FINANCIAL PLANNING
ASSOCIATION of AUSTRALIA

6 August 2021

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

Email: superannuation@treasury.gov.au

Dear Sir / Madam

Retirement Income Covenant – 2021 Position Paper

The Financial Planning Association of Australia[1] (FPA) welcomes the opportunity to provide feedback to The Treasury on its Retirement Income Covenant 2021 Position Paper.

The FPA acknowledges that the draft Covenant has been significantly improved since the 2018 consultation, and we welcome the following changes in particular:

- the clarity that assistance provided by funds must comply with financial advice laws if it exceeds factual information;
- the requirement that members must have flexible access to savings in retirement; and
- the removal of the mandate on funds to proactively push a default retirement income product on members.

Our submission includes recommendations to further improve the Retirement Income Covenant for the benefit of superannuation members.

We would welcome the opportunity to discuss with Treasury any matters raised in our submission. If you have any questions, please contact me on 02 9220 4500.

Yours sincerely

Ben Marshan CFP® LRS®
Head of Policy, Strategy and Innovation
Financial Planning Association of Australia

1 The Financial Planning Association (FPA) is a professional body with more than 12,000 individual members and affiliates of whom around 8,500 are practising financial planners and 5,207 are CFP professionals. Since 1992, the FPA has taken a leadership role in the financial planning profession in Australia and globally:

- Our first "policy pillar" is to act in the public interest at all times.
- In 2009 we announced a remuneration policy banning all commissions and conflicted remuneration on investments and superannuation for our members – years ahead of the Future of Financial Advice reforms.
- The FPA was the first financial planning professional body in the world to have a full suite of professional regulations incorporating a set of ethical principles, practice standards and professional conduct rules that explain and underpin professional financial planning practices.
- We have an independent Conduct Review Commission, chaired by Dale Boucher, dealing with investigations and complaints against our members for breaches of our professional rules.
- We built a curriculum with 18 Australian Universities for degrees in financial planning through the Financial Planning Education Council (FPEC) which we established in 2011. Since 1 July 2013 all new members of the FPA have been required to hold, or be working towards, as a minimum, an approved undergraduate degree.
- When the Financial Adviser Standards and Ethics Authority (FASEA) was established, the FPEC 'gifted' this financial planning curriculum and accreditation framework to FASEA to assist the Standards Body with its work.
- We are recognised as a professional body by the Tax Practitioners Board.

RETIREMENT INCOME COVENANT 2021 POSITION PAPER

Prepared for The Treasury

6 August 2021

Introduction

The FPA supports the intent of the Covenant to "*codify the requirements and obligations for superannuation trustees to improve retirement outcomes for individuals, while enabling choice and competition in the retirement phase."*

The introduction of a trustee retirement income strategy, as detailed in the position paper, will complement the trustee's existing investment, risk management and insurance strategies, as required under the SIS Act. The FPA supports and welcomes this policy and the potential enhancements it should provide users of the superannuation system in the lead up to and during retirement.

Objectives and strategy requirements

The position paper states:

> *The [retirement income] strategy will be a strategic document developed by the trustee, outlining their plan to assist their members to achieve and balance the following objectives:*
>
> - *maximise their retirement income*
> - *manage risks to the sustainability and stability of their retirement income; and*
> - *have some flexible access to savings during retirement.*
>
> *…trustees will be required to consider the broad needs of their members and identify what actions the trustee needs to take to assist their members to meet those needs. It is anticipated that the requirement to develop a retirement income strategy will result in many trustees evaluating the products they offer to their members and investigating whether their product offerings can be improved to better meet the needs of their members.*

The FPA supports the following requirements proposed in the position paper as a framework for trustees to put in place an appropriate retirement income strategy to assist their members to achieve and balance the above objectives:

