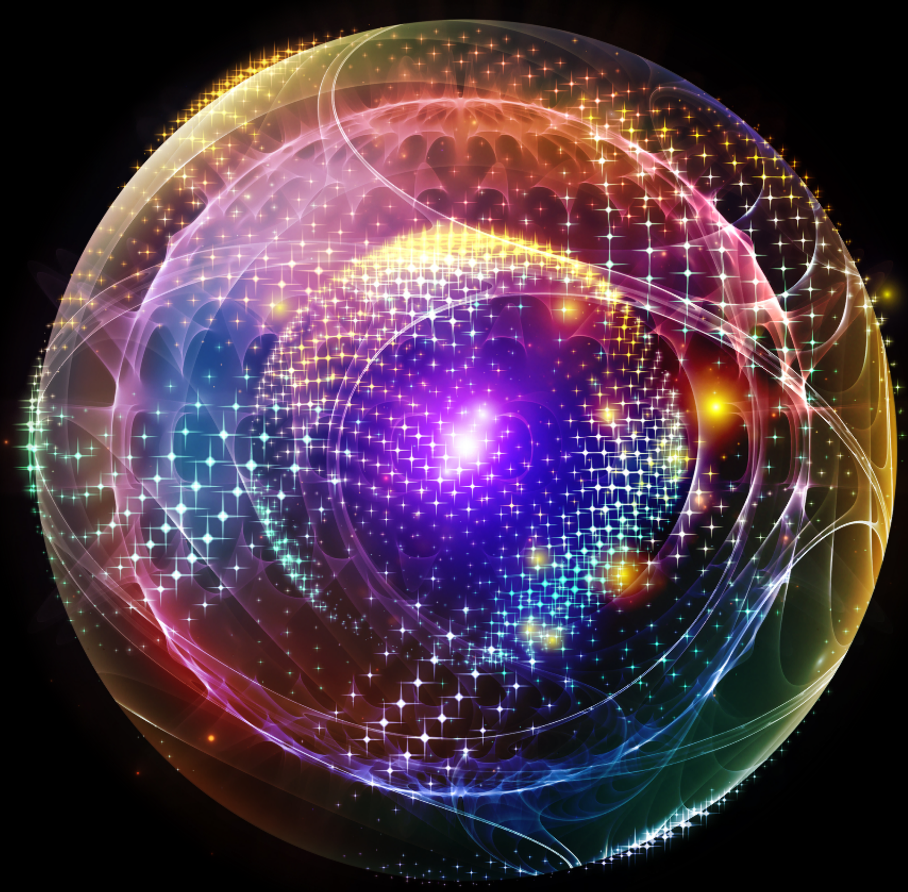
Deloitte.



Retirement Phase of Superannuation

Deloitte Response to Treasury Discussion Paper

February 2024

MAKING AN IMPACT THAT MATTERS since 1845

Deloitte Touche Tohmatsu
ABN 74 490 121 060
Quay Quarter Tower
50 Bridge Street
Sydney, NSW, 2000
Australia

Tel: +61 2 9322 7000
www.deloitte.com.au

2 February 2024

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

By email: Retirement@treasury.gov.au

Response to Treasury on Discussion Paper – Retirement Phase of Superannuation

Please find enclosed the Deloitte submission in response to the Discussion Paper released by Treasury on 4 December 2023 titled "Retirement phase of superannuation". Deloitte welcomes the opportunity to respond to the Discussion Paper, noting that the subject matter is highly relevant given the current Australian demographics, the nascency of the Retirement Income Covenant and the upcoming – albeit yet to be determined – Quality of Advice Review (QAR) legislation. It also crystallises more than a decade of thought around this topic, especially following the 2014 Financial System Inquiry Final Report and subsequent consultations.

The Discussion Paper is separated into three key themes – supporting members, supporting funds and lifetime income products – and we have considered each of these when constructing our responses to the Consultation Questions. Our response first summarises our high-level thoughts on each of the three themes, noting inextricable links between all three. Given the complexity of our retirement system and some of the topics on which consultation is being sought, we believe that it is difficult to consider many of the Consultation Questions in isolation. We therefore suggest reading our response in full so that our integrated position may be considered, and that the appropriate context can be provided to our individual question responses – which are provided separately in the Appendix of this response.

In our response, we note that some superannuation fund members with sufficient means will seek comprehensive financial advice and this enables strategy and product customisation tailored to individual circumstances on a holistic basis. This advice should be available, accessible, regulated and the products considered only limited to what is available in the market. For this reason, we do not believe the focus of any regulatory change should be on this type of advice – also noting that there are already products in place and emerging to solve for more complex retiree circumstances and this should be left to the market to solve.

On the other hand, there exists – for a variety of reasons – a large majority of members that are non-advised or totally disengaged with their superannuation. Non-advised members will typically not seek, or have access to, personalised holistic advice, but still would benefit from some kind of scaled advice to provide them with confidence and a customised retirement plan. Similarly, disengaged members generally do not respond to fund communications or make changes to their superannuation – posing an issue since the current environment necessarily requires action to be taken to achieve better retirement outcomes. We consider improving outcomes for these two groups of members to be the core challenge to solve for in the near term.

For these members, super funds are the natural touchpoint for product solutions. However, a proliferation of products that vary by fund would not be an ideal scenario, as that would result in more costly development cycles for funds, as well as a higher risk of legacy products throughout the industry – which are costly to maintain and unwind. The focus, rather, should be on increasing member engagement and providing fit for purpose, low cost guidance, advice and retirement solutions for the different cohorts of members that exist within funds. This may be achieved with product building blocks that have features that have been standardised in some way and which are simpler for funds to develop, easier for members to understand, and better facilitate the portability of solutions (being a combination of products) between funds – an important objective in a consolidating market.

We also acknowledge that there may be a role for the aggregation and safe sharing of information on member circumstances (elicited through online tools and calculators, or otherwise) that allows consistency of the information to be presented back to members by funds on potential retirement outcomes and the setting of default, or recommended, retirement solutions.

Irrespective of the policy direction taken from this point onwards, we encourage a retirement framework that carefully acknowledges and responds to three key truths:

1. Effective financial advice and guidance for retirement planning purposes, scaled or otherwise, needs to be made more accessible;
2. Retirement solution development costs should not be onerous, from a members' best financial interest perspective; and
3. Legacy products are very costly to members and the integrity of the system, and should be strongly avoided, particularly in a consolidating industry.

We welcome the opportunity to discuss this topic in more detail if required.

Yours sincerely

Anthony Saliba
Partner, Consulting
Deloitte Touche Tohmatsu

Andrew Boal
Partner, Consulting
Deloitte Touche Tohmatsu

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organisation"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Liability limited by a scheme approved under Professional Standards Legislation. Member of Deloitte Asia Pacific Limited and the Deloitte organisation.

PUBLIC

Response to Consultation

This section outlines our overarching response to the Discussion Paper themes. These are based on our local and global experience in retirement savings programs, as well as our extensive experience working with financial services institutions to design and implement retirement products and associated advice offerings. Our response summarises our high-level thoughts on each of the three themes, noting strong links between all three. Given the complexity of our retirement system and the interconnectedness of some of the topics on which consultation is being sought, we suggest reading this section first so that our integrated position may be considered, and that the appropriate context can be provided to our individual question responses – which are provided in the Appendix of this response.

