Retirement Income Covenant Position Paper

KPMG Submission

KPMG Australia

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Contents

Executive summary

Background

Section 1: Findings

Section 2: KPMG Insights

Key Authors

Executive Summary

As a leading professional services firm, KPMG Australia (KPMG) is committed to meeting the requirements of all our stakeholders – not only the organisations we audit and advise, but also employees, governments, regulators and the wider community. We strive to contribute to the debate that is shaping the future of the superannuation industry and we welcome the opportunity to provide a submission in response to the Retirement Income Covenant Position Paper (Position Paper).

KPMG welcomes the release of the Position Paper as it will help retirees gain the confidence to use their superannuation to provide higher retirement incomes that will improve their living standards in retirement.

Many retirees are not adequately supported to effectively manage their superannuation when they retire. Retirement involves multiple options and a level of complexity that makes it very challenging for retirees to make decisions on their own that will improve their standard of living in retirement.

The retirement income covenant should be a catalyst to innovate and transform the retirement phase of superannuation and spark the development of new and innovative retirement solutions that will challenge our thinking beyond the offer of conventional drawdown accounts.

Many Trustees have been actively designing and testing different retirement solutions for some time and there is an increasing level of development activity in the retirement sector. However, as recognised by the Position Paper, retirement involves difficult trade-offs, including complex interactions with other systems like tax, social security, aged care and housing.

The Position Paper outlines the objectives that need to be balanced in developing a retirement income strategy and encourages Trustees to provide guidance to their members to help them plan for a better retirement. We support and commend this approach in the form of the retirement income covenant.

However, there are several aspects of the proposal where further law reforms may need to be considered where Trustees are seeking to assist members in their retirement planning, especially where they are engaging with their members in a personalised and interactive way.

The following insights and findings from KPMG outline our support and highlight areas where clarification may be helpful, or further law reforms may assist Trustees to better meet the retirement needs of their members.

KPMG looks forward to continued engagement with the Australian Government as it develops its final policy approach to the Retirement Income Covenant over the coming months.

Yours sincerely,

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Background

About KPMG

KPMG is a global organisation of independent professional firms, providing a full range of services to organisations across a wide range of industries, governments and not-for-profit sectors. We operate in 146 countries and territories and have more than 227,000 people working in member firms around the world. In Australia, KPMG has a long tradition of professionalism and integrity combined with our dynamic approach to advising clients in a digital-driven world.

Superannuation Advisory

KPMG's Superannuation Advisory Team is dedicated to assisting our clients to address their business/fund needs and assist in delivering holistic advice that enables them to achieve their strategic, governance and tactical imperatives including delivering better member outcomes.

KPMG Law

Our experienced team of legal experts and consultants are committed and passionate about retirement products, having helped our clients to better understand the retirement incomes needs of their members and customers. We have designed, built and helped distribute various types of retirement products using different features and structures, all of which are intended to give retirees a better standard of living in retirement.

Section 1: KPMG findings

Finding 1: KPMG agrees with an approach that recognises that Trustees are well placed to help their members develop effective retirement income strategies, given the complexities involved in making retirement decisions.

Finding 2: KPMG welcomes a principles-based approach that provides Trustees with the flexibility to offer one or more retirement income solutions that enable members to combine them to better meet their retirement needs and preferences.

Finding 3: Trustees should be exempt from the personal financial product advice requirements in using member data to determine member cohorts, and tailoring retirement solutions to better meet the needs of those cohorts in accordance with the retirement income covenant.

Finding 4: Trustee guidance and assistance provided in accordance with the retirement income covenant should be exempt from the personal financial product advice and anti-hawking requirements, to allow Trustees to explain their retirement solutions to their members to help them make better retirement decisions. This should be distinguished from, and regulated separately to, the provision of holistic personal financial product advice.

Finding 5: Trustee guidance and assistance provided in accordance with the retirement income covenant should be regulated under the prohibition against misleading and deceptive conduct rather than the personal financial product advice and anti-hawking requirements.

Finding 6: KPMG welcomes the Quality of Advice Review by Treasury in 2022 and encourages a focus on law reforms that will better facilitate the development of service models that will provide members with access to personalised guidance and assistance, as well as holistic personal financial product advice that is affordable and scalable.

