

Development of the
framework for
comprehensive income
products in retirement

CSRI Submission on the Treasury
Discussion of December 2016

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Contents

Executive Summary	3
1. Defining a CIPR.....	8
2. Regulatory Settings for Trustees	11
3. Ensuring that Products Meet the Minimum Product Requirements	13
4. Facilitating Trustees to Offer a CIPR	13
5. Disclosure	14
6. Competition	15
7. Products Outside the Mass-Customised CIPR Framework.....	18
8. Other	18
9. Personal Financial Advice	19

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Executive Summary

The Committee for Sustainable Retirement Income (**CSRI**) is an independent, non-partisan, non-profit think tank whose mission is to promote “adequate incomes through all the years of retirement for all Australians on a fair and fiscally sustainable basis”.

The CSRI supports the development of a regulatory framework that focusses the superannuation system on providing members with stable retirement incomes through all the years of retirement.

Treasury has made significant progress in this important area by preparing, and consulting extensively, on its discussion paper that sets out a clear preferred regulatory approach for Comprehensive Income Products in Retirement (CIPRs) and flags the issues and alternatives for further consideration. This complements the progress Treasury has already made in removing impediments in respect of innovative retirement income products. Before the CIPR regulations can be introduced, the new Age Pension means testing rules for income stream products (which were expected for 1 July 2018) would need to be finalised.

While the CIPR discussion paper makes considerable progress on this important issue, the proposed model may not do enough to encourage change given the lack of industry preparedness. A recent survey of super fund CEOs (Mercer 2017) confirms that the majority of super funds have no clear strategy as to how they will service the needs of retirees and pensioners.¹

The proposed facilitative approach offers trustees the binary option of following specified minimum product requirements or doing nothing at all. In this situation, trustees may decide that offering a CIPR is too difficult and that they will wait and see how the market unfolds. If too many funds decide to do nothing, member outcomes will not be improved. The scale and diversification needed to make viable longevity products which pool their own members funds will not be achieved.

Instead of simply offering trustees a binary choice, the framework should also require trustees to develop a retirement benefits strategy, not dissimilar to the requirement on trustees to have an insurance management plan, that takes into account longevity risk. An appropriate starting point is for trustees to consider the impact of demographic change on the movement of members into the retirement phase and the implications for the fund’s strategy and business plan. Such a plan, as discussed in Section 2, would consider the needs of the membership and the retirement products and options to be provided and would complement current trustee requirements to have a written strategic and business plan. The CSRI views the requirement for a retirement benefits strategy as an important complement to, rather than substitute for, the CIPR framework proposed by Treasury (subject to the modifications proposed in this submission).

A second major issue relates to the scope of a mass customised solution. A small number of CIPR options catering for different member cohorts would yield better member outcomes and avoid the anomalies of one mass customised product. While not proposing to prohibit multiplicity of retirement products, the discussion paper seeks to limit the legal safe harbour protection to one mass customised product. If this proposal is adopted, it may create the incentive for trustees not to seek to better customise solutions for their membership as doing so would result both in extra expense and forgoing this legal protection.

¹ Mercer (2017), 2020 Super Fund Executive Report.

This could be addressed by allowing trustees to develop multiple variations of CIPRs and to offer one of those to each member (as discussed in Section 1). A precedent for segmentation exists in MySuper with lifecycle funds. And it is important to recognise that members' needs are even more diverse in retirement. Preselecting a CIPR for each member also should not be construed as requiring advice as this would make it prohibitively costly. While the case for a legal safe harbour has yet to be made, similar protections should cover the provision of single and multiple CIPRs to create the right incentives, as discussed in Section 2.

A final major issue relates to the interaction between the CIPR framework and the superannuation alternative default model. Excluding the retirement phase from the alternative default super model has the potential to leave default members even less well prepared for the decisions they are required to make at retirement than they are currently. To ensure that the needs of members at retirement are given their due consideration, access to retirement benefits should be included in the criteria for assessing the efficiency and competitiveness of the super system. If the government does move to introduce an alternative default model, it will be important to ensure that default members receive the support they need at retirement through access to a CIPR whether sourced internally of the fund or outsourced to another superannuation fund. Transitional arrangements will be required, as discussed in Section 6.

The next section outlines the principles that underpin the CSRI's policy position followed by a summary of recommendations.

Proposed principles for determining the preferred approach

- To meet members' needs for stable retirement incomes by encouraging product design that includes a component of longevity pooling and drawing down (rather than preserving) capital. In doing so it will encourage the development of a competitive and cost-effective longevity risk pooling product market.
- The framework design should seek to balance the need for standardised solutions to achieve scale and simplify decision making with the need for tailoring to member needs. This will be achieved by developing mass customised solutions for member cohorts that are collectively suitable for the majority of members while retaining individual member's ability to seek out tailored solutions.
- The system must be capable of accommodating solutions on a household basis recognising that women have much lower superannuation balances than men with which they must finance higher life expectancy.
- Regulation of retirement benefits, including product regulation, taxation and social security means testing arrangements, should ensure competitive neutrality among retirement benefits products. At the same time, the inherent differences between longevity risk pooling products and account based products need to be accommodated in these regulations.
- Members are empowered to make better retirement decisions by retaining the flexibility to decide how to use their super while receiving support to aid their decision making. This support includes streamlining of choices, enhancing product comparability, providing member communication focussed on member outcomes and guidance from trustees on the selection of suitable product choices.
- Trustees are to preselect one CIPR for each member on a mass customised basis to simplify members decision making and enable the provision and distribution of CIPRs on a cost-effective basis. Where members do not make a choice, they are offered a solution that is suitable for the majority of members.
- The framework should further support members who are unable to make a choice by ensuring a contestable default retirement benefit market that is integrated with the accumulation default market.

