



# KPMG Observations and Recommendations

**Retirement Income Covenant Position Paper –  
Phase One of the Retirement Income Framework**



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**Retirement Income Covenant Position Paper – Stage One of the Retirement Income Framework (May 2018)**

KPMG welcomes the opportunity to respond to the Government's *Retirement Income Covenant Position Paper* and to provide input into the shaping of a future Retirement Income Framework.

KPMG supports the Government in the establishment of a Retirement Incomes Framework which aligns to the objective of superannuation.

KPMG is supportive of measures that result in:

- more education to members to enable them to make informed decisions;
- flexibility in the advice model; and
- flexibility of product design (we believe the paper generates some limitations).

We discuss our observations and concerns regarding the following matters:

- consumer protection v trustee safe haven;
- two tier advice model; and
- cross subsidisation of advice (retirement advice via intra fund).

KPMG provides more detailed comments to the Retirement Income Covenant Position Paper in the following section *KPMG Observations and Recommendations*.

KPMG would be pleased to provide further information to assist you in the refinement of the Retirement Income Covenant and related Framework.

Should you require further information or have any questions please do not hesitate to contact Peter Bentley on (02) 9455 9654 or at [pbentley1@kpmg.com.au](mailto:pbentley1@kpmg.com.au)

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# KPMG Observations and Recommendations

## Covenant Principles

### 1. Retirement Income Strategy

KPMG is supportive of the introduction of a Retirement Income covenant in the Superannuation Industry (Supervision) Act (SIS Act) and the requirement to develop a Retirement Income strategy is a rational and consistent addition to the SIS Act and obligations on a trustee.

We understand that the covenant:

- “would outline specific factors trustees need to take into account when developing a retirement income strategy”;
- That the strategy should focus on the collective needs of members (that the primary focus should be “on delivering retirement income solutions that are appropriate for members as a whole or for a large cohort”); and
- Will seek to have trustees consider specific factors the paper lists – such that these factors provide consistency in assessment by trustees including considering the trade-offs the trustee has made.

Further we understand that the development of a Retirement Income strategy will be the only principle that will apply to a self-managed superannuation fund (SMSF) which is an appropriate obligation to impose on an SMSF.

Further, the Paper articulates that the trustee will need to take into account member’s “needs and preferences” in determining the Retirement Income strategy. We note that the terms “needs and preferences” are not defined terms in the SIS Act today (see section 2 below for further comment on the introduction of these terms and obligations).

We recommend that the terms “needs” and “preferences” be defined terms so that the Act clearly articulates how these terms differ and therefore how the trustee is to consider members’ needs and preferences in the trade off analysis, development of a strategy and in the development of a corresponding product/product suite.

### 2. Engagement

We understand the Government proposes that the trustee will provide “guidance” to help a member to understand their choices with regards to the Retirement Income(s) options offered by the fund. It is proposed the trustee can provide guidance by providing:

- information (no advice – no AFSL required);
- Intra-fund advice; or
- Financial advice (under an AFSL)

We note that the paper states that the guidance and tools should be “proportional” to the offering. However, it is not clear what this statement means. Does this mean that the more complex the choices offered by the fund, the guidance and tools should be more complex, more in number, or offered under an AFSL?

We recommend that expectations regarding “proportional” guidance, be clearly articulated especially if this principle is embedded in the SIS Act.

### Needs and preferences

“The tool should assist members in making the most appropriate choice, given their needs and preferences.”<sup>1</sup>

KPMG is supportive of measures which increase education and information which enable members to make more informed decisions.

We note that the Corporations Act with regards to advice provision requires that the advice provider (such as a trustee) determine and have regard to an individual’s **objectives and needs**. Whilst it is proposed in this Paper that the covenant will ask the trustee to consider **needs and preferences**, both require needs to be determined and trade-offs to be made in developing a member’s advice needs and their retirement income needs. Whilst an “objective” is different to a “preference” we query whether the use of different terms are on purpose (perhaps to differentiate the different requirements in the different Acts) or if this is an oversight?

We note that there may be an expectation that a tool (potentially developed without an AFSL – which on the face of it would potentially breach the Corporations Act) is to provide guidance such that it enables a member to determine the **most** appropriate choice given the member’s needs and preferences. If the SIS Act is written such that a tool is only required to “guide”<sup>2</sup> an individual to determine between a finite number of offerings made by the fund (preference) and not consider matters outside the fund such as the individual’s need to pay off debt (such as a mortgage or a credit card) then could this principle give rise to the potential to ‘sell’ an individual into a product without regard for the individual’s objectives and needs (potentially, a product that may not suit the member’s objectives and needs and one that they may not be able to exit without loss)? That is – the retirement income product may meet the individual member’s or even members’ needs and preferences, but can a tool developed without an AFSL guide individuals to make informed decisions about their retirement income needs without regards for their objectives and needs?

We recommend that further thought be given to ways in which a fund may assist their members to make informed decisions having regards to the limitations (risks to consumer protection) a non-AFSL model may deliver.

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<sup>1</sup> Retirement Income Covenant Position Paper, Page 5

<sup>2</sup> That is only provide information (not general or personal advice).

