Implementing a retirement income strategy

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Challenger Retirement Income Research

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The retirement income covenant (RIC) will require super fund trustees to have a retirement income strategy for the benefit of retired (or retiring) members. New 52AA(2) of the SIS Act sets out the requirements for the strategy:

> (2) The strategy must be for the benefit of beneficiaries of the entity who are retired or who are approaching retirement and must address how the trustee will assist those beneficiaries to achieve and balance the following objectives:
>
> (a) to maximise expected retirement income over the period of retirement;
>
> (b) to manage expected risks to the sustainability and stability of retirement income over the period of retirement of the following kinds:
>
> (i) longevity risks;
>
> (ii) investment risks;
>
> (iii) inflation risks;
>
> (iv) any other risks to the sustainability and stability of the retirement income;
>
> (c) to have flexible access to expected funds over the period of retirement.

For trustees to comply with the covenant, the retirement income strategy will need to address all these objectives. This paper will assess each element in turn, with the aim of exploring some of the practical issues in designing and implementing a compliant strategy.

Maximise expected retirement income

The core purpose of super is to provide workers with a source of income in retirement. There might be some debate over whether that income needs to be significant or the lifestyle it supports dignified; and whether it replaces or supplements the Age Pension, but there is agreement that super's role is to provide income in retirement. Maximising this income provides a good measure of success for super. There are a couple of additional qualifiers in this statement. It is worth exploring what the additional terms, 'expected' and 'retirement income' mean for a fund to be able to design and execute its retirement income strategy.

Retirement income

The concept of 'retirement income' differs from the ordinary concept of income, say for tax or accounting purposes. The explanatory memorandum (**EM**) to the RIC legislation provides guidance on what the term (which was not previously defined in the SIS Act) includes. It is not what an accountant would put in a tax return. New subsection 52AA(5) defines the scope of retirement income, for the purposes of the strategy, as involving two limbs. The first limb (paragraph (a)) outlines the types or sources of income that must be included in the strategy. The second limb (paragraph (b)) permits other sources of income to be included if the trustees think it is appropriate. The subsection says:

> (5) The trustee must determine the meaning of retirement income for the purposes of the strategy, which:
>
> (a) must include income, net of tax, received during the period of retirement of the following kinds:
>
> (i) income paid from, or supported by, a superannuation interest in the entity;
>
> (ii) income from an age pension under the Social Security Act 1991; and
>
> (b) may include income from any other source if the trustee determines that it is appropriate to include income from that source.

The EM explains further [para 17.41] that other sources could include other income support payments such as from Veteran's Affairs, income from non-super assets or superannuation interests in another fund or income from a partner. This provides a wide range of potential sources of income for a super fund to consider. In order to comply with the covenant, it is only the income under (a) from the super fund and the Age Pension that **must** be included. The other sources are optional. Capturing this information could lead to a better outcome for a particular member or type of member, but is not required to comply with the RIC.

The reference to 'income' includes the drawdown of accumulated super (ie the regular consumption of the capital balance). The EM is explicit in explaining that the maximisation of retirement income is not subject to 'any objective quantitative measure'. Rather, 'trustees **should assist beneficiaries to drawdown superannuation balances**'. Balances left to an estate on death cannot

be part of the maximisation objective. This is the case even if a member wishes to leave a bequest. In such a case, the bequest would be a personal member goal, but cannot form part of the trustee's strategy.

This aspect of the RIC appears to be a conscious attempt to alter the current practice of under-spending by many retirees, as noted in the 2019-20 Retirement Income Review final report. Rice Warner research for the Retirement Income Review found that more than half of retirees over 65 drew down their super at the minimum rate.[1] The reliance on minimum drawdown strategies means that most retired fund members will leave up to 32% of their super, even if they live to 100.[2] The Retirement Income Review found higher estimates in other research, with one study estimating that up to 90% of retirees' wealth was being left to their beneficiaries.[3] If there were a way for retired members to draw more of their savings, so that only 10% was expected to remain on death, then on average, retirement income would be 28% higher.[4] That would see a significant increase in living standards in retirement and would see more spending of tax advantaged savings that were accumulated for that purpose.

Need for an ex-ante perspective

The fact that no one knows how long they will live makes it complicated for the fund to develop the strategy. However, the legislation provides some guidance. The first point is that the retirement income need only be **expected** to be maximised. There is no hindsight measure for members who die at younger ages. In expectation, the income received will be dependent on being alive. This implies that a mortality-weighted approach is suitable. In other words, trustees will have to make informed assumptions about what proportions of their members are likely to reach older age bands. Trustees are also required to balance longevity risks to the income, and as we will see below, managing longevity risks increases retirement income for many members.

The requirement to consider expected income highlights another point of difference in retirement. As retirement income includes the drawdown of capital, the actual income received will only be known once the member's capital has run out or the member has died. In either case, it will be too late to do anything to help the member. Looking at likely member outcomes in advance provides the opportunity to improve those outcomes in most cases.