1. Supporting members

There is no doubt that superannuation fund members face a very complex task when navigating their plans for retirement due to its holistic and uncertain nature – and the generally low level of financial literacy amongst many in society does not help. One way some members address this *retirement literacy* challenge is to purchase financial advice – whereby a trained professional can step through a member's holistic financial position and recommend a specific retirement plan tailored to their client. This approach can work well, however only approximately 20% of Australians seek and acquire financial advice[1] and the number of financial advisers has reduced by about 40% since the establishment of the 2017 Royal Commission into "Misconduct in the Banking, Superannuation and Financial Services Industry"[2].

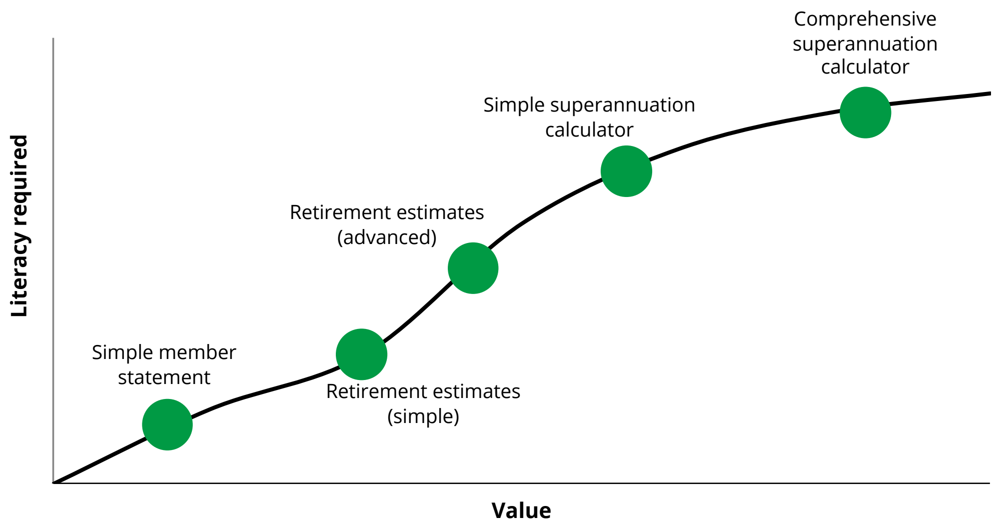
Therefore, a solution to the retirement literacy challenge needs to be found for non-advised members – by bringing down the cost of comprehensive advice and/or by providing an effective scaled advice alternative. This second group is the main subject of our response and, although concepts such as defaults and product standardisation are referred to below, we maintain that product providers should be able to continue to innovate within the confines of the law when it comes to adviser-intermediated channels.

A logical first step for a fund might be to estimate the level of retirement literacy across its membership. Then, targeted information, education and guidance can be provided to members in a more personalised way, consistent with the direction provided by the Retirement Income Covenant (subject to incoming QAR legislation). For example, consider Figure 1 below and the tools available to a fund to both measure and uplift retirement literacy. A fund may want to educate a new member about their regular member statement and establish a method to elicit their level of retirement literacy to ensure that the member first understands the basics before providing that member with something a little more advanced, such as a retirement estimate. (That is not to say that members should be precluded from receiving nudges at important moments in time based on what information is known about that member.) In this way, funds can simultaneously measure the degree of retirement literacy across their memberships and help move individual members up the retirement literacy curve. We note that this

[1] https://theconexusinstitute.org.au/wp-content/uploads/2022/09/Transforming-Financial-Advice-Whitepaper-20220923.pdf
[2] https://www.afr.com/companies/financial-services/wealth-adviser-exodus-opens-door-to-fraudsters-20220310-p5a3fj

approach is similar to the concept of time-related nudges raised in the Disussion Paper (and also in the Rice Warner article, "The Future is Now – Dynamic Member Education"[3]), and would also support funds with measuring the effectiveness of the assistance that they provide to members, which is an obligation that they have under the Retirement Income Covenant.

Figure 1: Moving up the retirement literacy curve



Expressing retirement estimates in terms of expected annual retirement income is particularly important, as this can help reframe the purpose of superannuation savings for members – moving away from the traditional "nest egg" philosophy that can deter retirees from drawing down capital from their balances in retirement. One option might be to mandate the inclusion of retirement estimates on all member statements and online member portals – with retirement estimates to be produced in alignment with ASIC Instrument 2022/603. We do note, however, that generating accurate projections of the Age Pension is the most troublesome part of calculating retirement estimates and therefore any attempt to simplify the Age Pension means tests and/or safely centralise eligibility data[4] should be investigated.

Of course, there will always be those members that are disengaged with their superannuation, making attempts to uplift their retirement literacy and take action difficult. For these members, the Government may want to consider allowing them to be defaulted – after a certain age – into recommended retirement solutions based on what their fund knows about them. To practically achieve this, funds would need the details of a personal bank account to pay income into, but perhaps the income could be transferred to the ATO in that member's name if account details are unknown. As average balances in the industry increase with system maturity, we expect member engagement to increase over time (particularly for members approaching retirement).

When it comes to assisting members with retirement planning, there may be a benefit to having a minimum data standard defined for the purpose of providing funds with the minimum amount of data

[3] https://www.ricewarner.com/the-future-is-now-dynamic-member-education/
[4] This would necessarily require superannuation funds to be considered Accredited data recipients under the Consumer Data Right.

they would need to provide more fit for purpose scaled advice. This data may be stored centrally, perhaps in a Government-owned repository – but with content and access controlled by each individual – to support portability between funds and reduce the need for repetitive fact finds (that themselves may be facilitated by online retirement calculators).

The Discussion Paper also explores the concept of retirement solution defaults, as well as free and impartial services to uplift retirement literacy. For reasons set out in the following section (Supporting funds), we believe that both innovations would have a better chance of success in the near term in an environment where both retiree preferences and retirement products are *standardised* within a certain permissible range. For the purpose of careful definition, we define *retirement products* to be the discrete building blocks (such as an account-based pension or immediate lifetime annuity) that provide a retirement income for a member, whereas a *retirement solution* is the holistic set of income streams, which itself can be comprised of any given combination of underlying retirement product building blocks (and should also consider any Age Pension benefits).

Once a degree of standardisation at the retirement product level has been achieved, retirement solution defaults (perhaps, say, after reaching a certain age) and trustee-directed solutions may be considered by funds to provide better retirement outcomes to disengaged and non-advised members, respectively. This would reduce the cost of, and increase the effectiveness of, member education services since the universe of possible solutions covered by this standardised product framework would be significantly constrained. Product innovations which require more comprehensive financial advice to be used effectively could still be provided outside this simplified framework.

2. Supporting funds

The potential policy responses mentioned in this section of the Discussion Paper focus on disclosure, comparison tools and regulatory barriers. We note that, for the non-advised population, modifying regulation with the intent to encourage product innovation, and allowing even more variations of retirement product than currently exist would, necessarily, reduce the impact of the desired standardisation of disclosure and comparisons. This is because catering for a large variety of product features and terminologies would increase the cost of compliance for funds, representing a departure from what has been achieved in the accumulation disclosure regime. In addition, as posited above, there looms a retirement literacy challenge for an increasing number of non-advised members, who will not be able to afford comprehensive financial advice (at least in its current form). Constraining the available product set for non-advised retirees would greatly help with standardising disclosure and comparison, which can indeed bring about its own form of innovation[5].

