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Manager, CIPRs
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email: superannuation@treasury.gov.au

Dear Sir / Madam

Public consultation: Retirement Income Covenant Position Paper

Thank you for providing the opportunity to comment on the Retirement Income Covenant Position Paper published on 17 May 2018 (the Paper).

Macquarie Group (Macquarie) is a global financial services institution headquartered and listed in Australia. As at March 2018, it managed $A496.7 billion of assets. With regard to CIPRs and retirement income activities, Macquarie is:

1. an active investment manager;
2. the provider of retail investment products; and
3. the trustee of three superannuation funds and administrator for several other funds.

Macquarie welcomes initiatives that promote the development of retirement income products and to build on existing retirement options that will meet the CIPR objectives and provide certainty to retirees.

Summary

Macquarie makes the following observations and suggestions for a CIPRs market that will deliver effective outcomes for retirees:

- Flexibility of timing around the start date would allow, and encourage, providers to develop and offer products earlier than mandated, while a two-to-three-year transitional period may be appropriate to allow providers and trustees to better address the complexity involved.
- Authorised Deposit-taking Institutions (ADIs) be permitted to offer and issue products with an element of life insurance, provided life risks are adequately hedged. To this end, CIPRs could be considered a new category of financial product.
- Retirees be given the choice of using non-superannuation savings to access CIPRs, given retirement savings are not always exclusively held in superannuation.

- Allow a conservative cap on an insured's lifetime of, say 110 years of age, in order that CIPR life risks of the entire market of CIPR holders remain within the capacity and risk appetites of life insurers.
- Trustees require clear and specific guidance on what they can rely on in determining the most appropriate product for a member, particularly where financial advice has been provided. This will clarify responsibilities between trustees and financial advisers and reduce the risk of overlap, and avoid practical obstructions to member choice.
- Consideration be given to the practical execution of trustee obligations in providing available choices to a member.
- Certification of CIPR products be principles-based and not overly prescriptive as this would encourage a broader range of products can be developed. Comparison across retirement products could be enabled through the publication of key prescribed comparative metrics.
- The lower limit of $A50,000 be raised to $A100,000, as the cost of providing CIPRs to small balance accounts relative to the benefits would also apply to balances up to $A100,000.
- Provide exemptions over the portability of the longevity portion of a CIPR, as well as allowances to permit members to roll-over account-based pension portions without losing social security means testing benefits.

CIPRs is a positive initiative, providing retirees with greater income certainty
The proposed treatment of CIPRs within the means testing to the Age Pension is both appropriate and well targeted. It will encourage the middle tiers of superannuation accounts to more prudently allocate their retirement assets to achieve stable income and longevity protection without burdening those with smaller balances or advantaging those with larger balances.

A framework which considers income from both CIPRs and the Age Pension appropriately directs focus onto the retiree, and is well-aligned with the stated purpose of superannuation "to substitute or supplement the Age Pension"[1].

Implementation timing
The intended timing of legislation by 1 July 2019 to take effect from 1 July 2020 may present some implementation concerns for trustees.

Trustees have two requirements as part of the proposals: the creation of a retirement income strategy; and the development of the CIPR(s) that meets the trustee's strategy. Practically, these are likely to be consecutive steps and as such, a longer implementation period may be required to meet these requirements.

The certainty of enacted legislation and published regulations is a pre-requisite for trustees when making definitive assessments of their retirement income strategy. While draft retirement covenants are informative, the detail typically contained in regulations may significantly alter a trustee's strategy.

Additionally, trustees need to develop such products, either in-house or through a third party. Certainty of retirement strategy is likely to be a pre-requisite for products to be developed

[1] Superannuation (Objective) Bill 2016

efficiently and effectively. Further, any product would require significant technology implementation, including the prudent inclusion of testing to integrate the product into existing product suites.

Insufficient implementation time may result in limiting the products offered to those already in the market, rather than fostering innovation and competition. It may also be contrary to a trustee's prudential obligations when outsourcing, including provisions within Superannuation Prudential Standard 231 and associated Prudential Practice Guides.

