



AUSTRALIAN INSTITUTE of
SUPERANNUATION TRUSTEES

Response to Retirement Income Covenant Position Paper

15 June 2018

AIST Submission to Treasury

AIST

The Australian Institute of Superannuation Trustees is a national not-for-profit organisation whose membership consists of the trustee directors and staff of industry, corporate and public-sector funds.

As the principal advocate and peak representative body for the \$1.2 trillion profit-to-members superannuation sector, AIST plays a key role in policy development and is a leading provider of research.

AIST provides professional training and support for trustees and fund staff to help them meet the challenges of managing superannuation funds and advancing the interests of their fund members. Each year, AIST hosts the Conference of Major Superannuation Funds (CMSF), in addition to numerous other industry conferences and events.

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Executive summary

In brief:

AIST supports the proposal to include a retirement income covenant in the SIS Act. However, we do not support the proposal to mandate a CIPR as a default product for members' retirements, as this is a decision that trustees should make having regard to the needs of their members. AIST believes that should a CIPR be mandated as a default product in retirement, trustees must be protected by a safe harbour.

AIST welcomes the opportunity to respond to this Position Paper and welcomes the proposed addition of the retirement income covenant to the *Superannuation Industry (Supervision) Act 1993* (the "SIS Act"). We have proposed in various submissions to date that trustees be required to consider the retirement income needs of their members as part of a holistic approach to member needs. However, we do not consider the imposition of a specific product such as a Comprehensive Income Product for Retirement (CIPR) to be appropriate as a "default" product.

AIST believes that the subject of a default product should be a matter for trustees, who are in the best position to determine what is in the best interests of their members.

Trustees should also not have their best interest duty fettered by arbitrary and restrictive rules, such as an inability to offer more appropriate products for balances of \$50,000 or less, or be required to assume that all members will live to be 105 or older.

We agree with the Productivity Commission, who pointed out in their recently issued draft report that complex products which remove members' consumer rights must be examined by members with the assistance of financial advice, since there can be no single product which meets member needs.

We point out in this submission that a safe harbour would be necessary in the event that trustees were forced to implement specific products for their members as preferred retirement income products. We have explained at various points that a CIPR is unlikely to always be in the best interests of members, and that a safe harbour must ensure that trustees are not in breach of adviser or trustee duties regarding best interests and appropriateness.

This submission recommends that informed consent be obtained from members prior to commencement of a retirement income product, and that disclosure of retirement income products be improved in line with the Productivity Commission draft recommendations. Black

boxes must provide visibility to ensure that appropriate risk assessment can be obtained by members and other end users.

AIST supports efforts to reframe superannuation benefits as income, however we recognise that member expectations cannot change overnight. The loss of flexibility must not mean loss of visibility or consumer rights: Even with protections granted by a safe harbour, it is trustees who will be held responsible if member expectations are not met.

Response to covenant principles and recommendations

This section outlines our high-level response to the principles contained in the Position Paper. More detail is contained later on in our submission.

1. Retirement income strategy

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

AIST supports this requirement. This has been AIST's position since the Retirement Income Review commenced in 2014. However, we believe that trustees should be tasked with selecting products or strategies in the best interests of their membership, and should not be required to impose specific products such as a CIPR upon members, particularly if this is not in members' best interests.

AIST also does not believe that an implementation date of 2020 is realistic, as funds will require a considerable amount of time to ensure that they are able to comply.

AIST recommends that trustees formulate and give effect to retirement income arrangements that are in the best interests of their members. This may or may not involve a preferred product, and may or may not involve a CIPR.

AIST recommends that for the retirement income framework to work, questions regarding regulatory oversight must be resolved prior to implementation.

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.

AIST supports this requirement. We note that the Position Paper points out the potential for guidance to become advice and implies that relief will be provided so that providers do not need

to change their AFSL. We have requested clarification in this submission as to whether “guidance” will be considered a subset, or separate from, financial product advice.

We also note that there is an assumption in the Position Paper that only advice recipients may be offered competing products to CIPRs. This implies that funds without authorisation may need it in order to offer products which are in certain members’ best interests.

AIST supports the proposal to develop simple, standardised disclosure to enable members to compare different retirement income products. This is a threshold issue: Our sector will not support implementation until this is in place. Currently, all APRA regulated post-retirement money is in choice products, where serious erosions have been made to the consumer protection framework. Also, there is insufficient disclosure regarding pooled income products.

