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Senate Standing Committees on Economics
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Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021: Retirement income covenant

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

Our submission to the Economics Legislation Committee focuses on the **retirement income covenant** in Schedule 9 to the Corporate Collective Investment Vehicle Framework and Other Measures Bill 2021 (the Bill).

We previously made submissions to Treasury on the position paper and draft legislation for the retirement income covenant. These submissions are attached.

We reiterate that **the legislation should be amended so that self-managed super funds are subject to the covenant**. This approach would improve retirement outcomes for members of self-managed super funds who are close to or in retirement. Additionally, given self-managed super funds are often used for wealth preservation and estate planning, their exclusion from the covenant undermines the broader objective of the covenant, which is to improve retirement outcomes by focusing on increasing the use of super assets in retirement.

ISA considers the flexible principles-based approach to the covenant in Schedule 9 to the Bill can be broadly applied to self-managed super funds as it allows each fund to comply with the obligations in a way that appropriately takes into account the nature, scale and complexity of the fund. This is discussed further in our submission to Treasury dated 15 October 2021.

Our submissions to Treasury also included a number of other recommendations which go to the implementation of the covenant and broader related issues, such as the interaction with financial advice. While we do not consider that amending Schedule 9 to the Bill is the appropriate mechanism for implementing these recommendations, we have summarised them below for the Committee's information.

- **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.
- **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.

These issues are discussed further in the attached submissions to Treasury.

If you have any questions, please feel free to contact us.

Kind regards

[redacted]

Anne Nguyen
Policy Adviser

Industry Super Australia

Retirement Income Covenant

Executive Summary

ISA supports the proposed principles-based approach to the covenant outlined in the position paper. We expect that we will have further feedback when we see the detail of how the covenant will operate in legislation.

The proposed approach relies on members seeking guidance to select an appropriate retirement income strategy. It is ISA's long held position that in a compulsory system, where levels of member engagement and financial literacy are generally low, members should not have to pay for guidance to be connected to good products. Those who legitimately choose to do nothing should be able to trust the system to connect them to good quality accumulation and retirement products. They shouldn't have to pay for that outcome.

ISA has identified the following areas for further consideration by government.

- **Cohorts of members:** The government should assist funds to supplement the information they have on characteristics of members by facilitating access to data held by government agencies.
- **Appropriate guidance:** The government:
    - can facilitate access to appropriate guidance by expanding the provision of intra-fund advice to include entitlements to Centrelink payments such as the Age Pension, assets outside super and the circumstances of the member's household.
    - may wish to consider the provision of free or subsidised advice in its *Quality of Advice Review*.
    - should expand the exemption from the anti-hawking prohibition to allow superannuation trustees to make offers to members about moving to the retirement phase to facilitate the take up of retirement income products.
- **Meeting the needs of disengaged members/defaults:** Regardless of the available avenues for people to seek guidance to help them make a choice, there will always be some members for whom this model will not work. The Government should also consider the role of carefully designed default retirement income products.
- **Spending flexibility:** Not all retirement assets will be taken as income and fully spent. The retirement income covenant must have sufficient flexibility to support choices by retirees about how they use their savings in retirement.

ISA Recommendations

1. ISA recommends that the government consider making available to funds data it holds about members on a de-identified basis to assist funds to determine characteristics of cohorts.

2. 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.

3. ISA encourages the Government to explore the benefits of free, subsidized or low-cost advice on retirement planning.

4. ISA recommends that the government amend the exemption from the anti-hawking prohibition to ensure that it is broad enough to allow funds to offer retirement income products to members without breaching the prohibition.

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

6. ISA recommends that the retirement income covenant contain sufficient flexibility to enable members to make choices about how they spend their money.

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About Industry Super Australia

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

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Retirement Income Covenant

ISA supports the proposed approach to the covenant outlined in the position paper. The shift from the previously proposed prescriptive approach to a more flexible principles-based approach is welcome. The rest of the feedback in this submission should be taken within this context of overall support for the proposed approach. We think that the following issues that we identify are worthy of consideration to improve the proposal before it is implemented, or as issues to monitor following the implementation of the RIC. We expect that we will have further feedback when we see the detail of how the covenant will operate in legislation.

The policy relies on "appropriate guidance" (ranging from the provision of factual information to personal financial advice) to manage this problem - while acknowledging that "barriers to seeking advice such as cost and lack of trust, can make it hard for people to make well-informed decisions about their retirement income".

