Retirement phase of superannuation

Discussion paper

December 2023
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Consultation Process

Submitting to the consultation

Closing date for submissions: **09 February 2024**

Submissions should be provided online using the form on the consultation home page.

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Enquiries | Enquiries can be directed to the Director of the Retirement Income and Adequacy Unit

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The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.
Introduction

The trajectory of Australia’s superannuation system

Superannuation is one of the core pillars of Australia’s retirement income system, and into the future will play an increasing role in providing income to Australians. Superannuation is about both saving for retirement (accumulation) and delivering an income for a dignified retirement (decumulation). The Government’s proposed objective of superannuation sets this out as part of a broader, holistic approach to superannuation: to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.

Australia’s system for compulsory retirement saving – the superannuation guarantee (SG) – has been in place for over 30 years; a system that is unique and world-leading. As the Intergenerational Report recently highlighted, the superannuation system has put Australia on a strong footing by international standards to manage the cost of pensions from an ageing population.¹ The flexibility and individual choice of our superannuation system is also unique.

Much of the focus of trustees of superannuation funds, Governments and regulators to date has been on refining the accumulation phase. This concerted and sustained policy effort has seen the size of the system grow to $3.6 trillion in super assets – the fourth largest in the world.² The gradual increase in the SG to 12 per cent by 1 July 2025, coupled with robust prudential standards and performance testing supporting member outcomes, have all contributed to the size and quality of the superannuation system today.

These successes have set up Australia for better retirement outcomes but comparatively, there has been less consideration of the retirement phase of superannuation.

The retirement phase

For many Australians, retirement represents a big and complicated life change. It is inherently challenging to navigate the different parts of the retirement income system, combine multiple income sources, consider the needs of your partner and dependents, and manage the numerous risks and changes in circumstances.³ Retirees will face many of these complexities throughout retirement. Australians need better access to information, advice, and well-rounded retirement income products to help them navigate these challenges.

Retirees remain worried about running out of savings.⁴ In spite of this concern, 84 per cent of retirement savings are in account-based pensions which do not manage the risk of outliving one’s

² Australian Prudential Regulation Authority (APRA), Quarterly Superannuation Statistics September 2023; Organisation for Economic Cooperation and Development (OECD), OECD Pension markets in focus: Preliminary 2022 data, September 2023.
⁴ Australian Government, Retirement Income Review, p 438
To manage this concern, retirees seek to self-insure by withdrawing the minimum amount possible from their superannuation – around half of all retirees withdraw at the minimum drawdown rate, rather than considering alternative strategies or products to manage this risk. Since 1 July 2022, superannuation trustees have had an obligation under the retirement income covenant to formulate, review regularly and give effect to a retirement income strategy. The strategy must help members achieve and balance the following three objectives: maximise retirement income, manage risks to the sustainability and stability of that income, and maintain flexible access to capital. These are the characteristics that define a well-rounded retirement product.

The Australian Prudential Regulation Authority (APRA) and Australian Securities and Investments Commission (ASIC) recently completed a joint thematic review of trustees’ retirement income strategies. While the review found trustees are improving assistance provided to members in and approaching retirement, “Overall, there was a lack of progress and insufficient urgency from RSE licensees (APRA regulated funds) in embracing the retirement income covenant to improve members’ retirement outcomes.”

The thematic review found that most trustees had not conducted an in-depth analysis of their members’ income needs in retirement, and the majority lacked any metrics to assess the retirement outcomes provided to members.

Of the 15 trustees surveyed, seven were providing access to retirement products with longevity protection, while six were considering developing or offering a new longevity product. Some funds had already or were considering refining their existing products by introducing certain default features, such as default investment options to help members manage risks or default drawdown rates to help members confidently draw a higher income in retirement.

The take up of lifetime income products by members remains low, and the market remains underdeveloped. This is the case despite broader regulatory changes in 2017 to remove impediments to innovative product design, including extending the tax exemption on earnings in the retirement phase to these products. Since then, few new innovative products have come to market. Most funds only offer an account-based pension and a transition-to-retirement income stream product. Typical account-based pensions provide retirees with flexible access to capital, but without more guidance or active engagement from the retiree, they risk not effectively meeting the other two retirement income covenant objectives: maximising retirement income and managing risk.

These are not new problems. In 2014, the Financial System Inquiry (the Inquiry) raised concerns about the lack of choice in products available in retirement. The Inquiry found that the use of well-rounded standardised retirement income products that balance income, risk management and flexibility could increase retirees’ incomes.

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5 APRA Annual Superannuation Bulletin June 2022, table 8.
While the 2020 Retirement Income Review (the Review) found Australia’s retirement income system to be effective, sound and broadly sustainable, it confirmed the Government and funds should focus more on the retirement phase. The Review found that retirees are not maximising the benefit of their superannuation, with the pervasiveness of the ‘nest egg’ framing of superannuation balances making retirees reluctant to draw down on their superannuation savings. The Review also called out the lack of innovative products available, and highlighted behavioural studies that found retirees are more likely to take up longevity protection when they receive sufficient explanation and information.8

Now the need to focus on retirement outcomes is becoming more urgent. An ageing population will see more Australians retiring and looking to their superannuation to play a greater role in providing income. There are currently 1.6 million people aged 65 and over receiving income from a superannuation product, but over the next 10 years, an estimated 2.5 million Australians will move from the accumulation to the retirement phase. They will be retiring with higher balances, having benefited from the SG for a longer period of their careers. By the mid-2040s, most people retiring will have been receiving the SG at 9 per cent or greater for the duration of their working lives.10

As balances increase, superannuation will become the primary source of retirement income for many retirees, relying less on the Age Pension. Over the next 40 years, drawdowns from superannuation are estimated to increase from 2.4 per cent of GDP in 2022–23 to 5.6 per cent of GDP in 2062–63.9 Australians – now more than ever – need to have access to the right information, advice, strategies and products to help them make the most of retirement through superannuation, and understand how it integrates with the rest of the retirement income system.

