Retirement Income Covenant

Executive Summary

ISA supports the proposed principles-based approach to the covenant outlined in the position paper. We expect that we will have further feedback when we see the detail of how the covenant will operate in legislation.

The proposed approach relies on members seeking guidance to select an appropriate retirement income strategy. It is ISA's long held position that in a compulsory system, where levels of member engagement and financial literacy are generally low, members should not have to pay for guidance to be connected to good products. Those who legitimately choose to do nothing should be able to trust the system to connect them to good quality accumulation and retirement products. They shouldn't have to pay for that outcome.

ISA has identified the following areas for further consideration by government.

- **Cohorts of members:** The government should assist funds to supplement the information they have on characteristics of members by facilitating access to data held by government agencies.
- **Appropriate guidance:** The government:
    - can facilitate access to appropriate guidance by expanding the provision of intra-fund advice to include entitlements to Centrelink payments such as the Age Pension, assets outside super and the circumstances of the member's household.
    - may wish to consider the provision of free or subsidised advice in its *Quality of Advice Review*.
    - should expand the exemption from the anti-hawking prohibition to allow superannuation trustees to make offers to members about moving to the retirement phase to facilitate the take up of retirement income products.
- **Meeting the needs of disengaged members/defaults:** Regardless of the available avenues for people to seek guidance to help them make a choice, there will always be some members for whom this model will not work. The Government should also consider the role of carefully designed default retirement income products.
- **Spending flexibility:** Not all retirement assets will be taken as income and fully spent. The retirement income covenant must have sufficient flexibility to support choices by retirees about how they use their savings in retirement.

ISA Recommendations

1. ISA recommends that the government consider making available to funds data it holds about members on a de-identified basis to assist funds to determine characteristics of cohorts.

2. ISA recommends that intra-fund advice be expanded to include advice about retirement income products:
    - which takes into account Age Pension eligibility, Centrelink payments, non-super assets and non-super income, and
    - which covers the members household, i.e., spouse/partner of the member and, if applicable, dependant/s of the member.

3. ISA encourages the Government to explore the benefits of free, subsidized or low-cost advice on retirement planning.

4. ISA recommends that the government amend the exemption from the anti-hawking prohibition to ensure that it is broad enough to allow funds to offer retirement income products to members without breaching the prohibition.

5. ISA recommends that the government consider the role of carefully designed default retirement income products to cater for those members who are unlikely to make an active choice about a retirement income product.

6. ISA recommends that the retirement income covenant contain sufficient flexibility to enable members to make choices about how they spend their money.

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About Industry Super Australia

Industry Super Australia (ISA) is a research and advocacy body for Industry Super Funds. ISA manages collective projects on behalf of a number of industry super funds with the objective of maximising the retirement savings of over five million industry super members.

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Retirement Income Covenant

ISA supports the proposed approach to the covenant outlined in the position paper. The shift from the previously proposed prescriptive approach to a more flexible principles-based approach is welcome. The rest of the feedback in this submission should be taken within this context of overall support for the proposed approach. We think that the following issues that we identify are worthy of consideration to improve the proposal before it is implemented, or as issues to monitor following the implementation of the RIC. We expect that we will have further feedback when we see the detail of how the covenant will operate in legislation.

The policy relies on "appropriate guidance" (ranging from the provision of factual information to personal financial advice) to manage this problem - while acknowledging that "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".

It is ISA's long held position that in a compulsory system, where levels of member engagement and financial literacy are generally low, members should not have to pay thousands of dollars to advisors to be connected to good products. Those who legitimately choose to do nothing should be able to trust the system to connect them to good quality accumulation and retirement products. They shouldn't have to pay for that outcome.

ISA has identified the following areas for further consideration by government.

- Cohorts of members
- Appropriate guidance
- Meeting the needs of disengaged members/defaults
- Spending flexibility

Cohorts of members

Understanding the personal and financial situation and retirement objectives of cohorts of members is central to a fund's retirement income strategy. The position paper seems to assume that funds have a depth of information about members beyond their age, gender, address and super balance. The feedback that we have received from funds is that this is not the case.

