



FINANCIAL
SERVICES
COUNCIL

Retirement Income Covenant Exposure Draft

FSC Submission

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1. About the Financial Services Council

The FSC is a peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of Australia's largest industry sectors, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advice licensees and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing \$3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2. Introduction

The FSC welcomes the opportunity to provide a submission on the exposure draft of the *Treasury Laws Amendment (Measures for a later sitting) Bill 2021: Retirement income covenant*.

The FSC strongly supports a principles-based Retirement Income Covenant that ensures that superannuation trustees consider the retirement income needs of beneficiaries.

This submission canvasses various technical amendments for Treasury's consideration.

We recognise that the exposure draft leaves considerable discretion to trustees to develop retirement income strategies that suit their particular membership profiles. This is entirely appropriate. However, similarly to other provisions in the *Superannuation Industry (Supervision) Act 1993 (SIS Act)* we would welcome further Australian Prudential Regulation Authority (APRA) guidance. This will help to minimise the provisions under the Bill being interpreted too differently by regulators and trustees.

The FSC encourages the Government to affirm its ongoing commitment to the key elements of Australia's first and third pillar retirement system components, to reinforce and validate the new requirements being asked of super fund trustees via the retirement income covenant.

3. Transition and ongoing development

The implementation of the covenant is a significant policy change which is likely to have wide-ranging influence on the retirement sector. While trustees will be required to have their retirement income strategies in place by 1 July 2022, the implementation of the covenant itself is only the start of this journey.

With the covenant commencing on 1 July 2022, trustees may have a limited ability to make product and service changes in advance of its commencement, particularly if substantial guidance is not provided as soon as practical – see Sections 5 and 6 below.

As a result, the retirement sector is reasonably likely to remain similar to today at the outset, an expectation that should be unsurprising given the short timeframe until commencement of the Covenant.

However, as trustees develop a more sophisticated approach to their retirement income strategies, their understanding of their membership improves, and further data sources (both internal and external) become available, this is expected to lead to further development of retirement income products and services.

This increasing complexity of the retirement system will also necessitate greater need for access to affordable advice or appropriate guidance and disclosure as members require greater assistance navigating a complex system, and we welcome the Government's previously stated position that consideration will be given to advice in retirement as part of the Quality of Advice review in 2022.

However, noting the findings of the Quality of Advice review are unlikely to be delivered until after the commencement of the covenant, and as the Government is also yet to respond comprehensively to the findings of the Retirement Income Review, we submit that it would be appropriate for trustees to take a staged approach to implementation of the covenant.

4. The meaning of 'period of retirement'

The exposure draft provides in section 52AA(5) that the trustee must determine the meaning of retirement income, and this definition must include income from a superannuation interest in the entity, income from an age pension and may include income from any other source the trustee determines that it is appropriate. The exposure draft in section 52AA(6) provides the trustee must determine the meaning of period of retirement for the purposes of the strategy.

In the explanatory memorandum, guidance is provided that a trustee must determine the meaning of 'period of retirement' for the purposes of working out what is included as 'retirement income'. The 'period of retirement' can differ for different sub-classes of beneficiaries. This period will be an average for the relevant sub-classes and members in a particular cohort will live for a longer or shorter period than the expected.

It is envisaged that a trustee may wish to consider the retirement patterns of their members when working out the start of that period and consider the distribution of life expectancies of their members in forming views about the end of the period.

We note that in the exposure draft, it is open to trustees to determine a period shorter than the life expectancy for the sub-classes of beneficiaries. We submit this does not align with the purpose of the retirement income covenant to maximise the expected retirement income. We also submit a better way is to specifically include a provision that a trustee must determine the period of retirement income which may include the life expectancy of the beneficiaries or such longer period as the trustee may deem prudent.

A longer period should be allowed as it should be open to trustees to target (for example) the 25th percentile of life expectancy distribution, not the median, as a 50:50 chance of depleting

savings is very risky, especially if the trustee is factoring in couples to its cohort definitions not just individual members.