Next steps

While industry is moving in the right direction, there is still a long way to go. Superannuation funds need to do more to understand their members’ retirement needs, set a vision for their members’ retirement outcomes, and provide well-rounded retirement products. There is a role for government and regulators in creating an environment that supports these changes.

The Government has committed to expanding the provision of retirement advice by superannuation funds through its Delivering Better Financial Outcomes package. This includes understanding and addressing the roadblocks in regulatory settings that currently prevent the provision of helpful retirement advice and information.

This paper builds on this work with a specific lens on the superannuation retirement phase, extending beyond the provision of financial advice to cover broader themes. This paper also takes a holistic approach to ensure a complete understanding of the issues at play and the connections between them to inform better solutions.

The Government is consulting to gather views on the roles of the superannuation industry, government, and the community in helping Australians make the most out of their superannuation in

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9 Treasury modelling.
10 Intergenerational Report 2023, p 165.
11 Intergenerational Report 2023, p 166.
retirement. This process invites feedback on how this can be achieved through better availability of assistance, information, and well-rounded retirement products.

As part of this consultation process, the Government is interested in feedback on the opportunities, barriers and challenges to improving the experience and outcomes of members in the retirement phase. The Government welcomes views on how these issues should be tackled and the merits and risks of different approaches.
Supporting members to navigate retirement income

The challenges for retirees in managing their superannuation

Members face complex decisions to plan their retirement income

Planning an income to see out one’s retirement is inherently complex. Better tools, information and guidance are needed to help retirees confidently make these decisions.

On reaching retirement, most Australians are accustomed to relying on a single source of income from employment. In retirement, income comes instead from superannuation savings, the Age Pension, and savings or investments outside of superannuation. For many, these income sources will change over time as their superannuation is drawn down and their Age Pension entitlement increases.

Planning in this complex environment is made harder when members don’t have access to the information and guidance they need or struggle to understand it. Around a quarter of people seek advice as they approach retirement age.\(^\text{12}\) The Review found that a lack of assistance, guidance or advice, low financial literacy, and inherent complexity makes it hard for people to make well-informed choices about their retirement income.\(^\text{13}\)

Planning for retirement income requires retirees to solve a “risky, long-horizon, multi-dimensional problem” – a problem that any individual retiree cannot be expected to solve on their own.\(^\text{14}\) Retirees are required to decide how they will best draw down their superannuation over the course of their retirement, while managing health and aged care costs, leisure and other living expenses, as well as being prepared for the unexpected.

To make matters even more complicated, retirement income products and annuities are often complex, making them difficult for members to understand and compare. This could in part explain the high prevalence of members defaulting to account-based pensions, even when those settings might not adequately meet their needs.

Self-managed superannuation fund (SMSF) trustees also face these complex risks and decisions. SMSFs constitute a significant component of the superannuation pool, making up 26 per cent of all superannuation assets at 1.1 million members as at June 2022.\(^\text{15}\)

While SMSF members are encouraged to consider their long-term retirement income requirements, they do not receive the same entitlement to support that members of APRA-regulated funds receive under the retirement income covenant. There is no safeguard that they will receive an equivalent level of guidance, risk management, or retirement income product solutions.

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\(^{13}\) Ibid., p 57.


In addition, SMSFs may face unique challenges in retirement, including a need for exit planning in the event of the member-trustee becoming unable to manage the fund at older ages or due to the death of a member of the fund who undertook management responsibilities.

**For retirees, superannuation is no longer a nest egg, it’s their income**

The Government’s proposed objective of superannuation makes it clear that the purpose of superannuation is to deliver Australians with income for a dignified retirement. Australians, however, often perceive and characterise their superannuation balance as a ‘nest egg’ or an investment, rather than as savings to be drawn down to deliver retirement income. Individuals spend decades accumulating superannuation savings and it can be difficult to shift to seeing it as income. The Review found some retirees held the view that they should only draw on the income earned on their superannuation assets, not the capital. While this mindset is often held when people are saving for retirement, it can lead to lower living standards in retirement.

There have been suggestions that expressing superannuation in terms of the retirement income it may provide over time could assist people to understand how they can draw down from their savings in retirement. Framing superannuation in terms of income can help put it into terms that are helpful for budgeting and decision making, the same way people are used to managing their finances from working life.

**Default behaviour, precautionary saving, and withdrawing at the minimum**

Retirees are tasked with the complex issue of working out how to spread their life savings in a way that delivers them enough income to cover both expected and unexpected living expenses over an uncertain timeframe. There is a longstanding trend that retirees holding an account-based pension product typically withdraw at or near the minimum amount they are allowed. This can arbitrarily reduce retirees’ income with a resulting impact on their living standards.

Minimum drawdown rates are generic settings which are not designed for, and do not lead to, an optimal retirement income for all retirees.

For many, withdrawing at the minimum leads to a sub-optimal income stream. Their income varies arbitrarily and increases throughout their retirement despite the tendency for retirees’ spending to fall as they age, notwithstanding costs such as increased health expenses. Better strategies could see them with a higher income that is smooth across their life or better reflects consumption patterns.

Without an appropriate product solution and faced with the uncertainty about one’s life expectancy, this approach is a reasonable strategy. Life expectancy at birth in Australia is 83, however this translates to a female retiree at age 65 having a 45 per cent chance of living to 90, and 33 per cent for a male retiree. In effect, the likelihood is even higher as improvements in health and medicine will

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further increase life expectancy during a person’s retirement. As a result of increased life expectancy, more retirees need to rely on retirement incomes that are sustainable into their late 80s and 90s.