It is ISA's long held position that in a compulsory system, where levels of member engagement and financial literacy are generally low, members should not have to pay thousands of dollars to advisors to be connected to good products. Those who legitimately choose to do nothing should be able to trust the system to connect them to good quality accumulation and retirement products. They shouldn't have to pay for that outcome.

ISA has identified the following areas for further consideration by government.

- Cohorts of members
- Appropriate guidance
- Meeting the needs of disengaged members/defaults
- Spending flexibility

Cohorts of members

Understanding the personal and financial situation and retirement objectives of cohorts of members is central to a fund's retirement income strategy. The position paper seems to assume that funds have a depth of information about members beyond their age, gender, address and super balance. The feedback that we have received from funds is that this is not the case.

The paper repeatedly suggests that funds can obtain the necessary information by undertaking member surveys or using publicly available data. While this is theoretically possible, such an approach is likely to be inefficient and come at a cost to members. On the other hand, the ATO and the Department of Social Services hold relevant data that would assist funds to identify the characteristics of cohorts of members. We accept that current privacy laws may prevent personal information about individual members being provided to funds, however de-identified information would still be of assistance.

ISA recommends that the government consider making available to funds data it holds about members on a de-identified basis to assist funds to determine characteristics of cohorts.

Appropriate Guidance

Assisting members to meet their retirement objectives in light of concerns about access to affordable, quality advice is a significant issue. The paper rightly acknowledges current concerns around the provision of financial advice and the barriers to seeking advice. There is no shortage of research on the issue and both ASIC research and Government inquiries highlight the need for retirement advice.

- The Productivity Commission found that "Impartial advice will be especially important for many members in the retirement phase, where diverse needs, preferences and non-super assets mean one size can never fit all." [1]
- The Retirement Income Review highlighted the complexity of the retirement income system pointing to the need for advice to assist members to navigate the system, noting that, "it is however not clear the system is sufficiently simple to navigate without resorting to some form of financial advice, or that there is sufficient support provided to ensure individuals feel confident making financial decisions about their retirement."[2]
- ASIC Report 627 *Financial advice: What consumers really think* (REP 627) found that retirement income planning was the second most accessed topic among respondents who had recently accessed advice, being accessed by just over 50% of the cohort.[3]
- ASIC Report 639 *Financial Advice by Superannuation Funds* (REP 639) found that one of the most popular advice topics sought by members was retirement planning.[4]

While it is hoped that the *Quality of Advice Review* in 2022 will offer some solutions, any solutions will not be available by July 2022 when it is proposed that the covenant will commence. There are however improvements that can be made now to facilitate access to affordable, quality advice about retirement.

Intra-fund advice

Intra-fund advice is advice that a superannuation trustee can provide to members where the cost of the advice is borne by all members of the fund. The objective of intra-fund advice is to allow super funds to give members simple, non-ongoing personal advice on the member's interest in the fund. This advice can be collectively charged across the fund's membership.

The law prescribes types of advice that *cannot* be collectively charged.[5] ASIC has given guidance on the types of non-ongoing advice for which a superannuation trustee is likely to be allowed to collectively charge. [6] The topics are narrow and do not take account of a members wider financial and household situation, or access to Centrelink payments.

[1] Superannuation: Assessing Efficiency and Competitiveness, Productivity Commission Inquiry Report, 21 December 2018, Overview, p.40.
[2] Retirement Income Review (RIR) Consultation paper, November 2019, p.26.
[3] ASIC Report 627 *Financial advice: What consumers really think*, August 2019, p.19.
[4] ASIC Report 639 *Financial Advice by Superannuation Funds*, December 2019, p.5
[5] Superannuation Industry Supervision Act, s99F
[6] ASIC Information Sheet 168 Giving and collectively charging for intra-fund advice

Expanding intra-fund advice to include advice to members about retirement income strategies that take into account Age Pension eligibility, other Centrelink payments, non-super assets and non-super income, and which include the member's household, would be an efficient and cost-effective way for members to receive trusted advice on retirement income strategies.

ASIC adopted a similar approach in its COVID-19 measures to allow intra-fund advice on early release of super to extend to a member's household. The Government can achieve a similar and permanent outcome by amending the law to expand the situations in which intra-fund advice can be given.