Standardising product terminology and disclosure would be welcomed, as it would introduce greater familiarity amongst members, product issuers and product distributors alike. This would result in a network effect being achieved[6]. A network effect is the effect described in economics and business that an additional user of a good or service has on the value of that product to others. When a network effect is present, the value of a product or service increases according to the number of others using it. As

---

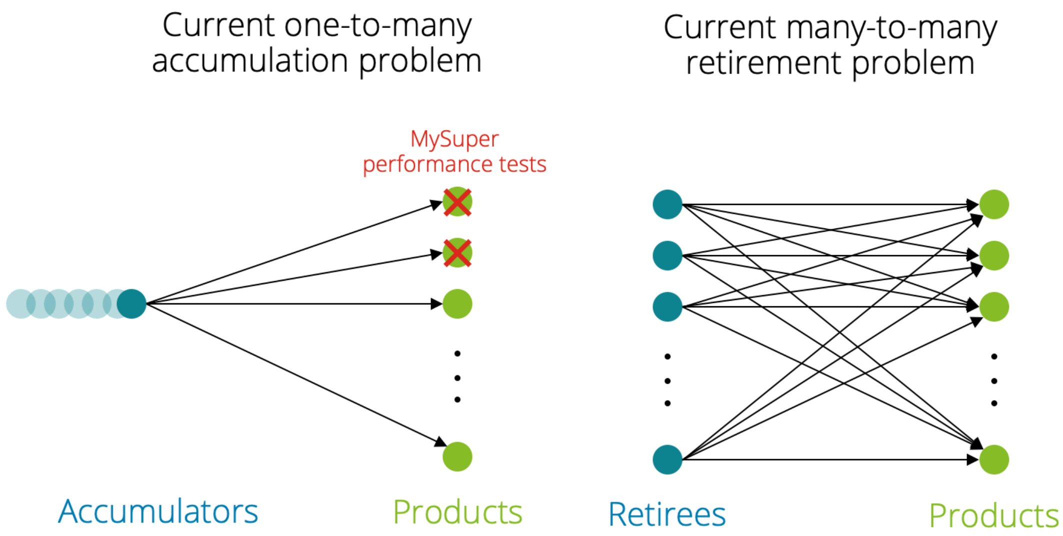
[5] https://hbr.org/2019/11/why-constraints-are-good-for-innovation

[6] *Simple Ideas for a Complex Retirement: A Blueprint for an Improved Retirement Income System, Anthony Saliba (Actuaries Summit 2019)*

more retirees are added to a standardised retirement income system, this increases the value of the system to other retirees, as financial literacy propagates throughout the network via word of mouth and standardised disclosure and tools. Of course, this would only apply to the non-advised market, as we believe that providers distributing products through traditional advice channels should be able to continue to innovate as they see fit.

When it comes to retirement, as mentioned in the Discussion Paper, "individual circumstances are different" and therefore we face a many-to-many problem (see Figure 2 below) when matching retirees with solutions. This makes product comparisons extremely difficult, since two individuals with similar finances may have very different retirement preferences, and therefore this limits the utility of a single performance test. Performance tests were able to be introduced in the accumulation phase, because the ultimate goal is to maximise net returns (irrespective of the member's personal circumstances) and therefore everyone's preferences are ultimately, theoretically, the same – i.e. a tractable one-to-many problem. It is therefore not recommended that the same approach to accumulation performance tests be extended to the retirement phase.

Figure 2: Differences between the accumulation and decumulation product-matching problems



The above figure is illustrating that, although there exist many different types of accumulators, ultimately their preferences are the same: to maximise their net return (investment option preferences notwithstanding). It may therefore be deemed intuitive to develop metrics that can measure the performance of products against that common preference. Further, the introduction of MySuper options and the Annual Performance Tests have resulted in several products being closed to new business and reducing the set of products available to investors[7]. This product rationalisation has resulted in a simpler accumulation market and arguably better outcomes for members.

[7] https://www.apra.gov.au/insights-paper-2023-performance-test

In retirement on the other hand, there is not a single metric by which to measure success, since:

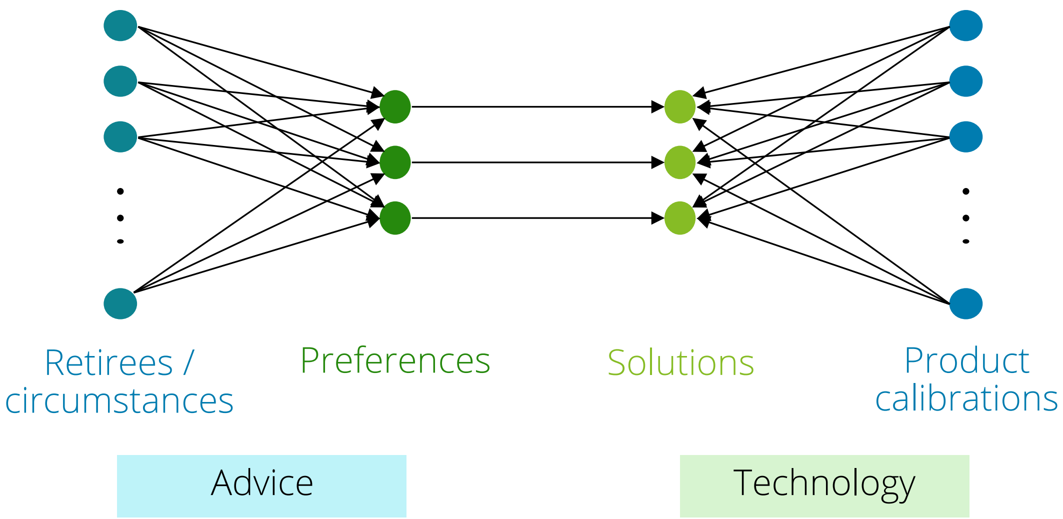
- Individual circumstances and preferences in retirement can vary significantly, including consideration of things like retirement income levels, access to capital at various points in time and risk management; and
- Retirement products may actually be configured in different ways (e.g. an account-based pension's drawdown rate) and combined with other products (e.g. a lifetime annuity) to construct retirement solutions.

One solution to this problem in retirement is to first elicit circumstances and preferences from individuals using various assistance offerings and, once those are known, targeting a retirement solution to an individual based on those pre-selected preferences. Example preferences may be:

- To maximise retirement income up to life expectancy,
- To minimise risks to the sustainability and stability of retirement income for the rest of one's life,
- To always have a certain amount of capital available throughout retirement, and
- A balance of all three above preferences (noting that they compete).

This extraction of preferences is shown in the left hand side of Figure 3 below and may be facilitated by a scaled advice offering from a super fund.