Evidence suggests varied reasons for low drawdowns. Retirees often do not have access to the right tools to assess what drawdown amount is best for their circumstances. Retirees may default to the minimum amount as a rule of thumb when faced with choice overload, concerns about the cost of aged care and medical expenses, or concerns about the risk of running out of savings. Some retirees may have minimum drawdown rates effectively chosen for them by their fund and are unaware they can even vary the rate of their superannuation pension.

Some retirees perceive minimum drawdown rates as the Government’s recommendation for superannuation drawdowns. However, minimum drawdown rates are not a recommendation nor guidance tool. Their purpose is to ensure that retirement savings receiving an earnings tax exemption are used appropriately for retirement income purposes.21

Potential policy responses

Guidance, education, and communication

Increasing or changing the way funds and government communicate to members about their superannuation could enable members to make the mindset shift necessary to confidently draw down on their superannuation in retirement.

Separately, the Government has committed to expanding the provision of advice by superannuation funds through its Delivering Better Financial Outcomes package. This would include ‘nudges’ that allow funds to communicate basic information about retirement to members at certain ages or times during their working lives before they reach retirement, for example at ages 50 and 55, and checking in throughout retirement. It would also support the use of digital tools provided by superannuation funds such as calculators and retirement income projections.

Evidence suggests that presenting key information in a relatively simple manner helps with consumers’ understanding of retirement income and can influence consumer preferences for certain types of products.22 This paper considers additional actions that would build on this financial advice package to improve the member experience during, and in transition to retirement. This might include basic factual information, education, or information produced by government. Other potential policy options include:

- Requiring funds to provide general information about both phases of superannuation and the objective of superannuation when onboarding members, particularly those at the start of their working life.

21 Superannuation Legislation Amendment (Superannuation Drawdown) Regulations 2021, Explanatory statement.
• Government providing and distributing educational and guidance material on key retirement income sources (including savings, superannuation drawdowns, the Age Pension, home equity release, annuities, etc.) and factors that may impact on these sources.

• Prompting members to investigate government information services, such as Services Australia’s Financial Information Service and Aged Care Specialist Officers.

• Providing free and impartial guidance for retirees in or approaching retirement, for example, through a service similar to the United Kingdom’s PensionWise service.

• Including SMSFs in the retirement income covenant to assist their retirement planning.

Funds assisting and defaulting members to better settings

Under the retirement income covenant, trustees are required to undertake analysis of their members to assess member outcomes. This information could allow funds to nudge members towards settings that better suit their circumstances. These settings could include a range of features or products, such as ‘default’ drawdown rates, investment strategies and/or longevity products.

The minimum drawdown framework could be redeveloped to shift retirees into drawdown patterns that better suit their circumstances. This could include revising minimum rates to achieve a smoother drawdown profile over retirement which better reflects retirees’ expenditure needs, or providing clarification that they are not intended to be guidance on optimal drawdown rates. As minimum drawdown rates are often interpreted as a recommendation or default, a set of alternative recommended drawdown rates could also be provided as a guide.

Some funds are considering ways to nudge members towards more suitable drawdown profiles. For example, the APRA and ASIC joint thematic review found that one licensee was considering development of different ‘default solutions’ for different sub-classes of members, where cohorts were based on estimated financial need and superannuation balance.23 Some actions funds may consider taking include:

• Developing alternative drawdown profiles to present to members, aimed at achieving different objectives.

• Developing ‘default solutions’ to offer to different sub-classes of members based on factors such as superannuation balance or expected needs.

• Developing alternative investment allocations for members in retirement.

Simplifying the retirement income system

There may be opportunities to reduce the complexity of the retirement income system to make it easier for retirees to navigate and understand the interactions between its different parts.

Retirees could be better supported by information that considers all three pillars of the retirement income system – the Age Pension, superannuation, and savings and investments outside of

23 REP 766 Implementation of the retirement income covenant: Findings from the APRA and ASIC thematic Review, 2023, p 18.
superannuation. Specifically, information on how these streams of income might interact and change across the period of their retirement. Trustees could do more in this space, with government providing the appropriate policy settings to enable this kind of information being provided.

An example of a light touch approach that superannuation funds could take is when prompting members to consider superannuation retirement matters, members could also be prompted to investigate whether they may be eligible for the Age Pension or other supports that may be available. Superannuation funds could also prompt members to consider accessing government information services and tools to help them make informed decisions, such as Services Australia’s Financial Information Service and Aged Care Specialist Officers.

In addition to the provision of more holistic information, reducing friction points in the system could also better support retirees to deal with complexity. Some funds have suggested that a retiree’s touch point with their superannuation fund could be used to assist them to apply for the Age Pension. More active approaches may include funds providing prompts to members to apply for the Age Pension, or provide simply formatted information about their superannuation interests which they can use in applying for the Age Pension. This could improve retirees’ experiences at these early touch points.

Some funds have advocated for improved data sharing between government and superannuation funds, such as information related to the Age Pension. There are also other avenues for funds to obtain better data, such as requesting the right type of data from their members at appropriate times and becoming a recipient of the member data enabled by the Consumer Data Right. This could cover data relating to private savings.

This might assist funds in better supporting their members to understand their overall retirement income position and a retirement strategy that best suits their needs.
Consultation questions

- Please provide comments on the issues facing members identified in this section.
- What actions are industry or other participants in the community taking to address the issues identified in this section?
- Of the approaches identified, what should be prioritised and what risks should be considered as policy is developed? What other approaches, if any, should the Government consider?

Further questions:

- What does ‘good’ look like for how funds support and deliver products to their members in retirement?
- What basic information do members most need to assist their understanding and simplify decision-making about retirement income?
- Where can government and industry reduce complexity in the retirement income system, and provide simpler consumer experiences?
- How might funds utilise guidance, nudges, defaults and other actions to assist members into better solutions for their retirement income? What are the barriers to funds being more active in these ways?
- Data is a critical input for funds to provide better retirement income strategies. What processes are funds undertaking to collect, analyse, and apply data analysis to understand their membership? What barriers are there to better practices, and what policy approaches could help achieve better data use?
- The retirement income covenant does not apply to SMSF trustees. What approaches do SMSF trustees take to manage risk, ensure they have access to savings, and maximise their income? Are there barriers to improving how SMSF trustees achieve these objectives, and what role can government or industry play to improve these outcomes?