- Trustees are supported in their role of guiding member choices through legal clarity of their legal responsibilities to their members. The framework should encourage trustees to improve member outcomes in a cost-effective way.
- Recognising that the cost of financial advice may be a factor inhibiting members from seeking individually tailored solutions that would deliver improved member outcomes, the framework should facilitate the development of cost effective financial advice delivery mechanisms.
- CIPRs designed to be suitable for the majority of members would be useful for all members not just MySuper members. Offering CIPRs more broadly would be conducive to achieving scale and countering adverse selection which impedes the effectiveness of products that pool longevity risk.

CSRI Summary of Recommendations

Defining a CIPR

1. The CIPR framework should encourage trustees to design CIPRs suitable for their membership. Trustees should retain discretion over whether to provide more than one CIPR based on weighing up the relative costs and benefits with a focus on members' best interests.
2. Trustees should be able to determine which of its multiple CIPRs is appropriate for each member using information provided by the member. Members who do not engage with the fund would be offered the mass customised CIPR suitable for the majority of fund members based on the limited information the fund has available about the member (age, gender, super balance).
3. Given that women on average have lower superannuation balances and longer life expectancy than men, it is important that members with a spouse are able to share their superannuation benefits to improve the adequacy of retirement incomes. All members should be offered the option of a joint CIPR (or its underlying components) with a spouse, with continuing benefits to the surviving spouse to facilitate the sharing of superannuation balances among couples on a cost-effective basis. This should be accommodated within both single and multiple CIPRs.
4. The income efficiency test should require the use of consistent investment return assumptions to value both the account based pension (ABP) and the non-guaranteed component of the CIPR. Only the ABP cost assumption should be prescribed.
5. The income efficiency test should control for market risk to ensure that the income efficiency is not able to be achieved by simply increasing risk. This would not preclude funds from designing CIPRs that allow for higher risk adjusted returns. It would prevent them from relying on higher market risk to meet the income efficiency test.
6. The constant real income requirement should require that the income be provided at a higher percentile for success than the 50% probability implied by the actuarial best estimate. Considering the outcome for markets at a 25th percentile for someone living to the 75th percentile of life expectancy would provide a constant level of real income to a high probability, although there would still be circumstances where adverse markets and/or high longevity could result in constant real income not being payable through the entire life.

Regulatory settings for trustees

7. A legal safe harbour should apply to the design and offer of a mass customised product to protect trustees against claims that the product doesn't address peculiarities of the member, but the safe harbour will not extend to the provision of advice. The safe harbour should only seek to overcome impediments trustees face in pre-selecting a CIPR and offering that CIPR to a member, without providing a defense or carve-out, for instance, from financial advice law for any subsequent actions. Any legal safe harbor should apply equally to funds offering one or multiple CIPRs.
8. To encourage funds to make further progress in meeting the needs of members at retirement, trustees should be required to develop a retirement benefit strategy for the fund that includes consideration of the needs of the membership and the retirement products and options to be provided. An express requirement for a retirement benefit strategy would ensure that all funds

have considered the members' needs in retirement and have a plan for addressing these challenges. All funds should be required to have a retirement benefit strategy in place by 2020.

9. Funds seeking to be a default super provider, in any alternative super default model that the government introduces, should be required to have a retirement benefit strategy in place by the time the alternative default superannuation model is introduced. Once the CIPR framework is established, the criterion for the selection of default funds should require funds to provide their default members access to a CIPR, either sourced internally or through a third-party provider.

Ensuring that Products Meet the Minimum Product Requirements

10. Trustees should be required to submit to the regulator an independent actuarial report to certify that the proposed CIPR design meets the minimum product requirements before launching a CIPR.

Facilitating Trustees to Offer a CIPR

11. CIPRs designed for the majority of members would serve as a useful anchor for all members not just MySuper members. Offering CIPRs more broadly would lead to higher take-up of CIPRs and increasing scale (important particularly for products pooled within a superannuation fund). It would be inappropriate for members of legacy funds, life office statutory funds, eligible rollover funds, Approved Deposit Funds, small APRA funds, SMSFs and funds that are being 'wound up' to offer their members a CIPR.
12. Members of SMSFs should also receive access to appropriate retirement benefits to ensure stable income in retirement. SMSF trustees should be required to develop a retirement benefit strategy for the fund that also considers the ability of the other members of the fund to manage the fund on the death of the trustee and includes an appropriate transition plan.

Disclosure and Competition

13. There would be merit in the government, industry and consumer groups working together to develop CIPR product offer and disclosure standards. Once these have been developed and endorsed by the regulator, trustees operating in accordance with the guidelines would have certainty that they are meeting their obligations regarding members' best interests.
14. To reduce the complexity of decision making and to allow comparability across funds, there would be merit in making available a low-cost universal advice tool to assist members to make a choice among CIPRs and to assist funds to communicate to their members the trade-offs involved in tailoring a CIPR. Government, industry and consumer groups should work together to develop standards and a core CIPR product comparison tool. Once the standard tool has been developed, it should be authorized by the regulator and made widely available to members both via their super fund and to all retirees via the ASIC Money Smart Website. This should be made available in time for the market launch of the first CIPRs.
15. The launch of the CIPRs framework should be accompanied by a government awareness campaign targeted at pre-retirees and people in early retirement. This would inform the public of the government's rationale for facilitating the development of CIPRs, how CIPRs can benefit members and where members can go for more information.
16. Superannuation funds seeking default fund status, should be required to ensure that their members have access to a CIPR, either sourced internally or through a partnership with another superannuation fund. This requirement would only come into effect once the new income stream products are available on the market and the CIPR framework has been established. Appropriate transitional arrangements would apply. In the period before the CIPR framework is introduced, trustees would simply be required to have a retirement benefit strategy to meet the requirements for a default fund. Once the new income stream products are available and the CIPRs framework is introduced, all default funds should be required to offer a CIPR.
17. Retirement benefits should also be included in assessment of the efficiency and competitiveness of the super system by the Productivity Commission.

