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Retirement Income Covenant Position Paper

Cbus welcomes the opportunity to comment on the Government's *Retirement Income Covenant Position Paper – Stage one of the Retirement Income Framework*.

Cbus supports measures that seek to generate the best possible retirement outcomes for members. It is important that funds develop a Retirement Income Strategy that addresses member needs and preferences for certainty, income stability and flexibility throughout all stages of retirement. Trustees are in the best position to determine the most optimal retirement arrangements for their membership. While we agree that longevity risk is a matter that needs more attention in our policy settings, we do not consider that a forced product based solution is the answer.

Cbus strongly believes that the mandatory requirement for trustees to develop and offer a Comprehensive Income Product for Retirement (CIPR) should be removed. It should not be compulsory to offer a CIPR, where it is unlikely to suit the fund membership - particularly those members who have worked in hazardous industries with less favourable mortality experience and those with relatively lower superannuation balances.

The measures as currently provided will require the development of a new 'in-house' longevity product, or more likely the purchase of a longevity product such as an annuity from a third-party retail provider. We question whether the take up of this product by our members would justify the implementation and ongoing costs of an in-house or outsourced solution.

Our members place a lot of trust in Cbus which is evidenced by having received the highest overall member satisfaction ratings in the industry, particularly in member guidance services[1]. The use of the term 'flagship' CIPR (the 'soft nudge' approach) may infer that this product is being offered by the trustee as their best retirement solution. A CIPR containing a longevity income product would not be the most suitable product for a large proportion of our members. Building and construction employees have a shorter life expectancy than the general population. Pooling building and construction members with members from other occupational groups would put them at a comparative disadvantage as they would essentially

[1] 83% alongside ESSSuper - May 2017 Member Sentiment & Communication Report

be funding others' retirement. In offering a CIPR, the trustee may not be acting in the best interests of members.

Recognition needs to be given to the integral role that the Government's Age Pension plays in ensuring that retirees are provided a safety net retirement income for life. A large number of Cbus members have low to modest balances and accordingly are reliant on the Government's Age Pension as their main source of retirement income. Our modelling shows that 98% of members receive some form of the Age pension, with 48% of members having 80% of their retirement income from the Age Pension. It is our view that a CIPR should not mandate a longevity component, particularly in circumstances where the Age Pension is likely to be the primary income source. It is likely that as the system matures and average balances increase, a default retirement income-for-life product, supported by the Age Pension and voluntary savings will require trustee attention, but mandating longevity protection is certainly not supported by research on our current membership profile.

By virtue of the longevity component, a CIPR is a highly complex financial product. Cbus considers that there are risks in requiring trustees to offer a CIPR (as currently proposed) to all members in circumstances where they may not seek advice about their individual financial situation. In addition, member's changing needs throughout retirement and any potential requirements to access capital to fund health services and residential age care should also be contemplated.

The importance of a holistic approach is recognised in the Productivity Commission Draft Finding 4.4 which notes, "*A 'MyRetirement' default is not warranted. The diversity in household preferences, income and other assets when approaching, and in, retirement means there is no single retirement product that can meet members' needs. The most important task remaining is to improve the quality of financial advice to guide members among the various complex products, especially where members may decide to make the mostly irreversible decision to take up a longevity (risk pooled) income product*".

The proposed commencement date of 1 July 2020 should be extended to allow sufficient time for funds to develop their own tailored solutions.

Attached are our detailed comments in relation to each of the Covenant principles. Please do not hesitate to contact Jane Barrett on 03 9910 0339 or jane.barrett@cbussuper.com.au if you have any queries in relation to our submission.

Yours sincerely

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Brand, Advocacy, Marketing & Product
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PROPOSED CHANGES

1 Retirement Income Strategy

The Treasury position paper provides that trustees should assist members to meet their retirement income objectives throughout retirement by developing a retirement income strategy for members.

1.1 Cbus comment

Cbus agrees that it is important that trustees develop a retirement income strategy to assist members to meet their retirement income objectives. Trustees are best placed to determine this strategy, having regard to their member needs and profile. However, we highlight that we cannot have a 'one size fits all approach' to the strategy. The strategy will need to contemplate differing types of members, their occupations ('blue collar'/'white collar'), differing retirement age experience and importantly longevity expectations.

2 Engagement

The Treasury position paper provides that trustees should assist members to meet their retirement income objectives by providing guidance to help members understand and make choices about the retirement income products offered by the fund.

2.1 Cbus comment

Cbus agrees that trustees should assist members in making retirement income decisions. Cbus dedicates significant resources to engage, guide and offer advice as part of its service offering to members. To ensure the system is responsive to member needs the trustee should continue to have flexibility in how this guidance is provided with no mandated longevity component.

To adequately provide guidance in respect to the specific CIPR product (encompassing a longevity component) we question whether it would be necessary for the trustee to have a full understanding of the member's full financial situation taking into account their particular needs and preferences. If this is the case this would constitute personal financial advice, which would have legal and practical ramifications. The position paper notes that there is no expectation that trustees would need to provide financial advice and hold an Australian Financial Services Licence (AFSL) to comply with this requirement. Further information, examples and case studies will need to be provided so there is clarity as to how the trustee can meet this covenant principle without providing personal financial advice in conflict with current advice rules.

3 Definition of a Comprehensive Income Product for Retirement

The Treasury position paper provides that a CIPR is a retirement income product which is designed to provide:

- efficient, broadly constant income, in expectation;
- longevity risk management (income for life); and

- some access to capital.

