Superannuation in retirement

Submission

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About The Conexus Institute

The Conexus Institute is an independent, not-for-profit research institution focused on improving retirement outcomes for Australian consumers. Philanthropically funded, the Institute is supported by the insights of a high-quality advisory board, who work on a pro-bono basis. The Institute adopts a research-for-impact model and frequently collaborates with researchers from academia, associations, and industry. Where possible research is made open source to assist industry and create transparency and accountability. Further information here.

About David Bell

Dr David Bell is Executive Director of The Conexus Institute. Bell's career has been dedicated to the investment and retirement sector. He has worked with both commercial and profit-for-member firms, and ran his own consulting firm. Bell worked with APRA in the development of the APRA Heatmap. Academically, Bell taught for 12 years at Macquarie University and in 2020 completed his PhD at UNSW which focused on retirement investment problems. Full bio here.

About Geoff Warren

Dr Geoff Warren is a Research Fellow with the Conexus Institute and an Honorary Associate Professor at the Australian National University, as well as a member of various investment and research advisory boards. Warren's research focuses on investment-related areas specially including superannuation and retirement, and is widely published in leading journals. He has a prior career in the investment industry spanning over 20 years. Full bio here.

***** The authors are willing and able to participate in further consultation. *****

Overview and summary

We much appreciate the opportunity to comment on issues and options for policy in the retirement phase of superannuation (super). Assisting super fund members with their retirement needs is probably the biggest challenge facing the industry at present. It is a very important topic.

As a non-aligned thinktank, the mission and only agenda of the Conexus Institute is achieving the best outcomes for Australians and society at large. Our primary aim in this submission is to assist policymakers (i.e. the Government and Treasury) in their policy deliberations. We highlight what we see as the main issues, and raise a range of policy measures for consideration. In doing so, we have taken note of the comment made in a consultation session that Treasury is looking for ideas and "everything is on the table". We have used this as license to go beyond the matters raised in the "*Retirement phase of superannuation*" discussion paper of December 2023.

We take a somewhat different approach in this submission. At the foundation of our submission is a series of 13 essays plus one draft research paper (in support of Essay #4) that explore topics of potential interest to policymakers and put forward recommendations for consideration. The essays are designed to be read individually, and hence could be allocated to various members of the review team to consider or shared as appropriate. Many of the essays are interrelated, and reference each other accordingly.

This summary and overview draws the threads together, and contains:

- An overview of the main themes
- A list of the essays and the main recommendations that arise from each
- A response to the consultation questions, including linking each question to the essays and providing additional comments where appropriate.

1. Our main themes

The Treasury retirement discussion paper is arranged around three areas where input is being sought, with a variety of "potential policy responses" raised for each area:

a) Supporting members to navigate retirement income
b) Supporting funds to deliver better retirement income strategies
c) Making lifetime income products more accessible

Our essays and associated recommendations are much wider in scope than the matters raised in the discussion paper. We also consider the interaction with the Delivering Better Financial Outcomes (DBFO) reforms, specifically the issue of how the role of super funds in providing advice might be further developed, offering comments and recommendations that are relevant for this policy initiative. Our essays also often cross all three areas listed above. Below we aim to draw together the threads through discussion of five themes that run through this submission.

Theme 1: Wariness over placing too much reliance on market-based solutions

Essay #1 set the scene by highlighting the limitations on competition and the capacity of members, which motivates the stance taken across many of the essays. A central theme is that the market cannot be relied on to deliver good outcomes for many retirees. We identify the two main alternatives to a wholly market-based approach. One is government intervention, including regulation and direct involvement in the market. The other is having well-informed and aligned 'agents' operating within the system that either guide members, or even make decisions on the behalf of members where they are not well-placed to do so. We explore the role for super fund trustees as such an agent, noting that personal financial advice is constrained by cost and capacity issues in serving all members; and offer suggestions for how policymakers might ensure that trustees perform this role effectively. This theme runs through:

- Essay #2 on the choice architecture, where we argue for facilitating a form of 'trustee direction' under which trustees select a retirement solution on behalf of members;
- Essay #3 suggests a beefing up of trustee obligations to ensure they meet minimum standards and provide suitable assistance to all members;
- Essay #4 investigates the collection and use of personal information by trustees, which we consider to be foundational for assisting retired members on an individual level;
- Essay #6 recommends the establishment of a dedicated member outcomes assessment regime for retirement to help ensure that funds are doing an effective job in assisting retired members;
- Essay #7 explores the possibility of introducing a licensing regime for retirement, which might require funds to have the capabilities in place to offer effective retirement solutions, products and services.

Theme 2: Business issues conflict with delivering on retirement

The Retirement Income Covenant (RIC) places a clear obligation on *all* super fund trustees to develop a retirement income strategy (RIS). Policymakers and regulators have clearly been disappointed with the progress so far. We suggest a key piece of the puzzle relates to the business barriers faced by funds in developing RIS, which is the subject of the concluding Essay #13. This essay points out that the business case for RIS development can be weak for some funds (e.g. those with a small amount of assets in the retirement phase), while development times are long. Our concern is that retiring members will bear the impact of this conflict through funds delaying and/or under-developing their RIS. A number of our essays confront this conflict.

This theme is most relevant for Essay #7, which raises the possibility of establishing a retirement licensing regime. A licensing regime would force super funds to confront the business case for participating in the retirement market. This may be financially sympathetic for those funds where the strength of the business case is far weaker than the obligation to develop a RIS, providing a mechanism through which these funds may choose not to participate in retirement. While retirement licensing would amount to a somewhat heavy-handed policy initiative, it should be highly effective in giving a push-along for funds that decide to be in retirement to develop their RIS to the required standard. As the majority of funds will probably want to participate in the retirement market, the need to satisfy licensing requirements should get the industry at large moving.

In additional to the licensing regime, two other essays explore policy measures that could help ensure super funds develop their RIS to a good standard, noting that the principles-based RIC leaves scope for funds to deliver RIS to a low standard (which they could be inclined to do if the business case is weak). Essay #3 considers imposing clearer obligations on trustees on what they need to do in delivering a RIS. Essay #6 discusses establishing a retirement member outcomes assessment framework. There is scope to tie member outcomes assessments to trustee obligations and any licensing regime.

Essay #13 also suggests that the business considerations faced by super funds be taken into account in formulating policy and engaging with the industry. In particular, allowance should be made for lengthy development time frames in determining when to bring policy measures into effect, and in setting expectations around how quickly the industry can deliver. For example, in discussing the need for the Government mandating or endorsing a standardised retirement product and underwriting longevity risk in Essay #11, we note that the lack of apparent action in these areas may have more to do with development lags than market failure. Further, we suggest that any requirements around member outcomes assessments or licensing be established as soon as feasible, but the formal need to comply is deferred by some years to give the industry time to prepare.

Theme 3: There is a type of member that fund trustees should be looking after

Essay #1 notes that many members do not have the cognitive abilities to make informed retirement decisions without assistance. While financial advisers could assist these members in theory, they are unlikely to serve all members due to cost and capacity constraints. This is a well-recognised issue that provides motivation for expanding the ability of super fund trustees to provide advice under the DBFO reforms, with aspects such as nudges, a different type of adviser and expanding the use of collective charging for advice being considered. Most of the potential measures being raised seem to assume that members are able to make choices on some level, and aim at assisting them to make good decisions.

We think the ante should upped here. A class of members exists that has limited capacity or desire to make financial decisions on *ANY* level – be it for reasons of very low financial literacy, poor language skills, cognitive decline or even 'fear of finance'. One of our key recommendations is that trustees should be able to make decisions *on behalf of* such members. This is what we describe as 'trustee direction', which is discussed in Essay #2 and could entail a recommendation or assignment of members to a comprehensive retirement solution. For trustee direction to be effective, trustees will need to source and use personal information. The type of information that is required and how it might be sourced is discussed in Essay #4 and the draft retirement 'explainer' provided as part of this submission.

Finally, Essay #3 raises the idea of imposing an explicit obligation on trustees to look after ***all*** members with the aim of ensuring that no member is left behind. This recommendation has in mind the type of member being described here.

Theme 4: Mechanisms to help funds assist their retired members

We investigate multiple mechanisms through which funds might be able to better assist their members. The measures we discuss include:

- Allowing trustees to span the 'choice architecture spectrum' (see Essay #2) so that they can support members to engage with retirement decisions as suits them best. Here we support the use of 'default' (i.e. recommended) settings and retirement solutions for member types, but also view trustee direction as the major component of the spectrum that seems absent from the policy discussion.
- Accommodating the ability of trustees to use and source personal member information (Essay #4) is assisting members on an individual level.
- Encouraging the take-up of lifetime income streams (where appropriate for the member) through embedding them within retirement solutions that are offered to members, as well as improving the manner in which lifetime income streams are being framed when communicating with members.
- Facilitating contingency accounts (Essay #9), which is our version of the 'capital reserve' appearing in the 'example bundled retirement product' in the Appendix of the discussion paper, in order to facilitate precautionary savings and provide both confidence and flexibility.
- Adjusting the minimum drawdown rules in the presence of lifetime income streams so that total income may be better managed, noting that this may require an easing of the rules (Essay #10).

Theme 5: A few things could be done to make the market work better

While we argue that the market cannot be relied on, we also recognise that some members will want to decide for themselves and that they need to be supported. We discuss two possible policy actions:

- Investigating how ASIC's Moneysmart might be revamped to assist individuals with their retirement decisions (Essay #5)
- Standardising disclosures, where we recommend commissioning a research and consultation process to scope out what might be done (Essay #11)

We are sceptical over some of the potential policy responses described in the Treasury retirement discussion paper that appear directed at improving the operation of the market. For example, in our view: the retirement income system is not amenable to be simplified in any meaningful way (Essay #1); tools for comparison and performance evaluation of retirement products will be ineffective (Essay #6); and the Government underwriting longevity risk would have little effect in encouraging members to give deeper consideration to lifetime income streams (Essay #8).

2. Essays and recommendations

The table over lists the 13 essays along with the main recommendations from each.

List of essays and recommendations

Essay	Main recommendations
1. Limits of reliance on the market in the retirement phase	• The retirement phase is more prone to market failures that both inhibit competitive forces and limit the capacity of members to make informed choices. Policymakers should be cognisant of this feature in formulating retirement policy, and remain cautious over placing reliance on market mechanisms. • Competition in the retirement phase is weak, primarily due to an incumbency effect that results from many interacting factors including complexity, weak financial literacy, limited access to comparators, and switching costs (likely alongside trust in existing providers). Competition appears far healthier in the advised pathway. A small number of policy proposals that might improve competitive tension are made via other essays. • Limits on the capacity to make informed retirement decisions varies considerably across members. Additional policy focus should be given to assisting those members with low capacity and willingness to make decisions for themselves to ensure they are not left exposed. A number of policy proposals are made to this effect via other essays, most of which are aimed at helping ensure that fund trustees are acting in the best interests of members.
2. Role of superannuation fund trustees within the choice architecture for retirement solutions	• The role that superannuation fund trustees are expected to play within the choice architecture for retirement is a foundational issue for policy. We recommend that the Government make clear its position on this matter; and factor it into policy formulation including the Delivering Better Financial Outcomes reforms. • The potential 'choice spectrum' ranges from member self-direction, to various forms of trustee guidance, through to true defaults. We see benefit in enabling trustees to span much of the spectrum, including some form of trustee direction under which trustees identify a comprehensive retirement solution for members who are not capable or willing to make financial decisions for themselves.
3. Spurring action through trustee obligations	• Obligations on superannuation fund trustees under the Retirement Income Covenant should be further defined, with the aim of spurring action to help ensure that no member is left behind. • We recommend that obligations be established in relation to two matters: (i) Obligation to provide retirement assistance to at least a minimum standard (and ideally better) (ii) Obligation to attempt to offer suitable assistance to every retired member • Mechanisms that might be used to define and impose obligations on trustees include: a) Member outcome assessments of retirement income strategies, with APRA oversight b) Licensing regime for retirement c) Review of the Design and Distribution Obligations with the intent of establishing how it will operate in retirement

Essay	Main recommendations
4. Personal information trustees require to effectively cater for member differences *Paper in support of this essay:* "Member characteristics: What matters for retirement solution design?", Retirement explainer, February 2024 (draft)	• Policymakers should facilitate superannuation fund trustees to collect and use personal information for the design and offering of retirement solutions that cater for important member differences. • We support extending the use of the Consumer Data Right by superannuation funds and giving fund trustees access to certain member data held by government agencies. However, we refrain from making recommendations over the details, as this is outside of our expertise. • The personal information that trustees are able to collect and use without triggering the full obligations under the personal financial advice rules should be defined as part of the Delivering Better Financial Outcomes reforms. We recommend the scope of this information be set with reference to that needed to match members to a suitable solution that is offered by the fund.
5. Revamping ASIC Moneysmart	• Policymakers should review the role and purpose of ASIC Moneysmart (Moneysmart) in the future retirement ecosystem. The review should account for low financial literacy in the context of a highly complex retirement setting (explored in Essay #1), the (evolving) choice architecture for retirement solutions (Essay #2), and the emerging dispersion in the retirement offerings of super funds. • Any review of the role of Moneysmart in retirement ecosystem should acknowledge the challenges posed by the complexity of retirement, explore the potential for technology to deliver significant enhancements, and be highly cognisant of user experience and the need for user testing.
6. Developing a policy framework for assessment of retirement income strategies (RIS)	• RIS assessment should be established as a dedicated component of member outcomes assessments under the APRA prudential standards, i.e. separate from that applying to accumulation. We suggest listing the areas that trustees need to address within their RIS as items for assessment. • Extending the tools for comparison and performance assessment of accumulation products – such as the YourSuper comparison tool and the Your Future, Your Super (YFYS) performance test – to retirement will be very difficult and could lead to significant unintended consequences. At best, the YFYS performance test might be applied to return-generating components of retirement solutions, such as account-based pensions. These assessment tools are quite unsuitable for other retirement products or retirement solutions.
7. Exploring the case for a retirement licensing regime	• Policymakers explore the possibility of introducing licensing for super funds to operate in the retirement market, as a means of spurring action in developing retirement income strategies, setting minimum standards and establishing what is expected from fund trustees.
8. Barriers to take-up of lifetime income streams	• Policy measures with high potential to impact the take-up of lifetime income streams include: a) Facilitating super fund trustees to offer or direct members to comprehensive retirement solutions that contain lifetime income streams. Here some form of trustee direction (as discussed in Essay #2) should have the strongest impact. b) Providing information and encouraging the framing of lifetime income streams in a consumption frame rather than investment frame. • While government underwriting of longevity insurance may be helpful at the margin, we do not expect it to have a major impact on the take-up of lifetime income streams.

Essay	Main recommendations
9. Establishing contingency accounts (i.e. capital reserves) as a standard component of retirement solutions	• Policymakers should enable the offering of “contingency accounts” from which members can draw to support spending that is not funded by regular income. A type of retirement ‘account’ should be established that is exempt from the minimum drawdown rules up to a specified value. • Super fund trustees might offer contingency accounts as a standard feature of retirement solutions, while giving members the ability to vary the amount or opt-out.
10. Drawdown rules and retirement solutions	• Any review of the minimum drawdown rules (MDRs) should account for the possibility that retirees who utilise a retirement income stream as part of their retirement solution may be forced to draw more income than is optimal. • While most solutions have adverse policy consequences or are operationally difficult to implement, two possibilities are: (1) implement a ‘drawdown discount’ (i.e. a reduced drawdown schedule) for retirees with a retirement income stream; and (2) allow trustees to tailor drawdown rules for members, which aligns with the obligations of the Retirement Income Covenant.
11. Potential role for standardisation	• Standardising certain disclosures for retirement solutions and products should be beneficial. Policymakers should investigate what can be done through a research and consultation process. • We recommend against introducing a standardised retirement product.
12. Terminology	• The term “retirement income” helps to foster misunderstanding around the purpose of retirement savings. While “retirement funding” would have been a better term, changing this now seems too hard. As an alternative, we suggest providing a clear definition of retirement income such as “drawdowns from savings to fund spending in retirement”, and substituting ‘funding’ for ‘income’ where appropriate. • The word “default” should be used only to describe situations where no member choice occurs.
13. Business barriers to developing retirement income strategies	• Super funds face a range of barriers that challenge the business case and act to delay the development of RIS. For many funds there is likely a strong conflict between the rational business case to develop a high-quality RIS and the obligation to do so. Our concern is that retiring members will be the release valve through funds delaying and/or under-developing their RIS. Policymakers should allow for these business barriers in framing policy and setting expectations around delivery times. • Policy measures such as imposing additional obligations on trustees (explored in Essay #3), introducing a retirement members outcomes assessment framework (Essay #6), and enacting a licensing regime (Essay #7) may reconcile some of the issues by providing clarity of requirements and a choice for trustees to not participate in the retirement market.

3. Responses to the consultation questions

The table over lists the consultation questions and provides a response to each. Our responses entail highlighting essays that help to address the question being asked, along with additional comments where appropriate and potentially useful. Our responses are not intended to be comprehensive, but hopefully are helpful nevertheless.

Consultation questions – Essay links and selected comments

Consultation question	Link to essays plus selected comments
Topic area 1: Supporting members to navigate retirement income	
Please provide comments on the issues facing members identified in this section, i.e. • Members face complex decisions • Superannuation is for income • Defaults, precautionary saving, withdrawing at minimum	Essays that touch on decision challenges being faced by retirees and how this links to policy formulation: • Essay #1: limits to reliance on markets • Essay #2: choice architecture • Essay #8: barriers to use of lifetime income streams • Essay #9: contingency accounts • Essay #10: drawdown rules • Essay #11: standardisation • Essay #12: terminology
What actions are industry or other participants in the community taking to address the issues identified in this section?	• Essay #13: on business barriers discusses why some funds appear to be dragging their feet in developing retirement income strategies (RIS).
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?	• Trustee direction should be a priority (see Essay #2) • Other policy measures that may assist members are covered in the following essays: - Essay #5; revamping Moneysmart - Essay #7: introduce a retirement licensing regime - Essay #8: barriers to using lifetime income streams - Essay #9: contingency accounts - Essay #10: drawdown rules in the presence of lifetime income stream - Essay #11: standardisation of product disclosures - Essay #12: defining 'retirement income' as a term
Further questions	
What does 'good' look like for how funds support and deliver products to their members in retirement?	• We recommend that this issue is addressed through imposing trustee obligations (Essay #3) and introducing a member outcomes assessment framework for retirement (Essay #6). • Retirement licensing regime (Essay #7) would also address the issue through licensing requirements.
What basic information do members most need to assist their understanding and simplify decision-making about retirement income?	• We caution about relying too heavily on members to make decisions in Essay #1 (limits to reliance on markets) and Essay #2 (choice architecture). • Essay #5 on Moneysmart discusses one approach to providing members with information. • Essay #11 supports standardisation of disclosures, and suggests further investigation through a research project and consultation.
Where can government and industry reduce complexity in the retirement income system, and provide simpler consumer experiences?	• Our general position is that complexity will be hard to reduce (see Essay #1), and hence it is better to focus on assisting members to navigate complexity. • An expanded role for super funds through facilitating trustee direction see (Essay #2) is key in our view, as it affords members with an opportunity to have trustees make complex financial decisions with respect to retirement on their behalf. • Essay #11 supports standardisation of disclosures in part to reduced complexity.

<table>
<tr><th>Consultation questions (continued)</th><th>Link to essays plus selected comments</th></tr>
<tr><td>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?</td><td>This is the central issue addressed in Essay #2 on the choice architecture, where we recommend facilitating some form of trustee direction.
Essay #4 on trustees accessing and using personal information addresses one of the major barriers to funds assisting individual members.</td></tr>
<tr><td>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?</td><td>Addressed in Essay #4 on trustees accessing and using personal information.</td></tr>
<tr><td>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?</td><td>We offer no comments on SMSFs.</td></tr>
<tr><th colspan="2">Topic area 2: Supporting funds to deliver better retirement income strategies</th></tr>
<tr><td>Please provide comments on the need to support competition and comparisons across the services and products funds provide in retirement, or the need for greater consumer protection.</td><td>Essay #1 highlights the significant limitations on effective competition and member choice in the retirement phase. Only so much can be done to improve the operation of the retirement market, and the impact is likely to be modest.
Measures to buffer consumer protections are discussed in a number of essays:
- Placing clearer obligations on trustees (#3)
- Member outcomes assessment for retirement (#6)
- Licensing regime (#7)
Essay #5 raises the issue of whether a revamped Moneysmart might be able to provide comparisons.
Essay #13 on business barriers notes that weak competition constrains the business case for developing RIS (i.e. there is very limited upside).</td></tr>
<tr><td>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?</td><td>While we do not directly address this question, Essay #5 on a revamped Moneysmart has relevance.
In Essay #1 we comment that it is difficult for the work of research houses to reach members directly.</td></tr>
<tr><td>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 discussion paper lists these potential policy responses:
Standardised product disclosure framework, including RIS assessment
Tools for comparison and performance, including a YFYS style test
Addressing regulatory barriers (with no specific proposals put forward)</td><td>Establishment of a RIS assessment framework is discussed in Essay #6. We consider this a priority.
We endorse taking measures to standardise disclosures, as discussed in Essay #11.
Essay #5 raises the question of whether a revamped Moneysmart could provide a vehicle for retirement solution and product comparisons.
We address the application of the YFYS performance test to retirement in Essay #6, and suggest caution over doing so. We note that a Treasury review on this topic is expected, and would expect that any action on this front would follow this process.
We encourage the Government to consider a retirement licensing regime, as outlined in Essay #7.</td></tr>
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Consultation questions *(continued)*	Link to essays plus selected comments
Further questions:	
What are the key characteristics or metrics for comparing retirement income products and services?	• Our stance appears in the Conexus Institute papers that are being cited in the Treasury discussion paper. • The discussion in Essay #6 on member outcomes assessments and the applicability of the performance testing to retirement are also relevant.
What approaches could make product disclosure useful for members? How might barriers such as complexity, or individuality of products, be overcome?	• Essay #10 addresses standardisation of product disclosures and suggests undertaking a research project and consultation to establish what might be done, given that this is a specialist and nuanced topic. • Our misgivings over applying performance testing in retirement (see Essay #6) also apply to retirement solution and product comparisons. Nevertheless, Essay #5 raises the question of whether a revamped Moneysmart might carry comparisons on some level.
What barriers are there for product switching in retirement and are there opportunities to make product switching easier?	• We do not directly address this issue. However, we note that major barriers to switching include capacity of members to choose and incumbency (both discussed in Essay #1) and inability or costs to exit for lifetime income products.
Topic area 3: Making lifetime income products more accessible	
Please provide any comment on the barriers in the supply and demand for lifetime income products.	• Essay #8 is focused on the barriers to take-up of lifetime income steams (products).
What actions are industry or other participants in the community taking to assist retirees to better manage the risks for retirement income?	• Our essays tend to focus on policy options to assist members to manage risks, rather than the current state of industry practice. In this regard, the relevant essays include: - Essay #2: choice architecture - Essay #4: personal information - Essay #8: contingency accounts - Essay #10: drawdown rules
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?	• Essay #8 highlights two areas where policy measures might significantly impact on the use of lifetime income streams: - Embedding lifetime income streams within comprehensive retirement solutions that are offered via a recommended or default should be the *most* effective way of getting members to take up lifetime income streams. This in turn buffers the case for facilitating trustee direction, as discussed in Essay #2. - How lifetime income streams are often framed to members is another important issue, e.g. presented or viewed as an investment product rather than income product. Policymakers may be able to influence framing through information provision and disclosure requirements.

Consultation questions *(continued)*	Link to essays plus selected comments
Further questions:	
What product options (or strategies within current retirement products) could better manage risks to retirement income?	• Essay #10 on drawdown rules has relevance by highlighting the interaction between the minimum drawdown rules and lifetime income streams. Here we warn against tightening the minimum drawdown rules, and suggest they might be adjusted to allow flexibility in the presence of lifetime income streams.
What is the role for a 'suggested' product in overcoming low take-up of lifetime income products?	• We discuss the suggested 'standardised retirement product' in Essay #11 on standardisation, where we question the need for a Government mandated or endorsed retirement solution. • As argued in Essay #8, embedding lifetime income streams within a recommendation or default for a comprehensive retirement solution should be the most effective way to increase use of lifetime income streams. The 'suggested product' would need to be deployed in this way to have greatest effect.
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?	• While we offer no detailed comments, we do see signs of developments occurring around the delivery of lifetime income streams by funds to their members. Life insurance companies are also actively courting funds to support them through outsourcing.
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?	• Essay #8 questions whether the Government directly entering the market through underwriting longevity risk is needed. We argue it would have no meaningful impact on use of lifetime income streams. • We sense that the industry does not need assistance to offer lifetime income streams, as outsourcing to life insurance companies will be readily available to small-medium sized funds. • Government underwriting of longevity risk would improve pricing for members (see Essay #8), but may have unintended consequences for the industry.
Questions on the standardised retirement product • 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)?	• We discuss the standardised retirement product idea in some depth in Essay #11 on standardisation. • Our general stance is that we query whether it is necessary for the Government to direct the industry in this manner. Policy efforts may be better directed at prodding and assisting funds to develop their own solutions to an appropriate standard. • If a standardised retirement product is to be introduced, it is important that it has functionality to cater for the differing member needs. We raise the point that doing so adds complexity, which moves away from the ideal of providing a basic product. • The 'example bundled retirement product' appearing in the Appendix is very well-designed in terms of components and functionality. It would provide a good foundation if the standardised retirement product idea is pursued. • The term retirement "solution" better describes what Treasury is suggesting than "retirement product" (see Essay #13 on terminology).