Guidance in the form of education (non-advice information) is generally recognised as valuable to those seeking to know more and on the face of it, it is a reasonable expectation that a fund would provide this type of information to their members (usually funded by an administration fee charged to all members). The Paper suggests the fund could provide intra-fund advice (“asking a few questions through intra-fund advice”<sup>3</sup> which we assume could be delivered verbally or via a ‘tool’ such as a robo-advice tool. Given not all members are likely to need this advice and that the investment required to build advice tools can increasingly add costs to a fund, we query the equity and appropriateness of the “intra-fund” caveat to fund this form of advice for a potential subset of members.

Further we recommend that consideration be given as to whether intra-fund advice funded by an administration fee, which cross subsidises advice, is an appropriate model for the provision of guidance to pre-retirees and retiring members.

## Supporting Principles

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

KPMG supports the definition as articulated in the Paper and the objective of assisting members to meet their retirement income objectives throughout retirement by developing a Retirement Income strategy.

However, we make the following observations and recommendations with regards to the required or implied features of a CIPR.

#### Flexibility in Product Design

A core objective of the framework is to “enable individuals to increase their standard of living through increased availability and take-up of products that more efficiently manage longevity risk”. The conflict in design between capital access and longevity protection naturally leads to this strategy being considered in two phases, with greater flexibility around access to capital more likely required in the initial phase. The implied CIPR design splits the product into these two phases, an account based pension (ABP) phase and a DLA phase. Arguably for many members, providing a guaranteed level of income beyond a pre-determined period, for example based on life expectancy at retirement, could achieve the objective by providing long term longevity protection and greater certainty around the ability to draw down an account based pension.

We believe that the flexibility for trustees to offer separate, but complementary, products for each of these phases as an alternate to a single bundled product, may provide greater ability to meet the needs of members. It may be that the trustee promotes a pooled ABP phase product to members providing the ability to trade some degree of capital access for the

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<sup>3</sup> Op. Cit.



expectation of enhanced returns for the surviving members. Separately, the DLA phase product would more likely be promoted as a pure longevity insurance. Members could elect to take either product or both.

Further flexibility in the product principles, by applying them at the strategy level rather than product level, and reducing the Flagship product restrictions may be required to facilitate this approach.

We believe there are other potential benefits to this approach:

- A standalone DLA product could help address the concern relating to the impact of cognitive decline, irrespective of the member's product selection of a standard ABP or a pooled product through the ABP phase.
- A key issue inherent in the product objective of maximising income for life for members is the interactions of the product income with income from the age pension and assets held outside of superannuation. As the trustee does not have access to complete information in this regard, and members' circumstances will differ, offering greater flexibility may enable members to better manage this outcome, potentially through the use of simple calculators provided by the trustee as contemplated in the position paper.
- If the recommendations in the Productivity Commission report are taken up, there is potential that the expected growth of the default funds will lead to even greater diversity in membership of these funds and therefore require greater flexibility in product offers (beyond the three Flagship products) for trustees to meet member needs.

The product example provided (A+ Retirement) implies an expectation of some flexibility in product terms. It is not clear why variation in some of these factors are considered to constitute a single CIPR product offer whereas variation in others would be deemed to be a different CIPR. We question whether this should be left to the discretion of the trustee or, at a minimum, further guidance would be required as to the reasoning for the distinction drawn between single or multiple CIPR products in the example.

### Broadly Consistent Income

We believe the requirement for broadly consistent expected income (defined as perhaps +/- 2.5% from the first year income) is unclear in its intended impact on product design. A deterministic projection of income based on mean assumed investment returns and mortality assumptions will always be able to satisfy the criteria of broadly consistent. It is noted in the paper that the actual income may not be broadly consistent, so this implies that both volatility (for example arising from investment performance) or changes in the mean expected income (for example under a GSA due to actual mortality rates deviating from assumptions) is acceptable.

We note that an expectation of broadly consistent may not always be the primary objective for members. For example, greater flexibility may be considered more desirable through a

large part of the ABP phase, whereas certainty and consistent income may be a primary objective in the DLA phase.

Further, without some reference to, and disclosure of, the different risks associated with alternate product structures a comparison of expected income alone can be misleading. We comment on this further below.

### Development of simple standardised metrics in product disclosure

We support the intentions to develop simple standard product metrics to enable comparison between products and improve member engagement through the provision of retirement income projections.

However, we note the difficulty in developing measures that are understood by members without risking negative outcomes such as limiting product innovation or promoting a member bias to higher risk strategies. For example, without some measure of the implied risk associated with the income level that is readily understood by members, then a simple estimate of retirement income may drive members to a higher risk product (or strategy) on the basis of a higher expected mean income. This issue would apply to all products that provide some level of guarantee, not just pure lifetime annuities.

The paper also proposes the trustee may target consistent income in nominal or real terms, the product metrics would require consistency to enable comparison.

The development of product metrics should carefully consider the likely impact on member choices to avoid unintended outcomes.