- that the trustee has appropriately considered the retirement income needs of their members and that they are sufficiently equipped to address them
- the key member objectives that the strategy should outline and identify how they intend to balance the these objectives when assisting their members
- the requirement to include some flexible access to savings during retirement
- the defined benefit scheme exemption
- that there is no requirement for trustees to offer a particular retirement income product to members
- the key terms of the Covenant as proposed in the position paper (pgs 7 – 11)
- the strategy should be formulated for all members of a fund who are retired or approaching retirement (as a whole or groups of cohorts), with discretion given to the trustee as to the factors used to identify cohorts of their members
- trustees of SMSFs and SAFs with retired members should have a retirement income strategy
- should consider any entitlement to the Age Pension and drawdowns from the member's interest in the trustee's fund as a source of retirement income, and take into account the tax system's treatment of retirement income
- to consider longevity risk and investment risks
- to review their fund's performance against their retirement income strategy on at least an annual basis, and conduct a comprehensive review of their retirement income strategy every three years at a minimum

- to communicate the broad conclusions of these reviews to their members
- that the strategy be publicly available to members.

The FPA recommends the legislated Retirement Income Covenant must oblige trustees to formulate, review regularly and give effect to a retirement income strategy that is in the best interest of its members.

Maximising retirement income and retirement income assumptions

The position paper states:

> *A significant body of evidence shows that the real spending needs of most retirees decline over the course of retirement.*

However, as detailed in our submission to the Retirement Income Review, FPA members have witnessed a distinct change in the needs and expenditure requirements of their clients throughout retirement, which can be broadly segregated into three phases:

1. Active phase – retirees are likely to be more active early in retirement and are inclined to continue with their existing lifestyle, including more leisure and travel time, during this active phase.

2. Passive phase – this phase starts to see increased expenditure on health costs, less travel and a change to less active leisure interests.

3. Frail or high dependency phase – later in retirement a retiree's restricted mobility means expenditure on leisure is increasingly replaced by higher expenditure on health and aged care.

Increasing health and aged care costs often change retirement income patterns to reflect the need for a steady or even increasing income (rather than a decreasing one) in the frail or high dependency phase.

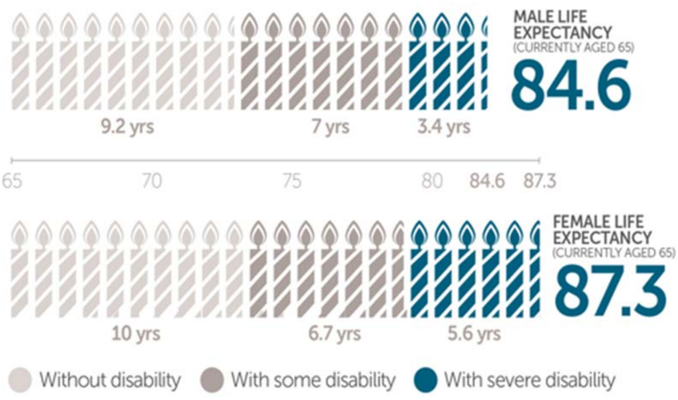
According to Aged Care Steps[2]:

> *"Retirees can reasonably expect to need increasing levels of support over the last 10-12 years of their life, with many experiencing high levels of care dependency in the last 4-5 years, which we refer to as the 'frailty years'. This represents on average 17-25% of retirement years."*

While the position paper requires trustees to consider longevity in their retirement strategy, the health stages that the client goes through in retirement and the impact that health has on their retirement planning, outcomes, and future care needs is not required.

Data from the Australian Institute of Health and Welfare provides details the different levels of health for an average male and female.

[2] Aged Care Steps specialise in the application of aged care rules to consumers' needs to help advisers create effective advice solutions so clients can make informed choices about aged care options and funding mechanisms.



Source: Aged Care Steps, July 2021

The FPA notes the following statement from the Aged Care Royal Commission Report referred to in the Covenant position paper:

> *When considering their members' expected future needs for flexible savings for health costs (including aged care), trustees should take into account the significant financial and in-kind support provided by the Government. Health and aged care costs are heavily subsidised in Australia. Most people's expenditure on these items does not increase significantly in real terms during retirement.*[3]

Aged care is heavily subsidised by the Government. However, these aged care costs will continue to increase for the Government with the implementation of the Royal Commission recommendations to improve the quality of aged care services in Australian. The increase in demand from the projected ageing population will put further pressure on the level of Government support available to each individual.