Figure 3: Proposoed solution to the many-to-many retirement problem



Note that the retiree is ultimately matched with a solution, not a product. As defined earlier, a retirement solution is a combination (bundle) of retirement products and their calibrations, rather than discrete products themselves. For example, a fund may have available to it an account-based pension and a deferred lifetime annuity. With these two product building blocks[8], it is actually possible to construct thousands of different retirement solutions by varying the:

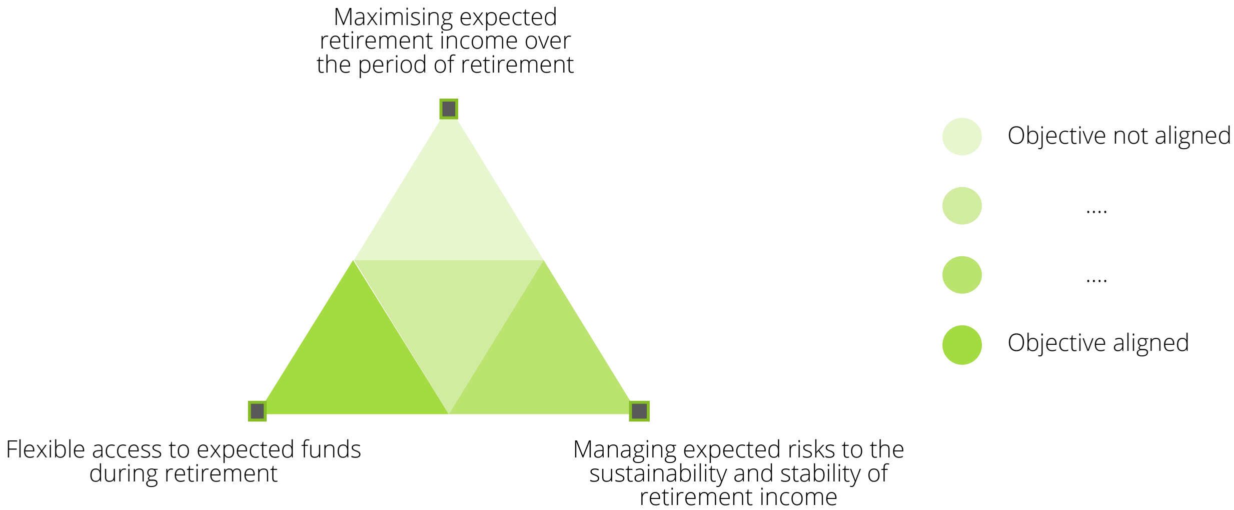
- proportion in each product building block,
- deferral period in the annuity,
- target drawdown rate in the account-based pension, or
- asset allocation in the account-based pension.

Based on what a fund knows about a member, it should be able to link a member's circumstances and preferences to a recommended calibration of its available product building blocks – resulting in a more tailored retirement solution for that member. This is illustrated by the right hand side of Figure 3 above and may be facilitated by technology. In this way, the fund can achieve true mass-customisation, whereby it is receiving the cost benefits associated with mass-production, whilst simultaneously allowing for customisation at the individual level. An example of mass-production *only* would be offering a rigid combination of, say, 80% account-based pension and 20% 15-year deferred lifetime annuity to all members that signal a desire for longevity protection. This solution would be too blunt an instrument and result in poor outcomes for many members, due to idiosyncratic circumstances such as Age Pension eligibility and health status. We note that any mass-customised approach will require funds to have access to information about their members, and therefore risks associated with data management need to be considered.

As for performance tests, they can still be conducted at the product building block level, for example the annual annuity rate or the account-based pension net return, for a given asset allocation. Any legislative change should consider the potential for retirement products to fail and the need to protect members in these products. At the retirement solution level, comparison metrics should be aligned with all three of the Retirement Income Covenant objectives. That is, the metrics should show how a bundled retirement solution (as opposed to individual product building blocks) performs against each of the covenant objectives. This is because any given member may have a preference for one objective over the others. Perhaps this can be achieved with a rating system based on the resilience of the retirement solution under various stresses. The below figure gives an example of how this might be achieved.

[8] https://www.deloitte.com/au/en/Industries/investment-management/blogs/building-blocks-guide-members-retirement-success.html

Figure 4: Example of holistic retirement solution disclosure



Note that, if only an expected retirement income metric is used, there are potential issues with comparing products with varying degrees of income guarantees embedded in them – with expected projections favouring those non-guaranteed products that are not required to be supported by as much capital as guaranteed products.

In the scenario where a fund does not have all of the minimum data required to confidently offer a suggested, or trustee-directed, solution for a member – then perhaps it becomes a requirement for that fund to offer the member a session with a salaried planner (potentially a "qualified adviser" as per the Government's final response to the Quality of Advice review[9]) prior to defaulting that member into the suggested retirement solution. If the product set is standardised to some extent, the provision of this very specific retirement "advice" should not be costly – and in fact could be outsourced to third parties, including life insurers and other product providers. This is because a system design whereby the product building blocks are standardised would be considered to have high *composability*; that is, it is able to have various components brought together in modular ways to create larger and more complex systems that meet customer needs.

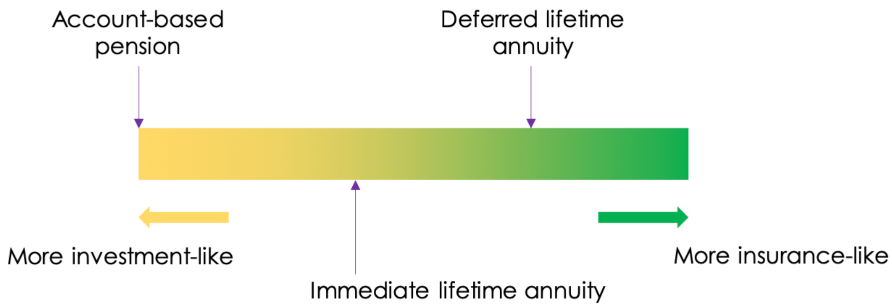
Also, to support with uplifting retirement literacy, super funds should be able to contact their members and illustrate their own retirement solutions (constructed using standardised product building blocks) without breaching anti-hawking requirements. Currently, funds commonly do not include their own products in online tools and calculators for fear of falling foul of anti-hawking legislation and missing out on the advice relief provided in ASIC Instruments 2022/603 and 2016/207. This means many funds are not currently using a digital channel to help communicate their actual retirement products to members and this is a missed opportunity.

[9] https://treasury.gov.au/publication/p2023-471470

3. Lifetime income products

Most superannuation funds currently offer an account-based pension for their decumulation members. This is a versatile product that provides members with tax benefits, varied drawdown patterns (subject to legislated minima) and a range of investment allocations. A feature not present in account-based pensions is an explicit longevity-protection mechanism whereby mortality credits can be transferred from deceased retirees to surviving retirees (i.e. an insurance-like element). This is illustrated in the figure below, however note that this is a one-dimensional comparison on the basis of investment versus insurance features only, and is not a recommendation for products sitting in the middle.

Figure 5: Spectrum of investment to insurance features in retirement income products[6]



As the Discussion Paper points out, “individual circumstances are different, and there is no one size fits all approach”. In fact, the Retirement Income Covenant requires trustees to give effect to a retirement income strategy that will assist beneficiaries with achieving and balancing the three different covenant objectives. In the Explanatory Materials[10] to the Retirement Income Covenant, it is explicitly noted that there will be instances where these objectives compete for particular subsets of members (para. 1.28). As there is no one product type that can address all three competing objectives, it is our view that members should be provided with the product “building blocks” to help them achieve and balance their objectives based on their own individual preferences (i.e. where they sit on the following triangle):

Figure 6: The retirement trilemma[11]

[10] https://treasury.gov.au/sites/default/files/2021-09/c2021-209553-explan_memorandum.pdf
[11] https://retiremix.com/about

Some members may be content with a 100% account-based pension approach, while others will require a lifetime income product (such as a lifetime annuity), to help them manage risks to the sustainability and stability of their retirement income. Currently, only a handful of funds offer such longevity products.