We also note that the use of 'life expectancy' will not include life expectancy improvements if backwards-looking estimates of life expectancy are used.

In this context, life expectancy should be a minimum requirement, recognising that the average might still differ for some potential cohorts with different demographic profiles.

We also note that while the use of the expected period of retirement for each cohort of members may be a useful concept in developing a retirement income strategy, that the retirement income received by each individual from all sources should be payable for their life and not be significantly reduced at a pre-determined time.

Recommendation

1. The explanatory memorandum should include the following in explanatory memorandum para 1.33:

The 'period of retirement' is intended to cover the period between the start of retirement and life expectancy of the sub-class of beneficiaries, or such longer period as a trustee may deem prudent.

5. Further guidance from APRA

The open-ended nature of many of the legislative provisions, and the prospect that these may be interpreted differently by regulators than they are by some or all trustees, suggests appropriate guidance from APRA is required, in a similar way that currently applies to other comparable provisions in the SIS legislation.

Section 52 of the SIS Act relates to covenants to be included in governing rules for registrable superannuation entities. Subsections 52(6), 52(7) and 52(8) relate to investment covenants, insurance covenants and covenants relating to risk respectively. We note that APRA has issued Prudential Standards and Prudential Practice Guides in respect of each of these topics:

- Investment Governance – SPS530 and SPG 530
- Insurance in Super – SPS 250 and SPG 250
- Risk Management – SPS 220 and SPG 220
- Operational Risk Financial Requirement – SPS 114 and SPG 114

The exposure draft legislation inserts a new subsection after subsection 52(8) into the SIS Act. Given that the Retirement Income Covenant is to be inserted into the same section of the SIS Act, it is reasonable to expect that APRA will publish both a Prudential Standard and Prudential Practice Guide in respect of the new covenant.

Given that RSEs will be required to have formulated a retirement income strategy by 1 July 2022, subject to the passage of the legislation, it is essential that APRA issue a draft Prudential Standard and a draft Prudential Practice Guide before 31 December 2021. This is particularly important as the proposed retirement income covenant will require trustees to formulate a strategy, gather data and information, make decisions and determinations, and publish their strategy in a new and evolving area.

The FSC recommends that the APRA guidance should cover the following topics, which may be separate guidance or could be included as amendments to existing standards (eg SPS 515):

- The minimum matters that trustees must address in the short term (i.e. before 1 July 2022) and those can be considered in the medium term (say before 1 July 2024);
- The permitted meanings or definitions of “maximise expected retirement income”;
- The extent to which “broadly constant” income is to be expressed in real or nominal terms, noting that personal expenditure on average tends to reduce with age (although there are cases where expenditure needs increase);
- The permitted meanings or definitions of “period of retirement”, as this is likely to vary between different cohorts of members within the same fund;
- The need to consider these issues on an individual or household basis;
- The relevance (or otherwise) of certain factors that trustees can use to determine sub-classes of members;
- Any constraints on the discretion of trustees to gather the data and information to help formulate their strategy. (For example, what is the appropriate balance between industry-wide data (such as that held by the ATO) and information from the fund’s members, possibly from a member survey?);
- The extent to which modelling and data analysis is a preferred, desirable or required process;
- The appropriate way the Covenant applies to products with advised clients, particularly superannuation platforms – See Section 9.2 below.
- The appropriate way the Covenant applies to Small APRA Funds, given these funds are similar in many ways to Self Managed Super Funds (**SMSFs**), and are often subject to financial advice;
- The internal governance framework, delegations, processes, resource adequacy and review frequency that APRA expects Trustees to adopt to meet their obligations under the covenant;
- How to develop a ‘governance document’ (see EM at 1.11);
- How to conduct an assessment/review of outcomes from the strategy (see EM at 1.16);
- The extent to which trustees can assume the ongoing financial support provided by the federal and state governments to future generations of retirees; and
- The relationship between the requirements under the new covenant and those that already exist under current standards and guides; for example SPS 515 Strategic Planning and Member Outcomes and SPG 515 Strategic and Business planning.

