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

6 August 2021

Director
Retirement, Advice, and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: superannuation@treasury.gov.au

AFA Submission – Retirement Income Covenant – Position Paper

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 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.

We were disturbed to see the statement about studies showing that retirees die with around 90% of the assets that they had at retirement. In our view, this is another indicator of the importance of getting financial advice, which better enables people to plan for their futures and to know how much they have available to spend and to continue to carefully manage their ongoing expenditure during retirement. We have no doubt that this would not be representative of advised retirees. In addition to other benefits from financial advice, they would have greater confidence to spend at a sensible level that both protects them against longevity risk, and provides them with the confidence to live comfortable lives in retirement. With the rising cost of financial advice, that is being driven by the never-ending stream of regulatory reform that continues to add significant layers of complexity and red-tape to the advice process, we suspect that this problem will only get worse as less people can afford to access financial advice. The significant decline in the number of financial advisers is also going to impact access to advice for everyday Australians.

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 paper seems to be positioning the retirement income strategy as a mechanism to minimise the need for financial advice and we consider this to be an erroneous proposition that will potentially lead to material client detriment.

Our Response

Better Products

Whilst we note the changes to enable the emergence of new products and the changes to the tax treatment and the social security means test, ultimately the selection of the right product comes down to the personal circumstances of the client and their specific needs and tolerance to risk. In the absence of increased knowledge or access to financial advice, products alone are unlikely to substantially address the underlying issues.

Appropriate Guidance

We note the use of the words 'appropriate' and 'guidance'. Appropriate implies that it is suitable to an individual, which suggests that it would take their circumstances into account. Guidance is a term that is not part of the Corporations Act, which uses the term financial product advice, in both a general advice and a personal advice context. This section lacks clarity on what is meant by guidance, leaving us uncertain as to exactly what it is expected that super trustees would be doing. We nonetheless make the point that in most situations, people do not make big decisions, such as those involved in retirement, without some level of input. What is critical is that this input is in the best interests of the member, as opposed to being either ill-informed or in the best interests of the fund.

This section lacks sufficient information and specificity to understand exactly what is being proposed and exactly how Australians might actually end up invested in the products that best meet their needs.

Retirement Income Strategy

We note with alarm the suggestion that the strategy could be intended to assist their members to achieve the following objectives:

- maximise their retirement income (taking into account the Age Pension and any other relevant income support payments identified by the trustee paid under the Social Security Act 1991 or the Veterans Entitlements Act 1986)
- manage risks to the sustainability and stability of their income
- have some flexible access to savings during retirement

Firstly, the trustee will not know the member's employment income and non super/pension income that would be required in order to provide any input on maximising retirement income. They will have no knowledge of an entitlement to Veterans benefits. Further in the context of not having the knowledge of the client's full situation, they are not in a position to manage risk, or to recommend a solution for flexible access to savings.

We suspect that the provision of "guidance" in these areas would breach the Sole Purpose Test.

We would agree with the proposal that a retirement income strategy would not be required for defined benefit members.

We struggle with the statement that trustees would be expected to "identify the particular needs of their members and develop a retirement income strategy that is suited to those particular needs". Trustees have not been expected to understand these needs in the past and they do not have the means to obtain this information or to interpret it.

We note the comments that "This does not preclude the trustee from assisting their members to meet their individual needs through tailored advice or guidance", which seems to conflict with the statement that a retirement income strategy is not financial advice. We come back to the positioning of this later.

Members

We note the discussion on cohorts and the suggestion that trustees will have access to a range of information, however we do not believe that they will necessarily or should have 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;

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, thus putting them at risk of detriment.

Examples

The first example suggests that a trustee would be able to tell whether a member would receive a full, part or no age pension. In the absence of knowledge of employment income, other super fund accounts 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.

We are surprised that an example would be put forward of a fund that works on two cohorts, with one being those who retire early and the other being those who retire late. Firstly, how do you define what is early and what is late, and in any case how can this be predicted reliably and what about those who retire neither early nor late. The example provides no basis for trustees to make such an assessment.

SMSF Funds

Given the fact that the trustees are also members of the fund, we question the necessity for the trustees to prepare a retirement income strategy for the fund. Surely, they are better to get financial advice that is suitable for each member of the fund.

Retirement Income

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.

Surveying members seems to be an overreach of the role of the trustee and intrusive into the lives of 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 about 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.

How can they use publicly available data to determine home ownership and in any case is this appropriate for them to do?

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 return. Does it however align with the needs of the client or their tolerance for risk?

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.

A comparison has been made between this exercise and the exercise to apply a group insurance strategy. They are very different. When it comes to group super, typically they have information from the employer about employment income to be used alongside occupational data and age to set the level of cover. This is very different from working out a suitable retirement strategy without meaningful knowledge of the member's personal circumstances.

We note the statement that "To the extent that their members are coupled, trustees may decide to construct a strategy that assists their members to maximise the retirement income of the couple". This seems to imply a tailored strategy for individuals. How is this possible or appropriate?

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?

We find the discussion on whether trustees should "assist their members to manage the longevity risk of the reversionary beneficiaries of members" to be quite remarkable. This is taking trustees way outside of their core role. This seems to be an incredible ask of a super fund trustee, who in most cases has a very distant relationship with their members.

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. Surely there are certain things that the member needs to take responsibility for?

Reviewing the Strategy

In our view the suggestion that reviewing the retirement income strategy is similar to reviewing the investment strategy is flawed. Assessing the investment strategy is largely an objective exercise. Reviewing the retirement income strategy is an incredibly subjective exercise based upon imperfect data and a huge number of assumptions. It would only ever be pure speculation.

What is the Objective and Outcome of this 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 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. We ask the question of what is the real objective with this and is this really the role of super fund trustees? Is it really the right thing for a product provider to have so much influence and power? Isn't this a return to a model of vertical integration?

We are totally supportive of super funds providing information and calculators and developing products for their members to 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. Is this really what Australians want their super fund to do?

Neither is there any justification for why this type of approach is required, and whether there are better options for addressing whatever the underlying reasons for such an expectation might be. 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.

We are concerned that this implies some excessive level of paternalistic expectation in the role of super fund trustees.

Concluding Comments

The AFA supports super fund trustees to provide more information and education to assist members in the preparation for retirement, however we are deeply concerned about what has been proposed in this paper and question the motives for such a proposition.

We would be happy to provide Treasury with any further information required for the consideration of this Position Paper.

Yours sincerely,

Phil Anderson
General Manager Policy and Professionalism
Association of Financial Advisers Ltd