The focus on retirement income should help funds and members move away from the traditional wealth management view of account balances as the key measure of success. It is true that, all other things being equal, the higher of two balances at the start of retirement can support a higher retirement income in the future. However, as Professor Robert Merton shows, it is not necessarily true that an increase in an account balance produces an increase in income.[5] The 'cost' of the income could increase by more than the increase in the account balance. A related concept is that it is the stream of dividends from a share investment that matters in retirement. Market gains that are just reflected in higher prices do not make a retiree better off if there is no increase in income.

The RIC avoids the trap of focusing on a savings balance, which is only an interim step to producing sustainable retirement income, by requiring the payments to the member to be 'maximised'. Maximising expected retirement income will call for a strategy for delivering cash flows to members over their retirement. This is **in addition to** an investment strategy that maximises (risk-adjusted) returns.

The 'period of retirement'

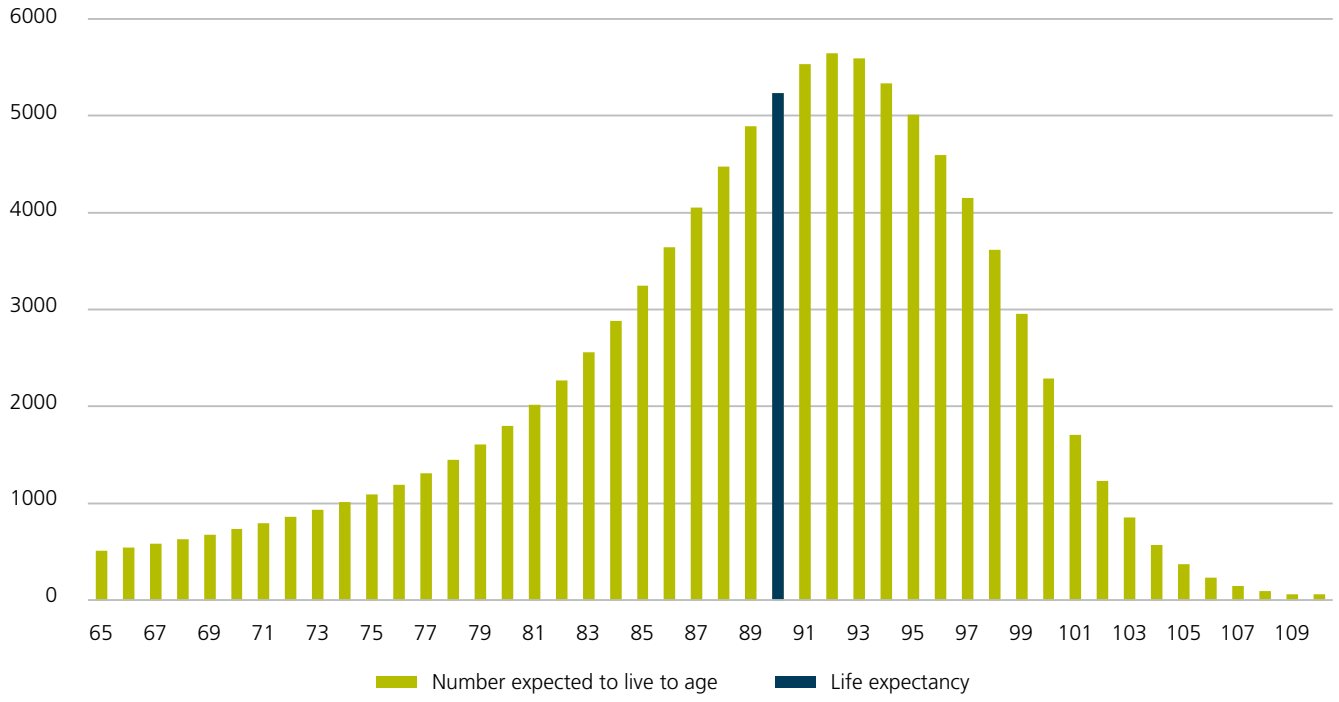
Trustees will also have to determine the 'period of retirement' for the purposes of the retirement income strategy: new subsection 52AA(6) of the SIS Act. Unlike the prescriptive 25-year period (age 67-92) required by ASIC's RG 229 on Superannuation Forecasts, the RIC does not provide a specific number of years to apply to a fund's strategy. Instead, the EM says that the period of retirement could be different for different sub-classes of members [para 17.43].

In considering the period of retirement, trustees should consider potential changes in behaviour, such as the changing pattern of consumption over retirement [EM para 17.45] whereby many retirees reduce discretionary spending as they become less active. It is also necessary to adjust for the impact of inflation [EM para 17.40]. This means that it will not be sufficient for trustees only to consider payments in the first year of retirement. The retirement income strategy needs to apply across the whole period of retirement.

There is no specified starting point to the period of retirement either. This keeps the option open for funds to consider members who might retire 'early', say before Age Pension eligibility age. While this extends the

1 Retirement Income Review Final Report July 2020 p445 https://treasury.gov.au/publication/p2020-100554.
2 *Retirees should splash on themselves, and save the economy,* J. Cooper & D. Knox, Australian Financial Review 4th May 2021.
3 Retirement Income Review Final Report July 2020 p432 and Asher, A., Meyricke, R., Thorp, S. & Wu, S., 2017. Age Pensioner Decumulation: Responses to Incentives, Uncertainty and Family Need. Australian Journal of Management, 42(4), pp. 583-607.
4 Based on Table2C-3 of the Retirement Income Review Final Report p184 replacement rates would increase from 68 to 87.
5 Merton, R.C., 2014. *"The crisis in retirement planning". Harvard Business Review,* 92(7/8), pp.43-50.