AIST recommends that relief be granted to ensure that funds without advice authorisation in their AFSL can continue to operate their existing business models without fear of inadvertent breaches.

AIST recommends that where advice is to be provided by fully owned subsidiaries, relief provided to trustees under their own AFSL is extended to these entities as well.

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.

AIST does not support this this definition, for a number of reasons. The definition of “broadly constant income” as defined in the document is difficult to interpret and we believe it should be re-written. We also do not support requirements specifying a minimum (or otherwise) life expectancy of members in anticipation of lifetime income.

This is a judgement that trustees should undertake in the best interests of their own members, and default products should not be subject to this high a degree of potential variation.

AIST recommends that the definition of “broadly constant income” should be re-written as it is vague and difficult to interpret.

AIST recommends that the requirement to provide income to age 105 be reworded to make it clear that this is an example only.

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).

AIST does not support this principle and recommends against the use of mandated default products.

AIST also considers that the example involving A+Retirement is difficult to understand. We believe that more explanation needs to be provided as to when a product changes as it is not clear from this example.

AIST recommends against the use of CIPRs as a mandated default. AIST considers arrangements involving preferred products to be default arrangements. Members’ best interests must be the key driver.

AIST recommends against the use of mandated default products where such products are difficult to exit, or where other consumer rights are lost.

5. Third party products

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

AIST supports this principle, however we agree with the Productivity Commission’s recommendations in relation to improving disclosure in relation to choice superannuation

products. Transparency must ensure that members are able to have informed consent about the risks presented by third parties, particularly where “black boxes” are used.

We also have concerns about the increasing use of insurance to contain member investments and consider that these should be subject to equivalent disclosure to investment vehicles.

AIST recommends that standardised disclosure must look into the workings of black boxes to enable informed consent from fund members. Disclosure must be of a standard expected under the product dashboards, portfolio holdings disclosure and RG 97 regimes. “Proprietary” reasons for non-disclosure must not be allowed as an excuse.

AIST recommends that the costs of investing member money in insurance products must be disclosed properly to members on an equivalent basis to investment products.

AIST recommends that, as choice superannuation products, retirement income products should be subject to improvements to disclosure as recommended by the Productivity Commission.

6. Consent

Consent should be required for a CIPR to commence.

AIST cannot support this as it is presently worded and consider that all consent must be informed.

AIST recommends that the proposal be reworded to ensure that informed consent (rather than mere consent) is required from members prior to commencing a CIPR.

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.

AIST supports this principle.

The provision of complex products to superannuation fund members necessarily requires explanation by appropriately qualified financial professionals and there must be efforts to ensure that advice is available to members if this is required. Existing limitations to answering member queries must be addressed in order to ensure that funds can address all queries trustees deem relevant to their members. Consideration as to whether this is appropriate to form part of intrafund advice rules must also be addressed.

AIST recommends that any impediments to the ability for funds to offer advice on CIPRs or other retirement products as part of intrafund advice must be removed prior to implementation of this package.

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.

AIST disagrees with the threshold settings in this principle and believes that the threshold is set too low.

AIST recommends that the proposed \$50,000 threshold for CIPR advice exemption must be raised to \$250,000.

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.

AIST supports this principle and notes the commitment to ensuring that member expectations are appropriately met.

Legacy products

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

AIST supports and welcomes the inclusion of legacy products as a future consideration. We believe that the combination of the Government's recently announced ban on exit fees, together with an approach to legacy product portability will provide a once in a lifetime opportunity to rationalise members in legacy and grandfathered products.

A no-disadvantage rule should apply, and the ability to keep means testing concessions must form part of such an initiative.

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.

AIST supports this principle, noting that if CIPRs are mandated as default products, a safe harbour is a minimum requirement. We have noted in this submission several areas where the safe harbour would have to operate, and have made recommendation to ensure that this safe harbour is properly constructed.

AIST recommends that the proposed safe harbour protects against breaches of the adviser's best interest duties, as well as the requirement for advice provided to be appropriate.

AIST recommends that relief be granted to ensure that funds without financial product advice authorisation can continue to operate their existing business models without fear of inadvertent breaches.

AIST recommends that the safe harbour encompasses the trustees' requirement to act in the best interests of members in the instance that they are forced to provide a preferred product to members which is not in their best interests.

Comments and recommendations

Support for the covenant

AIST supports the intended requirement for trustees to ensure that they have a retirement income framework in place. We have long supported the position of trustees as the entities most suited to determining what is best for their members.