Given the quantity of issues that trustees need to address in implementing the Covenant, the FSC recommends that APRA also provide guidance on when trustees are expected to meet the various requirements under the Covenant.

We emphasise that in recommending that these topics should be covered in future APRA guidance, we are not aiming to re-introduce a prescriptive, rules-based approach. Rather, our aim is to seek a better understanding of the parameters within which trustees can confidently progress development of their strategies without fear of subsequently falling short of regulatory expectations. In this sense, prudential guidance by APRA will materially improve the degree of confidence with which trustees can approach the development of their retirement income strategies and the associated products and services.

Recommendation

2. APRA should release appropriate draft guidance before 31 December 2021 covering the matters recommended in this submission, including a timeline indicating when trustees are expected to meet this guidance.

6. Interaction with personal financial advice

Subsection 52AA(2) of the exposure draft notes that the retirement income strategy “must address how the trustees will assist those beneficiaries”. The Explanatory Materials note:

- It is expected that trustees will consider the broad needs of the beneficiaries
- Trustees must operate within the existing financial advice framework
- The retirement income strategy is to express the general actions the trustee will take to assist their members
- Collecting information on beneficiaries in and of itself, would not result in the provision of personal financial advice

Understandably, the drafting leaves the trustees with considerable discretion. Yet as noted in FSC’s previous submission on the Position Paper, there is concern about trustees’ ability to gather the additional information that is envisaged in the draft legislation without crossing the boundary into personal financial product advice.

This concern persists despite the above comments to the contrary in the Explanatory Materials and has been accentuated by the recent High Court decision on general advice.¹

We note the “Quality of Advice” Review by Treasury into financial advice may provide an opportunity to address concerns regarding provision of guidance and advice to superannuation members planning their retirement. The timeframe for the Retirement Income Covenant will not, however, allow for resolution of issues identified through the advice Review before commencement of the Covenant.

In this environment, and without greater regulatory clarity, some FSC members are concerned that eliciting additional personal information from members may still be seen by ASIC as triggering the ‘subjective’ definition of personal advice in the Corporations Act. Under these provisions, advice is counted as ‘personal’ if the member *believes* that the

¹ *Westpac Securities Administration Ltd v Australian Securities and Investments Commission* [2021] HCA 3.

request has been made to provide them with a personal recommendation. The existence of such a belief seems on its face plausible from a member's perspective, in a situation where his/her super fund is actively eliciting additional information, which in turn likely proceeds to some form of cohort-based product solution or drawdown/spending strategy.

We therefore submit that ASIC issue guidance for registrable superannuation entities as to the extent that trustees can assist their members in balancing the three objectives within the Retirement Income Covenant while ensuring the protection of such processes and actions not being deemed to be the provision of personal financial advice.

We also submit that some form of specific exemption for trustees should be introduced, at least pending further substantive law reform in this area.

The recent exemption provided by the legislation implementing the Design & Distribution Obligations (**DDO**) provides a relevant comparison. In order to fulfill DDO obligations, a product distributor may decide to collect information from customers for the purposes of determining if they are in the target market for a product.

To help ensure that the collection of this information is not the provision of personal financial advice, the following subsection has been inserted into the *Corporations Act 2001*:

766B(3A) However, the acts of asking for information solely to determine whether a person is in a target market (as defined in subsection 994A(1)) for a financial product, and of informing the person of the result of that determination, do not, of themselves, constitute personal advice.

The Government has already decided that it is important to clarify that collection of information from customers for DDO purposes is not consequentially classified as financial advice. The FSC submits there is a similar argument that a parallel exemption from personal advice should also be provided for the collection of information from fund members for the purposes of complying with the Covenant.

