15 October 2021

Director
Tax and Transfers Branch
Retirement, Advice and Investment Division
Treasury
Langton Cres
PARKES ACT 2600

Via email: superannuation@treasury.gov.au

Dear Sir/Madam

Retirement Income Covenant - September 2021

CPA Australia and Chartered Accountants Australia & New Zealand (Chartered Accountants ANZ) welcome the opportunity to provide comments on the *Retirement Income Covenant* (RIC) Exposure Draft legislation and explanatory memorandum (the "Exposure Draft").

CPA Australia and Chartered Accountants ANZ represent over 200,000 professional accountants in Australia and New Zealand. Our members work in diverse roles across public practice, commerce, industry, government and academia throughout Australia and internationally.

We note that this is the third major consultation concerning the RIC released by the government. We remain of the view expressed in Chartered Accountants Australia & New Zealand's first submission[1] that:

> *... the creation of a retirement income covenant for superannuation funds at this time is unnecessary.*
>
> *For reasons outlined in this submission we believe this new covenant will add to the costs of running superannuation funds but will be of little or no practical benefit to fund members, trustees, regulators or the government.*

Australian Prudential Regulation Authority (APRA) data shows that retirees deplete their superannuation retirement savings in retirement. CPA Australia and Chartered Accountants ANZ also consider that retirees spending their non-superannuation monies in retirement is not the business or concern of a superannuation fund trustee. Finally, we have significant concerns about the implication in the Exposure Draft that superannuation fund trustees will be required to

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1 Chartered Accountants Australia & New Zealand, 2018. *Retirement Income Covenant Position Paper* submission. [online]

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effectively offer a form of financial advice to retired members and members “close to retirement”.

For further information in relation to our submission, please contact Tony Negline, Superannuation Leader at Chartered Accountants ANZ at [redacted] or Richard Webb, Policy Advisor Financial Planning and Superannuation at CPA Australia at [redacted].

Yours sincerely

Tony Negline CA
Superannuation Leader,
Advocacy and Professional Standing,
Chartered Accountants Australia
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Richard Webb
Policy Advisor Financial Planning and
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Attachment

Response to the Exposure Draft

Executive summary

The proposed RIC is a duty which is designed to further develop the retirement phase of superannuation. The covenant will require trustees to regularly formulate, review, and implement a retirement income strategy, outlining how they plan to help their members' balance key retirement income objectives. The key objectives of this strategy are to maximise expected retirement income, manage stability and sustainability risks (such as longevity, investment, inflation and other similar), provide flexible access to savings and balance these three items.

We welcome the decision by Government to no longer require superannuation fund trustees to offer a default retirement income product to their members. Additionally, we are pleased that Self-Managed Superannuation Fund trustees would not be required to develop a RIC or *Retirement Income Strategy* (RIS).

However, we do not support the proposed new covenant for several reasons:

1. The complexity of retirement planning results in a process which is convoluted and difficult for many to navigate. Consequently, we believe that it would be more efficient for this process to be streamlined and simplified prior to subjecting trustees to increased compliance costs.
2. We disagree with the assertion in the exposure draft explanatory memorandum that, "current legal obligations of superannuation trustees have a focus primarily on the accumulation phase and there are no specific obligations to consider the needs of beneficiaries in retirement". The proposed RIC requirements are already contained in obligations with which trustees must comply, including but not limited to, general trust law obligations, the best financial interests duty (BFID), the sole purpose test, requirements regarding the formulation and maintenance of investment strategies and the new Design and Distribution Obligations (DDO)[2]. We are concerned that requirements for trustees to consider their members' non-superannuation investments is beyond their remit.
3. The recommendations requiring trustees to provide appropriate guidance to their members is likely to create a substantial additional compliance costs burden. In addition, a grey area is created where what policy makers may consider is general financial product advice may be perceived by members as personal financial product advice. This may conflict with existing member engagement strategies, as well as business planning at the trustee level.

