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18 January 2019

Committee Secretary  
Economics Legislation Committee  
Department of the Senate  
PO Box 6100  
Parliament House  
CANBERRA ACT 2600

By email to: [economics.sen@aph.gov.au](mailto:economics.sen@aph.gov.au)

Dear Sir/Madam,

**Submission re: Schedule 1 of the Social Services and other Legislation Amendment (Supporting Retirement Incomes) Bill 2018 ('the Bill')**

Industry Super Australia (ISA) undertakes policy research and advocacy on behalf of over five million members of industry superannuation funds, to ensure that the policy settings for superannuation are consistent with the objective of maximising their retirement incomes.

ISA welcomes the opportunity to make this submission to the Committee.

In particular, we wish to focus our comments on Schedule 1 of the Bill that deals with the proposed establishment of new means test rules to be applied to lifetime income streams.

ISA Recommendation

ISA recommends that Schedule 1 of the Bill does not proceed to become law.

If the proposed new means testing rules commence on 1 July 2019, they will encourage the sale of new and complex retirement income products before an appropriate disclosure and regulatory framework has been put in place to protect consumers.

In the absence of such a framework, there is a high probability that from 1 July 2019 growing numbers of retirees will be sold into complex and expensive income products that are not in their best interests – and from which they may not be able to leave.

The government's current approach to reforming the retirement income system lacks coherence, with insufficient regard being given to implementing reform in a manner that will protect retirees.

In place of the current approach, ISA recommends that the government initiate a comprehensive review of the transition of superannuation from accumulation to a retirement income system.

We elaborate on these points below.

### The Proposed New Rules in Context

The proposed new means testing rules are part of a broader package of measures in support of the government's planned retirement income framework based on the development of Comprehensive Income Products for Retirement (CIPRs).

ISA supports there being a retirement income framework, but not one based on CIPRs. Our reasons for this are set-out in a prior ISA submission copied as an attachment to this submission.

At the time of writing (mid-January 2019) there are a number of unresolved moving parts relevant to implementing the government's CIPRs-based framework. They are:

a) The introduction of a retirement income covenant to the Superannuation Industry (Supervision) Act 1993 that will include a requirement that trustees develop and offer CIPRs to their members.

One reason given by the government for defining and mandating the offering of CIPRs is that CIPRs will provide a reference point for consumers, a benchmark for design and performance they can use to either purchase a CIPR or another retirement income product.

Draft legislation defining the proposed covenant, and defining what features a product must have to be certified as a CIPR, has yet to be published. The government has stated it intends to legislate by 1 July 2019, with the covenant to commence from the revised date of 1 July 2022. However, we understand that even the 1 July 2019 target date is now uncertain.

We also note that the final report of the Productivity Commission's inquiry into the efficiency and competitiveness of the superannuation system has urged the government to reassess the need for the proposed covenant, in part because requiring trustees to offer a CIPR may conflict with their fiduciary obligations to act in members' best interests.<sup>1</sup>

In addition the Commission has questioned if CIPRs will be suitable for some cohorts of members and has suggested that other income products may be preferable.<sup>2</sup>

In sum, the new means testing rules have been designed in large part to support the CIPRs framework. There is now considerable doubt that the framework should or will be implemented.

b) The design and implementation of a disclosure framework that will provide consumers who wish to purchase a retirement income product with a factsheet for each product containing simplified metrics that will enable meaningful comparisons to be made prior to purchase.

The government intends that this disclosure framework will apply to all retirement income products, not only those certified as a CIPR.

In December 2018 Treasury issued a consultation paper to obtain views on how appropriate metrics could be designed and presented.<sup>3</sup> This consultation will close on 28 March 2019. Treasury then intends to conduct consumer testing. This is likely to be followed by further rounds of consultation prior to draft legislation.

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<sup>1</sup> Productivity Commission (2018) Superannuation Inquiry Report (Overview), p. 40.

<sup>2</sup> Productivity Commission (2018) Superannuation Inquiry Report, pp. 229-231.

<sup>3</sup> Treasury (2018) *Retirement Income Disclosure Consultation Paper: Stage Two of the Retirement Income Framework*.

The government has not indicated when it intends the new disclosure framework to begin operating.

c) Proposed new means testing rules

The proposed new rules in Schedule 1 of the Bill are intended, in part, to encourage the development of pooled lifetime income stream products. The proposed rules have a commencement date of 1 July 2019.

If the proposed rules are implemented, a result will be that from 1 July 2019 product providers will be encouraged to sell pooled income products prior to the planned CIPRs framework being legislated (if the framework proceeds). This means that consumers will not be in a position to use a certified CIPR product as a benchmark to assess what they are being offered.

In addition to the CIPRs regulatory regime not being in place, the sale of income products encouraged by the Bill will take place in a context where there will be no disclosure framework to help consumers compare what they are being offered with other products (including non-pooled products such as Account Based Pensions) that may be more appropriate.

In short, the proposed rules are intended to promote the sale of complex retirement income products before implementing measures that would help to protect consumers from buying products that may not be in their best interests.