The proposed covenant represents an encapsulation of this important element of trustee planning, and members will benefit from the mandated attention paid to members in the drawdown phase. However, we point out that by mandating retirement products to be offered ahead of other retirement products, this impedes trustees' ability to ensure that they are acting in the best interests of members. AIST maintains that the duty to act in the best interests of members must be unfettered.

To this end, we recommend that trustees formulate and give effect to retirement income arrangements that are in the best interests of their members. This may or may not involve a preferred product, and may or may not involve a CIPR.

AIST suggests, however, that the proposed implementation date of 2020 is too soon. We believe that funds require more time to develop solutions that take into account the best interests of their members, to undertake appropriate processes to enlist service providers where necessary and to ensure appropriate consumer testing and financial advice is in place prior to the provision of new products.

The pros and pitfalls of default mechanisms

AIST understands the need to better manage the transition by members into the drawdown phase of superannuation. The presence of a variety of investment choice in account-based income streams with no mandated default strategy has led to understandable and well documented confusion amongst members at the point of retirement. A default option, similar to the MySuper product which exists in the accumulation phase, would provide an important starting point for members to explore other options which they might or might not be better suited to later in their working lives.

In addition, a default mechanism is a way of efficiently allocating Australians at the point of retirement into high-quality retirement income products.

The industrial default model is a critical component of the superannuation system and works in the best interests of members. There is merit exploring further ways to incorporate a system-level retirement default through the existing default system.

This does not, however mean that a specific product is going to always satisfy the definition of “high-quality” as this would be different for members. As the Productivity Commission explained¹ at Draft Finding 4.4 of their draft report:

A ‘MyRetirement’ default is not warranted. The diversity in household preferences, incomes, and other assets when approaching, and in, retirement means there is no single retirement product that can meet members’ needs. The most important task remaining is to improve the quality of financial advice to guide members among the various complex products, especially where members may decide to make the mostly irreversible decision to take up a longevity (risk pooled) income product.

The key problem that we have consistently identified at various points throughout the various consultations to date – and which the Productivity Commission also identifies in the final sentence of the Draft Finding – is that a longevity (risk-pooled) income product is going to be very difficult for most people to exit. This is a point that we will return to later in this submission.

The language used in this Position Paper reflects the language used to date in various legs of the consultation cycle – that is, there is to be a mass-customised product which trustees will be holding out in front of all others as their preferred product for members. The Final Report of the Financial System Inquiry² used the term “pre-selected”, subsequent documents from Treasury used the terms “offered”³ and in the Position Paper, “flagship”, “starting point” and the various rules outlined which require various criteria to be satisfied prior to allowing discussion in relation to competing products.

Trustees know their members better than anyone. Throughout members’ working lives, trustees are aware of occupational, gender, account balance and account activity information which enables them to generate a general picture of their membership. Consideration of which strategies are appropriate for members of a specific fund are going to vary from fund to fund,

¹ Productivity Commission (2018). *Superannuation: Assessing Efficiency and Competitiveness*. Productivity Commission Draft Report. [online] Canberra: Commonwealth of Australia, Draft Finding 4.4. Available at: <https://tinyurl.com/ycmuoojq> [Accessed 13 Jun. 2018].

² Murray, D., Davis, K., Dunn, C., Hewson, C. and McNamee, B. (2014). *Financial System Inquiry Final Report*. November 2014. [online] Canberra: Commonwealth of Australia. Available at: <https://tinyurl.com/n7wl3lb> [Accessed 13 Jun. 2018].

³ Most notably: Australian Government The Treasury (2016). *Development of the framework for Comprehensive Income Products for Retirement*. Discussion Paper, 15 December 2016. [online] Canberra: Commonwealth of Australia. Available at: <https://tinyurl.com/ycrbmen2> [Accessed 13 Jun. 2018].

however the overwhelming consensus of AIST's members is that trustees need to make this determination themselves, otherwise there is the genuine risk that a product which is less appropriate for the majority of a fund's members is going to be thrust upon them.

We therefore have concerns regarding the use of a CIPR product which is to be considered a "flagship". The term "flagship" is used to mixed success in other industries, most notably the sale of motor vehicles. A good example of this might be the car manufacturer, Toyota, who would generally be accepted as considering their Camry model as their flagship.

