Actuaries Institute.

9 February 2024

Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: retirement@treasury.gov.au

Dear Sir/Madam,

Consultation: Retirement phase of superannuation – Discussion paper

The Actuaries Institute (Institute) welcomes the opportunity to provide feedback on Treasury's Discussion paper on the opportunities, barriers and challenges to improving the experience and outcomes of members in the retirement phase.

The Institute is the peak professional body for actuaries in Australia. Our members have had significant involvement in the development and management of superannuation in Australia, and work across APRA regulated funds, self-managed superannuation funds (SMSFs) and public sector funds.

The Institute strongly supports Government's intention to shift policy focus to the retirement phase of superannuation. The Discussion paper articulates well many of the wide-ranging and connected retirement income issues faced by members and potential measures to respond to these challenges.

The following areas merit particular attention and priority.

- Superannuation drawdown policy would benefit from an even broader framing of the complex challenges that people must navigate as they approach and journey through retirement. Beyond superannuation, people must consider eligibility for the means-tested Age Pension, health card concessions and aged care entitlements. Increasingly, they should be encouraged to consider drawing from other additional retirement income sources, such as salaries and wages from part-time and casual work (for those who can and wish to do so) or accessing income from equity in the family home.
- Superannuation's current nest egg mindset is deeply entrenched. Considerable and continued effort from all stakeholders is needed for superannuation to instead be seen as the primary means to generate income in retirement.
- Evidence suggests the current small market for various lifetime income products is a demand not a supply issue. The primary barrier to more product development is the risk of inadequate take-up, and improving take-up is contingent on successfully reframing the superannuation nest egg mindset and enabling members to access free or low-cost help, guidance and advice on retirement matters.

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- Given the risk of maintaining the status quo, there is a role to introduce both “nudges” and defaults in the design of effective pathways for people to access well-rounded retirement income solutions that can cater for retirement as a personal event and the heterogeneity in member needs in retirement. Rather than a requirement for a single type of standardised product, an effective product option to manage risks to retirement income would be to require an opt-out product feature that moves a portion of a member’s superannuation balance at an agreed age (e.g., 70) above a certain asset level to an income stream retirement product(s). Some degree of standardisation could help to reduce the level of complexity that non-advised retirees have to consider. An income stream requirement is a common feature of top-ranked systems globally, and its introduction would serve to emphasise that Australia’s system is focused on income, not nest eggs.
- Both Government and industry have a responsibility to raise financial literacy, and to provide retirement phase guidance, education and communication to individuals. We support the Government taking a proactive approach to encourage financial planning, from early years to and through retirement. This could be done together with initiatives to improve the consistency and comparability of disclosures, such as standardising definitions of key features of retirement income products.
- The current complexity of the system makes it difficult to understand for many people and restricts the freedom of trustees and life insurers to improve their offerings. We would support the Government taking bolder steps to reduce complexity in the retirement system, especially for those that are less able or willing to access their own professional advice.

We set out in the Attachment to this submission our specific responses to the questions raised in the Discussion paper.

The Institute would be pleased to discuss this submission. If you would like to do, please contact me on (02) 9239 6100 or executive@actuaries.asn.au.

Yours sincerely

(Signed) Elayne Grace

CEO

Attachment: Detailed responses to Discussion paper questions

Supporting members to navigate the retirement income system

Comment on the issues facing members identified in this section

The Discussion paper articulates well many of the challenges for retirees in managing their superannuation. It focuses on the complex planning decisions required, treating superannuation as an income stream, and default behaviour. We make the following comments on the challenges raised:

- Members face complex decisions to plan their retirement income

  The paper raises many relevant issues that retirees face. As stated, retirees must solve a “risky, long-horizon, multi-dimensional problem”. There are many unknowns in the retirement phase, even for those who are well-informed. Not least of these are determining retirement income needs (which are not linear in retirement and depend on lifestyle, health and family support) and incorporating longevity risk in a rational manner. Beyond superannuation, assessing eligibility for the means-tested Age Pension, health card concessions and aged care entitlements adds to the complexity faced by individuals.

  The paper does not consider some of the other additional retirement income sources retirees can draw on. These could include salaries and wages from part-time and casual work or accessing income from equity in the family home. We believe these should also be considered as part of the complex decision making involved in planning retirement income.