Recommendation

3. The Corporations Act should be amended to state that acts of asking for information for the purposes of complying with the Retirement Income Covenant do not of themselves constitute personal financial advice (similar to provisions relating to the Design and Distribution Obligations).
4. ASIC should provide guidance to trustees explaining how trustees can balance the objectives within the Covenant without such processes and actions being deemed to be the provision of personal financial advice.

7. Access to government data by superannuation funds

The Australian Taxation Office (**ATO**) and the Department of Social Services (**DSS**) hold substantial data about members of superannuation funds and age pensioners. Such data would be extremely useful for trustees as they seek to assist their members in developing an

appropriate retirement income strategy. This data could potentially include information such as income, total superannuation balance, marital/partnered status, and demographic data the fund may not have.

It is recommended that relevant data, initially in an aggregated form for various cohorts, be provided to trustees of all superannuation funds. Subsequently the ATO data could be subdivided by fund and provided to the relevant trustee.

We submit the exact data to be included in this process would be subject to further consultation with industry.

We do not suggest that the ATO or DSS would need to divulge large volumes of highly granular personal information about every super fund member. Instead, we believe that an aggregated data set profiling each fund's membership (on a de-identified basis) by key data variables (age, income, gender, total super balance, marital status, etc) provided by relevant public agencies would go a long way towards filling the data requirements expected of trustees to identify meaningful member cohorts. It would also be much more efficient, and replicable, compared to each fund doing it for themselves.

Recommendation

5. The ATO and DSS should be required to provide relevant aggregated data to superannuation fund trustees, with the exact data included to be subject to further consultation.

8. Need for confidence around future policy

The FSC submit that the retirement income covenant proposal will operate more coherently if it is accompanied by a more holistic response from Government to the overall Australian retirement income framework.

The Retirement Income Review was commissioned in 2020 with the express purpose of assessing the moving parts of Australian retirement income system together – tax, social security, other social transfers, private savings incentives and so on – in a co-ordinated way. This legislation inescapably draws other parts of the overall system into discussion.

There is an implicit suggestion in the legislation that trustees should take on faith issues such as the permanence of the Age Pension and ongoing support for other social transfers around unemployment benefits, aged care, health care etc over the lifespan of their members. However, in the absence of explicit long-term commitments from governments, super fund trustees are not the right parties to be making these assurances, nor to dispel scepticism from their members about them – particularly at a time of heightened insecurity such as we are currently experiencing with the pandemic.

The FSC encourages the Government to affirm its ongoing commitment to the key elements of Australia's first and third pillar retirement system components, to reinforce and validate the new requirements being asked of super fund trustees via the retirement income covenant.

Recommendation

6. The Government should provide policy confidence around the first and third pillar retirement system components (Age Pension, and voluntary savings) and Government support for aged care costs.

9. Other issues

9.1. Technical amendments

We are aware of previous consultation between The Treasury and industry regarding technical amendments to other aspects of the Retirement Income Framework. To enable effective implementation of the Retirement Income Covenant, we request finalisations of these amendments as soon as possible, as previously raised in a submission by the Actuaries Institute.² Following is a summarised list of issues that we have identified:

- The Capital Access Schedule (**CAS**) in SIS Regulations 1.06 B allows no flexibility for variable income products. We propose that the schedule be amended to apply to expected commutation benefits.
- The CAS applies only to the primary member and is based on official ABS life expectancies. This creates an actuarial mismatch, because lifetime income products will be calculated on life expectancies of actual annuitants and their spouses where applicable, which will typically be materially longer than population averages. Conversely, this issue also impedes the commerciality of lifetime income products for those with shorter life expectancies, such as those with poor health and retirees in indigenous communities. We propose that the CAS be aligned to the life expectancies which are used for the calculation of lifetime incomes of actual individual and couple recipients.
- The CAS does not contemplate product portability which may impede both product development and industry merger activity. We propose that the CAS does not apply to successor-fund transfers or rollovers between Innovative Retirement Income Stream (**IRIS**) products.
- The Transfer Balance Cap (**TBC**) creates potential conflict with the CAS (and with the product rules) in cases where an excess balance triggers an ATO commutation authority. This issue could be addressed if all IRIS products are treated in a similar manner to Capped Defined Benefit income streams.
- In the case of family-law splits, product providers may be required to split a member's interest in the IRIS with a spouse who may not otherwise have met a relevant condition of release. For the avoidance of doubt, the regulations could be updated to clarify that splitting of a member's interest to an ex-spouse following a family court order does not put in jeopardy the product's ability to satisfy 1.06A of the SIS Regulations.
- If a retiree has a younger spouse who has not met a condition of release, there can be scenarios where IRIS products can't meet the "income for life" requirement (of the

