Manager  
CIPRs  
Retirement Income Policy Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

18 June 2018

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

Dear Manager

#### Retirement Income Covenant Position Paper

IOOF Investment Management Limited (ABN 53 006 695 021 AFS Licence No. 230524) welcomes the opportunity to provide feedback on Treasury’s considerations in relation to enhancing the retirement income framework.

IOOF has a proud history as a provider of innovative income stream products. IOOF has been providing income streams to members for more than 20 years. Indeed one of our legacy products, the Lifetrack Cashback pension, was the first “account-based” income stream ever offered to Australian retirees and pre dates the commencement of the allocated pension rules.

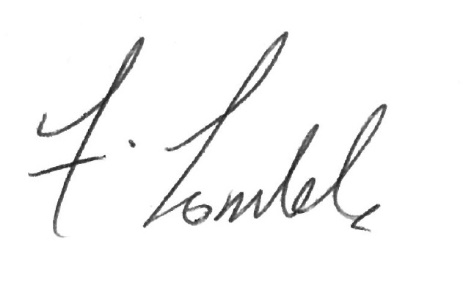
Currently we have in excess of 40,000 income stream accounts provided through our public offer super fund and also through Small APRA Funds. We believe we can provide a unique perspective to Government on policy issues in relation to consumer requirements for retirement income stream products.

We are a strong supporter of developing innovative incomes streams and we welcome the removal of regulatory and tax impediments to developing new income products to suit the 21st century. However we believe the Government should carefully consider the nature of the Australian superannuation system in the requirements for CIPRs:

* Australians have a defined contribution superannuation system. Contributions to superannuation, whether compulsory or voluntary, have come from the member’s own earnings; in lieu of pay rises; from the sale of their houses and their businesses; from their private savings etc. Principles that are more aligned to a defined benefit system, such as pooling, don’t sit comfortably within a defined contribution system.
* Australians operate in a retirement savings systems that assumes choice and flexibility. Member can choose their fund; their investments; their contribution levels. Disengaged members and paternalistic superannuation arrangements should be discouraged. Therefore CIPRs should not be forced on anyone. Members should opt into a CIPR or get advice on what is best for their needs. Although super funds should provide a CIPR, trustees should not be required to market a CIPR as a preferred option.
* The Australian superannuation system runs alongside, but independent of, the Government sponsored social security system – the Age pension. Super funds can provide tools for members to view and plan how their private pension benefits can integrate with the Age pension. However requiring trustees to include age pension entitlements in the design of retirement income products is inappropriate.

We have addressed the issues raised in the consultation paper in the attached submission.

Yours sincerely



Frank Lombardo

**General Manager – Client & Process**

# Submission to Treasury: Retirement Income Covenant position paper

This submission has been prepared in response to the retirement income covenant draft proposal paper released 17 May 2018.

1. Background

A key factor that needs to be considered when developing a retirement income framework is the operation and positioning of the accumulation system in place at present.

When members are saving for their retirement they are doing so through a defined contribution system, which has a direct correlation between an individual’s actions and the contributions which are made to super by their employers or themselves directly. This creates a link between the member and that capital which has come directly as a result of their efforts. The superannuation system further develops this link by providing specific contribution benefits directly related to the member’s circumstances and much of the rhetoric of superannuation is around individual control and responsibility for saving for their retirement.

This strong connection between a member and the fruits of their savings through super does not disappear on retirement. Members are concerned with not only providing themselves with an income through retirement but also ensuring their savings are able to benefit their dependants and issue.

A pooled product, where a member has reduced rights to the capital they have personally contributed – potentially even from the sale of their family home – poses some fundamental problems in this defined contribution world. The positioning of a Comprehensive Income Product for Retirement (CIPR) needs to be balanced to ensure members are aware of the trade-offs inherent with these types of products. We suggest that no cap (outside the amount of unpaid compensation) should be applied for clawing back of ‘out of character’ contributions, as the assessment of contributions will provide a natural cap and in many cases will exclude the majority of super capital for many perpetrators.

***Retirement income framework***

The underdevelopment of retirement income products has been due, in part, to restrictions imposed by superannuation regulation and taxation law. However at its core there is a natural dichotomy between having access to capital and guaranteeing an income stream for the longer term. These two needs are satisfied at their extremes through the current products of account-based pensions and lifetime annuities. Introducing a new income stream type which tries to find a better balance between access to capital and providing guaranteed income is a worthy objective, as this may suit many retirees. Further, providing social security concessions for these products could help members feel more comfortable with the trade-off through having a higher entitlement to an alternative baseline income stream, being the Age Pension.