Essay #1 – Limits of reliance on markets in the retirement phase

Main recommendations

1. The retirement phase is more prone to market failures that both inhibit competitive forces and limit the capacity of members to make informed choices. Policymakers should be cognisant of this feature in formulating retirement policy, and remain cautious over placing reliance on market mechanisms.
2. Competition in the retirement phase is weak, primarily due to an incumbency effect that results from many interacting factors including complexity, weak financial literacy, limited access to comparators and switching costs (likely alongside trust in existing providers). Competition appears far healthier in the advised pathway. A small number of policy proposals that might improve competitive tension are made via other essays.
3. Limits on the capacity to make informed retirement decisions varies considerably across members. Additional policy focus should be given to assisting those members with low capacity and willingness to make decisions for themselves to ensure they are not left exposed. A number of policy proposals are made to this effect via other essays, most of which are aimed at helping ensure that fund trustees are acting in the best interests of members.

Motivation

A foundational issue for policy formulation is the extent to which reliance can be placed on market-based mechanisms such as competition and individual choice to deliver the best outcomes for individuals and society at large. And where the market is liable to fail, what alternatives are available to ensure good outcomes for individuals and society. We open our set of essays by considering this age-old debate with respect to the retirement phase.

Market-based approaches can bring significant advantages and should not be discarded lightly. Indeed, our view is that a market-based approach should be given initial consideration and treated as the default. Where the market works, policy makers should either leave things be, or set out to assist the market to operate more efficiently.

Unfortunately, we see substantial areas where market mechanisms are liable to fail in retirement. To a large extent, potential failures relate to the complexity of retirement, where individuals with widely differing circumstances and needs are required to convert assets into income under conditions of uncertainty over both investment returns and longevity (among other matters). We outline the main potential sources of market failure in retirement further below.

Our prime motivation for this essay is thus to issue a warning against relying too heavily on the markets in devising policy, and point to areas where alternative action may be needed. Many of the essays that follow below and the associated recommendations for policy action are aimed at addressing some notable areas of potential market failure.

After providing background and identifying key sources of potential market failure, we move to separately address the limits of the market in two broad areas. Part A deals with limits to effective competition in retirement, and hence the extent to which policymakers can rely on markets to discipline providers. Part B then addresses limits on the capacity of many individuals (which we refer to as super fund 'members') to make informed retirement decisions. Member choice impacts outcomes in two different ways: firstly as a potential driver of competition (part A), and then directly if members make well-considered, informed choices (part B).

Background

The limitations of market-based approaches in financial services has been long been recognised in policy circles. Multiple references to the shortcomings in the operation of markets and for individuals to be subject to various 'behavioural' influences can be found in the Super System (Cooper) Review of

2010[1], the Financial System Inquiry of 2014, the Productivity Commission Super Review of 2018 (PC (2018a) into efficiency and competitiveness in superannuation, and the Retirement Income Review of 2020. Also of note is *ASIC's REP 632 Disclosure: Why it shouldn't be the default* of 2019 warning against the limitations of disclosure as a mechanism to drive good outcomes through consumer choice; and the Government setting up a Behavioural Economics Team (BETA). The Treasury retirement discussion paper of December 2023 also recognises the difficulties that members have in making retirement decisions in the face of complexity, e.g. the discussion on pages 8-10.

The possibility that markets can fail is thus widely acknowledged, and hence is not at issue here. Rather, the issues relate to where and how markets are liable to fail, and what actions might address the situation. Our central theme is that the propensity for market failure is relatively high in the retirement phase. This calls for placing less reliance on the market, and a greater need for action to ensure good consumer outcomes in the retirement phase such as government intervention.

Retirement is quite different to accumulation. Pre-retirement, the primary focus is the accumulation of wealth and investment returns are the central concern. Post-retirement, the focus shifts to deployment of accumulated wealth. Retirement solutions facilitate this deployment through combining investments, products and strategies to generate outcomes that are largely defined by delivery of income. Retirement outcomes are impacted by a broader range of drivers and risks beyond investment returns, most notably longevity risk. The Age Pension also enters the fray as an additional asset that is available to many members. The need to cater for significant member differences is much greater in retirement, which is more an exercise in tailoring to individual needs. Member services such as advice and guidance are far more important. This situation gives rise to considerable complexity that lends itself to market failure. Policy formulations applied in accumulation to enhance the operation of markets – such as member choice and the Your Future, Your Super performance test – are liable to be much less effective.

In this essay, we first identify the major sources of potential market failure in retirement. We then outline how these market failures can impact on competition in part A, and on the capacity of members to make informed retirement decisions in part B.

Before proceeding, a distinction is worth making around the two levels of choice that retirees face:

a) **Choice of provider** – Retirees need to select the super fund or other provider that delivers a retirement solution, financial products from which a solution is constructed, or related services such as financial advice and guidance. This is the counterpart of 'choice of fund' in accumulation.

b) **Choice of retirement solution** – Retirees need to choose either a comprehensive retirement solution, or products from which a solution is constructed and couple it with a drawdown plan to generate income. This the counterpart of 'choice of investment option' in accumulation.

We will discuss competition in part A as synonymous with choice of provider, noting that this is an over-simplification as competition may also occur at the solution or product level. The latter would occur through members choosing solutions or products that are available within the market, rather than adopting a provider and then using one of the offerings made by that provider. The discussion in part B of capacity of members to make informed retirement decisions relates to both levels of choice.

Potential sources of market failure in retirement

Below we outline four potential sources of market failure that may inhibit either the effectiveness of competition or the capacity of members to make informed choices in the retirement phase. The discussion sets the scene for identification of areas where policy intervention could be beneficial.

1. **Cognitive limits, i.e. bounded rationality** – Members are being asked to make decisions when many face cognitive limits related to financial literacy, behavioural influences and possibly cognitive decline with age. Nevertheless, members can vary significantly in their cognitive abilities when it comes to financial decisions. While many members may lack the capacity to make well-informed

[1] See Section 3.3. and 4.1 of Part One of the Final Report in particular.

choices for themselves; others will be quite capable. Thus any market failure that stems from cognitive limits may not be universal, but may relate to certain member groups.

2. **Complexity and information asymmetry** – Not only do many members have limited capacity to make informed financial decisions, but making effective decisions in retirement is quite difficult. High complexity in retirement hampers the ability to compare providers and to understand solutions, products and strategies (which often needs to be explored in combination). Considerable information asymmetry can exist between providers and the member. These features inhibit the capacity of members to make effective choices and drive competition. Some risk also exists of complexity and information asymmetries being weaponised by providers through obfuscation and redirection to choices that are not in the member's best interest.
3. **Market frictions, including switching costs** – It can be more difficult to switch providers or products in retirement for a range of reasons. The cognitive load and time involved in making a switch between complex and often hard-to-compare offerings is considerable. Further, switching out of lifetime income streams – if it is even feasible – typically entails some sort of cost, such as incurring exit penalties or sacrificing of the accrued longevity insurance upon leaving the pool. These frictions hamper the operation of the market.
4. **Less-than-competitive markets** – Members have the opportunity to switch providers, but there is little evidence of switching. It appears that a form of fund incumbency exists based on many factors ranging from familiarity with, and trust in, the present provider; to the complexity of retirement and the difficulty of choosing a super fund for the retirement phase.

A comment on the role of informed agents in fostering competition

Informed agents comprise those who are active, knowledgeable participants in the marketplace. They can help to foster competition through contributing to a more informed marketplace. They can do this via education, providing comparisons, and directing individuals to products offered in the market. In the context of retirement, we consider financial advisers, external research houses and government comparison sites as candidate informed agents.

Financial advisers provide a personalised service to their clients utilising a range of service providers, the products of which are often offered via a 'platform'. In effect, the platforms represent a separate segment of the retirement sector that is targeted by a smaller number of superannuation (super) funds, in particular 'retail' funds. Many of the services provided by the funds operating in this segment are designed to enable financial advisers to run their businesses efficiently. There are indicators that this market segment is quite active and appears to exhibit more of the elements of good competition. However, this segment is constrained in size as adviser numbers are at historically low levels (circa 16,000 advisers), and for structural reasons is unlikely to grow quickly. Accordingly we focus on the marketplace that does not involve external financial advisers, which is effectively the trustee-to-member segment.

External research houses are beginning to undertake retirement solution research. However it is unclear how their research will directly reach, hence influence, individual members. It is also unclear to what degree their research will consider integrated retirement solutions tailored to relevant cohorts. Finally there are presently no government comparison sites that focus on providers in the retirement phase of super[2]. We raise the issue of whether this might be possible through an expanded version of ASIC Moneysmart in Essay #5.

Overall, these informed agents seem unlikely to foster effective competition across the retirement market, although they may be able to contribute to competition at the margin.

[2] The ATO's YourSuper comparison tool provides comparison information for accumulation options.

When the market fails … what are the alternatives?

Below we list three types of action that might be taken in situations where markets are liable to fail, and are relevant for the retirement market and the potential policy measures discussed in this submission:

(a) Taking action to address the market failure.

(b) Government intervention in the market, either through regulation or direct involvement by providing products and services.

(c) Ensuring that individuals have access to well-informed and aligned 'agents' that can either assist them to make decisions or make decisions on their behalf.

In retirement, the parties that are best positioned to act as informed and aligned agents include financial advisers and super fund trustees. The agent approach is particularly well-suited to overcoming any inability of members to make retirement decisions for themselves. It might also help address any lack of competition, although this requires the agent to be choosing from offerings that are available on the open market. Financial advisers offer the potential to both assist members and drive competition, but do so at a greater cost and are capacity constrained. Super funds offer the potential to assist members in a low-cost and scalable way. However, they cannot be expected to drive competition.

The potential policy measures that we discuss in this submission all fit into at least one of the three types of actions listed above. In this regard, we feel that the Treasury retirement discussion paper has put insufficient weight on the role that super funds might play as an informed and aligned agent under (c). Accordingly, many of the potential policy measures we discuss are directed at ensuring that fund trustees are acting in the best interests of their members by delivering suitable retirement solutions, and that no member is left behind. In doing so, they aim to buffer the fiduciary and best interest duties that already exist for fund trustees, while improving delivery standards.

Part A) Choice of provider and competition

This part investigates competition in retirement, highlighting the barriers to effective competition. We explain why competition is weak between providers of retirement solutions, and likely to remain so.

Importance of competition in retirement

Productivity Commission Competition in Financial System Inquiry (2018) (PC (2018b)) states the benefits of competition in financial services: *"Competition has been demonstrated repeatedly, in both Australia and abroad, to generate strong incentives for providers of services and goods to act efficiently and, at the same time seek to meet the constantly-changing needs of consumers."* They further cited the work of Fletcher (2011)[3]: *"At their best, competitive markets adequately meet society's needs with little government intervention. When both sides of a market function well, a virtuous circle is created between consumers and competition."* These sentiments are shared by FSI (2014) and PC (2018a). We acknowledge that competition can be quite beneficial, and agree it should be fostered where effective.

Current state of competition

Unfortunately, competitive forces have often been weak within financial services, including super. PC (2018b) states that *"there is no prospect that Australia's basic financial markets will be fully competitive."* PC (2018a) largely focused on the accumulation phase of superannuation, identifying that (1) *"On some indicators, the system looks competitive"*; but, (2) *"Muted competitive pressure from the demand side — members and their advisers — means that competition is not playing the corrective role that it does in other, less complex markets."* The PC also states that: (3) *"In the default segment, competition is at best superficial. Members who default are typically disengaged and exert no competitive pressure — there is limited or no competition in the market. As a result, competitive pressure has to come … for the market.*

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[3] Fletcher, A., *Competition in the microscope*, 11 January, 2011.

But this is not happening either. Default policy settings mean that competition is muted. In particular, those funds that have gained access to the default market face no systematic pressure to compete strongly."

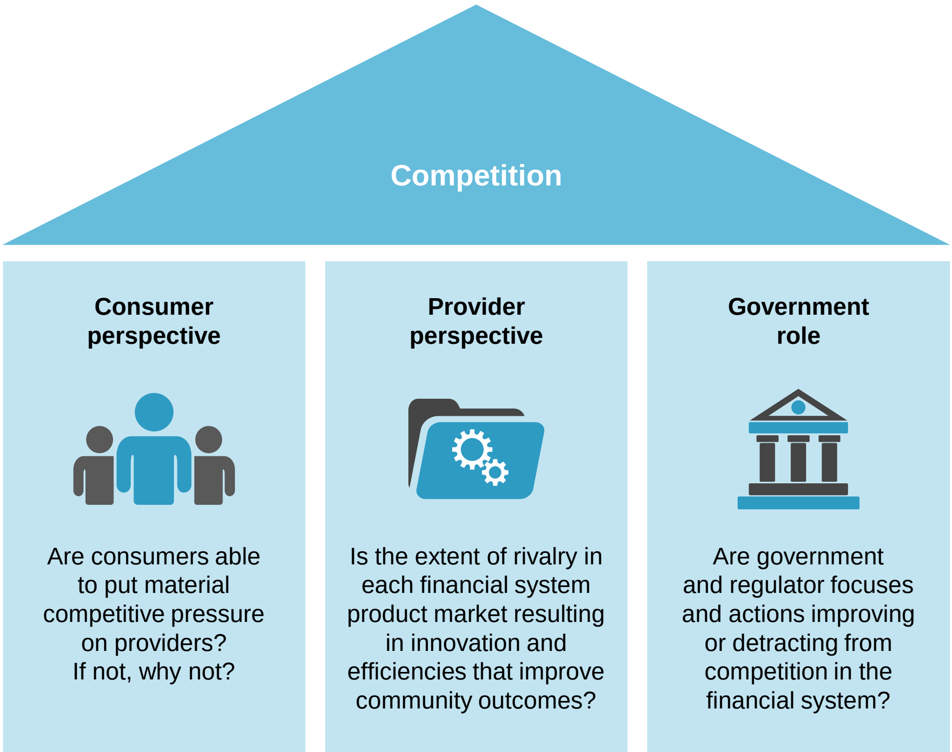
Since the inquiry by PC (2018a) there have been multiple policy and regulatory initiatives aimed at creating a more efficient super industry. These include fund stapling (part of the Your Future, Your Super (YFYS) reforms), the YFYS performance test, APRA heatmaps, and APRA's Member Outcomes Assessments. However, while these measures improve accountability and system efficiency (e.g. fund stapling), they do not necessarily address market competitiveness[4].

The retirement phase of super is at a relatively nascent stage. We see it characterised by the following:

- The Retirement Income Covenant (RIC) formalises an obligation for super fund trustees to develop a retirement income strategy (RIS); and is principles-based with a design intent to foster innovation[5].
- Two key client groups: (1) members, who find retirement highly complex; and (2) financial advisers.
- Policy and regulatory uncertainty in the important area of how super funds can assist members into appropriate strategies.
- Business challenges for funds in developing RIS, explored in detail in Essay #13.

In assessing competition in the retirement phase, we work with the competition framework detailed in PC (2018b), reproduced in Figure 1. Through this framework, we consider competition in the retirement phase focusing on the trustee-to-member segment.

Figure 1: Competition framework



Source: PC (2018b)

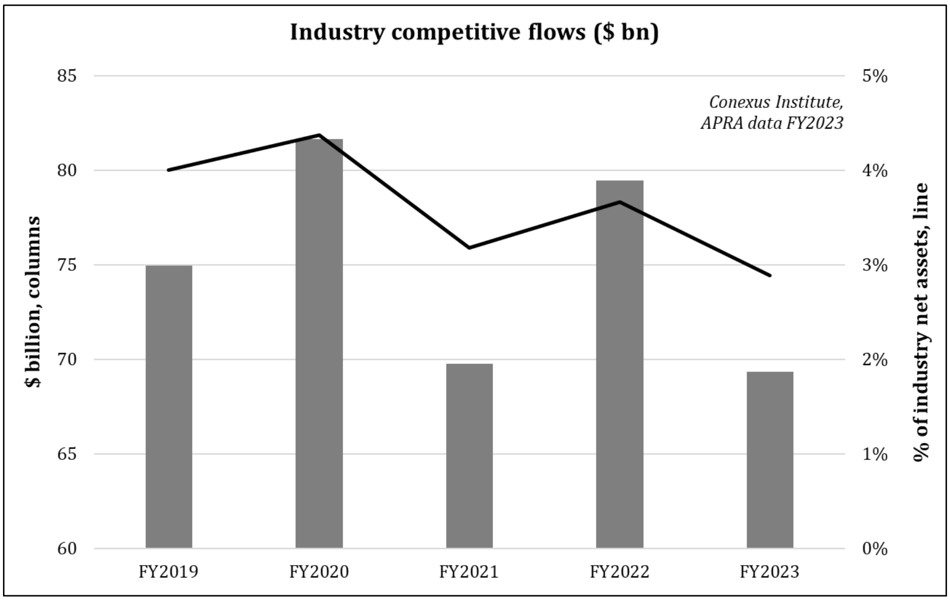
[4] There are strong arguments that the YFYS performance test and APRA Heatmaps increase peer-grouping activities amongst superannuation funds, while fund stapling is largely a competition neutral policy.
[5] See Minister Jane Hume: *"Remarks to the COTA Australia National Policy Forum on Retirement Income"*, (2021).

Consumer perspective

Current evidence suggests that consumers (i.e. members) don't contribute to competitive pressure amongst super funds. There is little to suggest that this situation will change. Analysis by the Conexus Institute (see Figure 2) reveals that overall member fund switching activity is declining. Further, much of this switching activity appears to be undertaken by financial advisers (which we do not consider). However, it is unclear whether the switching level is different amongst pre-retirees and retirees. We believe that the degree of member switching during the retirement phase is small, and that an incumbency effect exists.

Figure 2*: *Industry competitive flows

Measured by total one-sided fund-to-fund switching activity



There are multiple factors indicating that this situation will continue. The core challenge is a self-reinforcing combination of (commonly) low levels of financial literacy, the complexity of retirement (which is increasing), and the inability to readily compare provider offerings. Switching costs, especially the personal time commitment required to switch providers, represents a further barrier to switching.

Provider perspective

At present it is difficult to identify strong rivalry amongst super funds with regard to RIS. Two important elements here are competition for the market and competition in the market:

1. Competition for the market is defined by Geroski (2003)[6] as *"the struggle to create a new market, or to erect a new standard, and it is usually associated with the process of innovation that brings new displacing technologies to market"*. We identify very little competition for the market due to the incumbency effect between members and their existing funds. This incumbency effect is not impacted by the RIC, which only creates an obligation to take action in developing a RIS but bypasses the process of creating a new marketplace and fostering competition within that market.
2. Competition in the market is defined by Geroski (2003) as *"the conventional view of competition, and concentrates on the actions of incumbents and imitative entrants in well-established markets"*. The incumbency effect limits competition in the retirement market. While some innovations have been forthcoming[7], it is difficult to gauge the degree to which these are a result of rivalry versus obligation.

[6] *"Competition in Markets and Competition for Markets"*, P. A. Geroski, Journal of Industry, Competition and Trade (2003).

[7] See for example, the Aware Super Retirement Confidence Score and associated app.

Government perspective

Overall, the current Government and regulator policy settings appear to aid competition to a moderate degree. The RIC, while principles-based and intended to foster innovation, effectively bypasses the issue of fostering competition in the new market for retirement. This means that the efforts and innovations to create a market are not being experienced, leaving incumbency effects to dominate.

The regulatory approaches of APRA and ASIC are evolving. The highlight has been the 2023 joint thematic review[8], from which examples of good practice have been shared with the marketplace. This feedback process aids innovation and standard raising in a manner that members would struggle to achieve. However, it does not directly impact on competition for members.

Finally, we note that Government provides little assistance to help to compare retirement solutions, products and services. In accumulation, the two main consumer-facing information services are ASIC Moneysmart (which doesn't consider individual products) and the ATO's YourSuper comparison tool (which only considers accumulation products).

In summary – weak competition in retirement phase

Our overall reflection is that competition is presently weak in the retirement phase of super. There is a strong incumbency effect that is influencing members, little rivalry amongst providers, and Government policy and regulatory settings have had modest impact in fostering competition. Table 1 summarises our analysis.

Table 1*: Summary assessment of competition framework applied to retirement phase*

Consumer perspective	Provider perspective	Government / Regulators
• Low member fund switching activity • Incumbency effect • Combination of: - Low levels of financial literacy - Complexity of retirement - Inability to readily compare provider service offerings (with very little assistance from government) - Switching costs, especially the personal time commitment to switch providers	• To date a modest number of funds have advanced their offering in the retirement space • Little competition for the market due to: - the incumbency effect between members and their existing funds - impact of the RIC bypassing the creation of a new market • Business cases impaired by policy uncertainty, limiting the incentive to innovate	• Government and regulator policy settings moderately aid competition • The RIC bypasses the creation of a new retirement market but attempts to foster competition within the market • Regulatory approaches of APRA and ASIC are evolving but have aided a feedback loop which consumers would struggle to enact themselves • Government provides little assistance to help consumers compare financial products and services relating to retirement • Policy uncertainty in many areas, including advice and guidance, impair business cases

Source: The Conexus Institute

[8] Information report - Implementation of the retirement income covenant: Findings from the joint APRA and ASIC thematic review

Possible actions to create more competition in the retirement phase

There are some actions that could create greater competition between super funds in the retirement phase:

1. **'Disrupt' the incumbency effect in retirement** – The term 'disrupt' isn't intended to damage a trusted relationship a member has with their fund, so any policy developments would have to be cognisant of this risk. Broadly, policy interventions could be developed that create a formal need for members to choose a fund provider for retirement (which could include their incumbent). Policies of this nature were considered with respect to choice in accumulation in PC (2018a). The recommendation consisted of an assisted choice framework linked to a 'best in show' shortlist of providers. This would represent substantial and potentially disruptive change, which we would defer recommending until super funds have suitably evolved their offerings.
2. **Provide services to assist members in choosing a retirement provider** – This includes financial literacy programs (with a long timeframe for impact) and comparator services. The second has merit, and is something that Government might consider. Here the preparedness to provide a recommendation of a provider, as opposed to metric-based information (which is more complex in retirement versus accumulation), is a threshold issue for Government. This issue is further explored in Essay #5.
3. **Introduction of a retirement licensing regime for funds** – Essay #7 explores the case for a licensing regime. Assuming that not all funds would be licensed, this would create potential for competitive tension as funds with a retirement license compete for the accumulation members of unlicensed funds that are entering or contemplating retirement.
4. **Continued joint thematic reviews by APRA and ASIC** – Sharing of best practice examples could tap into the 'spirit of rivalry'.
5. **Provide policy certainty** – This would de-risk business cases, potentially allowing new innovative ideas to be implemented by super funds.

Part B) Limits on the capacity of members to make informed retirement decisions

The need to make decisions under a combination of cognitive bounds and considerable complexity and information asymmetries provides the primary source of the limits on the capacity of members to make informed retirement decisions. This situation impacts on the ability of members to identify both the provider and the retirement solution that is best able to meet their needs. The ability to access suitable solutions is further influenced by market frictions such as switching costs and incumbency effects, which can tend to lock members into a particular provider – most likely their existing super fund.

Figure 3 is lifted from PC (2018a). Shortcomings in all three pre-requisites for effective engagement are exacerbated in retirement, including skills, knowledge and attitudes (with the latter being inhibited by incumbency effects). This situation can leave members exposed to the risk of landing in unsuitable retirement solutions that deliver poor outcomes. The policy challenge is to limit the scope for this to occur.

Figure 3: Pre-requisites for effective engagement with financial decisions

What do members need to engage effectively?

To effectively engage with the superannuation system, members require knowledge and skills. However, knowledge and skills are not useful if there is no motivation to engage. Conversely, as outlined in the figure below, a preference for engagement may not translate into good outcomes if members do not have the necessary knowledge and skills.

Skills, knowledge and attitudes to engagement are all important

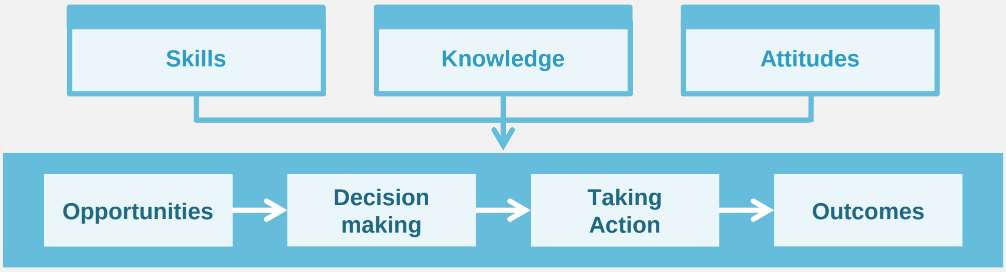


Figure adapted from ASIC (2013b)

Source: PC (2018a), page 250

An important nuance is that the way that members prefer to engage with retirement decisions and the limits on their capacity to make those decisions varies considerably. A key theme of the Conexus Institute's research on the decision 'pathways' for identifying retirement solutions[9] is that large differences exist in the willingness and capability of members to engage, and that this should be recognised and accommodated in formulating policy. *Here a key policy objective might be to ensure all members are being looked after, and protected from the impact of potential sources of market failure.* To meet this objective, policy may need multiple prongs in order to cater for different member types.