The FPA understands the Aged Care Royal Commission did not agree on how to meet the rising aged care costs and the Government did not accept all the recommendations in the Royal Commission Report in relation to aged care funding arrangements. Without a rise in Government assistance there will need to be more of a user-pays system for funding aged care.

There are a range of aged care services available in Australia, many of which offer additional beneficial programs and lifestyle options which can impact the cost. If retirees want greater control and choice over their housing, lifestyle and care needs throughout their retirement, they need to factor in health and aged care costs rather than just rely on Government funding. It is unlikely that Government funding will cover the range of aged care costs to each individual's satisfaction.

According to Aged Care Steps, the costs of aged care have been accelerating, are likely to continue to increase at a rate higher than inflation, and these higher costs will need to be recovered through higher fees to the consumers:

> *"Aged care costs can be difficult to predict and can vary from $100 a week to $5,000*[4] *a week depending on care needs and family circumstances. This equates to $5,200-$260,000 a year.*
>
> *Access to government subsidies helps to drastically reduce the cost payable by the user, but having adequate savings opens up the choices and ability to control the level and type of care*

[3] Retirement Income Review, pg 440, cited Retirement Income Covenant Position Paper, pg 13
[4] Based on a range from basic daily fee for home care packages to 24-hour private nursing care.

received. This means that clients are likely to spend more on aged care if they want to maintain independence and control throughout retirement."

This in turn will reduce the pressure on Government funding of aged care services.

Costs to be considered in the 'frailty years' may include the following:

- Contributions for home packages received which are based on assessable income
- Contribution towards Commonwealth Home Support Program (CHSP) services
- Funding private care to supplement home care packages received
- Funding private care while waiting for a home care package to be allocated
- Capital expenditure to modify the home to cater for the client if they are less mobile
- Funding a move to residential aged care services including upfront (Refundable Accommodation Deposits – RADs) and ongoing costs
- Funding the transactional and other costs of moving to another living arrangement such as retirement villages.

The level of income that an average person will need in retirement will vary based on their health and is likely to increase in the last phases of their life, rather than decline as is assumed in the paper. Aged Care Steps and the feedback received from FPA members about their clients' experience, strongly suggests the income needs in retirement are likely to be U-shaped rather than a straight line.

The position paper requires trustees to make assumptions about life expectancy. However, it does not require trustees to make assumptions about aged care and health needs, rather it relies on Government funding to cover such costs for retirees which is unrealistic and unsustainable.

The FPA suggests the assumptions in this paper are oversimplified and recommends the Retirement Income Covenant require trustees to make assumptions about the health and aged care needs of their members (particularly in their 'frailty years') when developing the retirement income strategy for the fund.

Managing risks to the stability and sustainability of retirement income and flexible access to savings

The position paper proposes that trustees need to consider how to assist their members to manage risks to the stability and sustainability of their retirement income. The position paper requires that trustees consider the impact of longevity risk and investment risks on the stability and sustainability of their members' retirement income.

As discussed above, retirees can reasonably expect to need increasing levels of support during 17-25% of retirement years on average, with aged care costs of anywhere from $5,200 to $260,000 a year. Given the average balance of superannuation accounts of men and women aged 75 years and over is $366,200 and $270,300[5] respectively, this could represent as much as 71% (men) or more than 96% (women) of a retiree's superannuation savings as they enter the years of their retirement during which they will require the most care. Aged Care Steps refer to this as the 'frailty risk'.

[5] Australian Bureau of Statistics Household Income and Wealth, Australia 2017-2018.

However, this ‘frailty risk’ is largely ignored in the position paper even though it significantly impacts longevity risk, and can result in the member running out of funds prematurely and losing control and independence in retirement.

The FPA believes trustees should be required to consider the ‘frailty risk’ of their members in the retirement income strategy, and factor in greater levels of income for aged care support. This should cover at least the last 25% of the members’ retirement years (severe disability and high care years).

Trustees consideration of ‘frailty risk’ should not rely on Government support covering members’ future health and aged care needs, particularly given the pressure on Government funding of these services. The Covenant should require trustees to consider ‘frailty risk’ when identifying how they will assist their members to have some flexible access to their savings during retirement.