Figure 1 Range of expected lifespans, 65yo women in 2022



Source: Australian Life tables, with 25-year mortality improvement factors from the AGA

period of retirement, making the challenge of funding retirement harder, it provides flexibility to trustees to determine the best retirement income strategy for members. The end of the 'period of retirement' is also not specifically defined. The EM [para 17.43] refers to the 'life expectancy of the sub-class of beneficiaries, or a longer period as the trustee may deem prudent.'

There is a potential conflict in this suggestion of a fixed point (life expectancy) in the EM and the requirement in the legislation to maximise expected retirement income. Taken literally, this could imply that a retirement income strategy to deplete accumulated savings by life expectancy might comply with the RIC. This approach could have the effect of maximising the retirement income up to life expectancy while, minimising it after life expectancy. The requirement under subparagraph 52AA(2)(b)(i) to consider longevity risks to the sustainability and stability of retirement income reduces the appropriateness of such a strategy.

In practice, no one knows in advance how long they will spend in retirement. Figure 1 highlights the wide range of potential individual lifespans. It projects the number (out of 100,000) of 65-year-old women in 2022 who would be expected to live to particular ages. It uses the Australian Life tables 2015-17, with the 25-year mortality improvements provided by the Australian Government Actuary. These improvements reflect better health management practices over time, both historical and likely improvements in the future. What Figure 1 illustrates is the difference between the life expectancy concept, which is merely the average of a large pool of lives, age 90 for this cohort, and the likely distribution of actual lifespans. Only 5.2% of this cohort are expected to pass away at 90.

More than half of this population of women will live to 90 or beyond. Not only is there a wide range of expected outcomes, but the most common (mode) age at death is expected to be 92. One in four women are expected to live to at least age 95. What Figure 1 illustrates is that taking the literal approach to 'life expectancy' would fail to provide stable income to the majority of members who are projected to live beyond the expected average. The prudent approach might be to cover at least three out of four members by planning for income up to age 95. A potential alternative is a detailed modelling approach [EM para 17.45] for those funds with the resources and actuarial capabilities to determine the expected income across the whole of retirement by allowing for the full range of lifespans. This could also be used to manage the longevity risks for retired members.

Manage expected risks to the sustainability and stability of retirement income

The retirement income strategy also needs to address specific risks faced by retirees, as well as a more general requirement to manage other risks to the sustainability and stability of retirement income. The RIC emphasises that the key is to provide sustainable and stable retirement income. The EM [para 17.48] defines sustainability as 'lasting for a beneficiary's entire period of retirement' while stability refers to income that is 'broadly constant and predictable year on year'. The stability needs to be considered in inflation-adjusted terms [EM para 17.40]. The three specific risks that must be addressed are:

- Longevity risks [subparagraph 52AA(2)(b)(i)];
- Investment risks [subparagraph 52AA(2)(b)(ii)]; and
- Inflation risks [subparagraph 52AA(2)(b)(iii)].

Longevity risks

Longevity risks are unique to the decumulation phase. It is only when people are drawing income from their capital that it can run out. To maximise the income that is drawn for retirement, it should last as long as a retiree lives.

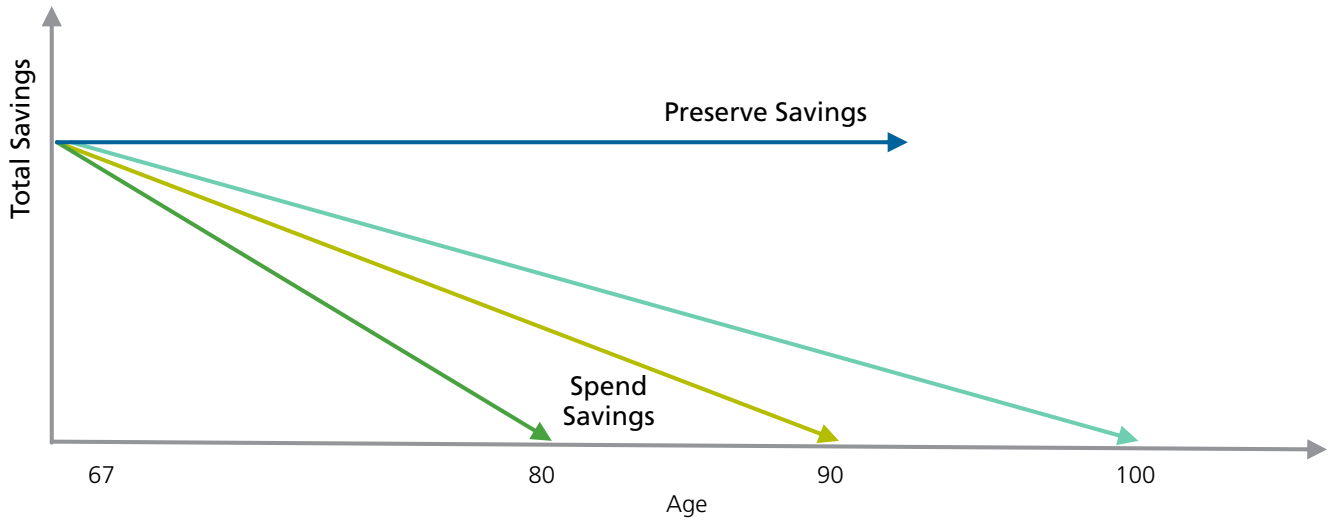
Someone who lives to 95 should plan to run out of money at 95. Someone who only lives to 80 should plan to spend all their money by then (assuming no surviving spouse or other dependants). But not knowing the length of their life in advance, people don't know if they should spend to 80 or 95. Indeed, targeting any single point, such as life expectancy, will leave a large proportion of survivors exposed to a potential shortfall. This is the key risk that needs to be managed. This highlights that longevity risk has two limbs: not knowing how long you are going to live and the risk of outliving your savings if it turns out to be for a long time.