A 100 per cent allocation to an account based pension (ABP) would not meet the definition of a CIPR.

3.1 Cbus comment

As noted above, Cbus considers that decisions regarding the product type or mix of products should be made by the trustee as part of formulating the overall Retirement Income Strategy for members. Trustees are well equipped to make judgements that balance stability/certainty/longevity considerations given their access to member specific information and targeted actuarial advice.

The position paper notes that there is no requirement for products to be fully or even partly guaranteed. However, the use of the terms "efficient, broadly constant income in expectation" coupled with "income for life" (up to age 105) means that the trustee will have to purchase or develop in-house a guaranteed income type (longevity) product. It is more than likely that the longevity component will need to be obtained externally (for example, as an annuity) in order to obtain the specialist advice required to manage uncertain outcomes from longevity pools and given current self-insurance restrictions. This will result in additional costs that will ultimately be borne by the member.

Cbus questions the necessity of mandating the longevity component of the CIPR, given that members with low to modest superannuation balances will largely rely on income from the Age Pension. Therefore, we would argue that the CIPR should not require a longevity component for members, particularly when the Age Pension is still the primary income source.

Further, we would question whether there needs to be more flexibility around access to capital. It is often the case that later in life significant capital is required for retirees to access residential aged care and other expensive health services. The longevity component of the CIPR may preclude any early release arrangements on financial hardship/compassionate grounds or prevent members from switching to another retirement income option should their circumstances change.

In this regard, we put forward that an Account Based Pension should be able to be offered as a complying CIPR solution where it aligns with member needs and life expectancy considerations. It is important to highlight that Cbus offers an account based pension (allocated pension) for members with balances of more than $10,000. Members select the product directly or with advice. Investment options are tailored to retirees with default Conservative growth options. Our members typically withdraw the minimal income and our forecasts suggests their balance will exceed life expectancy. Given our membership do not typically have an issue with longevity risk given less favourable mortality experience, mandated inclusion of longevity products will simply expose our membership to unnecessary expense.

If mandating retirement solutions is to be seriously countenanced, then the clear issue that must first be tackled by policy makers and regulators is system adequacy. This includes, but is not limited to:

- Increasing the SG

- Eradicating unpaid super
- Addressing the increasing numbers of members who are missing out on receipt of SG due to non-traditional forms of employment
- Removing the $450 threshold
- Ensuring better outcomes for women

This will increase maturity in the system and retirement balance outcomes providing the necessary scope and scale to look to mandating income-for-life solutions.

4 Offering a flagship CIPR

The Treasury position paper provides that all trustees should offer a flagship CIPR to members at retirement, subject to limited exceptions (see principles 7 and 8).

4.1 Cbus comment

Overall, Cbus strongly considers that trustees should not be compelled to offer a flagship CIPR to members at retirement. As outlined earlier, a CIPR (with a mandated longevity component) may not suit a large proportion of Cbus members as they have lower life expectancy compared to the general population, retire earlier and have low to modest superannuation balances. While flexibility would be partly achieved in allowing three flagship CIPRs tailored to different cohorts of members, consideration should be given to allow a flagship CIPR to be developed without the longevity component.

5 Third party products

The Treasury position paper provides the Trustees can fulfil their obligations in part or in full by using a third party.

5.1 Cbus comment

There are risks and costs to the fund in catering for the longevity component of the CIPR product 'in-house'. While it may be feasible for these obligations to be met in part or in full by using a third party, Cbus notes that traditionally retail providers provide longevity risk products such as annuities but the take up has been low. This is largely due to the fact that these products are complex, advice led and do not provide flexible access to capital.

6 Consent should be required for a CIPR to commence

The Treasury position paper provides consent should be required for a CIPR to commence.

6.1 Cbus comment

Member consent is imperative and it should not be onerous for members to accept a CIPR offered to them. However, the member should be advised of the importance of seeking financial advice in any decision they make, particularly one where they are unable to access a portion of their capital.

7 Offering an alternative retirement income product through advice

The Treasury position paper provides that Trustees may offer an alternate CIPR or another retirement income product to a particular person or cohort of people through any form of personal financial advice, including scaled personal advice, intra-fund advice or full financial planning.

7.1 Cbus comment

While it would be appealing for Cbus to be able to offer an alternate CIPR to our members in the building and construction industry that takes into account their specific mortality and retirement experience, we have reservations about how this would work in practice. The trustee will be in the position of engaging costly advice resources to direct members away from the mandated flagship CIPR product that the trustee knows will not be in the best interests of the member. This mixed messaging will likely to create confusion and not support a member's transition into retirement.

8 Exception for individuals for whom CIPRs are unsuitable

The Treasury position paper provides trustees may choose not to offer a CIPR at all to a particular person if the trustee has reliable information that a CIPR would not suit that person. Essentially, funds are required to promote the CIPR over any solution unless a member has a life-threatening or terminal illness or balances less than $50K.

8.1 Cbus comment

While Cbus' primary position is that there should be no requirement to include a longevity component in the CIPR offering, we consider that if there are exceptions for individuals for whom such a CIPR are unsuitable, this should be extended to members who:

- have a minimum balance as set by the Fund taking into account the profile of the membership, likely income sources for retirement and other assets;
- are in an occupation that detrimentally impacts life expectancy;
- have been paid a total and permanent disability benefit.