Of particular concern is members who are particularly poorly placed to make informed retirement decisions, yet are unlikely to seek personal financial advice due to an aversion to paying for advice or because advice is not cost effective or accessible. These members may have very low financial literacy, poor comprehension (e.g. migrants with poor English), low cognitive ability, or simply suffer from 'fear of finance'[10] that leads them to avoid making financial decisions. Cognitive decline with age may also be at play. One sign this type of member exists is the substantial number of members who appear to have retired but are still invested in accumulation accounts[11]. This type of member is likely to be the most vulnerable, and hence might be a primary focus for policy action.

Potential policy measures to improve decision making for retirement

Below are four categories of policy measures that could help mitigate limits on the capacity of members to make informed retirement decisions. In line with the notion that policy should have multiple prongs, a range of the measures discussed below might be pursued. Some of the essays that follow will address selected measures in detail.

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[9] *Ensuring all retirees find a suitable retirement solution*, August 2021 and *Pathways for directing members into retirement solutions*, November 2023.

[10] For instance, see *Fear of Finance*, Barclays, 2019.

[11] We estimate that members aged 65 and over had $226 billion in assets and 1.37 million accounts in the accumulation phase at June 2022 (last available data from APRA). While there are many explanations (see page 10 of our 'pathways paper'), it seems likely that a meaningful portion of these members are failing to act out of either inertia, low engagement or poor understanding.

1. **Measures to improve the operation of markets** – Such measures would largely be directed at assisting those members who are willing and capable to make choices for themselves. The policy aim would be to assist these members by ensuring that the market is operating as well as it can through addressing potential market failures and frictions. The measures might include actions to ensure that members have the resources available to make informed decisions, and that complexity is reduced as much as is practicable. A number of the 'potential policy responses' in the Treasury retirement discussion paper sit within this category, including improving guidance, education and communications (pages 10-11), simplifying the retirement system (pages 11-12), standardisation of product disclosures (pages 17-18), and providing tools for comparison and performance (page 18). The idea of the Government providing support for better longevity pricing (page 24) is also motivated as a way of addressing market failure in an insurance market. To this effect, standardisation of disclosures as discussed in Essay #11 should help improve the operation of markets and the ability of members to choose.
2. **Make guidance and assistance readily available** – Another category of policy measures might aim at providing guidance to assist members to make better retirement decisions for themselves. This category is distinguished from that above by some sort of recommendation or direction being offered by trustees. The main potential policy response listed in the Treasury discussion paper within this category is allowing funds to present members with 'defaults' (we prefer the term 'recommendations' – see Essay #12) for particular settings or solutions for member sub-classes with which the member self-identifies. Other policy proposals also sitting within this category have been mentioned as part of the Delivering Better Financial Outcomes (DBFO) reforms, including permitting super fund trustees to 'nudge' members and expanding general and infra-fund (i.e. collectively charged) advice. One other possible policy measure, which we discuss in Essay #5, would be a significant revamp and expansion of Moneysmart to assist members in identifying a suitable retirement solution. Other ideas that would sit within this category would be the Government facilitating public access to the fund and product research from research houses; or establishing an expert panel to rank and endorse retirement providers, solutions or products, similar to what was suggested by the PC (2018a) review. We express caution on the use of metric-based comparators for retirement as retirement is highly complex with many dimensions to consider.
3. **Aligned 'agent' that looks after the member** – Another avenue involves ensuring that members who need assistance have access to an aligned agent who can make retirement decisions on their behalf. Financial planners play this role, although are costly and capacity constrained (as discussed in our 'pathways' papers. The other obvious candidate is super fund trustees. We discuss the need for trustees to play this role in Essay #2 where we argue that facilitating trustee direction, whereby fund trustees identify and offer a comprehensive retirement solution on behalf of the member. Policy actions under this category would largely be aimed at ensuring that the agent is acting in the best interests of the member, which would include emphasising fiduciary duty in the case of super fund trustees. In this vein, Essay #3 discusses the idea of imposing an obligation on fund trustees to attempt to offer suitable assistance to every retired member. Other measures we discuss that could help ensure that fund trustees are providing suitable assistance to members include establishing a member outcomes assessment framework for retirement (Essay #6) or introducing a retirement licensing regime (Essay #7).
4. **Impose minimum standards of delivery** – Another category of policy measures would aim to ensure minimum standards of delivery to guard against members landing in highly unsuitable retirement solutions due to limited capacity to make retirement decisions – a risk that is heightened by limited competitive pressure to provide quality solutions, as discussed in part A. A number of our essays are directed at the aim of ensuring minimum standards. Essay #3 explicitly recommends imposing an obligation on trustees to "provide retirement assistance to at least a minimum standard". Essay #6 discussing the establishment of RIS member outcomes assessments with APRA oversight should have the effect of ensuring minimum standards while encouraging continual improvement. Essay #7 explores the case for a licensing regime, which could provide a powerful mechanism as meeting minimum standards would be required to operate in the retirement market.

Essay #2 – Role of superannuation fund trustees within the choice architecture for retirement solutions

Main recommendations

1. The role that superannuation fund trustees are expected to play within the choice architecture for retirement is a foundational issue for policy. We recommend that the Government make clear its position on this matter; and factor it into policy formulation including the Delivering Better Financial Outcomes (DBFO) reforms.
2. The potential 'choice spectrum' ranges from member self-direction, to various forms of trustee guidance, through to true defaults. We see benefit in enabling trustees to span much of the spectrum, including some form of trustee direction under which trustees identify a comprehensive retirement solution for members who are not capable or willing to make financial decisions for themselves.

Motivation

We have two primary motivations in writing this essay. The first is to make an appeal to policymakers to establish a clear position on the role that super fund trustees are expected to play within the choice architecture. We see this as foundational for the formulation of policy with respect to the role of trustees in guiding members to suitable retirement solutions. We sense that policymakers may not have yet established a clear position on this matter, or if they have, the position could be enunciated.

A second, more important motivation is that we are concerned there exists a class of members who are not well placed to make informed decisions over financial matters for retirement, and that the policy debate is not directly addressing how to best cater for these members. The type of member we have in mind may lack the cognitive ability or motivation to engage with retirement decisions, and is discussed in Essay #1. We suspect that some members in this group are traumatised by the idea of making financial decisions, and would actually *prefer* that somebody provide them with clear direction rather than make *any* choices for themselves. We consider super fund trustees to be a natural party to assist such members by selecting a comprehensive retirement solution on their behalf, and offering it to them. We hence use this essay to argue that some form of 'trustee direction' should be facilitated.

Our overall position regarding the role of super funds within the choice architecture is that we see benefits in fund trustees playing multiple roles, thus catering for the variety of ways in which members engage with retirement decisions. Within this, we consider it important that the role extends to making choices on behalf of members who are incapable or unwilling to make financial decisions.

Background

The role that superannuation fund trustees might play in guiding members has become a central policy issue. In a speech on 7 December 2023, Minister Stephen Jones indicated the intent of the Government to "expand the role of superannuation funds in providing advice to their members" under the DBFO reforms. He referred to various potential adjustments to the advice framework including a new class of financial adviser, defining the topics that may be addressed under collective charging, and allowing funds to 'nudge' members. The issue of providing better guidance and assistance to members also emerges in the Treasury retirement discussion paper. This includes mention of nudging members through 'default' settings, or 'default' solutions for sub-classes of members (which we refer to as member 'types'); simplifying the retirement system so it is easier for members to navigate; and standardising product disclosures so they can be more readily understood and compared by members.

The role that trustees might play in guiding members was addressed in a Conexus Institute paper of November 2023 titled "Pathways for directing members into retirement solutions", denoted here as our 'pathways paper'. This paper discussed the mechanisms through which members might find their way to a suitable retirement solution. We delineated the pathways according to the party responsible for identifying the retirement solution. This included the member themselves (self-direction), a financial adviser (adviser direction) or a super fund trustee (trustee direction). The latter comprised three pathways of trustee recommendation, trustee assignment and default. We envisaged the trustee direction pathways entailing trustees identifying comprehensive retirement solutions for individual members, with members required not to make any choices other than whether to request trustees to provide direction and then whether to accept the retirement solution they were offered. That is, we assumed that the member would not be forced to make any financial decisions unless they wanted to.

This essay builds on our pathways paper in focusing on the role that super fund trustees might play in the choice architecture for retirement solutions. We revisit and hone the choice structure presented in the pathways paper in light of the stated intentions of the Government with regard to the DBFO reforms and the Treasury retirement discussion paper, particularly around the mention of 'nudges' and 'defaults'. One motivation in doing so is to point out the need for policymakers to establish a clear position on the role (or roles) that they envisage trustees playing, and then look to enable trustees to perform their role(s) through the policy framework.

Framing the policy discussion

In our view, the current framing around the DBFO reform and the Treasury retirement consultation limits the scope of the policy discussion in some areas:

1. **Presumption that members are willing and able to choose on some level** – The current policy discussion continues to be based around a presumption that members are willing and able to choose on some level in identifying the retirement solution that is suitable for their needs (or otherwise seek out paid personal financial advice). This area was considered in Essay #1. The matters being raised by policymakers seem directed at assisting members to make better decisions. For example, the Treasury retirement discussion paper refers to nudges in the form of 'default settings' or 'default solutions' designed for member types (i.e. sub-classes). Engaging with these nudges still requires some level of choice by the member. For instance, members would still need to decide if the default settings are suitable, while making choices around solution components not covered by the nudge. Default solutions for member types require the member to exercise much less choice, but still require them to understand and self-identify with their member type. The framing does not seem to address members who may be unwilling or incapable of making financial decisions for themselves on any level.
2. **Trustee direction is not directly contemplated** – Trustee direction as discussed in our pathways paper involves the trustee identifying a retirement solution that is suitable for the member *on their behalf and offering it to them directly* – either through recommendation, assignment or default. The possibility of facilitating some form of trustee direction appears to sit outside the current discussions. Policymakers should give strong consideration to providing trustees with the capacity to identify a suitable retirement solution and offer it to individual members, thus playing a role that extends beyond presenting options to members and assisting them to make choices.

Terminology is another area where we suggest framing might be adjusted relative to that used in the Treasury retirement discussion paper. First, we prefer member 'types' rather than 'sub-classes', noting that the latter seems to presume a cohorting process. Types better accommodates other forms of engagement with the member such as presentation of member personas, or even individual tailoring (if it occurs in due course). Second, we suggest that the word 'default' should only refer to situations where the member is not required to make any choice in identifying a retirement solution or its settings; and 'recommendation' is used where an element of choice is involved. We will apply this alternative terminology in this essay; although acknowledge that policymakers may prefer to use the term 'sub-classes' as this term is used within the Retirement Income Covenant legislation[12]. Essay #12 discusses terminology and provides further discussion on the meaning of 'default'.

[12] See S52AA(4) of the *Corporate Collective Investment Vehicle Framework and Other Measures Bill 2022*.

Choice spectrum

To assist the discussion and policy formulation, we first present a 'choice spectrum' to delineate the range of roles that could be played by super fund trustees versus members in choosing suitable retirement solutions. The table below describes this choice spectrum as ranging from self-direction where a member chooses for themself, to three types of trustee guidance where the trustee offers some form of recommendation, through to default mechanisms where the trustee assigns a member to a solution. The spectrum captures the degree to which the member or the trustee is responsible for identifying either a suitable retirement solution or certain solution components.

The table adjusts the delineations in our pathways paper. We have excluded the adviser direction pathway in order to focus the table on the nature of the engagement between trustees and their members. We have also combined trustee assignment and default, denoting them as types of default in the sense that both entail the trustee assigning the member to a solution. The key difference is that trustee assignment occurs at the request of the member, while default occurs without member assent.

The choice spectrum appearing in the table captures the varying roles that might be played by trustees in guiding members towards retirement solutions. It thus maps out potential divisions of responsibilities for making decisions around retirement solutions between trustees and members. On the left side, trustees act as providers of products and services to members, who might be considered customers and primarily responsible for making decisions. On the right side, trustees act as fiduciaries who are looking after their members as beneficiaries and are carrying the decision-making load.

Choice spectrum for retirement solutions: Roles of members and trustees

Self-direction *(member choice)*	Recommended settings *(limited nudges)*	Recommended solutions for member types *(firm nudges)*	Trustee recommendation of a comprehensive solution *(strong nudge)*	Trustee assignment and trustee default *(forms of default)*
Member initiates action and makes decisions	*Trustee directs member in some way*			*Trustee assigns member*
Trustees as providers; members as customers				*Trustees as fiduciaries; members as beneficiaries*
• Trustee provides solutions, products and services, e.g. decision tools, information • Member engages with fund offerings and makes choices • Accommodated by current financial advice rules; amounts to the *status quo*	• Trustee provides solutions, products and services that include recommended default settings (perhaps for particular member types) • Member engages with fund offerings and makes choices cognisant of default settings • Examples of default settings: - recommended drawdowns - lifetime income streams for certain balances - asset mix within account-based pension • DBFO reforms might consider allowing personal information to be used in directing nudges	• Trustee offers set of recommended default solutions designed for member types (sub-classes) as defined by cohorts or personas • Member engages with options offered; may adopt solution based on self-identified member type, or choose from other solutions and products on the menu • DBFO reforms might consider allowing personal information to be used in assisting members to identify their member type, or in directing any nudges	• Trustee collects personal information and uses it to recommend a retirement solution to the member • Could be based around either member cohorts or personal tailoring • Member only required to request recommendation, which they may then accept or reject • DBFO reforms would need to permit personal information to be collected and used to ensure recommendation is appropriate for member	• Both entail direct assignment to a solution by trustee, either on request or upon member taking no action • Trustee attempts to collect personal information to effect assignment • Legislation would be required to enable trustees to assign members

The three middle columns of the table capture the forms of recommendation that might be made by trustees. The second and third columns cover what the Treasury retirement discussion paper refers to as 'default settings' and 'default solutions', where the latter entails recommended solutions for member types (or sub-classes) as defined by cohorts or perhaps personas. As mentioned above, both these forms of recommendation require engagement from members with what is being suggested, and hence entail some element of member choice or self-direction. The fourth column is trustee recommendation as described in our pathway paper, where trustees identify and recommend a comprehensive retirement solution to the member. A key point of distinction is that trustee recommendation *does not force the member to make any financial decisions*, apart from asking the trustee for a recommendation and accepting it. We view all three recommendation-based mechanisms as nudges to varying degrees, ranging from a limited nudge for recommended settings through to a hard nudge for trustee recommendation where the member is not required to exercise any choice in identifying a solution.

We envisage opt-outs being provided under all mechanisms. Trustees would also make decision support services available to all members regardless of the mechanism.

Our first recommendation for policymakers is to provide clarity over the role of super fund trustees, i.e. the parts of the choice spectrum in which they may operate. In effect, this means stating how far to the right of the above table that trustees are permitted and expected to operate. We see establishing a stance on this matter as not only foundational for policy formulation, but also important for setting expectations for both trustees and members around the role of super funds within the retirement system. We next discuss the implications of the stance adopted by policymakers in this matter, after which we recount the arguments for and against accommodating trustee direction.

Policy implications

The positioning of super funds across the choice spectrum as outlined in the above table has a range of implications for the superannuation industry and related policy, legislation and regulations. Below we highlight and discuss two implications that are important at the current juncture.

Trustee obligations

Establishing the positions on the choice spectrum across which super funds are expected to operate would inform the issue of trustee obligations. A flash point is the degree to which trustees are acting as product and service providers or fiduciaries. The provider role implies an obligation to supply an effective range of products and services that members may use. The fiduciary role implies a concern with the best interests of all members, and notably involves duties of care, loyalty, good faith, confidentiality, prudence, and disclosure. It suggests that trustee obligations might include a requirement to take positive steps to ensure that all members are looked after. Essay #3 discusses the issue of trustee obligations in more depth.

Need for trustees to collect and use personal information

The requirement for personal information about *individual members* increases in moving along the choice spectrum to the right. Under self-direction (which amounts to the *status quo*), trustees provide products and services without needing to access personal information. In this case, collecting general information about the member base would be useful for RIS design (e.g. forming cohorts), and amounts to one of the areas for improvement highlighted in the APRA/ASIC joint review. Recommendations of retirement settings or retirement solutions for member types does not strictly require access to personal information on individual members. However, access to personal information would assist trustees to gauge whether the recommendation might be suitable, i.e. whether to provide the 'nudge'. For instance, knowledge of member characteristics such as total financial assets, homeownership or existence of a partner may inform trustees on whether to recommend considering a lifetime income stream or honing the member types or personas to present to the member. Recommending or assigning members to a comprehensive retirement solution – as envisaged under trustee direction – necessitates the collection and use of personal information on individual members to be effective. For example, trustees cannot identify the cohort to which a member belongs without knowledge of how the member lines up against the personal characteristics on which the cohorts have been defined.

The requirement for access to personal information on individual members has important implications for the DBFO reforms. It determines the scope of information that trustees require in order to play their role. This in turn might affect what information trustees could be permitted to collect under any reframing of the personal financial advice rules. We revisit this issue in more depth in Essay #4, which discusses the information that trustees require to cater for retired members in an effective manner.

Case for and against accommodating trustee direction

The key question at hand is how far along to the right of the choice spectrum should super funds be allowed to operate. While our pathways paper was largely written as a reference document, we nevertheless argued that trustee direction should be facilitated in some form (see pages 3-4 in particular). However, our pathway paper was written as if a clear delineation exists between self-direction and trustee direction. As highlighted in the prior table, we are dealing with a more nuanced spectrum where there is potential for trustees to make recommendations on a lesser level than suggesting a comprehensive retirement solution, e.g. presenting recommended solutions for member types. We revisit the debate of the role for trustees in this light. That is, could nudges of a more restricted form suffice? Or is trustee direction as envisaged in our pathways paper required? Here we reiterate that the key distinction is the degree of engagement over financial decisions that is required from members, noting that it is minimised under trustee direction.

- **Effectiveness of nudges** – One argument for facilitating trustee direction is the relative strength of the nudge that it affords. A definitive recommendation (or assignment) for a comprehensive retirement solution presents as a strong offering on which the member might anchor, relative to presenting a choice menu or recommendations over particular solution settings. The advantage of a definitive recommendation is that it should increase the probability that members will adopt beneficial solution features that could otherwise face resistance. For instance, members may be more likely to purchase lifetime income streams or apply higher drawdown rates if presented as part of an integrated solution. This issue is particularly relevant given the interest expressed in the Treasury retirement discussion paper in making lifetime income products more accessible and improving drawdown behaviour. Trustee recommendations should provide a more effective means of shifting member behaviour than recommended solutions for member types, which in turn may be more effective than recommended settings. Trustee assignment and trustee defaults would be even more powerful. We see nudge strength as an important reason to facilitate trustee direction.
- **Supporting a class of member that might otherwise be left behind** – Perhaps the strongest argument for facilitating trustee direction is the existence of a class of member who is unwilling and incapable of successfully engaging with retirement decisions on any level, as highlighted in the 'motivation' section and initially discussed in Essay #1. For example, these members may have very low financial literacy, poor comprehension (e.g. migrants with poor English), low cognitive ability, 'fear of finance' or be suffering cognitive decline. Such members should benefit from being 'looked after' by trustees. Such members may be left behind in the absence of scope for trustees to select a retirement solution on their behalf.
- **Accommodating member preferences** – Providing a wide range of pathways accommodates differing preferences for how they want to engage with retirement decisions. This argument suggests allowing superannuation funds to span the entire choice spectrum, thus supporting members to choose their own pathway.
- **Legislative change that is required** – The extent of change required to the regulatory framework tends to increase as the choice architecture moves further from the *status quo* based around self-direction (and personal financial advice as currently defined). For example, facilitating trustee direction necessitates permitting trustees to collect and use relevant personal information, which in turn would be wider in scope than that required to support other forms of nudges. Trustee assignment would require additional legislation to enable trustees to make an assignment. Trustee default would require even further legislation around the default process.
- **Demands on trustees and regulators** – The demands placed on both trustees and regulators increases in moving from the left to the right of the choice spectrum, although the demands on the members simultaneously decrease. The more territory that is spanned by trustees and regulators, the greater the complexity and the more work they will need to do. For example, it is much easier for trustees to provide a range of products and services for use by members than it is to also understand and tailor for individual members. The burden on regulators also increases due to the need to assess whether trustees are operating in the best interests of members who may be disengaged. Meanwhile,

the need for financial product regulation remains. In this regard, trustee direction would entail a step-change in the demand placed on trustees and regulators, and hence should be more costly. A consideration in this regard is whether super funds and regulators can build the required capabilities to span the choice spectrum effectively.

- **Impacts on competition and reliance on trustees** – Competitive tension reduces and reliance on trustees increases in moving toward the right of the choice spectrum. Risks relate to embedding more vertical integration into the system, and the possibility that some trustees could fail to implement effectively and act in a member-aligned way. We discuss the limits on competition in Essay #1, where we argue that competitive forces are likely to be weak in retirement in any event.

After balancing these considerations, we conclude there is a relatively strong case for facilitating some form of trustee direction, i.e. the role of trustees extending into the right side of the choice spectrum. Establishing a mechanism for looking after members who are poorly placed to make decisions for themselves is our primary reason for forming this conclusion; although the ability to issue strong nudges is also a substantial consideration. We consider the benefits large enough to justify the greater effort and costs involved.

Facilitating trustee direction in the form of trustee recommendation should achieve most of the benefits, and may suffice while not requiring the same degree of legislative change. However, if trustee recommendation were to be accommodated, trustee assignment would then become relatively straightforward for funds to implement given the underlying mechanism for identifying a solution for the purpose of making an assignment is very similar to that required to offer a recommendation. Hence legislative change to permit assignment might also be contemplated. Defaults are more problematic for reasons outlined in our pathways paper, and might be considered at a later time.

Concluding comments

We have framed the issue of the role of super fund trustees in assisting retired members as related to the choice architecture around retirement solutions. The policy question at hand is how far should trustees be permitted and expected to go in guiding members to a suitable retirement solution, i.e. how much of the choice spectrum should be spanned by superannuation funds? Should super funds largely play the role of providers of solutions, products and services to members, including assisting members to make better decisions? Or should their role extend all the way to identifying a suitable retirement solution on behalf of individual members?

Our first recommendation is that policymakers determine and state a clear position on this matter as part of policy deliberation for retirement, including the DBFO reforms. Our second recommendation is to give strong consideration to facilitating trustee direction in some form. Here the central question is whether it suffices to rely on members to take action and make choices with regard to retirement financial decisions on some level? Or should trustees be given the scope to recommend or assign members to a retirement solution to assist members who are incapable or unwilling to make decisions for themselves? We see a strong case for accommodating this group of members through establishing the capacity for trustees to identify and offer comprehensive retirement solutions on the basis that there exists a meaningful group of members who would benefit.

Essay #3 – Spurring action through trustee obligations

Main recommendations

1. Obligations on superannuation fund trustees under the Retirement Income Covenant (RIC) should be further defined, with the aim of spurring action to help ensure that no member is left behind.
2. We recommend that obligations be established in relation to two matters:
   (i) Obligation to provide retirement assistance to at least a minimum standard (and ideally better)
   (ii) Obligation to attempt to offer suitable assistance to *every* retired member
3. Mechanisms that might be used to define and impose obligations on trustees include:
   - Member outcome assessments of retirement income strategies (RIS), with APRA oversight
   - Licensing regime for retirement, explored in Essay #7
   - Review of the Design and Distribution Obligation (DDO) with the intent of establishing how it will operate in retirement

Motivation

The RIC[13] places an obligation on trustees to develop a RIS. However, it places no requirements around the quality of that RIS, or whether it caters effectively for all members. This opens up the risk that some trustees could develop a basic RIS that superficially meets their obligations under the RIC but leaves some members behind. This possibility is exacerbated for super funds with a relatively small portion of assets and members who are in or approaching retirement[14], as these funds face weak incentives to apply effort and resources to RIS development (explored further in Essay #13). More clearly specifying the obligations on trustees may spur action that should help mitigate this risk. It would complement, and add focus to, the jawboning that policymakers and regulators have been directing at trustees to get on with the job of RIS development. For trustees, better-defined obligations would provide direction to help them focus their efforts; and could make more apparent what is required to operate in the retirement market.