Applying a long horizon to ensure that very few people outlive their savings, say to age 100, creates the problem of a strategy where most people will underspend. The benefits they get from super would be reduced by adopting this strategy. Someone who only lives to 80 would not even spend half their savings. Figure 2 provides a representation of what this looks like.

A retiree who wanted their money to last to age 100 would reduce their spending so that the drawdowns would follow the path of the grey arrow. (In reality, this won't be a straight line, but the concept holds). By age 80, they haven't consumed half their original capital (compounding returns on that original capital drives some of this). They could have benefited from higher spending along the dark green line to age 80 and enjoyed the full benefit of their accumulated savings. It is possible for someone to reduce their spending far enough that they could preserve their savings entirely. This will be good for the next generation, but it comes at a cost of a lower lifestyle for the retiree. Unless a retiree can afford a very comfortable lifestyle without spending any capital, it is unlikely to be an optimal strategy.[6]

The challenge in managing longevity risks for a large number of members is to have a drawdown strategy that meets the target across all the different expected lifespans.

Figure 2 Spending trajectories in retirement



6 The extent of the cost is explored in Minney, A. (2017). "Adding Direction to the Consumption Rate in Retirement". *The Journal of Retirement,* 5(1), 106-116.

The only way to manage the risks associated with the uncertain length of life is to pool across a number of lives using a lifetime income stream. This is what happens when a retiree insures themselves by buying an annuity from a life insurer. The insurer is the one who is pooling across a number of lives. Innovative structures that don't use an insurer (with prudential capital) still need to pool longevity risk across those different lives. This is similar to the diversification of investments in equity portfolios and balanced funds. Diversification spreads an investment over assets with different returns over the same period.

Pooling enables all the accumulated savings to be used for consumption in retirement. Outcomes can be adjusted to ensure that people don't fear being disadvantaged. The death benefit able to be paid from a lifetime income stream under the capital access schedule[7] ensures that someone who doesn't live very long does not contribute excessively to the pool.

The key advantage of pooling is that a retiree can maximise their retirement income by drawing (and spending) the amount that would last for the right time, on average. There is no need for them to accrue a personal buffer by underspending. The result is that they have more confidence to spend their savings.

A buffer can help a retiree increase their confidence of not running out of money, but it means that their expected income will be lower. A recent paper from the UK attributes the economic utility of leaving a bequest as only 1/10th as valuable as having the same amount of money to spend as income while alive.[8]

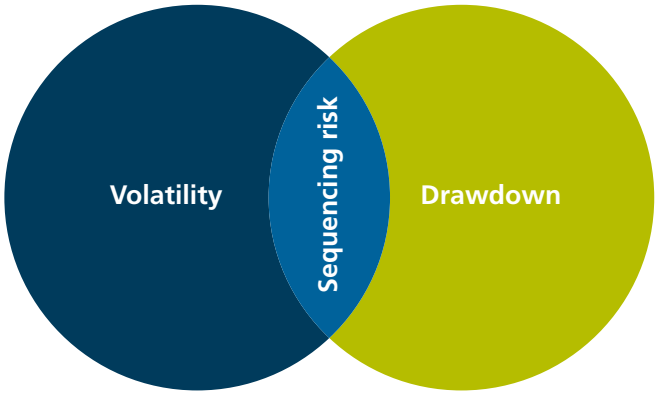
It is also notable that a higher investment return does not remove longevity risks. With higher expected returns, the income drawdowns should be higher, but the challenge to ensure that they last for life still exists. Without some form of pooling, longevity risk remains, and the expected retirement income will be reduced by the money that is not drawn down when implementing a drawdown strategy which uses a buffer for the risk of living a long time. It is possible to have a solution with both some pooling for longevity risk management and high expected investment returns.

The challenge in managing longevity risks is to maintain retirement income at the highest level possible, without the risk of it running out at any point. Conversely, if there is some spending/lifestyle choice that a retiree won't need beyond a certain age, then the retirement income to support that lifestyle does not need to be protected against longevity risks. With the typical pattern of consumption, being a decline in total spending through retirement,[9] it is not necessary to protect all income from longevity risks.