Finding 7: Additional guidance should be provided to Trustees to assist them in understanding how the retirement income covenant will intersect and interact with other Trustee obligations, and how APRA and ASIC will expect Trustees to comply with those obligations.

Finding 8: The requirements of the retirement income covenant should be tested against the DDO regime to identify any areas of overlap and duplication. Where obligations overlap, there should be a clear articulation of the rationale for the two obligations in terms of the desired policy objectives.

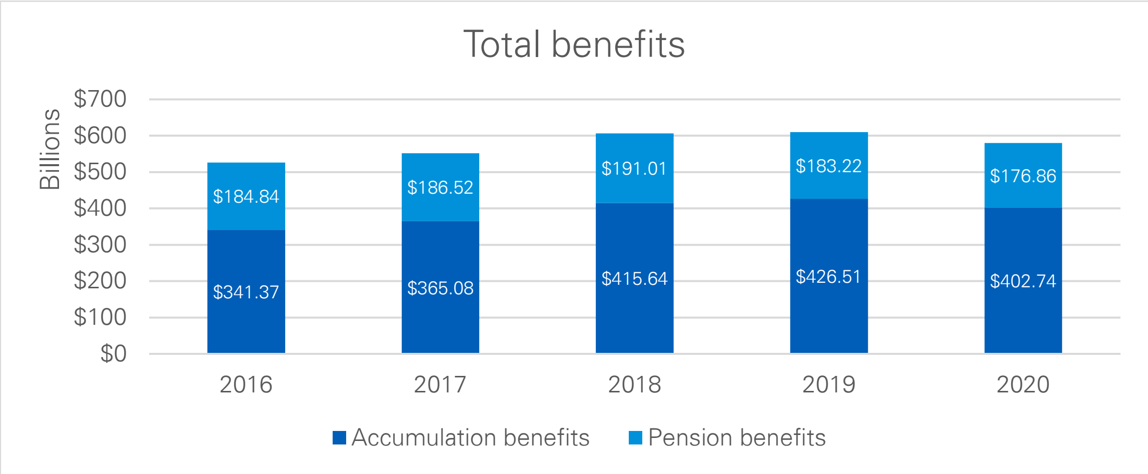
Section 2: KPMG Insights

KPMG Insights

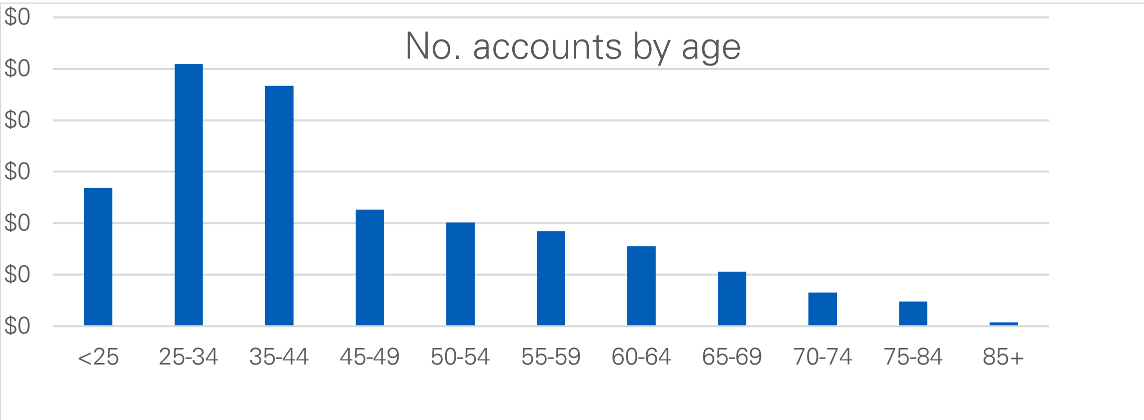
Introduction

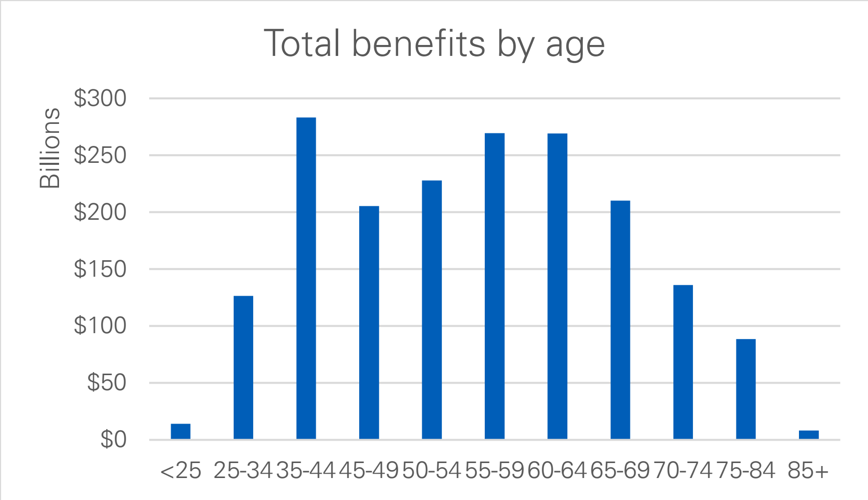
KPMG welcomes the Australian Government's proposal to introduce a retirement income covenant for superannuation trustees (Trustees) as a further measure to address the under-development of the retirement phase of superannuation.

Noting Australia's demographics, in the 29 years since compulsory super was introduced, based on APRA data as at 30 June 2020 (which excludes self-managed super funds (SMSF)), approximately one third of superannuation assets were in the pension phase.



This data also shows that as at 30 June 2020, 10 percent of account holders are aged 65 years and over and held 24 percent of total benefits





Generationally, by 2029, 100 percent of Boomers will be over 65 years of age and the oldest of Gen-X will have hit 65 years of age, supporting the need for Trustees to ensure they have products which are fit for purpose for their cohort and target markets.

Retirement income objective

KPMG agrees with the Retirement Income Review that the fundamental role of compulsory superannuation is to provide income in retirement with the objective of delivering adequate standards of living in retirement in an equitable, sustainable and cohesive way.

We also recognise the challenges facing retirees in making decisions about how to spend their superannuation in retirement, which is reflected in the studies that project that by 2060, one in every three dollars paid out of the superannuation system will be a part of a bequest.[1]

Given the complexities involved in making retirement decisions, it is not surprising that retirees struggle to develop effective retirement income strategies on their own. Accordingly, we agree with an approach that recognises that Trustees are well placed to help their members to do so.

