Deloitte.

Deloitte Touche Tohmatsu
ABN 74 490 121 060

477 Collins Street
Melbourne VIC 3000
GPO Box 78
Melbourne VIC 3001 Australia

Tel: +61 3 9671 7000
Fax: +61 3 9671 7001
www.deloitte.com.au

6 August 2021

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

By email: superannuation@treasury.gov.au

Response to Treasury on Position Paper

Retirement Income Covenant

We refer to the Position Paper released by Treasury on 19 July. The Paper is well written, and the subject matter is highly relevant given that the number of Australians entering retirement is growing rapidly and is expected to continue to grow, both in terms of the assets held in retirement and the number of members accessing an income stream in retirement. It also crystallizes a decade of thought around this topic.

Background

Government and industry have debated the rules around retirement products since **Australia's Future Tax System** (the 'Henry' Review of 2010) pointed out a key structural weakness of the retirement income system was the "*failure to provide products that would allow a retiree to manage longevity risk".*

Later, the **Financial System Inquiry** (FSI) recommendations set out in its final report in November 2014 included a suggested objective for the superannuation system as well as introducing the concept of Comprehensive Income Products in Retirement ('CIPRs'). The FSI also recommended that "*Government should require superannuation fund trustees to pre-select an option for members to receive their superannuation benefits in retirement… The pre-selected option should… include a regular and stable income stream, longevity risk management and flexibility*[1]*."*

[1] Financial System Inquiry Final Report, page 117.

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms and their affiliated entities are legally separate and independent entities. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Asia Pacific Limited and the Deloitte Network.
PUBLIC

Further work was performed as part of the Retirement Income Review which delivered its final report last year. It concluded that the objective for the system should be developed around the goal *"to deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way."*

We consider that the Position Paper has set out a structure which has built on the past inquiries and industry feedback. Overall, we consider the strategies outlined will significantly improve the retirement income system over time. We are pleased that the Paper is built on broad principles rather than setting out prescriptive rules such as those which were previously announced in relation to CIPRs.

We also expect the Paper to assist superannuation funds to develop more tailored strategies and products for their members. However, we anticipate that the recommended structure for developing retirement income strategies will cause problems both in timing and implementation.

In this letter, we make suggestions to alleviate these issues. We highlight these key areas needing attention:

- Expanding the role of trustees.
- Collecting relevant member data to better assess their personal circumstances.
- Complications with current laws on delivering financial guidance and advice, including the use of technology to enhance member communications and their understanding of retirement matters.
- Defining member cohorts.
- Developing a timeline to ensure smooth implementation of the Retirement Income Covenant.

Role of trustees

For the first time, trustees of all superannuation funds will be required to develop a retirement income strategy for their members. We commend this development as we believe funds are the logical entities to guide people into understanding the complexities of the financial aspects of retirement, provide suitable products to meet their needs, and to assist members in how best to use these products to efficiently access an optimal retirement outcome.

When trustees set an investment strategy for accumulation members, the target is largely homogenous – members aged 20 through to 60 all want solid long-term investment returns. This supports funds offering a MySuper default investment strategy[2] that is designed to be suitable for the majority of members.

The product offer and the investment strategy need to change for retirement. Given the heterogeneous personal circumstances of a fund's retirement members, it is not possible to set a single investment strategy to cover the full range of circumstances. Hence, it will usually be necessary to group retirees into cohorts to ensure each strategy can be properly tailored to groups of broadly similar individuals.

This means that trustees need to assess members and provide guidance/advice on the available options before they can be allocated into products. This is a new role for trustees who currently rely on members to make their own retirement decisions, sometimes supported by formal financial advice. The adviser is usually at arm's length though some funds have related-party licensees which offer this service.

The principles set out in the Position Paper will require trustees themselves to know much more about their members. Much of this is private information, difficult to access and can only be obtained with member consent as we discuss later. Effectively, trustees will need to assume the role of a trusted adviser to members and to monitor their circumstances to ensure continued relevance of any product they are using.

In this expanded role, trustees will need to analyse their membership, determine appropriate product strategies, and then guide members into them. They will also need to monitor the progress of each strategy and its impact on retirees over time.