24 Further questions are designed as a prompt for further points of consideration for submissions. It is not necessary to provide a response to all questions.
Supporting funds to deliver better retirement income strategies

Trustees moving from investment manager to retirement service provider

Reviews and reforms of superannuation in retirement

There is longstanding evidence that products and services in the retirement phase could be more accessible and better suited to retirees’ needs.

In 2014, the Inquiry raised concerns about the lack of choice and well-rounded products available in retirement. This established a need for funds to better support members in retirement. Six years later, the Review similarly found that there has been insufficient attention on assisting members to optimise their retirement income through the efficient use of their savings. The Review stated that better use of retirement savings could provide a way to significantly boost retirement incomes without the need for members to make greater contributions.

The Government also has a role to play to create an enabling environment for funds to deliver on members’ retirement needs. However, reforms to support retirement phase outcomes have historically been modest (see Box 1) and there have only been two retirement phase reforms implemented since the Inquiry.

Comparatively, over the same period, there have been a number of reforms to support the accumulation of superannuation benefits. Many of these reforms are setting the right sort of enabling environment in accumulation so that funds are delivering the best possible member outcomes, and members are able to make informed decisions about their superannuation. Notably, the introduction of standardised default MySuper products and then the Your Future, Your Super reforms in 2021.

The most important reform to the retirement phase was the recent retirement income covenant. It legislated trustees’ obligation to assist members, taking effect from 1 July 2022. The retirement income covenant is principles-based, not prescribing an approach for funds to take but obligating trustees to develop, publish, implement and regularly review a retirement income strategy to assist their members in balancing three key goals in retirement. These objectives are:

- maximise their retirement income,
- manage risks to the sustainability and stability of their retirement, and
- have some flexible access to savings during retirement.

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27 Ibid. p 19.
Box 1: Recent policy processes relating to the retirement phase

- There have been some policy processes canvassing improvements to the retirement phase, with relatively few reform outcomes.

- The 2014 Financial System Inquiry highlighted the lack of choice and well-rounded products in the retirement product market and emphasised opportunities to improve retiree standards of living. 28 It found retirees had a lower standard of living to avoid outliving savings. There was broad recognition of the opportunity for better use of superannuation to insure against the risk of outliving savings, and there was support for proposals that better managed members’ longevity risk, including the final recommendation for a default product with longevity protection.
  - The proposed default was termed a ‘Comprehensive Income Product in Retirement’ or CIPR. The features were to be determined by Government in consultation with funds and the community. The Inquiry envisaged that a combination of underlying products would likely be required to provide regular income, flexibility, and manage longevity risk – for example an account-based pension paired with a pooled product that provides longevity risk protection.

- In late 2016, a discussion paper on CIPRs was first released to examine the possibility of requiring trustees to offer retirement products to members. 29
  - In 2016, Treasury consultation found widespread agreement on the policy intent of CIPRs as outlined in the Inquiry, but disagreement on how to achieve them.
  - In 2017, exposure draft consultation on innovative income stream regulations occurred. These regulations came into effect from 1 July 2017 and provided for a range of lifetime products that did not meet the annuity and pensions standards. Examples of products included deferred lifetime income products and investment-linked pensions. Only a small number of these products have been developed since.

- The 2018-19 Budget announced the More Choices for a Longer Life Package, which would require trustees to formulate a retirement income strategy for members (the retirement income covenant) and offer a CIPR to their members, alongside requirements to provide assistance in meeting retirement objectives and simplified, standardised metrics for retirement income product disclosure. The CIPR and covenant requirements had a start date of 1 July 2020. Consultation was also undertaken on standardised disclosure for retirement income products in 2018-19. 30

The introduction of the retirement income covenant laid the groundwork for better retirement outcomes, and allowed funds the flexibility to determine how to best meet their members’ needs under this obligation.

Prior to the introduction of the retirement income covenant, the only substantive law change to support the better use of superannuation in retirement was the innovative income stream regulations. These regulations came into effect from 1 July 2017 and provided for the development of a new kind of retirement income product.

Findings of the ASIC and APRA thematic review

In the period following the introduction of the retirement income covenant, ASIC and APRA undertook a joint thematic review on a subset of superannuation fund trustees to look at how funds have implemented the covenant to date, released on 18 July 2023. The review found that while there were pockets of better practice, “Overall, there was a lack of progress and insufficient urgency from RSE licensees in embracing the retirement income covenant to improve members’ retirement outcomes.”

Most funds were focussing the majority of their efforts on expanding existing assistance and supports available to members in or approaching retirement, however their evaluation processes – measuring success towards these goals – were underdeveloped. While some funds had proposed new initiatives for assisting members, there was a notable lack of concrete implementation plans. This was a similar theme in funds implementing the initiatives of their retirement income strategy.

APRA and ASIC subsequently set out an expectation that all RSE licensees should urgently consider the findings and examples of better practice in this report and address the gaps in their approach. They highlighted the following priorities:

- Address fundamental data and analytical gaps to enhance their understanding of members to support effective strategy formulation and deliver useful assistance to members.
- Tailor assistance to cater to diverse member preferences and needs, and regularly test and track their effectiveness to improve assistance offerings.
- Integrate the retirement income strategy with the broader business planning cycle and measure the success of their strategy using appropriate metrics.

An enabling environment can help funds achieve their retirement income covenant obligations

While funds are working to meet their covenant obligations and looking to evolve their practices, it is clear there is work to be done for funds to assist members in making the most of their superannuation in retirement. The retirement income covenant was an important first step, but there are opportunities for the Government to further support an enabling environment for funds to achieve their goals under the retirement income covenant.