In particular, many of the products that will be sold from July 2019 are likely to comprise annuities that purchasers may not be able to exit from should they later conclude (perhaps when a disclosure regime is in place) that a different product is better.

While some product providers may welcome the commercial opportunity to sell new retirement income products prior to an effective disclosure regime coming into force, it is not in the public interest that they be encouraged by government to do so.

#### Problems of Financial Advice

A further important context for understanding the likely consequences of implementing Schedule 1 of the Bill is the work of the Royal Commission into Misconduct in the Banking, Superannuation and Financial Services Industry, and the Productivity Commission on the efficiency of the superannuation system.

It might be argued that retirees will be able to make effective choices between different pooled products after 1 July 2019 by utilising financial advice.

The Productivity Commission's recent final inquiry report provides support for the view that the current regulatory framework for financial advice cannot be relied upon to connect retirees to the best income products. It observes that:

‘Despite the Future of Financial Advice reforms, conflicted financial advice remains an egregious problem (especially within vertically integrated organisations).’<sup>4</sup>

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<sup>4</sup> Ibid, p. 19

Further, the report notes that ‘few know where to look for impartial and affordable advice, or how to judge the quality of the advice received.’<sup>5</sup> On the importance of advice in a retirement income context the Productivity Commission is clear:

‘Given that many retirement product decisions are largely irreversible, the need for good quality advice and member protection is essential.’<sup>6</sup>

The final report of the Royal Commission has yet to be published. However, the Royal Commission’s interim findings highlighted a number of recurring problems with advice provided by advisors employed or franchised by for-profit product providers.<sup>7</sup>

In particular the Royal Commission found that the routine provision of advice that was in the best interests of the advisor and product provider – rather than the client. FOFA has proven ineffectual partly because it does not actually require advisers to act on the best interests of their clients, permitting advisers to recommend in-house products when other products may be more appropriate. In its interim report the Royal Commission concludes:

‘The result is not surprising. Advisers may be expected to know more about the products manufactured by the licensee with which the advisers are associated than they know about a rival licensee’s products. Advisers will often be readily persuaded that the products ‘their’ licensee offers are as good as, if not better than, those of a rivals. And when those views align with the adviser’s personal financial interests, advising the client to use an in-house product will much more often than not follow as the night follows day.’<sup>8</sup>

In short, the current financial advice regime cannot be relied upon to protect consumers.

Until appropriate regimes for retirement income products, disclosure and financial advice are in place, legislating concessional means testing rules for retirement income products amounts to ‘putting the cart before horse.’

It risks exposing consumers to significant, and unnecessary, financial harm.

### Problems of Concessionality

In addition to the absence of a set of product, disclosure and advice regimes that will protect members from mis-sold inappropriate products, there are some specific problems with the rules being proposed.

In particular, the proposed rules intend that the percentage of a pooled income product’s purchase price or income that will be assessed for means testing purposes will fall from 60 per cent to 30 per cent at the relevant ‘threshold day’ (defined as the life expectancy of a 65 year old male at the date when the product commences payment to the member).

This approach does not take into account that, on average, life expectancies vary by levels of income and by occupation. In the context of the proposed rules, this means that those on

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<sup>5</sup> Ibid, p. 19

<sup>6</sup> Ibid, p. 195

<sup>7</sup> Royal Commission into Misconduct in the Banking, Superannuation & Financial Services Industry (2018) *Interim Report, Volume One*.

<sup>8</sup> Ibid, p. 141

relatively high incomes when they retire, after working in white-collar occupations, will tend to benefit more from the proposed fall from 60 to 30 per cent.<sup>9</sup>

It also means that pooled products such as deferred life annuities that commence at the proposed 'threshold day' may not be appropriate for low income/blue collar workers. However, the proposed rules may result in such products being sold to retirees for whom the highly concessional 30 per cent rate of assessment will be of little or no financial value.

Any new means testing rules for pooled products should give regard to the mortality of different groups, such as blue and white collar employees. Defining and applying such distinctions in ways that are in retirees' best interests should form part of a comprehensive review of how the retirement income system should be designed.

#### The Need for a Comprehensive Review

The current approach of the government to reforming the retirement income system lacks policy coherence. Some parts of the government's vision for the system appear to be on hold (and may not proceed), while others – the proposed new means testing rules – are being rushed through Parliament with little apparent regard for the interests of retirees.

There is an urgent need for the government to pause its retirement income agenda in favour of a considered review of the system and how it can be designed to ensure the best possible outcomes for retirees. This review should consider the full implications of the final reports of the Productivity Commission and Royal Commission, and what regulatory regimes need to be in place *before* government uses new means testing rules to incentivise the sale of products that may not be in the best interests of retirees.

If we can assist the Committee further, please do not hesitate to contact us

**Zachary May**  
Director of Policy

**Michael Fisher**  
Senior Policy Adviser

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<sup>9</sup> Some relevant evidence on this from Australia and internationally is discussed in Knox, D. and A. Tomlin (1998) 'An Analysis of Australian pensioner Mortality by Pre-Retirement Income,' *Journal of Actuarial Practice* 1993-2006, 94.