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Submission: Retirement Income Covenant Exposure draft legislation

Thank you for the opportunity to provide feedback on the draft legislation relating to the Retirement Income Covenant: *Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Retirement income covenant.*

About Colonial First State

Established in 1988, Colonial First State (CFS) provides investment, superannuation and retirement products to individuals and companies. CFS has a significant footprint in the retirement market in Australia. As the largest account-based pension provider in the market CFS makes more pension payments than any non-government entity[1]. As at 30 June 2021, CFS managed approximately $47.9 billion in retirement income products (around 180,000 accounts). We are also the second largest administrator of retail funds with $140 billion Funds Under Administration[2] (FUA) and $57 billion in superannuation FUA. Approximately 90 per cent of our total pension membership has a financial adviser attached[3].

CFS has long supported a greater focus on enhancing member outcomes in the retirement phase of superannuation. Most recently, CFS made a submission to the Retirement Income Covenant position paper in August 2021. Whilst CFS has contributed to our major industry body submissions in relation to this consultation, we take this opportunity to emphasise our position on certain key topics here.

Executive Summary

CFS welcomes the release of the draft legislation for consultation. We appreciate the degree to which the draft legislation addresses some of the matters raised in earlier submissions, for example further clarification in relation to the expectations on trustees with respect to information gathering requirements and that the retirement income strategy should be general in nature.

[1] APRA Annual fund-level superannuation statistics June 2020
[2] Plan For Life December 2020
[3] As at 30 June 2021

In this submission we raise the following policy suggestions which we believe will enhance the proposal by improving member outcomes and providing certainty for trustees in implementing this new and complex reform:

- Government should consider responding comprehensively to the findings of the Retirement Income Review prior to, or in conjunction with, implementing the Covenant. This could also consider relevant findings of the Quality of Advice Review (due to take place in 2022)
- To the extent the timeline for implementing the Covenant remains as proposed, regulator guidance should clearly outline the expectations for trustees to fully implement the reform. Under these circumstances CFS believes a staged implementation would be appropriate. This would means trustees record and publish a retirement income strategy by 1 July 2022 and then implement the strategy by a future date (e.g. 1 July 2023)
- Defer any decision on the inclusion of the objective "maximising retirement income" until this has been further tested as part of the Government's response to the Retirement Income Review.
- Ensure the legislation or regulator guidance clarifies that trustees have discretion to consider whether to apply the retirement income strategy to advised members, and to what extent it might apply to such members.

Considerations relating to commencement of the reforms

CFS supports further development of the regulatory framework for trustees to improve retirement outcomes for individuals, while enabling choice and competition in the retirement phase. As is evident in the draft legislation and its preceding proposal paper, the drawdown phase of super draws in other important parts of the overall regulatory and policy framework, including tax, social security and financial advice. It is essential that changes to these systems are considered in conjunction with one another.

Retirement Income Review

The draft legislation draws on certain conclusions from the Retirement Income Review. In particular, the view that members are not drawing down their balances efficiently in retirement and focusing on bequests.[4] This is one of a number of interdependent findings from the Review, and has been challenged by certain stakeholders.[5] The Government has not yet completed a comprehensive response to the Retirement Income Review and so it is difficult to judge the Covenant against the adoption of alternative policy reforms implemented as a result of Review's observations.

Quality of Advice Review

In addition, the draft legislation is careful to specify that the retirement income strategy, to be designed under the covenant, outlines a trustee's plan to assist beneficiaries covered by the strategy *in generality*.[6] It is not designed as a mechanism for trustees to provide personal advice to members.

Separately, trustees are "not precluded…from assisting their members to meet their individual needs through tailored guidance or advice." This appears to be a statement of fact based on current arrangements, to the extent that the trustee is licensed to provide advice and adheres to the legislative requirements relating to the delivery of advice, including the rules banning the receipt of conflicted remuneration. On this matter the draft legislation is making a very important distinction between a trustee obligation to the membership at large and a service delivered to an individual member.

[4] Retirement Income Covenant Position Paper, page 4
[5] ASFA analysis completed in March 2021: https://www.superannuation.asn.au/ArticleDocuments/359/2103-Super-balances-just-before-death-Paper.pdf.aspx?Embed=Y
[6] Explanatory Memorandum, paragraph 1.50

Under the covenant it is acknowledged trustees will increasingly play a role in helping to deliver quality financial advice to pre-retiree and retiree members. Given the complexity of the advice framework, and to maintain a regulatory level playing field, the advice rules with respect to retirement products (including the commencement of a retirement product) should apply equally to trustees and financial advisers providing advice to members. It will be important for the retirement income strategy requirements to not impede or impact the existing financial advice process. It may, however, be helpful to consider these issues in the context of the development of the covenant as part of the forthcoming Quality of Advice Review.