Investment risks

A retiree's investment portfolio will look broadly similar to an accumulator's. All the investment risks that are managed in the accumulation phase are relevant in the retirement phase. There is an additional risk faced by a retiree drawing down their savings: sequencing risk. This is the risk that capital can be run down too early because of the order of a series of volatile returns received during retirement. Lower returns overall are a market risk that is the same as in accumulation. When a low return (or even a fall) occurs before a drawdown, the subsequent higher return does not restore capital to the original position. This is because investment returns are path dependent.

Figure 3 Cause of sequencing risk



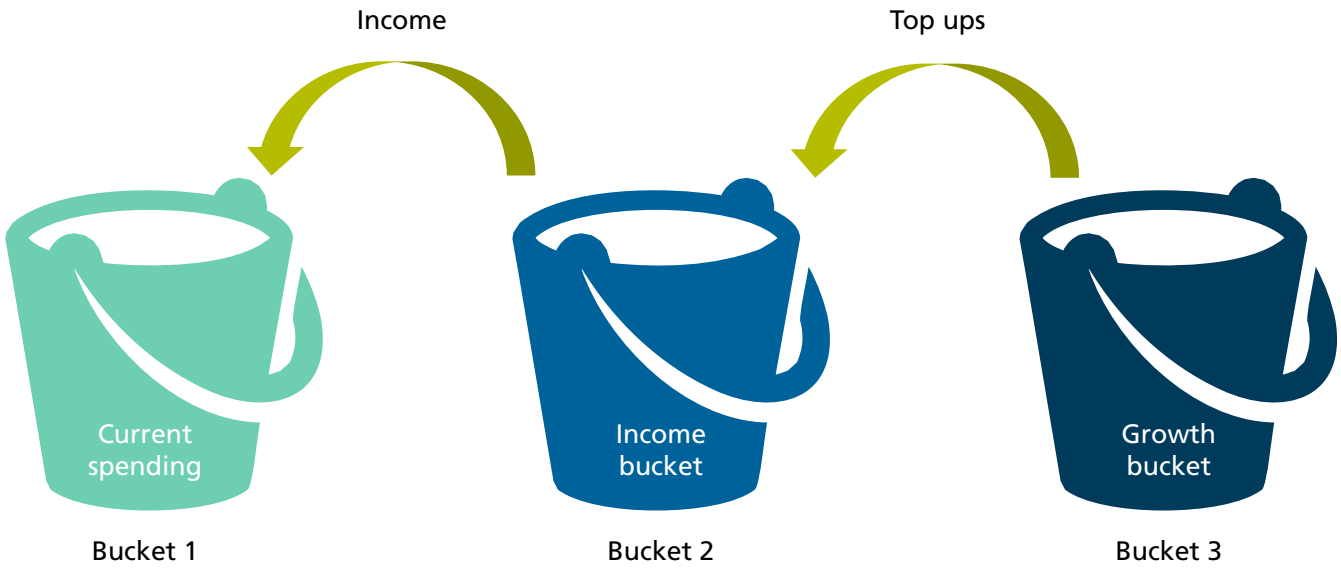
As Figure 3 indicates, sequencing risk occurs when (investment) volatility is present when drawdowns are made. For a retiree, a low initial return followed by a withdrawal means that the capital for the recovery has been reduced. The reverse order, high returns first, would increase the level of capital relative to plans, extending the time that the savings are expected to last.

7 The declining capital access schedule is detailed in Superannuation Industry (Supervision) Regulations 1994 Reg 1.06B. The available capital declines at a linear rate from purchase to a measure of life expectancy (that excludes mortality improvements) at purchase. A death benefit of up to 100% of the purchase price can be paid for the first half of this period.

8 Lane Clark & Peacock LLP (2021): Is there a right time to buy an annuity? https://www.lcp.uk.com/media-centre/2021/11/on-point-paper-is-there-a-right-time-to-buy-an-annuity/.

9 Daley, J., B. Coates, T. Wiltshire, O. Emslie, J. Nolan, and T. Chen (2018). *Money in retirement*: More than enough: Grattan Institute reports this for Australian retirees and Blanchett, D., (2014). Exploring the Retirement Consumption Puzzle. *Journal of Financial Planning*, 27(5), pp. 34-42 reports a similar pattern for US retirees.

Figure 4 Bucket strategy



The solution to manage sequencing risk is to separate the required cash flows from market volatility. A common approach to this is a 'bucket', or time diversification, strategy as seen in Figure 4.

The essence of any bucket strategy is to draw the money required for spending from a bucket that is not impacted by market volatility. In the Figure 4 example, there is a second 'income' bucket that is designed to generate income for spending over the medium term, often 3-5 years. This provides time for growth investments in the third bucket to recover from market downturns. At some stage, the spending and income buckets need to be refilled. If managed appropriately, the drawings from the growth bucket can be made when capital is not 'under water', maintaining the expected period that the savings will last.

Using buckets is not the only way to manage sequencing risk in retirement. It also doesn't work if the allocation to the volatile 'growth' assets is too high to allow for recovery in time. In this situation, the impact of sequencing risk needs to be considered as another aspect of the familiar risk-return trade-off. Reducing the risk involves reducing the expected return (by reducing growth assets). This can lead to a lower allocation to growth assets in retirement, relative to the accumulation phase.

