Submission

Retirement, Advice, and Investment Division

Retirement Income Covenant

Submission from Aware Super

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Submission to Treasury

About Aware Super

Aware Super has been the fund for people who value the community since 1992. We're one of Australia's largest funds and we're continuing to grow.

We merged with VicSuper and WA Super in 2020 and manage approximately $150 billion in savings, including $32.6 billion in retirement assets at 30 June 2021. Our members—including teachers, nurses, public servants and emergency services officers—work in roles that support our community, and they expect us to do the same by investing in ways that do well for them, and good for all.

1. Aware Super's submission – overview

There is strong alignment between Aware Super's strategic approach to retirement income solutions, and key aspects of the Retirement Income Covenant (the Covenant).

We welcome the proposal to introduce this Covenant in the SIS Act, as it acknowledges the true purpose of superannuation, recognises the importance of retirement income strategy, and represents an important step forward for the industry as it matures and seeks to better meet the needs of retired members. We support the passage of this initiative, earlier rather than later, so APRA can release draft guidelines in early 2022 to give funds sufficient time to absorb and incorporate these in development of their retirement strategies.

Aware Super endorses the principles-based approach Treasury is proposing for the Covenant, and believes the combination of obligations, discretion and flexibility will assist trustees in designing solutions to suit their specific member demographics.

We are supportive of the three objectives proposed in the Position paper to:

- maximise the member's retirement income (taking into account the Age Pension and any other relevant income support payments),
- manage risks to the sustainability and stability of their income, and
- have some flexible access to savings during retirement.

These appropriately reflect the challenges members face, and reinforce that funds should help members to optimise income and balance risks in retirement. We suggest Treasury provides greater clarity by directly referencing, in the description of each objective, the importance of balancing each against the others, so adequate consideration is given to members' circumstances and retirement goals.

Our main concerns with the Position paper relate to making sure members can access relevant personalised information, guidance and advice – easily, safely, and inexpensively. This is important so funds can support members of all demographics with education about super and retirement, lifting financial literacy and helping members to feel confident about their retirement. We also note that, in future, supportive changes in advice regulations could meaningfully improve members' outcomes as funds implement retirement strategies.

Overall, Aware Super's responses to the Position paper are positive:

- We endorse the overall approach to the Covenant, acknowledging that trustees can use discretion in developing retirement solutions to meet members' needs in line with the objectives,
- Endorse the notion that trustees will be able to offer multiple solutions/ approaches, given one size fits no one in retirement,
- Endorse the recognised importance of the role funds can play in helping members to engage with their super, understand their choices, meet their retirement needs, and have peace of mind about their futures (sometimes by confirming what members have already planned for themselves),
- Highlight the need for more sophisticated income projections to help inform members through personalised information, and combat the 'nest egg' mentality identified in the Position paper:
  - improved guidelines from ASIC would support funds in this process, and help them to communicate risk and uncertainty, so that members can value and demand products that appropriately manage the risks to the sustainability and stability of their income, and understand any trade-offs,
- Ensure that any performance and outcomes measures reflect **all three objectives** in conjunction,
- Consider the role and importance of Government supported member data (eg HILDA, ATO or Centrelink) to facilitate the research, development and application of member cohorts and solutions, and to assist funds in broadening their member data,
- Suggest that, as Treasury scopes and conducts the Quality of Advice Review in future, it considers the objectives of the Covenant and the practicalities for funds implementing retirement strategies. Significant reforms are required to enable funds to appropriately support their members with affordable and accessible guidance as they navigate retirement. Specifically, we suggest that the Review considers:
  - the role guidance and personalised information can play to empower members to make informed decisions, and nudge them to consider solutions that may better service their needs in retirement; and simplifying product and advice processes as they transition from accumulation to pension phase,
  - re-visiting the "Safe Harbour" concept (from prior CIPR consultations) to support trustees in being able to offer their members relevant and personalised information, guidance and mass customised solutions,
  - providing additional guidance on the concept of intrafund advice with a view to it having broader application to address the issues of access to good quality affordable advice for the general population (and ensuring this is regarded as being in members' best financial interests),

- the need to simplify members' experience as they engage various forms of guidance and advice – for example as they explore digital information and tools, moving to general advice (for validation), to intrafund advice (where advice is required) and on to full personal advice (where the bounds of intrafund are exceeded), and
- re-position advice to be accessible and focused on helping consumers (with appropriate consumer protections in place), rather than an expensive legalistic process.

