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Retirement income covenant

Position Paper

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Consultation Process

Request for feedback and comments

The Government welcomes feedback and comments on this position paper. Interested parties are invited to comment on the policy position presented in this position paper by Friday, 6 August 2021. Any comments received will feed into the development of legislation to give effect to the retirement income covenant.

While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted. All information (including name and address details) contained in submissions will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence. Automatically generated confidentiality statements in emails do not suffice for this purpose. Respondents who would like part of their submission to remain in confidence should provide this information marked as such in a separate attachment.

Legal requirements, such as those imposed by the *Freedom of Information Act 1982*, may affect the confidentiality of your submission.

Closing date for submissions: 06 August 2021

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Summary

The Government committed in the 2018-19 Budget to introducing a retirement income covenant for superannuation trustees and consulted on the covenant in June 2018. This position paper reflects the feedback from that consultation process and presents the Government's refined policy, with the aim of guiding trustees ahead of the covenant being legislated and taking effect from 1 July 2022.[1]

The covenant is a key stage of the Government's retirement income framework. The covenant will codify the requirements and obligations for superannuation trustees to improve retirement outcomes for individuals, while enabling choice and competition in the retirement phase.

Existing covenants in the *Superannuation Industry (Supervision) Act 1993* include obligations to formulate, review regularly and give effect to investment, risk management and insurance strategies. The Government intends to introduce a retirement income covenant in the *Superannuation Industry (Supervision) Act 1993* outlining a fundamental obligation of trustees to formulate, review regularly and give effect to a retirement income strategy.

The strategy will be a strategic document developed by the trustee, outlining their plan to assist their members to achieve and balance the following objectives:

- maximise their retirement income
- manage risks to the sustainability and stability of their retirement income; and
- have some flexible access to savings during retirement.

Requiring trustees to have a retirement income strategy ensures that they identify and recognise the retirement income needs of the members of their fund and have a plan to build the fund's capacity and capability to service those needs.

The strategy should reflect a trustee's broad understanding of their membership, either for the members of the fund as a whole or for cohorts of members. The characteristics of these cohorts are at the discretion of trustees but could be determined by factors such as superannuation balance, home ownership status, partnered status, or age of retirement.

As with the other covenants in the *Superannuation Industry (Supervision) Act 1993,* APRA, ASIC and the ATO will regulate trustees' compliance and provide information on how trustees can comply with the new retirement income covenant.

The Government welcomes feedback and comments on this position paper. Any comments received will feed into the development of legislation to give effect to the retirement income covenant. Subject to the passage of legislation, trustees will be required to have in place a retirement income strategy as outlined in this position paper, from 1 July 2022.

[1] On 22 May 2020, the Government deferred the introduction of the retirement income covenant to 1 July 2022. This deferral was necessary to allow for continued consultation and legislative drafting to take place following the COVID-19 crisis and for the covenant to be informed by the Retirement Income Review.

Background

Why do we need a retirement income covenant?

The Retirement Income Review (the Review) suggested an objective of the retirement income system be designed around the goal '*to deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way*.'[2] It noted that '*providing income in retirement is the fundamental role of compulsory superannuation.*'[3] However, 29 years after the introduction of compulsory superannuation, the retirement phase of superannuation remains under-developed. There is substantial room for improvement in how the superannuation system delivers adequate incomes in retirement.

That Review found that Australians are projected to accumulate increasingly significant superannuation assets by retirement. The median superannuation balances of men and women approaching retirement in 2019 were around $179,000 and $137,000 respectively.[4] By 2060, the median earner is projected to accumulate over $450,000 by retirement.[5] With the robust design of the accumulation phase of superannuation after years of reform, Australians are well placed to have enough funds to provide for an adequate retirement.

But most retirees are not currently supported to effectively manage their superannuation when they retire. Retirement involves multiple decisions and difficult trade-offs, such as:

- when to retire
- whether to keep their money in superannuation
- how to invest their savings, both in and outside of superannuation
- how to draw down their savings, both in and outside of superannuation; and
- their future expenditure and capital needs.

The long-term implications of these decisions, and their complex interactions with other systems like tax, social security, aged care and housing, make it very challenging for retirees to determine an optimal retirement income strategy on their own. Yet most people do not seek financial advice at retirement to help navigate this complexity.[6] Rather, in the face of this complexity, evidence shows that Australians currently follow others, disengage, or fall back on rules of thumb and defaults that are not fit-for-purpose.[7]

The 'nest egg' framing of superannuation compounds the complexities around deciding how to manage their superannuation in retirement. Partly because they have only ever been primed to save as large a lump sum as possible, retirees struggle with the concept that superannuation is to be consumed to fund their retirement.

