TO:

Director
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

superannuation@treasury.gov.au

FROM:

Bruce Gregor FIAA AIA
Financial Demographics
4 Towradgi Street
Narraweena NSW 2099
bruce@ozdemographics.com.au

Submission relating to Retirement Income Covenant Position Paper dated 19 July 2021

The goal of encouraging more efficient use of superannuation assets through retired years of participants is a worthy one.

However, there are major elements of this paper that will present difficulties for trustees in implementing them and opportunities for fees to increase substantially within funds to address what is specified which will not necessarily benefit many individual members.

The "covenants" as drafted do not relate to implementing financial products/choices offered by the fund. (This is surprising to me as that is what the investment and insurance covenants are directed to). Instead, they relate to "strategies" to address all needs of members as one universe or a cohort. Since fund members might have anything between 1% and 99% of their financial assets within the trustee's particular superannuation fund, a prudent Trustee could only fully address this by having a full service financial advisory workforce gathering information on all their assets, health and circumstances and offering this individual advice to every member. The annual fees for this would likely exceed current admin fees for funds. I see nothing in the paper which would preclude a trustee acting in this way in response to the proposed covenants.

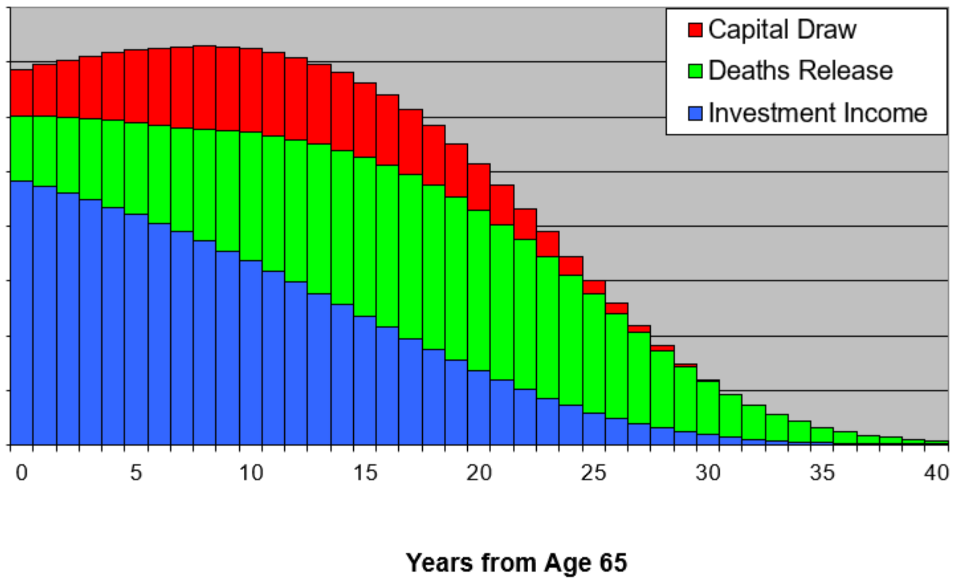
On page 7 I note "The formulation of a retirement income strategy is not considered to be financial advice". I doubt the legal ability of such a covenant to prevent this conclusion by a court. I find it hard to believe that this makes sense anyway if the purpose is for individual members to make more effective decisions on their financial assets.

On page 5 under Appropriate Guidance, I note some significant issues are outstanding on Quality of Advice review and ASIC and will not being addressed until 2022. It seems putting the cart before the horse to consider what is in the Retirement Covenant paper now until these issues have been resolved.

This leads me to wonder what the problem is that the government is trying to solve right now. I note at the top of page 4 the concern about superannuation assets being left in bequests rather than spent in retirement. I find the studies these comments are based on are not very reliable and suffer from not studying a full cohort of members with current balances and total personal assets through retirement until all have died – this is not yet possible of course but could be simulated given adequate data.

Curiously the one product that does avoid leaving super as a bequest, a lifetime pension, is excluded from the covenant requirements (see page 6 under Defined Benefit schemes). Nevertheless, this ideal product is instructive to examine, if the bequest issue and delayed drawdown rate is the major concern of government.

The following diagram illustrates the origin of lifetime CPI indexed pension fund cash outflows in providing for a cohort of retired pensioners. These are calculations I have made using 5% investment return, 3% inflation and Australian Life Tables mortality. The vertical scale represents annual payments from the fund as a proportion of the initial assets for the cohort.



What you will notice from this is that despite the fund paying the indexed pensions from time zero, they imply the actual cohort fund size keeps growing in early years because the force of mortality is low in early years leading to reinvestment of investment income and providing for future inflation.

This partly explains why (intuitively) members (using drawdown investments and not life annuities or pensions) might be reluctant to drawn down in early years given future uncertainty of longevity and inflation.

The other point to note is the green "Deaths Release" component which is the recirculation of reserves from dying pensioners. This is the assets which would otherwise be left as bequests for retirees who attempted to emulate the same pension income from normal investments.

My conclusion from the above comments is that, if there is to be a retirement income covenant introduced, it should be like the following:

1. A retirement income covenant would apply to any funds offering "Retirement Income Products" which would be defined as follows:
   "A choice of investment offered to members who satisfy conditions of release, which has a primary objective of paying a stated annual payment to the member which does **not** have a lifetime guaranteed payment **nor** guaranteed inflation indexing."
2. Trustees should consider the extent to which reserves or longevity insurance should be established for a cohort of members choosing Retirement Income Products and implement and regularly review the effectiveness of such reserves and insurance for meeting expectations of future payments. In all other respects the pool of assets supporting Retirement Income Products (whether for all such members or a cohort) should be governed by the investment and insurance covenants.
3. Trustees should provide reasonable expectations (initially and annually) of the future period of payment which might be expected before the members initial assets (and any reserves) are exhausted by continued payments (a) at the fixed initial/current level, and (b) at two assumed future inflation increase rates (e.g. RBA inflation band 2 to 3%).
4. The term "pension" should be proscribed to **not be used** within any superannuation fund communications and legislation unless it refers to a lifetime annual payment supported by a defined benefit fund or a fully reinsured lifetime annuity contact (i.e. like the age pension characteristics).

Whilst I have not attempted to draft covenants along the above lines, I would encourage any development of covenants for Retirement Income Products to be simple principles based like the approach to drafting the investment and insurance covenants.

The ambit of covenants discussed in the Proposal paper is far too broad and includes things that should be left to regulations and policy documents of each fund.

Yours sincerely

Bruce Gregor