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

  The Discussion paper identifies this key issue. Superannuation needs to be re-framed not as an investment, but as a means to generate income in retirement. The Institute very strongly supports continued effort to change the superannuation narrative from a focus on the accumulated lump sum benefit to providing an income throughout and for the retirement years. Consistent with the Government’s intent to legislate an objective of superannuation, ongoing superannuation policy must reframe this narrative. However, given over 30 years of promoting superannuation through a focus on inputs (e.g., the Superannuation Guarantee rate), investment returns (e.g., consider how the ATO YourSuper tool presents to users) and account balances (e.g., consider the Industry Super Australia *Compare the Pair* campaign), the challenge in re-framing superannuation in terms of income should not be underestimated. The current frame is so widespread that it will need considerable effort to change.

- Default behaviour, precautionary saving and withdrawing at the minimum

  In the absence of a well-established help, guidance and advice framework for individuals approaching retirement, and for those already in the retirement phase, it is not surprising that many individuals are cautious about superannuation drawdown. Without guidance on both the retirement income mindset and effective pathways to accessing well-rounded retirement income solutions, many retirees do not convert their accumulation product into a tax-free pension product and many of those that do then gravitate to the minimum account-based pension drawdown rates (we support the Discussion paper’s observation that many retirees perceive the minimum drawdown rates as a recommendation).

What actions are industry or other participants in the community taking to address the issues identified in this section?

Following the introduction of APRA’s SPS 515 *Strategic planning and member outcomes* and the legislation of the retirement income covenant into the SIS Act, the superannuation industry, with support from the life insurance industry on developing and insuring longevity products, has actively looked to promote members' retirement income outcomes.

As set out in the Discussion paper, the joint ASIC and APRA thematic review of how superannuation funds have implemented the retirement income covenant indicated *"a lack of progress and insufficient urgency from RSE licensees in embracing the retirement income covenant to improve members' retirement outcomes."* However, the review noted that lifetime income products were offered by nearly half (7 of the 15) superannuation funds surveyed, and so there were efforts being made by funds to enhance members' retirement outcomes.

We note also the review was undertaken immediately after introduction of the covenant. There is now more evidence of more superannuation funds acting, including:

- Enhanced retirement sections on superannuation fund websites. These include guidance and education, with retirement checklists and budgeting tools, and a focus on retirement income not simply account balance. By way of example, refer to the retirement section of the Rest super fund website.
- Improved cohorting of members, to better tailor potential retirement income solutions to different member needs and enhance default behaviour. By way of example, refer to the Media Release from Commonwealth Superannuation Corporation on its retirement income solutions by member cohort.
- More focus on retirees' drawdown behaviours, leading to implementation of strategies to reduce anchoring to the account-based pension minimum drawdown rates. By way of example, refer to the NGS Super Easy Default option.

Innovation by superannuation funds will continue to occur, focused on each fund's specific membership. As noted in the Explanatory Memorandum to the legislation, implementation and improvements to the retirement income strategy are an ongoing process. We nevertheless concur with the Discussion paper that policy responses by the Government at an industry level are necessary to further 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?

The Discussion paper suggests three potential policy responses, under the over-arching themes of i) guidance, education, and communication; ii) super funds assisting and defaulting members to better settings; and iii) simplifying the retirement income system. We comment on these approaches and the specific policies that could be prioritised.

- Expanding the provision of guidance, education and advice through the Government's *Delivering Better Financial Outcomes* package: The Government's announcements to date in this area have the potential to make financial guidance on retirement matters more accessible and affordable to the broader population whether provided by Government, financial institutions or financial advisers. We would support measures such as:
  - The Government, in collaboration with consumer and industry bodies, providing educational and guidance material on key retirement income sources, and factors that may impact on these sources.
  - Requiring superannuation funds to show retirement income estimates alongside account balance information on member benefit statements and website benefit illustrations, including for members in receipt of account-based pensions.

  - The Government providing educational material to support individuals to better understand the potential large expenses they may or may not face in the retirement phase, and hence better understand their retirement income needs. For example, a common fear of individuals is that they will need additional funds for medical expenses and aged care, and providing information on the out-of-pocket expenses for these would greatly assist.