Further discussion in response to the Exposure Draft follows.

[2] Located in Part 7.8A of the *Corporations Act 2001*

Retirement involves complex decisions

The second Treasury RIC Position Paper[3] stated that:

> *Retirement involves multiple decisions and difficult trade-offs, such as:*
>
> - *when to retire*
> - *whether to keep their money in superannuation*
> - *how to invest their savings, both in and outside of superannuation*
> - *how to draw down their savings, both in and outside of superannuation; and*
> - *their future expenditure and capital needs.*
>
> *The long-term implications of these decisions, and their complex interactions with other systems like tax, social security, aged care and housing, make it very challenging for retirees to determine an optimal retirement income strategy on their own.*

CPA Australia and Chartered Accountants ANZ agree with these sentiments. However, it is worth noting that the "complex interactions" are a result of government legislation and regulator oversight.

We argue that most of the complexity concerning retirement occurs because of the intricate regulatory environment. As the government has created this complexity it is clearly within its power to work expeditiously to eradicate as many inconsistencies and complexities in its laws as possible. We stand ready to work constructively with the government to achieve this urgent and important objective.

Interaction with other existing trustee obligations

We note that the existing obligations contained in the SIS Act and *Corporations Act 2001* ("Corps Act") place significant requirements on trustees. In particular, we refer to:

- General trust law obligations
- The sole purpose test
- All trustee covenants, especially the BFID, and the requirement to create and implement an investment strategy
- DDO[4]

The BFID and DDO are new obligations that trustees are currently implementing within every aspect of their fund's operations.

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[3] Treasury, The, 2021. *Retirement income covenant*. Position Paper 19 July 2021. [online] Canberra: Commonwealth of Australia. Available at: https://tinyurl.com/dhdn8hfk [Accessed 14 October 2021].

[4] Refer to Part 7.8A of the *Corporations Act 2001*

We note that in a letter to its regulated entities[5], APRA said that it would be conducting a "comprehensive review of other key standards next year [2022] to ensure a sharper focus on the best financial interests duty".

The DDO requires relevant product issuers – including superannuation fund trustees – to consider the target market for their product. On its website[6] ASIC states this obligation in the following way:

> *The target market for a product is the class of consumers for which the product is likely to be appropriate, having regard to their likely objectives, financial situation and needs. The issuer must set out the target market for the product in a target market determination (TMD) along with other information about how they will distribute the product and monitor consumer outcomes.*

It is our expectation that if the RIC is legislated then it is highly likely that APRA would deem it essential to issue a prudential standard which will place an additional compliance burden on trustees.

It is our view that the above obligations already cover most of the issues that the government believes it needs to address with the RIC legislative requirement.

We are of the view that the government needs to allow time for the BFID and DDO requirements to be fully implemented throughout the superannuation sector before embarking on additional legislative complexity which in time may be found to be unnecessary.

It is our view that when APRA reviews its existing standards to take into account the BFID, it could also consider if further small changes could be made to take into account some of the RIC requirements, thereby obviating the need for further proposed RIC legislation.

That said we see little need for trustees to be required to develop a RIS as required in the Exposure Draft.

Retirees are depleting their superannuation retirement savings

In the second Position Paper it is claimed that "retirees struggle to develop effective retirement income strategies on their own, much of the savings accrued by members through the superannuation system are not used to provide retirement income. Rather, they remain unspent and become part of the person's bequest when they die". It is our view that this key premise is misleading and needs to be re-cast.

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5 Roberts, R., 2021. *APRA policy priorities: Interim update*. 24 September 2021. [online] Canberra: Australia Prudential Regulation Authority. Available at: https://tinyurl.com/3rj8ayjs [Accessed 14 October 2021].

6 ASIC, 2021. *Information Sheet 264: FAQs: Design and distribution obligations for advice licensees and financial advisers | ASIC - Australian Securities and Investments Commission*. [online] asic.gov.au. Available at: https://tinyurl.com/2fnzxarv [Accessed 14 October 2021].