Because retirees struggle to develop effective retirement income strategies on their own, much of the savings accrued by members through the superannuation system are not used to provide retirement income. Rather, they remain unspent and become part of the person's bequest when they die.

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[2] Retirement Income Review (2020), p. 17
[3] Retirement Income Review (2020), p. 100
[4] ATO TaxStats 2018-19, Table 5, Chart 12 (2021)
[5] Retirement Income Review (2020), p. 520
[6] Retirement Income Review (2020), p. 449
[7] Retirement Income Review (2020), p. 447

Multiple studies have shown that retirees die with around 90 per cent of the assets they had at retirement.[8] Without a change in behaviour, it is expected that bequests from superannuation will grow. By 2060, it is projected that 1 in every 3 dollars paid out of the superannuation system will be a part of a bequest.[9]

Low consumption of superannuation lowers living standards. The Review noted that '*whether retirees draw down at minimum rates or effectively use their superannuation is critical*' to determining whether they have an adequate retirement income.[10] How retirees draw down on their superannuation can be more important than whether they make additional contributions to superannuation in working life.[11] People could have a higher standard of living in retirement if they had greater confidence to spend their superannuation.

A retirement income covenant will improve these mechanisms by creating an obligation for superannuation trustees to assist members to meet key retirement income goals.

The future direction of the retirement income framework

The retirement income framework is the Government's broad approach to addressing under-development of the retirement phase of superannuation outlined above. The framework intends to support the retirements of Australians by increasing the availability of better retirement income products that provide higher retirement incomes while also providing flexibility and efficiently managing the risks faced by retirees.

As the framework is established, and retirement income strategies are devised and implemented, the way consumers are assisted through access to affordable advice or appropriate guidance and disclosure will evolve. The section below considers what, if any, adjustments to existing frameworks could complement the retirement income framework, and the most efficient way of doing this in a competitively neutral way.

Better products

The Government has already legislated to remove barriers to the development of innovative retirement income products through changes to the tax treatment and the social security means test.

The retirement income covenant will require trustees to develop a retirement income strategy. In doing so, trustees will be required to consider the broad needs of their members and identify what actions the trustee needs to take to assist their members meet those needs. It is anticipated that the requirement to develop a retirement income strategy will result in many trustees evaluating the products they offer to their members and investigating whether their product offerings can be improved to better meet the needs of their members.

Future reforms will also encourage the development and offering of better retirement income products. Member outcomes assessments are required for retirement income products following the inclusion of choice products in the *Treasury Laws Amendment (Improving Accountability and Member Outcomes in Superannuation Measures No. 1) Act 2019*. The Government will review and refine the member outcomes arrangements for retirement income products to ensure their design supports measuring and comparing how retirement products deliver retirement outcomes.

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[8] Retirement Income Review (2020), p. 432.
[9] Retirement Income Review (2020), p. 435.
[10] Retirement Income Review (2020), p. 181.
[11] Retirement Income Review (2020), p. 19.

Importantly, trustees do not have to wait to start developing or offering innovative income products to their members. Leading funds have already started to bring innovative products to market.

Appropriate guidance

Guidance covers a range of information provided to members, from factual information through to personal financial advice. Broadly, it is information that helps people make informed decisions about their finances. In the context of retirement, appropriate guidance helps members understand how they can convert their retirement savings into a retirement income in a way that suits their needs and desired financial outcomes. Guidance in this context does not mean defaulting members into particular products or pushing people towards particular forms of advice. Further, guidance should not create competitive distortions in adjacent markets for financial advice.

Through the requirement to develop a retirement income strategy, trustees will be required to consider the broad needs of their members and identify what actions the trustee needs to take to assist their members meet those needs. This includes consideration of what guidance trustees may need to provide to their members in implementing a fund's retirement income strategy.

The Government is aware that there are concerns regarding current laws and regulations governing guidance. These concerns, combined with 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.

The Government has already acted on the recommendations of the Final Report of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry (FSRC), and implemented reforms to the way advice and guidance are provided both within and outside superannuation. These reforms have affected when and how superannuation funds offer guidance and advice to their members, and the quality of that advice.

The Government has also legislated for providers of retirement income products to meet design and distribution obligations from 5 October 2021, as per the *Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019*. [12] These will ensure retirement income products are offered in a more targeted manner to retirees for whom they are suitable.