One key question in relation to the social security concession is how this is linked to ‘pooling’. CIPRs may have a component of pooling, but this is not necessarily compulsory. Social Security guidance however indicates that concessions will be provided to pooled products. Would the exemption apply equally to all CIPRs regardless of the level of pooling that is undertaken or is the intention for this to be linked to products that undertake substantial level of pooling?

We propose that all CIPRs, so long as they are meeting the CIPR standards, would benefit from the same level of social security concessions. Historically, social security concessions have been linked to products which have reduced access to capital and applying these new concessions to all CIPRs, which by definition will have restricted capital access. Allowing only products which explicitly use pooling to benefit from the concessions will create further barriers to innovation, as a product which reduces access to capital for a lifetime income stream that obtains social security concessions will have a substantial advantage against another product offering the same trade-off without the concession.

We agree with the proposal that trustees should provide members with tools that help them understand what retirement income they can expect based on their current level of capital. However such projections need to be carefully framed. Most members are accumulating capital in a defined contribution world and positioning the end benefit as a level of annual income throughout retirement can potentially be misleading or inaccurate. In a defined benefit world the number of factors which impact a member’s end benefit are less and have less variance than a defined contribution benefit, so members in this circumstance can have higher certainty as to the result of that projection.

Super trustees could also rely on ‘standardised’ tools such as the retirement calculator provided by MoneySmart to ensure a level of consistency between super trustees – particularly in relation to default assumptions – which would ensure members are not subject to trustees trying to appear as providing a better outcome for members simply because of their projection tool.

***Retirement income covenant***

We agree with the proposal to introduce a retirement income covenant and associated framework at a fundamental level. Care needs to be given with how the underlying principles and regulations supporting the covenant are positioned, to find a balance between ensuring superannuation trustees are able to develop new innovative products and ensuring those products are ‘fit for purpose’.

The proposed implementation timeline, particularly having super funds complying with the covenant from 1 July 2020 needs to be considered in the context of requiring a superannuation trustee to offer CIPRs from that date. There is significant work involved in developing and offering a CIPR, such as understanding the demographics of how members are accessing their retirement savings, developing new products which may require different underlying investment strategies to operate as well as a detailed consideration as to the lifetime impacts of these products and ensuring communications to members provide a balanced view of the benefits and consequences of using a CIPR. On this basis the superannuation industry may require additional time beyond 1 July 2020 to appropriately implement this measure.

1. Covenant principles

***Retirement income strategy***

We agree with the phrasing of the covenant to ‘assist members to meet their retirement income objectives’ however this covenant should be considered in the same context as the other superannuation trustee covenants, such that the requirement is around the operation of the trustee at a higher level, rather than the application of specific outcomes for specific members.

In relation to the factors identified in the consultation paper, we agree with trustees needing to consider these factors however the phrasing of the priority being ‘optimising the retirement outcome for members’ will need to be considered in context of what the retirement years will look like for members. Some of the considerations for an average retirement, such as providing a mechanism to pay accommodation deposits for members moving into aged care, are strongly against a reducing capital access schedule provided by a CIPR. Whilst not all members will be requiring to use their superannuation capital for this cost, trying to account for this in a CIPR is virtually impossible.

Further, superannuation trustees are not necessarily in a position to understand what social security benefits a member may be entitled to, as trustees are only aware of potentially a small portion of the overall financial resources which can be used to support a person in retirement. Limiting the consideration of this factor to simply ‘a CIPR can provide a relative advantage for members who are eligible for social security’ would be achievable and appropriate, however further developing a CIPR to estimate or incorporate social security benefits is not practical and could put trustees into a position of providing personal advice. Developing a CIPR relative to an expected social security benefit can also introduce additional legislative risk into the product, as changes in social security benefit payment rates and means testing could then have an adverse impact on how the CIPR operates or whether the CIPR would then meet the retirement income covenant.

Given the potential complexity a trustee may face in what level of consideration is appropriate, we propose that specific guidance on how trustees are expected to analyse and develop around these factors is developed.

We strongly agree with the proposal to exempt self-managed superannuation funds from the specifics of developing a CIPR, as these products are not appropriate for a smaller fund with a small membership. On this same basis, we strongly propose extending this relief to small APRA funds.

***Engagement***

We agree with the proposal for trustees to ensure members are provided with guidance between the retirement income products offered by that trustee. This could also be extended to provide that trustees are open with their members that other superannuation products may offer different income streams.