Products Outside the Mass-Customised CIPR Framework

18. If a product meets the minimum product requirements of a CIPR as determined by an independent actuary but it is not offered as the mass-customised product, the trustees and product providers should be allowed to label the product as 'meeting the minimum product requirements of a CIPR'. Legal safe harbor protection would not be available to the trustee or product provider given that the product offer requirements have not been met or the product was provided under advice. In this way, competitive neutrality among products meeting the CIPR minimum product requirements would be maintained.

Personal Financial Advice

19. The rules for intra-fund advice should be broadened to accommodate the sharing of costs of providing a limited form of advice (which extends beyond the trustee's pre-selection and offering of the CIPR) to assist trustees offering CIPRs. In particular, intra fund advice should permit consideration of members' broader circumstances and assets that go beyond the beneficial interest of the fund but only in so far as is necessary to determine an appropriate CIPR offer. It should also be possible within intra-fund advice to inform members of the benefits of consolidating super assets within one fund, without advising them which fund to consolidate within, given the obvious conflict of interests.

The attached submission elaborates on, and provides justification for, the above recommendations and responds to the questions posed by the Treasury Discussion Paper.

We would welcome the opportunity to participate in any future consultative processes to further discuss our views.

Kind regards,

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Founder and Executive Director
Committee for Sustainable Retirement Incomes

1. Defining a CIPR

Question 5: How should income efficiency be defined?

The Australian Government Actuary (AGA) released a discussion paper on the Actuarial Certification test for Comprehensive Income Products for Retirement on 29 May 2017. The paper details a certification test that has been designed to test two of the three minimum requirements for CIPRs:

- a **minimum level of income** that would (subject to consideration of guarantees) generally exceed an equivalent amount invested fully in an account-based pension that is drawn down at minimum rates; and
- provide, in expectation, a **stream of broadly constant real income for life**.

Minimum additional income

The overall methodology of the proposed test provides a reasonable basis to assess the income efficiency of a CIPR. While the methodology requires some complicated steps, the basis of ensuring that the income payments are significantly higher than the common practice of minimum drawdowns from an account-based pension should ensure an increase in income efficiency for the retirement phase of superannuation. There are however concerns with the source of the assumptions that the AGAs proposes to be used in the test.

First, the earnings and discount rates underlying the valuation of the account based pension are set at a prescribed rate. However, the earnings and discount rates underlying the valuation of the non-guaranteed part of the CIPR are based on the provider's best estimates. This approach therefore introduces inconsistency between the valuations that would reduce the accuracy of the income efficiency test. The rationale provided by the AGA for proposing prescribed rates was to prevent funds from manipulating the income efficiency test by inflating the costs of the ABP minimum. However, this concern would be better addressed by other means. In particular, the ABP cost assumption could be prescribed while allowing funds to use consistent investment return assumptions to value both the ABP and the CIPR. In this way, the income efficiency test would maintain all the return assumptions consistent between the ABP and the CIPR the only difference being the inclusion of the guaranteed component in the CIPR.

Second, the income efficiency test should control for market risk - to ensure that the income efficiency is not able to be achieved by simply increasing risk. This would not preclude funds from designing CIPRs that allow for higher risk adjusted returns. It would only prevent them from relying on higher market risk to meet the income efficiency test.

Third, there is a mismatch between the prescribed R^* and guaranteed returns that are available in the market that will cause material distortions in the assessment of the income efficiency of a CIPR. While the assumed investment returns of the non-guaranteed component and the pricing of any guaranteed component would reflect market conditions at the time, R^* seeks to represent a "long term" view of real rates of return. The prescribed rate of 3.3% real is well above what is available in the bond market now or in the last decade. The long term historical average, while close to 3.3%, is distorted by the 1980s and 90s when real interest rates were held high to control inflation.

While the high benchmark rate would not, at present, prevent a CIPR with a guaranteed component from passing the test, future market conditions could either make it impossible to provide a guaranteed product or require the guaranteed component to be reduced to sub-optimal levels. This would not be driven by any objective assessment of the value of the guaranteed product, but rather by the use of a parameter based on an average historic rate that does not reflect market conditions. Economists, including Robert Shiller, question whether historical average returns are achievable even for non-guaranteed product. It would be more appropriate to link the discount rate for any guaranteed component to the real government bond yield. These currently range from 0.25% p.a. for a 5-year bond to 0.94% p.a. for a 33-year bond. These rates are consistent with other market-based rates that would be used in the assessment of a CIPR, such as future return expectations on a balanced fund. If real yields increase in the future, the expected returns on both balanced funds and annuities would be expected to increase, resulting in consistency in the assessment of products.

The discount for a guaranteed product proposed in the discussion paper addresses a separate issue – that is the need to attribute value to the guarantee which removes the downside risk of adverse outcomes on income to the retiree. While guarantees usually carry additional cost, they provide secure incomes in retirement which surveys indicate are valued highly by retirees. A 5% discount represents a reasonable estimate of the additional benefit of a guarantee.