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.

Free or subsidised advice

There are a range of models that the government could consider in its *Quality of Advice Review* to deliver affordable, quality advice to members. One is the broader provision of free or subsidised advice.

For example, MoneySmart provides helpful factual guidance and the Financial Information Service[7] assists eligible Australians with financial advice. Financial counsellors also provide assistance to people experiencing money problems. These are free, trusted and independent services.

Some ways in which the government can increase assistance it provides are through:

- expanding the Financial Information Service to service more people.
- enhancing the role of MoneySmart beyond giving factual information.
- adding an advice service to the Government's new financial capability website.[8]

The UK MoneyHelper service[9] may provide a useful model for Government to consider.

ISA encourages the Government to explore the benefits of free, subsidized or low-cost advice on retirement planning.

Anti-hawking prohibition

The anti-hawking reforms which commence in October 2021 are designed to protect consumers from unsolicited offers of financial products, which often contribute to consumer acquiring products that do

[7] https://www.servicesaustralia.gov.au/individuals/services/financial-information-service
[8] https://www.financialcapability.gov.au/
[9] https://www.moneyhelper.org.uk/en

not meet their needs. The reforms contain an exemption from the anti-hawking provisions for account-based pensions.

ISA understands that - consistent with the government's efforts to increase take up of retirement income products - the exemption from the anti-hawking prohibition for offers made by or on behalf of superannuation trustees relating to a member's move to the retirement phase was intended to include retirement income products offered by a fund to its members.

However, we are concerned that the *Corporations Regulations* 2001 may not achieve this result. This is because the exemption relies on reg 7.1.04E which relates only to account-based pensions. Applying the anti-hawking prohibition to retirement income products (that are not account-based pensions) will hamper funds' ability to offer retirement income products to members. There should be a clear exclusion that readily enables trustees to offer and promote retirement income products that they believe are in the best financial interests of members.

ISA recommends that Government amend the exemption from the anti-hawking prohibition to ensure that it is broad enough to allow funds to offer retirement income products to members – not just account - based pensions - without breaching the prohibition.

Meeting the needs of disengaged members and defaults

It has long been ISA's position that in a compulsory superannuation system with poor financial literacy, most members should be able to rely on default settings that protect their interests without recourse to personal advice. Where individuals decide otherwise, then obviously there should be ways for members to receive affordable, quality personal advice.

The government has justified the *Your Future, Your Super* measures on the grounds that in a compulsory system government has a duty to act to defend member interests. But in the retirement phase, the proposed retirement income covenant offers few protections to members beyond hoping that any guidance members receive will be in their interests - while acknowledging that this may well not be the case. The *Your Future, Your Super* performance test does not cover retirement income products so there is a risk that consumers will be sold into poor performing products which they may not be able to leave.

Underpinning the Government's proposed approach is the assumption that members will make an active choice about a retirement income product. Regardless of the available avenues for people to seek guidance to help them make a choice, there will always be some members for whom this model will not work.

Recent research by the Conexus Institute[10] presents a spectrum of retiree types - from "fully-advised" to "disengaged" and argues that different solutions may be needed for different types. The paper notes that "unfortunately, financial literacy is too low and comprehensive advice too costly and capacity constrained for a system based on self-directed and fully-advised choice to operate effectively for all

[10] Geoff Warren and David Bell, Ensuring all retirees find a suitable retirement solution, 23 July 2021

retirees".[11] Conexus proposes allowing a fund to select a retirement income option for those members who prefer not to make the choice while also acknowledging the role of defaults.

The Retirement Income Review arrived at a similar conclusion noting that "carefully designed defaults, guidance from superannuation funds, as well as accessible and affordable advice at retirement, would help people get better outcomes in retirement."[12]

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.