Trustee obligations and the RIC

The RIC imposes an obligation on trustees to formulate a RIS to assist members who are approaching or in retirement (s52(8A)(a)). It requires trustees to address certain matters in forming their RIS, which might be summarised as:

- Assist members to achieve and balance the three objectives of maximising expected income, managing risks to expected income and providing flexible access to funds (s52AA(2));
- Determine the beneficiaries to which the RIS applies (s52AA(3));
- Determine the meaning of income (s52AA(5));
- Determine the period of retirement (s52AA(6));
- Gather necessary information (s52(8A)(b)); and,
- Record the RIS in writing (s52(8A)(c), s52(8A)(d)).

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[13] The RIC legislation was passed as part of the *Corporate Collective Investment Vehicle Framework and Other Measures Bill 2022*.
[14] Conexus Institute analysis of the APRA fund-level superannuation data for FY2023 indicates that the median percentage in tax-free (i.e. pension) accounts was only 11.5% by assets and 3.6% by account number. The range by assets is 1% to 69%. Thus a large portion of the industry currently has low exposure to members in retirement.

The principles-based nature of the RIC affords trustees considerable scope to formulate their RIS. In this essay, we argue that greater clarity is required over the nature of the obligations placed on fund trustees under the RIC. We see two particular areas where clarity would be helpful to underwrite acceptable outcomes for all members, while providing direction to trustees on what they are expected to deliver to satisfy their obligations under the RIC:

(i) ***Quality of the RIS offerings to members*** – The RIC only imposes an obligation to form a RIS. It imposes no requirement that the offerings to members are of satisfactory quality or suitable for the member. This would appear to leave scope for a super fund to offer a very basic set of products and services under the RIC that may not cater for the needs of all members in an effective manner. To date, the requirement to deliver a RIS of sufficient quality has taken the form of policymakers and regulators highlighting areas that require further development, notably following the ASIC/APRA joint review[15]. Clearer direction on what trustees need to deliver is preferable to telling them what they are not doing well enough.

(ii) ***Whether there is an obligation to 'look after' all retired members*** – This issue closely relates to the question of the role of superannuation funds that was raised in Essay #2. As noted in that essay, a flash point is the extent to which it suffices for superannuation funds to act as a provider of products and services to assist members; or whether trustees have an obligation to look after the best interests of all members as a fiduciary. The fiduciary lens suggests taking steps to ensure no member is left behind, and would imply setting out to understand the needs of individual members and attempting to meet them. This might include aspects such as engaging with members to discover their needs and wants, and having a concern over whether members are making good use of the solutions, products and services they are offered. An analogy might be the contrast between making water available for the horse to drink versus leading the horse to water. The RIC appears to leave scope for trustees to adopt either of these positions.

Of course, the RIC is not the only legal obligation imposed on trustees that may be relevant to their interactions with retired members. The Australian Law Reform Commission[16] describes how "*the superannuation industry is subject to a host of general law principles, Acts, standards, instruments, regulatory guidance materials as well as self-regulatory regimes*". Two notable aspects in the current context include fiduciary duties under common law and the DDO. We also note that trustees are currently inhibited in the extent to which they are able to cater for individual member needs by the rules around personal financial advice, at least in the absence of the member actually seeking and paying for personal advice. The question of the scope of trustee obligations with regard to retired members thus interacts with the Delivering Better Financial Outcomes (DBFO) reforms.

In summary, what trustees are expected to do in assisting their retired members is not well-defined, giving rise to the risk that some members are left behind due to a failure by their super fund to cater for their needs. We offer some suggestions below on how this situation may be addressed.

Possible framing of trustee obligations

We recommend that two sets of obligations might be imposed on trustees:

(i) ***Obligation to deliver assistance of at least a minimum standard*** – This obligation would require trustees to provide retirement solutions, products and services of a basic quality, if not better. The aim in imposing this obligation would be to set minimum standards for the industry, and thus avert the possibility that some members are provided with retirement offerings that are of poor quality

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[15] APRA and ASIC, *Information report - Implementation of the retirement income covenant: Findings from the joint APRA and ASIC thematic review*, July 2023.
[16] See *Superannuation and the Legislative Framework for Financial Services*, Background Paper FSL11, Australian Law Reform Commission, May 2023

and or quite unsuitable for their needs. This obligation should be imposed irrespective of the role that super funds are envisaged to play within the retirement system, as discussed in Essay #2.

(ii) ***Obligation to offer suitable assistance to all retired members*** – We further recommend that a 'positive' obligation be placed on trustees to make a genuine attempt to offer suitable assistance to every retired member. We feel such an obligation is necessary to help ensure that no member gets left behind because no-one takes an interest. This obligation could entail a requirement to attempt engagement with members to understand and accommodate their needs and wants, and to offer them suitable solutions, products and guidance. This creates a potential link to the DDO, which we discuss further below. The scope of this second set of obligations would be contingent on the role envisaged for super funds, as raised above and discussed in Essay #2.

In keeping with the principles-based nature of the RIS, we envisage both sets of obligations would be framed as general principles. The main exception is how the DDO could apply under the second obligation, given it is a legislative requirement under the Corporations Act.

The table below presents some indicative framing around the general principles. We frame the *obligation to deliver retirement assistance to a minimum standard* around ***both*** supplying specific solutions, products and services of a basic quality ***and*** offering a range of solutions, products and services that caters for key member differences. The latter recognises that an ability to cater for important member differences is integral to the provision of retirement solutions.

The framing around the *obligation to offer suitable assistance to all retired members* is based around the notion that trustees should attempt to understand and accommodate the needs of all their retired members. This obligation might entail a requirement to engage with the member, and then attempt to facilitate their needs and wants as understood through either the engagement or via other information sources. Precedent for establishing obligations requiring trustees to engage with and understand the member and take action to protect their interests exist in the form of the *Protecting Your Superannuation Package Act 2019* and the *Putting Members First Act 2019* with regard to the treatment of insurance and small balances.

We further suggest there could be an obligation to direct the member to alternatives in instances where the retirement solutions offered by the trustee are unlikely to be unsuitable for that member. This could occur where the member has complex circumstances, in which case a recommendation to seek personal financial advice may be appropriate. If the trustee is unable to assist the member, then a recommendation to seek an alternative provider could be in the member's best interests.

Indicative framing of the trustee obligations:

Deliver retirement assistance to a minimum standard	***Offer suitable assistance to all retired members***
• Retirement solutions, products and services should be of at least a basic quality in light of prevailing industry standards • A range of solutions and products should be offered that cater for key member differences • A suitable set of decision support and guidance services should be provided catering for the differing ways that members might engage with retirement decisions	• An effort should be made to engage with all members over their needs and wants for both retirement solutions and guidance • Attempts should be made to facilitate the needs and wants of individual members • If the retirement solutions offered by the trustee are likely to be unsuitable for the member, they should be informed and a recommendation made that they seek an alternative

The scope of the obligation to engage might depend on the role envisaged for superannuation funds. If trustee direction is facilitated in the form discussed in Essay #2, the obligation to engage should extend to seeking to collect the member personal information required to give effect to the solution recommendation or assignment. A lesser role for trustees where they make solutions, products and solutions available for members, or issue nudges, might entail an obligation on trustees to make members aware of their options.

Mechanisms

We discuss three possible mechanisms for regulating and assessing whether trustees are meeting their obligations. The three mechanisms are not mutually exclusive and could be applied in unison.

a) Member outcome assessments

We discuss RIS assessment in Essay #6, recommending that it is undertaken as a dedicated component of member outcomes assessments. RIS member outcomes assessments could provide a natural vehicle for assessment and regulation of trustee adherence with their obligations. For example, the RIS assessment checklist might include an item assessing whether the retirement solutions, products and services offered by the fund have met and exceeded minimum industry standards, and that these offerings adequately cater for key member differences. Similarly, the success of attempts to engage with all members over their retirement needs could also be included as an item on a RIS assessment checklist. We envisage APRA oversight of RIS self-assessment by trustees as a mechanism for regulatory monitoring of whether trustees are meeting their obligations.

b) Licensing regime

Another mechanism might be to require trustees to meet certain standards in order to provide retirement solutions and related services to members under a retirement licensing regime. Essay #7 discusses the idea of a licencing regime for retirement in some depth.

c) DDO

The intent of the DDO is to ensure that consumers are being offered suitable financial products. ASIC RG 274[17] states that "*issuers must design financial products that are likely to be consistent with the likely objectives, financial situation and needs of the consumers for whom they are intended*"; and that "*issuers and distributors must take 'reasonable steps' that are reasonably likely to result in financial products reaching consumers in the target market defined by the issuer*". RG 274 also mentions adopting a "*consumer-centric approach*" to the DDO.

It strikes us that the intent and framing of the DDO closely aligns with the notion that trustees should deliver retirement solutions and products that cater for members with differing needs and wants. In particular, there appears to be an equivalence between understanding member needs in retirement and designing products that are consistent with their "*likely objectives, financial situation and needs*". There also seems to be a strong equivalence between forming member cohorts and the concept of a target market determination (TMD), on the basis that cohorts would represent member types for which retirement solutions are designed.

There are some differences, however. The DDO is based around regulating 'financial products', which RG 274 notes as including "*products for which a Product Disclosure Statement (PDS) must be prepared … (including) … interests in a superannuation fund*." In this regard, the status of retirement solutions as 'financial products' is unclear when they may comprise a number of financial products with their own PDSs and a drawdown plan. For the DDO to have greater effect in retirement, it would need to be framed around overall retirement solutions, which in turn would need to be structured or decreed to meet the definition of a financial product. In addition, RG 274 notes that the DDO does *"not equate to an individualised product suitability test that requires assessment of each individual's personal circumstances at point-of-sale*". Indeed, the DDO appears to presume that consumers will be choosing and purchasing products while informed by a TMD, and hence would seem to operate within the 'self-direction' world as discussed in Essay #2. Arguably, the DDO may not cover trustee obligations in situations where the trustee is issuing nudges or directing members to retirement solutions based on personal information, as this requires undertaking an individualised product suitability test.

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[17] RG 274, [Product design and distribution obligations](), issued 11 December 2020.

In light of the above, we recommend that ASIC works with the Government in reviewing the DDO with the intent of establishing how it, or a similar mechanism, will operate with regard to retirement products and retirement solutions more broadly[18].

[18] The ASIC Corporate Plan 2023-27 identifies retirement as a strategic priority and the DDO as a core strategic project for 2023-24.

Essay #4 – Personal information that trustees require to effectively cater for member differences

Main recommendations

1. Policymakers should facilitate superannuation fund trustees to collect and use personal information for the design and offering of retirement solutions that cater for important member differences.
2. We support extending the use of the Consumer Data Right (CDR) by superannuation funds and giving fund trustees access to certain member data held by government agencies. However, we refrain from making recommendations over the details, as this is outside of our expertise.
3. The personal information that trustees are able to collect and use without triggering the full obligations under the personal financial advice rules should be defined as part of the Delivering Better Financial Outcomes (DBFO) reforms. We recommend the scope of this information be set with reference to that needed to match members to a suitable solution that is offered by the fund.

Motivation

The Conexus Institute paper of November 2023 titled *Pathways for directing members into retirement solutions* noted that one of the key challenges was to find a way that superannuation funds could deliver retirement solutions that cater for members with differing needs in a scalable and efficient manner. For this to be achieved, fund trustees require the capacity to collect and use a *sufficient yet manageable set of personal information* on their members. In this essay, we consider the core set of member personal information needed by superannuation funds to provide solutions at scale, without having to undertake a comprehensive fact-find (as currently required under the personal financial advice rules) or requiring members to pay for a financial adviser. We also explore the potential actions that policymakers might take to facilitate the collection and use of such personal information.

Key member characteristics

In a drafted 4th edition to the Conexus Institute "retirement explainer" series titled "*Member characteristics: What matters for retirement solution design*", we discuss retiree characteristics and how they impact on retirement solution design. This 'explainer' is provided as part of our submission. It nominates eight 'major' characteristics deemed of high importance for determining the retirement solution that is suitable for a member. The selection of these characteristics is informed by the academic literature and our own research, and is based around two criteria:

- The characteristic makes a significant difference to retirement solutions; and,
- The characteristic forms an important point of distinction between members for most funds.

In sum, the eight characteristics are a 'need to know' list for trustees to design retirement solutions that effectively cater for key differences across their member base, and to match members with suitable solutions. The eight characteristics are listed in the table below. Each is addressed in depth in the explainer, where we outline why the characteristic matters and how it impacts on retirement solutions.

Key member characteristics

Personal attributes	*Objectives and preferences*
1. Age 2. Total net financial assets a) inside of super b) outside of super 3. Homeownership 4. Partnered status (potentially expanding to household level)	5. Type of income stream desired 6. Preferences over income risk and related trade-offs 7. Tolerance for return volatility 8. Requirement for accessible funds

We are not suggesting that the characteristics listed above are the only ones that may be relevant. Indeed, we acknowledge others within the explainer[19]. However, we believe the list amounts to the core set of personal information that trustees should be aiming to collect in order to inform both member cohorting and retirement solution design, and to match individual members to retirement solutions (subject to the constraints of the personal financial advice rules). The list provides an aspirational objective for both superannuation funds and policymakers.

Potential sources of personal information

We now identify potential sources of the eight key member characteristics. The table below provides a roadmap by listing six possible sources, which are discussed after the table.

Potential sources of member personal information

Type	Characteristic	Already available to trustees	Potential sources				
			Member engagement	Consumer Data Right	Government databases	Internet search	Trustee assumptions
Attributes	1. Age	✓					
	2. Total financial assets						
	a) with the super fund	✓					
	b) outside of the super fund		✓	✓	**Limited**	**?**	
	3. Homeownership		✓	✓	✓	**Probably**	
	4. Partnered status	**?**	✓	✓	✓	**Limited**	
Objectives and preferences	5. Type of income stream desired		✓				**Limited**
	6. Preferences over income risk and related trade-offs		✓				**?**
	7. Tolerance for return volatility		✓				**?**
	8. Requirement for accessible funds		✓				**?**

Below we offer comments for each of the potential information sources based on our understanding. We do so with the caveat that we may have incomplete or possibly incorrect knowledge of the details of the data held by some sources and its accessibility.

a) **Existing information held by fund trustees** – This may be limited to just age and balance held with the superannuation fund, unless the member has provided information that may allow trustees to establish other characteristics, e.g. death nominations may indicate the existence of a partner.

b) **Member engagement** – Asking the member could potentially supply all the required information. Caveats include that the member may be unwilling to provide personal information to their superannuation fund, or they could supply incomplete or incorrect information if provided on a 'what comes to mind' basis.

c) **Consumer Data Right (CDR)** – The Treasury consultation paper refers to the possibility of super funds using the CDR. The CDR is already available for accessing data held by banks, but might be expanded to permit trustees to collect information from government agencies (see point d) or perhaps other financial service providers that hold relevant personal information. The CDR might

[19] Other member attributes we acknowledge include life expectancy, health, personal network (e.g. expecting a bequest), Age Pension eligibility (e.g. residency) and gender (albeit effect mostly captured by other attributes).

supply 'hard' information that is more reliable in some instances than that sourced directly from members. One issue with the CDR is that it would provide insights only into member attributes, and not objectives and preferences. It hence would provide incomplete understanding of a member's needs and wants so they may be matched to a suitable retirement solution.

d) **Government databases** – Information on homeownership and partnered status is held within government databases, although homeownership would be at the state level. The Australian Tax Office (ATO) has complete knowledge of any superannuation of both a member and their spouse that could be held across multiple funds, and some information on investments. Access to information from these sources may allow trustees to paste together a more accurate picture of member attributes, even if incomplete. If the member receives the Age Pension or other social security benefits, then Services Australia (Centrelink) would have all the major member attributes we list above.

   Providing trustees with access to information held by government agencies might be achieved through the CDR (point c), or the Government mandating that certain information is made available to fund trustees. The latter may be politically difficult, especially with respect to personal information on individuals. It may be easier for government agencies to supply de-identified data to facilitate cohorting and solution design; although unidentified data would not help trustees to match members to suitable solutions. Again, a limitation is that information sourced from government databases only provide insights into member attributes but not member objectives and preferences.

e) **Internet search** – Trustees could feasibly source some personal information from the internet, noting this is done by many businesses. However, there could be issues with breaching trust with members in doing so. Establishing homeownership and partnered status may be feasible online, although this may only yield that a partner exists and not relevant information such as their assets or income. Similarly, ability to source information on any other financial assets that the member holds outside of the super fund may be limited. Again, the internet will probably not provide insights into member objectives and preferences, unless it can be imputed from observed member actions.

f) **Trustee assumptions** – The most problematic information to collect relates to the objectives and preferences of a member. Here an alternative approach may be for the trustee to make assumptions for the purpose of retirement solution design. Assumptions about objectives and preferences might be formed in a number of ways, which we mainly explain through examples.

   - *Imputing from existing information on the member* – An income target might be calibrated as an income replacement rate based on earnings prior to retirement, which in turn might be imputed from contributions. Homeowners could be assumed to need lower income and have less requirement for flexible access for funds[20] than renters. Tolerance to take risk might be imputed from investment options used in accumulation.
   - *Cater for a 'typical' member* – An income target could be set with reference to an income standard, such as those compiled by ASFA or Super Consumers Australia. Members might be assumed to have some base level of demand for flexible access to funds, and be provided with a modest precautionary or contingency account. (A 'capital account' of $50,000 is suggested as part of the 'example bundled retirement product' in the Appendix of the Treasury discussion paper). Members could also be alerted that the solution has been designed for a 'typical' member, and invite them to pursue another solution if they differ significantly from the average person.
   - *Minimise potential for harm* – In the absence of solid information on income needs, an income optimisation objective might be pursued rather than make tenuous assumptions about an income target. Low risk tolerance might be applied as a default assumption, thus limiting exposure to risky assets and setting drawdowns for lower income to reduce the risk of running out. Another example

[20] A home is an asset that can be accessed through home equity release or downsizing if need arises and can be used to fund bequests and entry into aged care.

might be to limit the amount allocated to lifetime income streams to provide the member with an element of flexibility. Members could be alerted that the solution has been designed conservatively, and invited to pursue another solution if this is unsuitable for their needs.

The information sources discussed above are not mutually exclusive. Indeed, there may be benefit in trustees drawing on multiple information sources for cross-validation.

Potential policy actions

We see three sets of actions that policymakers might take to support trustees to collect and use personal information on their members. Our level of expertise on the first two action points related to the CDR and data held by government agencies is relatively low, and thus we largely offer support for investigating what might be done in these areas. We consider the third action point related to the personal financial advice rules to be of high importance. We initially raise the relation to the advice rules below, and then expand on how this matter could be addressed in the next section.

d) **Application of the CDR to superannuation** – We see the CDR as a potentially effective mechanism for collecting personal information. Accordingly, we support policymakers looking at ways to encourage super funds to make use of the CDR, and investigating how the CDR might operate with respect to data held by government agencies and other financial service providers.

e) **Provide direct access to data held by government agencies** – We also support exploration of this possibility and offer a few general comments. First, providing access to unidentified data is likely to be of modest benefit. Much greater benefit would arise from finding a way of supplying personal data on individuals to facilitate understanding of the member for use in matching them to a suitable retirement solution. Second, even just supplying some high-level information that allows trustees to better understand their members would be helpful. For instance, it might assist trustees to know whether an individual is also a member of another superannuation fund, has a spouse, is receiving an Age Pension, or is not earning any wage income and hence may be retired. Third, the major pieces of personal information required would be supplied if trustees were also acting as agents for the member in applying for, or even collecting, the Age Pension. Thus, the idea of super funds playing this role as mentioned in the Treasury discussion paper would have the ancillary benefit of providing trustees with a core of key personal information on members[21].

f) **Reframe personal financial advice as applied to superannuation funds** – The personal information that super fund trustees are able to collect and use without triggering the full obligations under the personal financial advice rules should be defined as part of the DBFO reforms. The Government has already indicated the intention to reformulate advice rules to expand provision of advice through super funds. We propose that facilitating the ability of funds to deliver suitable solutions to members in an efficient and scalable manner should be a key aim of these reforms. As mentioned above, we believe this requires a capacity to collect and use a sufficient yet manageable set of personal information without having to undertake a comprehensive fact-find or requiring members to take paid financial advice. Our main recommendation is discussed in the next section, and entails defining the scope of the information that may be collected and used by fund trustees.

Recommendation: Permission to collect and use certain personal information

The principle underpinning our recommendation is that trustees should be able to collect and use the personal information required to match members to a suitable solution amongst those offered by the fund without triggering the need to meet all the rules and requirements of personal financial advice. This framing would define the scope of advice and personal information that may be collected on the topic of

[21] We also note that super funds acting as a 'Age Pension' agent for members may also imply an ongoing obligation to monitor the status of member information that is relevant for Age Pension eligibility, including total financial assets and income for the purpose of the pensions means-test. Doing so would not be far from trivial.

identifying a retirement solution that is suitable for a member. It also ties the information that trustees are permitted to collect to design retirement solutions. For example, if trustees have designed their solutions to cater for members that differ by age, total financial assets, homeownership and partnered status, they would be permitted to collect information on all these characteristics and related key data (such as the assets and any income of a partner) for the purpose of identifying a suitable solution. Note we are not trying to rule out additional advice topics being addressed or services being supplied by trustees under other arrangements, e.g. applying for the Age Pension, or entering aged care. We leave this matter to the DBFO reform process. Rather, our intent is to propose a way that assists trustees in designing and matching members to retirement solutions in an efficient and scalable manner.

To give effect to the approach, a set of "prescribed factors" might be specified within legislation (or perhaps under delegated legislation to retain flexibility) that defines the personal information that trustees are permitted to collect and use for the purpose of design and provision of financial advice on retirement solutions. A similar approach is used within the MySuper legislation with respect to the 'lifecycle exception', which gives permission for RSE licensees to take into consideration (in addition to age) a member's account balance, contribution rate, current salary, gender and expected remaining time to retirement in designing lifecycle products.

A potential list of prescribed factors that might apply to retirement solutions appears below. The list covers the major characteristics we discuss in Explainer #4 as provided as part of this submission, with the objectives and references collapsed to a single general factor and an explicit mention of the Age Pension added given its importance to retirement solution design. The list below is for illustration purposes, and the factors included might be expanded on or extended. In any event, we would suggest industry consultation be held if this recommendation is embraced.

Potential prescribed factors for provision of advice over retirement solutions
• Age • Balance with the fund • Financial assets held outside of the fund • Homeownership • Existence of a partner, and their financial resources that are available to the member • Eligibility for the Age Pension and other social security benefits • Member objectives and preferences

We envisage that trustees would be able to collect and use personal information that is required to identify the factor of interest. For example, to ascertain the resources that a partner brings to the party, the trustee may need to collect information on their assets and possibly their income. Use of any of these prescribed factors by trustees might be subject to the condition that the factor is incorporated into the fund's retirement solution design.

Essay #5 – Revamping ASIC Moneysmart

Main recommendations

1. Policymakers should review the role and purpose of ASIC Moneysmart (Moneysmart) in the future retirement ecosystem. The review should account for low financial literacy in the context of a highly complex retirement setting (explored in Essay #1), the (evolving) choice architecture for retirement solutions (Essay #2), and the emerging dispersion in the retirement offerings of super funds.
2. Any review of Moneysmart's role in the retirement ecosystem should acknowledge the challenges posed by the complexity of retirement, explore the potential for technology to deliver significant enhancements, and be highly cognisant of user experience and the need for user testing.

Motivation

The Treasury retirement discussion paper mentions improving 'guidance, education and communications' as a potential policy response (see pages 17-19). One approach for giving effect to this policy action could be revamping Moneysmart so it can provide decision support services in the retirement phase. The discussion paper further mentions 'tools for comparison' (and performance) on page 19. It is also possible that a revamped Moneysmart could act as the vehicle to provide comparisons between the retirement solutions and products offered by various providers. We hence explore the role that Moneysmart might play in the retirement ecosystem.

Moneysmart – Current state

Moneysmart details its purpose as:

> *"One in three Australians find dealing with money stressful and overwhelming. Everyday we all make dozens of decisions about money.*
>
> *Making informed decisions leads to greater financial wellbeing. That's where we come in.*
>
> *Moneysmart offers guidance for all Australians, whatever your situation, wherever you find yourself in life.*
>
> *Our simple tools, tips and calculators help people of all ages, backgrounds and incomes to be in control of their financial lives."*

Moneysmart is a broad service that provides assistance on many topic areas, which we commend. Here we focus on retirement. Moneysmart currently provides the following retirement-related services:

1. **Retirement planner calculator** – This calculator provides a deterministic retirement income projection. It is reasonably detailed, broadly accounting for the household situation and incorporates the Age Pension. Since the calculator is deterministic it cannot estimate the range of possible retirement outcomes. This makes it difficult to consider the benefits of lifetime income stream products, which are not included as candidate products. In many cases, the retirement planning calculator is more highly specified than the retirement calculators provided by super funds.
2. **Short guides** – The guides are short reads on twelve retirement planning topics, such as the Age Pension, annuities, and downsizing. These will sometimes refer to tools (such as the Moneysmart budget planner) and other Government services (e.g. Services Australia for Age Pension eligibility).

Research undertaken by The Conexus Institute and CoreData identifies high levels of trust in Moneysmart (Figure 1) but low levels of awareness, usage, and consideration (Figure 2).