Source: RBA Data

Constant Real Income

The CSRI does not consider that the proposed income efficiency test succeeds in establishing an effective test of the achievement of the constant real income requirement. The problem arises from the inherent inconsistency between the phrases “in expectation” and “will be achieved”. The test is based on an actuarial best estimate of real income levels, meaning that all risks are ignored and has only a 50% probability of eventuating. In contrast, the phrase “will be achieved” would lead the average member and trustee to reasonably expect a much higher probability than the 50% implicit in the best estimate.

A related issue is that, while the discussion paper clearly states that “the test is not intended to test for volatility of outcomes around the best estimate”, the payments ought to be achieved for a period of life beyond life expectancy.² Specifying clearly a requirement for steady income beyond life expectancy would provide greater consistency and better address longevity risk management in retirement.

A proposed approach to address both these issues would be to require that the income be provided at a higher percentile for success. For example, it might consider the outcome for markets at a 25th percentile for someone living to the 75th percentile of life expectancy. This would provide a constant level of real income to a high probability, although there would still be circumstances where adverse markets and/or high longevity could result in constant real income not being payable through the entire life. A regular assessment of any non-guaranteed component of the CIPR could adjust drawdowns over time to avoid sudden drops in income.

A second issue with the constant income test is that it excludes the Age Pension income which may be an important moderating component of income for many retirees. Consideration should also be

² This was noted in discussion at a consultative meeting convened by the Australian Government Actuary and Treasury in Sydney on 19 June 2017.

given to expanding the definition of “constant real income” to allow for two possible tests – one that takes into account the Age Pension and another one that does not. It would then be up to the Fund to decide whether Age Pension is an appropriate consideration for its own “default” member base.

Question 13: Should Trustees be able to offer one or multiple CIPRs as the mass customised retirement income product offering to member? Why or Why not?

Given that the retirement phase includes the additional complexity associated with managing variable consumption levels and varying age pension entitlements, it is fair to say that members’ circumstances are more diverse in retirement than during the accumulation phase. Given this diversity, there would be merit in designing the CIPR regulatory framework to facilitate the ability of trustees to provide mass-customised, rather than mass produced, solutions.

A mass customised solution at a minimum should take account of members’ ages, gender, health status, outstanding debt, while also providing the option of a reversionary benefit for couples. Having gone this far it may not be a huge leap to also take into account the member’s age pension entitlement to better ensure the stability of total income over the course of retirement.

The CIPR framework should enable trustees to design CIPRs suitable for their membership, providing flexibility and equal support for single and multiple CIPRs. Trustees should be given the discretion to decide whether the additional benefits of providing more than one CIPR would outweigh the additional cost and effort.

It would be possible to use readily available additional factual information held about the member’s circumstances (including gender, age, and super balance) to pre-select which of the trustee’s CIPRs would provide the most reliable retirement income with a component of access to capital suitable for the majority of members.

While the trustee will have certain information about the member, they should also be permitted to seek additional broad information from, and about, the member that would assist in pre-selecting an offer for the member, particularly where the fund provides multiple CIPRs on a member segmentation basis.

Where a fund provides multiple CIPRs on a mass customised basis, each CIPR should be required to fulfil the trustee’s best interest duty in relation to a segment of the funds membership. Only one CIPR would be expected to be suitable for the majority of the membership to be offered, with appropriate disclosures, to members who do not engage.

While there may be multiple variations of CIPRs for different member cohorts based on a market segmentation approach, by offering each member only one CIPR, the member’s decision-making would be considerably reduced. There are certain circumstances in which it would not be appropriate to offer a member a CIPR such as in the case of diagnosed terminal illness.

Question 14: If funds were able to offer multiple CIPRs as the mass-customised retirement income product, on what basis would CIPRs differ?

Whether the fund provides a single or multiple CIPRs, the minimum information required for each member should ideally include:

- Whether the member wants to consolidate other super accounts into the fund.
- Whether the closing superannuation balance will be used to pay off debt.
- The member’s health status to judge whether a pooled longevity product is appropriate.
- Whether the CIPR is to be provided for an individual or couple to determine whether a reversionary benefit may be called for.
- Age and gender to permit pricing of pooled longevity components.

Further segmentation would enable trustees to take into account the members’ social security entitlements in developing a constant income stream. Additional member information would include:

- Whether the member is a homeowner or renter.
- Total level of superannuation assets of the individual or household.

- Level of means testable non-superannuation assets of the individual or household.

On the basis of this information, the fund would be in a position to determine which of its multiple CIPRs is appropriate for each member. Members who do not engage with the fund would be offered the mass customised CIPR suitable for the majority of fund members based on the objective information the fund has available about the member (age, gender, super balance). The process for preselecting a CIPR for the member is discussed in Section 5.

2. Regulatory Settings for Trustees

Questions 16: Would a safe harbour for their best interest obligations remove a key impediment to trustees designing and offering CIPRs?

In developing a regulatory framework for CIPRs, the Government has indicated that it will not limit individual choice and flexibility. Retirees will be given the option to opt in and the framework will facilitate trustees offering CIPRs but it will not require them to do so.

This is an appropriate position as it would be difficult to make CIPRs a requirement from the date they are planned to be introduced (July 2018 at the earliest) given the range of longevity pooling products current on offer is limited and deferred annuities will not be available (at the earliest) until various regulatory changes come into effect. Specifically, the new income streams means-testing requirements are not expected to be introduced until 1 January 2018 at the earliest.

In the absence of an express requirement on trustees to offer a CIPR, trustees would need to be encouraged to provide CIPRs through a range of mechanisms. Providing trustees with legal certainty as to their obligations (legal safe harbour) is one such mechanism, but it is not necessarily the most effective. Other mechanisms are outlined in the response to the answer to question 18.