The *Retirement Income Review Final Report*[7], (RIR) best illustrates this with a finding (quoting Asher et al 2017[8]) that most retirees leave the majority of their wealth as a death benefit when they die, with a figure quoted in Asher's paper as 90 per cent of assessible assets on average.

The RIR commissioned research which suggested that superannuation assets tended to grow in retirement and concluded that "investments have tended to equal or exceed drawdown rates."[9]

At a cursory glance, the RIR research appears to provide a strong argument for retirees to draw down more of their capital in retirement. However, nearly half of Australians predecease their life expectancy, meaning that it is to be expected that a large number of Australians will die with retirement savings unspent.

Furthermore, the combination of steadily high annual returns over the past ten years in excess of historically low inflation, offset against the lower minimum drawdown rates required through the initial period of retirement, will produce precisely the result that Asher et al (2017) notes. The account balance – and implied death benefit – in some cases will increase throughout the early years of retirement before declining as drawdown rates outpace investment returns.

Our analysis of APRA data shows that retirees generally deplete their superannuation savings in retirement. There are two aspects here – the total number of accounts (both accumulation and pension) and the number of pension accounts, noting that, for a number of reasons, not all Australians will roll over their superannuation benefit into the pension phase.

The following data has been extracted from APRA's June 2020 Annual Superannuation Bulletin[10] issued in January 2021, from funds with more than four members:

	Total Member Accounts ('000)		Total Pension Accounts ('000)	
Age	**June 2015**	**June 2020**	**June 2015**	**June 2020**
60 to 64	1,690	1,668	284	266
65 to 69	1,002	1,149	387	412
70 to 74	486	720	292	388
75 to 84	323	548	282	409
85+	80	113	76	109

In most cases member accounts for retirees will be closed for four main reasons:

7 Callaghan, M., Ralston, D. and Kay, C., 2020. *Retirement Income Review Final Report*. July 2020. [online] Canberra: Commonwealth of Australia, p.432. Available at: https://tinyurl.com/hderwhpu [Accessed 6 August 2021].

8 Asher, A., Meyricke, R., Thorp, S. & Wu, S., 2017. Age Pensioner Decumulation: Responses to Incentives, Uncertainty and Family Need. *Australian Journal of Management*, 42(4), pp. 583-607

9 Callaghan, M., Ralston, D. and Kay, C., 2020 (as cited in a previous footnote), p.434

10 Australian Prudential Regulation Authority (APRA), 2021. *Annual superannuation bulletin - superannuation entities*. June 2020 (Issued 29 January 2021). [online] Canberra: APRA. Available at: https://tinyurl.com/y4r6mcnc [Accessed 6 August 2021].

- benefits paid out of the superannuation system to the member,
- benefits transferred to another member account in the same superannuation fund,
- benefits transferred to another superannuation fund, or
- benefits paid out of the superannuation system because the member has died.

Transfers between superannuation accounts and between funds will offset themselves, leaving death and transfers out of superannuation as the relevant reasons for account closure for this cohort.

In 2015, APRA regulated funds had 20,000 accounts with at least $1 million in them for those aged 60 to 64 but had **no** accounts with at least $1 million for those aged at least 85. One conclusion that could be drawn from these figures is that anyone aged at least 85 in 2015, who retired with an account balance of more than $1 million aged between ages 60 and 64 (i.e., before 2005) has less than that amount of money in superannuation.

In 2015, for younger age brackets (ages 65 to 69), pension accounts are less than 40 per cent of total member accounts, but by age 85+ pension accounts are 95 per cent of total member accounts. This indicates that retirees are taking money out of the superannuation system.

In our view the overall reduction in pension accounts within APRA regulated funds is an indication that the minimum pension factors (found in Schedule 7 of *the Superannuation Industry (Supervision) Regulations 1993*) work in removing money from the superannuation system for those retirees who live until older ages.