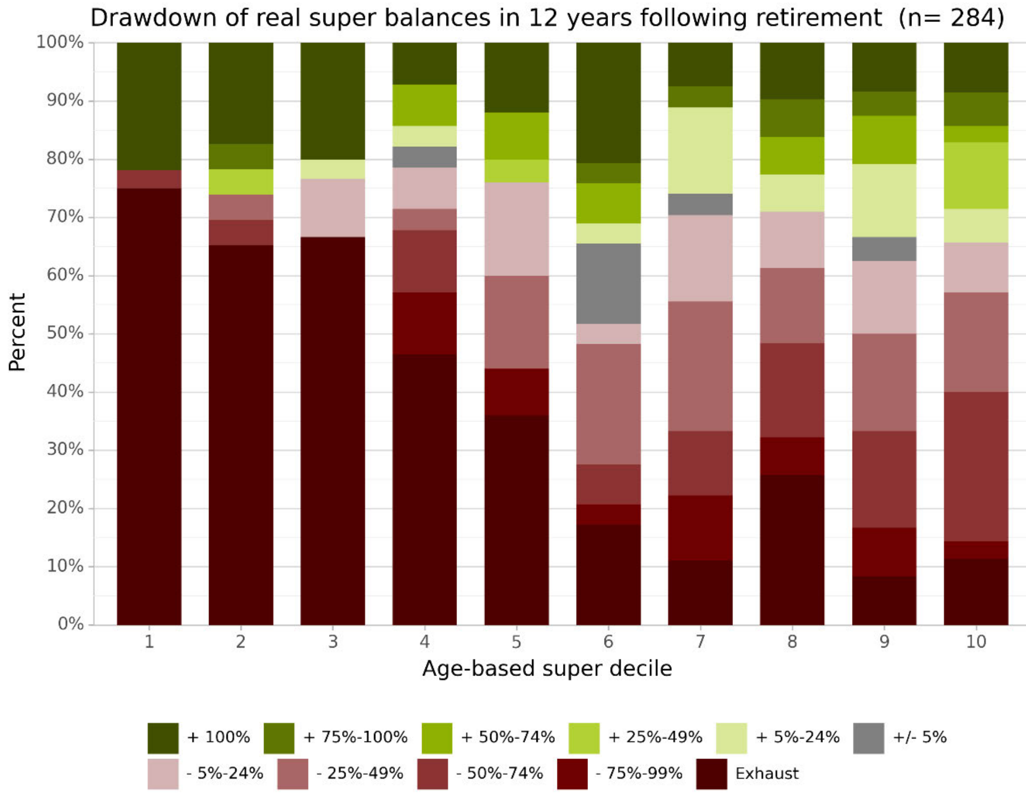
Spending flexibility

The position paper rests on the assumption that all retirement assets will be taken as income and fully exhausted. In doing so it ignores retirees' spending behaviour, the legitimacy for many of holding money in an account-based pension and that even modest precautionary savings may be needed.

We agree that the superannuation system should not be used for estate planning or to facilitate significant bequests to non-dependent family members. Analysis by ASFA[13] indicates that households are, on average, not using the superannuation system for estate planning. Using HILDA data, they show that 80 per cent of people aged 60 and over and 90 per cent of people aged 80 and over who died in the period 2014 to 2018 had no super at all in the period of up to four years before death. Of those aged 80 and above, only 5 per cent of individuals had more than $110,000 in superannuation.

Longitudinal analysis of superannuation drawdown patterns in the 12 years following retirement supports the view that most people are utilising their superannuation savings. For many, 12 years would represent roughly half of residual life-expectancy upon retirement. For those newly retired, around half of individuals across the wealth distribution reduce their real super balance by 50 per cent or more, with most individuals in the lowest quartile exhausting their superannuation balances in the intervening 12 years. For those in the lower deciles experiencing real balance increases, it is noted that most have relatively small superannuation holdings to begin with and therefore these increases are relatively small in absolute terms.

[11] Warren and Bell, "Ensuring", p 7
[12] Retirement Income Review, p 58
[13] Clare, R., Superannuation balances prior to death: Superannuation balances of older Australians, March 2021, ASFA.



Source: HILDA, Waves 19 (years 2002, 2006, 2010, 2014, 2018)

This suggests that, for most individuals, estate planning is not a significant motivation. It is therefore important that any retirement income strategy maintains sufficient flexibility to support choices by retirees about how they use their savings in retirement, including having some reasonable precautionary savings set aside for:

- Health and aged care costs
- Emergencies and contingencies including home maintenance
- Funeral expenses
- Surviving spouse retirement needs in the case of a couple

ISA recommends that the retirement income covenant contain sufficient flexibility to enable members to make choices about how they spend their money.

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15 October 2021

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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 a number of 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 takes into account 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 similar to 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 particular 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
[redacted]

Yours sincerely

[redacted]

Anne Nguyen
Policy Adviser