- Encouraging superannuation funds to assist, "nudge" and/or default members to better settings as they approach, enter and then live through their retirement phase: We welcome the Government's commitment through its *Delivering Better Financial Outcomes* package to permit "nudges" that allow superannuation funds to communicate basic information about retirement to members before they reach retirement, and to check-in throughout retirement. To implement this measure well, superannuation funds should be able to "nudge" their members approaching or already in retirement about both the type(s) of retirement income products available in that fund and how these help meet a member's retirement income needs, without falling foul of the anti-hawking requirements. Falling foul of these provisions is currently a key concern for funds.
- Simplifying how individuals navigate the system: Substantial changes cannot be undertaken without consideration also of the Age Pension, Aged Care and all sources of potential funding, including ongoing part-time/casual employment income and drawing down of housing wealth. We would support measures such as:
  - Simplifying the means testing of the Age Pension by, for example, combining the asset and income components of the means test.
  - Improving the interaction between the retirement income and aged care systems by, for example, integrating (a potentially simplified) means test for the Aged Pension and Aged Care eligibility.

The following risks should be considered as policy is developed.

- There is a general need to raise financial literacy of Australians. Australians are used to being able to rely on the default-driven accumulation phase of the superannuation system where superannuation funds can "do it for me if I want". This contrasts with the complexities and decisions that retirees need to make for themselves in retirement, often with limited help or guidance. Any policy approaches risk being ineffective as many retirees do not possess the financial literacy to best navigate the complex Australian retirement income system.
- Current and future retirees are wary that successive governments may change the rules, and that this will impact on their planning and decisions regarding the Age Pension, health and aged care entitlements, as well as taxation of superannuation balances. With a substantial increase in the Australian retiree population as Baby Boomers continue to retire, the prevailing sentiment is that government funding or subsidies will reduce – it is therefore not surprising that retirees want to conserve their available assets to protect against this uncertainty. Providing more certainty by, for example, establishing broad political consensus or making it more difficult to change long-term policy settings would alleviate some of these concerns.
- There is a risk that superannuation legislation and regulation place a superannuation trustee in a position where it holds (or is perceived by members to hold) responsibility to solve for each member's complex individual retirement income planning decisions. Employers are not expected to "solve" individuals' employment income needs or inquire into an employee's aspirations, family, health and other lifestyle aspects, or how these have changed (e.g., divorce

or separation). In a similar fashion, policy should not expect superannuation funds to "solve" for members' retirement income needs.

  - Superannuation funds only have a limited window into their members' financial affairs and other important considerations such as home ownership arrangements and relationship status. Whilst superannuation funds can use external data sources and seek to obtain this information from members to determine likely "personas" for their membership, they will never be able to put themselves precisely into every member's shoes.
  - Having said this, it should be made easier for superannuation funds to be able to collect with consent more information from members (including about the members' relationship status and aggregate family finances) to improve the guidance given to individual members or to support allocating members to specific "personas" or "cohorts" (see comments on Data below).

Other potential approaches could include:

- We support the Government taking a proactive approach to help individuals understand and undertake financial planning and budgeting, from early years to and through retirement. The Government could consider allocating funding and resources for Treasury to review and recommit to the National Financial Capability Strategy published in February 2022.
- Establishing a taskforce or equivalent to develop a National Longevity Strategy, as suggested by Williams in https://nationallongevitystrategy.au/.
- A review of the disincentives to work after age 67 generated by the Age Pension system, to identify ways to encourage extended work patterns for those individuals who can and wish to do so. Despite recent changes, there remain substantial disincentives to earning income for those on the Age Pension. One way these could be ameliorated without substantial additional financial impact to the Government would be to provide flexibility for individuals to defer commencement of their Age Pension entitlements. The US social security system has a flexible "social security claim age", with benefits actuarially adjusted for late commencement. The Institute provided some suggestions in this regard in a thought leadership paper on Age Pension Reform several years ago - see sections 6.31 to 6.34. The benefits of such changes should be weighed up against the increase in complexity.

Further questions

We make the following observations.

A good retirement

When planning retirement and making decisions in retirement, financial considerations typically take centre stage, whereas, after the event, it is more likely that non-financial considerations dictate whether one has a good retirement (underpinned by financials of course). Consequently, the non-financial retirement phase considerations merit much more extensive attention in public policy. The Institute's recent Dialogue Paper, Retirement Matters, refers to this in more detail. There may be merit in equipping superannuation funds to take a broader role with these non-financial aspects of retirement, noting that the sole purpose test and a trustee's Best Financial Interests Duty both currently restrict the role superannuation funds can play in this regard. The Institute's recent submission to APRA on enhancements to the member outcomes framework discusses this Best Financial Interests Duty constraint.