This suggests that the minimum pension factors **do not** need to be adjusted to force retirees to remove more income from their superannuation savings.

We noted above that the premise that Australians are dying with most of their superannuation savings intact is skewed by nearly half of all retirees predeceasing their life expectancy. Although the total accounts figures shown above appear to confirm this, we can examine this effect more closely by looking at the total member benefits and average balance data provided by APRA[11]:

	Members Benefits ($ million)		Average Member Balance ($)	
Age	**June 2015**	**June 2020**	**June 2015**	**June 2020**
60 to 64	225,397	305,696	133,364	183,313
65 to 69	159,432	242,492	159,152	211,043
70 to 74	86,530	157,541	178,079	218,894
75 to 84	51,440	105,299	159,261	192,181
85+	15,188	12,512	190,114	110,602

11 Australian Prudential Regulation Authority (APRA), 2021 as cited in a previous footnote.

This table shows that even though there has been a consistent overall decline in total member benefits during these periods (as well as a decline in member accounts, as shown in the previous table), the average member balance shows a pattern consistent with our observations above, in respect of members predeceasing their life expectancy.

Figures obtained from Chant West to the end of June 2021[12] show that with the exception of conservative funds, the ten-year average annual returns on amounts invested in portfolios with 41 per cent or more in growth assets, on average exceeded minimum drawdown rates up to age 84. Balanced funds of between 41-60 per cent in growth assets match the normal minimum drawdown of 7 per cent for 80-84 year old retirees. It is worth noting that normal minimum drawdown amounts have been halved for the 2019/20, 2020/21, 2021/22 financial years as a temporary COVID-19 relief measure. Also, Chant West's figures are for the accumulation phase where a 15 per cent tax on earnings applies. Equivalent performance figures for the exempt pension phase are likely to be higher.

The RIR acknowledges that many Australians draw down the minimum rate, which for members in account-based or market linked income streams, is recalculated based on the previous year's closing balance. However, where investment returns have outstripped drawdown rates for most of an Australian's life expectancy, the blanket assertion that Australians are dying with almost all their superannuation intact on average is misleading, given the skew towards more recent retirees who will have higher account balances because they are yet to spend their superannuation balances in retirement.

It is also worth noting that the RIR commissioned research shows that at least 80 per cent of retirees, both male and female, had exhausted their account balances by age 80[13]. Given that the number of account balances in APRA funds falls as people age this seems a logical conclusion.

To put this in its simplest terms: Australians are depleting their superannuation in growing amounts, and where account-based or market-linked income streams are used, benefiting enormously from investment performance which creates a feedback loop of higher drawdown amounts in subsequent years. Furthermore, the average member balances for those aged 85 and over are demonstrably less than the younger cohorts, confirming that those who live past their life expectancy are likely to have depleted their superannuation savings as expected.

Unfortunately, we do not have access to similar data for Self-Managed Superannuation Funds.

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[12] Drury, B., 2021. Super fund performance: Monthly returns to June 2021. *SuperGuide*, Available at: https://tinyurl.com/xff4ztsa [Accessed 6 August 2021].

[13] Polidano, C., Carter, A., Chan, M., Chigavazira, A., To, H., Holland, J., Nguyen, S., Vu, H. and Wilkins, R., 2020. *The ATO longitudinal information files (ALife): A new resource for retirement policy research*. TTPI - Working Paper 2/2020, April 2020. [online] Canberra: Australian National University. Available at: https://tinyurl.com/8c6xzrun [Accessed 6 August 2021].

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Responding to member perceptions of risk

A major focus of the Exposure Draft is concerned with maximising retirement income. While this is a laudable aim, it imposes specific limitations on retirees' abilities to manage risks, which are very important to them, given that the maximisation of income necessarily impacts flexibility in the later years of retirement.