The paper repeatedly suggests that funds can obtain the necessary information by undertaking member surveys or using publicly available data. While this is theoretically possible, such an approach is likely to be inefficient and come at a cost to members. On the other hand, the ATO and the Department of Social Services hold relevant data that would assist funds to identify the characteristics of cohorts of members. We accept that current privacy laws may prevent personal information about individual members being provided to funds, however de-identified information would still be of assistance.

ISA recommends that the government consider making available to funds data it holds about members on a de-identified basis to assist funds to determine characteristics of cohorts.

Appropriate Guidance

Assisting members to meet their retirement objectives in light of concerns about access to affordable, quality advice is a significant issue. The paper rightly acknowledges current concerns around the provision of financial advice and the barriers to seeking advice. There is no shortage of research on the issue and both ASIC research and Government inquiries highlight the need for retirement advice.

- The Productivity Commission found that “Impartial advice will be especially important for many members in the retirement phase, where diverse needs, preferences and non-super assets mean one size can never fit all.” [1]
- The Retirement Income Review highlighted the complexity of the retirement income system pointing to the need for advice to assist members to navigate the system, noting that, “it is however not clear the system is sufficiently simple to navigate without resorting to some form of financial advice, or that there is sufficient support provided to ensure individuals feel confident making financial decisions about their retirement.”[2]
- ASIC Report 627 *Financial advice: What consumers really think* (REP 627) found that retirement income planning was the second most accessed topic among respondents who had recently accessed advice, being accessed by just over 50% of the cohort.[3]
- ASIC Report 639 *Financial Advice by Superannuation Funds* (REP 639) found that one of the most popular advice topics sought by members was retirement planning.[4]

While it is hoped that the *Quality of Advice Review* in 2022 will offer some solutions, any solutions will not be available by July 2022 when it is proposed that the covenant will commence. There are however improvements that can be made now to facilitate access to affordable, quality advice about retirement.

Intra-fund advice

Intra-fund advice is advice that a superannuation trustee can provide to members where the cost of the advice is borne by all members of the fund. The objective of intra-fund advice is to allow super funds to give members simple, non-ongoing personal advice on the member’s interest in the fund. This advice can be collectively charged across the fund’s membership.

The law prescribes types of advice that *cannot* be collectively charged.[5] ASIC has given guidance on the types of non-ongoing advice for which a superannuation trustee is likely to be allowed to collectively charge. [6] The topics are narrow and do not take account of a members wider financial and household situation, or access to Centrelink payments.

[1] Superannuation: Assessing Efficiency and Competitiveness, Productivity Commission Inquiry Report, 21 December 2018, Overview, p.40.
[2] Retirement Income Review (RIR) Consultation paper, November 2019, p.26.
[3] ASIC Report 627 *Financial advice: What consumers really think*, August 2019, p.19.
[4] ASIC Report 639 *Financial Advice by Superannuation Funds*, December 2019, p.5
[5] Superannuation Industry Supervision Act, s99F
[6] ASIC Information Sheet 168 Giving and collectively charging for intra-fund advice

Expanding intra-fund advice to include advice to members about retirement income strategies that take into account Age Pension eligibility, other Centrelink payments, non-super assets and non-super income, and which include the member's household, would be an efficient and cost-effective way for members to receive trusted advice on retirement income strategies.

ASIC adopted a similar approach in its COVID-19 measures to allow intra-fund advice on early release of super to extend to a member's household. The Government can achieve a similar and permanent outcome by amending the law to expand the situations in which intra-fund advice can be given.

ISA recommends that intra-fund advice be expanded to include advice about retirement income products:

- which takes into account Age Pension eligibility, Centrelink payments, non-super assets and non-super income, and
- which covers the members household, i.e., spouse/partner of the member and, if applicable, dependant/s of the member.

Free or subsidised advice

There are a range of models that the government could consider in its *Quality of Advice Review* to deliver affordable, quality advice to members. One is the broader provision of free or subsidised advice.

For example, MoneySmart provides helpful factual guidance and the Financial Information Service[7] assists eligible Australians with financial advice. Financial counsellors also provide assistance to people experiencing money problems. These are free, trusted and independent services.

