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Retirement Income Covenant Position Paper

Thank you for the opportunity to provide feedback on The Treasury's Position Paper, Retirement Income Covenant Position Paper: Stage one of the Retirement Income Framework (Position Paper). With a strong presence in the Australian retirement income market, and given increasing longevity in Australia, Colonial First State is pleased to see the continued policy focus on the draw-down phase, including recent changes to income stream regulations.

Colonial First State

Established in 1988, Colonial First State (CFS) specifically provides investment, superannuation and retirement products to individuals and companies. CFS is the largest account based pension provider in Australia, making more pension payments than any non-government entity[1]. CFS is also the third largest administrator of retail funds with $130.2 billion in funds under administration.[2]

CFS's passion for high performance, customer service and innovation has made us one of the most consistently awarded superannuation funds in Australia. According to Investment Trends[3] CFS is the most trusted retirement brand. Moreover, CFS was recently ranked number one by advisers for overall satisfaction in the annual Wealth Insights Platform Service Level Report 2018, for the 9th time in the past 11 years.

CFS supports a greater focus on enhancing outcomes in the retirement phase of superannuation. Through previous submissions, including a submission made in response to the Treasury discussion paper on CIPRs in 2017, CFS has outlined its support for the development of the retirement market. We have also actively engaged in previous consultations in this area including the Financial System Inquiry and Treasury's review of income stream regulations both through direct submissions and through industry bodies. Whilst CFS has contributed to industry body submissions in relation to this consultation, we take this opportunity to emphasise our position on certain key topics here.

Sequencing of further retirement reforms

By way of general comment on the timing and sequencing of reforms in this area we make the following points.

The Position Paper relies on the following view about the objective of the superannuation system, "The retirement phase of the superannuation system is currently under-developed and needs to be better aligned with the overall objective of the superannuation system of providing income in retirement to substitute or supplement the Age Pension."[4]

1 Rice Warner 2018 using APRA'S Superannuation Fund-Level Superannuation Statistics 2017

2 Strategic Insights, 31 December 2017

3 Investment Trends, Retirement Income Report, October 2017

4 Treasury Retirement Income Covenant Position Paper p.2

It is worth highlighting that the objective of superannuation has not yet been legislated. Once the objective has been finalised and becomes law we expect it will be relevant in forming a basis for future draw-down phase reforms.

Another relevant policy/legislative dependency is the proposed Product Design and Distribution obligations, also in draft legislation, which are designed to ensure that products are suitable for customer/member segments.

Recent reforms to existing income stream product regulations (both legislated and proposed) have been positive, effectively facilitating the development of CIPRs through changes to the taxation rules and social security proposals applying to deferred lifetime annuities. These are welcome developments, however, it will take time for product providers, members and their financial advisers to understand how best to employ these tools in strategies to address longevity risk.

The above suggests a need to pause and ensure recent and proposed policy settings have had time to establish before confirming the sequence of further reform for the retirement phase.

Feedback on the Position Paper

Below we address the key elements of our feedback on the Position Paper, centring on the following areas:

- Trustee flexibility is an important element in respect of any reforms to establish a retirement covenant relating to income stream solutions for superannuation members. Superannuation trustees should be able to make their own assessment about the need to offer CIPRs to their members at retirement, including whether some or all members are subject to the offer, and in what form the CIPR will take.
- Clear and express consent is required to commence CIPRs. We note this position is broadly represented in the Position Paper.
- Quality financial advice and consistency in applying advice regulation is critical – quality financial advice is central to good member outcomes in the drawdown phase of super. We support a level playing field for regulations which govern the delivery of advice, including relating to retirement.
- Recent changes to remove regulatory barriers – recent changes to income stream regulations and proposed changes to Department of Social Security rules relating to lifetime income stream products are positive and should largely remove previous barriers which impeded product development to address increasing longevity. These rules create a new framework for income stream products which will require time to effect broader take-up in the market.

Trustee flexibility

CFS believes Trustees should have the flexibility to consider whether to develop and actively offer CIPRs to members, including to which members or segment of the membership it makes the offer. Importantly, it should not be mandatory for trustees to offer CIPRs. In the drawdown phase, a 'one size fits all' approach is not appropriate given members' needs and circumstances vary greatly and will depend on the mix of super and non-super assets. Further, active member engagement in relation to a member's full financial circumstances at retirement is important. If trustees are required to offer CIPRs to all members we are concerned this may lead to higher risk of poor consumer outcomes and open the trustee to greater risk of claims for loss – if, for example, a CIPR is accepted and the product does not meet the member's expectations or if they die before life expectancy.