Assistance through advice and guidance is one way that funds support members, and this will remain an evolving means of improving member outcomes in retirement. The Government is already acting to expand access to retirement income advice for members through their superannuation fund, as part of the Delivering Better Financial Outcomes package.

However, advice has its limits if retirement income products are not available to meet members’ needs. Funds need to provide well-rounded products that are appropriate for the complex risks and decisions members face, and that balance all three of the retirement income covenant objectives. The approach funds take will also need to recognise that some members will not be proactive or seek advice, and their retirement income interests must also be upheld.

The market for retirement income products will work best when it is competitive, comparable, and transparent. These were the lessons learnt from recent reforms to the accumulation phase, and there is an opportunity to apply these lessons to the retirement phase. Members are best served if they can readily compare products and switch providers to one that meet their needs. There may also be opportunities to ensure these products perform well, through comparison and testing of the outcomes they seek to deliver. These can all support a competitive market, which can help keep products priced well and improve quality.

Potential policy responses

Standardised product disclosure framework

Standardised retirement product disclosure is a way funds can help consumers have access to information on the product they purchase, compare it to others, know how well it is performing, and ensure that it meets their needs. This approach can complement the retirement income covenant, so that members can compare how funds may assist them in meeting the three covenant objectives.

A standardised product disclosure framework for retirement products could require funds to publish simple consumer-focused disclosure documentation that provides important product information.

There are three dimensions for information that could be disclosed:

- **Characteristics of retirement products**: e.g. expected income, how risks are managed, investment strategy, fees, access to underlying capital, whether it can be switched to another product and when, and death benefits or support for dependants. There may be other services or assistance that the fund provides specific to that product.

- **Performance characteristics**: e.g. fees, investment performance, and risk pricing and measures.
A regular assessment of how funds fulfill their covenant obligations: as funds evolve their practices in implementing the covenant, assessments of their effectiveness can allow consumers to be better informed of the quality of the products and services funds offer in retirement and the outcomes for their members. Funds are already required to regularly review their strategies under the covenant, and the way they conduct these reviews may evolve over time alongside implementation of their strategies. However, any requirement for assessment of covenant obligations should not be overly prescriptive as it is up to funds to determine how they will implement the covenant for their members.

Simple first steps for product disclosure may apply only to account-based pension products or set out what advice services are provided and their cost. A framework could also be an extension of existing product disclosure requirements to ensure consistency across the accumulation and retirement phase.

However, it is clear that new approaches would be required that are specific to retirement, and there are some further challenges compared to disclosure in the accumulation phase. For example, what the characteristics of a ‘good’ product are, and how relevant metrics can be formulated and presented in a consumer-friendly manner. Appropriate performance metrics will differ from accumulation phase performance assessment. The complexity and individuality of retirement income approaches may make comparisons and assessments difficult, including in relation to retirement income strategies where there are a range of good approaches funds could be taking.

Accessible and consistent disclosure arrangements can help members to identify better retirement income products to meet their needs. Where a member has already commenced with one fund’s product, they may face difficulty switching to another fund, depending on the type of product. Good disclosure before choosing a product could assist members to manage future barriers to switching products.

There are other opportunities to support fund disclosure practices. For example:

- Development of a standard risk measure that could assess the relative risk of retirement income products to a fall in income from year to year.\(^\text{32}\)
- Establishing scorecard approaches that demonstrate how products balance the three retirement income covenant objectives or other metrics.\(^\text{33}\)
- Similarly, retirement income strategies might be compared via the combination of a broad qualitative checklist to assess fund activities undertaken to deliver on good member outcomes, as well as quantitative modelling where potential member outcomes are simulated and assessed against the covenant objectives.\(^\text{34}\) These comparisons would recognise that there is not one correct approach for funds to take in implementing the covenant, however as discussed by APRA


\(^{34}\) For example, Bell and Warren, ‘Assessing retirement income strategies... when outcomes are but a promise’, *Thought pieces with the Conexus Institute*, 2022.
and ASIC’s thematic review, members could be well served by evaluation of how funds are meeting the covenant.

The themes of standardised disclosure for retirement phase products have previously been proposed in the Financial System Inquiry in 2014, proposed as a Comprehensive Income Products in Retirement (or ‘MyRetirement Products’). Subsequent consultations found there was broad agreement on the objectives and importance of a standardised disclosure framework, but there were divergent views on how this would be best achieved. At that time, it was identified that removing the barriers to developing lifetime products and establishing a retirement income covenant would be appropriate first steps.

**Tools for comparison and performance**

Government regulators can provide tools that make product disclosure, comparison and performance assessment more accessible. Such tools can empower retirees to make well informed decisions that reflect their own preferences and needs. They can also protect consumers from poor performing products. Two particular examples of tools that exist in the accumulation phase are:

- The YourSuper comparison tool — this tool displays simple information about MySuper products from a single source and has the functionality to rank products by fees or net returns. It provides members with a trusted source of digestible information to assist them in choosing who manages their retirement savings.
- The performance test — the current performance test in the accumulation phase was designed to reduce underperformance by assessing products against standardised benchmarks. This test has applied to MySuper products from 2021 and has recently been expanded to a sub-set of choice accumulation products known as ‘trustee-directed products’.

Developing similar tools in the retirement phase would rely on better disclosure practices, outlined in the previous section. This would necessarily include establishing metrics for comparison.

Applying performance testing to retirement products would also require careful assessment of the unique challenges present in the retirement phase, including consideration around liquidity and longevity risks. A performance test for retirement products should not constrain innovation in product design.

**Regulatory barriers**

Reforms could be made to the existing regulation of retirement income products to ensure regulatory settings are fit-for-purpose, do not impede innovation, and maintain equitable social security and taxation treatment.