We acknowledge these advice issues are not likely to be addressed prior to commencement of the Covenant. Given their importance in helping members make appropriate decisions, it would be useful to provide more near-term clarity in advice definitions and processes, particularly for intrafund advice. This would improve consistency of experience for members, provide a more level playing field on definitions of intrafund advice, and give trustees more confidence to progress implementation of their retirement strategies. We note there is potential for the imminent introduction of anti-hawking measures, DDO provisions and recent High Court decisions on definitions of general and personal advice, to add to current uncertainties and increase the (real or perceived) risks for trustees in supporting their members through retirement in the manner called for in the Position paper.

2. Trustee obligations, discretion, and Covenant objectives

We endorse the proposed approach which will give trustees discretion to design suitable solutions for their member demographics, and acknowledge the thinking that Treasury has put into the development of the Covenant.

Covenant objectives

We support the three objectives proposed in the Position paper and believe these appropriately reflect the trade-offs members face and agree that funds should be supporting their members to balance these objectives for their circumstances and retirement goals:

- maximise the member's retirement income *(taking into account members' needs, the Age Pension and any other relevant income support payments)*,
- manage risks to the sustainability and stability of their income, and
- have some flexible access to savings during retirement.

In the first objective, the proposed term 'maximise' is broadly appropriate, given the second objective to manage associated risks, and the Position paper's stated context: *"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."*

Full context is necessary to nuance the understanding and application of the proposed objective. Without the context provided in the Position paper, the term 'maximise' could serve to perpetuate the prevailing tendency to focus on returns and fees at the expense of managing the complexities and risks inherent to the retirement phase. Given the real risk that this nuance and complexity could get lost in translation over time, Aware Super suggests Treasury increases the clarity of the objectives, by directly referencing—in the descriptions—the need to balance each one against the others with respect to members' circumstances and retirement goals.

Absolute concepts such as "maximise" are challenging, and contradictory to the need to balance objectives. Perhaps in drafting an alternative could be to "efficiently meet members' retirement income needs to fit their circumstances". For this reason, we also prefer the term "balance" to alternative terms such as "optimise".

Aware Super also suggests the Government clarifies the first objective further, with supporting guidance from APRA, that it relates to the provision of *real* income in retirement (that is, in today's dollars). Inflation plays a central role in retirement outcomes, which ultimately aim to provide retirees with the purchasing power to meet their needs/desired lifestyle. Clarity as to *real* income in associated guidance would:

- encourage funds to consider the impact of inflation on retirement income over time, without implying the need to deliver constant real income, or indeed actively manage inflation (the appropriateness of which can be determined by trustees as part of a broader consideration of investment risks),
- enable Government to take a nuanced approach to inflation in the context of its interaction with the real retirement income trustees are targeting on behalf of members (and what this implies for the appropriate shape of income through retirement). We acknowledge the Retirement Income Review's findings that spending in retirement typically declines over time in real terms, noting this may apply in generality across the system, but not necessarily to *all* member cohorts,
- ensure emerging risks are appropriately considered as inflationary forces evolve over time (for example, with the emergence of externally driven cost push inflation), and the likelihood these risks will evolve given the decades associated with retirement,
- ensure consistency with the CPI+ investment objectives targeted by most funds for their diversified investment options, (noting the Age Pension is also indexed), and
- reinforce ASIC guidance that trustees should undertake projections in real terms, ensuring a level playing field in the communication of retirement income targets to members, necessarily framed in forward looking terms.

Measurements of performance

In light of recent comments from APRA and references in the Position paper to assessing a fund's retirement income strategy, we highlight the need for the Government to consider that what is measured/monitored invariably gets managed. With this in mind, the success of the Covenant in meeting the Government's objectives, will depend in part on the specifics of any assessments applied to the pension phase.

We caution against any rollout to retirement solutions of a Your Future, Your Super style performance assessment and comparison approach and/or APRA's existing heatmap. These approaches are underpinned by a focus on net investment returns and fees, which minimise or ignore the role for risk management and the broader needs of retirees.

