



Law Council
OF AUSTRALIA

Retirement Income Covenant – Position Paper

Treasury

10 August 2021

Table of Contents

About the Law Council of Australia	3
Acknowledgement	4
Introduction	5
Observations	5
Formulate, review regularly and give effect to a retirement income strategy – supplementary protection required	6
Costs of formulating and implementing strategy and advice costs – deemed permitted expenditure	9
Regulatory overlap – Design and distribution obligations	9

About the Law Council of Australia

The Law Council of Australia exists to represent the legal profession at the national level, to speak on behalf of its Constituent Bodies on national issues, and to promote the administration of justice, access to justice and general improvement of the law.

The Law Council advises governments, courts and federal agencies on ways in which the law and the justice system can be improved for the benefit of the community. The Law Council also represents the Australian legal profession overseas, and maintains close relationships with legal professional bodies throughout the world.

The Law Council was established in 1933, and represents 16 Australian State and Territory law societies and bar associations and the Law Firms Australia, which are known collectively as the Council's Constituent Bodies. The Law Council's Constituent Bodies are:

- Australian Capital Territory Bar Association
- Australian Capital Territory Law Society
- Bar Association of Queensland Inc
- Law Institute of Victoria
- Law Society of New South Wales
- Law Society of South Australia
- Law Society of Tasmania
- Law Society Northern Territory
- Law Society of Western Australia
- New South Wales Bar Association
- Northern Territory Bar Association
- Queensland Law Society
- South Australian Bar Association
- Tasmanian Bar
- Law Firms Australia
- The Victorian Bar Inc
- Western Australian Bar Association

Through this representation, the Law Council effectively acts on behalf of more than 60,000 lawyers across Australia.

The Law Council is governed by a board of 23 Directors – one from each of the constituent bodies and six elected Executive members. The Directors meet quarterly to set objectives, policy and priorities for the Law Council. Between the meetings of Directors, policies and governance responsibility for the Law Council is exercised by the elected Executive members, led by the President who normally serves a 12 month term. The Council's six Executive members are nominated and elected by the board of Directors.

Members of the 2021 Executive as at 1 January 2021 are:

- Dr Jacoba Brasch QC, President
- Mr Tass Liveris, President-Elect
- Mr Ross Drinnan, Treasurer
- Mr Luke Murphy, Executive Member
- Mr Greg McIntyre SC, Executive Member
- Ms Caroline Counsel, Executive Member

The Chief Executive Officer of the Law Council is Mr Michael Tidball. The Secretariat serves the Law Council nationally and is based in Canberra.

Acknowledgement

The Law Council is particularly grateful for the expertise of the Superannuation Law Committee of its Legal Practice Section in leading the development of this submission, as well as its National Elder Law and Succession Law Committee.

Introduction

1. The Law Council makes this submission in relation to the proposed introduction of a retirement income covenant for Australian Prudential Regulation Authority (**APRA**) regulated superannuation trustees (**Covenant**) as set out in the Department of Treasury's (**Treasury's**) Position Paper of 19 July 2021 (**Position Paper**).
2. The Covenant is proposed to be added to the existing suite of statutory covenants applying to APRA regulated superannuation trustees under the *Superannuation Industry (Supervision) Act 1993* (Cth) (**SIS**).
3. The context and policy purpose of the introduction of the Covenant is expressed as:

The proposed retirement income covenant outlines a pathway to further develop the retirement phase of superannuation. The covenant will place a key obligation on trustees to formulate, review regularly and give effect to a retirement income strategy outlining how they plan to assist their members to balance key retirement income objectives.

The Government welcomes feedback and comments on this position paper. Any comments received will feed into the development of legislation to give effect to the retirement income covenant. Subject to the passage of legislation, trustees will be required to have in place a retirement income strategy as outlined in this position paper from 1 July 2022.
4. The Law Council's comments are intended to raise issues for consideration by Treasury in the legislative framework of the Covenant and supporting regulatory guidance or mandated requirements in order that the Covenant may be more likely to fulfil its intended purpose and promote the intended behaviour of superannuation providers and members.

Observations

5. In the Law Council's view, the revised form of the Covenant is likely to be less contentious within the superannuation industry than other recent new covenants, because it is not prescriptive about the action which must be taken from a product design perspective. By requiring trustees to formulate a strategy, and leaving trustees with a discretion how to balance the competing objectives, trustees are likely to have the discretion and flexibility they need to make decisions in the best financial interests of their members.
6. That said, the Law Council notes that it will be less certain under the Strategy-based approach whether there will be the same level of product innovation as could be achieved by more prescriptive measures. Competitive forces will be the main determinant of product innovation and it will remain to be seen whether trustees might be inspired by the Covenant to innovate new products and whether this becomes a key area for competition between funds. It might be viewed similarly to the MySuper reforms, where there will be a pathway to complying with the new Covenant through existing product offerings – not compelling further innovation. Most funds already have an account-based pension product offering and it seems this would be a sufficient basis to comply with the cornerstone of the new Covenant.