Finding 1: KPMG agrees with an approach that recognises that Trustees are well placed to help their members develop effective retirement income strategies, given the complexities involved in making retirement decisions.

[1] *https://treasury.gov.au/sites/default/files/2021-02/p2020-100554-udcomplete-report.pdf*

Framework

As explained in the Position Paper, retirement involves the balancing of often conflicting objectives and complexity that does not lend itself to a "one-size fits all" solution.

The Position Paper encourages Trustees to provide guidance to their members to help them understand how they can convert their retirement savings into retirement income in a way that suits their needs, preferences and desired financial outcomes.

However, it states that guidance does not mean defaulting members into particular products or pushing people towards particular forms of advice.

There is a deliberate policy move away from hard defaulting or even soft defaulting members into Trustee endorsed retirement solutions. There is no mention of the Comprehensive Income Product for Retirement (CIPR) based approach of earlier versions of the covenant, in which the Government sought to prescribe the features of its preferred default retirement income product.

We welcome the adoption of this flexible principles-based approach that does not prescribe or mandate the features of a default retirement product solution. Rather, the proposal will require Trustees to identify and recognise the retirement income needs of their members and formulate a strategy or plan to build the fund's capacity and capability to service those needs.

We anticipate that the retirement income covenant will encourage Trustees to evaluate the products they offer to their members and investigate whether their product offerings can be improved to better meet the needs of their members.

It will provide Trustees with the flexibility to decide whether they will build their own retirement income solutions, procure externally offered products or offer a combination of insourced and outsourced retirement income solutions to their members. This approach is more likely to meet the different retirement income needs and preferences of different member cohorts.

We have a strong conviction that the superannuation industry in Australia is at a stage of maturity where the best financial interest duty and the statutory duty of care already enable and require Trustees to do just that. Accordingly, we agree with previous pronouncements by the Government that Trustees should not wait to start developing or offering innovative retirement income solutions to their members.