Our member research and advice experience suggest many retirees prefer stability and reduced exposure to downside impacts from volatile markets. We note that the costs of downside protection and comparatively lower returns associated with lower risk asset allocation mean that any comparison of returns should be on an "apples for apples" basis and reflect the objectives set out in the Covenant. We suggest the "largest peak-to-trough loss over a given period" is a relatively accessible risk metric for member understanding. This approach would align with the need to manage sequencing risk for retirees.

As noted in our submission on Your Future, Your Super regulations, we consider the pre-retirement phase is a critical and distinct period for members. Members' needs and risk strategies through this phase differ from those of younger accumulators. Members often engage more with the superannuation system as they near retirement and most plan for their retirement *before* they enter the pension phase. It is critical that this pre-retirement cohort of members is actively considered in any Retirement Strategy. We welcome the recognition of this by the Position paper; current policy settings are not sufficiently nuanced to allow funds to appropriately support pre-retirees as they transition into retirement.

Once again, we note that a Your Super, Your Future style product comparison for pre-retirees is problematic because of its sole focus on returns and fees, which does not recognise the need to balance returns with appropriate risk management for this cohort, or the need to help transition retirees into an appropriate strategy for their retirement.

Simplifying transitions from accumulation to retirement

Aware Super has recently enhanced its MySuper Lifecycle approach, including transitioning members more gradually over the last decade of their work, into an appropriate risk/return asset allocation for their typical risk preferences and investment needs. This process helps members stay the course and plan for their retirement with confidence, while also avoiding the need for a major asset allocation adjustment as they move into retirement. Our next challenges are to simplify the steps for members to transition from accumulation phase to drawdown phase and develop more fit for purpose retirement solutions to meet the needs of our member cohorts in retirement. We expect this will include a mix of product, guidance and advice in formats which are easily accessible and understandable by the member to help them make informed decisions.

While the Position paper notes the need for guidance and advice, one of the gaps we see in the paper is the need for explicit regulatory simplification so funds can deliver on the required "plan to build the fund's capacity and capability to service those needs". Our view is that further legislative assistance is required:

- to recognise the pre-retiree cohort, noted above, as needing separate treatment from younger accumulation members, and
- to expand and clarify the bounds of intrafund advice and enable, with appropriate consumer protections, the provision of relevant personalised information, nudges and guidance.

This is to ensure that all super funds can really help members with the consumption of their superannuation and other savings in retirement, striking an appropriate balance between the three Covenant objectives for their circumstances, preferences and retirement goals. It is important for all pre-retirees and retirees, regardless of their account balance size, to be able to talk through their financial challenges and goals, so they can feel confident and secure as they leave paid work. The product solutions become a by-product of those considerations.

We are interested in working with Treasury on how we can progress these ideas.

Need for and Importance of improved member data

Aware Super is well progressed in developing cohorts of its members, based on their needs, in the lead up to and through retirement, and is currently industrialising this approach by applying it to the member level. In doing this, we have encountered some challenges that highlight the difficulties funds might face when implementing their retirement strategy, especially where they take generalised cohorts and associated retirement solutions, and look to apply these to specific individuals. Further difficulties may arise as funds assess whether take up has been appropriate from a DDO/target market perspective, given individual preferences inherent in member choice.

Funds will need to broaden the member data they collect and store. Access to appropriate MyGov, ATO and Centrelink data with members' permission could present an efficient means for sourcing relevant data, reducing both frictions for members and the cost of fact finds in advice settings. The data should be accessible for appropriate purposes in a safe and seamless way, allow for the purpose of industrialising cohorts, and then implementing strategies and solutions at the member level. For example, data could feed into digital tools, support call centre staff to ensure delivery of relevant information, and be used by advisers in the provision of advice. Current regulations create barriers to this process and subject members to onerous fact finds and the production of 50-80 page Statements of Advice that make it impractical to provide members with access to relevant, tailored and timely information.

The complex nature of retirement means the industry's understanding of retirement as a whole remains in its infancy. Improved access to higher quality data sources for research purposes would serve to accelerate this understanding and assist funds as they seek to cohort members and develop fit for purpose retirement solutions.

We suggest the Government expands the HILDA survey to capture participants over age 65 and combine this data (at the member level) with relevant data from the ATO and Centrelink to collate an appropriately de-identified database for research purposes and to inform the ongoing development of retirement policy.