In late 2020, ASIC consulted on impediments to the delivery of good-quality affordable personal advice, including advice for retirement. The Treasury will also conduct a Quality of Advice Review in 2022, as recommended by the FSRC. The review will consider the full breadth of issues impacting on both quality and affordability of all forms of financial advice, including advice for retirement.[13] This will inform future policy development. The Government welcomes feedback from stakeholders on barriers to providing appropriate guidance that could prevent members from using their superannuation to take up retirement products that would be in their interest, or otherwise inhibit trustees providing guidance to members.

Feedback received on these issues will help inform the Quality of Advice Review in 2022, as well as future policy direction in this area to help improve access to appropriate guidance in retirement.

[12] The design and distribution obligations were originally scheduled to commence on 5 April 2021. Due to the Coronavirus crisis, ASIC provided a temporary exemption from the obligations for six months.

[13] Senator the Hon Jane Hume, 2021. *Address to the 12th Annual Financial Services Council's Life Insurance Summit 2021*.

Retirement income strategy

Box 1 outlines the Government's proposed requirement for superannuation trustees to develop a retirement income strategy for the members of their fund who are retired or approaching retirement. The retirement income strategy requirement will apply for all trustees, including trustees of self-managed superannuation funds (SMSFs) and small APRA funds (SAFs).

Box 1: Proposed retirement income strategy principles[14]

Trustees are required to formulate, review regularly, and give effect to a retirement income strategy for the retired members of their fund, and the members of their fund approaching retirement.

The strategy can be formulated for:

- all members in generality, or
- cohorts of members in generality, as identified by the trustee

The strategy should outline how the trustee intends to assist their members to achieve the following objectives:

- maximise their retirement income (taking into account the Age Pension and any other relevant income support payments identified by the trustee paid under the *Social Security Act 1991* or the *Veterans Entitlements Act 1986*)
- manage risks to the sustainability and stability of their income
- have some flexible access to savings during retirement

Where these objectives compete, the strategy should identify how trustees intend to assist their members to balance these objectives and whether the trustee's intended assistance is likely to increase or decrease the retirement incomes of their members.

Defined benefit schemes

Trustees of defined benefit schemes that offer a defined benefit lifetime pension are not required to develop a retirement income strategy for members whose interest in the fund is limited to the defined benefit scheme. It would not be appropriate to require trustees of these fund types to do this because a defined benefit scheme already reflects an implicit retirement income strategy.

Where a fund offers both a defined benefit scheme and an accumulation scheme, the trustee should develop a retirement income strategy for members with interests in the accumulation scheme. In line with the definition of 'retirement income' discussed below, the trustee could consider their members' other interests in the fund, including defined benefit interests, when developing their retirement income strategy.

What does a retirement income strategy look like?

A retirement income strategy outlines 'how the trustee intends to assist their members' to achieve and balance key retirement income objectives.

[14] This is not draft legislation and does not reflect the way these principles may ultimately be reflected in legislation.

In effect, the strategy is a strategic document developed by the trustee that:

- identifies and recognises the retirement income needs of the members of the fund; and
- presents a plan to build the fund's capacity and capability to service those needs.

The retirement income needs of members, and the plan to service those needs, may be different from fund to fund, or from cohort to cohort within a fund. There is significant flexibility for trustees to identify the particular needs of their members and develop a retirement income strategy that is suited to those particular needs.

The strategy requirement outlined in Box 1 provides a framework for trustees to develop this document and what trustees should consider when doing so. These mandated considerations aim to ensure the trustee has appropriately considered the needs of their members and that they are sufficiently equipped to address them. Trustees are also free to consider other factors they deem relevant when designing their retirement income strategy in addition to the considerations required by the retirement income covenant.

APRA will publish guidance on how trustees can meet the retirement income strategy requirement. consistent with the approach taken to guidance for other strategies required by the *Superannuation Industry (Supervision) Act 1993*.

The retirement income strategy should be made publicly available to members. This could be achieved by providing a copy of the retirement income strategy on the fund's website.