An alternative that could overcome these issues is a two-to-three-year implementation period that has the flexibility of allowing product providers to launch ahead of time if they are ready to do so. This would recognise that CIPRs are complex products to develop, while recognising that some trustees / funds may be unable or unwilling to offer CIPRs and therefore may need to transfer member benefits to another fund.

Non-superannuation savings

Some retirees, such as those that are self-employed, hold a significant proportion of their retirement savings outside superannuation. The retirement outcome for these retirees may be adversely impacted if the policy intent is to limit CIPRs to superannuation fund balances.

Macquarie would support the inclusion of non-superannuation savings in determining the availability of CIPRs, supported by clear guidance in legislation or regulations to that effect.

Managing longevity risk

One of the three key factors required for a CIPR is protection against longevity either through lifetime annuity, deferred lifetime annuity (DLA), mortality pooling or group self-annuitisation (GSA).

The Life Insurance Act 1995 (Life Act) requires insured life risk to be managed within registered life corporations. It defines a life policy as "a contract of insurance that provides for the payment of an annuity for a term dependent on the continuance of human life".

While the Life Act appropriately ensures life risks are managed within a regulated regime for life companies, it excludes superannuation funds (RSEs) and banks or other Authorised Deposit-taking Institutions (ADIs) from directly offering longevity solutions regardless of whether the RSE or ADI has reinsured with a regulated life company. Limiting the types of regulated institutions able to offer CIPRs constrains competition and choice for retirees.

To overcome these outcomes, the limitations on the provision of life products could be eased subject to strong APRA regulated risk controls such that RSEs and ADIs must pool and / or reinsure so that they do not retain life exposures.

Alternatively, it may be possible to introduce CIPR as a new type of financial product that could be issued by an entity appropriately authorised by APRA, such as an ADI, to do so.

Market capacity for longevity risk

Mortality pooling can manage individual mortality risks (that is, short lives creating mortality credits to support long lives) but cannot manage population-wide mortality improvements (where average life expectancy improves faster than anticipated). Medical science might, for example, extend life expectancies for the whole population and this could stress both GSA pooling and life insurers.

These types of mortality risks in this scale are new to the Australian life insurance market and have the potential to exceed market capacity and / or diminish the effectiveness of GSA pooling. These risks could be mitigated by allowing the capping of maximum life at a conservative but reasonable age such as 110 years old. This would be sufficient to satisfy a retiree's expectations whilst removing the impracticality of managing unlimited longevity risk to providers.

Trustee obligations
The Covenant Paper obligates Trustees to offer up to three 'flagship CIPRs' without constituting financial advice.

A RSE trustee's obligation comprises both the accumulation of wealth and the beneficial use of those retirement assets to achieve optimised retirement outcomes. This obligation is complicated for wrap platforms where members may only join the fund through a financial adviser. Platforms have clients from multiple dealer groups, each of which provides financial advice with individual investment philosophies often targeted to specific cohorts of investors. As such, different CIPRs may appeal to differing dealer groups.

Importantly, a platform may only comprise a portion of the retiree's investment portfolio and, consequently, the platform provider would not have access to the retiree's entire set of information.

Macquarie would welcome regulations that clearly set out that where the member receives financial advice, the obligation to ensure the CIPR is in the best interests of a particular member should remain with the financial adviser, who will have access to additional, relevant information that the trustee may not otherwise have. The trustee would remain responsible for ensuring CIPR products are available to select and offer sufficient materials and support to enable appropriate choice by financial advisers.

An alternative would be clear and specific guidance on what trustees could rely on for determining that a chosen CIPR was in the best interest of members. This is a less effective alternative as it would result in tools and intra-fund advice which do not consider the member's personal circumstances. Ensuring members choose the most appropriate flagship or alternative product may necessitate the provision of personal financial advice for which a trustee may not be authorised to provide in its Australian financial services licence.

Offer and consent
The position paper notes CIPRs must be offered 'at retirement' of the member which places the onus on the member to notify the trustee. Often, the trustee becomes aware of retirement only when a member requests commencement of a pension or to roll benefits to another fund. By this stage the offer of a CIPR may be too late.

