



Association of Financial Advisers Ltd  
ACN: 008 619 921  
ABN: 29 008 921  
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

15 June 2018

Manager, CIPRs  
Retirement Income Policy Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600

By email: [superannuation@treasury.gov.au](mailto:superannuation@treasury.gov.au)

Dear Treasury,

### **AFA Submission – Retirement Income Covenant**

The Association of Financial Advisers Limited (**AFA**) has served the financial advice industry for over 70 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

The Board of the AFA is elected by the Membership and all 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 wealth.

### **Introduction**

Whilst we accept the proposition that the retirement income market in Australia is underdeveloped, we do not agree that the solution is for superannuation fund trustees to design pre-packaged retirement income solutions. We think that this is a very poor substitute for retirees seeking personal financial advice that is tailored to their needs, objectives and personal circumstances.

Retirement or the period in the lead up to retirement is a period of huge change and necessarily requires extensive preparation. Much of this change is unrelated to the members superannuation account. It is important to appreciate that this is not simply a financial transition, but also an emotional transition. The divorce rate spikes in the period following retirement. Getting this transition right requires quality advice. It is overly simplistic to think about retirement as a transition from an accumulation phase product to an income stream product and expect that this can be done with some general advice and a simplified decision set.

In terms of a Comprehensive Income Product for Retirement, we note the likely inclusion of an account based pension and a lifetime annuity or a deferred lifetime annuity. There is certainly an additional level of complexity for a superannuation fund in running an account based pension, however it is a very different proposition to offer lifetime annuities or deferred lifetime annuities where the product provider is taking on substantial product risk. This requires significant capital and substantial additional resources (ie actuarial). We are particularly concerned about the implications of the average superannuation funds developing this capacity and taking on this risk.

An analysis of the lifetime annuity marketplace shows that it is dominated by one player and there is very limited competition. We pose the question as to whether if these products are available, and clients can choose to use them, then why has the market evolved as it has? This is not to say that we don't support annuity products. In fact, they are very much appropriate for some clients, particularly those who are risk averse and have reasonable grounds to suggest that they will continue to live long lives. For anyone with a family history or personal health history that suggests a shorter remaining lifetime, then they may not be appropriate.

Typically, lifetime annuity products have largely been backed by fixed income investments, although this has changed somewhat in recent times. Where they have been based upon fixed income products then the return available to clients has been very much influenced by the state of the market for fixed income securities. Where longer term fixed interest rates are high, then the rate of return on annuity products is high. Where interest rates are low, then the return on annuities is low. Investing in a lifetime annuity is a long term decision. Those clients who lock in when interest rates are low are likely to experience much reduced earning rates for the life of the product.

We note that the consultation paper is in a number of places setting out that certain actions would not be considered to be personal advice. We have concerns about the very nature of this proposal in that it is all about designing solutions for members, but then claiming that it is not personal advice and implying that personal advice may not be required. We believe that the Government should focus upon promoting personal advice at the time of retirement rather than promoting solutions like this that are not tailored to individuals and might cause serious detriment if they are simply not suitable to the individual and if other key personal finance matters get left unattended.

We question whether a form of mandating lifetime annuities or deferred lifetime annuities is really in the best interest of consumers. They should be available to clients to select on the basis of financial advice, where they can be demonstrated to be in the best interests of the client.

In a time where vertical integration is subject to such close scrutiny, we are somewhat surprised that there is a proposal to further entrench elements of vertical integration in the financial services industry.

## **Covenant Principles**

### **1. Retirement income strategy**

**Trustees should assist members to meet their retirement income objectives throughout retirement by developing a retirement income strategy for members.**

We are not convinced that it is the role of the trustee to develop a retirement income strategy, which in our view is very dependent upon the specific circumstances of the individual client. We question whether it is sensible or possible to lump members into specific cohorts and suggest that they are sufficiently similar that it would make sense to develop a strategy that should apply identically to each of them.