How far this safe harbour should extend will influence trustees' decisions regarding the design and offer of CIPRs. At the same time, it is important that sufficient protections are in place to guard against members being placed in a product unsuitable for their needs and having no legal recourse. The safe harbour would need to be clearly limited to ensure that members' interests are appropriately protected.

The safe harbour should apply to a mass customised product design and offer, to protect trustees against claims that the product doesn't address peculiarities of the member, but the safe harbour will not extend to the provision of advice. Further, that the safe harbour should only seek to overcome impediments trustees face in pre-selecting a CIPR and offering that CIPR to a member, without providing a defense or carve-out, for instance, from financial advice law for any subsequent actions.

Given that the needs of members are more diversified in retirement than during accumulation, the framework should facilitate the provision of multiple CIPRs on a segmented basis where segmentation adds value to the member cost effectively.

Question 18: After an appropriate transition period, should the government consider whether there should be an express obligation on trustees to offer a CIPR? If so, what length of transition period would be appropriate?

It is appropriate that the CIPR framework is being designed as a facilitative rather than a compulsory model to allow time for the market to develop in accordance with member needs, advancements in member engagement technologies and product innovation. Once the market for innovative income stream products is established, it would be appropriate to make it an express obligation of trustees to offer a CIPR to their members, whether it is sourced internally or through a partnership with a third-party product provider, given the importance of access to suitable retirement benefit products for the outcomes of members in retirement.

During the intervening period, all funds should be required to have a retirement benefit strategy in place by 2020 (as discussed below). Based on this plan, trustees who do not offer a CIPR should be required to disclose the reasoning behind their decision. Also, funds seeking to be a default super

provider should be required to have a retirement benefit strategy by the time the alternative default superannuation model is introduced as discussed in Section 6. By including retirement benefits as a criterion for the selection of default funds, this will ensure that all super default members will have access to an attractive CIPR solution as they approach retirement.

Superannuation Trustee Retirement Benefit Plan

A concern with the proposed framework is that it offers trustees the binary choice of following specified product and process requirements or doing nothing at all. The consequence is that trustees may decide that it is all too difficult and that they may as well wait and see how the market unfolds. This concern is reinforced by a survey of super fund CEOs (Mercer 2017) that indicated that 55 per cent of funds have "no clear strategy" on how to service the needs of retirees and pensioners.³

If funds do nothing, the development of the market may be stifled as the scale and diversification needed to make pooled longevity protection work within funds, will not be achieved, member outcomes will not be improved and the government's policy objectives will not be met.

What is needed is an overarching framework that encourages trustees to make progress at an appropriate pace in helping members to transition to retirement. An appropriate starting point is for trustees to consider the impact of demographic change on the movement of members into the retirement phase and the implications for the fund's strategy and business plan.

Trustees should be required to develop a retirement benefit strategy for the fund that includes consideration of the needs of the membership and the retirement products and options to be provided. An express requirement for a retirement benefit strategy would ensure that all funds have proactively considered the issues and have a plan for proactively addressing the challenges of an aging membership.

A broad framework should be provided for the provision of CIPRs through the development of prudential standards for the retirement phase. This would be similar to the requirement on trustees to have an insurance management framework that reflects the risks associated with making available insurance benefits to their members.⁴ These standards would be principles based and may cover the following considerations:

- Requirement to have an CIPR framework that includes a strategy, policies and procedures; defined roles and responsibilities, a review process, compliance procedures, and risk management framework.
- CIPR strategy consistent with section 52(6) of the SIS Act (including modification below).
- Documentation requirements of CIPR policies and arrangements.
- Selection and monitoring of third party providers (fund managers and/or life companies) of CIPR components.
- Review of CIPR framework on a regular basis (for example every 3-5 years).
- Transitional arrangements where the RSE licensee has already commenced offering CIPRs prior to the commencement of this standard.

Trustee requirements in relation to the investment strategies of the fund and the range of risks that need to be taken account of (section 52(6) of the SIS Act) should also be updated. In particular, these should require trustees to devise an investment strategy not just for the fund as a whole and for each investment option, but also for the assets held on behalf of post-retirement members. This should have regard to the existing factors — risk, diversification, liquidity and the ability to discharge liabilities, as set out in section 52(6) of the SIS Act — plus two additional factors — inflation risk and longevity risk. This would complement the current trustee requirements to have a written strategic and business plan.

³ Mercer (2017), 2020 Super Fund Executive Report.

⁴ Superannuation Prudential Standards SPS 250

3. Ensuring that Products Meet the Minimum Product Requirements

Question 19: What process should be used to ensure that a CIPR meets the minimum product requirements?

As identified in the discussion paper, self-assessment would raise the risk of CIPRs being launched in the market that do not meet the minimum product requirements, leaving the regulators to take action after members have already been placed in the product and commenced the income stream.

Recognising that regulatory approval of both the product and the offer process will be required, the CSRI recommends a hybrid approach to authorisation.

Regulator authorisation would provide certainty that trustees have met the product and process requirements before launching a CIPR. This determination would provide binding approval subject to appropriate review processes. A public register of past product determinations would further support innovation and competition by providing guidance to other parties on the development of CIPRs.

As part of the CIPR authorisation process, trustees should be required to submit to the regulator an independent actuarial report to certify that the proposal meets the minimum product requirements. In this circumstance, the actuary would need to be independent of the trustee to provide the necessary degree of confidence that the CIPR design is consistent with the policy principles. This recognises that a degree of professional judgement is required to determine the appropriateness of the underlying assumptions notwithstanding the fact that parts of the assessment are objective.

4. Facilitating Trustees to Offer a CIPR

Question 24: To which members would it be most appropriate for trustees to offer a CIPR? All members or only MySuper members?