The formulation of a retirement income strategy is not considered to be:

- **financial advice** – The development of a retirement income strategy by a trustee does not, in and of itself, constitute the provision of financial advice to their members. The retirement income strategy expresses the broad actions the trustee will take to assist their members to balance key retirement income objectives. It does not consider the specific circumstances of individual members. However, any assistance provided by the trustee to give effect to their retirement income strategy needs to comply with existing financial advice rules
- **a requirement to offer a soft default** – Whether a trustee's gives effect to their retirement income strategy by offering a particular retirement income product is at the discretion of the trustee. There is no requirement for trustees to offer a particular retirement income product to members. If a trustee's strategy identifies that specific retirement income products are needed to assist their members, it is not a requirement for members to consider or take-up those products.
- **mandating a 'one-size fits all' approach** – A retirement income strategy outlines a trustee's plan to assist all their members, or cohorts of their members, in generality. This does not preclude the trustee from assisting their members to meet their individual needs through tailored advice or guidance.

Key terms

Retirement

There is no mandatory retirement age in Australia. Australians retire from the workforce at a variety of ages, triggered by factors such as:

- their personal circumstances (e.g. health, finances)

- whether they meet superannuation conditions of release;[15] and
- the age they become eligible to receive the Age Pension.[16]

Retirement is also not a static condition. A person who has retired can return to work, and people in retirement can supplement their income with employment income. A person can also be transitioning to retirement, for example through the use of a Transition to Retirement Income Stream.

Retirement may also not directly coincide with when a person starts accessing their superannuation savings. For example, a person may use private savings or the Age Pension to fund expenses for a period at the start of their retirement. Alternatively, they may access their superannuation before retirement while still working post-age 65.

As a retirement income strategy is constructed for members in generality, it is not expected that a trustee's retirement income strategy will encompass each of the wide variety of individual circumstances in which their members may retire. Trustees should develop strategies such that reflect the broad understanding of when and how their members, or cohorts of their members, retire. This understanding may be based on:

- surveys of retirement ages, or expected retirement ages, of the fund's membership
- key retirement policy settings (such as the superannuation preservation age or the Age Pension eligibility age)
- broad demographic information (such as information on retirement ages from the Australian Bureau of Statistics).

Members

The strategy should be formulated for all members of a fund who are retired or approaching retirement. As outlined above, trustees have discretion to develop strategies such that they reflect the broad understanding of when and how their members retire, and when they start planning for retirement.

Trustees of SMSFs and SAFs with retired members should have a retirement income strategy. Where all of the members of an SMSF or SAF are in the accumulation phase, trustees have discretion as to when they require a retirement income strategy, in so far as members of their fund are 'approaching retirement'.

How can trustees determine cohorts of members?

It is at the discretion of the trustee as to whether they construct their retirement income strategy for all members of the fund in generality, or for cohorts of the fund's members in generality.

[15] For the purposes of the *Superannuation Industry Supervision Regulations 1994* (SISR) and conditions of release of superannuation benefits a person is retired if they fit the definition contained in sub-regulation 6.01(7). For a person who has reached their preservation age but not 60, retirement means a gainful employment arrangement has ended and the trustee is reasonably satisfied that the person intends never to again become gainfully employed, either on a full-time or a part-time basis. For a person who has reached the age of 60 retirement also includes any situation where an employment arrangement has ended. Finally, a person who has reached the age of 65 satisfies an unrestricted condition of release regardless of their employment status.

[16] The eligibility age for the Age Pension is increasing by six months every 2 years to reach 67 from 1 July 2023.

For larger funds, it is anticipated that trustees will consider structuring their retirement income strategy for cohorts of their members. Different approaches may be required for different cohorts when a fund has a membership with diverse needs.

Trustees are already expected to understand their membership composition and construct cohorts of members under APRA Prudential Standard SPS515 Strategic Planning and Member Outcomes. Additionally, trustees already hold some member data to meet APRA Reporting Standards. This includes members' demographic data, such as age, gender and account balance. This and other data may assist trustees in determining potential factors or cohorts for which it may be appropriate to formulate the strategy.

The factors used to identify cohorts of their members are at the discretion of the trustee, but could include consideration of:

- the size of a member's superannuation balance
- whether a member is expected to receive a full, part- or nil-rate Age Pension at retirement
- whether a member is partnered or single
- whether a member owns their own home outright, owns their home with a mortgage, or is renting at retirement;
- the age a member retires and/or starts to draw down from their superannuation.

If a trustee develops their strategy for cohorts of their members, they need to ensure that all the members of the fund are covered by the strategy. For example, if a fund has both home-owning and non-home-owning members, it is not sufficient for a trustee to develop a retirement income strategy only for cohorts of homeowning members.