Box 4: *Examples of identifying the trade-offs between objectives* of the position paper makes reference to ways of managing risks on retirement income and refers to the ‘bucket strategy’. A fourth bucket – the aged care bucket - should be included in the strategy to fund future aged care needs.

The aged care bucket could be used as an allocation for:

- Funds invested specifically to meet the future aged care costs
- A product that can address future aged care costs (e.g., deferred annuity)
- Strategies to meet future aged care costs such as downsizing the home to release equity or equity drawdown strategies.

The FPA recommends the Retirement Income Covenant should require trustees to consider the impact of ‘frailty risk’ on the stability and sustainability of their retirement income and when identifying how they will assist their members have some flexible access to their savings during retirement, during the formulation, review and giving effect of the strategy.

Assisting members to balance the retirement income objectives

The position paper states:

> *Assisting members to balance the retirement income objectives could include, but is not limited to, actions such as:*
>
> - *introducing default settings or ‘nudges’ that encourage their members to draw down faster on their retirement savings, where appropriate (pg 14)*

The FPA notes that default settings offer considerable benefits for members who are disengaged with their superannuation and financial affairs more broadly. However, care must be taken to ensure the option to introduce ‘nudges’ that encourage members to draw down faster on their retirement savings to urge consumption of superannuation savings during retirement, do not adversely effect members’ longevity risk and ‘frailty risk’.

The FPA acknowledges calls from other stakeholders to include in the Covenant 'nudge' requirements as a retirement planning solution for Australians. While the experience of FPA members reflects recent survey findings that "*56% of the pre-retiree survey respondents felt retirement planning will be moderately to extremely complicated*"[6], the FPA strongly advises that care must be taken in relation to the inclusion of 'nudge' requirements in the retirement income strategy of superannuation funds.

A primary key to improving the retirement incomes of members must be initiatives that improve consumer financial literacy and capability, and encourage member engagement.

Making decisions about financial matters when planning for and during retirement are multifaceted and complex. Creating a 'nudge' regime will not overcome these challenges. Continuous active, rather than passive, engagement is vital to ensuring members' retirement needs are met, and to reduce strain on the social security system. 'Nudging' members sends the message that it is ok to be disengaged with your financial affairs in relation to retirement.

Meeting retirement needs cannot be achieved by making one decision during the pre-retirement phase on a retirement income product sold through 'nudging'. The position paper discusses several significant risks related to retirement incomes. These are further discussed in this submission. A desired standard of living which considers these retirement income risks in retirement can only be achieved through ongoing engagement and understanding of changing needs, circumstances, and financial options, to make informed and continuous financial decisions. It is not a one decision process.

Evidence disclosed at the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, saw misconduct around the requirements product providers have in the past placed on representatives to push products on consumers. Recommendation 5.6 of the Royal Commission aims to address the core of this issue:

> *All financial services entities should, as often as reasonably possible, take proper steps to: assess the entity's culture and its governance; identify any problems with that culture and governance; deal with those problems; and determine whether the changes it has made have been effective.*

Commissioner Hayne stressed that this recommendation should be read as reflecting and building upon the other recommendations made in the final report. Relevant to the call for the Covenant to include 'nudge' requirements, is the intent of the Commissioner's following recommendations:

> *Recommendation 5.4 – Remuneration of front line staff: All financial services entities should review at least once each year the design and implementation of their remuneration systems for front line staff to ensure that the design and implementation of those systems focus on not only what staff do, but also how they do it.*
>
> *Recommendation (3.4) - 'No Hawking': Hawking of superannuation products should be prohibited. That is, the unsolicited offer or sale of superannuation should be prohibited except to those who are not retail clients and except for offers made under an eligible employee share scheme. The law should be amended to make clear that contact with a person during which one kind of product is offered is unsolicited unless the person attended the meeting, made or received the telephone call, or initiated the contact for the express purpose of inquiring about, discussing or entering into negotiations in relation to the offer of that kind of product.*

[6] Retirement Planning Survey, Super Consumers Australia, February 2021

The FPA questions whether the proposal that trustees should consider "*introducing default settings or 'nudges' that encourage their members to draw down faster on their retirement savings…."* is in line with the obligation in s52 of the SIS Act for trustees act in the best interest of beneficiaries and the best financial interest of their members under the Your Super, Your Future reforms.