## 2. Engagement

**Trustees should assist members to meet their retirement income objectives by providing guidance to help members understand and make choices about the retirement income products offered by the fund.**

We strongly support the role of trustees to provide general information to members to assist them to prepare for retirement. This, in our view, is very different from trustees playing an active role in selling their own retirement income products to their members.

Members need to be thinking about a broad range of factors as they approach retirement, including access to the age pension, steps to maximise their pension eligibility, repayment of debt, financing any living expenses including children who are still at home, expectations of inheritance, ensuring that their wills and powers of attorney meet their needs etc. Trustees should seek to paint a more complete picture of the issues to consider at the time of retirement and the importance of personal financial advice that is tailored to their needs, objectives and personal circumstances.

## Supporting Principles

### 3. Definition of a Comprehensive Income Product for Retirement

**A CIPR is a retirement income product which is designed to provide:**

- **efficient, broadly constant income, in expectation;**
- **longevity risk management (income for life); and**
- **some access to capital.**

**A 100 per cent allocation to an ABP alone would not meet the definition of a CIPR.**

Whilst we do not disagree with the stated objectives of a CIPR, we question the practicality of achieving a broadly constant income over time. There will always be transition points, particularly where a deferred lifetime annuity might kick in and where an account based pension is declining rapidly. We also question whether the charts in the Appendix actually demonstrate that such an outcome is achieved by what is proposed. This seems inconsistent.

We also make the point that spending may naturally decline over time in retirement as people are less capable of overseas and domestic travel and are less likely to spend money on entertainment. This will be partly offset by an increase in health costs. Nonetheless, the need for income in retirement is unlikely to be constant over the course of an extended period of retirement.

Whilst it is suggested that the use of a deferred lifetime annuity will give members greater confidence to spend at a higher rate whilst in retirement, we expect that this would simply add an additional stage point and since members will have less money in their ABP, they will still have concern about whether their ABP assets will last until their DLA commences.

It is our view that for clients who have a high risk appetite and significant assets, a 100% allocation to an account based pension may be the most appropriate outcome. Given that the ABP will typically be invested in a higher proportion of growth assets, as compared to the underlying investment allocation for annuities, they should be expected to overperform over the longer term. Thus, where there are significant assets available to invest, the investment return should be higher in an account based pension, and there should be little risk of assets running out.

We also make the point that a lifetime annuity or a deferred lifetime annuity may not be a suitable product for some people who have medical reasons to expect that their life expectancy is less than

the average. This might be because of family history, genetic testing or previous illnesses or injuries. It might be possible that a trustee could become aware of some of this information over the course of a long term relationship with the member. This potential exposure could provide grounds for the member or their family to take action against the trustees, should such an investment in a CIPR (and particularly a DLA) turn out to be a poor choice. How can trustees be certain that they have not become aware of this information?

**4. Offering a flagship CIPR**

**All trustees should offer a flagship CIPR to members at retirement, subject to limited exceptions (see principles 7 and 8).**

As discussed above, we believe that trustees should be promoting the need for personal advice in preparation for retirement, not building products and assuming that they can meet the needs of their members by providing pre-packaged products that fail to take into account the specific needs of each of their members.

**5. Third party products**

**Trustees can fulfil their obligation in part or in full by using a third party.**

Given the lack of expertise in the lifetime or deferred lifetime annuities space and the need for capital to offer these products, it would seem that it is a much more sensible outcome to outsource this to third parties. There is a need for greater consideration of the exact nature of this outsourcing or reliance on third parties. For example, what might the financial arrangement be where a trustee promotes a particular provider of deferred lifetime annuities?

**6. Consent**

**Consent should be required for a CIPR to commence.**

The AFA believes that informed consent is a critical requirement for all important financial decisions. There should be no doubt that informed consent is mandatory, and it is surprising that this is even included as a principle. This appears to imply a thinking that this solution will be suitable for more clients that is in fact likely to be the case.