Transition

Incorporating any changes to the covenant as a result of fully considering the outcomes of these associated policy would require a deferred commencement beyond 1 July 2022.

To the extent government insists on the proposed commencement date, CFS believes a transition (period or a staged approach) to the full implementation of the retirement income strategy is appropriate. Given the legislation is currently in draft and may not be passed until next year, it will be challenging for trustees to meet the timeframe required to implement. Trustees may have a limited ability to make product and service changes in advance of commencement, especially as there will be some reliance on guidance from regulators on implementing the reforms. This is unlikely to be available until after the legislation passes the Parliament.

- Government should consider responding comprehensively to the findings of the Retirement Income Review prior to, or in conjunction with, implementing the Covenant. This could also consider relevant findings of the Quality of Advice Review (due to take place in 2022)

- To the extent the timeline for implementing the Covenant remains as proposed, regulator guidance should clearly outline the expectations for trustees to fully implement the reform. Under these circumstances CFS believes a staged implementation would be appropriate. This would means trustees record and publish a retirement income strategy by 1 July 2022 and then implement the strategy by a future date (e.g. 1 July 2023)

'Maximising expected retirement income' objective

From a policy perspective this objective relies on conclusions drawn from the Retirement Income Review. This view suggests standards of living in retirement are compromised by the complexity of decision-making retirees face when setting appropriate levels of retirement income, and a lack of confidence to spend their super in retirement. In other words the Review effectively said people should be confident to consume more in retirement (particularly early in retirement). And if they did this would lead to improved standards of living. It also cited studies which have "shown that retirees die with around 90% of their assets they had at retirement" and that bequests are growing.[7]

This is not consistent with industry analysis nor our experience as a pension provider. Analysis by ASFA [8] suggests, by life expectancy, the majority of retirees have reduced their super balances to zero (many of whom may not have had any super at retirement anyway) and that it may be a small percentage of individuals who still have substantial super balances at death who are skewing the average. This suggests an opposite issue may be at play, which is that most individuals are not retiring with adequate superannuation balances. In any case, we question the validity of basing the development of this aspect of the policy on these particular conclusions cited in the Retirement Income Review.

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[7] RIR, pp432-435
[8] ASFA March 2021

CFS believes further investigation into this issue needs to be undertaken before requiring trustees to address this matter through the proposed retirement income strategy.

To the extent some members with very high retirement balances intentionally retain capital solely for the purpose of succession planning then we would expect this to be considered as part of the Government's response to the Review, with consideration of other policy measures which could be employed to address the issue.

Under the draft legislation, 'expected retirement income' is proposed to include age pension entitlements and income from private savings. Ultimately, given the range of personal factors that are required to be taken into account when assessing members' expected retirement income, and how it might be 'maximised', CFS believes this is best achieved through personal financial advice for retirement.

- Defer the inclusion of the objective "maximising retirement income" until this has been further tested as part of the Government's response to the Retirement Income Review.

Trustee discretion for advised members

CFS believes the role of financial advice is particularly 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.

While the Covenant's proposed retirement income strategy is a useful tool to assist non-advised and disengaged members achieve better retirement outcomes, members with an existing financial advice relationship have the opportunity to receive comprehensive advice which has been tailored for their unique circumstances. We believe this tailored approach will lead to better member outcomes for individual members. As such, where a member is receiving financial advice, it will be important for a trustee to ensure the settings of their retirement income strategy do not impede the advice process.

A trustee's role for advised members should therefore be to offer high quality, flexible and customisable products to enable advisers to implement strategies tailored to their clients.

Recognising that a 'generalised' retirement income strategy cannot by definition provide the same degree of tailoring to individual members as personal financial advice, it may not be appropriate for a trustee to implement a retirement income strategy for advised members.

CFS believes trustees should be permitted to consider whether offering a retirement income strategy to cohorts of advised members is appropriate or necessary. This will enable trustees to offer a product suite with sufficient features and flexibility for financial advisers to recommend a tailored retirement income solution to their clients, which we believe will lead to better retirement outcomes for members.

- Ensure the legislation or regulator guidance clarifies that trustees have discretion to consider whether to apply the retirement income strategy to advised members, and to what extent it might apply to such members.