Within the facilitative (rather than compulsory) framework being developed, trustees will not be required to offer a CIPR although this will likely change over time. The question of which members would it be most appropriate for trustees to offer a CIPR is relevant to determining the scope of the legal safe harbour.

CIPRs designed to be suitable for the majority of members would serve as a useful anchor for all members not just MySuper members. Offering CIPRs more broadly would also lead to higher take-up of CIPRs. In doing so, this would increase scale (which is important particularly for pooled products) and would allow the proposed objective of the superannuation system (to provide income in retirement) to be met more efficiently.

Members of SMSFs should also receive access to appropriate retirement benefits to ensure stable income in retirement. While SMSFs will not be able to create CIPRs because they lack the expertise and scale to pool longevity risk, they could access retirement benefit products from third party providers. SMSF trustees should be required to develop a retirement benefit strategy for their members. This requirement would at least prompt SMSF trustees to consider the ability of the other members of the fund to manage the fund on the death of a principal guiding trustee.

At the same time, there is not the same necessity for defined benefit schemes to offer CIPRs. These schemes have traditionally placed the emphasis on the end benefit. Therefore, the framing issue that CIPRs are designed to overcome in encouraging better retirement benefit choices is not present in defined benefit schemes.

It would be inappropriate for members of legacy funds, life office statutory funds, eligible rollover funds, Approved Deposit Funds, small APRA funds, and funds that are being 'wound up' to offer their members a CIPR.

Finally, it would be inappropriate for the legal safe harbour to extend to the offering of a CIPR in cases where the trustee is aware that the member has a terminal illness.

5. Disclosure

There would be merit in the government, industry and consumer groups working together to develop CIPR product offer and disclosure standards. Once these have been developed and endorsed by the regulator, trustees operating in accordance with the guidelines would have certainty that they are meeting their obligations regarding members' best interests. Suggestions for the development of the offer process guidelines are provided below.

Question 27: What information about CIPRs should be conveyed to members by trustees during the pre-retirement phase and how often should this occur?

There would be merit in trustees engaging with members in advance of possible retirement to encourage them to start planning and make them aware that a CIPR will be offered to them at the appropriate time.

In the pre-retirement stage (10-15 years before age pension age), communication with the member could include the following:

1. Information on the choices at retirement to manage the key retirement risks they will face and the factors to consider in making their choices (information and education).
2. Provision of projected balance at retirement and peer group comparisons including disclosure of underlying assumptions and appropriate caveats.
3. Provision of retirement income projections based on an indicative CIPR option and the available key member information and/or assumptions, including disclosure of underlying assumptions and appropriate caveats eg health status, liabilities, and other assets.
4. Identification of actions members should consider to improve their retirement income including making additional contributions and consolidating accounts, and the consequences for the members' projected retirement income of either delaying or bringing forward their retirement.
5. Notification that in due course they will receive further information about a retirement benefit offer (CIPR).

Nearer to retirement (age 55-65) communication with the member could include the following:

1. Reiteration of points 1 to 4 above.
2. Notification of the availability of a CIPR offer from the fund. If they are interested in receiving the offer of a CIPR product from the fund they should confirm, correct and/or complete the required information. Further notification that a CIPR is not a tailored solution and will be based on limited information.
3. Advising that if the member seeks a tailored solution, they should seek advice from a financial planner or other appropriately qualified profession, either through the fund or externally.
4. Extension of an invitation to a retirement seminar and references to useful sources of information provided in members' best interests that can assist their planning.

Question 29: What is the best way to communicate the offer of a CIPR to members?

The requirements for the offer process should include an acknowledgement of the absence of advice, that the offer has been made without taking into account the specific circumstances of the members and the requirement for the member to opt in. The offer would also include:

- Other relevant disclosure requirements (as outlined in the response to Question 30) including descriptions of the product characteristics and expected benefits sufficient to allow the member to make an informed choice.
- Refer the member to other sources of advice and information in the members best interest to assist in making a decision (such as financial advice, super fund retirement seminar and links to relevant Commonwealth Government websites.)

Regardless of whether the member has engaged with the fund, the offer acceptance process would require the member to expressly confirm that they have been offered:

- A product, including a longevity component, and that they understand the consequences.
- A reversionary benefit for a dependent partner which they have accepted/declined.
- That they have not been diagnosed with a terminal illness.
- That they are aware of the cooling off period and the portability restrictions.

The CSRI supports that the Treasury has commissioned research from the Behavioural Economics Team of the Australian Government on the presentation of the features of retirement income products and intends to commission further research to better inform the requirements of the CIPR offer requirements.

Question 30: What is the most appropriate type of disclosure document to provide further information about a CIPR to consumers and intermediaries such as financial advisers?

Comparative product disclosure is simply a starting point from which members can gain a basic understanding of the product features which may prompt them to seek further information as needed. The disclosure requirements should explain how the pooled longevity risk component's return profile fits within the overall portfolio. Additional tools to support this disclosure should focus on and reflect member outcomes of using the longevity product.

The current principles-based product disclosure regime in part 7.9 of the Corporations Act applies to all financial products and should be able to accommodate any form of CIPR. This requires that the risks, benefits and significant characteristics of a financial product be disclosed. Existing financial products that insure against longevity risk via pooling and guarantees are issued under the Corporations Act product disclosure statement regime.

It would be appropriate for the relevant 'product disclosure' for a CIPR to be addressed in a document 'incorporated by reference' (IBR) into the PDS offering the trustee's superannuation product where that is appropriate. A standalone, short form PDS for a CIPR is unlikely to enable sufficient disclosure of relevant detail for a member.