The key reasons for the dearth of lifetime income products are listed in the Discussion Paper and we provide our commentary on each factor below – starting with supply-side factors (Table 1), and then demand-side factors (Table 2).

Table 1: Barriers to product availability (supply)

Factor	Commentary
Development costs	This is a very real consideration for funds who need to demonstrate their duty to act in members' best financial interest[12] (MBFI). The concept of standardised retirement products for default purposes mentioned in the Discussion Paper could be used to reduce this cost and we discuss this further below.
Incentives and competition	Our experience with funds recently is that a solid retirement proposition will simultaneously assist with member retention and fulfilling Retirement Income Covenant objectives, and therefore we do not believe this factor is a strong barrier to supply – although it may very well have been previously. There has sometimes been an argument historically that guaranteed income products cannot draw the same quantum of fees as account-based products, however perhaps impacts on cost recovery can be mitigated by allowing funds to charge an ongoing administration fee for these products (rather than a FUM-based fee).
Legacy product risk	Lack of flows into a newly-developed retirement solution can result in the creation of legacy products. This should be avoided by funds, since legacy products are costly to administer and/or close, plus they result in suboptimal outcomes for members in those products. Furthermore, without any standardisation, we would argue that legacy products would be almost impossible to avoid in our current rapidly-consolidating superannuation industry[12].

Therefore, out of the above three supply-side factors, we believe that the two largest ones are development costs and the potential emergence of legacy products. We note that both of these challenges would be negated by strong take-up by members, however, short of relying on a considerable uptick in demand, development costs and legacy product risk may be mitigated through the availability of a framework with the following areas of standardisation:

- Development costs: Rather than relying on every fund to develop their own comprehensive retirement solution, suppose a fund only needs to offer an account-based pension and a generic lifetime income product (such as a lifetime annuity with an adjustable deferral period). There would be no need to invest heavily in the development of a new comprehensive product that requires careful legal consideration of the various rules associated with such products and heavy regulator engagement, as well as a significant increase in risk and compliance costs. The fund can instead focus on how to use these two product building blocks to assist their members with achieving and balancing the three covenant objectives. Treasury may also want to consider the

[12] https://www.deloitte.com/au/en/Industries/financial-services/analysis/retirement-solutions-assessment-framework.html

development of standard personas or recommended product bundles to further streamline retirement solution development.

- Legacy product risk: As above, if the type of lifetime income product is standardised to some extent, then this product can be underwritten by insurance companies, who can manage the pools across various funds. If take-up of the lifetime income product is low for a fund, then administrative duties can be transferred to the insurer (if not already) to prevent costs becoming onerous. Furthermore, in the event of a fund merger, of which there will still be many over the coming decades, standardising the lifetime income product will facilitate the simpler transferring of members from one fund to another (as is the case with account-based pension members currently).

Table 2: Barriers to member take-up (demand)

Factor	Commentary
Upfront cost and "wasting capital"	Hyperbolic discounting and loss aversion are indeed behavioural biases that inhibit the take-up of guaranteed income products. As Minney explains[13], a key to helping overcome these hurdles is to provide extra flexibility in a retirement solution, for example by using only part of a member's accumulated savings to guarantee a layer of income (i.e. a building block approach).
Challenges to comparison (to non-guaranteed products)	It is true that a guaranteed income product requires an insurer to set aside capital as part of offering the guarantee. This means that a "cost of capital" drag will necessarily reduce the customer yield on such products. However, if a member was to live long enough, then the mortality credits accumulated would more than compensate for this drag (that is, the guaranteed income product is providing longevity protection, fulfilling its original purpose). Again, a guaranteed income product should be considered as only one "building block" within a holistic retirement solution to help overcome this hurdle.
Lack of flexibility ("locking up capital")	Comprehensive retirement calculators can be used to help members understand how much of each product building block they require, and the implications of those proportions. For members with lower levels of retirement literacy, pre-selected personalised solutions can be constructed based on what the fund knows about the member.
Counterparty risk	The LAGIC solvency requirements regulated by APRA are set to ensure that providers of guaranteed income products are resilient in the face of asset and insurance-based events. For non-guaranteed income products such as group self-annuitisation schemes, the consumer still needs to rely on the product provider properly managing the assets and liabilities, which gets operationally complicated within the common "open pool"[14] arrangements.

Again, we see that the building block approach, whereby a degree of standardisation occurs at the product and not the solution level can assist with the demand-side barriers. This is in addition to the

[13] https://www.firstlinks.com.au/overcoming-loss-aversion-higher-retirement-income
[14] https://actuaries.asn.au/Library/Events/SUM/2015/5bChaoQiaoAaronMinney.pdf

ability of standardisation to, as mentioned in the Discussion Paper, “anchor expectations” – i.e. the network effect referred to in the previous section of this response.

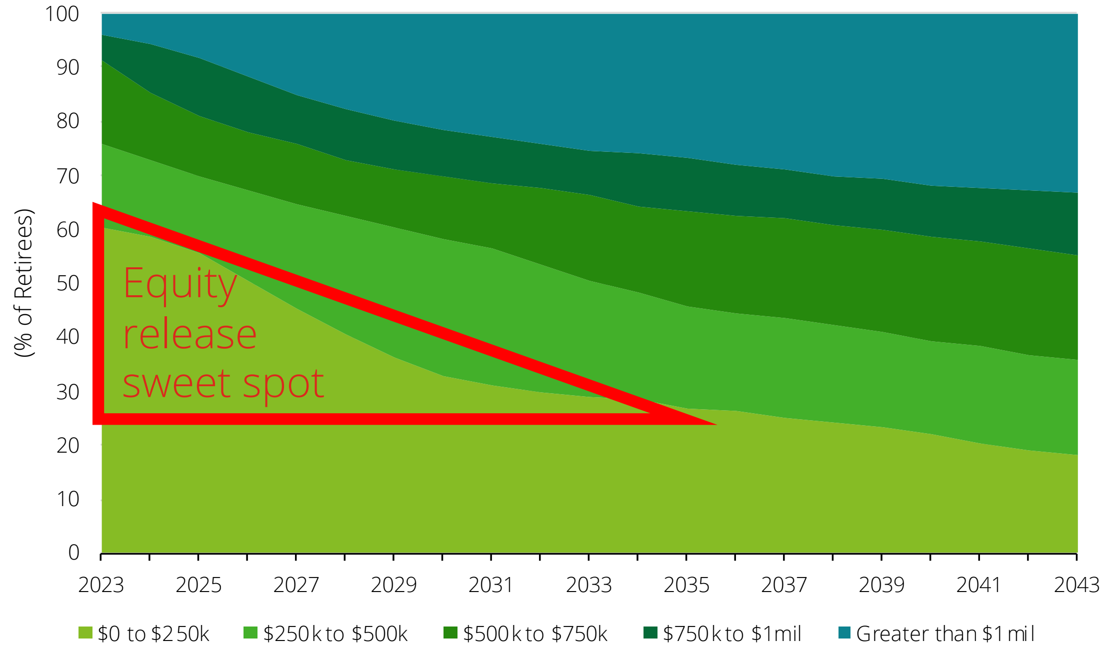
The sample standardised product provided in the appendix of the Discussion Paper seems to be an example of standardisation at the solution level, whereby multiple individual product components are brought together in a rigid way to provide a solution that works for the “average member” (mass-production). We believe standardisation at the product level, rather than the solution level, would be preferable, as it allows for the construction of customised holistic solutions by varying calibrations of each underlying product building block (mass-customisation), while also better facilitating transferability and mitigating the legacy product risk that a standardised *bundled* product would have.