We also question whether genuine consent, that is informed, can be achieved through the model that has been proposed. How is the average Australian going to understand a CIPR product in the absence of personal advice and financial education? Deferred lifetime annuity products are inherently complex and will take some effort to explain and understand.

**7. Offering an alternative retirement income product through advice**

**Trustees may offer an alternate CIPR or another retirement income product to a particular person or cohort of people through any form of personal financial advice, including scaled personal advice, intra-fund advice, or full financial planning.**

There is no question that trustees should have the ability to provide personal advice and that this personal advice could result in a different recommendation. The question is who is providing this advice, as it is more likely to be an employed financial adviser rather than the trustees. We would like to once again highlight that this is a most critical stage that involves consideration of a broad range of factors including all assets, all liabilities, expense needs, dependents and estate planning. Scaled advice and intra-fund advice is most unlikely to address all the needs that members will have at the time they seek to commence retirement.

8. Exception for individuals for whom CIPRs are unsuitable

**Trustees may choose not to offer a CIPR *at all* to a particular person if the trustee has reliable information that a CIPR would not suit that person.**

This once again is an obvious factor, however the question is what level of inquiries should be undertaken in order to confirm whether the product is suitable or not. How proactively do the trustees need to be in seeking this information? Where is the boundary in terms of presenting the option of a CIPR and providing financial advice? Where such an important decision is being made, it is concerning that it would be possible, without an adequate consideration of the member's personal circumstances.

### Future Considerations

Lifetime engagement

**Trustees should engage with members about retirement early (from the point of joining the fund onwards) and continue to engage on an ongoing basis.**

Whilst we support this in theory, the practical reality is that most younger people are not interested in thinking about their retirement income requirements that may not be relevant for another 40 years. Engagement is particularly important and this is the basis for financial education, but it necessarily needs to be tuned to the stage of life. Early in a member's working life, the focus is likely to be on getting a mortgage to purchase a first home and acquiring insurance to protect their assets, young family and themselves.

Legacy products

**An approach for managing legacy retirement income products and issues related to these legacy products should form part of the framework.**

We would support this proposal, however it should be backed up by greater explanation in terms of the issues with legacy products that the Government believes need to be addressed. There will undoubtedly be more issues to consider in addition to the implications of unviable products and fund mergers.

Safe harbour

**Trustees could qualify for a safe harbour, in limited circumstances, provided they act diligently and comply with all relevant legal obligations in designing and offering a CIPR.**

As stated above, if the trustee has been exposed in any way to information about the health status of their members then it will be difficult to hide behind a safe harbour. We also question the rationale for proposing a safe harbour. If this CIPR proposal is as strong as appears to have been suggested, then why would superannuation fund trustees need to hide behind a safe harbour protection? How is such a protection in the interests of consumers? It seems that there is a desire for some paternalistic direction of members, but offset by a safe harbour to protect them in the event that their members are disadvantaged by a solution that failed to take into account their personal circumstances and failed to provide them with personal advice, despite expecting them to make some very significant decisions.

### Other Feedback

We note the three scenarios in the Appendix, however believe that there is a need for supporting details to be included to back up the charts that have been included. Clearly there are a number of key assumptions and important calculations in these scenarios, however they have not been

presented. Considering the state of the deferred annuity market in Australia, it is very surprising that these projections have been made and these charts have been included, which appear to demonstrate that the standard CIPR delivers the best option. This should not be done without the supporting details being included.

### **Concluding Remarks**

Whilst we support the Government’s focus upon the state of the retirement incomes market in Australia, we have major concerns that this proposal over simplifies the nature of the decisions involved in retirement and understates the importance of personal financial advice at that most critical time.

The AFA welcomes further consultation with the Treasury should it require clarification of anything in this submission. If required, please contact us on (02) 9267 4003.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'P. Kewin', written in a cursive style.

**Philip Kewin**  
Chief Executive Officer  
Association of Financial Advisers Ltd