Figure 1*:* Trust in financial sources

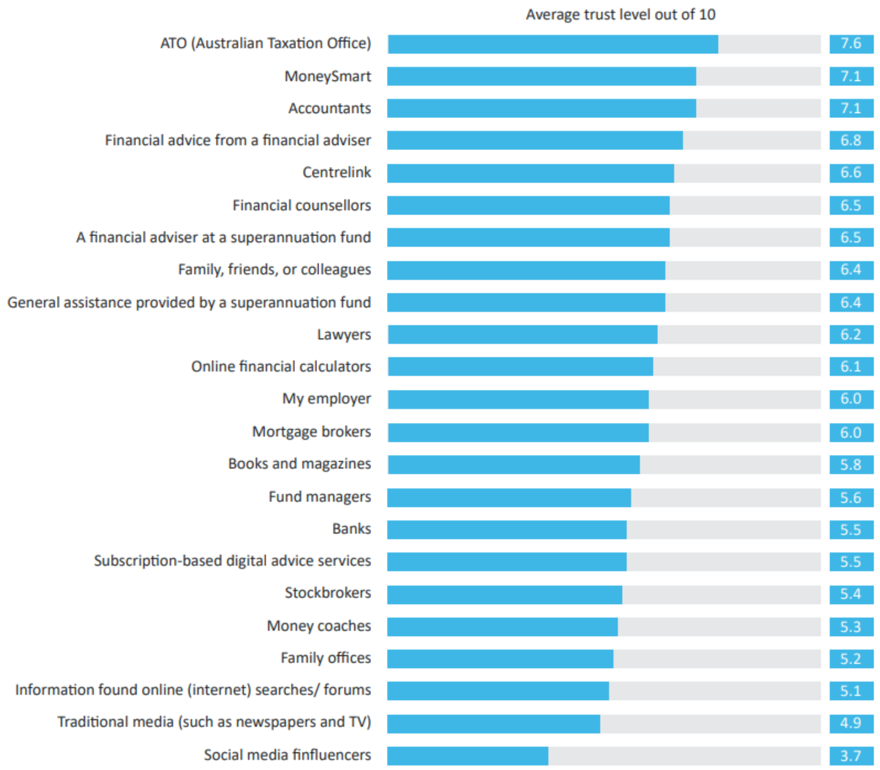
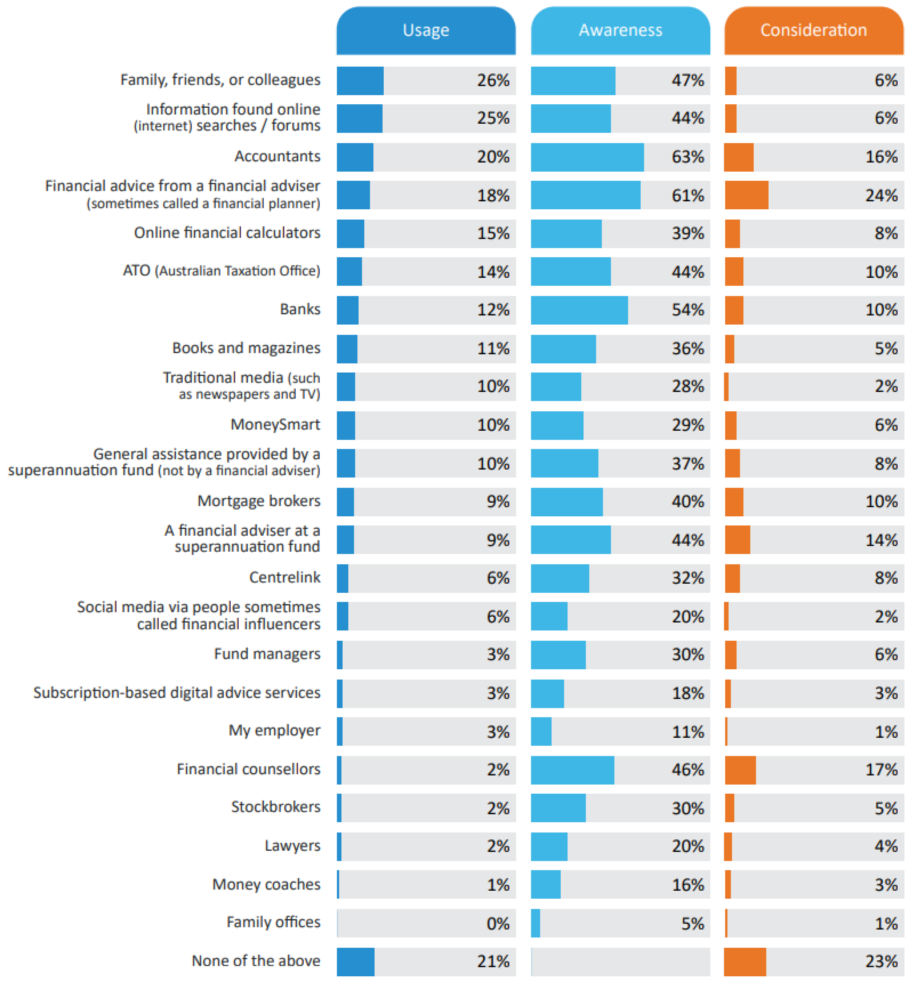


Figure 2*:* Sources of financial assistance



Sources: The Conexus Institute and CoreData, "Transforming financial advice".

Role currently performed by Moneysmart in the retirement ecosystem

The primary role of Moneysmart is to assist a range of retiree types. Research undertaken by The Conexus Institute identifies a range of retirement types, summarised in Table 1.

Table 1: Overview of pathways to a suitable retirement solution

Pathway	Self-direction	Adviser direction	Trustee direction		
	Member choice	Personal financial advice	Trustee recommendation	Trustee assignment	Default
Main features	Member chooses solution, drawing on decision support services	Member is directed to a solution by a financial adviser through: (a) limited advice, or (b) comprehensive advice	Trustee recommends a solution to member, who then opts-in or opts-out	Member requests trustee to assign them to a solution; but can opt-out	Trustee defaults member into a (probably basic) retirement solution
Member type most suited for	Members who want to choose for themselves	Members who desire a personalised recommendation and are willing to pay	Members looking for direction, but: • Do not want to seek a financial adviser • Not well-prepared to choose for themselves		Highly disengaged members who take no action

Source: The Conexus Institute, "Pathways for directing members into retirement solutions".

Across the spectrum of the pathways outlined in Table 1:

- Self-directed retirees are candidate users of Moneysmart's offerings. However, Figure 2 suggests that there are other sources of financial assistance that a higher proportion of self-directed retirees may be using.
- Financial advisers would typically use their own planning software.
- Members seeking trustee direction may seek to complement trustee-provided direction with calculator-based interactions. Ideal practice would be for fund recommendations to be accompanied by a calculator to assist members to understand the implications for their retirement outcomes, e.g. income levels and risks. However, we believe that most super funds have not yet reached this level of service. Some retirees in this category may utilise Moneysmart.

Moneysmart also performs some secondary roles in the retirement ecosystem:

- A number of super funds refer their members to the Moneysmart retirement planner calculator.
- Perhaps inadvertently, the Moneysmart retirement planner calculator represents a reference standard for retirement calculators more broadly. Simply, if super funds have the option to refer their members to the Moneysmart retirement planning calculator, any developed calculator should exceed the features and user experience provided by Moneysmart[22].

What role should Moneysmart perform in the future retirement ecosystem

In Essay #1, we suggest that market mechanisms such as competition and informed member choice are often ineffective in retirement. Our essays explore a range of candidate mechanisms to improve the current state. The appropriate future role for Moneysmart will depend on the retirement ecosystem that Government policy is aiming to achieve, thereby enabling Moneysmart to be targeted and resources to be used efficiently. We acknowledge that retirement is a subset of a broader problem of financial capability[23].

[22] This ignores any brand aversion to directing members away from a fund's website.
[23] Here we acknowledge previous Government initiatives on a National Financial Capability Strategy.

These considerations are central, and will inform:

- Appropriate structural model for Moneysmart, including degree of independence from Government;
- Range, depth and quality of services provided; and,
- How Moneysmart should be funded

It is informative to consider candidate models of Moneysmart from different ends of the spectrum. We undertake this exercise in Table 2.

Table 2*:* Overview of pathways to a suitable retirement solution

'Small footprint' Moneysmart	'Large footprint' Moneysmart
• Basic guidance to complement other information sources from industry and government • Primarily calculators and fact sheets	• Substantial role in assisting retirees to appropriate solutions. • Broader and richer set of tools and services to directly assist retirees, potentially including: - adoption of new technology - centralised provision of relevant government services - retirement provider, product and solution comparator services[24] - phone-based guidance service, perhaps similar to UK's Money and Pensions service • Significant advancement in core retirement planning calculator (and associated communications) to incorporate stochastic analysis and lifetime income stream products. • Potential for Moneysmart to draw data from Government agencies as a starting point for a tailored service. • Open-source code to allow funds to 'white label' the Moneysmart retirement planning calculator and incorporate their own products and assumptions[25]. • Services of super funds such as calculators and factsheets benchmarked against Moneysmart standards, with an 'if not, why not' posture towards adopting the Moneysmart retirement planning calculator[26]. • Tools sufficient to support provision of 'advice and guidance' by 'qualified advisers' as envisaged under 'Delivering better financial outcomes' (DBFO) reforms.

Source: The Conexus Institute

It is worthwhile noting that the 'large footprint' Moneysmart model would incur significantly higher direct costs. However, this may substantially reduce overall system costs relative to many individual providers attempting to develop their own services. Industry funding could be a candidate for financing the increased service offering.

Some of the services outlined in the 'large footprint' Moneysmart model compete with private providers. This highlights the importance of planning for a future retirement ecosystem and designing Moneysmart

[24] There could be potential for Moneysmart to provide the YourSuper comparison tool.
[25] This partly relates to the concept of a standardised retirement advice and guidance process explored by Conexus Institute: Bell, D. and Hanrahan, P., "Retirement transition support that is safe by design", 28 October 2021.
[26] This could remove dispersion in quality of calculators (and associated member experience) provided by funds, as well as disparity between projections produced by retirement calculators.

accordingly[27]. Such forward planning would consider areas such as the conditions being placed on super funds and the final outcomes under DBFO. For instance, if policy settings allow for laggards and sets no minimum standards in areas such as advice and guidance, then the role of a 'large footprint' Moneysmart is more justified in order to ensure retirees have access to quality assistance.

Opportunity to further develop Moneysmart's retirement planning calculator

We now expand on the opportunities and challenges afforded by technology to significantly enhance the retirement planning calculator that could be provided by Moneysmart.

The existing Moneysmart service experiences upper bounds in the following areas that could be addressed by developing an enhanced retirement service:

1. To provide effective guidance in retirement it is essential to adopt a stochastic framework to explore the range of possible retirement outcomes, and hence characterise and thus help manage income risk. Stochastic outcomes are extremely challenging to communicate effectively to retirees. Significant engagement with user experience experts (and associated technologies) would be required. Consumer testing would be integral to the design process.
2. The retirement planning calculator does not consider retirement income stream products. It is important that these be included in the calculator as a potentially integral component of some retirement solutions.
3. The retirement planning calculator could allow consideration of retiree preferences. An overview of such preferences is provided in Essay #4. It includes factors such as:
   a. Type of income stream
   b. Income risk / trade-offs
   c. Tolerance for return volatility
   d. Requirement for accessible funds
   e. Flexibility in retirement income through time
4. The retirement planning calculator could incorporate additional financial planning considerations (e.g. downsizer contributions) and integration of home equity release.
5. The operational capabilities of the retirement planning calculator could be enhanced to enable saving and/or printing off calculator results.
6. Technology could be used to create guided pathways and to make the experience more personalised. The use of medium such as curated information, checklists, infographics, chatbots, and videos can all create a more engaging and interactive user experience. User experience testing is critical to ensure quality design and implementation.
7. A phone-based service could be a great complement to the online services, increasing decision-making confidence.

[27] Account should be made of the need for assistance by retirees as the ecosystem takes shape.

Essay #6 – Developing a policy framework for assessment of retirement income strategies (RIS)

Main recommendations

1. RIS assessment should be established as a dedicated component of member outcomes assessments under the APRA prudential standards, i.e. separate from that applying to accumulation. We suggest listing the areas that trustees need to address within their RIS as items for assessment.
2. Extending the tools for comparison and performance assessment of accumulation products – such as the YourSuper comparison tool and the Your Future, Your Super (YFYS) performance test – to retirement will be very difficult and could lead to significant unintended consequences. At best, the YFYS performance test might be applied to return-generating components of retirement solutions, such as account-based pensions (ABPs). These assessment tools are quite unsuitable for other retirement products or retirement solutions.

Motivation

The Conexus Institute has released two papers on RIS assessment, both of which are referenced on page 18 of the Treasury discussion paper. The first paper[28] suggests undertaking a forward-looking assessment through combining a checklist to assess how well fund trustees are meeting their obligations under the Retirement Income Covenant (RIC), with quantitative modelling whereby potential outcomes are simulated and evaluated against objectives. The second paper[29] demonstrates how the quantitative modelling might be undertaken.

We appreciate Treasury acknowledging our work on RIS assessment. The aim of this essay is to scope out how the broad RIS assessment structure we propose could be embedded within the regulatory framework via the APRA prudential standards. We see it as important to establish a clear framework for RIS assessment in order to set expectations and provide direction for super fund trustees as they develop their RIS. Doing so can help to ensure that RIS are developed to meet minimum standards, and reduce the dispersion across the industry that could occur in the absence of a clear assessment framework. This essay links to Essay #3 addressing trustee obligations, and potentially Essay #7 exploring a licensing regime for retirement.

Assessment of RIS as a component of member outcomes assessment

To facilitate and further RIS assessment, we suggest establishing a dedicated (i.e. separate) retirement component within member outcomes assessments that requires trustees to assess the effectiveness of their RIS. Assessment might be based around evaluating specific areas that capture either key capabilities[30] or activities that are important for assisting retired members in an effective manner.

Areas to be assessed could be expressed in broad rather than prescriptive terms, thus affording trustees considerable flexibility in framing their RIS. This approach would accord with the principles-based

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[28] Bell, D. and Warren, G., "Assessing retirement income strategies … when outcomes are but a promise", 2 December 2022

[29] Bell, D., Khemka, G. and Warren, G. "How to Approach Quantitative Assessment of Retirement Income Strategies", 22 June 2023

[30] The Conexus Institute made the point that self-assessment of key capabilities deserves more attention within member outcomes assessment in a recent submission to APRA's consultation on "*Strategic and transfer planning: enhancing member outcomes*", 21 December 2023.

nature of the RIC and provide room for innovation. There would remain scope for APRA to issue more pointed direction as appropriate, either through incorporating a degree of prescription into the member outcomes assessment, prudential guidance, or continued highlight of examples of best practice. Specific areas to be addressed under the assessment might be framed along similar lines of the checklist introduced in the Conexus Institute paper on RIS assessment of December 2022 (see footnote 2). A requirement to undertake quantitative modelling would be included on the list as a specific assessment area. The table reworks the original checklist into an indicative listing of the type of areas where assessment might be required under prudential standards. This is a preliminary list that may require further investigation and ultimately industry consultation.

Indicative areas that might be addressed under RIS member outcomes assessments

Category	Areas to be assessed
Key capabilities	• RIS governance structure • Staffing • Member management systems - Capture of relevant member information - Data governance - Protecting members against cybercrime and fraud - Mechanisms for member engagement • RIS administration • Management of providers (in-sourced and out-sourced) • RIS assessment and improvement cycle - Assessment process developed that is linked to RIC objectives - Capability for quantitative modelling of projected outcomes
Retirement solutions	• Member cohorting or tailoring processes • Retirement solution design - Framing of objectives and associated trade-offs; linked to RIC - Stochastic modelling - Age Pension incorporated - Flexibility to adjust to market and policy developments - Portfolio construction and risk management processes • Suitable retirement solution components - Investment and/or product building blocks - Longevity protection - Design of drawdown strategies - Investment performance of market-exposed building blocks* - Fees or product prices* • Quantitative assessment of outcomes from retirement solutions • Member usage of retirement solutions and products*
Member guidance and direction	• Engagement with members over retirement matters* • Assistance to identify suitable solutions, including financial advice and other matching mechanisms • Decision support tools, i.e. calculators, etc - Suitability - Member usage* • Provision of information to members - Product and solution information, e.g. PDSs, key product features - Reporting of realised and projected outcomes - Education services - Accessibility and understandability of information provided - Take up rates* • Capacity to respond to changes in member circumstances - Process for ongoing engagement - Strategy for addressing cognitive decline • Member experience measures, e.g. surveys*; complaints*; call centres

** Quantitative indicators; ex post assessment possible*

Benefits

Basing RIS assessment around stating areas that trustees should be addressing offers various benefits:

- **Establish expectations** – Framing of the areas to be assessed would establish high-level guidance around what trustees are expected to do in meeting their obligations under the RIC. This would help fill the gap between a RIC legislation that gives minimal direction and how trustees implement their RIS in practice. To date, policymakers and regulators have largely focused on telling the industry what is being done poorly in meeting obligations under the RIC, e.g. the ASIC/APRA joint review[31]. Providing clarity around the areas that trustees should be addressing would set clearer expectations while providing guidance around what matters trustees should be addressing and looking to improve over time. Positive direction seems preferable to telling funds "not good enough" after they have put effort into developing their RIS.
- **Set minimum standards** – Listing areas to be assessed under a RIS and hence addressed by trustees should set minimum standards and foster standardisation across the industry with regard to what is incorporated into RIS. For example, requiring trustees to assess effectiveness in areas such as (say) member cohorting or tailoring, modelling of retirement solutions and a certain range of guidance services would send a message that these elements are integral components of a well-formed RIS.
- **Accommodate differences between accumulation and retirement phases** – Retirement is sufficiently different to accumulation to strongly suggest that it is appropriate (if not almost essential) to conduct dedicated RIS assessments. The Conexus Institute made this point in its recent submission to APRA[32], and it bears repeating here. Below are some of the more important points of distinction between provision of retirement solutions versus investment options in accumulation:
  - Retirement solutions combine differing investments, products and strategies to generate outcomes that are in turn defined by delivery of income. Accumulation options are typically single products that are directed at return generation. Assessing income and returns is quite different.
  - Retirement outcomes are impacted by a broader range of drivers and risks, e.g. longevity risk.
  - There is a much greater need to cater for significant member differences in retirement, which is more of an exercise in delivering solutions that are tailored to individual member needs.
  - Member services such as advice and guidance are far more important in retirement.
  - Policy frameworks differ between retirement and accumulation, e.g. governing legislation and regulations; tax and social security; separate account structures.

Implementation

We envisage a dedicated assessment component for retirement being established within the prudential standards. One possibility is a separate retirement section within SPS15 "*Strategic Planning and Member Outcomes*". Another option is to frame a new prudential standard dedicated to retirement, which might be one of the subsidiary standards to SPS515.

We recommend that APRA provides oversight of RIS member outcomes assessments performed by trustees. The aim would be to ensure that RIS assessment is being undertaken diligently and honestly, and is being fed into a process of ongoing improvement. APRA might also take note of any best practices that could potentially be shared with the industry. This would amount to an ongoing, formalised process building on the APRA/ASIC joint review that explored the implementation of the RIC during 2022-23.

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[31] APRA and ASIC, "Implementation of the retirement income covenant: Findings from the joint APRA and ASIC thematic review". Information report, July 2023.
[32] Bell, D. and Warren, G. "Strategic and transfer planning: enhancing member outcomes", submission to APRA, 21 December 2023.

We also recommend establishing an extended timetable for the implementation of RIS assessment to give the industry time to put the required processes in place. A two or three year time frame seems reasonable. For instance, the first formal assessment could be with respect to fiscal year 2025-26 and due during the second half of 2026. The fact that RIS assessment is imminent coupled with preliminary indications of areas to be assessed would provide direction to trustees in the interim.

Essay #7 explores the possibility of introducing a licensing regime for retirement. There may be potential to link any licensing regime to member outcomes assessments in retirement through embedding key assessment areas within the licensing conditions. Effectively this would require fund trustees to assess and document the extent to which they are successfully delivering on key areas and convey the findings to the licensing body. Doing so would attach additional importance to the member outcomes assessment.

YFYS performance test and retirement product assessment and comparisons

The Treasury retirement discussion paper (see page 19) raises the idea of developing counterparts to the YourSuper comparison tool and the YFYS performance test for retirement products. We counsel caution over extending these evaluation processes to retirement on any more than a very limited scale. For instance, the YFYS performance test could be extended to return-generating retirement products such as ABPs, ideally with adjustments to account for unique considerations associated with managing retirement investment portfolios. In this regard, there is a case for incorporating risk adjustments in to the YFYS test, which would be problematic in retirement as the nature of risk is complex and nuanced. In any event, we have strong reservations around introducing performance testing into the retirement phase for various reasons, included those covered in the dot points below.

Even if the YFYS test was applied to the return-generating components of RIS, we recommend that no attempt is made to extend the YFYS test to other retirement products or retirement solutions, or to provide comparison tools for use by members. Rather, RIS member outcomes assessments of the type outlined above should form the foundation of assessment in retirement. These assessments could incorporate the effectiveness of individual products as one of the items that needs to be assessed.

A variety of issues inhibit effective translation of the YFYS performance test to retirement products, and the potential use of its output as a basis for comparisons made by members:

1. **Income delivered matters most, but is unobservable** – The central concern in retirement is generation of income over an extended horizon into the future. As the income stream delivered is unobservable, it is virtually impossible to conduct ex post assessment of the primary member outcome of concern on an ongoing basis. This insight leads to the conclusion that ex ante assessment is required, as discussed in the Conexus Institute RIS assessment paper of December 2022 (cited in footnote 2).
2. **Retirement solutions comprise a combination of building blocks** – Income is often likely to be delivered through retirement solutions that combine investments, products and strategies (notably including a drawdown strategy), rather than through individual products. Any assessment of individual retirement products would thus be evaluating one component of a broad solution that could be only weakly connected with the outcomes delivered. How the various building blocks are combined is more important, and can only be assessed by examining the overall outcomes expected to be delivered. For instance, performance evaluation of ABPs does provide some insights, noting that higher returns boost the income delivered to members. However, this exercise does not speak to whether members are being delivered income streams that are suitable for their needs, whether risks to income are being managed appropriately, or whether an appropriate level of access to funds is being provided. Only examination of the overall solution can speak to these matters.
3. **Assessing lifetime income streams is problematic** – Products that deliver lifetime income streams cannot be comprehensively assessed in isolation, but rather should be assessed in light of the role being played within a retirement solution. It is the particular characteristics of the product and how it is being used that matters. At best, it might be possible to undertake an analysis of fees and pricing (i.e. rate of income offered) for a product. However, doing so is complicated as the fees and pricing

can reflect the cost of providing certain features, e.g. providing access to funds, either directly or as a death benefit.

4. **Comparison tools are likely to be ineffective in retirement** – Providing members with comparison tools is unlikely to yield meaningful benefits. The complexity of retirement makes it extremely difficult to generate simple comparison metrics that can be understood by members, who are often limited in their cognitive abilities (see Essay #1). Further complicating matters is that the appropriate retirement solution for a particular member varies depending on their personal needs and circumstances. For instance, members may differ in their preferences over expected income, income risk and flexible access to funds; the desire for front-loading versus restricting income so it is more likely to be sustainable; and their Age Pension entitlements. It is hard to consolidate these various dimensions into basic metrics. There is also a risk of unintended consequences due to members misinterpreting or misusing metrics. For instance, comparing ABPs based on performance might encourage take-up of retirement solutions offered by funds with the highest returns, without consideration of whether those solutions lack crucial features or do not suit the particular member.

In summary, we concede that a version of the YFYS performance test might be applied to return-facing components of retirement solutions such as ABPs, and then used within RIS assessments. We recognise this possibility by including "investment performance of market-exposed building blocks" and "fees/prices" on the previous list of areas to be assessed. Our overarching point, though, is that any product assessment should be subsumed within broader RIS member outcomes assessments.

Essay #7 – Exploring the case for a retirement licensing regime

Main recommendation

1. Policymakers explore the possibility of introducing licensing for super funds to operate in the retirement market, as a means of spurring action in developing retirement income strategies (RIS), setting minimum standards and establishing what is expected from fund trustees.

Motivation

Policymakers are clearly keen for superannuation funds to get on with the job of developing quality RIS, as intimated through public comments and the APRA/ASIC joint thematic review of *Implementation of the retirement income covenant* (RIC) of July 2023. Our Essay #1 and Essay #3 raise the need to establish minimum standards to protect members. Essay #6 highlights the benefits of establishing a formal RIS assessment regime as a means of setting expectations and providing direction for super fund trustees in developing their RIS, while helping to ensure minimum standards and reduce dispersion across the industry. A licensing regime to operate in the retirement market could act as a regulatory instrument that achieves *all* of these goals. We hence explore licensing in this essay.