3. Multiple solutions, guidance and advice

We endorse the flexibility for trustees to offer multiple solutions / approaches to suit members' widely varying information needs, financial circumstances and personal issues. We expect that coordinated approaches will emerge which incorporate some or all of the products, services, tools and actions listed in the Position paper (page 14). The emergence of product innovation, combined with the likelihood of members' needs changing over time will increase the importance of, and need for, support and guidance as identified in the Position paper.

We expect that members' needs could change as the system matures over the next two decades, as individuals retire with higher balances. This is why it will be important for members to have access to a qualified, listening ear in a super fund to test ideas and make their decisions.

Importance of income projections and more appropriate calculators

Research has shown that income projections are an effective means for combating the "nest egg" mentality highlighted in the Position paper, and of promoting engagement with superannuation. The Position paper lists income projections as a means to assist members to balance their retirement income objectives.

Most calculators, including Moneysmart, only provide deterministic projections of the expected outcomes without considering the potential range of outcomes members may experience. Without accounting for the "risk to the sustainability and stability of their retirement income", these tools are not sufficient to help members understand the trade-offs they are facing, and consequently increase the risk of members making inappropriate decisions.

Where funds are able to appropriately communicate risks and uncertainties to members, it will help members value elements of solution design that seek to address the Covenant objectives. Calculators should help members understand the potential range of outcomes under various market conditions and other uncertainties (through stochastic modelling or scenario analysis).

Improved guidelines on calculators from ASIC would be helpful. In light of the proposed Covenant objectives, we suggest revised guidelines would raise the bar by requiring calculators, which are intended to guide members in choosing their retirement income strategy, to incorporate key risks, in addition to the expected "standard" retirement income projection.

Income projections provided on statements and many retirement income calculators rely on the ASIC RG 229 and Class Order [CO 05/1122] which are very limited, with:

- onerous disclosures—could be simplified / streamlined to help members understand,
- unduly constrained assumptions that may not reflect a member's investments, and
- outcomes that cannot be aligned to other projections where funds provide access to more sophisticated calculators, based on a member's product objectives, risk and return profile, and fees.

The Class Order needs review to make sure statement projections are member friendly, reflect a members' actual investment strategy and avoid member confusion by enabling consistent messaging across various communications, tools and channels.

Guidance, digital solutions and intrafund advice

We seek further clarity on how guidance is likely to work especially in the current advice framework, especially as guidance looks like a logical and necessary approach to support members who do not take financial advice.

As we noted in our submission to ASIC, current advice regulations hamper the provision of affordable advice, and guidance will encounter the same issues. In particular, the intersection of guidance, digital tools and intrafund advice rules will challenge both regulators and funds. We suggest a series of industry and regulator technical working groups to resolve these issues.

Expand the reach of intrafund advice

Super funds are increasingly focused on supporting members' decision making. The Covenant reinforces the trustee's purpose in this regard, with a focus on retirement outcomes. We argue that intrafund advice is an integral part of this process. The provision of cost effective and affordable advice is critical to ensuring more members have access to adequate support in the lead up to, and through, retirement. An expanded form of intrafund advice is likely to adequately service the needs of most members, noting that the Retirement Income Review found the needs of most members are relatively straight forward. Guidance and advice offered in the context of the Covenant should be regarded as being in members' best financial interests.

There will always be a segment of members who will seek more comprehensive advice for reasons of complexity, more challenging financial or personal needs, or because they simply prefer to deal face to face.

4. Mass customisation and a "Safe Harbour" for guidance

We support the Position paper's proposal that trustees should be able to offer what are effectively mass customised solutions with guidance to help members select a suitable retirement solution.

Multiple studies have shown that most members will not seek advice, or pay the true cost to serve for full personal advice, despite the clear need for assistance through our complex retirement system. The recent exodus of advisers from the industry will only serve to further limit the number of members receiving advice in future.

These factors point to the important role guidance and personalised information can play in empowering members to make informed decisions, and in nudging them to consider solutions that may better service their needs in retirement. Guidance and soft defaults are likely to prove important for later phases of retirement where ongoing active decision making may be less desirable. This may occur, for example, following the death of a spouse who was relatively more engaged in a couple's financial affairs, or in instances of cognitive decline.