---

[2] We note that some funds already have lifecycle-based cohorts.

PUBLIC

In summary:

- Trustees are no longer expected to provide a CIPR (but they need to consider longevity in their benefit design).
- Trustees must prepare a strategic document that:
  - identifies and recognises the retirement income needs of the members of the fund (including existing retirees); and
  - presents a plan to build the fund's capacity and capability to service those needs.
- Trustees need to consider the different needs of different cohorts of members.
- Trustees need to consider when members might retire and what access to the Age Pension they might receive and what other financial assets they may hold.

To fulfil these new obligations, funds will need to hold up to date information on their members. For example, changes in member circumstances in retirement - are they part-time workers; have they shifted from receiving a full Age Pension to a part-Age Pension, has marital status changed?

Funds will also need significant extra data to assign members correctly to its various cohort strategies. Currently, funds do not hold this data. At a minimum, they will be required to know:

- The member's marital status and the age of the partner.
- The quantum and asset allocation of assets held by a member and their partner outside the fund – both in and outside superannuation.
- Whether the member owns a home or rents.

Funds will struggle to capture information on existing retirees, many of whom will have already set their own path for retirement.

This expanded role will require significant investment by funds. This raises the issue of who should pay for this investment. Will it be added to the fees on pension products (including for those who have already retired) or will members using the service (such as those approaching retirement) also contribute?

It also opens funds up to services which are close to comprehensive financial advice, which they have not been able to deliver on a cost-effective basis in the past.

Finally, we note that the Covenant will also apply to trustees of Self-managed Super Funds (SMSFs) and small Australian Prudential Regulation Authority (APRA) funds. We question whether this is sensible. The high average balances of members in these funds suggest they have the financial capacity to obtain their own advice around retirement strategies. Further, they are too small to participate in any pooling. We would exclude these groups, noting that individual members can always join an APRA-regulated fund at retirement if they desire the benefits of the Covenant.

If one of the goals of the Retirement Income Covenant is to encourage members to spend more of their superannuation rather than leave high bequests, it would make sense to change the minimum withdrawals (pension payments) from superannuation funds, small and large. The minimum factor could be raised by 1% to 6% of the member's account balance from ages 65 to 74.

Collecting relevant member data

Superannuation funds know very little about most of their members because the information is not needed for the administration and investment of accumulation accounts. Most young members and many older ones are unengaged and not likely to provide much data on a voluntary basis.

The paucity of data already has some adverse consequences. Funds which provide retirement income projections for members must comply with the Australian Securities and Investments Commission (ASIC) guidelines to ensure these are not seen as providing financial advice.

PUBLIC

The prescriptive rules mean that the calculations have several limitations:

- They use current life expectancy without allowing for future improvements;
- They ignore the Age Pension (which is received either wholly or in part by about 75% of retirees);
- They ignore assets held outside of the superannuation fund providing the calculations, including non-superannuation assets and superannuation assets held in other funds; and
- They are based on the member planning for retirement as an individual, even though about 70% of people have a partner at the time they retire.

Consequently, the majority of the retirement income projections provide incorrect results, though some funds do allow interested members to enter their own personal financial details in an online calculator to improve their accuracy.

A critical question is how much data could funds collect automatically to improve the quality of their guidance to members. Unless funds are able to allocate their members to specific cohorts, they will be unable to provide guidance that is any better or more relevant than the current, generic retirement information available on public web sites. The requirement to provide guidance will, therefore, be of limited value unless it can be supported with better and more relevant member data.

During accumulation

The path to retirement begins many years before a member retires. If funds are to provide better retirement income projections on member statements, including access to Age Pension entitlements, they will need to know the following additional information about their members:

- At what age do you intend to retire? (If a member is unsure, this can be defaulted to age 67, the Age Pension eligibility age).
- Do you have any other superannuation accounts? If so, advise the current account balance.
- Are you entitled to a defined benefit pension? If so, provide details.
- Do you have a partner? If so, provide their age, likely retirement age, current superannuation balance (across all funds).
- Are you a homeowner?
- What assets do you and your partner have outside superannuation (to the nearest $100,000)?
- Do you have, or are likely to have, any significant debt at retirement?