Some ways in which the government can increase assistance it provides are through:

- expanding the Financial Information Service to service more people.
- enhancing the role of MoneySmart beyond giving factual information.
- adding an advice service to the Government's new financial capability website.[8]

The UK MoneyHelper service[9] may provide a useful model for Government to consider.

ISA encourages the Government to explore the benefits of free, subsidized or low-cost advice on retirement planning.

Anti-hawking prohibition

The anti-hawking reforms which commence in October 2021 are designed to protect consumers from unsolicited offers of financial products, which often contribute to consumer acquiring products that do

[7] https://www.servicesaustralia.gov.au/individuals/services/financial-information-service
[8] https://www.financialcapability.gov.au/
[9] https://www.moneyhelper.org.uk/en

not meet their needs. The reforms contain an exemption from the anti-hawking provisions for account-based pensions.

ISA understands that - consistent with the government's efforts to increase take up of retirement income products - the exemption from the anti-hawking prohibition for offers made by or on behalf of superannuation trustees relating to a member's move to the retirement phase was intended to include retirement income products offered by a fund to its members.

However, we are concerned that the *Corporations Regulations* 2001 may not achieve this result. This is because the exemption relies on reg 7.1.04E which relates only to account-based pensions. Applying the anti-hawking prohibition to retirement income products (that are not account-based pensions) will hamper funds' ability to offer retirement income products to members. There should be a clear exclusion that readily enables trustees to offer and promote retirement income products that they believe are in the best financial interests of members.

ISA recommends that Government amend the exemption from the anti-hawking prohibition to ensure that it is broad enough to allow funds to offer retirement income products to members – not just account - based pensions - without breaching the prohibition.

Meeting the needs of disengaged members and defaults

It has long been ISA's position that in a compulsory superannuation system with poor financial literacy, most members should be able to rely on default settings that protect their interests without recourse to personal advice. Where individuals decide otherwise, then obviously there should be ways for members to receive affordable, quality personal advice.

The government has justified the *Your Future, Your Super* measures on the grounds that in a compulsory system government has a duty to act to defend member interests. But in the retirement phase, the proposed retirement income covenant offers few protections to members beyond hoping that any guidance members receive will be in their interests - while acknowledging that this may well not be the case. The *Your Future, Your Super* performance test does not cover retirement income products so there is a risk that consumers will be sold into poor performing products which they may not be able to leave.

Underpinning the Government's proposed approach is the assumption that members will make an active choice about a retirement income product. Regardless of the available avenues for people to seek guidance to help them make a choice, there will always be some members for whom this model will not work.

Recent research by the Conexus Institute[10] presents a spectrum of retiree types - from "fully-advised" to "disengaged" and argues that different solutions may be needed for different types. The paper notes that "unfortunately, financial literacy is too low and comprehensive advice too costly and capacity constrained for a system based on self-directed and fully-advised choice to operate effectively for all

[10] Geoff Warren and David Bell, Ensuring all retirees find a suitable retirement solution, 23 July 2021

retirees".[11] Conexus proposes allowing a fund to select a retirement income option for those members who prefer not to make the choice while also acknowledging the role of defaults.

The Retirement Income Review arrived at a similar conclusion noting that "carefully designed defaults, guidance from superannuation funds, as well as accessible and affordable advice at retirement, would help people get better outcomes in retirement."[12]

ISA encourages the Government to consider the role of carefully designed default retirement income products to cater for those members who, for a range of reasons, are unlikely to make an active choice about a retirement income product.