> **The FPA suggests great care must be taken around the use and reliance on terms such as 'nudge' as it is very sales focused, may encourage a sales based culture, is not focused on the needs and best interest of members, and is not in line with the recommendations of the Royal Commission.**

Appropriate guidance

The positions paper states:

> *The Government welcomes feedback from stakeholders on barriers to providing appropriate guidance that could prevent members from using their superannuation to take up retirement products that would be in their interest, or otherwise inhibit trustees providing guidance to members.*

The position paper also states that **"***any assistance provided by the trustee to give effect to their retirement income strategy needs to comply with existing financial advice rules" (pg 7).*

As stated in our submission in response to the 2018 consultation, the Corporations Act, Corporations Regulations, and ASIC guidance, thoroughly cover the requirements, factors and classifications for scaled personal advice, intra-fund advice, personal advice and general advice. The application of these requirements must be consistent, regardless of the product(s) involved otherwise there is a high risk that these consumer protection mechanisms will be watered down and consumers and providers will become confused as to which rules apply in which circumstances.

Recommendation 7.3 of the Financial Services Royal Commission stated that "*As far as possible, exceptions and qualifications to generally applicable norms of conduct in legislation governing financial services entities should be eliminated".*

The FPA has a long held concerns about the over prescriptive and complex nature of the regulatory environment for the provision of financial advice, and the risk that this would and has led to the inclusion of exemption for some providers. The FPA supports regulation that is simple, effective and with consistent application across the industry.

> **The FPA strongly recommends that it must be clear in the legislated Retirement Income Covenant that superannuation trustees are not provided any exemptions or exceptions from the financial advice regulatory requirements in relation to providing guidance or assistance to members, particularly in relation to retirement income.**

Terminology

The positions paper includes the following statements:

> *Guidance covers a range of information provided to members, from factual information through to personal financial advice (pg 5)*

> *The Government is aware that there are concerns regarding current laws and regulations governing guidance. (pg 5)*

- *financial advice - ….. any assistance provided by the trustee to give effect to their retirement income strategy needs to comply with existing financial advice rules (pg 7)*
- *mandating a 'one-size fits all' approach – …. This does not preclude the trustee from assisting their members to meet their individual needs through tailored advice or guidance. (pg 7)*

The FPA is concerned about the interchangeable use of the terminology throughout the position paper - *assist/assistance, guidance, information, factual information, advice, tailored advice, and personal advice.* Each of these terms have specific meanings both for 'ordinary persons' and in the law. Care should be taken to ensure the use of such terms in the Covenant does not inadvertently imply that trustees may provide general or personal advice to members without complying with the financial advice requirements.

> **The FPA recommends the legislated Retirement Income Covenant for superannuation trustees include terminology consistently and as defined in the relevant legislation. It must be made clear that the trustee's retirement income strategy and activities or tactics undertaken by the trustee to give effect to the strategy must comply with financial advice laws at all times.**

Separation of advice and product

The regulation of financial advice is currently tied to the recommendation of a financial product, reflecting a history in which a product recommendation was the core component of most financial advice. In a professionalised financial planning sector, this is no longer the case.

Contemporary financial planning is about a lot more than recommending financial products. There is a wide variety of topics that might be covered by financial advice and many may not include a product recommendation, including in relation to retirement income strategies. Regulation of financial advice should reflect the variety of advice that can be provided, and not continue to be tied to financial product recommendations.

Existing requirements to deliver financial advice should be reviewed to ensure they apply effectively to financial advice that does not include a product recommendation. Future regulation of financial advice should focus on the broad nature of contemporary financial advice and not limit its focus to financial products.

The FPA will provide further discussion on this issue directly to the Quality of Advice Review in 2022.

> **The FPA recommendations the law should be changed to separate the regulation of financial products from the regulation of financial advice**