CIPR’s are likely to be in the best interests of the majority of members, and individual members;
* whether proposed member consent to commence a CIPR is sufficient;
* introduction of standardised metrics;
* implications of partial or full outsourcing of CIPR products;
* retirement income strategy considerations

These issues are expanded upon below.

1. **Nature and features of CIPR’s**

Compulsory offering of CIPR’s by Trustees

The paper proposes that Trustees will be required to comply with the new SIS Act retirement income covenant, and must offer a flagship CIPR from 1 July 2020. To date, there has been very little interest and progress in the Australian market in the development and introduction of CIPR’s.

The structure of CIPR’s, which represents a combination of ABP and a pooled risk product (ie. Deferred Annuity), is necessarily sophisticated and complex. Such products will undoubtedly require actuarial input, and the Trustee will be required to enter into a partnership with a life insurer (for the pooled risk component to address longevity risk). CIPR’s will also likely require maintenance of significant reserves by Trustees. A material allocation to reserves also has the potential to detract from the investment earnings applied to member accounts. This may be considered an inappropriate outcome, particularly for those members who don’t take up a CIPR.

In light of expected low take-up of CIPR’s (as set out below), providers will need to be conservative in pricing as risk may be spread over a small proportion of members. As a result of the above factors, CIPR’s are expected to be more expensive than an ABP and will have considerable complexity.

The position paper also outlines that although the offering of a flagship CIPR is proposed to be compulsory, if Trustees have obtained reliable information (through financial advice), about an individual’s circumstances, the Trustee may offer them alternative retirement income products, if the Trustee deems it is in the best interests of the member to do so. This raises questions around Trustee liability. For example, if a member has a balance of $20,000 and the Trustee determines it is in the best interests of the member to offer them a different product, presumably the member could still decide to choose a CIPR (even though the Trustee has deemed it not in their best interests). Where would that leave the Trustee in terms of its obligation to act in the best interests of members? Also, we question the proposed requirement for the Trustee to only be able to rely on ‘reliable information’ sourced from financial advice, in offering an alternative retirement product to a member. In the above example of a low retirement balance member, financial advice is not required to conclude that a CIPR is unlikely to be appropriate for the member. This requires reconsideration.

We consider that there is merit in the introduction of a retirement income framework, requiring Trustees to actively consider the type of retirement income products they offer. However, having regard to the factors outlined in this submission, including expected low demand, we consider that the offering of CIPR’s by superannuation funds should be voluntary.

Disincentives to invest in CIPR’s, and likely demand

As above, CIPR’s will need to incorporate a pooled risk product from a life insurer. The position paper contemplates a split in the member’s balance of approximately 80% ABP and 20% Pooled Risk product. In relation to the monies invested in the Pooled Risk product, this would be forfeited to the life insurer if the member dies early. The risk of losing capital is a longstanding disincentive for members to invest in life insurance products, and is considered to be a significant reason why the take up of lifetime pensions has been much lower than the take up of ABP’s across the industry. This same disincentive exists (in part) in relation to CIPR’s, and we consider this will be one factor which will discourage members from investing in CIPR’s.

However, it is recognised that there may be some members who will be attracted to the security offered by a CIPR in terms of addressing longevity risk, but the CIPR’s model as outlined in the position paper contemplates limited flexibility by only allowing members to access to a lump sum payment, within limits. It is expected that many members will be reluctant to give up the greater flexibility offered by an ABP, which provides for unlimited lump sum commutation. It is recognised that the security against longevity risk offered by a CIPR (with limited flexibility), and the greater flexibility offered by an ABP are in conflict. When pressed to choose between the two products, we consider that most members would opt to retain the greater flexibility offered by an ABP (without loss of capital on death), rather than a CIPR.

As set out in the introduction, CIPR’s would also represent a higher cost product that provides reduced flexibility, with adverse lifestyle implications.

In light of the factors outlined above, Trustees may be faced with a scenario where many members may not be attracted to a product with complexity, high cost, reduced flexibility and potential for partial loss of capital on death. As a result, the take-up of CIPR’s may be low, which would leave the broader membership bearing higher fees and costs for a product that few of them are actually members of, or even interested in.

Member consent

The position paper outlines that members will be required to provide express consent to the opening of a CIPR for them. Consent is already required for the opening of all retirement income products through the completion of an application form, so there is nothing new in that respect. However, CIPR’s will contain far great complexity compared to an ABP, and will have greater potential for complaints. For example, some members will likely change their mind after commencing a CIPR, and want to revert to full flexibility for commutation, and won’t be able to do so. Beneficiaries are likely to complain about loss of capital following the early death of a member. Other complaints are likely around misunderstanding of the detailed rules of a CIPR. In this context, it will be vital that Trustees are offered the ”safe harbour” protections described in the paper, while ensuring there remain protections for the members from bad advice. The balancing of these two competing priorities needs careful consideration.