One option could be to prescribe an age upon which the offer must be made, which would allow for systemisation of the offer. It would be important to prescribe an age that allows the member sufficient time, before they have unrestricted access to their benefits at age 65, to assess their options and determine if they need to seek independent advice.

It would also be prudent to prescribe a time period to make the offer, for example 60 days from the prescribed date. Consideration should also be given to practicalities such as being unable to contact the member and providing trustees with a safe harbour where reasonable attempts have been made to contact the member.

Consideration could be given to those members who join a fund after they have retired, for example to directly commence a non-CIPR product, with specific exemptions provided in these circumstances.

Macquarie strongly supports the proposal that members must consent to the commencement of a CIPR. CIPRs should not become the automatic default selection for individuals at retirement and they should have the ultimate say as to which CIPR they choose, if any.

Certification of CIPRs

Macquarie welcomes the Covenant Paper's principle-based assessment of CIPRs. This approach allows for a broader range of products to be developed. It also allows for better management of restrictions that may later present due to unforeseen market or technological changes.

Macquarie also supports a certification and registration process whereby pension income investments are approved. Macquarie notes approval would be provided by APRA under advice from the Australian Government Actuary and would require regular certification by registered actuaries.

The Covenant Paper also announced the Government "will progress the development of simplified, standardised metrics in product disclosure". Macquarie understands these metrics are intended to measure *ongoing* performance rather than comparatives for *initial* consumer choice. Macquarie suggests the addition of standardised metrics which can be offered with each CIPR to enable informed retiree choice.

As with ongoing performance metrics, minimum required metrics should be prescribed and regular actuarial certification obtained for those metrics and / or the systems used to provide them.

Possible metrics could include:

- Median annual income expectation over the retiree's median expected life, and separately over the retiree's remaining life should they outlive the median.
- Potential minimum incomes in the advent of negative market events calculated according to APRA-prescribed scenarios consistent with life company capital regulations. This could include zero-product income if market performance causes ABP balances to deplete before DLA incomes commence.
- Potential minimum incomes in the advent of population-wide improvements to mortality calculated according to APRA prescribed scenarios consistent with life company capital regulations.
- Plain English descriptions of access to capital and liquidity.
- Plain English descriptions of other key terms including rollover restrictions if any.

Exemptions for small account balances

Macquarie is supportive of the Government's proposal to exempt trustees from providing CIPRs to certain individuals with small superannuation balances. (Macquarie would however reiterate the observations made above with regard to those retirees that maintain retirement savings outside of superannuation.)

As noted in the position paper, the costs and flexibility for small balance accounts would be outweighed by the likely benefits an individual could obtain from a CPIR at these values. As such, the proposed limit that an individual has less than $A50,000 in the fund is likely to be too small and $A100,000 may be more appropriate.

Portability and legacy products

There are some practical concerns regarding the application of current portability requirements to CIPRs.

Division 6.5 of the *Superannuation Industry (Supervision) Regulations 1994* (SISR) includes provisions covering the circumstances in which a member or the trustee of one fund can require a transfer to another fund, including the information that must be provided as a prerequisite for the transferring fund's obligation to the transfer being activated.

The longevity portion of CIPRs will contain an element that will be costly to terminate or may not be able to be terminated at all. Thus, trustees will not be able to meet their portability requirements as outlined in the SISR. Specific exemptions will need to be provided to cater for the longevity portion of CIPRs.

Another concern is the potential non-transferability of these policies which in effect, 'locks' members into specific products. Members should be able to transfer between funds, especially on the account-based pension portion, without losing any benefits from doing so (for example social security means-testing exemptions).

A third impact is inherent legacy product risks that will increase over time as product development continues. Some form of transferability of legacy products to new products could preserve choice for members, including access to lower fees or increased features / benefits.

Once again, we thank you for the opportunity to contribute to the development of a retirement income covenant and welcome further consultation opportunities as they arise.

Yours faithfully

Jason King
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Macquarie Specialised Investment Solutions
Macquarie Group