This is a useful example, as it allows us to explore the notion of a flagship in some detail. The evidence would suggest, for example, that if the preferences of buyers is any guide, over twice as many Toyota customers prefer the Hilux to the Camry, based on sales⁴. And even if the Hilux is removed from the statistics on the basis that it is a truck rather than a car, this still leaves the fact that the Toyota Corolla sold approximately 14,000 more units than the Camry in 2017. This contradicts the idea that the Camry has been designed and constructed with the majority of Toyota purchasers in mind.

There are considerably more limitations to this example. We are not, for example, aware of any evidence to suggest that Toyota dealers put forward the Camry as a starting point for all prospective purchasers of motor vehicles who visit a Toyota dealership. Nor are we aware of any plans by Toyota to ensure that comparisons are made between the vehicles that buyers indicate preferences for and the Camry being made mandatory at all points of sale.

However the use of flagships in this paper make it clear that CIPRs will be mandated to be offered in preference to all other products. Narrow usage of the term "default" in the superannuation industry aside, this is, in a very pure sense of the word, a default product. AIST wishes to make this clear that this is neither appropriate nor in members' best interests. We strongly recommend against the use of CIPRs as a mandated default.

This submission will return to this analogous example of flagships in the car industry at various points.

Loss of consumer rights

Commentary regarding the use of CIPRs as a preferred product in the Position Paper appears to have ignored the issues presented by a product which is difficult to exit easily.

⁴ All motor vehicles sales statistics reproduced from O'Kane, T. (2018). VFACTS - the top-selling cars in Australia in 2017. *Which Car*. [online] Available at: <https://tinyurl.com/yckw5482> [Accessed 14 Jun. 2018].

In most other superannuation products, the ability to exit, or change providers, is taken as a given. For the Defined Contribution and Account-Based Income Stream products which dominate the industry, members can provide three days' notice to their fund to exit via a number of separate communication media and funds are generally, with only a small number of exceptions, required to comply.

However, CIPRs will have a variety of consumer unfriendly terms and conditions built into them, making things very difficult if member circumstances change.

It is expected that CIPRs will generally comply with the new rules around innovative income streams, where a declining capital access schedule will determine the amount of withdrawal and death benefits available to income stream recipients. The limitations of these rules for members who will have reached the end of the specified periods where such benefits have been made available have been discussed at length.

The rules regarding transfers, on the other hand, are not so clear cut. It has been assumed during consultation that the only needs members may have for flexibility is for withdrawal or estate purposes. This is considerably short-sighted.

For members at any stage, there are no guarantees that members will be able to retain monies within the superannuation system if they wish to change providers, or even if they wish to change products. This affects members in several ways. The following are examples of where the inability to transfer can create great issues:

- A member who entered a CIPR with his fund two years ago now wishes to transfer to an account-based income stream simply due to preference. His fund does not allow this and will only allow him a withdrawal benefit. He is outside the age limits which will allow him to re-contribute the funds back into the superannuation system.
- A member has outlived her withdrawal period and is still in good health. Her CIPR is providing her with constant income which she is happy with. However, due to a long-running dispute with the fund over a technical issue involving which bank account her income is paid into, she would very much like to change providers. Her fund will not allow this.

If we were to draw a parallel with the Toyota example discussed earlier, the problems outlined above can be considered equivalent to an unlikely situation where Toyota buyers are automatically sold a Camry unless they indicate otherwise. And unless they use a short period at the commencement of their ownership to change cars, they are physically locked into the vehicle.

Further, unlike what would be available with a Hilux or a Corolla, the Camry would have no secondary market, except for a limited form of cash which is not exchangeable for another vehicle,

Toyota or otherwise. Neither could the Camry be traded in for another vehicle, in the same way as a Corolla or a Hilux.

AIST considers this loss of consumer rights to be critical. Trustees will have great difficulty in being mandated to provide a product that is not appropriate for many members and that is difficult to escape, and it is for this reason that we again recommend against mandating CIPRs as a default.

We share these concerns in relation to disclosure and transparency, which we return to later in this submission.

Safe harbour and other regulatory relief

We believe that mandating CIPRs as a default retirement income product will necessarily result in poor and/or inappropriate products being provided to members in the first instance, and if it is not made clear that alternatives exist, the results for members could be catastrophic.

AIST supports the proposal for a safe harbour in the event that funds are required to default members into a CIPR. Trustees must be protected from the perception that they are recommending poor or inappropriate product, as well as any adverse outcomes from this, and we consider that there must be several areas that this safe harbour protects against.