Reduce complexity

We note the work of the Australian Law Reform Commission (ALRC)[1], and agree with its assessment that *"there is a level of consensus among stakeholders that the law has become unmanageably and unnecessarily complex."* The burden falls on the industry, consumers and on Services Australia, with millions of unanswered calls and countless delays.

Apart from responding to the ALRC recommendations, we suggest that consideration be given to eliminating many of the relatively immaterial adjustments, exceptions and carveouts to the main regulation that create much of this burden. For example, permitting contributions directly into a retirement account, rather than requiring a separate accumulation account to be set up, or a roll back into an accumulation account and then taking a new retirement account.

Nudges and defaults

Nudges and defaults influence member behaviour. An example of an effective soft default in the superannuation system is group insurance. Most members are offered default insurance cover, with those over age 25 with an account balance of over $6,000 needing to opt-out, and other members to opt-in to receive cover. The "nudge" of offering opt-in insurance encourages some younger members to consider their personal circumstances and effect cover, but it is really the stronger opt-out default settings for members over age 25 that drives member behaviour to receive default insurance cover. The policy also recognises that insurance needs are personal, and members have the option and flexibility to adjust the cover to better suit their needs.

A similar approach could be taken to provide superannuation fund members with an opt-out income stream retirement product at an agreed age (e.g., 70) for a portion of their superannuation account balance if this exceeds a certain amount. Members would still have the flexibility to opt-out of the income stream product, but the expectation would be that there would be a significant increase in take-up of income stream products, and an improvement in retirement income outcomes as a result. Over time, this would be a policy action that would make a meaningful difference to reframe individuals' mindsets from nest eggs to income.

We note there are policy and product design considerations entailed with such a requirement. Considerations include the desired degree of choice architecture prescribed in policy versus designed by the trustee, for example the degree of standardisation that would be required for income stream products that trustees are permitted to default members into, as well as more practical issues such as how the trustee will pay an income to members who are defaulted into such products but who do not provide their bank account details.

Data

The data made available to superannuation funds with member consent could be enhanced by prioritising development of a streamlined process to allow superannuation funds to be an Accredited Data Recipient under the Consumer Data Right (CDR). Superannuation funds and advisers should also be able to access a retiree's eligibility to the Age Pension directly from Centrelink data (again, with member consent).

The data available could be further enhanced by making ATO data readily available to individuals through myGov, which could then be accessed (with permission) by superannuation funds. Refer to page 7 of the Institute's submission to the Productivity Commission in October 2022 5-year productivity inquiry: Australia's data and digital dividend.

[1] Particularly *Superannuation and the Legislative Framework for Financial Services,* and their Interim Report B, Financial Services Legislation.

Subject to ensuring appropriate safeguards are in place, enabling access to such data would significantly reduce the cost of providing help and advice to individuals as it can help with automating the pre-filled data population process, improve the accuracy of this data, and therefore simplifies the member experience.

For example, an individual wanting to apply for the Age Pension currently needs to fill out the income and assets forms that contain the following items all of which could be automated with help from their superannuation fund:

- Government payment (Centrelink data);
- Employment income (ATO data);
- Investment property, shares, and any other investment incomes (ATO data);
- Business interests (ATO data);
- Other superannuation accounts (ATO data); and
- Bank account (CDR, banking data).

Other data that members would still need to provide manually would include:

- Estimates for the value of household contents, personal effects, cars and boats;
- Homeownership;
- Payments and assets outside Australia; and
- Loans and gifts to others.

We would welcome participating in targeted consultation on specific data sharing proposals between members, superannuation funds and Government services.

SMSFs

SMSFs have a significant portion of the funds under management in the retirement phase. They have always been treated somewhat differently from APRA regulated superannuation funds, given they are designed to provide individual members more control of their superannuation. They were excluded from the retirement income covenant following consideration of submissions to Treasury on its 2021 position paper, including the fact that the SIS Regulations already require all superannuation trustees under the investment strategy covenant to have regard to, amongst other factors, the ability of the entity to discharge its existing and prospective liabilities.