Given the retirement income stream product market continues to evolve, it is important that funds have the flexibility to offer a retirement income solution that best suits the needs of its membership. This may be an account-based pension or an account-based pension offered in combination with an income stream which provides longevity protection, such as a deferred lifetime annuity. The final design may differ between trustees and will depend on a range of factors including the trustee's assessment of broader risks to members.

To the extent the Government resolves to follow the recommendation as presented in the Position Paper, and requires trustees to offer a CIPR to members, we believe a CIPR should only be offered to MySuper members at retirement alongside a suggestion they receive personal financial advice prior to taking up the offer.

The Position Paper raises a future suggestion to consider a safe harbour provision. In line with our feedback in June 2017 on the potential need for a trustee safe harbour provision in order to protect trustees from claims, we think this is evidence that a policy centring on offering CIPRs to all members has limitations. A safe harbour provision would be unusual in superannuation law and there appears to be a tension between the operation of a safe harbour provision and a trustee's legal obligation to act in the best interest of members. We are not yet convinced this concept has been explored sufficiently.

Clear and express consent

Where a trustee offers members a CIPR, it should only commence once the trustee has received the clear and express consent of the member.

It is pleasing to see this has been accepted as a feature of the CIPR proposal in the Position Paper. Whilst we agree that "it should not be onerous for members to accept a CIPR offered to them"[5] it would be concerning if members were effectively 'placed', or could perceive they were placed, into a CIPR without providing their explicit direction. This would require careful consideration in the design phase to ensure community expectations are met.

The role of quality financial advice

CFS believes the role of financial advice is important in the pre-retirement stage and throughout retirement. In the accumulation phase of superannuation there is generally a common objective of maximising savings. However, in retirement, needs, circumstances and objectives will vary between individuals with some members having simpler needs than others.

A member's superannuation balance at retirement is only one input in assessing how to manage their retirement. Other considerations include: age pension entitlements, assets outside super, health (individual life expectancy), other super funds, actual retirement age, their desired retirement income levels and expected retirement lifestyle etc. It is therefore imperative that a person's entire personal circumstances are taken to understand a retiree's circumstances and objectives for retirement in order to provide the optimal retirement solution for that customer. Without the aid of the personal financial advice process a superannuation trustee cannot undertake the level of inquiry necessary to make a recommendation.

Where retirement planning is concerned we believe superannuation trustees will increasingly play a role in helping to deliver quality financial advice to pre-retiree and retiree members. To the extent the regulatory framework for advice applies to recommendations to commence retirement products, these rules should apply equally to trustees and financial advisers providing advice to members on this topic. Intra-fund advice has a place in assisting trustees to have simple conversations with members about their existing product. However, intra-fund advice is not appropriate for the commencement of a new product such as a retirement income stream or a strategy involving the combination of retirement income streams. This is due to the complexity involved in the decision making process and the importance of ensuring the strategic and product recommendations are suitable to the person's individual circumstances.

To ensure good member outcomes, in the process of developing policy relating to the introduction of a retirement covenant where the application of advice is concerned, policymakers should be careful to ensure an even playing field is maintained.

Further, under the proposal in the Position Paper if the trustee decides to offer personal financial advice to a member on alternate CIPR products such that "the same requirements would apply if advice is provided by an independent financial adviser"[6] CFS assumes this may require the trustee to research other products and consider whether alternate products outside the trustee's suite of products are in the member's best interests, as could be expected of all financial advisers. It would be helpful if the Position Paper could elaborate on these and related matters.

Ultimately, consistency of application and enforcement of the advice regulatory framework is critical to the successful development of CIPRs and the member outcomes they produce.

5 Treasury Retirement Income Covenant Position Paper, p.9

6 Treasury Retirement Income Covenant Position Paper, p.9

Recent changes to remove regulatory barriers

As highlighted by the Productivity Commission in its recent Draft Report, Superannuation: Assessing Efficiency and Competition:

- CIPRs already play a role in the retirement income system, and they are growing in significance. Amendments to the Superannuation Industry (Supervision) Regulations 1994 (SIS Regulations) were implemented from 1 July 2017 and have reduced tax and regulatory barriers to the development of new retirement income products.[7]

For some time CFS has advocated for the removal of regulatory barriers such to facilitate product development in the longevity income stream market. In addition to these SIS amendments, proposed social security assets test changes for lifetime retirement income streams are also welcome and should continue to generate interest in the use of such products in the members' retirement portfolios.

These developments will take time to produce scale within the longevity income stream market in Australia.

We welcome the opportunity to discuss these issues in more detail with Treasury.

Yours sincerely,

Ms Linda Elkins
Executive General Manager
Colonial First State

7 Productivity Commission Draft Report, "Superannuation: Assessing Efficiency and Competition", p.203