Another solution to sequencing risk for a retiree is to have an allocation to a lifetime income stream. This will provide cash flows that will generally be independent of market swings. Even if this doesn't provide all the desired cash flows, it can substantially reduce the impact of sequencing risk on a retiree's savings.

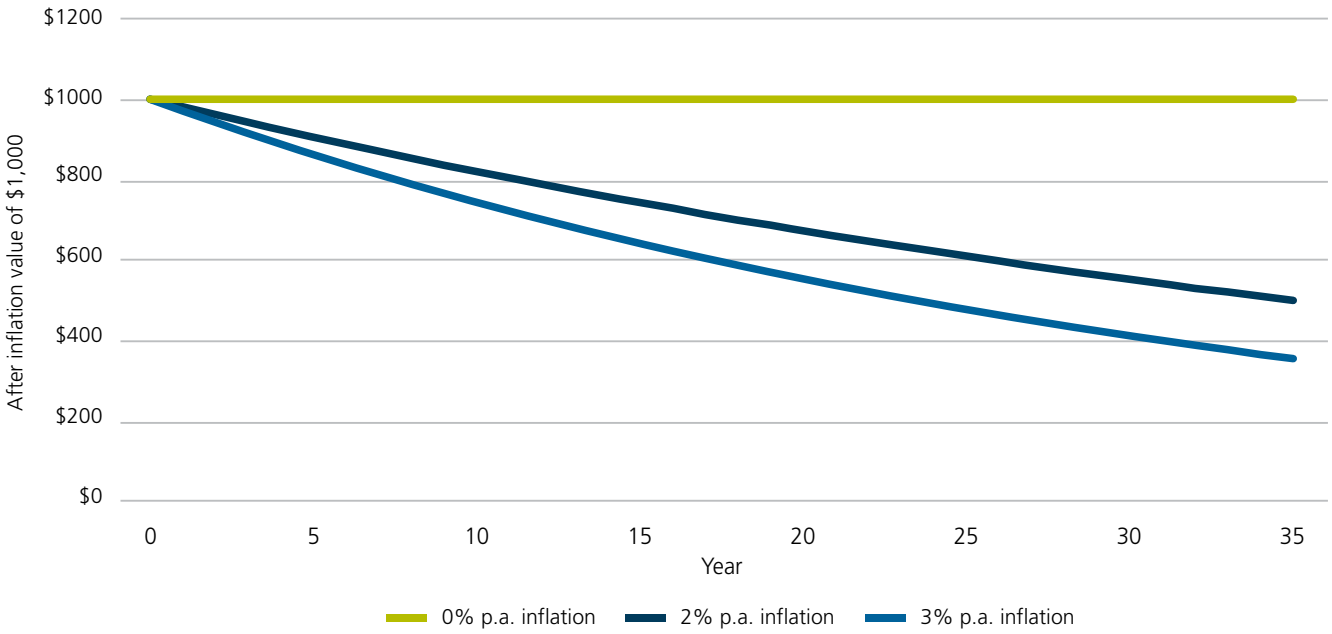
Inflation risks

The third set of risks specifically called out in the RIC are inflation risks. The key inflation risk is that a retiree's income does not retain its purchasing power over time. To hedge this risk, the retirement income needs to increase in line with inflation throughout the period of retirement. This will enable a retired member to afford a similar bundle of goods and services throughout retirement.

The impact of inflation over time is illustrated in Figure 5. This shows how the value of $1,000 is eroded over time, even at modest inflation rates. The fall over time represents how much a retiree's standard of living falls if their income is not protected from inflation. The 35 years represents a long retirement for someone who lives to age 100. An average retirement is expected to last more than 20 years and could be significantly impacted by inflation over time.

There is often debate about the level of inflation protection needed. This is because studies have highlighted that retiree spending tends to fall, in real terms, over time. However, the decline in real spending is typically small. Blanchett's paper on consumption paths reported a decline in spending (in real terms) that generally reflected a 1-2% decrease per year. Average US inflation over the period of his study was 2.4% p.a., so spending still increased in nominal terms.

Figure 5 Impact of inflation over time



Source: Author calculations

The risks from inflation to the stability of retirement income can be managed either by directly addressing the impact of inflation on the income stream or by managing the indirect impact through the real value of the savings. The indirect approach is similar to how inflation risks are managed in the accumulation phase. The idea is to maintain the real value of the pool of savings. Taking an income stream as a proportion of the inflation-protected savings will ensure that the drawdowns from savings will increase with inflation. As the capital value adjusts to inflation, drawing a proportion as income means that the income will also adjust to inflation.

Maintaining the real value of a pool of savings over the long run requires investing those savings to generate a high real rate of return. This is the same as the accumulation phase. Some assets, such as real property, are better natural hedges of inflation. Others, like shares, are expected to provide high long-term real returns even if the short-term impacts of inflation can be negative. Also, there are some assets, like inflation-linked bonds, that provide an explicit hedge to inflation movements. The risk to the value of the portfolio can be managed through a diversified portfolio with exposure to these different types of assets.