Firstly, insufficient details about individual members exists at funds to enable trustees to provide appropriate solutions to all members. It is *possible* that there may be enough information about individual members in some instances for trustees to construe one or more needs or objectives of members: This would satisfy the test of whether personal financial product advice is being provided to members in the offering of a CIPR. However, notwithstanding this, it is *probable* that any number of needs or objectives gleaned from member details will be insufficient for members to be properly advised on retirement income products.

We recommend that the safe harbour therefore protects against breaches of the adviser best interest duties, as well as the requirement for advice provided to be appropriate.

Secondly, the requirement to provide a CIPR as a “flagship” is highly likely to be considered, at the very least, as general financial product advice. We note the possibility that a trustee’s Australian Financial Services Licence (AFSL) may not contain any authorisation in relation to financial product advice, let alone specify general or personal advice. We recommend that relief be granted to ensure that funds without authorisation can continue to operate their existing business models without fear of inadvertent breaches. If a requirement of the introduction of CIPRs is that funds are required to have an authorisation to provide advice in their AFSLs, this will result in costly transitional and ongoing costs which will ultimately be borne by members.

Finally, we note the silence of the paper on trustees' duties to act in the best interests of members. If the approach recommended in the Position Paper is adopted, trustees will be required to offer a product that they expressly disclaim to be a recommended product. For example, if fund XYZ was to offer a CIPR to members which the trustees genuinely believed was not in members' best interests, the trustee may feel obligated to print in large red lettering on the outside of the product's PDS that the product is not necessarily recommended to the member.

This would quite clearly be highly undesirable policy failure.

AIST recommends that if trustees are forced to offer CIPRs as a flagship product, the safe harbour encompasses the trustees' requirement to act in the best interests of members in this instance.

It is regrettable that the downside of a safe harbour granted to trustees legitimises the market presence of substandard products which we believe will be defended on the grounds of innovation alone. However we believe that this should have been foreseen when the policy to mandate a specific product was conceived.

We add a note pointing out that mandating specific products for members ignores future products that better service member needs, in the eventuality that member expectations regarding retirement benefits are better communicated in the accumulation phase. One such example is recent modelling by Industry Super Australia of whole-of-life products, which shows better outcomes for members than CIPRs as presently defined.

Relief must enable trustees to provide side-by-side comparisons of products, and there must be no complications that prevents members from seeing such comparisons. Such relief will future-proof trustees in being able to present innovative future products on their own merits without the need for expensive legislative change, should such products not meet certification as CIPRs.

Inappropriate rules and exemptions

AIST is concerned about several of the proposed rules and exemptions in the Position Paper. In particular, we raise concerns regarding the \$50,000 threshold for members to be offered a CIPR, as well as the expectation that income is to continue until age 105.

We know from discussions with trustees that a mass-customised longevity product is not the preferred product in a number of instances. As the Position Paper admits, there are two criteria which would prevent a longevity product from being appropriate to members, being low account balances and lower life expectancy. We do not agree that the thresholds for these which are contained in the Position Paper are appropriate, and point to research by the Australian Centre for

Financial Studies for AIST from 2015⁵ which concluded that balances below \$250,000 were best served by account-based pensions. (See Box 1)

Box 1: Extract from *Superannuation in the post-retirement phase: The search for a comprehensive income product for retirement*⁶

Ideally, trustees would have a detailed knowledge of their fund's member demographic and offer a default CIPR based on this information. Where these details are unknown trustees will have to make assumptions based what they do know of their members. Trustees may offer the following defaults based on their members' account balances:

- Balances below \$100 000 – this cohort should be encouraged to use superannuation to pay off any outstanding debts. If significant funds remain they could be invested into an ABP or withdrawn and invested outside the superannuation system. The majority of income will be delivered by the Age Pension.
- Balances between \$100 000 and \$250 000 – this cohort should be encouraged to invest their superannuation into an ABP. These members are unlikely to have significant savings outside the superannuation system and a large proportion of their income will come from the Age Pension. The Age Pension will provide some longevity management and savings should instead seek to augment income.
- Balances between \$250 000 and \$500 000 – this cohort should be encouraged to invest the majority of their superannuation in an ABP with some annuitisation to manage longevity risk. While this level of superannuation alone will not preclude members from receiving the Age Pension, this cohort is likely to have assets outside the superannuation system. As such they may not receive much income from the Age Pension, and changes to the means test will likely further limit their eligibility.
- Balances above \$500 000 – this cohort should be encouraged to invest the majority of their superannuation in an ABP with some annuitisation to manage longevity risk. This level of superannuation alone does not prevent eligibility for a partial Age Pension, however this cohort is expected to have significant assets outside the

⁵ Ralston, D. and Maddock, E. (2015). *Superannuation in the post-retirement phase: The search for a comprehensive income product for retirement*. August 2015. [online] Melbourne: Australian Institute of Superannuation Trustees & Australian Centre for Financial Studies. Available at: <https://tinyurl.com/y7qmnx4> [Accessed 14 Jun. 2018].