Even so, the retirement income covenant is an opportunity to reinforce and clearly articulate the obligations of Trustees to formulate, review regularly and give effect to a retirement income strategy that will better serve the needs of their members in retirement.

Finding 2: KPMG welcomes a principles-based approach that provides Trustees with the flexibility to offer one or more retirement income solutions that enable members to combine them to better meet their retirement needs and preferences.

Member cohorts

The Position Paper states that it is at the discretion of the Trustee as to whether they construct their retirement income strategy for all members of the fund in generality, or for cohorts of the fund's members in generality. It then outlines the different factors that Trustees could use to identify different member cohorts. These factors include collecting a variety of data using member surveys and the paper goes on to state that "[d]ifferent approaches may be required for different cohorts when a fund has a membership with diverse needs."

For example, the paper states that Trustees could take into account "other sources of income their members may have in retirement, such as income from other superannuation funds, investments, or employment, when formulating their strategy". There are numerous other factors and examples of member data that the paper suggests Trustees can take into account in determining member cohorts.

KPMG has a concern that the collection and use of such a wide data set of personal information about members to develop retirement strategies for different member cohorts and then engage with those members, even in a generalised way, in relation to their retirement income needs will cross the line into personal financial product advice.

Given this risk, we see merit in providing Trustees with a safe harbour whereby they are exempt from the requirements to comply with the personal financial product advice requirements when they use member data in this way to determine member cohorts and tailor retirement solutions to better meet the needs of those cohorts in accordance with the retirement income covenant.

Finding 3: Trustees should be exempt from the personal financial product advice requirements in using member data to determine member cohorts, and tailoring retirement solutions to better meet the needs of those cohorts in accordance with the retirement income covenant.

Appropriate guidance

The retirement income covenant will require Trustees to consider the broad needs of their members, and identify what actions the Trustee needs to take to help their members meet those needs. This includes consideration of what guidance Trustees may need to provide to their members to help them make better decisions in relation to the use of their superannuation in retirement.

The Position Paper acknowledges that there are concerns regarding current laws and regulations governing guidance. While the paper does not articulate these concerns, for Trustees, the concerns relate to the difficulty in navigating the divide between general and personal financial product advice.

The current framework for the regulation of financial product advice makes it difficult for Trustees to engage with their members in relation to their retirement decisions in a meaningful and personalised way without having to comply with the complex requirements relating to the provision of personal financial product advice.

The fine line between general and personal financial product advice has been made even more perilous following the recent High Court decision on this issue. As a result of that decision, the concern is that any real-time interaction with members through any channel (including call centres, social media or interactive digital tools) is likely to be held by ASIC and now the Courts to involve the provision of personal financial product advice.

As an additional concern, any real-time interaction with members in the pre-retirement phase may also involve a breach of the new anti-hawking prohibition, without any safe harbour for Trustees.

In combination, these legal and regulatory developments will make it difficult for Trustees to provide any guidance to their members other than through non-interactive contact points such as advertising and the provision of static information of a very generalised nature, as contemplated by the Position Paper.

The only permissible use of personal information outlined in the Position Paper relates to the determination of member cohorts and formulation of the retirement income strategy. Any engagement with members must be in the form of generalised guidance that cannot extend into the area of assistance. This is reinforced by the statement in the paper that "any assistance provided by the Trustee to give effect to their retirement income strategy needs to comply with existing financial advice rules".

We query whether this focus on providing generalised guidance but not assistance will facilitate any meaningful engagement by Trustees with their members about the retirement income solutions offered by the Trustee. We query whether it will provide sufficient support for members to make better informed decisions relating to the use of their superannuation in retirement.

Accordingly, we see merit in reviewing the regulation of personal financial product advice to provide some form of exemption for Trustees that will allow them to use member data to formulate their retirement income strategies and engage with their members about those strategies.

It would also be beneficial to introduce a safe harbour for Trustees under the new anti-hawking prohibition to enable Trustees to engage with their members in the pre-retirement phase in order to support them in making better retirement decisions.

These two measures will encourage Trustees to proactively engage with their members within the regulatory guardrails of complying with the misleading and deceptive conduct requirements, but not the personal advice and anti-hawking requirements.

This Trustee guidance and assistance in accordance with the retirement income covenant should be distinguished from, and regulated separately to, the provision of holistic personal financial product advice (which is discussed below).