A retirement licensing regime – High level overview

Licensing is a well-recognised regulatory mechanism. The box below summarises some of the key features of licensing regimes as outlined by the Bureau of Industry Economics (which was subsequently merged into the Productivity Commission). While this report dealt with business licensing in general, there are numerous precedents for licensing in financial services including banking, financial advice and most notably super through registerable superannuation entity (RSE) licenses and MySuper licences.

A comparable regime for retirement might require super funds (RSE licensees) to seek a license to offer retirement solutions, products and related services to retired members. Effectively, it would amount to a license to operate a RIS. Super funds without a retirement license would be restricted to servicing members in accumulation. Once a member reaches retirement, these funds would have to either return the balance to the member[33], or transfer it to another provider that has a retirement license.

Overview of a Government report into licensing

The Bureau of Industry Economics issued a report in 1996 titled *Business licences and regulation reform* that discussed licensing. Listed on the left below are the four reasons provided for licensing. Reasons 2 and 4(a) are the most pertinent for retirement. Listed on the right are characteristics of licensing, which notably includes standard setting. The report also notes the scope for 'negative' licenses, where licenses are given but revoked if certain conditions are not met. It identifies adverse effects on competition as a potential disadvantage. The report also highlights alternative regulatory instruments to licensing, including: minimum standards; codes of practice; relying on notification; optional prescriptive codes; and, compulsory contacts. Establishing minimum standards or codes of practice through regulatory guidance could offer alternatives that might work in a retirement setting, albeit with less force.

Common explanations for use of business licensing	Essential properties of a licence
1. to account for spillover effects or externalities; 2. to address information failures; 3. to restrict competition and enhance market power; 4. paternalism, including: a) purchaser vulnerability b) preference manipulation	• ***notification*** – information is supplied to a specified agency; • ***prior approval*** – approval from a specific agency is obtained before commencing the prescribed business activities; • ***standards*** – minimum standards are to be complied with; and • ***enforcement or compulsion*** – licensing is not voluntary so that conducting the activities without a licence is unlawful, the standards are legally enforceable, and contravention of them may lead to the suspension or revocation of permission to conduct the activity

[33] Mechanisms may be required to encourage members to transfer to another fund with a retirement license.

Case for a retirement licensing regime

A retirement licensing regime would amount to something of a heavy-handed regulatory initiative. However, it would offer a number of benefits:

- **Strong incentive to develop RIS** – Most super funds will want to be involved in the delivery of quality retirement outcomes for their members. This goes to the purpose of the superannuation system and thus of the funds themselves. Operating a retirement offering is an important business consideration, with the prospect of losing assets once a member retires likely to be unpalatable for most funds. Further, being unable to offer retirement solutions once a member reaches retirement may have negative impacts on the ability to attract members in accumulation.
- **Introduce a competitive opportunity** – Assuming that not all super funds seek or receive a retirement license, there would be an opportunity for licensed super funds to compete for the retired or retiring members of unlicensed funds. This may improve the financial business case for retirement (explored in Essay #13).
- **Giving effect to policy** – The need to meet licensing requirements should provide a strong catalyst and very powerful incentive for fund trustees to get on with the job of developing RIS to a reasonable standard, thus furthering the policy aim of progressing RIS development in a way that sees funds satisfy their obligations under the Retirement Income Covenant (RIC). It represents a prescriptive hurdle that places an onus on trustees to fully commit to the retirement phase.
- **Establishing minimum standards** – Licensing criteria could be used to establish minimum standards that super funds need to attain in developing their RIS. In Essay #3 we discuss the need to place obligations on fund trustees to deliver retirement solutions, products and services to a minimum standard, along with a commitment to attempt engagement with all members who may be entering retirement. A licensing regime would give considerable force to these standards, as the consequence of not attaining them would be failure to attain (or loss of) a license.
- **Setting expectations and providing guidance to fund trustees** – Framing the regime around certain areas or items that need to be addressed in order to gain a license could go further than just establishing minimum standards. It could also be used to set expectations and provide guidance for fund trustees on what areas need to be covered in developing a RIS. Potential exists to tie licensing to a RIS assessment checklist under member outcomes assessment, as was discussed in Essay #6 and the Conexus Institute paper *Assessing retirement income strategies… when outcomes are but a promise* of November 2022. To obtain a license, trustees could be required to demonstrate that they have all the required elements in place. For example, licences could be made conditional on having access to required member information, an ability to form cohorts or tailor, possessing stochastic modelling capabilities, offering a sufficient set of tools and calculators to assist members, the capabilities to engage with retirees and potential retirees, and so on. Finally, there would be an opportunity for policymakers to set clear and realistic expectations around timing of the development and implementation of a quality RIS by super funds.
- **Reducing dispersion** – Through establishing a common set of requirements and minimum standards, the level of dispersion in RIS offerings across the industry might be limited at the margin.
- **A clear decision point for funds** – Currently the RIC requires every fund to develop and maintain a RIS. Margaret Cole challenged funds who cannot deliver good retirement outcomes to their members to consider directing those members to other funds[34]. Some funds may feel they are not well placed to operate in the retirement market, or that they require an extended time period to reach the required standards (perhaps due to membership demographics that influence the business case). It is difficult to rationalise how members of those funds should have to experience a poorer quality retirement. A licensing regime provides a decision point for funds. It presents them with the option

[34] APRA – Margaret Cole and ASIC – Jane Eccleston - Speech to the Conexus Retirement Conference (2023).

to specialise on accumulation through not seeking a retirement licences, or to defer their license application to a later date when there is a stronger business case to enter the retirement market.

Potential disadvantages and risks

Establishing a licensing regime also gives rise to some potential disadvantages and risks.

- **Effects on competition** – A licensing regime effectively establishes a barrier to entry. The main risk is not so much that the number of providers would fall to undesirably low levels. Rather, licensing could act as a barrier for new entrants, most notably smaller but innovative players that could challenge the incumbents and disrupt the retirement market. The dampening impact on competition from licensing may be minimal, however, given that new entrants already face substantial natural barriers to entry due to economy of scale and incumbency effects.
- **Impact on innovation** – There is a risk that providers anchor on the minimum standards to achieve a license, thus inhibiting innovation – although arguably this risk is just as strong in the current state where no requirements are imposed. This risk might be overcome to some extent through coupling licensing with a member outcomes assessment framework that encourages continual improvement. There is also the potential for licensing requirements to be reviewed over time in recognition of innovations in the industry[35].
- **Adverse impacts for members of funds without a license** – There may be negative impacts for the accumulation members of super funds that do not possess a retirement license. Such funds would have minimal incentive to engage and offer services to members over their retirement needs as they approach retirement. Further, members of such funds may be forced into a position of having to choose another provider at retirement (unless some mechanism is created to automatically transfer these members to another fund). As we argue in Essay #1 and Essay #2, some members may be very poorly placed to make this choice. There is also a risk that such members simply transfer their balance into a bank account or retain their superannuation assets in an accumulation account, rather than seek out a suitable retirement solution. Policymakers may need to consider the steps that could be taken to ensure all such members are transferred to a suitable retirement solution.
- **Fund sustainability** – Some funds that are not licensed to operate in the retirement market could suffer outflows and declining assets as members retire, especially as the superannuation system matures. This could be a threat to the sustainability of these funds. While this may have detrimental effects for the members of these funds, it may be better than such funds providing their members with a sub-standard retirement offering as could occur in the absence of licencing. Based on membership demographics, funds (and APRA) would need to establish the business sustainability impact as they contemplate whether to apply for a retirement license.
- **Regulatory load** – Managing a licensing regime would impose considerable load and possibly cost on regulators, especially given the complexity of retirement. This may prove to be a significant one-off effort. Nevertheless, the outcome should be a collection of funds with strong RISs along with less dispersion across funds than might occur under current policy settings, and hence the additional effort and cost may be worthwhile.

Implementation issues

Our primary aim in this essay is to explore the case for and against a licensing regime for retirement, rather than scope out the specifics of how it might operate. The implementation details would require investigation if the idea is to be pursued. Nevertheless, we do have a few observations to make.

- **Interaction with the RIC** – The RIC requires all APRA regulated super funds to have a documented strategy to assist members with their retirement needs. Any licensing arrangement would need to work alongside the RIC.

[35] Requirements have not been altered for MySuper licensing since its creation.

- **Outsourcing and white-labelling** – Consideration might be given to allowing super funds that do not have a retirement license to partner with, or out-source to, another fund with a retirement licensee. This may be one way to avoid the potential adverse impacts for members of funds that lack a retirement license, as discussed further above.
- **Transition to retirement** – The interaction between retirement licensing and transition to retirement arrangements would need to be addressed.
- **Licensing procedure** – It would be open to super funds (or new entrants) to apply for a license at a time of their choosing, including at a later date if development of a retirement offering is deferred. A fund could lose its license if it fails to meet licensing requirements. To allow for such an event, frameworks would have to be developed for how members are transferred to an alternative fund.
- **Management of licenses** – An important issue is the regulatory body that would be responsible for issuing licenses and ongoing monitoring for adherence with licensing conditions. There are various possibilities, including assigning the role to the existing regulators (perhaps in partnership) or establishing a dedicated retirement licensing body.
- **Time frame** – We envisage the industry being given considerable notice of when any licensing regime would come into formal effect, thus giving funds an opportunity to develop their RIS to the required standard. We suggest a couple of years, noting long lead times are required to develop products and services along with supporting resourcing and systems. Nevertheless, the licensing requirements should be released as early as feasible to advise fund trustees what will be expected and hence what they need to work towards.

Essay #8 – Barriers to take-up of lifetime income streams

Main recommendations

1. Policy measures with high potential to impact the take-up of lifetime income streams include:
   - Facilitating super fund trustees to offer or direct members to comprehensive retirement solutions that contain lifetime income streams. Here some form of trustee direction (as discussed in Essay #2) should have the strongest impact.
   - Providing information and encouraging the framing of lifetime income streams in a consumption frame rather than an investment frame.

- While government underwriting of longevity insurance may be helpful at the margin, we do not expect it to have a major impact on the take-up of lifetime income streams.

Motivation

The third section of the Treasury retirement discussion paper invites comments on "*making lifetime income products*[36] *more accessible*". We anticipate Treasury receiving a range of submissions covering the more technical details of this topic from parties more knowledgeable than ourselves, including on aspects such as the feasibility of the Government underwriting longevity risk for funds, capital requirements for product providers, and so on. We hence set out to provide Treasury with useful context for their policy deliberations through summarising factors that may be inhibiting the take-up of lifetime income streams, and offering thoughts on the policy measures that might have the greatest impact.

Overview of factors that may limit use of lifetime income streams

The table over summarises 36 factors that may contribute to the limited use of annuities as identified in a comprehensive literature review by MacDonald et al. (2013). The list is broken down into 12 rational decisions factors related to personal preferences and circumstances, 8 rational decision factors arising from environmental considerations, and 16 behavioural biases. In the third column, we have added some notes on the application of selected factors to Australia, including how different parts of the policy agenda might help to address some of the factors listed. We expand on the latter after the table.

MacDonald et al. comment that retires could feel disinclined to annuitise for a single reason or a combination of reasons. The fact that multiple influences may be at play suggests there is no silver bullet. We also note the existence of various rational reasons not to take up lifetime income streams. This implies the aim should be to encourage the take-up of lifetime income streams only where of benefit to a retiree. The reference in the Treasury retirement discussion paper to "*individual circumstances are different, and there is no one size fits all approach*" (page 21) indicates that Treasury agrees on this point.

MacDonald et al. note that some of the factors listed are not strongly supported by evidence from surveys or observed behaviours[37]. It should also be borne in mind that this review article is now over a decade old, and there would have been subsequent research and developments that the authors have not considered. In particular, it has become common practice to offer some access to capital in order to overcome factor 1a (loss in liquidity) and factor 1b (bequest motives), although this access is more often

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[36] Given that some super funds may employ group self-annuitisation (GSA), the term lifetime income "streams" might be more suitable than lifetime income "product" to the extent that GSA is more in the nature of an arrangement between members than a financial product that is purchased. Although either term suffices.

[37] This includes 1b (bequests), 1c (benefit to delay), 1g (family pooling), 2a (pricing) and 2c (lack of inflation protection, referring to the fact that annuity take-up is low in countries where real annuities are unavailable).

restricted to the nominal value of the purchase value that has not been paid out as income, and typically ends at life expectancy[38]. Nevertheless, the list provides a good launching pad for discussing what might be done to enhance the use of lifetime income streams.

Potential contributing factors limiting the use of annuities

Adapted from: MacDonald, B.J., Jones, B., Morrison, R.J., Brown, R.L. and Hardy, M., 2013. "Research and reality A literature review on drawing down retirement financial savings", North American Actuarial Journal, 17(3), pp.181-215

Factor	Summary	Additional comments on application to Australia
(1) Rational decision factors arising from personal preferences and circumstances		
(1a) Loss in liquidity	Annuitisation is a non-reversible decision: individuals cannot cancel an annuity and recover the principal.	Many annuities provide some access to capital, albeit often limited by capital not paid out as income, and life expectancy.
(1b) Loss of bequest	Annuitised wealth cannot be left as a bequest.	Many annuities provide death benefits, albeit limited by capital not paid out as income, and life expectancy.
(1c) Benefit to delay	Steeply increasing 'mortality premium' creates more advantageous annuity pricing as the retiree ages; hence may defer annuitisation to obtain a better price.	Somewhat overcome through purchasing a deferred annuity.
(1d) High risk tolerance	Retirees with high risk tolerance may be more willing to accept a volatile income stream and place less value on the stability offered by an annuity (reverse is also true).	
(1e) High personal discount rate	Individuals who place little value on future versus current consumption would have lower demand for annuities.	'Fear of running out' seems more important and runs in other direction.
(1f) Short life expectancy	Retirees in poor health could be averse to annuities as they do not anticipate a long future lifetime and view them as expensive.	
(1g) Ability to pool risk within families	May be expectation of inheritance from aging parents; in some cultures, the elderly are financially supported by their adult children.	
(1h) Confidence in personal financial abilities	Retiree may believe they will obtain a higher consumption by maintaining control of assets and investing them personally.	
(1i) Other sources of guaranteed income	Need to annuitise reduced by defined benefit pension plan or social security.	Age Pension is particularly important in Australia, especially for retirees with low wealth.
(1j) Sources of household wealth	Retirement savings may be illiquid (e.g. in property or businesses) and not available for annuitisation without tapping into the equity (e.g. reverse mortgage).	Majority of Australian retirees have superannuation, although not all do.
(1k) Insufficient personal savings	Annuitisation can be unattractive for retirees with trivial balances.	Reinforced by existence of Age Pension in Australia.
(1l) Debt	Reducing debt using financial savings makes more financial sense than purchasing an annuity.	

[38] A notable exception is Allianz's AGILE product, which offers access to capital throughout albeit at some cost.

(2) Rational decision factors arising from environmental limitations		
(2a) Expensive pricing	Annuities are overpriced from an actuarial perspective due to insurer costs and profit margin, including pricing for adverse selection.	Government underwriting of longevity insurance or adjusting capital requirements would address this hurdle, as would group self-annuitisation. Industry has raised issues of high capital requirements.
(2b) Poor financial market environment	Retirees could be dissuaded from annuitising because of poor market conditions, e.g. low interest rates or a drop in the value of their wealth.	Less of an issue following rises in interest rates; potential implications for investment-linked annuities.
(2c) Incomplete annuity market	Payment stream available may not match the desired consumption path, e.g. most annuity products sold in the US are fixed in nominal terms; retiree could intend to reduce consumption with age.	Real annuities available in Australia; innovative products accommodate tilting the income stream through a reference rate.
(2d) Access	In the US, annuitisation as a distribution option is relatively rare in retirement savings plans.	Live issue in Australia: super funds traditionally have not offered annuities to members, but many are considering doing so.
(2e) Seller incentives	Annuities fall into the same mental category as life insurance, which is sold not bought. Financial advisors may be averse to sell annuities where they lose future access to the funds and rollover commissions; non-affluent consumers may not get financial advice that might suggest an annuity.	Potential to address through DBFO reforms by expanding advice through super fund trustees. A related issue is that super funds have little experience in offering and communicating retirement income streams.
(2f) Distrust of annuity providers	Lack of trust or confidence in insurance companies and financial institutions; risk of insurer default.	Government underwriting of longevity insurance and group self-annuitisation might help overcome this hurdle.
(2g) Sex-distinct mortality assumptions	Use of sex-distinct mortality tables leads to higher prices for females than males, discouraging women from annuitising as 'unfair'; unisex annuities could similarly discourage men.	Government underwriting of longevity insurance might help overcome these issues.
(2h) Tax treatment	Depending on the country, tax treatments could be relevant; complexity of tax impacts may also act as a discouragement.	Tax irrelevant in Australia; treatment for Age Pension eligibility aims at neutral treatment of annuities.
(3) Behavioural biases		
(3a) Decision framing	Viewing annuities through an 'investment frame' rather than 'consumption frame can make them look like a risky and unattractive investment given positive probability of losing entire amount (upon death); manner in which annuities often presented to retirees exacerbates this issue.	Super funds may assist in overcoming this hurdle if DBFO reforms expand their capacity to give advice. Government might further assist through providing information and influencing framing via disclosure.
(3b) Longevity gamble	A life annuity could be viewed as a 'bet with the insurance company' that a retiree will exceed median life span; the odds in this gamble may be perceived to favour the insurer.	Government might further assist through providing information and influencing framing via disclosure.
(3c) Perception of insurance	View of insurance as only for 'bad' events, and since living a long time is not considered 'bad', the value of longevity insurance is not well-perceived.	Government might further assist through providing information and influencing framing via disclosure.
(3d) Absence of comprehensive plans	Retirees may apply rules of thumb, social norms and intuition in managing their wealth in retirement rather than developing a comprehensive retirement consumption plan, and hence may not contemplate annuities.	Funds are developing comprehensive retirement income strategies to offer to retirees (albeit slowly). Potential to address through DBFO reforms and hence access to advice. Government might further assist through providing information.

(3e) Control	Handing control over assets could be intimidating; some retirees may be attracted to managing their own income, and be subject to the 'illusion of control'.	
(3f) Buyer's remorse	Fear of regret if interest rate or mortality assumptions change so that annuity could have been purchased at a better price, leading to purchase being delayed or not occurring.	
(3g) Regret aversion	Desire to avoid the regret of purchasing an annuity, for instance, in case of being diagnosed shortly thereafter with a fatal disease.	
(3h) Misinformation	Imperfect information, such as ignorance of the features and availability of annuities.	Potential to address through DBFO reforms and facilitating trustee direction. Government might further assist through providing information and influencing framing via disclosure.
(3i) Financial illiteracy	Poor financial literacy may affect the ability of some individuals to appropriately plan for retirement, impacting the decision to annuitise.	Potential to address through DBFO reforms and facilitating trustee direction. Government might further assist through providing information.
(3j) Individuality	Social trend towards individuality, rather than working as a collective, works against the risk-pooling spirit of annuities.	
(3k) Default options	Default payout option of an employer's pension plan has a strong effect; when annuities are not the default option, the propensity not to annuitise is lessened.	Potential to address through DBFO reforms, in particular facilitating trustee direction.
(3l) Historical view on personal retirement savings	Shift from the traditional defined benefit pension schemes toward individual savings (defined contribution) is a relatively recent phenomenon, implying potential lag in understanding annuities.	Australia's defined contribution system is well-established, but system still immature. Retirement phase has only recently come under close focus.
(3m) Procrastination	It is easier to do nothing than something, particularly with regard to important decisions like purchasing an annuity.	
(3n) Other	Other feasible behavioural biases include: (i) aversion to thinking about unpleasant events such as dying or being old and poor (ii) ignorance on the probability of survival (iii) fear of being viewed negatively as annuities unpopular	

Factors that could be addressed by the policy measures currently under discussion

There are three groups of policy measures that are currently being discussed that have potential to impact on the take-up of lifetime income streams.

- **Delivering Better Financial Outcomes (DBFO) reforms** – The aim of these reforms is to expand the availability of financial advice, including potentially through super funds. These reforms offer scope to address a number of the behavioural factors that could be restricting the use of lifetime income streams via recommending them within the advice that is given. Advice can act as a vehicle to address a number of the factors in the above table, including decision framing (3a), the absence of comprehensive plans (3d), misinformation (3h) and financial illiteracy (3i). In addition, super funds may suffer to a lesser degree from the disincentives to not recommend lifetime income streams (2e) that relate to giving up control over the assets. The idea of issuing 'nudges' as part of the DBFO reforms may also help assist in uptake, depending on what nudges are accommodated.
- **Recommendations and defaults** – The strongest mechanism for prompting individuals to take up lifetime income streams would be to include them within a default retirement solution, as noted under factor (3k). The next strongest mechanism would be to include a lifetime income stream within a recommendation for a comprehensive retirement solution, of which it forms an integral part. In

this regard, we recommend in Essay #2 that trustee direction be facilitated under which fund trustees may identify a suitable retirement solution for a member and either make a recommendation or assign them accordingly. While trustee direction does not seem to be directly contemplated in the Treasury retirement discussion paper, we believe it could and should form part of the policy agenda through the DBFO reforms. Doing so would amount to the strongest policy action that could be taken to encourage take-up of lifetime income streams, where appropriate to do so. The Treasury suggestion for providing default (i.e. recommended) solutions for member sub-classes and default (i.e. recommended) settings could be used to a similar effect, but probably with lesser impact. All these measures would also address the factors mentioned in the above dot points, i.e. (2e), (3a), (3d), (3h) and (3i).

- **Standardised retirement product** – A standardised retirement product that incorporates a lifetime income stream could have a similar effect to that discussed in the dot point above. We discuss this proposal in Essay #11.
- **Government underwriting of longevity risk** – The proposal that the Government underwrites longevity risk would mainly address the expensive pricing factor (2a), although could also help address distrust of providers (2f) and possibly sex-distinct mortality pricing (2g). One intent of this proposal seems to assist smaller funds to offer lifetime income streams. Government underwriting longevity risk should make some difference at the margin to take-up and should provide members with better pricing.

  Nevertheless, we do not expect this initiative to have a major impact on the use of lifetime income streams. The extent to which pricing is a major inhibiting factor on the use of lifetime income streams is debatable. MacDonald et al. refer to some evidence that pricing may not be an inhibiting factor in the take-up of annuities[39]. Further, it is doubtful that members understand the pricing and value of annuities sufficiently for it to impact on their decisions. We also understand that many larger super funds are developing their own lifetime income streams, while life insurance companies are currently active in setting up services to support the offering of lifetime income streams by super funds who are seeking an outsourced solution including small and medium sized funds. It thus may not be necessary for the Government to enter the market in order to support the delivery of lifetime income streams.

Policymakers might also assist with addressing behavioural factors

We view the behavioural factors as particularly important in limiting the use of lifetime income streams. Many of the behavioural hurdles reflect a lack of knowledge and understanding of lifetime streams and their benefits, including the tendency to frame them as an investment rather than as a means of underwriting a level of income for life and hence insuring against the 'risk of running out'. Policymakers might play a role in addressing behavioural factors in two ways:

- Providing information on lifetime income streams, say through MoneySmart or an expanded version of MoneySmart (see Essay #5).
- Encouraging a reframing of lifetime income streams as a mechanism to guarantee some amount of income for life and emphasising their role within integrated retirement solutions. One mechanism could be through standardised disclosures, as raised in the Treasury retirement discussion paper on pages 17-18.

[39] MacDonald et al. refer to a paper (Babbel, D.F., 2008, "Lifetime income for women: A financial economist's perspective", *Wharton Financial*) showing that pricing could not completely explain the aversion to annuitisation, and referring to another study where the vast majority of retirees chose a lump-sum payment over an annuity even though the annuity was priced based on a guaranteed interest rate that was nearly three times the prevailing market rate and approximately twice as high as the expected return on risky assets at that time.

Essay #9 – Establishing contingency accounts (i.e. capital reserves) as a standard component of retirement solutions

Main recommendations

1. Policymakers should enable the offering of "contingency accounts" from which members can draw to support spending that is not funded by regular income. A type of retirement 'account[40]' should be established that is exempt from the minimum drawdown rules up to a specified value.
2. Superannuation fund trustees might offer contingency accounts as a standard feature of retirement solutions, while giving members the ability to vary the amount or opt-out.

Motivation

In a third edition of our "retirement explainer" series, we addressed the nature of 'flexible access to funds' objective under the Retirement Income Covenant (RIC) and how it could be accommodated by super fund trustees. We put forward a case for incorporating "contingency accounts" within retirement solutions that a member could use as a source of accessible funds, including for the purpose of meeting spending needs not covered by regular income.

Relatedly, the Appendix to the Treasury retirement discussion paper presented an 'example bundled retirement product' including what was called a 'capital reserve', described as follows:

> "***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.*"

Our vision for contingency accounts appears like it may differ in detail to the capital reserve idea as described above, but the underlying motivation is very similar. In this essay, we recount the reasons for proposing contingency accounts and how we envisage them operating in support of access to funds for the purpose of provisioning spending not covered by regular income, i.e. precautionary savings.

We prefer the term 'contingency account' over 'capital reserve' as it better describes the purpose of such a structure as a form of precautionary savings. In any event, the exact term ultimately used to describe this facility should be chosen based on how members would be expected to view and use the account.