⁶ Ralston, D. and Maddock, E. (2015) as cited in a previous footnote, p.56.

superannuation system. As such they may not receive any Age Pension until they have spent down some of their assets.

AIST strongly recommends that the proposed \$50,000 minimum must be raised to \$250,000 to reflect this.

We oppose the proposal in the paper for products to be designed to ensure that members be entitled to income up to age 105. We note that this requirement may be interpreted in a number of ways.

Firstly, we consider that if this is a requirement placed on trustees to ensure that all members are considered to live to age 105, this will result in very expensive products. Whilst we are aware that continual advances in medical science mean that the life expectancy of retirees is continually improving, we are aware that 105 is still very much at the top end of actuarial expectations of retirees ages at death. This assumption is particularly unrealistic for low and middle income earners, the majority of whom are members of profit to member superannuation funds.

Secondly, we would be very concerned if this was setting an upper threshold on how long income is to be mandated for. For example, if a retiree is to receive income until they are 105, however they manage to outlive this age, it would be expected that this subjects trustees to an enormous amount of reputation risk if products end up being designed which cut off “lifetime” income at this age.

Thirdly, if this is merely an example, we are uncertain why this needs to be spelled out in the way it has been. Funds are certain to engage actuaries and other consultants to ensure that members get what they pay for, whether they live to be 75, 105 or 135 years old.

AIST recommends that this requirement be reworded to make it clear that this is an example only. AIST does not support a requirement which assumes a minimum life expectancy of members.

More broadly, AIST wishes to make it clear that we do not support intrusions into the decision-making of trustees such as these. AIST’s position, which supports trustees making a decision based on their own member cohorts, must be unfettered. This would, as we have previously mentioned, include the decision to provide members with a default retirement income product such as a CIPR.

The need for financial product advice

We support all efforts to encourage trustees to provide their members with financial advice. The costliness of the provision of advice to members must be addressed to ensure that products

provided as a default (if trustees believe that default products are appropriate) are appropriate to the broader cohorts of members.

If members do not have access to advice, confusion will arise at points after acquisition of complex financial products. This means that additional resources must be dedicated to ensuring that members are reassured that their historical choice to enter a complex product was correct. Such reassurance may not even be financial product advice in the traditional or legal sense, particularly if the choice to buy, hold, sell or make changes to a financial product is no longer available.

AIST is concerned at the continuing apparent lack of involvement by the financial planning community in this measure. The provision of complex products to superannuation fund members necessarily requires explanation by appropriately qualified financial professionals and there must be efforts to ensure that advice is available to members if this is required. Advice about retirement income products cannot be provided by funds in the form of intrafund advice because it necessarily involves consideration of the member's Centrelink entitlements and often, their spouse. This needs to be addressed through regulatory change.

This may require new information sets being provided by Centrelink, the ATO and others to funds in order to ensure that advice can be provided effectively, accurately and in a timely fashion.

Finally, we note the focus of the paper on advice provided by trustees. AIST points out that a number of trustees make advice available through subsidiaries rather than through their own AFSL, and recommends that where relief is to be provided, it is extended to these entities.

Informed consent

AIST welcomes the proposal in this Position Paper that members be required to consent to a CIPR commencing. However we cannot support it in its current wording.

If trustees are to offer products that are designed to be considered first by members, AIST maintains that members must be in a position to have informed consent prior to accepting any products offered by trustees. AIST recommends that the proposal be reworded to ensure that informed consent is required from members prior to commencing a CIPR.

Disclosure and transparency

Investment risk disclosure remains a high priority for AIST for this measure. We have significant reservations regarding the level of seriousness that Treasury has attached to this issue, and have written more on this subject in the Appendix to this submission.

On numerous occasions, we have written about our growing concerns regarding the transparency and disclosure to be provided to members in relation to the CIPRs being provided to members.