Directly managing the inflation risk of retirement income is likely to result in more stable retirement income. If the drawdown is a proportion of the capital, then market movements that impact the capital will also lead to changes in the income level. The direct approach allows a retired member the opportunity to maintain a desired level of retirement income.

The 4% rule, originally proposed by Bengen, directly manages inflation.[10] This rule simply says that a retiree can safely spend 4% of their accumulated savings at the start of retirement and then increase (or decrease) the spending each year in line with changes in CPI inflation. The drawdowns in this strategy will be perfectly stable in real terms and will last until the capital runs out. Bengen estimated that this had a 95% probability of lasting 30 years and that would be sufficient.

However, there is continual debate over whether 4% is the right starting level, particularly in different equity market and interest rate environments. One problem with the 4% rule is that it doesn't explicitly manage longevity risk. It has a buffer to increase the probability of the money lasting, but it can still fail. A government defined-benefit pension and traditional lifetime annuity typically provide the same inflation protection by linking future payments to CPI inflation. These provide income for life for the retiree and remove all longevity risks as well.

Retirement income should also include any Age Pension payments, and this is important in managing inflation risks. The Age Pension has in-built inflation protection measures. Payments are adjusted for three different forms of inflation. Short term movements are adjusted by the higher of CPI inflation and a measure of inflation that relates specifically to pensioners and other beneficiaries. If the mix of price changes has a

10 Bengen, W. (1994) "Determining withdrawal rates using historical data." *Journal of Financial planning 7*, no. 4 pp171-180.

detrimental impact on pensioners, then payments will increase to match the increased cost. Over time, the Age Pension will be indexed to wages growth as the single rate is maintained at or above 27.7% of Male Total Average Weekly Earnings. As real wages tend to increase over time, the full Age Pension is expected to increase by more than CPI inflation.

Partial Age Pension payments receive even higher inflation protection. The operation of the means tests on the Age Pension results in increases for people on a part Age Pension to be the same in dollar terms as the full Age Pension. This means that it might not be necessary for a part Age Pensioner to have inflation protection on all their other income.

Consider a single homeowner who has a total of $400,000 in assets. This would make them subject to the assets test and they would be entitled to Age Pension payments of $15,577 a year. This compares to the full Age Pension (including supplements) of $25,678 a year, in March 2022. Their only other income comes from the $32,000 pa that they are drawing from their superannuation. What would happen if inflation over the next year was 5% pa? Assuming wages also rose 5% pa, the full Age Pension would increase to $26,943. This is slightly below a 5% increase because the energy supplement is fixed. Assuming that investment returns remained the same on the $400,000 total assets while the asset test threshold increases in line with the 5% inflation, the part Age Pension to the retiree would increase to $17,898 pa. Their payments increase by the dollar indexation of the full Age Pension. This provides them with an extra $2,320 p.a. in Age Pension payments compared to a 5% increase from $15,577 ($16,355) p.a. To maintain the real value of their retirement income [$47,577 + $47,577* 5% = $49,955] they only need to increase their drawdown to $32,058 p.a. An increase of 0.2% instead of 5%. Drawing down capital will increase Age Pension payments further (until the maximum Age Pension payment is reached).

Other risks to the sustainability and stability of retirement income

There is an additional catch-all for *any other risks to the sustainability and stability of the retirement income* – subparagraph 52AA(2)(b)(iv). Any risk covered here is in addition to longevity, investment and inflation risks.

It is not yet clear what is contemplated as being within this provision. It could cover potential operational, liquidity or counterparty risks that could impact members' retirement income.

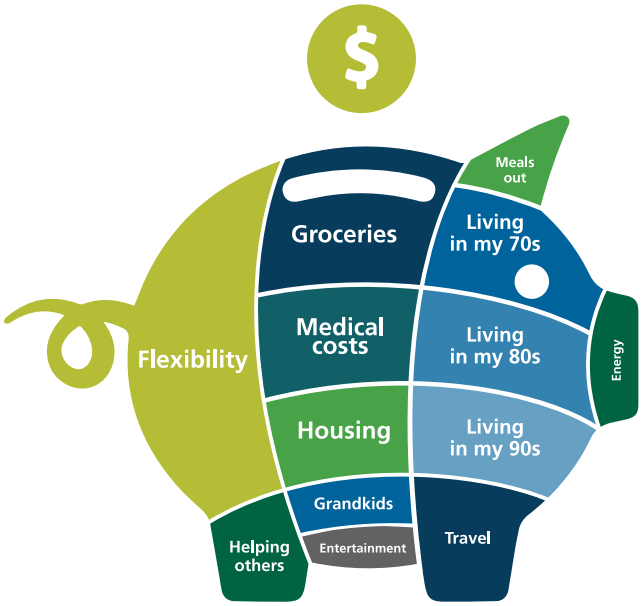
The costs of managing these risks still need to be balanced against the expected retirement income and flexibility objectives.

Flexible access to funds

The third element of the retirement income strategy that needs to be balanced against the other two is flexibility. Paragraph 52AA(2)(c) includes the objective 'to have flexible access to expected funds over the period of retirement.' It will be important to balance the aim of flexibility against maximising returns and managing risk. Typically, the flexible (ie liquid) component of the portfolio is likely to involve lower expected long-term returns – reflecting the absence of both risk and illiquidity premia.