Trustees of SMSFs and SAFs are not expected to develop their strategy for cohorts of their members, given their small size. However, if trustees of SMSFs and SAFs identify that their members need markedly different approaches to balance the objectives under the strategy, they are not precluded from developing their strategy for cohorts of their members.

Box 2: Examples of cohorts of members

- A trustee identifies that the members in their fund, because of their account balance, homeownership status and partnered status at retirement, are likely to have significantly different patterns of Age Pension receipt across retirement. The trustee may determine that the retirement income strategy needs to be different for those who receive a full, part- or nil-rate of Age Pension at retirement. The trustee could determine how these cohorts are constructed using relevant Age Pension policy parameters.

- A trustee identifies that the members in their fund can be segmented into two cohorts: members expected to retire 'early', and members are expected to retire 'late'. As the age of retirement materially changes how the trustee approaches assisting their members with achieving the objectives under the strategy, the trustee may determine that the retirement income strategy for these two cohorts needs to be different.

Retirement income

When developing their fund's retirement income strategy, trustees should consider drawdowns from the member's interest in the trustee's fund as a source of retirement income. Trustees should also consider any entitlement to the Age Pension under the *Social Security Act 1991* for their members, or cohorts of members, in generality.

The main income support entitlement relevant to developing a retirement income strategy is the Age Pension. However, depending on the fund's membership, consideration of other income support payments by the trustee may be appropriate, such as the Disability Support Pension, Carer Payment, JobSeeker Payment and the Service Pension. More information on the requirement for trustees to consider Age Pension entitlements is in Box 3, below.

Box 3: Considering Age Pension eligibility in generality

There are a range of factors that determine a person's Age Pension eligibility that are not visible to trustees. However, in considering Age Pension eligibility for the strategy it is reasonable to expect trustees to either collect information from their members, or make informed assumptions about their members' circumstances, to estimate their potential Age Pension entitlement for the purposes of developing a retirement income strategy. The key factors to estimate Age Pension entitlement are:[17]

- **Age** – a person must be of Age Pension age to receive the Age Pension. Trustees already have information about the age of their members.

- **Assessable assets and income** – a person's assets and income affect their Age Pension entitlement under the Age Pension means test. A trustee can readily identify a significant asset and source of income of their members – their superannuation. To identify their members' other assessable assets and income, trustees could undertake member surveys, or use publicly available data (such as the Australian Bureau of Statistics' Survey of Income and Housing, the Census, or the Household and Labour Dynamics of Australia Survey) to estimate the general patterns of their members' assets and income. At a minimum, trustees should consider members' interests in their superannuation fund in determining Age Pension eligibility.

- **Home ownership status –** if a person is not a homeowner, they have a larger assets test 'free area', and they may be eligible for Commonwealth Rent Assistance. A trustee could survey their members or use publicly available data to determine whether there are a significant number of their members who are renting at in retirement.

- **Coupled status** – the maximum rate of Age Pension, and means test parameters, depend on whether a person is single or a member of a couple. A trustee could survey their members or use publicly available data to determine whether their members are likely to be a member of a couple, and the assets and income of the other member of the couple.

With the above information, trustees can consider Age Pension eligibility for cohorts of members in generality using public information on Age Pension rates and means test settings from Services Australia. For smaller funds and SMSFs, the use of publicly available retirement income calculators

[17] Additional factors would need to be considered for Disability Support Pension (disability status), Carer Payment (carer status), JobSeeker Payment (employment status) or Service Pension (eligibility as a veteran or spouse of a veteran), should the trustee consider that these payments are relevant to their members.

(for example, on the MoneySmart website) may help determine the Age Pension eligibility of members.

While the use of broad demographic data to determine Age Pension eligibility is sufficient, trustees should aim to transition to using actual data on their membership where available to improve the accuracy of their estimations.

Trustees should also consider how the tax system may impact the retirement income of members. Superannuation benefits are generally tax free from most funds when paid to a person aged 60 or over, however tax can apply to some defined benefit schemes and very high paying income streams. Most income support payments, including the Age Pension, are taxable.

Trustees are not required to consider other sources of income their members may have in retirement, such as income from other superannuation funds, investments, or employment, when formulating their strategy. Should they decide to factor other income sources into their strategy, a trustee could obtain information on these other sources of income by surveying their members, or by making informed assumptions from publicly available data.

Retirement income strategy objectives

Maximising retirement income

The strategy needs to consider how the trustee intends to support their members to maximise their retirement income. Maximising retirement income for members means providing the highest expected net income possible for members over their retirement, in line with the definition of 'retirement income' above. This is subject to balancing this objective with the other objectives in the retirement income strategy.