We have observed with concern that there is a growing tolerance from policy-makers regarding the appearance of black boxes.

To put this another way, the provision of guaranteed income from various fringe superannuation and non-superannuation products in the past has been under the assumption that if product payments are met, then all requirements have been met. This has been tolerated to date on a materiality basis, however cannot be justified in the instance that a product is mandated as a “starting point” for members.

We return to our parallel from previously, regarding the sale of flagship motor vehicles. Where other vehicles have some visibility as to what is inside, the idea that black boxes be allowed to operate is akin to being provided with a vehicle that has the bonnet welded shut and no further information as to how the vehicle gets from A to B.

In reality, whether income provided is guaranteed or otherwise (as may be the case in GSA arrangements), informed consent cannot be properly gained without the provision of sufficient information to members.

Whilst the provision of disclosure is debated as to whether it actually assists members or not, the reality is that members are not the only end users of information that is to be provided. Analysts, researchers, paraplanners, regulators and other end users must access information inside the black box. No analyst, for example, can make a calculation of counterparty/credit risk on a guaranteed product without knowing details of what is inside.

AIST therefore supports the proposal to develop simple, standardised disclosure to enable members to compare different retirement income products. This is a threshold issue: Our sector will not support implementation until this is in place.

However, it is not enough to support disclosure and transparency requirements which are consistent with the existing status quo. The Productivity Commission has strongly criticised the disclosure provided for choice superannuation products and has recommended⁷ that:

The Australian Government should require funds to publish simple, single-page product dashboards for all superannuation products.

ASIC should:

⁷ Productivity Commission (2018), as cited in a previous footnote, Draft Recommendation 9.

- *prioritise the implementation of choice product dashboards to achieve full compliance by 1 July 2019*
- *revise the dashboards to simplify the content and provide more easily comprehensible metrics (drawing on robust consumer testing) by end 2019*
- *immediately publish all available MySuper and choice product dashboards on a single website, with the information clearly and readily accessible from the area of myGov that allows for consolidation of accounts.*

The need for standardised disclosure must look into the workings of black boxes to enable informed consent from fund members. Disclosure must be of a standard expected under the product dashboards, portfolio holdings disclosure and RG 97 regimes. “Proprietary” reasons for non-disclosure must not be allowed as an excuse.

Furthermore, we recommend that the costs of investing member money in insurance products be disclosed properly to members on an equivalent basis to investment products.

Investment risk disclosure must be thorough and must be of a standard to ensure that the risks and potential loss of consumer rights created by CIPRs are appropriately communicated to members to enable informed consent prior to entry into such products.

Finally, net returns must be used to promote comparability. Net income from lifetime products must not be entertained as viable substitute, due to the presence of drawn capital in the income payments – which was an original policy intention of this measure.

Regulatory oversight

Following on from our recommendations above, the issue of who will be responsible for the regulatory oversight of the risks and costs of retirement income products, as well as the potential for cross-subsidisation must be addressed. This is separate from our discussion above in relation to consumer disclosure and transparency. Who will be responsible for this, what data will they need to do it and how will the system force product providers to disclose this?

These questions must be resolved prior to implementation.

Other questions, comments and recommendations

Reframing benefits as income

AIST supports efforts to reframe superannuation benefits as income rather than account balances. However, we note that this will only benefit members entering the superannuation system now, as more mature Australians are already accustomed to seeing their retirement benefit as an account balance.

We believe that consultation on this proposal must cover the following questions:

1. When will this be implemented?
2. Which members will it affect?
3. How will transitional arrangements which involve members who are neither mature nor new entrants work?

Exemption for defined benefit funds offering DB lifetime pensions

Whilst we recognise that defined benefit funds are already in principle adhering to an implicit retirement income strategy, we have concerns that the blanket exemption to the covenant for DB funds may inadvertently open the door to sharply crafted special purpose vehicles with no trustee accountability.

We ask whether anti-avoidance rules or enhanced duties will be formulated for new entrants?

Retirement income strategy

As already discussed in this submission, AIST welcomes the requirement for funds to develop a retirement income strategy. We note that one of the requirements to be addressed in the strategy is “maximising income for life members”.

We have explained elsewhere our concerns regarding the lack of commentary on investment risk for members and query whether this might be a typographical error, where the corrected verb at the start of the dotpoint might have been “optimising” rather than “maximising”?