Finding 4: Trustee guidance and assistance provided in accordance with the retirement income covenant should be exempt from the personal financial product advice and anti-hawking requirements, to allow Trustees to explain their retirement solutions to their members to help them make better retirement decisions. This should be distinguished from, and regulated separately to, the provision of holistic personal financial product advice.

Finding 5: Trustee guidance and assistance provided in accordance with the retirement income covenant should be regulated under the prohibition against misleading and deceptive conduct rather than the personal financial product advice and anti-hawking requirements.

Retirement advice

KPMG acknowledges the importance of personal financial product advice in supporting members to make better decisions about the use of their superannuation in retirement. Trustees across all sectors of the superannuation industry are increasingly seeking to offer guidance, assistance and financial advice services that are accessible, affordable and scalable.

There are different models currently in place across the industry, which generally comprise call centre support, intra-fund advice arrangements and personal financial advice services. The latter will generally be delivered by an internal team, external provider, or a combination of both.

The challenge for Trustees and the financial advice industry is to make financial product advice accessible and affordable, which is critical to supporting the increasing number of members moving into the retirement phase (with all the baby boomers reaching age 65 within the next decade).

Accordingly, KPMG welcomes the Quality of Advice Review by Treasury in 2022, which will consider the full breadth of issues impacting on both quality and affordability of all forms of financial advice, including advice for retirement.[2]

We have a strong conviction that the regulatory framework for financial product advice should facilitate the development of models that support members through access to personalised guidance and assistance, as well as holistic personal financial product advice that is affordable and scalable.

[2] *Senator the Hon Jane Hume, 2021. Address to the 12th Annual Financial Services Council's Life Insurance Summit 2021.*

Finding 6: KPMG welcomes the Quality of Advice Review by Treasury in 2022 and encourages a focus on law reforms that will better facilitate the development of service models that will provide members with access to personalised guidance and assistance, as well as holistic personal financial product advice that is affordable and scalable.

Interaction with other Trustee obligations and regimes

It is important to recognise that the retirement income covenant will be an additional requirement that will be overlayed on top of the extensive trustee governance framework and will not operate in isolation.

Trustees will be required to formulate their retirement income strategy against the backdrop of:

- the best financial interests covenant with the reversal of the onus of proof
- the statutory duty of care and diligence
- the annual performance test under the Your Future Your Super reforms
- the annual member outcomes assessments, and
- the design and distribution obligations (DDO) regime, which will commence from 5 October 2021.

These statutory obligations are supervised by APRA and ASIC, who have different mandated responsibilities, approaches, guidance and drivers.

We note that the Position Paper helpfully refers to APRA providing guidance on how Trustees can meet the new retirement income strategy requirement.

While this will be welcomed, Trustees should also be provided with guidance on how the various obligations outlined above intersect and interact with each other and how the different regulators will expect Trustees to comply with their respective requirements, with the overlay of the retirement income covenant.

Of particular concern is the overlap between the retirement income covenant and the DDO regime. From 5 October 2021, the DDO regime will require a Trustee to design products appropriate for their target market (members) which includes retirees.

The description of the process required to be undertaken by Trustees in relation to the retirement income covenant (as outlined in *Box 1* of the Position Paper) is very similar to the Trustee obligations under the DDO regime.

We also note that the examples of cohorts of members outlined in *Box 2* of the Position Paper will overlap with the obligation on Trustees to design products consistent with cohorts or target markets in order to comply with the DDO regime.

This overlap between the two sources of Trustee obligations raises the question of whether both sets of obligations are necessary or, at the very least, whether there is a supportable policy rationale for having both sets of obligations.

For example, if the different obligations are seeking to achieve different policy outcomes, then this should be clearly articulated in the explanatory material and regulatory guidance.

Finding 7: Additional guidance should be provided to Trustees to assist them in understanding how the retirement income covenant will intersect and interact with other Trustee obligations, and how APRA and ASIC will expect Trustees to comply with those obligations.

Finding 8: The requirements of the retirement income covenant should be tested against the DDO regime to identify any areas of overlap and duplication. Where obligations overlap, there should be a clear articulation of the rationale for the two obligations in terms of the desired policy objectives.

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