This objective is not about maximising income in any given year or other period during retirement. It is a cumulative concept across the whole of retirement.

Maximising retirement income necessarily involves members drawing down their capital. While uncertainties in life expectancy and the objective to provide some flexible access to savings may result in bequests, the primary purpose of retirement savings (and the Age Pension) is to provide income for consumption in retirement.

Maximising retirement income requires consideration of when in retirement their members are likely to need income to meet expenses and maintain living standards. A significant body of evidence shows that the real spending needs of most retirees decline over the course of retirement.[18]

Maximising retirement income requires trustees to make assumptions about the life expectancy of their members. It is at the trustee's discretion as to what assumptions they make regarding the life expectancy of their members, or cohorts of their members. This should be based on information the fund has on their membership, as is the case for group insurance.

To the extent that their members are coupled, trustees may decide to construct a strategy that assists their members to maximise the retirement income of the couple. However, it is enough for trustees to assist their members to maximise their retirement income as individuals.

The objective to maximise retirement income should be balanced with the other objectives considered in the strategy. How that balance is reached is at the discretion of the trustee.

[18] Retirement Income Review (2020), p. 486-492.

Managing risks to the stability and sustainability of retirement income

What risks do trustees need to consider?

Trustees need to consider how to assist their members to manage risks to the stability and sustainability of their retirement income. A sustainable retirement income means that it is reliable and durable over a member's retirement. A stable retirement income means that it is broadly constant over that time, that is, from a member's point of view it is broadly predictable.

When developing their retirement income strategy, trustees should consider the following risks to the stability and sustainability of their members' retirement income:

- longevity risk; and
- investment risks.

Trustees may also decide to consider other risks to the stability and sustainability of their members' retirement incomes, should they consider them relevant.

It is at the trustee's discretion as to how they determine whether their members need assistance managing these risks, and how they provide that assistance. Trustees should balance their approach to assisting retirees to manage these risks with the other objectives in the strategy.

Longevity risk

Longevity risk is the risk a person will outlive their savings. In formulating their retirement income strategy, trustees should consider how they will assist their members to manage their longevity risk. Trustees may also consider whether they need to assist their members to manage the longevity risk of the reversionary beneficiaries of members, where relevant.

This should not include consideration of bequest motives to non-dependent persons. Rather, trustees may choose to consider how the longevity of those who are genuinely dependent on their members may impact their retirement income needs as part of their retirement income strategy.

Different members will have different exposure to longevity risk. The Age Pension provides a minimum amount of longevity risk management and, depending on the circumstances of the member, this may be sufficient without additional sources of longevity risk protection. As such, a approaches to assisting their members to manage longevity risk may vary between funds, and between cohorts of their members.

In considering longevity risk, trustees should also consider the likely expenditure and income needs of their members across retirement. As noted above, the expenditure of most retirees declines in real terms over the course of retirement.

Investment risks

Investment risks include risks such as market risk (including risk of variable or negative investment returns) and sequencing risk (the risk of converting assets to income at a disadvantageous time).

Trustees are already required to consider and manage investment risks through the investment covenant. However, the existing investment covenant is limited to setting risk objectives for the fund's investment options, and monitoring and managing those risks over a defined investment horizon. A trustee's consideration of investment risk under the retirement income covenant is different. It is specific to the impact investment risks have upon their members retirement income, across their whole retirement. In formulating their retirement income strategy, trustees should consider how they will assist their members to manage investment risks.

In assisting their members to manage investment risks, trustees should consider the implications of members being exposed to investment risks at different stages of their retirement, and the potential impact it may have on their retirement incomes. These implications may be different depending on the superannuation balance of members at given ages. These implications should be considered in the context of the broader sources of retirement income members are expected to have available to them, including the Age Pension, and the expected income and capital needs of members.

Providing flexible access to savings during retirement

In formulating their retirement income strategy, trustees should consider how they will assist their members have some flexible access to their savings during retirement. Trustees may consider whether they need to include reversionary beneficiaries in this objective.[19]

Flexible access to savings may be required by people at a variety of stages through their retirement. For example, people may want to buy a new car, or need to meet home maintenance or lumpy health costs.

Trustees should consider this objective in the context of the total savings available to their members (including savings outside of superannuation, such as private savings or housing assets) and the likely future needs of their members to flexibly access their savings. Depending on their members' total savings and their needs for flexible access, trustees may assist members to have more or less flexible access to their savings as part of their retirement income strategy. In making this assessment, trustees can source information on the amount of savings and the need for flexible savings from members (for example, through member surveys) or make informed assumptions through publicly available data.

