Association of Financial Advisers
Association of Financial Advisers Ltd
ACN: 008 619 921
ABN: 29 008 619 921
PO Box Q279
Queen Victoria Building NSW 1230
T 02 9267 4003 F 02 9267 5003
Member Freecall: 1800 656 009
www.afa.asn.au

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Director
Tax and Transfers Branch
Retirement, Advice and Investment Division
Treasury
Langton Crescent
Parkes ACT 2600

By email: Superannuation@treasury.gov.au

AFA Submission: Retirement Income Covenant

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for 75 years. Our objective is to achieve *Great Advice for More Australians* and we do this through:

- advocating for appropriate policy settings for financial advice
- enforcing a Code of Ethical Conduct
- investing in consumer-based research
- developing professional development pathways for financial advisers
- connecting key stakeholders within the financial advice community
- educating consumers around the importance of financial advice

With the exception of Independent Directors, the Board of the AFA is elected by the Membership and Directors are practicing financial advisers. This ensures that the policy positions taken by the AFA are framed with practical, workable outcomes in mind, but are also aligned to achieving our vision of having the quality of relationships shared between advisers and their clients understood and valued throughout society. This will play a vital role in helping Australians reach their potential through building, managing and protecting their wealth.

Introduction

Thank you for the opportunity to provide a submission on the Retirement Income Covenant. We note that the AFA provided a response to the Retirement Income Covenant – Position Paper on 6 August 2021, and our views in this submission largely reflect what we said in response to the earlier Position Paper.

We are supportive of the intent to create a Retirement Income Covenant, although we think that this proposal lacks substance and clarity of purpose. We acknowledge the need to assist Australians to prepare for retirement and to have the confidence to live comfortable lives in retirement. However, we believe that the best way to achieve this is to better enable access to financial advice that is tailored to the specific personal circumstances of each individual member.

Whilst we are supportive of the development of a retirement income strategy by super fund trustees, we do not believe that this should, in any way, be a substitute for quality financial advice. This legislation seems to be positioning the retirement income strategy as a mechanism to replace the need for financial advice and we consider this to be an erroneous proposition that will potentially lead to material client detriment. It is wrong to provide retired Australians with the expectation that their superannuation fund can provide a strategy that is designed for them, when that will not be the case.

We note the objectives, however we question exactly how it will be possible for a trustee to achieve these:

- maximize their expected 'retirement income';
- manage expected risks (including longevity risks, investment risks and inflation risks) to the sustainability and stability of their expected retirement income; and
- have flexible access to expected funds during retirement.

We ask the question, in the absence of specific knowledge about the client's personal circumstances, how is it possible for super fund trustees to maximise the members retirement income or manage risks? In a practical sense, what does this actually mean? In the absence of providing financial advice, how can they do this? In our view, this proposal is setting up what is a totally unreasonable expectation and one that runs the risk of pushing members to do things that might be contrary to their best interests.

We further note the statement "In formulating the strategy, trustees would be expected to identify the expected retirement income needs of beneficiaries and present a plan to build the fund's capacity and capability to service those needs". This very clearly implies that trustees need to investigate the personal circumstances of members without their knowledge and then present a plan to them. Surely this amounts to the provision of financial advice, in circumstances where it has not been requested.

How will the retirement income strategy be applied to members who are already retired and who have already locked in their retirement plans? How will it impact those who are well progressed in their retirement years? Surely this must be limited in its application, with a focus on those who are approaching or early on in their retirement years.

We are concerned about the risk of potential conflict between the financial advice provided by financial advisers, that is tailored to the specific needs and personal circumstances of a client, and that which might be provided by their super fund on the basis of assumptions about certain cohorts. How will this conflict be managed and what option is there for advised clients to opt-out of the fund's retirement income strategy and also opt-out of paying for the cost of it? There is nothing that addresses this issue, which we believe is critical.

How will the development of these retirement income strategies and the delivery of them be paid for? Why should financial advice clients be forced to pay for both financial advice that is tailored to their needs and the cost of this retirement income strategy.

Before this is legislated, the Government needs to explain exactly what this Retirement Covenant will mean at the individual client level and how it will be delivered in a way that does not inappropriately impact those clients who have taken the initiative to get financial advice.

We make a broader point on this regime, and the fact that a breach of this Covenant, whilst being a civil penalty provision, is not automatically deemed reportable to ASIC, as all civil penalty provisions in financial services laws, other than the Corporations Act, have been exempted from the new breach reporting obligations.

Retirement Income Covenant

A super fund that has the objective of maximising retirement income and managing risks and enabling flexible access to savings during retirement, would need to have extensive knowledge of the members situation, including:

- All other superannuation funds and other financial assets.
- An understanding of home ownership and the existence of any debt.
- Future plans for downsizing their home.
- The member's employment income and non super/pension income.
- The existence of a partner and an understanding of their employment status.
- The potential receipt of any insurance payments.
- Eligibility for the age pension or any other benefits such as veterans' affairs.
- Income needs and any planned major expenditure.
- Investment experience and tolerance to risk.
- Health status and medical history.

In the absence of specific knowledge of the above, how is it even possible for super fund trustees to seek to deliver on the objectives of this retirement income strategy.

We also need to ask the question about what super fund members would think, if their super fund trustees were seeking to investigate all this information with respect to them. This is an invasion of their privacy and it is likely that is would be perceived to be a 'big brother' intervention.