Reasons for establishing contingency accounts

Trustees are required under the RIC to provide flexible access to funds through the retirement solutions they supply to members. Our third retirement explainer raises two issues that are relevant in the context of this essay. First, how a member's desire for flexible access to funds is best met will depend on their motive for having access to funds. We identify four possible motives, including meeting unplanned spending needs (precautionary motive), bequests[41], funding of aged care and flexibility to adjust. We envisage contingency accounts being facilitated through policy changes to satisfy only the first precautionary savings motive. Second, trading off flexible access to funds against income is difficult

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[40] We use the word 'account' noting that the structure could potentially entail a separate account, a specific type of product or a component that resides within an account-based pension. These issues are discussed below.
[41] Bequest motives could include assisting family members prior to death, e.g. funding children into housing.

given that asset values occur at a point of time while income is a stream of value across time. Contingency accounts can help overcome the difficulty of comingled modelling of accessible funds and income[42].

Against this background, separating the provision of flexible access to funds out from the provision of income offers a number of benefits:

- ***Simplifying retirement solution design*** – Carving out assets into a contingency account allows the remaining assets to be directed towards achieving income objectives, without the need to give undue consideration to whether the income solution is leaving intact sufficient accessible funds. This does not mean that having access to funds should be ignored, as it would still be of value to the member. However, the existence of a contingency account would make the need to provide accessible funds through the other investments less of a primary consideration in the design of the income solution. The need to make ad hoc trade-offs between income and assets would be much lessened.
- ***Understandable by members*** – Creating pools that separately address income and precautionary saving demands accords with 'goal-based investing'[43], whereby different 'buckets' are created to address different objectives. Individuals often find this approach to be intuitive, as it aligns with their propensity to adopt narrow framing.
- ***Providing confidence to draw income and take more risk*** – Members may be given more confidence to spend their other assets knowing that they have something set aside 'just in case'. Thus carving out a portion of funds that is notionally not available to support income may help overcome the reluctance to draw down on savings overall. It could also provide more scope to increase drawdown rates on other assets on the basis the contingency account could be utilised in the event those assets become exhausted. It may also give members comfort with taking more risk within their remaining assets, where appropriate. In essence, members might view a contingency account as a form of insurance.
- ***Accommodating members with low balances*** – Our understanding is that members with very low balances often prefer to keep their super as a resource they can draw on if required (i.e. a type of savings account), rather than use it as a source of regular income – noting that they may be using the Age Pension for this purpose. A contingency account would accommodate these (reasonable) desires.

Potential complications include the operation and administration of the account, and its interaction with the minimum drawdown rules. We address these matters below, including recommending that contingency accounts be exempt from the minimum drawdown rules. One risk is that contingency accounts could boost unintended bequests. However, this is far from a forgone conclusion, and depends on the extent to which the existence of a contingency account can encourage higher drawdowns overall. Management of contingency accounts may also add to governance and operational costs. Impacted entities could include super funds, external administrators, Services Australia (Centrelink) and the ATO, depending on how these accounts are structured.

On balance, we see the advantages of contingency accounts as outweighing any disadvantages. They would overcome the technical difficulty of combining two disparate objectives, should offer a way of satisfying precautionary saving motives that is intuitive to members, and might even encourage higher spending overall – although this is just a possibility. The complications require scrutiny, particularly from an operational perspective. The efficiency loss of creating two components within retirement solutions to address income and flexible access to funds respectively seems minor at best[44].

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[42] The academic literature uses utility models to help evaluate the trade-off between income and bequests. However, these models are quite complex and not very intuitive. They also do not capture precautionary demand, as they assume that residual funds are accessed at the point of death.

[43] See Brunel, J.L., 2011. "Goal-based wealth management in practice", *Journal of Wealth Management*, *14*(3), p.17.

[44] Brunel (*op cit.*) argues that the efficiency loss is minimal in a portfolio context.

How contingency accounts could operate

Our third explainer discusses the contingency account as potentially supporting differing motives for having flexible access to funds. Here we address the application of the contingency account concept to supporting precautionary saving motives, on the basis that this would be the intent of any policy. Contingency accounts might be established for other purposes in parallel (e.g. funding bequests or aged care), although these motives could be accommodated within separate accounts that remain subject to the minimum drawdown rules. We assume here that policymakers do not wish to support these other purposes within 'officially endorsed' contingency accounts, on the basis that the primary objective of superannuation relates to income generation in retirement.

We see it as important that contingency accounts *functionally* operate as a separate account from the perspective of both portfolio management and member reporting and communications for two reasons:

- **Portfolio management** – The contingency account is best managed towards its own objectives, rather than being comingled with other funds that may have differing objectives (e.g. a balanced fund). We suggest that the primary objective should be to maintain the real value of capital. To this effect, we discuss the use of 'capital stable' funds for this purpose in a draft Conexus Institute report titled "*Investing for retirement*".
- **Behavioural benefits** – Framing the account as a quite distinct bucket would help to fully capture the behavioural benefits, particularly related to providing confidence to draw income at a higher rate and perhaps take more risk (if appropriate) with respect to the other assets. This requires members to view it as a separate pot of funds that is set aside.

While we are of the opinion that contingency accounts should be functionally separate, from an *administration* perspective a range of structures are possible. For instance, the contingency accounts could be offered as a type of account or product, or embedded within an account-based pension (ABP) structure while accounted for separately. In the latter case, the ABP could operate as the vehicle that houses a range of components, including for instance a balanced fund, a contingency account and a lifetime income stream[45]. We leave the question of the legal and administrative structure as a matter for future deliberation.

Our contingency account concept appears to differ from the capital reserve concept as presented in the Treasury retirement discussion paper, where it is described as a sub-division of the ABP and an "indexed capital reserve". As mentioned above, while a contingency account might be administered within an ABP structure, we see it important that it is functionally operated as a separate account from a portfolio management perspective; and that it is described to members as a separate 'bucket' of funds rather than a sub-division of the ABP. It is unclear exactly what the reference to an indexing capital reserve is intended to mean, but it seems to allude to an amount set aside with a guaranteed real value. If so, we think this would introduce substantial complexity with little benefit[46].

Our proposal of creating a functionally separate contingency account managed towards an objective of maintaining the real value envisages an investment in some form of capital stable fund, with the reported value of the contingency account fluctuating with realised returns on that fund. The member would thus bear the real return risk within the account. Such functional separation would also facilitate

[45] Some super funds may prefer to use their existing administrative systems for their ABP, as well as avoid the need to establish an additional product with its own product disclosure statement.

[46] For instance, any guarantee of the real value of the capital invested would give rise to the question of who bears the real return risk on the assets (or captures the benefit), given that available investments neither deliver nor guarantee a zero real return. It is much cleaner to have the contingency account as a standalone investment, rather than introduce capital guarantees or comingling with (say) an account-based pension.

separate performance evaluation of the contingency account and remaining investments within the ABP.

We fully agree with Treasury's intimation that their idea of a capital reserve – and hence our idea of a contingency account – should be exempt from the minimum drawdown rules.

Against this background, contingency accounts might have the following features:

1. Specialised, functionally separate account that is exempt from the minimum drawdown rules and tracked separately to the income-generating components of the retirement solution;
2. A standard feature of all retirement solutions that is offered as a default setting;
3. Invested towards an objective of maintaining the real value of the capital;
4. Standard amount is allocated into the account initially, which the member has an option to vary;
5. Member may draw from the account as they desire;
6. Member may top-up their contingency account to the maximum allowable if they wish.

Actions that policymakers might take

The main action that policymakers need to take is to enable the establishment of retirement accounts that are exempt from the minimum drawdown rules. A key matter is determining the amount that may be allocated to such accounts. We can see three issues, although there may be more:

- *Amount that may be allocated to such accounts* – The amount needs to be set high enough to be meaningful in relation to potential unexpected spending needs, and provide members with confidence that they have most contingencies covered. The $50,000 mentioned in the Treasury discussion paper seems a reasonable amount for a standard or default allocation. One variation could be to specify a standard allocation that trustees may offer as the default, and allow scope for the member to vary away from the standard allocation up to some maximum to provide members with some flexibility.
- *Possibility of the maximum amount being exceeded through investment returns* – It is possible that contingency accounts could exceed the maximum value if positive real returns are earned. Potential mechanisms to deal with such an occurrence might be an automatic switch to restore compliance, or allow the higher level to be retained in the contingency account if achieved through market performance and not via allocations.
- *Variation of permitted amounts over time to account for inflation* – One possibility is including a process for inflation adjustment to the maximum amount in the legislation. Another possibility is to enable the default and maximum amounts to be determined under delegated legislation. The latter would be more flexible, and provides a ready mechanism to adjust as the industry at large learns more about catering for retired members.

Essay #10 – Drawdown rules and retirement solutions

Main recommendations

1. Any review of the minimum drawdown rules (MDRs) should account for the possibility that retirees who utilise a retirement income stream[47] as part of their retirement solution may be forced to draw more income than is optimal.
2. While most solutions have adverse policy consequences or are operationally difficult to implement, two possibilities are: (1) implement a 'drawdown discount' (i.e. a reduced minimum drawdown schedule) for retirees with a retirement income stream; and (2) allow trustees to tailor drawdown rules for members, which aligns with the obligations of the Retirement Income Covenant.

Motivation

Presently the MDRs apply to account-based pensions (ABPs) but do not consider the full retirement solution. This essay makes the point that this can create inefficiencies for retirees who allocate to retirement income streams as part of their overall retirement solution. The discussion references Mine Super's submission to Treasury's 2017 consultation paper *"Development of the Framework for Comprehensive Income Products for Retirement"*, the relevant part of which can be found in pages 9-13.

Optimal drawdown rules on retirement portfolios

To explore whether the drawdown rules applying to ABPs are appropriate to retirement solutions that incorporate other retirement income streams, researchers at Mine Super undertook an optimisation exercise. At the heart of this exercise was to maximise expected utility using the MDUF utility function[48].

The research identifies the following results:

1. Optimal consumption as a percentage of total wealth is quite robust to the degree of annuitisation. For the purpose of analysis, this level was (reasonably) approximated by the current MDRs[49].
2. The optimal drawdown rate for ABPs falls when an allocation to life annuities is part of a retirement solution. This can occur from the moment the retirement solution is initiated, for example when high long-term bond yields result in large lifetime annuity payments[50]. The result is stronger from age 80 onwards, where the retiree's survival experience results in accrual of mortality credits, making the annuity a larger than optimal part of the retirement solution on a mark-to-market basis[51]. These effects can interact to create a compound effect, as drawing more than optimal from the ABP due to the MDRs further skews the allocation of the retirement solution to the lifetime annuity at older ages.

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[47] We prefer to use retirement income 'stream' rather than retirement income 'product' as we see it as better covering group self-annuitisation arrangements.
[48] Member's Default Utility Function v1 was a collaborative industry / academic project to create a parameterised utility function for trustees of super funds. All materials can be found at https://theconexusinstitute.org.au/resources/members-default-utility-function-mduf/.
[49] This should not be interpreted as implying that the MDRs represent the optimal percentage of total wealth that should be taken as income.
[50] This part of the result is parameter (i.e. yield) dependant.
[51] Here, the model allowed the retiree to enter but not exit or trim their life annuity arrangement.

3. The optimal drawdown rate for ABPs exhibits significant variability through time when an allocation to life annuities is included. This reflects the fact that the ABP is playing the role of absorbing the impact of investment outcomes on total assets through adjusting the drawdown rate to deliver the optimal income.
4. Both results (2) and (3) become more sizable as the proportion allocated to annuities increases as a portion of the value of the overall retirement solution.
5. A ramification of the above is that the statutory MDRs can force retirees to draw more than optimal from their retirement savings portfolio, with smaller ABP balances at older ages magnifying the effect.

Policy implications

The policy challenge is that policymakers are interested in retirees making greater use of retirement income streams, but such products may lead to retirees drawing down more than the optimal amount from their retirement savings portfolio in the presence of the MDRs. There are a range of possible solutions, but most could be difficult to implement or risk having negative consequences for encouraging more appropriate drawdown behaviours. Some candidate solutions include:

1. **Remove the MDRs altogether** – This risks lower drawdowns, particularly under the current circumstances where adoption of retirement income streams is modest, thus potentially exacerbating any tendency for retirees to fail to utilise their savings appropriately.

2. **Remove the MDRs for retirees who have a retirement income stream** – This would likely create substantial operational and compliance challenges for industry. It could be open to gaming, e.g. making a minimal allocation to retirement income streams to avoid the MDRs.

3. **Introduce a 'drawdown discount'** – This would be a reduced drawdown schedule for those retirees who have a retirement income stream as a component of their retirement solution. This is an approximate way of addressing the issue that should be broadly implementable through super fund operational processes. One issue is whether a generic adjustment should be applied that is easy to implement but not calibrated to the available income from the lifetime income stream, or some level of differentiation for varying exposures to lifetime income streams is incorporated.

4. **Allow trustees to tailor drawdown rules for members** – We suspect that this is something that not all industry participants would welcome as it would create significant fund-level operational complexity. However, it would support delivering an appropriate level of total income to the member, which aligns with the obligations placed on trustees by the Retirement Income Covenant.

Identifying and implementing a solution now may have the dual effect of countering the issue created by the MDRs that we raise, and could encourage greater take up of lifetime income streams. Of the ideas listed above, we believe (3) and (4) warrant further consideration.

Essay #11 – Potential role for standardisation

Main recommendations

1. Standardising certain disclosures for retirement solutions and products should be beneficial. Policymakers should investigate what can be done through a research and consultation process.
2. We recommend against introducing a standardised retirement product.

Motivation

The Treasury retirement discussion paper raises standardisation from two directions. The idea of a standardised product disclosure framework is floated on pages 17-19. Creation of a standardised retirement product is raised on pages 24-25, supported by an 'example bundled retirement product' in the Appendix. Our prime motivation in this essay is to provide some thoughts on these proposals.

1. Standardisation of disclosures

The apparent motivation behind standardising retirement income product disclosures is to provide members with better information to assist them in choosing retirement solutions and products. We support this goal. While market-based approaches have limitations as discussed in Essay #1, it is the case that some members will want to choose for themselves. Standardising disclosures can assist those individuals to better understand the features of the retirement solutions and products they are being offered, and hopefully make better decisions as a result.

Setting disclosure standards is a major undertaking. There are many complications. The range of retirement products continues to develop, with increasing complexity and nuanced features. Some products may be used in multiple ways, making it difficult to produce basic disclosure. For example, an account-based pension (ABP) can be used to deliver a constant income stream (until it runs out) or a variable retirement stream for life. Any disclosure framework for retirement would also need to look beyond individual products to cover retirement solutions and the outcomes they deliver (e.g. the income generated). Disclosures should be understandable by a typical member with limited financial literacy: a challenging task when retirement involves difficult and complex trade-offs.

We hence do not delve into the detail of how disclosures might be standardised. Rather, we recommend that the formulation of a disclosure framework should be made the subject of a research project, and accompanied by industry consultation. The research process might encapsulate the following:

- Researchers with expertise in consumer choice are involved.
- Consumer testing is conducted as part of the research.
- Consideration is given to the interaction between disclosure and product design, including how product complexity might be addressed and how product innovation might be accommodated while unhelpful product dispersion is constrained.
- Implications of technological developments like AI are addressed.

2. Standardised retirement product

The proposal for creating a 'standardised retirement product'[52] raises two main issues. First is whether a Government mandated or endorsed standardised retirement product is needed. We address this question in Section 2.1, and conclude that the case for Government involvement on this level is tenuous.

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[52] What is being raised for discussion is perhaps better described as an integrated retirement solution than a retirement product. Although it might be offered as a product.

Second is how a standardised retirement product might be structured in the event that the proposal is carried forward. We make some suggestions in Section 2.2.

2.1 Need for policymakers to frame up a standardised retirement product

We start by listing the arguments for and against the Government mandating or endorsing a standardised retirement product that could be offered by super funds, after which we sum up.

Arguments for

- Framing up a standardised retirement product could assist super funds that are struggling to move forward in developing their RIS. This might be most beneficial for small-medium sized funds with limited capabilities or resources, and could help some large funds to face into the challenge of delivering RIS at large scale. It may be useful for funds with a small portion of assets or members in the retirement phase where the business case for developing retirement solutions is weak (see Essay #13). The underwriting of longevity risk by the Government for standardised retirement products could assist in this regard.
- A standardised retirement product could populate the market with recognisable retirement options that help to address complexity through becoming familiar to members and helping to overcome the adverse impact of high dispersion in the retirement offerings across the market.
- A standardised retirement product might be designed to accommodate portability and hence switching, and hence add to competitive tension in the retirement market at the margin[53].
- A well-designed standardised retirement product would provide a benchmark for minimum standards across the industry. Super funds would be encouraged to develop products only if they are superior.
- Members would still have the option to seek another solution if the standardised retirement product is unsuitable for their needs.

Arguments against

- The case for Government intervention is unclear. Government direction of product design intervenes in the market when it is not obvious that a major market failure exists. The slow movement in RIS development by super funds may have more to do with development lags (see Essay #13 on business hurdles) than structural issues that will inhibit super funds from delivering retirement solutions in due course. As noted in Section 2.2 below, there seems to be considerable action 'under the hood' in developing capacity to offer lifetime income streams, for instance. We see no technical reason why funds should not be able to develop their own retirement solutions without Government direction if they plan to be in the retirement market.
- Other policy measures may be more effective in ensuring that super funds offer suitable retirement solutions and products to members. To this effect, we raise imposing enhanced trustee obligations in Essay #3, establishing a member outcomes assessment framework for retirement in Essay #6 and potentially introducing a licensing regime in Essay #7. Such policy measures would be aimed at ensuring that fund trustees develop RIS of appropriate quality that cater for all their members. The Government taking action directed at consumer protections through such policy measures could be viewed as preferable to intervening in the market directly.
- A standardised retirement product may have difficulty in catering for key member differences. The main differences impacting on retirement solutions are listed in Essay #4 on personal information and detailed in the draft 'explainer' provided as part of this submission. A standardised retirement product may be ineffective in spanning the required dimensions. Nevertheless, this is a complex issue that depends on the functionality provided by any standardised product and how members engage with it. Consideration needs to be given to the possibility that members would receive a standardised

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[53] As discussed in Essay #1, we expect competitive forces to be weak in the retirement market in any event.

retirement product as a Government recommendation, and take it up accordingly as offered even where it is unsuitable (notwithstanding the availability of an opt-out).

To this effect, members may end up with an unsuitable solution for various reasons:

- A basic product with minimal functionality would fail to cater for key member differences, but may be taken up by members nevertheless even where unsuitable.
- If the product has high functionality along with default settings (such as Treasury's example bundled retirement product – see below), the default settings may be applied regardless of whether they are appropriate, also resulting in the member taking an unsuitable retirement solution.
- If the product has high functionality but there are no default settings, members would be required to make choices that some could be poorly positioned to make. Again, the risk arises of members taking an unsuitable retirement solution because they do not use the product appropriately.

The last two issues might be overcome to some extent through coupling the offering of standardised retirement products with financial advice or guidance from fund trustees. We note that the risk of members taking unsuitable retirement solutions may also be present with respect to other solutions offered by super funds. However, it is arguably heightened when there exists an element of perceived Government endorsement (as observed with respect to the minimum drawdown rules).

- A standardised retirement product could crowd out other offerings, which would start to look more like the equivalent of choice products in accumulation when standing alongside a standardised product. This would reduce the incentive for funds to develop their own retirement solutions and products that might better cater for member needs.
- A related risk is that a standardised retirement product could inhibit both innovation and aspiration by sending a message that 'this basic solution is enough'.

Summing up

While there are potential advantages in establishing a standardised retirement product, we consider them to be outweighed by the disadvantages. Our main issues with the proposal are that a clear case for direct Government involvement in product design is not apparent, and there is a risk that a standardised product could be a vehicle for some members taking up unsuitable retirement solutions that do not cater for their specific needs. We suggest that policymakers may be better pursuing policy measures that place an onus on fund trustees to deliver suitable retirement solutions.

2.2 Structure of any standardised retirement product

We now comment on how a standardised retirement product might be structured, if it were to be introduced. Our baseline stance is that any standardised retirement product should have the functionality to cater for key member differences (which are discussed in Essay #4). A very basic 'one-size-fits-all' product solution, or one with limited scope to vary the settings, is unlikely to do the job effectively.

Hence we support any standardised retirement product having a reasonable level of functionality. The 'example bundled retirement product' presented in the Appendix of the Treasury retirement discussion paper captures this idea. We consider the example product to be very well-designed. We particularly like the idea of combining a deferred income stream (i.e. annuity) with an ABP that is used to deliver income until the deferred annuity income commences. We also endorse the inclusion of a 'capital reserve', and put forward a variation of this idea in Essay #9 in discussing 'continency accounts'. The Treasury retirement discussion paper says little about the ABP drawdown strategy that would be applied, but clearly drawdown rules would also be required.

Going by the description of ‘example bundled retirement product’, the member would be provided with considerably flexibility to determine certain settings, or vary them from a default setting. The functionality is provided with regard to the following:

- Asset mix within the ABP;
- Allocation to the capital reserve (with a ‘minimum’ of $50,00 being mentioned);
- Allocation to the deferred annuity;
- Age at which income from the deferred annuity commences; and,
- Risk taken via the deferred annuity – while an investment-linked annuity appears to be the default (based on the ‘balanced’ descriptor), we presume that a traditional fixed annuity could be chosen.

In sum, the basic componentry and functionality of the ‘example bundled retirement product’ appears quite appropriate. It should provide a good foundation if the standardised product proposal is pursued.

However, a relatively high level of functionality sets up a point of tension related to ensuring that the members make appropriate use of that functionality. In this regard, we question whether it is suitable to offer default settings. There is a substantial risk that members anchor on any default setting; and mechanisms might need to be put in place to guard against members simply applying the default settings where they are inappropriate. In any event, members will need guidance to assist them in using the product functionality, i.e. they will need to be provided with direction, or access to assistance including perhaps financial advice in some instances. Fund trustees would thus need to accompany a standardised retirement product with decision support services. The implication of introducing more functionality and thus member choice is a move away from the ideal of offering a standardised product that is relatively cheap to deliver and readily understandable by members.

Consideration might be given to accompanying any standardised retirement product with an obligation on trustees to attempt to ensure that it is being appropriately used by members. This could include a requirement not to offer the standardised retirement product solution to a member where there are reasons to believe it is unsuitable, or if they suspect it may not be suitable. In this event, the trustee might then be expected to engage with the member over their retirement needs, and offer access to financial advice.

Essay #12 – Terminology

Main recommendations

1. The term "retirement income" helps to foster misunderstanding around the purpose of retirement savings. While "retirement funding" would have been a better term, changing this now seems too hard. As an alternative, we suggest providing a clear definition of retirement income such as "*drawdowns from savings to fund spending in retirement*", and substituting 'funding' for 'income' where appropriate.
2. The word "default" should be used only to describe situations where no member choice occurs.

Motivation

The use of terms "retirement income" and the word "default" are creating some confusion in the context of policy debate. We offer some thoughts on how this confusion might be limited. There are also a few other terms on which we comment, including "nudges", member "sub-classes", and "retirement income products", and "lifetime income products". Words like "recommendation" require further consideration.

1. Retirement "income" is unfortunate phrasing: "funding" is a better word[54]

A major activity undertaken during retirement is conversion of retirement savings into spending, i.e. consumption. The term "retirement income" has become pervasive within policy and industry circles to describe the conversion of assets into amounts to be spent, including an attendant assumption that some drawdown of capital will be involved. The use of the word "income" to describe this activity has become embedded in legislation (e.g. the Retirement Income Covenant), policy formulation (e.g. the Retirement Income Review), industry jargon, retirement projections, academic and other research, and more. However, this particular use of "income" does not accord with the common meaning attached to the word, as discussed below. This gives rise to a framing that may be exacerbating some issues that policymakers are aiming to address, in particular encouraging members to draw down on their savings.

Dictionary definitions and common uses of "income"

A selection of dictionary definitions of "income" appear below. The majority allude to earnings or benefits arising from work (i.e. wages and salaries) or investments. The latter is most relevant in the current context. In this regard, some people view investment income in a narrow sense as referring to a 'recurrent periodic yield' or the 'running yield' arising from income that is distributed by investments such as dividends, interest, rent, and so on. A broader definition might extend to total investment return including capital gains, noting that the latter may be taxed as income. In any event, the common usage of income does not accord with the concept of drawing down on capital to support spending.

Cambridge
money that is earned from doing work or received from investments

Mirriam-Webster
gain or recurrent benefit usually measured in money that derives from capital or labor

Oxford Learner's
money that a person, a region, a country, etc. earns from work, from investing money, from business, etc

The Britannica Dictionary
money that is earned from work, investments, business, etc

Google Dictionary (Oxford Languages)
money received, especially on a regular basis, for work or through investments

Vocabulary.com
the financial gain (earned or unearned) accruing over a given period of time

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[54] We acknowledge Graham Harman for his input into this section of the essay.

Is there a problem to be fixed?