When considering their members' expected future needs for flexible savings for health costs (including aged care), trustees should take into account the significant financial and in-kind support provided by the Government. Health and aged care costs are heavily subsidised in Australia. Most people's expenditure on these items does not increase significantly in real terms during retirement.[20]

Trustees should aim to assist their members to have some flexible access to savings with the intention that they are expected to be consumed in retirement. Trustees should not consider the provision of a bequest as a reason why their members may need some flexible access to savings in formulating their strategy. While bequests may be a consequence of the strategy for some members, it should not be an aim of the strategy for members in generality. Such an aim would be inconsistent with the primary purpose of retirement savings to facilitate consumption in retirement. This does not preclude individual members managing their affairs, with or without the assistance of the trustee, to leave a bequest through superannuation should they wish.

Trustees should balance their approach to assisting retirees to have some flexible access to savings during retirement with the other objectives in the strategy.

Balancing the objectives

Trustees should identify how they intend to balance the three objectives of the strategy when assisting their members.

How the objectives are balanced is at the discretion of the trustee. An appropriate balance will depend on the characteristics of the members for whom the strategy is constructed. The trustee is best placed to know these characteristics and develop a strategy that accommodates them.

When balancing the three objectives, trustees should identify how their proposed approach to assisting their members manage the risks to the sustainability and stability of their retirement

[19] As with longevity risk, above, this should not include consideration of bequest motives to non-dependent persons. Rather, trustees may choose to consider how the capital needs of those who are genuinely dependent on their members may impact their retirement income needs as part of their retirement income strategy.
[20] Retirement Income Review, p. 440.

income, and provide them with some flexible access to savings, would increase or decrease the retirement income of their members in generality.

Box 4: Examples of identifying the trade-offs between objectives

- A trustee proposes to assist their members to manage market risk by developing a retirement income product that uses a bucketing investment strategy. The trustee identifies that this product may increase the overall retirement income of their members who choose the investment strategy, depending on potential future investment returns, as it allows members to have greater exposure to growth assets while still having confidence they will not have to sell assets at a disadvantageous time.

- A trustee proposes to assist their members to manage longevity risk by developing a retirement income product that allows the member to apportion part of their balance to a group self-annuity. The trustee identifies that this product may increase or decrease the overall retirement income of members who purchase the product, depending on their longevity and draw down pattern:
  - For those who die earlier, members may have lower retirement incomes with the group-self annuity as they will have sacrificed some capital without benefitting from income payments.
  - For those who die later, members may have higher retirement incomes with the group-self annuity as they benefit from mortality credits and longevity protection they otherwise would not have had.

  The trustee considers this trade-off is reasonable given that it significantly reduces the risk that members who purchase the product will have insufficient income to meet their needs if they live to older ages. The trustee also considers that a secure income in later life may give members who purchase the product more confidence to spend earlier in retirement, which may increase their retirement income overall.

Assisting members to balance the retirement income objectives

The retirement income strategy should outline how the trustee intends to assist their members meet and balance the retirement income objectives of maximising retirement income, managing key risks and having some flexible access to savings during retirement.

Assisting members to balance the retirement income objectives could include, but is not limited to, actions such as:

- developing or offering retirement income products that provide more income to their members over their retirement, potentially through the pooling of longevity risk and the sharing of mortality credits
- developing specific drawdown patterns that provide higher incomes to members over retirement
- introducing default settings or 'nudges' that encourage their members to draw down faster on their retirement savings, where appropriate
- undertaking specific investment strategies
- providing members with guidance to help them understand their potential income in retirement, such as retirement income calculators or income projections

- providing members with guidance to support them to identify their income and capital needs over time, such as budgeting tools or expenditure calculators
- providing members with factual information about key retirement income topics, such as Age Pension or aged care eligibility, the concept of drawing down capital as a form of income, the different types of income streams available and their trade-offs, life expectancy projections and approaches to managing longevity risk.

The assistance provided by the trustee is at their discretion and should be informed by the particular needs of their membership. While some trustees may opt to develop their own retirement income solutions, trustees can consider whether directing members to any products or guidance materials offered by third-party providers or Government (such as the MoneySmart website) is appropriate for their members.