The Trustees of many SMSFs are the members themselves, and the members are typically advised by financial advisers and accountants. This role of advisers in supporting SMSFs is important. It is difficult to see how a SMSF could directly provide to its members an equivalent level of guidance, risk management, or retirement income product solutions compared to an APRA regulated fund.

An efficient way to address this gap in support for SMSF members who do not source advice would be for greater Government involvement, together with SMSF service providers, in providing guidance, education and communication to individuals.

Supporting funds to deliver better retirement income products and services

Comment 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

Retirement income products are by their very nature different from accumulation superannuation products. Unlike accumulation products where the primary product features affecting outcomes for all members are investment returns after all fees, retirement products require consideration of investment sequencing, investment market, inflation and longevity (both individual and pool) risks. This leads to a need for a wide array of retirement income “products” (or “product options” within an umbrella product) to meet heterogeneous member needs and risk profiles. It follows that ensuring members understand the distinguishing features and potentially differing outcomes between different types of retirement income products is of more importance than comparing performance within similar types of retirement income products.

Therefore, we believe any retirement income tests or comparisons should be at the “member level” targeting the three objectives under the retirement income covenant: level of retirement income, associated risk to the sustainability and stability of the retirement income, and flexible access to retirement savings. This differs from the “product level” approach applied to compare accumulation superannuation products that focus on fees and investment returns. Superannuation funds could be required to perform these tests as part of their APRA *SPS 515 Strategic Planning and Member Outcomes* member outcomes assessments. For example, a trustee could test whether an individual member or a cohort of members satisfies the objectives of the retirement income covenant by considering:

- Projected retirement balances given current contribution levels and investment strategies;
- Projected retirement income, taking account of the accessibility and risk objectives included within the Retirement Income Covenant;
- Administration fees relative to costs for that type of member; and
- Value of insured benefits in the event of an insurance claim.

Refer to Page 4 of the Institute’s submission to APRA on draft enhancements to the SPS 515 framework: Draft Enhancements to SPS 515 Submission.

We note that a ”member level” approach does not effectively translate to members being able to readily compare retirement income products through standardised product disclosure or comparison tools. However, we believe that alternative measures can be adopted to better help members understand and compare the different types of products they use to achieve their outcomes (see below).

In terms of competition, there is significant market capacity through superannuation funds themselves and the life insurance industry to offer a broad range of retirement income products at scale to Australian retirees. The primary barrier to more product development is the risk of inadequate take-up, and inadequate take-up is driven by the restrictions that limit the ability of members to access free or low-cost help, guidance and advice on retirement matters.

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?

We believe that the responsibility should lie with APRA and ASIC to enforce consumer protections and competitive products and services in retirement. For example, the consumer protection that already exists (and will likely be strengthened) in APRA *SPS 515 Strategic Planning and Member Outcomes*, and in the ASIC Design and Distribution Obligations framework. APRA as prudential regulator is also able to require superannuation funds to provide competitive products and services to members (for example, by extending the Superannuation Heatmap publications to include retirement products) and take enforcement action if this does not occur. ASIC as conduct regulator is empowered to monitor whether the products and services provided to consumers represent good value for money and meet accepted standards, including whether superannuation trustees service consumers honestly, efficiently and fairly.

Where product features include any form of guarantees to members, these are typically supported by a life insurance entity. The regulatory capital regime that applies in Australia is particularly onerous (compared to global standards) when considering long-term guarantees. There are two aspects to this: the actual quantum of capital needed at a point in time, and the responsiveness of the capital requirement as market conditions change. Relative to other markets, we observe that Australian life insurers are subject to both high absolute levels of required capital, and required capital amounts that tend to increase in periods of market stress – making it more costly for insurers to offer long-term guarantees in Australia relative to other markets globally. While robust capital requirements help to reduce the counterparty risk for the consumer taking out a product with guarantees, APRA should consider reviewing its regulatory capital settings to ensure regulatory capital levels are appropriate and not overly conservative or rigid in this regard. One specific adjustment that could be considered is to allow a more market-sensitive illiquidity premium in liability valuations.

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?