This information will allow funds to provide a good estimate of the Age Pension entitlement of the member, if they qualify for this benefit. We note that the majority of SMSFs comprise of married couples. Consequently, these funds do hold much of the necessary information – and the trustees, being members, can easily complete any gaps. Conversely, most couples using APRA-regulated funds are not in the same fund. One previous suggestion has been to allow joint accounts for married couples as one means of simplifying the system[3].

Subject to privacy laws and a change in legislation, some of this additional information could be provided to members via the Australian Taxation Office (ATO) a few months before annual benefit statements are prepared. For example, the ATO knows marital status from personal tax returns, and it will have details of the balances in any other fund held by the member (and their partner).

If data can be provided via the ATO, members would just need to advise of home ownership status and other assets outside superannuation.

This information needs to be updated annually as the personal circumstances of members can frequently change.

[3] https://www.ricewarner.com/joint-superannuation-accounts/

Not every member will provide all this information or will update it every year, but without the funds having the ability to seek, collect and store this information, they will have little ability to provide suitable guidance.

Approaching retirement

Funds will first need to engage with their members and establish when they intend to retire. They will also need to begin detailed discussions with members at least a year before the planned retirement date to give them full information about their cohorts and to begin the process of guiding them to select a suitable strategy.

In addition to the information required for enhanced benefit statements, they will need to know whether the member intends to take money out as a lump sum at retirement, perhaps to pay off debts (such as mortgages), or upgrade the home or family car. Members can avoid the sequencing risk of taking large amounts out at a point in time by shifting money into cash in the year(s) leading up to retirement.

At present, while the fund could gather this information, providing guidance using this information is deemed to be comprehensive financial advice.

If the Covenant is to lead to better retirement outcomes for all members, funds will need the ability to provide the guidance envisaged without all of the current requirements for comprehensive financial advice. An enhancement/extension of the intra-fund advice regime will be a minimum requirement.

In retirement

The Position Paper states that trustees will be required to review their fund's retirement income strategies at least annually. This will require an attribution analysis of the fund's experience to evaluate it against expected results. This should be viewed as an extension of the current requirement for superannuation trustees to undertake a Business Performance Review[4] by 31 December year and a member outcomes assessment by 28 February following that.

Further, trustees should **regularly and comprehensively review the appropriateness, effectiveness and adequacy** of the strategy. This requires a triennial analysis to test the ongoing suitability of the strategy for each cohort and the experience of retirees.

While funds should be able to conduct these reviews with the information they hold, they will struggle to monitor individual retirees. Yet, they will be required to monitor the situation of their retired members and review those who are outliers – spending their balance too quickly or too slowly. This will require funds to develop new services.

In presentations to large superannuation funds, we have raised the concept of a **Retirement Counselling** service to assist retirees and those approaching retirement with setting annual budgets and monitoring their finances. This would be supplemented with a facility to assist when there is a major event which will change the member's circumstances.

Funds will need to set up a facility to provide event-based advice where a member's circumstances have changed. The facility could be outsourced if the fund does not have the competence or capacity to undertake these services.

[4] Prudential Standard SPS 515 Strategic Planning and Member Outcomes (SPS 515) sets out APRA's requirements for an RSE licensee to annually assess its performance in achieving its strategic objectives, incorporating monitoring of its business plan, the outcomes delivered to different cohorts of members and the annual outcomes assessment under section 52 of the Superannuation Industry (Supervision) Act 1993.

This would take place on any of the following events:

- Death of a partner or divorce.
- Marriage or new partner.
- Declining cognition – perhaps moving the benefit into an annuity and/or obtaining a Power of Attorney.
- Retiree requires advice about Aged Care options and costs.
- Accessing a reverse mortgage for supplementary income late in retirement.
- Terminal illness – review estate planning.
- Change in the circumstances of dependents, including of potential new dependents.

As funds interact with their retired members, they might find that their circumstances have changed, and they should move into a different cohort. It will be difficult to automate these changes.

To assist with identifying changes in circumstances that might have occurred, we would advocate using a Retirement Counselling service, or implement a framework that prompts the fund to initiate a five-year review of the retiree's circumstances.