Also, the example standardised product includes some degree of longevity protection provided by the Government, however the original CIPR recommendation from the Murray Inquiry was based on the desire to transfer longevity protection from the public sector to the private sector. We also believe life insurers are well positioned to provide and manage longevity protection for lifetime income products – including the ability to price in additional factors, as is already done internationally (e.g. underwritten, or enhanced, annuities in the UK) which provide higher incomes to customers with materially life-shortening medical condtions. They also have existing relationships with reinsurers and other global firms to help manage and diversify longevity risk.

It is worth pointing out that, although a small number of super funds have developed their own retirement solutions, with or without support from insurers, the current advice landscape makes it difficult for funds to educate their members about such products in a way that is personalised to the member’s individual circumstances – without providing comprehensive holistic advice. For funds that have developed their own solutions, they should be able to continue to distribute these solutions in an intermediated way, but those funds will still need a way of onboarding members from acquired funds that may already have a longevity product in place as part of their retirement solution – and so we believe every fund should participate in the standardised retirement product market and have infrastructure available to cater to such products.

We would also like to mention that many retirees may benefit greatly from the use of equity release products. As mentioned in the Retirement Income Review Final Report (2020), home equity constitutes voluntary savings (one of the three pillars of our retirement income system) and accessing home equity can significantly boost retirement incomes without having to rely solely on their superannuation. This would be particularly useful for those retiring in the next decade or so who have not experienced a full accumulation phase (i.e. working lifetime) with 9%+ p.a. compulsory contributions, with a need or preference to stay in the home they own – at least temporarily.

Figure 7: Proportion of superannuation balance ranges at retirement[15]



To date, our research estimates that Australia's take-up of equity release products is lower than comparable markets, with an approximate 1.5% penetration rate (compared with 5% in the UK). Making it simpler for super funds to help their members access equity release products (through integration with online tools, for example) could assist with take-up rates. We understand that the licensing requirements for the distribution of such products would need to change to facilitate this.

[15] Deloitte Super Projections 2023 Report

Appendix A: Consultation Question Responses

Table 3: Supporting members to navigate retirement income

Consultation Questions

Please provide comments on the issues facing members identified in this section.

A lack of financial literacy among non-advised members is a key issue. We are hopeful that the Delivering Better Financial Outcomes legislation will enable funds to safely and efficiently provide much-needed retirement advice to members, to uplift financial (and, in particular, retirement) literacy – especially in an environment where the number of financial advisers has almost halved since the establishment of the 2017 Royal Commission into "Misconduct in the Banking, Superannuation and Financial Services Industry".[16] Of the non-advised members, there are two cohorts that need to be catered for: those that are somewhat engaged with their super, and those that are not engaged (although we note that this second cohort does not necessarily have low levels of financial literacy).

We also agree with the Discussion Paper in that there exists (and for good reason) a "nest egg" view of superannuation among retirees that needs to be challenged if the intention is to ensure that superannuation is spent on retirement income. Although accumulation members can be provided with general information about superannuation and its objective, engagement at younger ages and lower balances has constantly been identified as a challenge for funds.

Choice architecture also currently plays a large role in decision-making, with default behaviour contributing[17] to the minimum drawdown phenomenon in account-based pensions. There is, therefore, a critical need for education, guidance and nudges from both super funds and the Government to steer retirees in the right direction.

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

Many trustees are taking positive action, most of which has been driven by the Retirement Income Covenant, to try to address these issues within the current regulatory settings. Some examples include:

- Establishing roles dedicated to retirement propositions.
- Investigating available lifetime income products and how they may be used to meet member needs.
- The provision of retirement estimates on member statements and online portals (including mobile).
- The development of comprehensive superannuation calculators.
- Dedicating areas within their public fund websites to retirement education and guidance.
- Creating default drawdown rates that are higher than the legislated minima.
- Quantifying progress against the Retirement Income Covenant and SPS 515 by virtue of retirement-specific metrics (not just minimising fees).

---

[16] https://www.afr.com/companies/financial-services/wealth-adviser-exodus-opens-door-to-fraudsters-20220310-p5a3fj
[17] https://www.superconsumers.com.au/minimum-withdrawals-blog

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?

We first note the inextricable links between the approaches identified in the Discussion Paper and therefore any policy needs to be considered holistically. For example, standardising retirement products would then result in changes to the way information, education and guidance are provided to super fund members. We therefore recommend that the product piece is ossified prior to developing any policy around assistance to members.

In terms of simplifying the system for non-advised members, our response makes the case for standardised product building blocks. Should this be introduced, this would then inform policy around member defaults and product disclosure. For example, it may be possible to use standardised product building blocks to construct a holistic retirement solution choice architecture consistent with a libertarian paternalism philosophy. This would involve constraining the choices available to a non-advised member. For example, a fund may choose to offer only three options to members, as shown in the interactive chart at the bottom of the Rice Warner article, "The Future is Now – Dynamic Member Education"18. Note that each option is still tailored to the individual member and can be made to be consistent with the three Retirement Income Covenant objectives.

As the system matures and the network effect takes hold, it may be beneficial to add building blocks to the standardised model – however caution is advised when considering adding new product building blocks prematurely, as the addition of each new product feature has implications for the cost of advice and guidance, the cost of product development, the cost of risk management and compliance, and legacy product risk – all of which may result in poorer member outcomes. In the short term, due to the interdependent nature of our retirement system (e.g. product, advice, service, data etc.), it is advised to promote a strong foundational system design with high composability; that is, the system should be able to have various components brought together in modular ways to create larger and more complex systems that meet customer needs.

Some risks and questions that need to be considered as policy is developed:

- There needs to be regulatory clarity for funds in terms of what assistance they can safely provide to members (e.g. how can personal information be used without providing comprehensive personal advice and how can members be provided with timely nudges without anti-hawking rules being breached?)
- Funds need to be able to safely explain their own retirement products and engage with members as they approach retirement.
- How can funds practically "default" someone into an income stream? There may be some information that they need but may not have (e.g. a personal bank account to pay funds into), or perhaps the funds could be transferred to the ATO in that member's name if account details are unknown.
- At what age should a default retirement solution commence? One option is to have a default retirement income solution that commences if a member has not acted within (say) five years of Age Pension age (currently 72). In the UK, this approach was used to prompt people to purchase a retirement product at the point of retirement and not too many years afterward. The five-year period also gives members time to understand and arrange their own retirement plans.[19]

[18] https://www.ricewarner.com/the-future-is-now-dynamic-member-education/

[19] https://committees.parliament.uk/writtenevidence/36224/html/

Further Questions

What basic information do members most need to assist their understanding and simplify decision-making about retirement income?

Expressing retirement estimates in terms of expected annual retirement income is important, as this can help reframe the purpose of superannuation savings for members – moving away from the traditional "nest egg" philosophy that can deter retirees from drawing down capital from their balances in retirement. We are open to this being mandated for all member statements and online member portals – with retirement estimates to be produced in alignment with ASIC Instrument 2022/603. Extensions of this Instrument to incorporate lifetime income products may be useful as a method of anchoring those as a potential product building block where appropriate.