We recommend the following:

- Consideration be given to allowing trustees to segment the CIPR strategy into the two phases (i.e. ABP and DLA phase) and offer distinct products rather than a single blended product and permitting additional flexibility in product design. Other product features such as capital flexibility may be as important as expected consistent income in the first phase.
- The development of the product metrics, including income projections, should have regard to the potential bias that these metrics may introduce to member decisions and the relative perceived attractiveness of alternate products.

## 4. Offering a flagship CIPR

We are generally supportive of the position that all trustees should offer a flagship CIPR subject to limitations of principle 7 and 8.

## Interaction of this Covenant and the Productivity Commission's Report

Whilst the Government has not yet responded to the Productivity Report – should the Government determine that a limited number of super funds be selected as default funds (the Report suggests 10 funds), then in the near future, these 10 funds would garner significant funds under management which may result in other funds, not on the list, experiencing outflows. Given the inflows/funds under management dynamics may change in the near future, we query the appropriateness of a SIS Act requirement which seeks to require that every trustee offer a flagship CIPR – given it may not be in the interest of their members to do so.

We recommend that consideration be given to the manner in which this Covenant and the Productivity Commissions' Report may interact.

### Advice

We note the statement "it should be clear that the flagship CIPR offering is the starting point for members"<sup>4</sup>.

Given that the trustee is not necessarily informed of the member's objectives and needs (the individual member's financial reality), is it appropriate for a trustee to "be clear" that the CIPR offered by the Fund should be the members starting point? Further, how does the Corporations Act section 961AB (Best Interest duty) interact with such a statement and potential SIS Act obligation?

Further, segmenting members into 3 CIPR offerings is said not to constitute financial advice. Will the SIS Act and the Corporations Act be amended to provide trustees with the exemptions from the financial advice provisions? We note that there is a case before the Courts at present that may set precedence confirming that use of information by an AFSL, such as account balances, is personal financial advice. Will SIS and the Corporations Act exempt the use of certain personal information for these purposes?

We recommend that consideration be given to the interplay of SIS Act and the Corporations Act. Should the government seek to permit a trustee to use personal information in a non-AFSL situation, we note that amendments to both the SIS and the Corporations Act may be required to exempt trustees and AFSL's who provide CIPR solutions to members, who use account balances for segmentation and product development, be exempt from requisite personal financial advice provisions.

## 5. Third Party products

KPMG is supportive of this principle, which will allow a trustee to fulfil their obligations in part or in full by using a third party.

No recommendation is made.

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<sup>4</sup> Op Cit. page 7.



## 6. Consent

KPMG is supportive of this principle which requires that a member consent explicitly to commence a CIPR.

No recommendation is made.

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

The Paper is unclear in intent in paragraph three of this principle. We assume the paragraph is intended to convey that;

1. Only a flagship CIPR can be offered by the trustee without personal advice; and
2. If a trustee offers a product that is not a 'flagship CIPR' – that the alternate retirement income product be "in the best interest of the member".

In the case of the latter, is the intention that the term "offer" means that a member can only invest in part or full in a non "flagship CIPR" if the member has received personal financial advice – given how else can a trustee determine the offering is in the "best interest of the member"? Or is the intent that the test is that the non "flagship CIPR" is in the best interest of "members" or a cohort of members? Or is it in all cases regardless if it is one member or many – that non "flagship CIPRs" can only be offered via personal advice?

With regards to "guiding members into products that are better suited to the member's circumstance", we note that a trustee may choose to offer scaled personal advice, intra fund advice and or financial planning services.

What is unclear is under which charging mechanism the advice should fall under. Is the intention that trustees can leverage current intra fund charging mechanisms (outside the Corporations Act) such that the fee is charged via the administration fee of a super fund, therefore equally being borne by all members of the fund? We note that not all members will be accessing retirement incomes advice, therefore there will be an element of cross subsidisation being borne by members, which is more complex and is likely to be more costly<sup>5</sup> to provide than current defined intra fund advice topics.

### Best Interest Duty

Reference is made in this section to the 'best interest' of members. Which best interest duty test will apply to a trustee? Further which regime will a member be protected under – Trust Law/SIS Act where a trustee provides guidance on a 'flagship CIPR' or the Corporations Act 961B Best Interest duty test if the trustee provides the advice under an AFSL?

The onus of proof and recourse to members are different. How will a member know which regime to choose from when choosing their course of action or how to take action should they have a complaint? Will any additional obligations and clarity be provided in the SIS Act

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<sup>5</sup> Cost of advice is expected to increase given legislated Adviser competency requirements.

such that a trustee be required to disclose any information to members should a member have a complaint about the 'guidance' or advice provided further to current requirements?

We recommend consideration be given to alignment of the SIS and Corporations Act so that consumers, in this case members, are not disadvantaged because of an action they chose to take, uninformed of the impacts the action could have on their redress capabilities.

## **8. Exemption for individuals for whom CIPRs are unsuitable**

KPMG is supportive of this principle which would exempt a trustee from providing a CIPR to cohorts/members:

- With a terminal or life threatening illness (where the trustee has knowledge) and or
- With balances less than \$50,000 in super (which the trustee will have knowledge of given the member is invested in their fund).

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