The identified potential policy responses include a standardised product disclosure framework, tools for comparison and performance, and reducing regulatory barriers. Of these, we believe reducing regulatory barriers should be prioritised, to ensure regulatory settings are fit-for-purpose, do not impede innovation, and maintain equity. With many superannuation funds now at a stage, or soon plan to be, where they offer to their members or provide them with access to a lifetime income product, the focus should be on fostering innovation and facilitating an enabling environment. We would welcome specific measures to address potential outstanding unintended consequences and legislative/regulatory inconsistencies with the Innovative Retirement Income Stream (IRIS) provisions of SIS Regulations 1.06 A and B. Refer to our submission Innovative Retirement Income Stream (IRIS) Legislative Considerations (actuaries.asn.au).

A standardised product disclosure framework could add value but comes with the risk of being something other than simple consumer-focussed disclosure documentation, given the complexities of many retirement income products, and that many members will use a portfolio of retirement income products and investment options. Government might instead consider focusing on elements of disclosure that would improve the consistency and comparability of disclosures. For example, requiring:

- Standardised definitions and disclosures of key features of retirement income products, including transparent disclosure of costs and benefits.
- An agreed approach to setting out the advantages and disadvantages of each type of retirement income product in different circumstances.
- Superannuation funds to show retirement income estimates alongside account balance information on member benefit statements as advocated for earlier in this submission, and for these to use standardised approaches to ensure expected outcomes and benefits are consistently presented alongside associated risks (longevity risk, investment market and sequencing risks, and inflation risk).

We see downside risks on pursuing developing tools for members to compare performance of retirement income products. Such tools tend to be simplistic to allow member understanding, yet by doing so they do not consider the many and varied features and risks attached to the retirement income products. There is a danger that there will be the unintended consequence of constraining innovation and shifting the focus away from maximising member outcomes. Considering the two examples of tools that exist in the accumulation phase mentioned in the Discussion paper:

- The YourSuper comparison tool and the performance test are designed for products with a much narrower range of benefits and offerings than retirement income products.
- The YourSuper comparison tool only focuses on fees and past returns, and then for a representative account balance - it does not focus on income and does not include risk or access to capital as metrics.
- Use of the performance test in its current form has the fundamental issue of being focused on implementation of the disclosed investment strategy, not whether the investment strategy is appropriate for the member or if the return compares well to competitor products. This is magnified with the fact that maximising performance (retirement income) is only one of the three objectives under the retirement income covenant.

Further questions

We make the following observations.

Comparison metrics

We believe there is likely most value by the superannuation funds comparing metrics that will potentially influence member retirement income outcomes as part of their member outcomes assessments, rather than focusing on metrics that allow individual members to compare retirement income products and services.

There will be a range of retirement related comparison statistics that superannuation fund trustees would benefit from understanding such as asset size for each investment option, membership, demographics, drawdown rates and innovative income stream take-up rates. It would be best for this information to be collected and provided by APRA.

Product switching

We make the following comments regarding product switching.

- We recommend that superannuation funds should be able to unilaterally switch retirees to more contemporary and better value products without the need for member consent if the move satisfies member best financial interest requirements at a cohort level (similar to how successor fund transfers operate at a fund level). This would improve member outcomes, as well as allow superannuation funds to address potential legacy product concerns associated with the risk of launching products that ultimately prove to be sub-scale. Refer to Page 6 of the Institute's pre-budget submission: Pre-Budget Submission 2024/25
- Product switching of account-based pensions can impact Centrelink/DVA deeming rules, and so impact on a member's Centrelink/DVA entitlements as well as aged care fees. We believe that this re-assessment is not generally appropriate and serves as a potential barrier to product switching.
- It is appropriate for some retirement income products that involve longevity risk insurance not to be able to be switched to prevent selection risk from healthier customers switching to new policies and leaving (much the same way as it is not possible to switch defined benefit pension products), or for certain provisos to be attached to switching (e.g., must be to another product with the same insurer).

Making lifetime income products more accessible

Comment on the barriers in the supply and demand for lifetime income products

We believe that the small market for various lifetime income products is a demand not a supply issue, although superannuation funds are constrained in their ability to promote lifetime income products.

Supply

As identified by the Discussion paper, development costs and the risk of legacy products are inhibitors to superannuation funds offering lifetime income products.

Trustees might naturally be concerned about the potential impact of offering long-term retirement income products on their ability to meet their Best Financial Interests Duty requirements. We observe therefore that some trustees are reluctant to promote these products because of real fears that these products might prove unviable and that they will be held responsible for acquiring and being lumbered with legacy products.