In addition, members need to understand their Age Pension entitlements in order to make appropriate decisions about their holistic retirement income, as it can also influence the products in their personalised retirement solution bundle, which in turn cyclically influence Age Pension entitlements by virtue of the means tests. It would be beneficial to members if super funds could provide assistance with applying for the Age Pension. The added benefit would be that the super funds would need to collect a lot of information about their members which could be used to hyper-personalise a retirement solution bundle.

Table 4: Supporting funds to deliver better retirement income strategies

Consultation Questions

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

As put forward in our response, standardising product disclosure would help achieve an industry "network effect" that can potentially uplift retirement literacy and bring down the cost of financial advice.

In terms of product comparisons and performance tests, we believe that this would be very difficult for retirement products, unlike accumulation, for the following reasons:

- It is not simply about maximising net return;
- Longevity risk makes the investment horizon uncertain;
- Products can offer differing degrees of longevity and income guarantees, meaning that best-estimate projections can be misleading (ensemble vs time probabilities[6]); and, similarly,
- Products can offer different varieties of withdrawal, death and reversionary benefits.

In other words, although accumulation is a tractable one-to-many problem, retirement is a much more complex many-to-problem, and so the same product comparison strategies would not work in the same way. While it would still be possible to compare homogenous product building blocks directly (such as account-based pensions and immediate lifetime annuities), it is really the overall retirement solution bundle (being a composition of individual product building blocks and the Age Pension) that drives outcomes for members.

Therefore, competition can still occur at the product level (on product features such as fees or annual income rate), but members will still need a way of observing and comparing their bundled retirement solutions, either through (guided) use of a comprehensive superannuation calculator or a simplified disclosure framework like the one mentioned below in our response to the Further Question.

Our recommendation therefore is that only very simple products (e.g. an account-based pension and a vanilla (deferred) lifetime annuity) are permissible for the non-advised market in retirement in the near term. This will facilitate the standardisation of disclosure at the solution level and will be necessary for comparisons at the product level to ensure that like is being compared with like. We note that this approach would also help with allowing members to switch funds, via successor fund transfer or otherwise. Also, this framework would allow insurers to easily enter and exit the market with their products, avoiding scenarios like the many instances over the past 15 years where new innovative products were developed and had to be subsequently shut down due to low take-up.

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?

APRA and ASIC currently support consumer protections and competitive products and services in retirement through their regulation of (for example) SPS 515 and the Retirement Income Covenant and we believe their continued regulation of these items will be necessary.

Further, industry bodies such as ASFA (The Association of Superannuation Funds of Australia) and CALI (Council of Australian Life Insurers) have codes of ethics or practice that require the adherence to all regulation first and foremost, but also include standards of expectation around how industry participants should conduct their business.

To the extent that product standardisation and disclosure is introduced, it may be worthwhile considering how research houses are able to compare and contrast products given the influence they may have over industry participants when it comes to product/provider selection.

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?

Should the recommendation in our response be pursued (that is, a degree of standardisation of product building blocks for the non-advised market), then standardised product disclosure will naturally follow, as well as the development of comparison tools and calculators. However, it is vital that product standardisation occurs first.

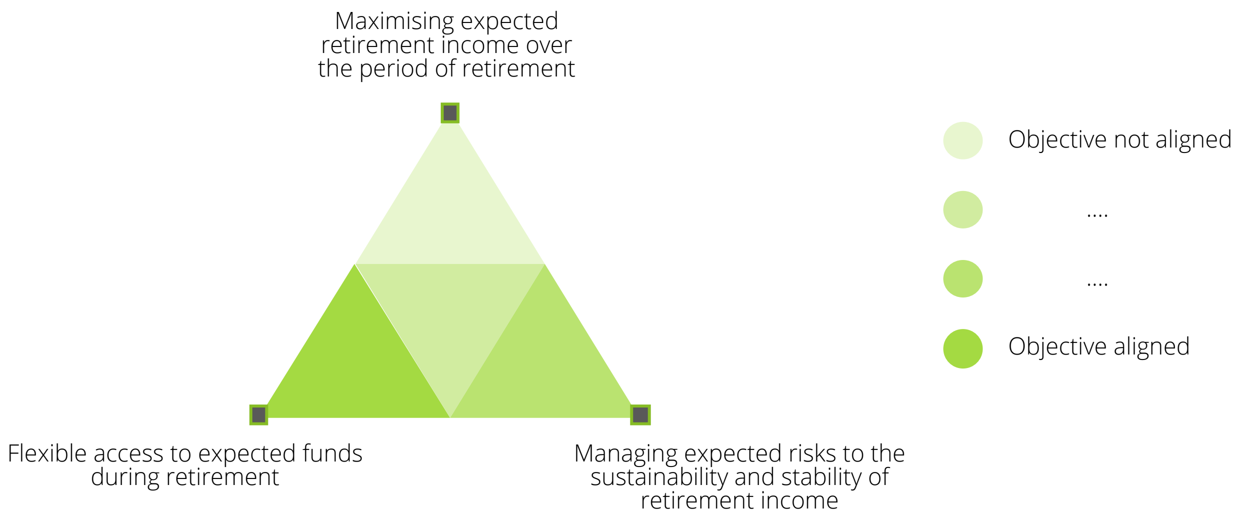
In terms of regulatory barriers, the Discussion Paper mentions several barriers relating to the development of new products, however we believe that allowing for new product features should not be a priority, especially given the implications of a large heterogenous product set on the cost of effective advice and guidance, product development costs and legacy product risk. That being said, we do believe there exist several barriers for funds looking to assist their members with uplifting retirement literacy and developing an appropriate retirement plan. Funds should be able to contact their members and illustrate their own retirement solutions (constructed using standardised product building blocks) without breaching anti-hawking requirements. Currently, funds commonly do not include their own products in online tools and calculators for fear of falling foul of anti-hawking legislation and advice relief provided in ASIC Instruments 2022/603 and 2016/207. This means many funds are not currently using a digital channel to help communicate their actual products to members and this is a missed opportunity. Also, we are hopeful that the Delivering Better Financial Outcomes legislation will enable funds to safely request and use personal information to provide effective retirement advice to members.

We also note that any personalised approach to advice and retirement solutions will necessarily require funds to have access to information about their members, and therefore risks associated with data privacy and management need to be considered.

Further Questions

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

To support funds, comparison metrics should be aligned with all three of the Retirement Income Covenant objectives. That is, the metrics should show how a bundled retirement solution inclusive of any Age Pension (as opposed to individual product building blocks) performs in each of the covenant objectives. Perhaps this can be achieved with a rating system based on the resilience of the retirement solution under various stresses. The below figure gives an example of how this might be achieved:



Note that, if only an expected retirement income metric is used, there are potential issues with comparing products with varying degrees of income guarantees embedded in them – with expected projections favouring those non-guaranteed products that are not required to be supported by as much capital as guaranteed products.

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

Some standardisation of language by the industry would be useful (endorsed and also used by Government and the regulators). For example, clearly defining each product building block in simple language and providing very clear statements describing the needs a particular product building block meets, and instances where it may be useful. Taking this further, there may be regulator-endorsed case studies, examples and training material that can be used by funds, (qualified) advisers, product providers and educators without fear of breaching advice rules.