7. The Law Council also notes that an obligation to have a retirement income strategy (**Strategy**) leaves open the question of when or how long a trustee has to implement or comply with their Strategy (if ever). A Strategy differs from, say, an investment strategy. Under trust law, a trustee has a duty to invest the trust funds, so it follows that the investment strategy formulated to comply with the legislation will in fact be implemented, especially since the statutory defence to legal claims for investment losses depends on having complied with the investment strategy. In contrast, there is no actual duty for a trustee to offer a retirement income product (unless required by the trust deed or by a future prudential standard), nor any statutory defence that depends on having complied with a Strategy. This means a trustee may formulate a Strategy without ever being compelled to fully implement it.
8. The Position Paper contemplates trustees taking into account a range of factors which go beyond a member's financial interests in the particular superannuation fund (for example, whether they own real estate, hold interests in other superannuation funds and whether they might be eligible for the age pension or other social security benefits). The Law Council considers that this may be contentious from a trust law perspective because it requires the trustee to look beyond the framework of the superannuation fund it operates and to have regard to considerations that are within the broader purview of giving financial product advice.
9. Further, some of the matters to which the Position Paper suggests a trustee's attention should be directed in formulating the Strategy would not be relevant considerations in a trust law context. From a practical perspective, it may be true that few members would complain if outside considerations led to decisions which enhanced the value of their superannuation interest (or the value of their retirement income from the relevant fund). However, a trustee would be at risk of liability if those outside considerations might lead to decisions which had the effect of moderating, trading-off or reducing the value of their interest or income from the superannuation fund. If trustees are going to be expected to make decisions for the fund having regard to what is perceived to be the interests which members have outside of the fund, there should be statutory protection or authorisation – a possible approach on this point is suggested below.

Formulate, review regularly and give effect to a retirement income strategy – supplementary protection required

10. Trustees are already required to comply with statutory obligations and covenants which authorise and require them to consider and promote the interests of their members in the retirement phase including:
 - to comply with the sole purpose test in the running of their fund – section 62 of SIS includes a core purpose for *'the provision of benefits for each member of the fund on or after the member's retirement from any business, trade, profession, vocation, calling, occupation or employment in which the member was engaged (whether the member's retirement occurred before, or occurred after, the member joined the fund)'*;
 - to perform all duties and exercise their powers in the best financial interests of members (paragraph 52(2)(c) of SIS); and

- to promote the financial interests of beneficiaries who hold a MySuper product or a choice product (and choice products include retirement products other than defined benefit interests) (subsection 52(12) of SIS).
11. Trustees are also constrained in terms of the information, guidance or advice they may provide to members to assess the suitability of available retirement product options and select what is most appropriate for them having regard to a member (and their family's) individual circumstances, objectives and needs in retirement.
 12. The Position Paper indicates '*that any assistance provided by the trustee to give effect to their retirement income strategy needs to comply with existing financial advice rules.*' The Law Council respectfully points out that this view seems to be at odds with the policy objectives. That is, the Law Council considers that a Strategy developed in compliance with the new Covenant will, if properly and thoroughly implemented, pose a real risk of the trustee being taken to give personal financial advice to members.
 13. It should be noted that all that is required for a finding that advice given by a trustee was personal advice is – pursuant to the objective test under paragraph 766B(3)(b) of the *Corporations Act 2001* (Cth) (**Corporations Act**) – that a 'reasonable person' might expect the provider to have considered their objectives financial situation or needs. Therefore, in the context of the trustee being required to disclose to members key retirement income objectives which align with characteristics of different cohorts of members, that very disclosure may provide sufficient context for a court to view that in fund communications with members a reasonable person would expect their 'objectives, financial situation and needs' to have been considered. The consequence for trustees will then be that in seeking to give only general advice to members at large about their fund's retirement income products, they may instead be taken to be giving personal advice with all of the associated cost and compliance burdens. In the Law Council's view, this aspect is not adequately addressed by the Position Paper.
 14. Further, the introduction of a new 'specific purpose' retirement income Covenant in isolation may not be sufficient to promote the change in behaviour and outcomes sought from trustees and members – in particular the adoption and participation in 'innovative' retirement income products, which go beyond account-based pensions. A significant barrier to design, delivery, take up and promotion of innovative retirement income products by trustees to their members are (i) the financial advice rules that currently constrain trustees in providing assistance to members; and (ii) the costs incurred in developing innovative products.
 15. Therefore, critical to promoting the change in behaviour sought of both trustees and members would be a legislative regime which in the Law Council's view:
 - provides clear and express (ie mandated) permission for the trustee to engage with their existing membership and utilise both fund level and member specific data collected and provided for the purpose of designing and promoting suitable retirement income options (including new innovative products) and for trustees to educate and guide members in their assessment and decisions on those options suitability as they transition from the accumulation to the retirement phase of superannuation investment;
 - allows trustees to do so within a protected framework where their actions to fulfil the requirements of the Covenant, deliver suitable retirement product

options and support their members (taking into account individual personal data) will not trigger or overlap with requirements that would otherwise apply in the provision of general or personal financial advice under the Corporations Act; and