Members

We note the assumption that trustees will have access to a range of information on their members, even if this is at a cohort level. However, in reality, and in the absence of specific permission, it will be very difficult for trustees to access meaningful information. For example, how would they access the following information:

- whether a member is expected to receive a full, part- or nil-rate Age Pension at retirement.
- whether a member is partnered or single.
- whether a member owns their own home outright, owns their home with a mortgage, or is renting at retirement.
- What cash reserves they have outside super.

Much of this they could only speculate on, or make crude assumptions, unless they actually seek to collect this information. This opens up the questions as to whether it is appropriate for trustees to be seeking information that is not required for their core role and where the member may not be willing to share it.

We expect that there is a huge risk of super funds making the wrong assumptions about members and putting them in the wrong group, and seeking to pursue a certain retirement strategy that is flawed, thus putting them at risk of detriment.

In the absence of knowledge of employment income, other super fund accounts, insurance benefits and non-super assets, in reality it would only be possible for the trustee to be definitive about those who are definitely not eligible for the age pension.

Information requirements and Understanding Members

We struggle to understand the benefit of a fund trying to speculate on a member's eligibility for the age pension. Surely there is a greater risk that they make the wrong assumption and therefore seek to apply a retirement income strategy that is not suitable for the member.

We are concerned that this Retirement Income Covenant sets up an unrealistic and unreasonable expectation on super fund trustees to collect information on their members. We question whether they should have the right to seek this information from advised clients, who already have their own retirement strategy. There is a very definite downside in empowering trustees to ask questions of their members that could be used for related or other purposes, where it may be more a matter of acting in the best interests of the fund, rather than the member. What right should they have to be asking their members private questions such as whether they have a partner or not? Members have the ability to nominate a beneficiary. This is all that they should be expected to respond to.

It seems that this expectation to do this assessment is only going to cost the fund more, but for what benefit?

Maximising Retirement Income

Ultimately, based upon historical investment performance, retirement incomes will be maximised by a total investment in high growth assets. This, on average, and over time, will most likely generate the best returns. Does it, however, align with the needs of the client or their tolerance for risk? We would suggest that in many cases it would not.

How can a trustee make a meaningful estimate about a members life expectancy without knowledge of their current health state, personal medical history and family medical history? Even with this information, it is only an educated guess. Without it, it is simply unfounded speculation.

How can a super fund trustee develop an understanding of a members income needs? How will they know what dependents they have, what commitments they have and what spending patterns they have? How will they possibly know what their income needs in retirement might be?

Managing Risk

We note with some alarm that trustees should think in terms of providing assistance with members managing risk. This is surely not something that they are in a position to do for a specific member, and in any case, is this a business risk that they should be taking? What happens in the event that a member runs out of funds due to the retirement income strategy developed by their super fund? Does that member have the right to take legal action against the trustee?

Flexible Access to Savings

Without knowledge of a member's non-super assets, it seems wrong for a super fund to leave a certain amount of the members funds out of the market. This all depends upon cash savings and other investments that they might choose to access first. It also depends upon their potential needs for flexible funds. This is something that is very specific to the individual. Surely other than providing information to support the member in considering this need, this is one thing that the member needs to take responsibility for?

What is the Objective and Outcome of this Retirement Income Covenant?

When we reflect upon the "objectives of maximising retirement income, managing key risks and having some flexible access to savings during retirement", this all seems to be an attempt to replace the role of a financial adviser in the life of the member. It seems to be designed, on the basis of seeking to extract large amounts of information on members, put them in buckets, make assumptions about what is in their best interests and then implement the strategy. Is it really the right thing for a product provider to have so much influence and power? Whilst we accept that the intention of this is to provide greater support for those approaching and in retirement, however there is a difference between supporting members to access information (or hopefully financial advice) and making decisions for them.

We are totally supportive of super funds providing information and calculators and developing products for their members to choose. We also support the development and availability of default retirement income products that clients can choose. However, this is very different to what seems to have been suggested in this paper.

Overall Assessment

It is our view that the expectations of a retirement income strategy have been ill-defined. It is not clear to us how a super fund trustee would go about the exercise of formulating such a strategy, and precisely what is required. There has been no example provided.

It is also very unclear what they would be trying to achieve in such an exercise, and whether the benefit of this would justify the additional cost of doing this. It seems that it would be an exercise of using rough assumptions to form a view about what is right for clients, when they have no reasonable way of assessing those assumptions.

Super fund trustees will need to increase fees to cover the additional work in developing retirement income strategies. There also seems to have been no consideration of how such a model would work for advised clients who already have their own retirement strategy. Advised clients are already paying their advisers to provide this advice, so why should they be forced to pay higher fees for the super fund trustees to develop a retirement income strategy?

Regulation Impact Statement

We are concerned that there is no regulation impact statement. There are genuine questions related to this proposal including - how much will this cost super funds and how will it be paid for, can it be charged only to members covered under the strategy, can other members elect to opt out of this? Also where is the analysis on the expected benefits of this proposal?

Concluding Comments

The AFA supports super fund trustees providing more information and education to assist members in the preparation for retirement, however we are deeply concerned about what has been proposed in the Retirement Income Covenant and question how this will work in practice and what it will achieve.

We would be happy to discuss this matter further, or to provide additional information if required. Please contact us on (02) 9267 4003.

Yours sincerely,

Helen Morgan-Banda
Chief Executive Officer
Association of Financial Advisers Ltd