We propose such guidance should come in the form of general comparisons between the different income stream options offered by the fund. This could include ‘standardised’ comparisons between all income stream products which discusses the level of income provided, the certainty of that income, as well as access to capital throughout various points during the life cycle of the product (including capital available on death).

1. Supporting principles

***Definition of a Comprehensive Income Product for Retirement***

We agree with the proposed objective of a CIPR to provide efficient and broadly constant income over a person’s life, with some access to capital. This appears to adequately weight towards lifetime income over capital access relative to the CIPR regulations.

We note the limits imposed on ‘broadly’ constant income will need to be very carefully considered. The more narrow the allowable range, the higher the chance that additional capital will be drawn down in years of negative investment return for CIPRs with a market-linked component – which would reduce the level of income these products would be able to reasonably offer. However if the range is too wide the level of income is no longer stable, resulting in CIPRs which are paying an income stream which is vastly different from that the member believed they would receive at commencement. There may also be a case where a member wishes to increase or decrease their income stream within a specific year, to account for temporary increased costs such as one-off travel or smaller medical expenses.

*Defining bounds on ‘broadly constant’ income*

We propose the ability for CIPRs and members to modify their income stream within the same limited range, say 5% of the annual payment at commencement, adjusted for inflation if the CIPR caters for inflation increases. This strikes a balance between constant income and allowing for variance to reduce the impact of negative markets on the ability for the CIPR to meet its longer term obligations.

*Consideration of inflation for ‘flagship’ CIPRs*

Inflation is one of the larger challenges members face with managing their income in retirement. As members are no longer generally in a position to increase their financial base, their capital at retirement will need to cater for changes in living costs over time. The age pension is also increased in line with inflation to help retirees maintain a standard of living. On this basis we propose that ‘flagship’ CIPRs by default must incorporate at least a portion, say 50%, inflation protection, with trustees able to ‘opt out’ of providing any inflation protection on their flagship products if they can justify this based on their specific membership. CIPRs offered under advice could be tailored to a specific member’s inflation protection needs.

The position paper suggests allowing trustees to include a member’s Age Pension in working towards ‘broadly constant’ income. We do not agree with this proposal. A member’s Age Pension entitlement can change due to factors outside the control of the superannuation trustee, such as the receipt of an inheritance, becoming a member of a couple or one member of a couple moving into residential aged care. There is also legislative risk in that means testing rates and threshold can change over time. It is not reasonable or efficient for a CIPR to be designed to vary the level of income it is providing based on what could be a moving Age Pension benefit. Further, taking Age Pension into consideration as part of constant income would be a one-way consideration. If a combined approach was used, the level of income the CIPR would need to generate would vary as the member’s Age Pension entitlement changes, however the member’s Age Pension entitlement would not change as the CIPR value changes, given the social security means testing is based on purchase price and initial payments. As such the level of income expected from a CIPR should be determined independently from a member’s social security benefits.

We agree with the concept of a CIPR providing an income for life, with flexibility to access a portion of capital. As discussed previously there is a requirement to favour one of these objectives over the other. CIPRs would best be positioned as a retirement income option that focuses on providing steady income over providing flexibility or access to capital. On this basis, and based on the capital access schedule for CIPRs, it is expected the ability to access capital will be minimal, particularly as members age. This could provide challenges when members are later in life and are required to move into residential aged care, as their capital may be better used for meeting aged care accommodation costs however the amount of capital accessible under the CIPR may be negligible or even nil.

***Offering a flagship CIPR***

The proposal that trustees would be required to offer a CIPR to members when they retire may pose some practical challenges. Broadly we find that the first indication we have that members have ceased working is when they apply for a retirement phase pension. At this stage the member has potentially been retired for some time however the trustee may not have been contacted so would be unaware of this. Rather than using retirement we propose a determinable event, such as the member reaching age 65 and not having already commenced a retirement phase income stream would be more appropriate. Otherwise the entire process of members engaging with superannuation trustees would need to be prescriptively revisited to require members to contact their superannuation fund ahead of applying for a pension product.

We do not agree with the proposal that a CIPR should be positioned as the ‘starting point’ for retirement income streams. Depending on the membership of the fund and a member’s specific needs, a product which provides flexibility and access to capital over the longer term may be more appropriate. If a member in such a circumstance were to acquire a CIPR based on the trustee’s representation that a CIPR is a starting point could create substantial issues in future. Rather than having a ‘starting point’ super trustees should be required to present all their income stream options equally, highlighting the benefits and consequences of each product in a clear and succinct manner. This same disclosure would also suggest members consider their own needs or seek personal financial advice before deciding on which income stream product to acquire.