Financial guidance and advice

We note that Treasury is to conduct a comprehensive review of financial advice during 2022 ("Quality of Advice Review"). Rice Warner undertook research for the Financial Services Council (FSC) last year recommending critical changes to the legislation around advice.

Without significant changes to the financial advice regime, Treasury's goals for the Retirement Income Covenant will struggle to have a material impact. The risks and costs of compliance will be too high and there will be many compromises which will reduce the efficiency and effectiveness of the system. For example, funds could opt to have a single retirement strategy on the grounds that the development of cohorts is too risky given the current financial advice regime.

We consider new laws are needed to cover:

- Expanded use of personal information on benefit statements projecting annual income in retirement (including the Age Pension).
- Collection of additional data to allow funds to provide guidance on appropriate retirement strategies for individual members.
- Collection of data and guidance for retirees on any change in circumstances such as the events we previously listed.
- Compliance requirements for retirement income guidance that are specific to and sufficient for this type of advice.
- Use of technology and delivery of guidance via call centres and web chat functions (including when supported by automated bots and humans). This will be needed to cope with the volume of guidance and advice required for members approaching retirement and for members in retirement.

We consider technology has a major role to play in keeping the costs of delivery to acceptable levels. We note the growth of Money Coaches providing advice on budgeting and debt collection using online tools. Similar concepts could be used by superannuation funds once the financial advice laws are amended.

Defining member cohorts

Some funds might believe they have a reasonably homogenous group of members and set up a single strategy. However, they could then be doing a disservice to a small group of members who are outliers, or for members who have significant superannuation assets in another fund or with their partner.

Before funds decide whether to develop a single strategy for all their members, or whether to split their membership into cohorts, they need to know more about their membership.

The key to categorising members is to collect the right information about them. This will be challenging for funds as most have very little data on their membership that is needed for this analysis. Some funds can collect data through the provision of a comprehensive financial plan, but few members obtain advice at retirement, so funds will need other means of collecting the necessary data.

The key is to engage with members at least five years before they retire. The process could take the following form:

- Contact members above age 55 and ask when they intend to retire. This is necessary as funds have no idea of the planned retirement age for their members (which could be any time from 50 to 70).
- Approaching the stated time of retirement, ask members the relevant information to help with allocating them into likely cohorts.

From the information gathered, funds can place members into what are likely to be appropriate cohorts. They will need to communicate to members why they have chosen a particular cohort for them and also provide them with options to share more information or change the cohort if they so choose.

As well as income from their superannuation account, members could be entitled to a full or part Age Pension. They could also use some of the equity in their home for income in retirement. These could be used as factors in allocating members into cohorts. We have attached in the Appendix a sample structure of how funds might generate cohorts.

Timetable

The Position Paper states that trustees must have a strategy in place by July 2022. This timeframe does not allow funds enough time to develop suitable products, develop suitable guidance structures and infrastructure, and develop the specific guidance that will be delivered. We consider that it would be sensible if a rough timetable for implementation of the various elements of the strategies is also provided. Given the volume of development work that will be required, we feel a three year ‘roadmap’ would be helpful and provide a tentative example in Table 1.

Table 1. Timetable

Date	Milestone	Description
July 2022	Develop Retirement Income Strategy	Each fund will set out its strategy.
July 2023	Enhanced member benefit statements	Annual member benefit statements will show projected retirement income including the Age Pension.
	Calculators to include personal circumstances for more accurate benefit projections	Members can input their own data to make their retirement income projection more accurate for their personal circumstances.
July 2024	New legislation for providing financial advice	Changes are needed to allow new retirement structure to proceed.
	New rules developed for financial advice	Superannuation funds will need to provide services which need modification of financial advice rules.
	Funds develop member cohorts	Member cohorts based on features such as Age Pension eligibility.
	Existing retirees provided with guidance and moved into cohorts	Retirees offered the opportunity to change investment parameters and pension withdrawal rates. Where a change to the existing arrangements is proposed, instructions for how to access advice should be provided
	Members above age 50 provided with details of cohort structures.	Members can input their own data to improve / refine the information that funds hold and to assist in improving the identification of appropriate cohorts for them.

We welcome the opportunity to discuss this letter with Treasury.