Table 5: Making lifetime income products more accessible

Consultation Questions

Please provide any comment on the barriers in the supply and demand for lifetime income products.

Barriers to the supply of lifetime income products:

- Development costs: This is a very real consideration for funds who need to demonstrate their duty to act in members' best financial interest[20] (MBFI). The concept of standardised retirement products for default purposes mentioned in the Discussion Paper could be used to reduce this cost, for example, as a result of reduced risk and compliance costs associated with complex product disclosure.
- Incentives and competition: Our experience with funds recently is that a solid retirement proposition will simultaneously assist with member retention and fulfilling Retirement Income Covenant objectives, and therefore we do not believe this factor is a strong one – although it may very well have been previously. There has sometimes been an argument historically that guaranteed income products cannot draw the same quantum of fees as account-based products, however perhaps this can be mitigated by allowing funds to charge an ongoing administration fee for these products (rather than a FUM-based fee).
- Legacy product risk: Lack of flows into a newly-developed retirement solution can result in the creation of legacy products. This should be avoided by funds, since legacy products are costly to administer and/or close, plus they result in suboptimal outcomes for members in those products. Furthermore, without some standardisation, we would argue that legacy products would be almost impossible to avoid in our current rapidly-consolidating superannuation industry[12].

Barriers to the demand of lifetime income products:

- Upfront cost and "wasting capital": Hyperbolic discounting and loss aversion are indeed behavioural biases that inhibit the take-up of guaranteed income products. As Minney explains[21], a key to helping overcome these hurdles is to provide extra flexibility in a retirement solution, for example by using only part of a member's accumulated savings to guarantee a layer of income (i.e. a building block approach).
- Challenges to comparison (to non-guaranteed products): It is true that a guaranteed income product requires an insurer to set aside capital as part of offering the guarantee. This means that a "cost of capital" drag will necessarily reduce the customer yield on such products. However, if a member was to live long enough, then the mortality credits accumulated would more than compensate for this drag (that is, the guaranteed income product is providing longevity protection, fulfilling its original purpose). Again, a guaranteed income product should be considered as only one "building block" within a holistic retirement solution to help overcome this hurdle.
- Lack of flexibility: Comprehensive retirement calculators can be used to help members understand how much of each product building block they require, and the implications of those proportions. For members with lower levels of retirement literacy, pre-selected personalised solutions can be constructed based on what the fund knows about the member.
- Counterparty risk: The LAGIC solvency requirements regulated by APRA are set to ensure that providers of guaranteed income products are resilient in the face of asset and insurance-based events. For non-guaranteed income products such as group self-annuitisation schemes, the consumer still needs to rely on the product provider properly managing the assets and liabilities, which gets operationally complicated within the common "open pool"[14] arrangements.

---

[20] https://www.deloitte.com/au/en/Industries/financial-services/analysis/retirement-solutions-assessment-framework.html

[21] https://www.firstlinks.com.au/overcoming-loss-aversion-higher-retirement-income

What actions are industry or other participants in the community taking to assist retirees to better manage the risks for retirement income?

- Insurers: Many are developing, or have already developed, longevity products – in anticipation of funds requiring said solutions as part of fulfilling their Retirement Income Covenant obligations. We note though, that almost every lifetime income product offered is different, and therefore simple comparisons between them are almost impossible, especially for non-advised members. In fact, some products have been developed to be distributed by advisers alone.
- Funds: Slower to offer retirement products, and this is driven by a lack of understanding of their member needs, but also an acknowledgement that standing up retirement products is costly – and the risk of low take-up and legacy products would not necessarily be in members' best financial interest and potentially impact equity and performance tests. Many funds are, however, investing in their assistance initiatives, such as the development of comprehensive superannuation calculators to help their members understand and manage retirement income risks.
- Advice software providers: The large incumbent advice software providers have a variety of tools that can be used to explore the risks retirees face. However, since the Retirement Income Covenant does not apply to them (as they are not superannuation trustees), the ways in which the retirement trade-offs are posed to members may vary. Further, on the topic of longevity protection, our understanding is that it has been difficult for funds and life insurers to have their lifetime income products integrated into this software due to the prohibitive costs of doing so for the current level of demand for (sales of) the products (another argument for a degree of product standardisation). Smaller digital advice providers have recently been entering the market (some with international parents) and are positioning themselves to play into the scaled advice space – although, understandably, traction has been limited with the Delivering Better Financial Outcomes legislation yet to be finalised.

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?

When it comes to retirement products, it is difficult to simultaneously achieve product innovation and standardisation. A careful balance therefore needs to be tread. By standardising the lifetime income product building block, this would achieve the following benefits that should support their use:

- Reduced product development costs (including associated advice/guidance tools) and therefore increased supply at the trustee level.
- Easier standardised disclosure, resulting in anchoring or a network effect within the industry – contributing to improved retirement literacy.
- Simpler product comparisons using online tools and calculators. Lifetime income products could even be added to retirement estimates.
- Easier transfer of lifetime income products between funds (especially in the case of fund mergers), resulting in fewer legacy products and a reduction in fees for members.

We also support the collection of data across the industry for improved longevity pricing and management.

Key Authors and Contributors

Anthony Saliba
Partner, Consulting
Sydney
asaliba@deloitte.com.au

John Weaver
Partner, Audit & Assurance
Brisbane
joweaver@deloitte.com.au

Mathew Norton
Partner, Consulting
Melbourne
matnorton@deloitte.com.au

Diane Somerville
Principal, Consulting
Sydney
dsomerville@deloitte.com.au

Andrew Boal
Partner, Consulting
Melbourne
aboal@deloitte.com.au

Alan Merten
Partner, Consulting
Sydney
almerten@deloitte.com.au

Melissa Gomes
Partner, Risk Advisory
Sydney
melgomes@deloitte.com.au

Michael Berg
Principal, Consulting
Sydney
micberg@deloitte.com.au

Deloitte.

MAKING AN IMPACT THAT MATTERS since 1845

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organisation"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our global network of member firms and related entities in more than 150 countries and territories (collectively, the "Deloitte organisation") serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 415,000 people make an impact that matters at www.deloitte.com.

Deloitte Asia Pacific
Deloitte Asia Pacific Limited is a company limited by guarantee and a member firm of DTTL. Members of Deloitte Asia Pacific Limited and their related entities, each of which are separate and independent legal entities, provide services from more than 100 cities across the region, including Auckland, Bangkok, Beijing, Hanoi, Hong Kong, Jakarta, Kuala Lumpur, Manila, Melbourne, Osaka, Seoul, Shanghai, Singapore, Sydney, Taipei and Tokyo.

Deloitte Australia
The Australian partnership of Deloitte Touche Tohmatsu is a member of Deloitte Asia Pacific Limited and the Deloitte organisation. As one of Australia's leading professional services firms, Deloitte Touche Tohmatsu and its affiliates provide audit, tax, consulting, risk advisory, and financial advisory services through approximately 14,000 people across the country. Focused on the creation of value and growth and known as an employer of choice for innovative human resources programs, we are dedicated to helping our clients and our people excel. For more information, please visit our web site at https://www2.deloitte.com/au/en.html.

Liability limited by a scheme approved under Professional Standards Legislation.
Member of Deloitte Asia Pacific Limited and the Deloitte organisation. © 2024 Deloitte Touche Tohmatsu