Guidance

We welcome the inclusion of guidance to assist members to understand retirement products. We note that the Position Paper points out the potential for this to become advice and implies that relief will be provided so that providers do not need to change their AFSL.

Will “guidance” be defined in the Corporations Act to ensure that it does not fall into a category of advice, or is it anticipated that this falls under the exemption for product providers provided in the Corporations Regulations (at 7.1.33H)?

Broadly constant income

The illustration on page 6 shows a path of modified income which varies from the initial year by an amount which is clearly greater than 2.5%. This may not be an issue, as language such as the paragraphs at the end of page 6 of the Position Paper makes the description “broadly constant income” subject to considerable variations in interpretation.

We are concerned that this makes the term meaningless.

Complicating this is the ability for trustees to choose whether or not to include the Age Pension in assessing when determining “broadly constant income”. Obviously, such an ability to pick and choose provides significant opportunities for bad actors to game the requirements, which are already somewhat slippery.

We believe that this concept is not useful in its current form and needs substantial improvement.

Legacy products

We welcome the inclusion of legacy products as a future consideration. We believe that the combination of the Government’s recently announced ban on exit fees, together with an approach to legacy product portability will provide a once in a lifetime opportunity to rationalise members in legacy and grandfathered products.

We believe that the scope of this should extend to complying income streams, term allocated pensions (TAPs) and other income streams. Consideration should also be given to non-super income streams where these were recommended due outdated issues such as Reasonable Benefit Limits, means testing concessions etc.

A no-disadvantage rule should apply, and the ability to keep means testing concessions must form part of such an initiative.

Appendix: Investment risk

Comprehensive Income Products for Retirement (CIPRs) were initially recommended as part of the FSI. Although the FSI final report discussed “investment risk” on a number of occasions, longevity risk was discussed far more often, and the only reference to market risk was in a quote from ASFA’s submission. It was generally assumed that the “investment risk” that the FSI referred to was more often than not market risk, as longevity risk tended to be referred to separately, as well as the fact that market risk is typically the dominant risk in traditional DC/ABP superannuation products.

The discussion paper on the retirement income review had a foreword from the Acting Assistant Treasurer, Senator The Hon Matthias Cormann, explaining that market risk and inflation risk were real considerations, with longevity risk downplayed slightly. This was echoed in the introduction. AIST’s submission to the review considered that the discussion of risk facing members in the document had been rudimentary at best: Discussion of risks facing holders of guaranteed products was limited to one mention of credit risk, with selection risk mentioned in respect of providers.

The May 2016 final response on the retirement incomes stream review, prepared by Treasury, makes no mention of market risk, with longevity risk referred to predominantly throughout. Interest rate risk was referred to once, and mortality risk was mentioned once, although its treatment in the response paper suggests that this is trivial (“there is a risk of ‘losing’ their investment on early death”).

However, as with the discussion paper, the risk to members of retirement income products appeared to be rated beneath the risks to providers: One mention of risk related to the risk that product development is hindered, another was the risk that funds breach existing minimum pension payment requirements.

The Position Paper discusses “risk management” as an objective of trustees, however we note that this comment lacks context and appears to only refer to longevity risk. Broader risk management which trustees must consider as part of prudential and disclosure requirements must consider investment risk. AIST makes a number of comments in relation to major classes of investment risk which are not specifically addressed in the Position Paper:

- Market risk: Market risk is a reality in the provision of a variety of retirement income products. The Position Paper considers imposing limits on fluctuations in income payments, which is designed to alleviate this.
- Counterparty/credit risk: No discussion at all on this in the Position Paper.
- Interest rate risk: No discussion at all on this in the Position Paper.

- Mortality risk: Has been trivialised as “estate planning” in the past, however is not equivalent. Proposed changes to statement disclosure may alleviate this to some extent, however this may have limited utility in relation to members of funds who have received statements throughout their working lives showing account balances, rather than expected income.
- Inflation: The Position Paper explains an expectation that some products will provide some protection. However there are no expectations at all in relation to this.
- Liquidity risk and the loss of consumer rights: Lack of commutability is likely to be a reality. In particular, where there is no withdrawal or death benefit available, members will be deprived of the right to change providers.
- Pricing/valuation risk and Interest rate risk: These are issues affecting members looking to enter or exit products. These risks are generally considered minimal with account-based products, but a considerable lack of transparency is apparent in relation to how this will be treated in any sort of guaranteed product where black boxes may be involved.