We also note that this approach is potentially challenging in light of current regulatory controls around advice. We noted the following in our January 2021 submission to ASIC on Affordable Advice:

> As found by the Royal Commission and previous reviews, financial products are frequently complex, and because advice is usually required to assist the consumer, the asymmetry of information means the consumer is vulnerable to mis-selling or exploitation. While we are very alert to this conundrum, leaving consumers to "self-help" in a complex financial maze is not a solution of its own.
>
> The Retirement Income Review noted that super funds are well placed to help meet the need with relevant low cost advice. The challenge is in being able to do this at low cost to the member, while ensuring a better outcome than if the member had not sought advice. Currently, delivering advice to fund members is operationally complex impacting both affordability, scalability and accessibility.

We envisage a number of guided pathways or scenarios which members could relate to and use as exemplars, supported by personalised information, digital tools and calculators (for example for income projections, expenditure / budgeting and drawdown / retirement income expectations), and by advice where appropriate. We see these as important first steps for many members as they explore and understand their financial position in retirement. These explorations, if conducted in a secure login area, could also form part of the fact find required for advice and should be made available across channels to ensure a consistent, coherent and seamless member experience.

In addition to these comments, we strongly suggest that Treasury re-consider the concept of a "safe harbour" for trustees in providing guidance to members. These could be built around a limited set of key characteristics including a member's retirement goals as well as key criteria used in identifying member cohorts, such as those listed in the Position paper (page 9).

There are risks that members will not provide full financial and personal information, or disguise information. For example, we could see a situation arise where a member's health or their spouse's health could have a significant impact on their financial decision making. If the member was not able to, or chose not to disclose this or allow for this in their thinking about retirement, a fund's guidance or digital advice may result in a sub-optimal outcome. Trustees need to be able to rely on reasonable protections for providing guidance and personalised information to member cohorts, allowing for the possibility of gaps or member omissions as highlighted here.

5. Conclusion

As demonstrated, Aware Super is supportive of the principles based approach outlined in the Position paper and the flexibility it provides for trustees to meet the needs of differing member cohorts. Our summary points are:

- We endorse the approach to the Covenant, and trustees' discretion in developing retirement solutions and guiding members to meet the stated objectives,
- We endorse the notion that trustees will be able to offer multiple solutions/ approaches,
- Consider re-visiting the "safe harbour" concept to assist funds in offering mass customised solutions and guidance,
- Highlight the need for improved ASIC guidelines and requirements for calculators and income projections,
- Expand intrafund advice to include the member's spouse / partner and include social security entitlements,
- Provide support for sharing research data (eg from HILDA, ATO and Centrelink), and
- Provide clarity in advice definitions and processes to help members through various stages of guidance and advice.

We welcome the opportunity to discuss our submission with you in more detail.

Appendix 1: Notes on the summary of obligations and discretions of trustees

Our comments on Treasury's table are marked in blue.

	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. Ensure that the three objectives are maintained in balance, so that investment return does not become the dominant metric. Clarify through guidance the need to measure retirement income in real terms.
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. While the use of broad demographic data to determine Age Pension eligibility etc… is sufficient, trustees should aim to transition to use actual data on their membership where available to improve the accuracy of their estimations. If population wide data capture is envisaged, relaxation of selected privacy requirements may be needed. Data capture and storage about income, health, property & other asset ownership could be required.
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 (market risks, inflation and sequencing risks) In considering the role and potential impact of these risks, their interaction with the desired	Determine what types of assistance, if any, is needed to help members manage these, and any other risks they consider relevant to their members. Health profiles and risks contribute to a person's longevity and can influence product choices. The potential for cognitive decline and individual preferences regarding advice

	Trustees must:	Trustees have discretion to:
	income profile *throughout* retirement should be taken into account.	should also be considered, ensuring soft default settings are available where active decision making is not desired/desirable.
6. Flexible access to savings	Consider how they will assist their members have some flexible access to savings during retirement. (Reversionary benefits for dependants can be considered but bequests can't systematically be planned for – though individuals can reflect this choice.)	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. Any personal choices to take high regret risk products should be guided by member's needs for flexibility and health prospects.
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. This is where guidance / guided pathways will be most effective in helping member to envisage their retirement lifestyle, income and expenditure.
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 (progress, effectiveness and need for change)	Review their strategy more frequently.