Given that variable annuities and deferred annuities have been sold in the US for many years (although under a different regime), the one-pager table/graph that is commonly used in those circumstances may serve as a useful starting point: (refer to <https://www.americansavingslife.com/products/annuities/premier-series-ii-annuity/annuity-calculator> and <https://personal.vanguard.com/us/whatweoffer/annuities/guaranteed-lifetime-withdrawal-benefit> as examples.) Members need to be helped to focus on the outcomes in different scenarios rather than the actual mechanics of the product.

6. Competition

Question 32: What is the best way to foster competition in the CIPR market and broader retirement income product market?

Employee choice has not been successful to date in driving competition and efficiency throughout the market. A range of factors limit demand side pressures and accentuate member passivity and disengagement. These include the compulsory nature of contributions, the availability of the age

pension, the complexity of retirement income decisions, long time horizons, various behavioral and cognitive biases, and the costs of active involvement.

Requiring members to make no choice at all however would stifle engagement further. If the individual is forced to choose an option, they may be much less prone to the effects of inertia and are encouraged to actively consider the choices. This may be effective at increasing engagement in the decision as well as competitive incentives on product providers. Experience in the United Kingdom with compulsory annuitisation provides some insight into the way members respond when they are not required to make a choice. In this case, the default product provided by the individual's pension provider resulted in consumer apathy and disengagement from the process, and often resulted in consumers not getting the best product available to them.⁵

To improve superannuation system outcomes, an important policy aim should be to empower members to better plan for retirement. To be successful, employee choice requires commitment to a number of supportive strategies including:

- Greater standardisation of options across the industry to remove complexity and enable greater comparability
- Clear communication to the member about the outcomes that they will experience rather than the technical details of the products offered.
- Provision of independent retirement planning information through channels targetted at various population cohorts to encourage member interest and motivation in managing their superannuation savings and taking charge of their retirement planning.

The first priority is to provide information and support to assist members approaching retirement to make the various decisions they need to make regarding their choice among CIPRs and other retirement benefits.

To reduce the complexity of decision making and to allow comparability across funds, there would be merit in making available a low-cost universal advice tool to assist members to make a choice among CIPRs and to assist funds to communicate to their members the trade-offs involved in tailoring a CIPR. For marketing purposes, super funds may be more inclined to develop their own proprietary tools (with or without the help of third party specialist application developers). However, cost-efficiency and member decision-making will more likely be enhanced though a consistent approach across the industry.

On this basis, there would be merit in the government, industry and consumer groups working together to develop disclosure standards and a core CIPR product comparison tool. Once the standard tool has been developed, it should be authorized by the regulator and made widely available to members via their super fund and to all retirees from the ASIC Money Smart Website. This should be made available in time for the market launch of the first CIPRs.

At the same time, the launch of the CIPRs framework should be accompanied by a government awareness campaign targeted at pre-retirees and people in early retirement. This would inform the public of the why the government is facilitated the development of CIPRs, how members will benefit and where they should go for more information.

The resources used to empower members are resources well spent to make the market work more effectively and improve member outcomes. To be clear, this doesn't mean turning every super member into a financial expert. On the contrary, it would mean removing unnecessary complexity in the system, focussing member communication on outcomes rather than technical product features and providing support for decision making.

Contestability

There is some concern that disclosure and competition in the market alone are insufficient to ensure that members' interests are met effectively in the superannuation market given the prevalence of

⁵ Financial Conduct Authority, 2014; 2015.

disengaged members. The government is thus considering introducing an alternative default model to inject greater competition **for** the market. Excluding the retirement phase from the alternative default super model has the potential to leave default members even less well prepared for the decisions they are required to make at retirement than they are currently. To ensure that the needs of members at retirement are given their due consideration, access to retirement benefits should be included in the criteria for assessing the efficiency and competitiveness of the super system. If the government does move to introduce an alternative default model, it will be important to ensure that default members receive the support they need at retirement through access to a CIPR.

The stated purpose of the alternative super defaults model is to encourage efficiency and competition across the whole super industry with a view to ensuring that members best interests are met. Excluding the retirement phase from the alternative default model however perpetuate an accumulation and wealth creation focus that sits at odds with the government's aim to legislate a purpose for super as "*to provide income in retirement to supplement and substitute the age pension*".

In limiting the scope of its inquiry to the accumulation phase, the Commission's Discussion Paper (2017) suggests that super funds should specialise in either the accumulation and retirement phases given the significant differences between these phases in terms of member needs and engagement. However, to require funds who are seeking default fund status to provide default members with access to a retirement benefit would not preclude funds from specialising in the accumulation phase and providing access to a retirement benefit from a third-party superannuation benefit provider.

Also, while there are indeed significant differences between the two phases, the evidence points to significant synergies, from both a member and fund perspective, in adopting an integrated approach across the two phases. Members face a range of barriers to effective retirement planning including high system complexity, low financial literacy, and behavioural biases in decision making. To help overcome these barriers, super funds are seeking to engage with members (through seminars, benefit projections, calculators for example) during the accumulation phase to adequately prepare members for retirement. Indeed, the CIPR framework should encourage trustees to engage and assist members with better decision making to enable a smoother passage to retirement.

Excluding the retirement phase from the alternative default model however works against such member engagement. This is because under any new default model, members would remain in the same fund throughout their working life unless they choose to switch. Default super providers would have little incentive to encourage member engagement because only an engaged member can make the choice to switch funds, leaving members less well placed to make decisions at retirement.

Rather than a discrete accumulation phase followed by a decumulation phase, an integrated approach avoids a forced and high-risk point-of-sale in the transition to retirement and facilitates projecting benefits in terms of income. From a behavioural perspective, an integrated approach would serve to anchor member benefits as a lifetime pension.