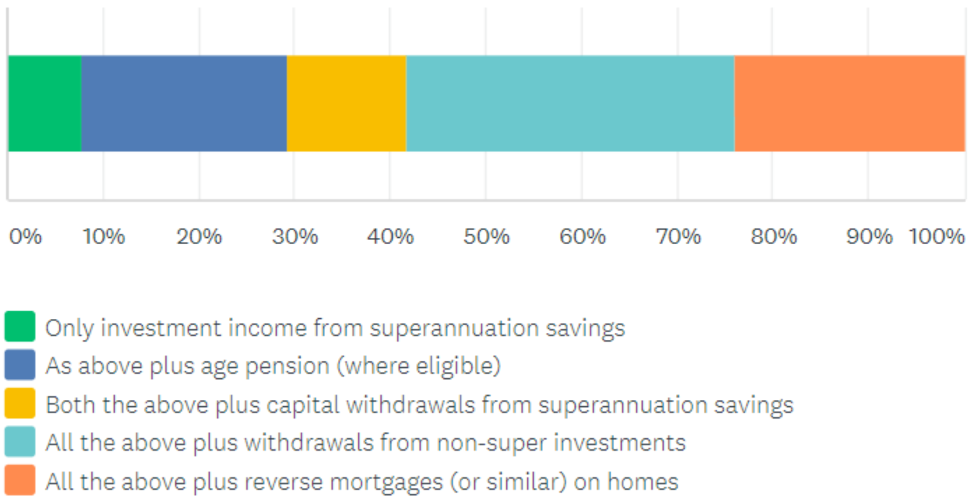
The issue is whether the use of "income" is exacerbating the reluctance of members to draw down on capital to fund spending during retirement. Words can have power. The term "retirement income" invites an interpretation that only investment gains or perhaps regular investment income such as dividends and interest should be drawn. Anecdotally, we see this interpretation being used by some private investors and even occasionally professionals, where we have encountered reference to the importance of delivering stable income (e.g. dividends, etc) from investments in order to provide income for retirees. Choi (2022, p179)[55] reviews popular financial advice. In reference to treating the need for income as relating running yields while ignoring capital gains, he finds that "*Nine of the books in our sample reject the dividend irrelevance theorem …. Multiplebooks refer to the need for "income," particularly when the investor is older*".

The Retirement Income Review Final Report of July 2020 expressed the view that this is an important issue. It states that a "*major misunderstanding is the view that 'retirement income' involves the return from investing superannuation balances*" (p17). It follows up with this comment on the perceived nature of retirement income:

> *"Most people die with the bulk of the wealth they had at retirement intact. It appears they see superannuation as mainly about accumulating capital and living off the return on this capital, rather than as an asset they can draw down to support their standard of living in retirement."* (p23)

Below are the results of a survey by Firstlinks of their readers over their preferred definition of retirement income. Just under 30% indicate that retirement income should be defined around investment income from superannuation, while making no allowance for drawdown of capital.

Q1 The definition of retirement income should be:



Source: Graham Hand, "*Unexpected results in our retirement income survey*", Firstlinks, 11 September 2021.

It is unclear how pervasively held is the view that retirement income should not include the drawdown of capital. But the view is definitely out there.

A better term is "retirement funding"

Substituting "retirement funding" for "retirement income" would help to address the issue by lessening the discord between the common meaning of income and the policy objective of encouraging people to draw down on their savings during retirement. It alludes to using available assets to support spending in retirement, whether it be to support regular spending or other spending needs or desires such as

[55] Choi, J.J., 2022. "Popular personal financial advice versus the professors". *Journal of Economic Perspectives*, 36(4), pp.167-192.

taking a holiday or funding aged care. It would invite superannuation fund members to think about how they will use their savings for retirement to fund the lifestyle they desire.

Is changing worth the effort?

Unfortunately, we think the switching costs have become too onerous. Income appears embedded in the retirement industry lexicon, and hence may be very difficult or even impossible to extract at this juncture. It seems extremely unlikely that the Government would rewrite legislation to accommodate a change in terminology. Major adjustments would be needed across the industry to the language being used and related written materials. It could also put Australia out of step with other jurisdictions like the US and UK, unless they followed suit.

An alternative approach

An alternative is to treat the use of income in a retirement context as another instance of multiple meanings for the same word in English, then set out to mitigate any adverse consequences. This could entail providing a clear definition of the meaning of income in a retirement context. We suggest issuing a definition such as that below, coupled with some education. A definition of retirement income might also be included in retirement disclosure requirements (see Essay #11).

> *Retirement income: drawdowns from savings to fund spending in retirement*

A definition along these lines would directly connect the term retirement income to the concept of drawing down on savings to fund spending in retirement. With this definition in hand, there may be instances where income could be replaced by funding, or simply "funding for retirement". For example, "drawing down on an account-based pension to generate income" could be replaced by "drawing down on an account-based pension to provide funding for retirement spending" without much disruption.

2. Use of "default"

Disparate use of the word "default" within the industry is emerging as a potential source of confusion. Default is being used to refer to various concepts or ideas that have some fundamental differences, and often seems to mean different things to different people. A selection of dictionary definitions appears below that are relevant in the context of retirement solutions, products, settings or actions. Generally these definitions refer to ***something that happens when no choice is made***.

Adhering to the existing definition might help avert confusion over meaning. We recommend that "*default*" be used only in circumstances where no choice is required by the member.

Dictionary definitions of default

Cambridge
the thing that exists or happens if you do not change it intentionally by performing an action

Mirriam-Webster
a selection made usually automatically or without active consideration due to lack of a viable alternative

Oxford Learner's
what happens or appears if you do not make any other choice or change

The Britannica Dictionary
used to describe something that happens or is done when nothing else has been done or can be done

Google Dictionary (Oxford Languages)
a preselected option adopted by (a computer program or other mechanism) when no alternative is specified (by the user or programmer)

Vocabulary.com
an option that is selected automatically unless an alternative is specified

Comment: Default has different meanings in other contexts, e.g. default on a loan, setting in a computer code, failing to field a sports team. While we refer to default as a noun here, it can also be used as a verb.

"***Recommendation***" would be a more appropriate word than default where an element of member choice over which option to select is involved, specifically with regard to retirement solutions, products or settings. We have applied this approach in Essay #2, where we have referred to the idea of 'default settings' and 'default solutions' for member types as presented in the Treasury discussion paper as 'recommended settings' and 'recommended solutions'. While recommendation seems the most appropriate word in such situations, we are cognisant that "recommendation" is a foundational word in the financial advice sector. It is important that terms with any legal or regulatory meaning are applied consistently across all settings, especially if super funds are to play a larger role in providing financial advice under the delivering Better Financial Outcomes (DBFO) reforms.

3. Comments on other terms

There a few other terms that are ill-defined or where we view an alternative to be more appropriate.

- **"Nudges"** – The term "nudges" has been invoked by policymakers, most notably in relation to the potential role for super funds under the DBFO reforms. It would be helpful if policymakers could define or better explain what they mean by nudges in the context of retirement policy – although there may well be plans to do so in due course.
- **Member "sub-classes" versus "types"**– An issue with "sub-classes" is that it alludes to a member grouping or cohorting approach. Potential also exists for trustees to tailor for individual members. There is also a possibility that members are asked to select solutions based on self-identifying with member personas, which are more of an exemplar member than a particular class. These possibilities are better captured by the term "member type". One consideration, however, is that the term "sub-class" appears in the Retirement Income Covenant legislation.
- **Retirement income "products" versus "solutions"** – We believe that the term "retirement income solution" should be used to describe integrated solutions that deliver income and other outcomes to members, such as that being described in the Treasury retirement discussion paper as a "standardised retirement product" and the accompanying "example bundled retirement product". Solution is a broader term that better covers situations where a number of different products are combined with a drawdown strategy. While retirement solutions could be offered as a single product option that bundles differing components, this need not be the case.
- **Lifetime income "products" versus "streams"** – The term "lifetime income products" does not seem to cover situations where members are pooled by the super fund in providing longevity protection, i.e. group self-annuitisation. "Lifetime income streams" better covers pooling arrangements between members, and dilutes the impression that a product purchase is involved.

We consider none of the above issues to be as serious as those discussed in sections 1 and 2. In fact, there is some risk we are being too pedantic.

Essay #13 – Business barriers to developing retirement income strategies (RIS)

Main recommendations

1. Super funds face a range of barriers that challenge the business case and act to delay the development of RIS. For many funds there is likely a strong conflict between the rational business case to develop a high-quality RIS and the obligation to do so. Our concern is that retiring members will be the release valve through funds delaying and/or under-developing their RIS. Policymakers should allow for these business barriers in framing policy and setting expectations around delivery times.
2. Policy measures such as imposing additional obligations on trustees (explored in Essay #3), introducing a retirement members outcomes assessment framework (Essay #6), and enacting a licensing regime (Essay #7) may reconcile some of the issues by providing clarity of requirements and a choice for trustees to not participate in the retirement market.

Motivation

Policymakers and the regulators are clearly concerned that the progress made by super funds in developing their RIS has been less than hoped. However, we feel that there are some genuine business barriers around the development and delivery of a RIS which should be recognised. Further, we believe they are grating against trustees delivering on their obligation under the Retirement Income Covenant (RIC) to assist members with their retirement needs. The Conexus Institute has been aware of the existence of business hurdles[56], but to date there is little analysis on the topic. Our motivation in this essay is to describe these business barriers so that policymakers (and regulators) may take them into account.

Barrier 1: Financial case for RIS development can be tenuous for some super funds

The first business barrier is that the financial case for developing RIS may be weak for some funds. We discuss this issue through the lens of analysing the commitment of resources to developing a RIS as an investment project. The table below sets out some of the key considerations in building a financial case through this lens, along with examples of specific matters that might be addressed in RIS development.

We note that the financial cases for profit-for-member funds and for-profit funds may differ. One key point of differentiation is how projects are funded. Profit-for-member funds finance projects through spending members funds (sourced through operational fees), while for-profit funds finance their initiatives through external shareholder funds. This may flow through to differences in the business case analysis in two main ways:

- Areas such as improving members outcomes can be captured more directly in a profit-for-member fund, whereas for a for-profit fund member outcomes do not directly impact financial outcomes to shareholders (though there is likely a strong indirect impact via member experience / retention).
- Profit-for-member funds and for-profit funds may use different discount rates in their business cases. For profit-for-member funds, the opportunity cost might be set in line with the expected investment return of the portfolio[57], whereas for-profit funds may apply a discount rate reflecting the required return-on-equity for shareholders.

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[56] For example, see *"Business case for retirement needs to stack up"*, Investment Magazine (2021).
[57] Projects in profit-for-member funds can be funded through strategic reserves (which would otherwise generally participate in investment portfolio returns) and/or through higher operational fees. When the member bears the

Overview of considerations in constructing a financial case

Business case feature	Applied to retirement
1. Investing in a business opportunity may be analysed as the **net present value (NPV)** of operating cash flows = revenues less costs, and investing cash flows, such as capital spending. For example: *NPV = Discounted value of (revenues – costs – capex)*	*Examples of benefits include:* • Attracting new members • Member retention • Improved member outcomes *Examples of costs include:* • Staff employed by the retirement function • Member servicing • Governance and compliance *Examples of capex include:* • Establishing systems to tailor towards, and service, individual retirees • Retirement solution and product development
2. The NPV is impacted by **timing of cashflows**, with the discounted value of cash flows further into the future being lower.	*Examples:* • The benefits for members span out over retirement • Fund demographics, and a super system that is still maturing, may act to delay the benefits • There would be a time lag in attracting new members
3. The NPV of a business case is impacted by the **discount rate** used to value future cashflows, which is affected by cost of capital and project risk.	*Example:* • The discount rate might be set as a hurdle rate, such as the expected portfolio rate of return in a profit-for-member fund or the shareholder's required return on capital in a for-profit fund.
4. **Risk and uncertainty of outcomes** can be reflected in the discount rate, or captured by considering different scenarios and applying a probability weighting.	*Example:* • Policy uncertainty may require a return premium or give rise to potential scenarios where an initiative fails and needs to be unwound or modified • Specific examples include longevity product legacy costs and advice process re-engineering.

Within the NPV framework, a range of issues impact on the financial case for committing resources to developing a RIS retirement:

1. **The revenue opportunity is unclear, but appears weak** – Rates of member switching between funds are relatively modest (see chart over); and in any event it is difficult to identify whether switching rates are higher or lower during the retirement phase. As discussed in Essay #1, we see little evidence of a competitive marketplace for the retirement offerings provided by funds, with the potential exception being fund platforms used by financial advisers. Rather, we consider it likely that a strong incumbency effect exists in retirement.

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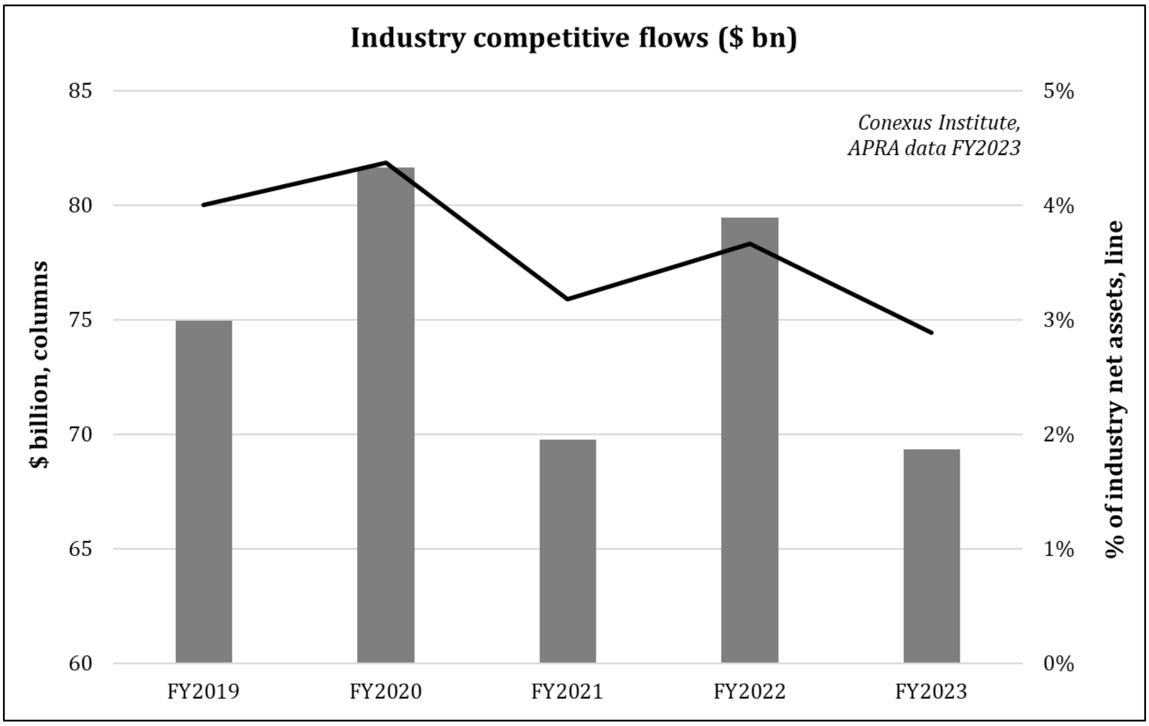
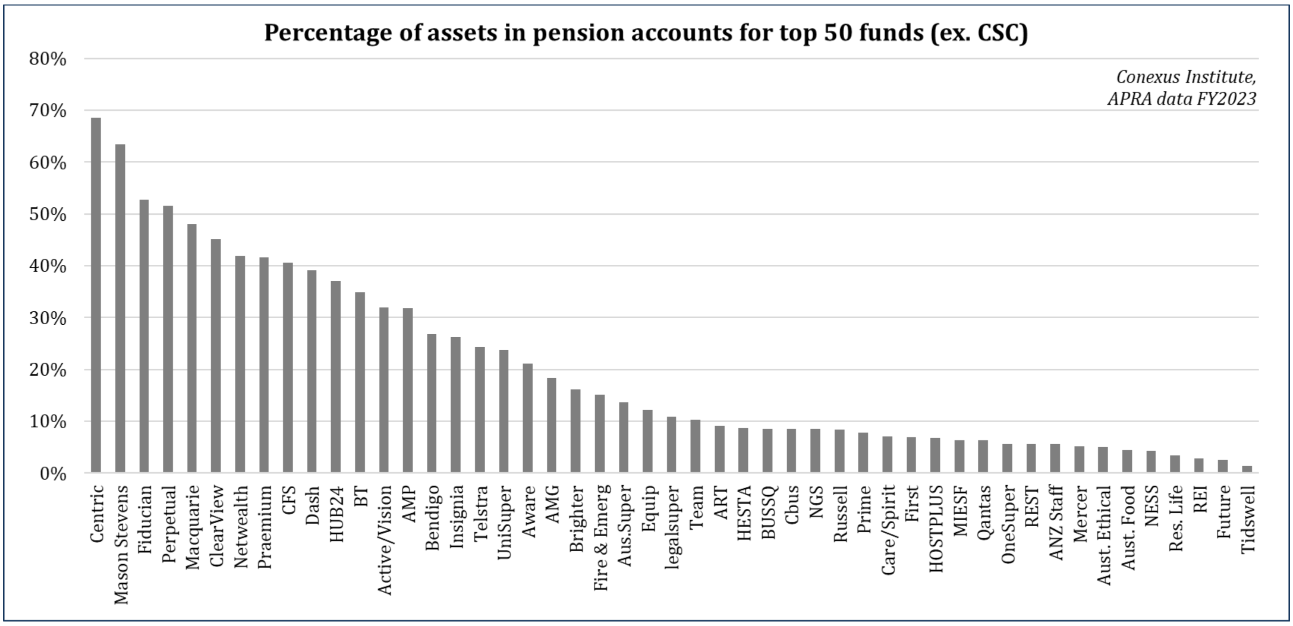
cost through fees, the trustee takes assets away from the member that would otherwise have participated in investment returns.



2. **Costs and capex should be high for retirement** – Key drivers of higher cost in the retirement phase include the need to cater for members with differing circumstances, needs and wants; the complexity of delivering retirement solutions that comprise a combination of investments, products and drawdown strategies; and the greater call for offering guidance to members who are retired or contemplating retirement. These features create a need for an expanded capacity to tailor and service individual members. This can be quite costly, including raising the bar on member information and systems in particular. In contrast, there is greater opportunity in accumulation to offer products and services that are more generic in nature, while member servicing requirements are lower.

3. **Significant dispersion in the demographic profiles of super funds** – Assets and members in retirement is a small component for some funds (see chart below). This can make the financial case for RIS development less attractive through both reducing the number of members who would benefit or generate revenues for the fund. It may also delay the timing of benefits relating to improved member outcomes to the extent that a trustee may have a preference to invest in retirement until there is a substantial cohort of retirement members.



4. **Uncertainty over the policy and regulatory environment is significant** – While the message from Government and regulators is clear ('deliver a strong retirement offering!'), the policy environment is less clear and highly contested in some areas. The uncertainty can give rise to downside risk scenarios that reduce expected NPV. Key areas of policy uncertainty include:
   - While the Government has outlined its intention around provision of financial advice, the Delivering Better Financial Outcome reforms process is not yet complete, nothing has been legislated, and regulatory structures to complement the legislation have not been developed. Indications are that this will be a contested policy area.
   - Frameworks for assessing the RIS developed by super funds by APRA and other groups such as research houses have not been developed. Assessment may impact the nature of what funds need to deliver through their RIS, and hence adds to the uncertainty.
   - The Treasury retirement discussion paper indicates that the Government is considering provision of longevity pooling, which could disrupt existing product development activities.

Barrier 2: Other business case considerations may not line up

The considerations in forming a business case typically go beyond financial analysis. For example, the following might be influential:

- **Business strategy** – Businesses can decide to address a market to either exploit or build competitive advantage. From this perspective, some funds might form the view that retirement is not a market they are well-positioned to address. This could be due to a member base that is highly skewed to younger members, lack of the scale required to offer an effective RIS, or an intention to pursue mergers first in order to build scale for the future. Funds with a smaller number of members in the retirement phase will also face heightened considerations around cross-subsidisation, given that all members would in effect be incurring the RIS development cost.
- **Keeping open your options** – Developing a RIS represents a commitment to a certain course of action. The concept behind real options suggests that it is often more valuable to keep a business option alive than to exercise it. In addition, it may make sense from a business perspective to be a follower than sit at the 'bleeding edge', especially when uncertainty exists over policy and technologies.
- **Legacy risk** – Related to the above, developing retirement solutions, products and services when considerable uncertainty exists gives rise to legacy risk. Legacy risk with respect to products can be a substantial business consideration, as products can be quite difficult to wind up once members have invested. This risk might be particularly meaningful for lifetime income streams.
- **Personal incentives of business leaders** – While arguably not a good excuse, personal incentives to put a lot of effort into RIS development may be weak for the boards and management of some super funds. Developing a RIS is hard work and would make life more difficult for the leadership; and it is not always obvious that personal financial rewards exist for taking on the challenge (apart from a sense of mission and purpose). Career risk – or the fear of making a mistake and being held accountable – may also be at play.
- **Capacity and competing projects** – Funds have a limited capacity for how many projects they can take on. While some projects will be board or executive team initiatives, many will be in response to policy and regulatory requirements. As an example, APRA has released its policy and supervisory priorities[58] for 2024 listing a very broad range of areas requiring attention, including (in addition to retirement) cyber resilience, operational resilience, climate risk, the Financial Accountability Regime, GCRA (governance, culture, remuneration and accountability), recovery and resolution, investment systemic risk and investment governance, system transparency and financial resilience.

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[58] APRA – Interim Policy and Supervision Priorities update (January 2024).

The principles-based nature of the RIC provides an 'out' for funds where the business case and incentives for RIS development is weak.

Barrier 3: Development time frames

The time frames involved in developing a RIS are substantial. Even funds that started on the retirement journey in earnest many years ago are still firmly in the development phase. We hear of time frames like 2-3 years to develop new products and bring them to market. Systems are critical, where development times can be long, and delays and cost below-outs are commonplace. We heard one anecdote that post-merger system integration was acting as a pre-requisite to enable the offering of retirement solutions. Meanwhile, organisational resources that are being absorbed by other initiatives including the need to respond to policy change and meet an increasing regulatory load (discussed above) and bed down mergers are reducing the bandwidth to deal with retirement. Finally, some funds face criticism over their administration and customer service, which will likely need to be resolved first (or at least in parallel) to enable effective development and implementation of a RIS.

We feel that the policymakers and regulators (and the media) may not have made sufficient allowance for such development lags and hurdles in criticising the industry for insufficient progress. While there are some funds that may deserve the criticism, other funds are making genuine efforts to develop their RIS but are facing some genuine hurdles. It is also an unfortunate but an irreversible fact that many funds delayed developing their RIS until the RIC was in place. These funds cannot be reasonably expected to turn the situation around quickly.

Implications for super funds – clear directive, conflicted business case

The business case for retirement is uncertain and, in our estimation, does not stack up for some funds through a purely commercial lens. Meanwhile, the RIC has created a non-negotiable obligation on trustees to develop RIS. Many trustees will find themselves conflicted. This situation could motivate a range of activities that might be considered rational but are counter to the spirit of the RIC, such as:

- ***Proceeding slowly*** – Doing so should not overly affect the revenue opportunity, and may provide an opportunity for some policy and regulatory risks to moderate.
- ***Do not lead*** – There is little revenue upside but many risks in taking the lead. Risks in being a leader relate to uncertainty over the policy and regulatory framework, the possibility of developing what turns out to be a legacy product or service, and possibly career risk.
- ***Focus on areas that align with other business functions*** – An example might be improving member administration and data, which will also assist to service accumulation members.

In identifying and acknowledging the pressures created by the conflict between the obligation versus the business case to develop RIS, we are concerned that retiring members will be the release valve through funds delaying and/or under-developing their RIS.

Implications for policymakers (and regulators)

The issues discussed in this essay have three main implications for policy and regulation:

- ***Business influences might be considered in framing policy*** – How fund trustees could respond to measures might be considered in framing policy. For example, making the RIC principles-based arguably afforded fund trustees with flexibility to do the minimum required in meeting their obligations around RIS development. This is one of the reasons for our recommendation that consideration be given to imposing additional obligations on trustees in Essay #3, and to introduce a retirement members outcomes assessment framework in Essay #6.
- ***Allow reasonable time frames*** – The time it takes to develop and implement a RIS might be allowed for in formulating any new policies, and also the manner in which regulators engage with the industry over RIS development. It is for this reason that we are suggesting that any policy to introduce a retirement member outcomes assessment framework (Essay #6) or a retirement licensing regime

(Essay #7) should come into formal effect in a few years' time, thus giving the industry time to develop their offerings and processes.

- ***A retirement licensing regime may provide a useful business strategy decision point*** – Introducing a retirement licensing regime as discussed in Essay #7 would require super fund trustees to address the business case for participating in the retirement market. It would hence establish a connection between retirement policy and business influences, while providing a mechanism that could remove the compulsion for funds to provide a RIS where the business case does not stack up. It could also help resolve the issues around development time frames by setting clear expectations around the timing of delivery.