² See: <https://www.actuaries.asn.au/Library/Submissions/2021/20210719Submission.pdf>

primary and reversionary). We propose that IRIS products be exempt from forced payout where the spouse has not reached retirement age (or for non-super, the Age Pension age).

- The IRIS asset test treatment creates an inequity where a reversionary benefit is less than 100% of the primary income stream. We propose that the asset test is proportionally reduced in these circumstances.
- The IRIS income test treatment is currently a disincentive due to historically low deeming rates. We propose creating better alignment between IRIS and account-based pensions. This could be achieved by deeming the income of IRIS products based on their assessable assets, or by adjusting the '60% of actual income' test to be variable based on actual deeming rates.

We would be happy to provide further information about these issues.

Recommendation

7. Appropriate technical and consequential amendments should be made to enable effective implementation of the Covenant.

9.2. Application to advised clients and superannuation platforms

The FSC supports the applicability of the Covenant to all beneficiaries who are retired or approaching retirement, including those with a financial advice relationship. We acknowledge the need for trustees to provide improved products, guidance and support to enable better retirement outcomes. However, we submit that trustees will require flexibility to implement a strategy differently for advised versus unadvised clients.

For example, superannuation platforms are commonly accessed via an adviser and trustees will not typically engage with members directly so as to not undermine the primary advice relationship. Advisers would not welcome platforms trying to insert themselves into the client relationship by contacting the clients directly.

Similar issues apply to Small APRA Funds (**SAFs**) which are likely subject to advice.

- We also note some of the proposed actions for the retirement incomes covenant are about ensuring the needs of members in retirement or nearing retirement are identified and taken into account in the investment strategy options made available to them. In principle that is very similar to what a financial adviser already does in giving appropriate financial advice to their clients.

We propose that an appropriate Retirement Income Strategy could involve development of improved products and provision of complementary adviser tools and education but may not involve direct retiree segmentation and engagement.

We request that any future regulatory guidance facilitates this flexibility and continues the principles-based approach currently evident in the Covenant.

10. List of recommendations

1. The explanatory memorandum should include the following in explanatory memorandum para 1.33:

The 'period of retirement' is intended to cover the period between the start of retirement and life expectancy of the sub-class of beneficiaries, or such longer period as a trustee may deem prudent.

2. APRA should release appropriate draft guidance before 31 December 2021 covering the matters recommended in this submission, including a timeline indicating when trustees are expected to meet this guidance.
3. The Corporations Act should be amended to state that acts of asking for information for the purposes of complying with the Retirement Income Covenant do not of themselves constitute personal financial advice (similar to provisions relating to the Design and Distribution Obligations).
4. ASIC should provide guidance to trustees explaining how trustees can balance the objectives within the Covenant without such processes and actions being deemed to be the provision of personal financial advice.
5. The ATO and DSS should be required to provide relevant aggregated data to superannuation fund trustees, with the exact data included to be subject to further consultation.
6. The Government should provide policy confidence around the first and third pillar retirement system components (Age Pension, and voluntary savings) and Government support for aged care costs.
7. Appropriate technical and consequential amendments should be made to enable effective implementation of the Covenant.