We note that where retirees are receiving more in retirement income than what they need, they may direct this into alternative savings vehicles. If it is true that retirees are self-insuring against longevity risk, with a mortality risk hedge, then the strategy of making retirees draw more in the early years of retirement may only result in members building these hedges outside of superannuation.

Do retirees deplete their non-superannuation savings?

As identified by the RIR and noted in the second Position Paper "retirees die with around 90 per cent of the assets they had at retirement".

We investigated Australian Taxation Office statistical data for the 2013 and 2018 years[14] [15]. The data in the tables in Appendices 1 and 2 shows interest, dividends, net rent and personal superannuation contributions for the 2013 and 2018 financial years respectively

It is noted that many retirees do not need to submit a tax return. Many people in this category would receive the maximum age pension, have modest savings and have no tax liability due to the Senior and Pensioners Tax Offset (or SAPTO).

This ATO data suggests that as people age they earn more interest from financial institutions, dividends (franked and unfranked) and net rent. We suspect that the amount of interest has fallen from 2013 to 2018 because of lower interest rates, while dividends received have increased strongly.

It is interesting to note the number of older Australians earning rental income declines faster than those in receipt of other assessable income sources such as interest and dividends. In these cases, it is likely that either those owning properties are dying or they have been disposing of these assets and are placing the funds into other investments.

The figures show how much Australians contribute to their superannuation, with some people aged over 65 still considering it to be important to make additional contributions to their superannuation.

Data for the private superannuation pension monies paid to those aged 60 or older are unavailable as such income does not have to be declared to the ATO.

It seems reasonable to conclude from the above data that:

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14 Australian Taxation Office (ATO), 2020. *Individuals - Table 3. Taxation statistics 2017-18*. [online] Canberra: Commonwealth of Australia. Available at: https://tinyurl.com/e3cy2ssa [Accessed 6 August 2021].

15 Australian Taxation Office (ATO), 2015. *Individuals - Table 3. Taxation statistics 2012-13*. [online] Canberra: Commonwealth of Australia. Available at: https://tinyurl.com/ykaww76s [Accessed 6 August 2021].

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1. the majority of retirees do not spend their accumulated non-superannuation wealth in retirement, however.
2. they are clearly depleting their superannuation assets

We cannot see why trustees would need to be concerned with what their members do with their non-superannuation monies, including money that has been paid out of the fund either by lump sum or pension payments. However, Australia presently operates under a three-pillar retirement income framework, where the third pillar includes voluntary savings, superannuation or otherwise. As previously explained, efforts to artificially accelerate the drawdown of one of these is likely to expand the footprint of alternative savings vehicles. It is not clear that this is a policy aim of the covenant.

Appropriate Guidance

We do not consider it appropriate that, according to the RIC, superannuation fund trustees would be obligated to provide some of their fund's members with quasi-financial advice.

The recent High Court case, *Westpac Securities Administration Ltd v Australian Securities and Investments Commission [2021] HCA 3*, examined the appellant's action in contacting its clients and suggesting that they should transfer superannuation money into a fund operated by Westpac Securities Administration Ltd or related entities. The appellant argued that it had provided "general advice" as defined in the *Corporations Act*.

The High Court found that:

> *On the undisputed facts of the case, a reasonable person in the position of each of the members called by Westpac might expect Westpac, in recommending that the member accept Westpac's offer to procure the roll-over of the member's external superannuation accounts into the member's BT account, to have considered one or more of the member's objectives, financial situation and needs.*

We consider this case to present a significant barrier to trustees assisting those beneficiaries who are retired and those near to retirement. To provide this guidance to an appropriate standard, a trustee would need to offer "personal advice" as defined in the *Corporations Act*. The provision of personal advice would require an Australian Financial Services License (AFSL) that permitted the trustee to offer retirement product advice to retail clients.