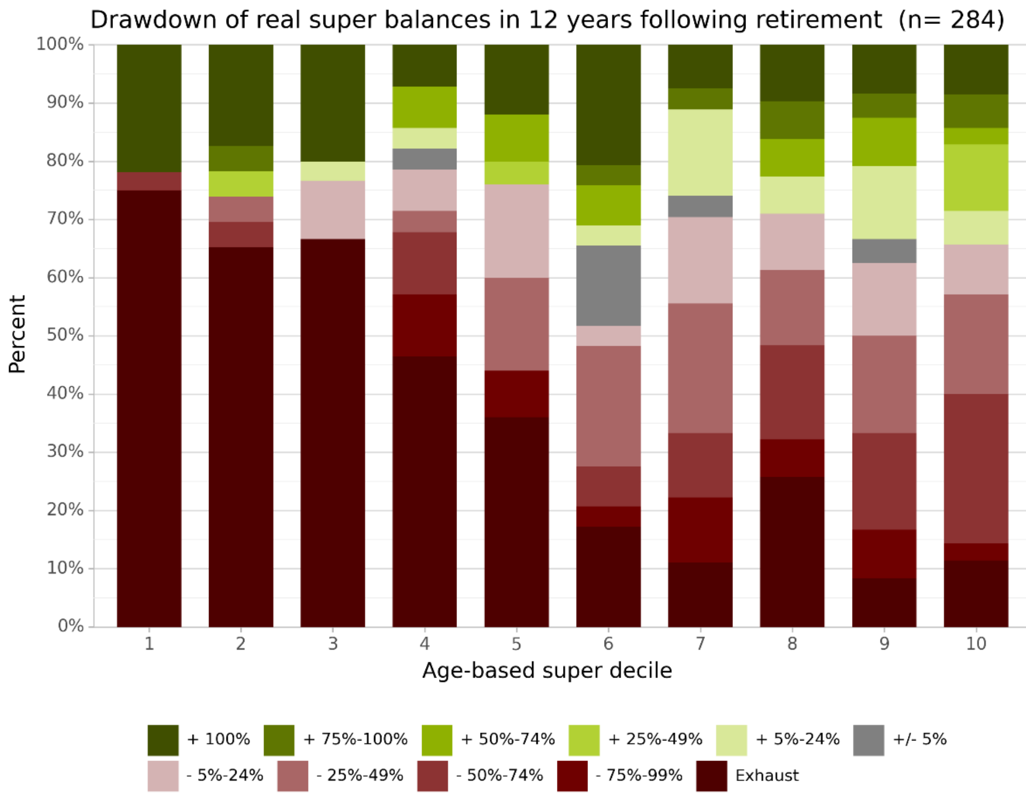
Spending flexibility

The position paper rests on the assumption that all retirement assets will be taken as income and fully exhausted. In doing so it ignores retirees' spending behaviour, the legitimacy for many of holding money in an account-based pension and that even modest precautionary savings may be needed.

We agree that the superannuation system should not be used for estate planning or to facilitate significant bequests to non-dependent family members. Analysis by ASFA[13] indicates that households are, on average, not using the superannuation system for estate planning. Using HILDA data, they show that 80 per cent of people aged 60 and over and 90 per cent of people aged 80 and over who died in the period 2014 to 2018 had no super at all in the period of up to four years before death. Of those aged 80 and above, only 5 per cent of individuals had more than $110,000 in superannuation.

Longitudinal analysis of superannuation drawdown patterns in the 12 years following retirement supports the view that most people are utilising their superannuation savings. For many, 12 years would represent roughly half of residual life-expectancy upon retirement. For those newly retired, around half of individuals across the wealth distribution reduce their real super balance by 50 per cent or more, with most individuals in the lowest quartile exhausting their superannuation balances in the intervening 12 years. For those in the lower deciles experiencing real balance increases, it is noted that most have relatively small superannuation holdings to begin with and therefore these increases are relatively small in absolute terms.

[11] Warren and Bell, "Ensuring", p 7
[12] Retirement Income Review, p 58
[13] Clare, R., Superannuation balances prior to death: Superannuation balances of older Australians, March 2021, ASFA.



Source: HILDA, Waves 19 (years 2002, 2006, 2010, 2014, 2018)

This suggests that, for most individuals, estate planning is not a significant motivation. It is therefore important that any retirement income strategy maintains sufficient flexibility to support choices by retirees about how they use their savings in retirement, including having some reasonable precautionary savings set aside for:

- Health and aged care costs
- Emergencies and contingencies including home maintenance
- Funeral expenses
- Surviving spouse retirement needs in the case of a couple

ISA recommends that the retirement income covenant contain sufficient flexibility to enable members to make choices about how they spend their money.