The regulatory framework should allow products to have features that would make them more attractive to consumers, without undermining the integrity of regulation requirements. At the same time it is important that regulations covering retirement income products do not create unintended consequences. For example, industry has previously raised issues and requested changes to the

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Innovative income streams regulations that might make them more workable and attractive to retirees such as portability of product in the case of a fund merger; the ability to bundle products; and the ability to purchase products in instalments.

### Consultation questions

- Please provide comments on the need to support competition and product comparison across the services and products funds provide in retirement, or the need for greater consumer protection.

- What role should industry or other groups in the community play to support consumer protections and competitive products and services in retirement? What actions are being undertaken already?

- Of the approaches identified, what should be prioritised and what risks should be considered as policy is developed? What other approaches, if any, should Government consider?

### Further questions:

- What are the key characteristics or metrics for comparing retirement income products and services?

- What approaches could make product disclosure useful for members? How might barriers such as complexity, or individuality of products, be overcome?

- What barriers are there for product switching in retirement and are there opportunities to make product switching easier?
Making lifetime income products more accessible

**Retirement income strategies need to manage different risks**

The retirement income covenant requires funds to assist their members to manage risks to the stability and sustainability of their retirement income. Risks to their retirement income are a foremost consideration for many retirees planning their retirement income strategies. National Seniors’ survey disclosed that over half of older Australians worry about their savings lasting through their retirement.³⁶

Risks to retirement income include:

- **Investment and sequencing risk** – investment or market risk is the uncertainty and risk of a loss in your retirement savings investments. Sequencing risk is how investment losses can be magnified if they are poorly timed with your retirement plans. Managing these risks is key for a person to get the income from superannuation they planned and worked for. It’s also important for managing volatility, as retirees naturally value some stability in their income from year to year.

- **Inflation risk** – an Australian can expect to be retired for 25+ years and the impact of inflation over that period of time will affect their retirement income needs. Directly insuring for inflation over the long-term can be difficult or expensive, however it may also be managed within an investment mix. A strategy for inflation may also consider the expected trajectory of a retiree’s spending as they age.

- **Longevity risk** – is the risk of outliving one’s savings. The concern about running out of superannuation during retirement is unsurprisingly a key consideration for retirees in their retirement planning. However, ‘self-insuring’ against this risk can be very inefficient, reducing retirement income and leaving large amounts of superannuation unused at the end of life.

Mitigation of these risks can broadly include investment allocation (for example, lifecycle investment or glide paths and bucketing - which can be achieved through an account-based pension), spreading the risk across members (pooling) or some form of insurance (annuitisation – a lifetime income product). These strategies all require active work from trustees to provide risk-management options. Management of longevity and investment risk does not preclude members exercising choice in their retirement or being able to direct their investment strategy for their retirement assets.

A well-rounded product (or portfolio of products) should assist members in managing these risks and will complement achieving the other objectives of the covenant – access to capital and maximising retirement income. Products that clearly meet these requirements, including lifetime income products, can empower Australians to navigate complex retirement decisions and give confidence that they are making the most of their superannuation.

Individual circumstances are different, and there is no one size fits all approach. The products, or mix of products, that are appropriate will vary.

Longevity and mortality risk

Longevity risk is the risk that a person’s lifespan is longer than they assumed or planned for. Mortality risk is the risk borne by the provider of a lifetime income product; that the mortality experience of holders of the product will result in a financial loss or there will be insufficient capital to fund the promised future income. There are different components to mortality risk, that can make it challenging for the market to offer cost-effective longevity products to retirees.

- Life expectancy improvement — historically the life expectancy of Australians has consistently beaten expectations. This improvement in the health of Australians must be projected and priced into a longevity product.
- Small member pool — if a product does not have a sufficient scale there can be a risk from undiversified mortality experience of holders of the product.
- Adverse selection — the annuity market in Australia is relatively small which can lead to products only being taken up by those who expect to have a high life expectancy. The providers will reflect this in the pricing of the product (or bear a cost from the lighter mortality). As annuities are sold to all retirees at one average price, products will appear to be overpriced for anyone with a lower life expectancy.

There are numerous design options for lifetime income products that manage personal longevity risk but broadly they can be grouped in two categories:

- Annuityisation — where an individual purchases longevity insurance through a lifetime income product. The life insurer holds the mortality risk of the income stream, which will be reflected in purchase price of the product.
- Pooling — where funds of members are held collectively to manage the longevity risk of the cohort. In this case members have insured their personal longevity risk, but there can be mortality risk in the pool. Pooling can reduce the cost of providing longevity protection but does not provide the level of guarantee of an insured product.

Lifetime income products insure against this risk

One of the highest priorities for older Australians, consistently identified in National Seniors’ surveys, is having a source of income that will last for life. William Sharpe, who won the Nobel Prize for his work in investment decision making, has said: “the nastiest, hardest problem in finance is longevity... running out of money in retirement.” Many retirees take active engagement in their superannuation investments and manage their level of investment risk; however, longevity risk cannot be efficiently self-managed without access to appropriate financial products.

In Australia, only 3.5 per cent of assets held in pension accounts are in annuities, while 84 per cent were held in account-based or allocated pensions. Retirees can be reluctant to purchase annuities: a reticence that is not unique to Australia. The lack of annuitisation by retirees globally, despite the commonness of the concern about outliving one’s savings, is known as the ‘annuity puzzle’. Over the

38 APRA Annual Superannuation Bulletin June 2022, table 8.
last five years, the number of annuities held by Australian members has declined in both absolute terms and as a proportion of total member pension accounts.39

There are a number of factors that may contribute to the small market for lifetime income products in Australia.

**Barriers to product availability by funds or life insurers:**

- Development cost – Funds have raised the cost of investing in product development and the need to justify these costs under the Best Financial Interests Duty, especially if there is likelihood that members may not take it up.