Some APRA-regulated superannuation fund trustees will have the necessary skills, knowledge, experience and membership, but will need to apply for and obtain this type of license; others will not. As envisaged by the Exposure Draft the AFSL would have to permit the provision of advice on a wide range of financial products. We question if the need to then obtain the requisite skills, knowledge and experience is acting in the best financial interests of beneficiaries who are yet to retire, particularly if trustees previously assessed that such a service was unnecessary for their members or could not be provided in the best financial interests of all beneficiaries.

An additional problem is presented by any general or personal financial advice which is provided by advisers working as authorised representatives of an AFSL issued to a superannuation fund trustee. Such advice is required to be provided in both the best interests of members under the *Corporations Act*, and the best financial interests under the SIS Act. We are not certain which duty takes precedence in this situation and suggest that this question be resolved at the earliest possible opportunity as these duties may give rise to an unreconcilable conflict.

A solution to this problem may be to exempt APRA-regulated funds from the need to hold a personal advice AFSL, however due to existing SIS Act requirements and the trustee obligations contained in the general law, we believe that many trustees may reluctantly feel obliged to obtain and hold such a license.

Appendix 1 – Data from 2013 ATO Tax Statistics

Gender	Age	Number of individuals no.	Gross interest no.	Gross interest $	Dividends - franked and unfranked amount no.	Dividends - franked and unfranked amount $	Net rent[2] no.	Net rent[2] $	Personal superannuation contributions no.	Personal superannuation contributions $
Female	60 - 64	397,920	295,365	984,729,212	226,895	1,047,609,772	85,800	177,888,577	13,745	273,252,266
	65 - 69	240,260	184,310	806,878,740	176,935	1,012,365,892	46,040	290,655,561	6,820	145,875,109
	70 - 74	168,580	133,580	1,019,301,359	158,220	1,329,065,142	32,225	428,992,330	5,440	124,632,559
	75 and over	220,030	179,015	1,996,466,207	222,005	2,321,548,436	30,860	522,043,155	260	5,544,242
Male	60 - 64	456,030	292,640	838,861,797	262,565	1,553,482,465	103,610	-55,763,038	22,630	397,432,628
	65 - 69	300,745	210,495	727,135,869	208,555	1,402,661,355	60,505	229,516,064	13,155	262,476,255
	70 - 74	153,815	111,090	522,198,857	131,800	926,780,074	26,590	229,939,688	5,775	126,235,869
	75 and over	210,075	161,435	1,390,273,498	207,885	1,925,558,738	28,195	405,725,498	550	12,173,055

Appendix 2 – Data from 2018 ATO Tax Statistics

Sex	Age range[3]	Number of individuals	Gross interest no.	Gross interest $	Dividends franked and unfranked no.	Dividends franked and unfranked $	Net rent[3] no.	Net rent[3] $	Personal superannuation contributions no.	Personal superannuation contributions $
Female	60 - 64	462,941	328,628	623,182,251	227,047	1,288,017,985	104,143	244,455,484	29,084	490,645,822
	65 - 69	295,073	221,645	555,429,810	195,117	1,214,542,237	62,752	398,116,261	14,252	265,816,246
	70 - 74	183,379	136,585	500,704,876	159,159	1,152,089,655	34,769	371,183,863	6,242	131,737,021
	75 and over	255,995	200,187	1,236,740,852	271,147	3,039,833,247	38,954	707,169,825	388	8,678,197
Male	60 - 64	501,767	297,675	517,929,994	251,301	1,873,459,744	119,909	-2,187,945	39,679	639,780,045
	65 - 69	441,582	316,347	709,543,989	293,291	1,382,083,710	90,541	483,827,117	16,266	295,034,319
	70 - 74	307,988	217,886	662,826,003	263,262	1,342,841,619	54,936	477,348,993	7,321	149,104,700
	75 and over	252,816	186,417	902,121,517	252,970	2,765,143,995	38,457	565,519,467	837	18,420,346

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