We also note that while a well-established process exists for the provision of insured death and disability benefits on a group insurance basis, applying similar concepts to lifetime income products proves challenging due to differences in the structure of these products. Greater standardisation of product features in retirement could assist with the tender of insured longevity benefits between superannuation trustees and life insurers.

In the context of supplying these lifetime income products accompanied with financial advice, we also observe that lifetime income products are traditionally perceived as more "risky" products, but that account-based pensions are not. Both products, however, include risks, and members are currently very poorly served in the information that they are given to evaluate these risks.

However, there is now increasing evidence of both superannuation funds (often partnering with insurers) and insurers developing and offering lifetime income products. Indeed, the Discussion paper (p.5) notes lifetime income products are offered by nearly half (7 of the 15) superannuation funds surveyed by APRA and ASIC in their first thematic review of trustees' retirement income strategies.

There is a broad range of current retirement income stream products, including: guaranteed annuity products with lifetime payments indexed to inflation or other market indices, which offer death and surrender benefits; and non- or limited-guaranteed products with lifetime payments indexed to the performance of an underlying pool of assets, which generally offer death benefits and may offer surrender benefits. These products are innovative and much more flexible than older, more traditional lifetime annuities that typically did not offer any death or surrender benefits. The new products address many of the historical member concerns with lifetime income products, allowing access to capital in some circumstances, and a payment on early death. Examples of lifetime income products offered by superannuation funds include AMP North, Australian Retirement Trust and UniSuper. Examples of insurers that offer lifetime income products directly and/or through superannuation funds include Allianz Retire+, Challenger Life and Generation Life.

Demand

The Discussion paper suggests several barriers to take-up of lifetime income products by members. These are all valid, although perhaps less so than historically given increased flexibility following product innovation and APRA's life insurer capital requirements significantly reducing counterparty risk.

However, this section of the paper overlooks what we consider the two most significant barriers to take-up by members: the fundamental challenge in how superannuation is framed - being seen as a nest egg, not as a primary source of retirement income; and, again, retirees do not have the help, guidance and/or advice they need to properly navigate retirement and make decisions to take-up lifetime income products. These two changes will have the greatest impact on 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?

The retirement income covenant requires superannuation funds to formulate, review regularly and give effect to a retirement income strategy. The strategy must (as one of its three objectives) help members manage the risks to the sustainability and stability of their retirement income.

As superannuation funds review their initial retirement income strategies, they are increasingly considering the different needs of different membership cohorts. Both product and service offerings are consequently being reviewed and tailored. We expect many of these developments to be offered to members in the next couple of years, with evidence of new offerings starting to appear in the market already (refer examples on page 4 of this submission).

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?

The Discussion paper identified support for better longevity pricing and standardised products as potential policy responses. We have concerns with the specific suggestions raised in the paper. These include:

- Price of insuring longevity risk – Life insurers and reinsurers (with deep worldwide experience in pricing longevity risk) are already able to efficiently price longevity risk and offer cover at a "fair" price, and have appetite to take on longevity risk. The Australian life insurance industry has already shown a significant interest in providing longevity protection. The competitive nature of recent longevity tenders in the Australian market serves as clear evidence that the local market remains highly efficient. We expect the level of competition for longevity contracts to be similar to tenders for group insurance contracts. This strong industry appetite is expected, given that many would realise capital and diversification benefits from taking on longevity risk. The introduction of longevity risk into the Australian life insurance industry brings industry-wide benefits by diversifying the risk pool across the entire sector.
- Standardised products – The example put forward in the Discussion paper is like the "Comprehensive Income Product in Retirement" (CIPR) default product proposed in the 2014 Financial System Inquiry (FSI). CIPRs are akin to a portfolio of different retirement income products put together for a retiree.

  Whilst the concept of a CIPR is sound, the needs of retirees are heterogeneous (e.g., different family, health and wealth considerations). The heterogeneity of member needs in retirement, many of which are not known to the trustee, makes it very risky for trustees to have confidence that defaulting members into a single type of standardised product would always lead to optimal retirement outcomes. The various submissions to the FSI on CIPRs supported their policy intent but recognised the difficulties in their practical application given heterogeneity of member needs.

  Further, any standardised product may be viewed as a Government recommended "best product", and this may not be the case for many membership cohorts.