- is less complex than the current regime in terms of what is a 'complying pension' for purposes of the SIS Act. In this regard the Law Council notes current regulation 1.06 of the Superannuation Industry (Supervision) Regulation 1994 (**SIS Regulations**) provides the meaning of 'pension' and is expressed in approximately 5,200 words, occupying a staggering 13 pages of the legislation. That is an enormous amount of drafting complexity for one regulation, and that count does not include the new regulation 1.06A on innovative income streams. It takes considerable technical legal skills to decipher the current legislation on what is a complying 'pension'. Most of the provisions relate to legacy pension types that trustees are no longer permitted to offer as new pensions, but members who commenced a legacy pension type are not able to commute them. The Law Council suggest that removing legacy pension types, and providing for members to transition to new pension types (without tax or Centrelink implications), would significantly simplify the regulations.

16. If the legislative regime were to be amended to expressly allow trustees to provide some personalised information on retirement income options without triggering the requirements that would otherwise apply in the provision of general or personal financial advice under the Corporations Act, a legislative framework could be developed to impose a subsidiary positive requirement on trustees to inform and equip members to understand their options (perhaps akin to what is provided in current SIS Regulation 4.02 in relation to member investment choice options).
17. Any action taken by a trustee to comply with such a requirement and for the purpose of fulfilling the implementation requirement of the proposed Covenant would not be regulated as financial product advice (either general or personal) under the Corporations Act. This could remove a significant impediment or inhibitor to the introduction of the Covenant fulfilling its intended purpose in practice over time.
18. Consideration could also be given to review and extension of the current generic calculator and retirement projection statement relief for application to the tools trustees may need to develop to promote suitable retirement income products to their members – including the application of a member's personal data in those tools for the purposes.
19. In summary, there are a range of legal complexities inherent in the provision of retirement income products, and any innovation and advice improvements to generate traction may be better achieved by real reform of the underlying legislative and regulatory issues, rather than imposing on its own a general covenant to formulate a Strategy without any underlying reform.

Costs of formulating and implementing strategy and advice costs – deemed permitted expenditure

20. The legislation introducing the Covenant could expressly specify that the reasonable costs of formulating and implementing the Strategy, including research and data collection about the fund's membership, are permitted under the 'best financial interests' duty.
21. This would assist trustees in the development of innovative retirement income products without giving rise to duplicative compliance measures and costs to demonstrate and discharge the trustee's burden of proof for discretionary expenditure on such measures which would otherwise apply under its best financial interests duty.
22. Similarly, it would assist if any fees deducted from member accounts for advice or information given in relation to retirement products (particularly in circumstances where their interests outside the fund have been taken into account) were expressly permitted, so that no question would arise in relation to compliance with the sole purpose test in section 62 of the SIS (ie, in contrast to the joint letter from APRA and ASIC to superannuation fund trustees in relation to advice fees).¹

Regulatory overlap – design and distribution obligations

23. From 5 October 2021, superannuation trustees will also be subject to the new requirements under the design and distribution legislation (Part 7.8A of the Corporations Act) (**Design and Distribution Laws**). Those requirements include in respect of the design and distribution of retirement products to ensure appropriate identification and consideration of member cohorts in determining suitable target markets and appropriate delivery of products to those target markets.
24. The Law Council notes that MySuper products which have their own specific statutory feature requirements enshrined under SIS are carved out of the Design and Distribution Laws. Similarly, the Law Council suggests that any retirement products offered by a trustee in compliance with a properly formulated Strategy could be carved out of the Design and Distribution Laws. Alternatively, compliance with the Design and Distribution Laws in respect of retirement products could be deemed to suffice for any cohort analysis and application required under the new Covenant and Strategy.

Broader Comments

25. In addition to the above, the Law Council's National Elder Law and Succession Law Committee (**NELSC**) note that in the context of self-managed superannuation funds (**SMSFs**) the risk that adding extra compliance obligations may lead to disengagement whereby trustees delegate the task to financial advisers who will perform a perfunctory assessment. If SMSFs are to be included, as is proposed by the Position Paper, the Law Council suggests that there be an incentive – possibly financial - for the trustee to perform the task rather than delegate it.

¹ See <https://www.apra.gov.au/further-guidance-on-oversight-of-advice-fees-charged-to-members%E2%80%99-superannuation-accounts>.

26. Finally, as highlighted in the Position Paper, much of the savings accrued by members through the superannuation system 'remain unspent and become part of the person's bequest when they die'.² If the objective is to increase income taken by members after retirement (so that the member's interest in the superannuation fund is not simply accumulated to fund an inheritance), given that the real spending needs of the member declines over the course of their retirement,³ the NELSC suggests that broader reforms reverse the minimum percentage of the member's interest which must be taken by the member when the fund is in pension phase. Presently the percentage increases as the member ages, ie the payment increases as the needs decrease. Further, as this trend is not well known, members should be educated and informed about this situation.

² Position Paper, 3.

³ Consultation Paper, 11 citing Retirement Income Review (2020), 486-492.