In addition, the limits on what appears to be considered a different CIPR may create additional problems with only having three flagship products. Given the number of factors which could impact an member’s future income, distinguishing between two CIPRs that operate on the same basis but have different underlying investments (such as a conservative option and a balanced option – both investing in the same underlying assets but in different weightings) as two separate CIPRs could potentially limit product innovation. We would suggest the distinction between CIPRs would be drawn on the mechanism under which the CIPR provides its income stream. For example, a CIPR consisting of an underlying account-based pension with a deferred lifetime annuity would be the same regardless of the investment option the member selects within the account-based portion of the CIPR, however a separate CIPR would be a lifetime annuity which accrues bonuses based on the performance of the underlying annuity pool or mortality factors for example.

As noted above, we are against the proposal that age pension entitlements should factor into CIPR considerations. This would extend to differentiating between what CIPRs are offered to members based on the trustee trying to derive a member’s expected Age Pension benefit.

***Third party products***

We agree with the proposal to allow trustees to offer third party CIPRs through their platform. Care may need to be exercised here however as if trustees are under time pressure to comply with the commencement of the retirement income framework this could lead to a concentration of many trustees using the same CIPR through the same or a small number of providers.

***Consent***

We strongly agree with ensuring members must actively consent into a CIPR. The balance of income over capital may not be appropriate for individuals, and some individuals may prefer to access their accumulated superannuation in a lump sum rather than an income stream altogether. This would also allow members to consider alternative CIPR offerings from other product providers which are more suitable, without having to worry about a reducing commutation value.

***Offering an alternative retirement income product through advice***

We agree with allowing trustees to offer CIPRs to members which are more tailored to their personal needs. Ideally the majority of members would seek some form of advice in relation to their retirement income needs and the introduction of income stream choices with various trade-offs may drive retiring members to actively seek advice.

***Exception for individuals for whom CIPRs are unsuitable***

Under the proposed framework, we would agree with exempting trustees from offering CIPRs to individuals who are suffering a terminal illness. Again a practical issue may occur in which trustees may not necessarily be aware of members who are of retirement age that are also suffering from a terminal illness.

Consideration should also be given to members who are accessing their superannuation benefits before retirement age, and how CIPRs will interact with these members. For example a member who suffers total and permanent disablement may require a lifetime income stream from their superannuation benefits. Unless a CIPR has been specifically designed to cater for members who may be starting an income stream in their 30s or 40s it would be inappropriate for the trustee to offer that member a CIPR. The trustee in some cases will have an advance indication the member is suffering from total and permanent disablement where the member has insurance through their superannuation.

1. Future considerations

***Lifetime engagement***

We agree with the proposal that trustees should be engaging with members throughout the entire superannuation lifestyle. Recent changes such as the First Home Super Saver Scheme should help drive engagement for younger members and many trustees have been trying to develop strategies to engage their membership generally.

Additionally, this engagement should not cease when a retirement phase income stream is cashed. A member’s needs throughout retirement will change and unexpected events in members’ lives could necessitate a change in retirement income strategy. Personal advice for members is also important in developing a lifetime engagement with a member’s superannuation.

***Legacy products***

We strongly support the proposal to consider legacy products (such as Complying Pensions with large reserving issues and Term Allocated Pensions where lump sums cannot be accessed in cases of financial hardship) and provide members in these older, generally restricted, products options to move into alternative income streams. We understand there are significant social security complications with many legacy products as members may have received a social security advantage by using these legacy pensions. However this should not prove an insurmountable barrier to providing options for these members to wind up these income streams without severe tax or social security implications.

It is also critical that in developing CIPRs both Government and industry take the lessons from our past and ensure as far as possible that members are not practically locked in to an income stream that may not continue to be appropriate over their lifetime. The current CIPR capital access rules may result in members being ‘trapped’ in positions where they have an ‘account’ with a value, however the amount of capital they can access is substantially less than the balance of their CIPR account.

***Safe harbour***

We agree with the principle of a safe harbour for trustees in the provision of CIPRs. We note this will be strongly influenced by the resulting covenant and supporting regulations however the provision of a safe harbour gives trustees some certainty they are operating in line with the intent of the covenant, and the standard of action Government expect in this space.