Given the significant complexity of CIPR’s and the potential for complaints, it is questioned whether just requiring members to consent to the opening of a CIPR is sufficient. The financial services industry lives by the mantra that members should not invest in products that they don’t understand, and Trustees are required to act in the best interest of members. It is doubtful that obtaining mere consent in the opening of a CIPR will be sufficient demonstration that the Trustee has acted in the best interests of each individual.

Full or partial outsourcing of the CIPR product

The paper provides that Trustees may decide to offer their CIPR in part, or full, by a third party, if it is in the best interests of members. We consider it will not be an option for the vast majority of superannuation funds to offer a CIPR alone, as they will not have the required authorisations to be able to offer pooled risk products themselves. Consequently, most CIPR’s will either be a partially or fully outsourced product between a superannuation fund and a life insurer. Under the partially outsourced model, it is understood Trustees would run the ABP and would outsource the pooled risk product component to a life insurer. Under the fully outsourced model, it is understood both the ABP and pooled risk product component would be outsourced to a life insurer.

This raises a number of issues. Firstly, the Trustees would retain responsibility and accountability for the operation of the CIPR, but would have limited control in the operation of the product. While Trustees would undoubtedly conduct appropriate due diligence before selecting an external provider, this creates a troubling divergence between responsibility and control. There would need to be tight legal arrangements in place to ensure that the Trustee is indemnified for any errors or misdeeds of the life insurer.

Secondly, this creates issues around philosophy and values. For example, industry funds operate on a not for profit model, whereas life insurers operate on a profit model. The partial or full CIPR outsourcing model will undermine the values of industry funds, as they will be compelled to offer a CIPR (with a profit component).

Introduction of standardised metrics

The paper proposes that the Government will require Trustees to disclose standardised metrics in relation to their retirement products offering. It is noted that similar standardised metrics have previously been introduced for MySuper products, in the form of a MySuper dashboard. In our experience, the MySuper dashboard is accessed by a very small proportion of members. We expect that most superannuation funds in the industry would have a similar experience. This reflects the relatively low levels of engagement across the superannuation industry. As a result, the MySuper dashboard has proven to be more of a compliance burden for superannuation funds, rather than being an effective tool for members in comparing alternative products.

Introduction of standardised metrics for retirement products runs the risk of similarly representing an additional compliance task for superannuation funds, without serving much practical purpose, unless engagement levels can be increased.

Are CIPR’s in the best interests of members?

Trustees will be required to develop CIPR’s (in partnership with life insurers), having the best interests of members (collectively) in mind. Due to the range of factors outlined in this submission, we consider it cannot be assumed that the opening of a CIPR will be in the best interests of individuals. That is a decision each individual will have to make, based on their needs and preferences.

This submission has highlighted that compared to an ABP, there are a range of considerations in relation to the commencement of a CIPR, around partial loss of capital, reduced flexibility in terms of commutations, expected higher cost, and increased complexity (which has the potential to reduce comprehension and result in more complaints). Consequently, we consider there may be low interest levels from members.

Further, when considering the best interests of members collectively, it may in fact not be appropriate for some superannuation funds to offer a CIPR based on the demographics of their membership. The paper recognises that CIPR’s are unlikely to be in the best interests of members who have an account balance under $50,000. Many funds in the industry have relatively low average account balances. Rather than being a compulsory offering, we consider it should be up to Trustees to decide whether the offering of a CIPR is suitable, and in the best interests of their members collectively.

Retirement Income strategy considerations

The position paper outlines that in devising and implementing a retirement income strategy, Trustees will be required to consider a range of factors. This includes:

1. maximising income for life for members;
2. the potential life spans of members and the costs and benefits of managing longevity risk for members as a whole;
3. managing risks that affect the stability of income, including inflation;
4. providing members with access to capital;
5. member needs and preferences for the factors above;
6. the costs and benefits to members of developing a CIPR in-house compared with offering a CIPR developed and managed by a third party or a combination of both in-house and a third party;
7. expected member eligibility for the Age Pension; and
8. whether and how cognitive decline may affect outcomes.

In relation to point 7, it needs to be recognised that Trustees will generally not have access to this information. While account balance information provides a guide, members may have arrangements external to their superannuation account, which the Trustee is completely unaware of. Trustees are also being asked not just to assess current eligibility, but future eligibility to access the age pension. Therefore, it seems unreasonable to require Trustees to account for this factor in devising a retirement income strategy.

Similarly, in relation to point 8, Trustees will be required to assess whether cognitive decline may occur across the membership, which may hinder members’ ability to make optimal retirement income decisions. As future cognitive decline is entirely unpredictable, how are Trustees supposed to assess this? Trustees will not have access to family histories of members who may have dementia or other cognitive conditions. It is entirely unclear on what basis Trustees could account for such factors. This requires reconsideration.

Additionally, point 5 will require Trustees to consider member needs and preferences for factors 1-4, including maximising income for life in retirement. As it is proposed that the offering of CIPR’s will be compulsory, it seems the member’s preferences won’t matter in this respect, as CIPR’s will have to be offered regardless.