  On the other hand, having a handful of standardised products and / or features that might be suitable for most non-advised groups of retirees would help to reduce the level of complexity they have to consider. This policy would be particularly impactful for individuals with limited assets and income outside superannuation to support their retirement. It would also make the education initiatives more targeted and impactful. Financially literate retirees could still opt-out and decide to purchase other products offered outside the standard set (with or without financial advice).

On balance, we believe standardised products as a “first offer” would not on its own be the best policy response to address the low take-up of lifetime income products. Instead, we support focusing on other policy options such as: enabling a choice architecture framework for trustees to provide help, guidance and advice for their accumulation members as they transition to the retirement phase; setting some degree of standard definitions and disclosures of key features of retirement income products; and an opt-out product feature requirement to move a portion of a member’s superannuation balance under certain circumstances to appropriate “standard” income stream product(s) as a “last resort”.

The following risks should also be considered as policy is developed:

- As already noted, it will take time and concerted effort to change the perception of Australians from superannuation being a nest egg that should be primarily preserved as a source of income in retirement.
- Australians will likely not welcome any moves to mandate that a portion of superannuation is required to be taken as an income stream. Hence, enhancing financial literacy coupled with nudges/soft defaults and incentives (or disincentives) are more likely to be effective mechanisms to change retiree behaviour as compared to compulsion.

Further questions

We make the following observations:

Product options

Pathways

Retirement income needs vary considerably across individuals and throughout the retirement phase for each individual, and depend on lifestyle, health and family support. We believe the pathways to support members are of as much importance as the product offerings themselves. For example, providing ready access to personal financial advice for those who can afford this, and providing cohort-based suggested solutions for all members that can be tailored by the more engaged members.

Opt-out products

We believe an effective product option to manage risks to retirement income would be to introduce an opt-out product feature that moves a portion of a member’s superannuation balance at an agreed age (e.g., 70) above a certain asset level to a pathway dependent “standard” income stream retirement product (for example, with the product guardrails on possible pathways set by Government and the specific design of those pathways and products determined by each trustee for their members). If this is combined with re-framing superannuation as a source of retirement income, the take-up of income stream products would be much greater.

This move would bring Australia closer in line with the leading worldwide retirement income systems. For example:

- The 2023 *Mercer CFA Institute Global Pension Index* (MGPI) assessed and ranked 47 retirement income systems from around the world and noted that 9 of the 11 top ranked systems (excluding Australia that ranked 5th) require a portion of a member’s superannuation to be taken as an income stream in retirement. These income stream requirements are not necessarily lifetime income products, and in many cases are fixed term annuities. However, they serve to emphasise that the retirement system in that country is one focused on income, not nest eggs. Analysing the income stream requirements and optionality for the Scandinavian countries (all of which are in the top ranked retirement income systems in the MGPI) could provide useful insights when determining policy settings.

- The *OECD Legal Instrument 0467* Recommendation of the Council for the Good Design of Defined Contribution Pension Plans recommends (recommendation 7) that DC pension plans provide some level of lifetime income as a default for the pay-out phase unless other pension arrangements already provide for sufficient lifetime pension payments. Full lump sums should be discouraged in general, except for low account balances or extreme circumstances (such as health conditions).

Capital reserve

We note the suggestion of an indexed capital reserve which is exempt from minimum drawdown rates, as included as part of the Example bundled retirement product in the Appendix to the Discussion paper. Setting up an explicit contingent fund for unforeseen circumstances may help with retirement income planning and that superannuation should ultimately be used for retirement. It is, however, not clear that superannuation should necessarily be the vehicle to hold such reserves (or whether this might simply be held outside of superannuation).

Incentives and disincentives

Taxation and Age Pension eligibility rules can be used to incentivise retirees to take income streams in retirement, or disincentivise retirees from taking lump sums or leaving assets as a bequest.

The change to the Age Pension means test rules in July 2019 to incentivise qualifying lifetime income streams is a recent example. Allowing higher tax effective superannuation benefits for those taking a lifetime annuity under the old Reasonable Benefit Limit rules was another past example. Examples of potential incentives and disincentives include: to require taxation of account balances above a certain amount, but not if the balance has been converted to a qualifying income stream; and to introduce taxation of withdrawals that exceed a set amount annually after a certain age.