From the perspective of the super fund, it is also questionable whether specialising in accumulation products in the context of an aging member demographic would be a viable strategy for many funds. With members entering the retirement phase at an accelerating rate, funds who do not offer pension products would face increasing fund outflows.

The PC Discussion Paper has also stated that the additional complexity of including retirement benefits "*is not likely to illuminate the question of default models at the start of a working life*". Rather than adding complexity for the member, including retirement benefits in the default model would provide a more supportive framework for member choice and a smoother transition at retirement. Explicitly linking the default system and the CIPRs requirements would better ensure that default members receive the advantages of a suitable retirement benefit rather than remaining in a product designed for accumulation members.

An alternative to including retirement benefits in the selection criteria for default funds is to develop a separate alternative default model for retirement products. However, this would result in unnecessary duplication and higher regulatory costs without the benefit of providing members with a smoother transition to retirement.

It might be argued that retirement benefits cannot be included in the alternative default model because CIPRs are not yet developed. Rather than being an argument for excluding retirement benefits from the scope of the default model, this simply reinforces the need for alignment between the alternative default model and the stage of development of the CIPR market. To this extent, inclusion of retirement benefits would not add complexity to the alternative default model process as it would simply link with the CIPR framework.

More particularly, in the period before the CIPR framework is introduced, trustees should simply be required to have a retirement benefit strategy (as discussed in Section 2) to meet the requirements for a default fund. Once the new income stream products are available and the CIPRs framework is introduced, default funds should be required to offer a CIPR.

The CSRI recognises that whether the alternative default model is introduced is contingent on a number of unresolved factors. However, if the alternative default model is to be introduced, default members should be assured of gaining access to an appropriate retirement benefit, whether that is provided internally by the fund or through a partnership with a third-party superannuation provider.

7. Products Outside the Mass-Customised CIPR Framework

Question 35: Should a retirement income product that meets the minimum product requirements of a CIPR be labelled as such?

There may be trustees who would wish to offer CIPR-like products directly, or via financial planners, to their members or other customers. The CSRI notes that only superannuation funds would be able to 'manufacture' CIPRs.

On this basis, if a product meets the minimum product requirements of a CIPR as determined by an independent actuary (as discussed in Section 3), but it was not offered as the mass-customised product, the trustees and product providers should be allowed to label the product as 'meeting the minimum product requirements of a CIPR'. In this way, competitive neutrality among products meeting the CIPR minimum product requirements would be maintained.

In this situation, legal safe harbor protection would not be available to the trustee or product provider given that the product offer requirements have not been met or the product was provided under advice.

8. Other

Question 40: Should the CIPRs framework accommodate a joint CIPR for couples (and if so how)?

Given that women on average have lower superannuation balances and longer life expectancies than men, it is important that members of a couple are able to share their superannuation benefits to improve the adequacy of retirement incomes for women. The framework should facilitate the sharing of superannuation balances among couples and this should be accommodated for within both single and multiple CIPRs.

Particular care will be needed in the CIPR offer process to ensure that disengaged members are not placed in inappropriate products. The CIPR offer acceptance process should require members to expressly confirm that they have been offered a joint CIPR (or underlying product components) and have either accepted or rejected it.

9. Personal Financial Advice

As CIPRs are a mass customised solution designed for the majority of members or for member segments, many members would benefit from receiving financial advice that takes into account their individual circumstances, goals and needs to assist in deciding which CIPR to select. There is an imperative to develop more cost-effective means of delivering financial advice in forms other than face to face, including intra fund and robo advice to assist members in planning and managing their retirement.

This raises the question of how well the current financial advice regulations would accommodate the provision of advice relating to CIPRs for members on a cost-effective basis.

Regulation to support the provision of advice that is limited in scope already exists within the scaled advice regime. This provides guidance on the best interests' duty and related obligations in the provision of advice that is not comprehensive⁶. This ensures that the clients' relevant circumstances are taken into account and that the scope of scaled advice is determined by the requirements of the member rather than the interests of the agent providing the advice. It also provides a series of steps that advice providers may rely on to demonstrate that they have complied with the requirements.⁷ The scaled advice regime, including the scenarios relating to retirement income advice, would appear to provide sufficient clarity for scaled advice relating to CIPRs. Implementation of CIPRs may raise questions relating to scaled advice that would warrant clarification in the scenarios – however those questions are not apparent at this stage.

The cost of financial advice is often raised as a factor to explain why so few people seek financial advice. This is an issue particularly for members of limited means who are nonetheless exposed to highly complex tax and social security arrangements. 'Intra-fund advice' refers to the types of advice that superannuation trustees can provide to members (over the phone, via email or face to face) where the cost of the advice is borne by all members of the fund whether sourced internally of the fund or outsourced.

Recognising that all members will at some stage benefit from advice to help select a retirement benefit, there is some justification for making such advice available within intra-fund advice. A number of restrictions currently apply to intra-fund advice that serve to limit its use for advising members in their choice of CIPRs. In particular, it can only relate to a beneficial interest in the fund or related assets and cannot relate to the consolidation of superannuation holdings in two or more superannuation entities. The rules for intra-fund advice should thus be broadened to accommodate the sharing of costs associated with a limited form of advice to assist members in selecting among CIPRs.

In particular, intra fund advice should permit consideration of members' broader circumstances and assets that go beyond the beneficial interest of the fund but only in so far as is necessary to assist members in selecting a CIPR. It should also be possible within intra-fund advice to inform the member of the benefits of consolidating super assets within one fund without advising them of which fund to consolidate in given the obvious conflicts of interest.

⁶ ASIC Regulatory Guidance 244

⁷ Section 961B(2) Corporations Act