Any assistance provided by the trustee to give effect to their retirement income strategy needs to comply with the existing requirements under the *Superannuation Industry Supervision Act 1993*, the *Superannuation Industry Supervision Regulations 1994*, Design and Distribution Obligations and financial advice rules. Assistance must also meet the sole purpose test and be in members' best financial interests.

Reviewing the strategy

Reviewing fund performance under the retirement income strategy

Trustees should review their fund's performance against their retirement income strategy on at least an annual basis. Depending on the circumstances of the fund, trustees may review their performance against their strategy more frequently. This review of performance will involve an assessment of:

- how the trustee has progressed in implementing the proposed methods of assisting their members to meet the objectives outlined in the strategy;
- whether this assistance has been effective in meeting the objectives outlined in the strategy; and
- where assistance has not been effective, whether changes are required in order to meet the objectives outlined in the strategy.

This annual review of performance against the retirement income strategy will achieve a similar objective to the annual review of the investment strategy against its investment objectives currently required under the investment covenant and related Prudential Standards.

Reviewing the retirement income strategy

Trustees should regularly and comprehensively review the appropriateness, effectiveness and adequacy of their retirement income strategy including the assumptions underpinning it, every three years at a minimum. This aligns with the current requirement for trustees to comprehensively review the risk, insurance, conflicts and investment frameworks containing the existing covenant strategies every three years at minimum.

In reviewing their strategy, trustees should consider:

- whether assumptions made about the generality of their members are still appropriate, including assumptions around:
  - when and how their members retire

  - what sources of retirement income are considered
  - the Age Pension eligibility of their members
- whether the cohorts used under the strategy are still appropriate;
- whether the balance of the objectives under the strategy is still appropriate for the generality of members; and
- whether the assistance provided by the trustee to help members balance the objectives is still appropriate.

In line with the existing comprehensive review requirements for existing covenant strategies, the review of the retirement income strategy will be required to be undertaken by operationally independent, appropriately trained, and competent persons. Similarly, in considering the above factors, the scope of the review should have regard to the size, business mix and complexity of the fund's business, and in any changes in the fund's business or the external environment in which it operates.

Trustees should consider reviewing their strategy more frequently if:

- the characteristics of the fund change (e.g. a large influx of new members, a merger with another fund)
- new information about the fund's membership becomes available (e.g. the fund commissions a new survey of their membership)
- circumstances outside the fund significantly change (e.g. an economic shock, changes in government retirement policy).

Communicating conclusions of reviews to members

Trustees should communicate the broad conclusions of these reviews to their members. This could be achieved through annual statement letters or published in the fund's annual report. This will encourage trustees to create thorough and considered retirement income strategies and promote better member engagement with their superannuation.

Appendix 1: Summary of obligations and discretions of trustees

	Trustees must:	Trustees have discretion to:
1. Core obligation	Formulate, review regularly and give effect to a retirement income strategy for their members, assisting members to balance three key retirement income objectives: • maximising retirement income • managing risks to stability and sustainability of income • having some flexible access to savings in retirement	Consider and include other objectives they deem relevant to their membership and determine how they will assist their members.
2. Member coverage	Ensure all members of the fund in retirement, or approaching retirement, are covered by the strategy.	Formulate their strategy for either members in generality or cohorts of members. Trustees can determine the characteristics of these cohorts.
3. Sources of retirement income	Consider, at a minimum, members' interest in the fund, and Age Pension and tax implications when analysing retirement income.	Consider other potential sources of retirement income.
4. Maximising retirement income	Consider how they intend to assist their members to maximise their retirement income as a cumulative concept across the whole of retirement.	Determine what types of assistance, if any, is needed to help members maximise their retirement income, based on the information they have on their members.
5. Managing risk	Consider how to assist their members to manage risks to the stability and sustainability of their retirement income. This involves consideration of: • longevity risk • investment risks	Determine what types of assistance, if any, is needed to help members manage these, and any other risks they consider relevant to their members.
6. Flexible access to savings	Consider how they will assist their members have some flexible access to savings during retirement.	Determine what types of assistance, if any, is needed to help members have some flexible access to savings, based on the information they have on their members.
7. Balancing strategy objectives	Consider how to balance the objectives of the strategy requirement when assisting their members, including how their approach to assisting retirees to achieve and balance the strategy's objectives may increase or decrease their members' retirement income (in generality).	Balance the mandated objectives of the strategy and consider other objectives as they see fit.
8. Reviewing the strategy	Review fund performance against the strategy annually, review their strategy every three years, and communicate the outcomes of the review to their members	Review their strategy more frequently.