- Incentives and competition — Superannuation funds have largely focused on growth and contributions over the past 30 years of the SG. Many funds did not offer any retirement product options until recent years. Although the objective of superannuation is retirement, funds may not be incentivised to help their members draw down savings from the fund. There has also been an assumption that a member will remain with the same fund as they transition to retirement, reducing the need to compete on retirement product offerings.

- Legacy products — Legacy products are ongoing retirement products that are no longer offered to new members. Lifetime income products require a long-term commitment, however if the environment changes and it becomes a legacy product it can be expensive and inefficient to manage.

**Barriers to take-up by members:**

- Upfront cost and ‘wasting’ capital – Lifetime income products are generally sold as a one-off capital purchase in return for a lifetime income stream. The upfront price can represent a ‘sticker shock’ to retirees. There can also be a concern that if they die prematurely, they have then ‘wasted’ those savings. This is despite the availability of reversionary annuities where the benefit goes to a person’s nominated beneficiary.

- Challenges to comparison — An annuity includes a cost from the longevity insurance provided. The relative value of this insurance is complex to evaluate. Retirees also tend to underestimate how long they will live making the cost look unattractive, especially if they compare to an investment without the protection e.g., a typical account-based pension.

- Lack of flexibility — Longevity products by their nature require a long-term fixed investment which may dissuade members concerned about being locked in. Retirees may be concerned about their ability to fund large, unexpected costs they may face. However, most retirees would not annuitise their entire retirement savings. Some may not understand their options on how much to annuitise.

- Counterparty risk — Concern whether the fund (or insurer) will be able pay the income for the length of their retirement, which may be expected to be 30+ years.

These barriers, for both funds and members, raise the question of whether funds will be able to act rapidly enough to provide the necessary services and products for members in retirement, in light of Australia’s ageing population.

There is a variety of research about when and what form of longevity protection is most efficient based on retiree circumstances. Nonetheless, it is evident that fear of running out of savings hampers retirees from getting the full benefit from their superannuation. Over time Australians in defined benefit schemes have increasingly chosen to take a lifetime income stream over a lump sum indicating that, when they have confidence in the product, Australians appreciate the security of longevity protection.\(^4\)

**Potential policy responses**

**Support for better longevity pricing**

A potential barrier in the provision of lifetime income products is the price of insuring longevity risk. The Commonwealth Government has an existing role in insuring the longevity risk of older Australians through programs like the Age Pension and Pharmaceutical Benefits Scheme. As it has in other insurance markets, if it was considered there was significant market failure (e.g. Australian Reinsurance Pool Corporation), the Government could potentially support the reinsurance of longevity risk to ensure the insurance is available to Australians at a reasonable price.

Options for the Government to support in this space could involve:

- Facilitating funds in risk pooling within retirement products. For example, smaller funds could be allowed to pool mortality risk with each other, which is currently not possible as any movement of mortality credits are constrained by contribution rules.

- The Government directly intervening in the pricing of longevity risk through reinsurance or the selling of longevity bonds that allows providers to manage their financial risk in offering these products.

Advantages of the Government’s support in the management of longevity risk could include: diversifying mortality risk across the market; providing assurance for retirees and reducing counterparty risk; and applying ‘fair’ risk pricing across retirees meeting community standards (for example, setting uniform rates by gender whilst differentiating based on other metrics, such as socio-economic or First Nations status) meaning those with lower life expectancy would not be disadvantaged.

**Standardised products**

A framework could be developed which outlines attributes and features of a standardised retirement product to balance the objectives of the retirement income covenant. This framework for a standardised, recommended product could provide retirees with the confidence that a solution will balance key retirement objectives and risks. A standardised product would, in turn, promote competition and anchor expectations of how retirees use their superannuation for income.

Funds could be required to develop at least one product which meets the framework attributes and provide as a ‘first offer’ to members. This could help to improve outcomes for less engaged members, while retaining member choice.

Features of standardised product might include:

1. A longevity protection component, for example a deferred guaranteed income stream that commences later in life.
2. A forward-planned income stream that accounts for the member’s preferences (e.g. a stable real income over retirement; a higher income at earlier ages).
3. An investment allocation that adjusts the investment risk for the member’s stage in retirement.

Desired features of retirement income products

A standardised product could assist in building the necessary scale for offering lifetime income products. This could be combined with a mandate for funds to offer longevity protection or other incentives for members. A standardised design would also reduce hurdles for development.

However, a standardised product wouldn’t be suitable for all retirees. It would need to be designed in a way that ensures those it would benefit have access to it, and guardrails are set to prevent take up for those who would be disadvantaged by taking it up.

The appendix provides an example of how these three components may be integrated into a standardised product.
Consultation questions

- Please provide any comment on the barriers in the supply and demand for lifetime income products.
- What actions are industry or other participants in the community taking to assist retirees to better manage the risks for retirement income?
- What policy approaches should be taken to support use of lifetime income products to address the risks to retirement income? What risks should be considered?

Further questions:

- What product options (or strategies within current retirement products) could better manage risks to retirement income?
- What is the role for a ‘suggested’ product in overcoming low take-up of lifetime income products?
- What action are funds taking to better manage longevity risk, and what role do funds see guaranteed income products (e.g. annuities, pooled products) playing in the future?
- Do the barriers to managing longevity risk in the Australian market necessitate Government action? What Government action could assist funds in offering appropriate longevity protection to members?
- Would an industry-standardised product(s) assist funds to develop and offer lifetime income products to their members?
  - What features should a standardised product include?
  - Should there be a path to more easily transition members to a standardised product?
  - Should superannuation funds be required to offer a standardised retirement product, similar to MySuper for accumulation?
  - How should a product vary for individual circumstances of the member?
- Would a standardised product be cheaper to develop and offer (e.g. compared to a general mandate to offer a longevity product)?
Appendix: Example product
A product that will work with your account-based pension and Age Pension to give you more financial freedom and security to achieve a dignified retirement. You’ll get income for life no matter how long you live, and flexibility to access your capital for the bigger expenses. This will be a product that you purchase for guaranteed ongoing income commencing from an age you choose. The Government bears the risk the longer you live.