Yours sincerely

Deloitte Touche Tohmatsu

DELOITTE TOUCHE TOHMATSU

Andrew Boal
Partner

Steve Freeborn
Partner

Appendix Example of Cohorts

Table 2 below provides an example of how a set of cohorts could be developed. It should be noted that this is just one example and there will no doubt be many variations that these could take. In our example, we have set the bands close to Age Pension asset test thresholds.

Cohort A is for low-wealth members. These members tend to take a lump sum at retirement and put the money into a bank account as a nest egg for emergencies. The aim is to hold back any money they don't need to pay off debt and to provide a higher return than they would receive from a term deposit outside superannuation.

They are looking for capital preservation so a conservative investment strategy would be suitable. This could be a single "Capital Secure" option.

Cohort B is for those who might have a balance of up to the asset test threshold for receiving a full Age Pension, noting that this relies on marital status and home ownership.

The investment strategy might be allocated as:

- Cash (for pension payments) 10%
- Capital Secure (emergency nest egg) 20%
- Balanced fund (based on MySuper investment strategy) 60%
- Longevity protection product 10%

The member could draw the minimum account balance to age 75 (5%), which will allow their benefit to last longer. As this cohort is unlikely to have much wealth outside superannuation, the members may need to draw additional lump sums periodically to cope with relatively large one-off expenditure needs. Additional amounts could be placed in Cash for this contingency or the member could take a small risk and draw it from the Capital Secure fund when required.

The Cash account will need to be replenished periodically. This can be optimised by transferring money into Cash from the Balanced fund when the fund has had higher than expected investment earnings or at least defer withdrawals for a period at times of falling asset values.

Homeowners could draw more annual income, or forego the longevity protection product, as they can access a reverse mortgage late in life when the superannuation benefit has been depleted.

Cohort C is designed for those who will receive a part Age Pension when they retire. As they draw down their superannuation benefit, they will receive a higher part pension, eventually being able to draw a full Age Pension.

The investment strategy might be allocated as:

- Cash (for pension payments) 12%
- Balanced fund (based on MySuper investment strategy) 78%
- Longevity protection product 10%

The member could draw 6% of the account balance to age 75, which is 20% more than the minimum required.

Homeowners could draw more annual income, or forego the longevity protection product, as they can access a reverse mortgage late in life when the superannuation benefit is depleted.

Cohort D is designed for those who will not receive any Age Pension when they retire. Later in retirement, as they draw down their superannuation benefit, they might move towards a part Age Pension.

PUBLIC

These members could maintain a high account balance well into their retirement years. They could place money into a Growth account for some quasi longevity protection or, in some cases, they may also elect to allocate a portion to a genuine longevity protection product.

The investment strategy might be allocated as:

- Cash (for pension payments) 12%
- Balanced fund (based on MySuper investment strategy) 70%
- Growth 18%

The member could draw 6% of the account balance to age 75, which is 20% more than the minimum required.

Homeowners could draw more annual income, or forego the growth product, as they can access a reverse mortgage late in life when the superannuation benefit is depleted.

Table 2. Allocating members to cohorts

Member	Super balance*	Marital status	Home Ownership	Age Pension	Strategy
Low wealth	< $100,000	Not relevant	Renter/Owner	Full	A
Low wealth	$100,000 to $275,000	Single	Owner	Full	B
Low wealth	$100,000 to $400,000	Partnered	Owner	Full	B
Low wealth	$100,000 to $500,000	Single	Renter	Full	B
Low wealth	$100,000 to $625,000	Partnered	Renter	Full	B
Medium wealth	$275,000 to $600,000	Single	Owner	Part	C
Medium wealth	$400,000 to $900,000	Partnered	Owner	Part	C
Medium wealth	$500,000 to $800,000	Single	Renter	Part	C
Medium wealth	$625,000 to $1,100,000	Partnered	Renter	Part	C
High wealth	Above threshold for part pensions	Single/partnered	Owner/renter	None	D

*based on current age pension entitlements

As can be seen from Table 2, it is apparent that members will move between cohorts over time and that allocating members to different cohorts is looking a lot like comprehensive financial advice.

PUBLIC