In planning for spending over the course of retirement, it is important to understand how a retired member's finances can be committed over that period. Retirement spending involves committing accumulated savings to the various spending needs, and other goals, over retirement. Flexibility can involve some trade-offs, but it shouldn't put a retiree's lifestyle at risk for the rest of their retirement.

Figure 6 Flexibility in retirement savings



Flexibility should not extend to a retiree spending all of their savings in one go, say on an Italian sports car. This might provide near-term consumption benefits for a new retiree, but if they have nothing left, they could struggle to survive in later years. Consider the allocation of the piggy bank in Figure 6. A significant proportion of the accumulated savings will be needed for different expenses over the period of retirement. Some of the essentials in later life will be non-negotiable. A retirement income solution needs to provide liquidity when the money needs to be spent, but the amount of savings that are completely flexible and available for spending now is limited. The key is to have a level of flexible access over the period of retirement.

A fund will need to decide on the split between flexibility and commitment. One benefit for the committed component is that it can benefit from the illiquidity premium. With cash flows for consumption not required for several years, savings can be invested in assets with lower liquidity, while also supporting a higher income stream. Directly held property and infrastructure are options here, as is corporate debt and high yielding fixed interest assets.

Balance

Trustees are required to balance the three competing objectives under subsection 52AA(2). By implication, the trustees should have a methodology to determine this balance. Economists typically propose a utility function, but this is not a requirement. If such a utility function were used, trustees would be unable to put a weight on a bequest, except to the extent that it meets one of the objectives. A bequest is not retirement income, and it will not help to manage any of the risks to the sustainability and stability of income. It is possible that balances available for flexible access might be left to an estate if they are not accessed, but this shouldn't form part of the fund's strategy. The strategy needs to focus on expected retirement income, not an unexpected estate balance.

Developing the retirement income strategy will require trustees to make a trade-off across the objectives regardless of whether or not a specific measure has been applied. The covenant requires, in paragraph 52(8A)(d), that any decision made in regard to the retirement income strategy be recorded along with the reason for the decision. Thus, any trade-off that is applied will need to be clearly justified in writing.

Application to class of beneficiaries who are retired or approaching retirement

The RIC requires that trustees have a retirement income strategy for all members who are retired or approaching retirement. Subsection 52AA(3) provides an exemption from this requirement for members who hold a defined benefit interest that is not commutable. Beyond this exemption, trustees must determine the classes of members that are in or approaching retirement. Every surviving fund member will eventually be classified as retired. Thus, the retirement income strategy will apply to every remaining member of the fund, at some point.

The need for the retirement income strategy to cover all applicable members is also relevant when a trustee develops different cohorts (sub-classes of beneficiaries) to provide more tailored but not individualised, strategies.

Trustees will be required to have a strategy that applies to all cohorts [EM para 17.34] and every member retired or approaching retirement should be covered by the strategy [EM para 17.33]. Further, while every member needs to be included at a strategic level, the fund is not required to assign a member to a particular cohort.

To the extent that a trustee develops different strategies for separately identified cohorts, the strategy needs to be appropriate for each cohort.

Assistance to retired and retiring members

A retirement income strategy 'must address how the trustee will assist those beneficiaries to achieve…' [subsection 52AA(2)]. The covenant does not specify how trustees must assist their members, but helpfully the financial regulators have commented on this. On 7 March 2022, APRA and ASIC released a joint letter setting out their expectations of trustees from 1 July 2022. The letter notes that a trustee's strategy, in addition to any offer of a retirement income product, can assist to members by:

- developing specific drawdown patterns;
- providing budgeting tools or expenditure calculators;
- providing factual information about key retirement topics; or
- providing forecasts to beneficiaries.

The letter also suggests that trustees consider whether and how to offer financial product advice (either general advice or personal advice) to members. Where a trustee is not licensed to provide general or personal advice, or would be unable to comply with the obligations for giving advice, they should consider referring members to external advice providers.

The EM makes clear that any assistance provided to members will need to adhere to the requirements for the provision of personal advice and to all other applicable laws, such as the design and distribution obligations.

The RIC requires that a summary of the retirement income strategy be publicly available on the fund's website. This will be the first piece of information that most trustees will offer to members in respect of the strategy. Additional options for trustees could include:

- static information on the fund's website
- directing members to ASIC's MoneySmart website to help them understand retirement income
- publishing case study examples to demonstrate the appropriateness of the strategy for different cohorts
- education sessions of a general nature about retirement income and related issues.

Deciding which of these, or other guidance methods, to employ is up to trustees, and will likely depend heavily on trustees' existing business models. How trustees address this aspect of the RIC is likely to evolve over time, as best practice emerges.

Summary

Funds will have to comply with the RIC from July 2022. They will need to publish their retirement income strategy which details how they are helping to balance the objectives of retired members. For many, this will be the next step in improving the outcomes for their members in retirement. A well-functioning retirement income strategy is one that will maximise members' retirement income while managing the risks to the stability and sustainability of that retirement income. The principles in the RIC provide the framework which can be used to deliver better outcomes in retirement.

The information in the report has been compiled by the Challenger Retirement Income Research team.

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