Account-based pension income stream

You will be able to remain with the fund you have had throughout your working life, and have control over your preferred investment strategy.

The default recommended drawdown from the ABP would provide income until you reach your chosen annuity age. At that time the account would be drawn down to the ‘capital reserve’ and your deferred income stream begins.

Capital reserve

The account-based pension would have an indexed capital reserve which is exempt from minimum drawdown rates. This provides you with a reserve to use for any large unanticipated expenses during retirement without affecting your expected annual income. You can still take a lump sum from your account-based pension but this will reduce the income from this component in future years. If a member dies before reaching their annuity age, any remaining amounts in their account-based pension or capital reserve will be paid out as a death benefit.

Deferred income stream

A deferred income stream protects you against the risk of outliving your savings. The guarantee is for income provided as long as you live. You can choose the age it commences, with a default age of 90 (the latest it can commence). It can also include a benefit for any surviving dependants or partners.

The value of the income stream payment will vary based on investment performance. You can choose the amount of deferred income, based on your circumstances and cost. The more that’s held in the product, the more you can make the most of its features, like the capital reserve.

You can choose your investment preference for your deferred income stream, so that you can take on greater risk for returns if you prefer. The default investment is ‘balanced’, that accounts for age and investment horizon. The Government will provide a guarantee for the life expectancy risk of the investment pool.

You can purchase up front on retirement, or in annual premiums (from the balance of your superannuation) until commencement. If you cannot complete the payment, the value of the income stream at commencement will be lower.

Key specifications:

Minimum balance: [$100,000]
Requirement to offer: Funds must offer to members with balance above [$150,000]
Commencement age for deferred income stream: Default for 90 (any age between 65 and 90 can be chosen but will impact cost)
Payment options: Annual payment or lumpsum upfront, with cooling off period
Minimum capital reserve: $50,000

Government guarantee of mortality pricing:

The Commonwealth will set pricing of longevity risk and the fund will maintain investment of the assets supporting the longevity protection.

Government can provide more equitable prices so that certain cohorts do not cross-subsidise the longer life expectancies of other groups in the population (for example, lower socio-economic cohorts).

The Government will support a national mortality credit pool from all funds’ complying products – allowing diversification across the population. The Government also guarantees the longevity risk of the products, so if life expectancy is longer than expected (a shortfall of mortality credits) the Government will cover the shortfall.

The longevity protection component will have no ability to commute (after an initial cooling-off period), reducing the cost of the product.
Glossary of terms

**Account-based pension (account-based income stream or allocated pension):** An account-based pension is a flexible retirement income stream product. Retirees who are in an account-based pension are required to draw a minimum pension payment amount each year or elect to draw an amount of pension payment above the required minimum amount. They can withdraw some or all of the account balance and the income is tax free from age 60.

**Annuity (lifetime income product or a fixed-term pension):** An annuity provides the member with a guaranteed regular income for a number of years (fixed-term annuity) or for the rest of their life (lifetime annuity). Common features of annuities include guaranteed regular payments regardless of how the share market performs, indexation of payments in line with inflation, reduced flexibility to move capital held in the annuity or to opt out and/or a guaranteed death benefit to dependants. Annuity providers bear both longevity and investment risks while the member can be sure of their future income.

**Comprehensive Income Product in Retirement (CIPR):** A default product proposed by the Financial System Inquiry in 2014 which funds would provide to members in retirement to provide regular income, flexibility, and manage longevity risk. It was envisaged that a combination of underlying products would likely be required to achieve these outcomes – for example an account-based pension paired with a pooled product that provides longevity risk protection.

**Longevity risk:** Refers to the risk that retirees face of outliving their savings.

**Minimum drawdown rate:** The minimum legislated amount that must be withdrawn from a superannuation account when it is in the retirement phase. The minimum drawdown rate is generally determined by the member’s age.

**Mortality risk:** The risk borne by the providers of annuity products. It is the risk that the annuity provider may suffer financially if, collectively, members of their annuity product die before their expected lifespan and before the members’ premiums have been paid on the annuity policy.

**Objective of superannuation:** The proposed objective of superannuation is: ‘to preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.’

**Retirement income covenant (the covenant):** The retirement income covenant was introduced to the Superannuation Industry (Supervision) Act 1993 and commenced effect on 1 July 2022. APRA regulated super funds are required to formulate a retirement income strategy to enhance retirement outcomes for members; demonstrate compliance with the new obligations; and further build on their understanding of their members who are approaching, or are in, the retirement phase. Funds were required to publish a summary of the strategy on their website by 1 July 2022. In July 2023 APRA and ASIC published a joint thematic review and disclosed that there has been a lack of urgency from super funds in embracing the covenant and have urged funds to immediately address any gaps in their current approaches.

**Retirement phase:** Generally, ‘retirement phase’ refers to the period between the start of retirement or when an individual begins to draw down on their super as an income stream (or lump sum), and the end of their life.
Self-managed superannuation fund (SMSF): The difference between an SMSF and other types of superannuation funds is that the members of an SMSF are usually also the trustees. This means the members of the SMSF run it for their benefit and are responsible for complying with the superannuation and taxation laws. The Australian Taxation Office and ASIC are joint regulators of SMSFs.

Superannuation Guarantee (SG): The minimum amount of money an employer must contribute to a superannuation fund on behalf of an eligible employee. SG is calculated as a percentage of the ordinary time earnings of the employee and is payable on top of the earnings of the employee. Currently, the SG rate is 11 per cent. It is scheduled to gradually increase by 0.5 percentage points in July each year until it reaches 12 per cent by 1 July 2025.