Superannuation in retirement – consultation

February 2024

Introduction

Frontier is pleased to provide this submission to Treasury's consultation on Superannuation in retirement.

Frontier is one of Australia's leading institutional investment advisers. We have been advising Australian institutional investors as a trusted adviser for over twenty-five years. We provide advice on more than $630 billion of assets across the superannuation, charity, public sector, insurance and higher education sectors. The fact our advice is free of any product, manager or broker conflicts, means we can provide truly unconflicted advice aligned with our client's best interests.

Frontier believes the implementation of the Retirement Income Covenant expedited some welcome progress but agrees the retirement phase of superannuation remains under-developed. We agree Australians need better access to information, advice, and well-rounded retirement income products to help them navigate the challenges retirees face.

As noted in the consultation problem retirement may be characterised as "the nastiest, hardest problem in finance". But Frontier believes there is a danger that the solution is overcomplicated in striving for a perfect answer. Many retirees' financial outcomes could be improved with a relatively simple solution.

We agree that such solutions would see retirees with a higher income that is smooth across their life. While retirees may benefit further from a solution which is more tailored to their individual needs, there is a danger that striving for this solution initially will delay the implementation of a simple solution.

Similarly, individual financial advice shouldn't be required for those retirees whose financial circumstances are relatively straight-forward. "Nudging" superannuation members to drawdown income more than the minimum rates is a simple step to improve retirees' outcomes.

Supporting member – consultation questions

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

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

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

Further questions:

What does ‘good’ look like for how funds support and deliver products to their members in retirement?

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

Where can government and industry reduce complexity in the retirement income system, and provide simpler consumer experiences?

How might funds utilise guidance, nudges, defaults and other actions to assist members into better solutions for their retirement income? What are the barriers to funds being more active in these ways?

Data is a critical input for funds to provide better retirement income strategies. What processes are funds undertaking to collect, analyse, and apply data analysis to understand their membership? What barriers are there to better practices, and what policy approaches could help achieve better data use?

The retirement income covenant does not apply to SMSF trustees. What approaches do SMSF trustees take to manage risk, ensure they have access to savings, and maximise their income? Are there barriers to improving how SMSF trustees achieve these objectives, and what role can government or industry play to improve these outcomes?

As noted in the consultation paper, planning for retirement income requires retirees to solve a “risky, long-horizon, multi-dimensional problem” – a problem that any individual retiree cannot be expected to solve on their own. Quality personal financial advice should be the method to deliver an **optimal** retirement outcome tailored to a retiree’s unique financial needs.

Nevertheless, it is imperative to recognise that a reliance on personal finance advice to provide a **good** outcome implies a systemic shortcoming. This is particularly critical considering the current lack of advisers to service all retirees.

We concur that too many retirees are currently drawing at low rates. As noted in the consultation document, there are a number of reasons for this, many of which are related to retirees’ lack of knowledge and uncertainty. The minimum drawdown framework is contributing to this under spending as it provides an “anchor” upon which retirees act.

In our opinion, providing information which helps retirees choose an appropriate retirement income product is an easy first step. Simple, clear, and consistent communication is key. Guidance can play an important role and we are strong supporters of introducing communication which acts as a ‘nudges’ to encourage members to draw down faster on their retirement savings.

Modifying the minimum drawdown framework would compel retirees to take more income, increasing the risk of some running out of money.

Instead, Frontier suggests that a more effective solution lies in improved guidance and communication strategies. Potential measures include:

- Mandating retirement income projections for members in the accumulation phase, transitioning from a 'nest egg' to an income framework.

- Allowing funds greater ability to tailor income projections to a member's specific investment option.
- Requiring funds to provide 'wake-up packs' as members approach retirement, outlining available options (similar to the UK investment pathways) and indicating the level of 'sustainable' income their balance can generate.
- Implementing a similar requirement for the government to issue Age Pension wake-up packs as individuals approach retirement age.
- Providing greater regulatory clarity regarding offering 'default solutions' to members. Consider whether funds should be required to offer a default solution.
- Explicitly allow funds to easily tailor their offering to retirees taking into account members’ family circumstances.
- Enhancing the information available to retirees on the moneysmart website, ensuring it is more comprehensive. Consumers may value more highly information sourced from a trusted government outlet rather than individually from each fund.

The consultation document notes under the “guidance, education and communication” section that the “Government has committed to expanding the provision of advice by superannuation funds through its Delivering Better Financial Outcomes package. This would include ‘nudges’ that allow funds to communicate basic information about retirement”.

We agree with this and acknowledge the government's commitment to expanding advice through the Delivering Better Financial Outcomes package. However, we advocate for a more defined distinction between education, guidance, and advice. Recognising the nuanced differences, especially in focusing on whether product recommendations are made, is crucial as it has implications for regulatory constraints.

Drawing inspiration from the United Kingdom FCA's explicit approach[1], a clearer demarcation would provide better regulatory clarity.

[1] Advice Guidance Boundary Review | FCA

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.
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> 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?
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> 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?
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> Further questions:
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> What are the key characteristics or metrics for comparing retirement income products and services?
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> What approaches could make product disclosure useful for members? How might barriers such as complexity, or individuality of products, be overcome?
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> What barriers are there for product switching in retirement and are there opportunities to make product switching easier?

It is widely acknowledged that retirees have more diverse financial needs compared to those in the accumulation phase. The greater the customisation of a retirement solution to an individual's circumstances, the more challenging it becomes to draw meaningful comparisons with alternative offerings from competitors.

The initial consideration of MySuper options under the YFYS framework by the government was logical, given that these represent the least tailored products. While the YFYS requirements have been extended to some choice products, it would be premature to apply them to retirement products, especially given the lingering unresolved issues associated with the introduction of YFYS. Persistent concerns about potential negative consequences warrant caution in further extensions.

Rather than emphasising competition, we propose that enhancing comparability and transparency through simple and standardised disclosure would provide greater value to consumers. Ensuring retirees are in the right type of product, rather than with the right provider (acknowledging both factors are important), should be the initial focal point. There is the potential that a competitive focus will inhibit product development, particularly at this early stage in retirement solutions.

We agree with the two suggested characteristic dimensions of a standardised product disclose framework – characteristics and performance. However, we express reservations about the necessity and relevance to a retiree of a third dimension assessing a fund's covenant fulfillment, which we believe caters more to regulatory needs than member interests.

To reinforce consumer protections, we recommend maximising the utility of the current Design and Distribution Obligations and Target Market Determinations. For instance, an annuity-like product may not be suitable for an ill-health retiree, while a part-Age Pension consumer could benefit from an innovative income stream product. We advocate for more comprehensive and helpful TMDs that specifically address such circumstances.

The introduction of a standard risk measure is something Frontier could support conceptionally but would require much research and industry consultation. To our knowledge, no such measure exists globally. The Australian Government Actuary measure is a good start, but in our opinion needs much more development. In particular, it is difficult to design a single risk measure which encompasses both investment and longevity risk, particularly where individuals will 'value' these differently. Frontier would welcome the opportunity to work with the AGA and the industry to research this further.

Lifetime income products – Consultation questions

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

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

What policy approaches should be taken to support use of lifetime income products to address the risks to retirement income? What risks should be considered?

Further questions:

What product options (or strategies within current retirement products) could better manage risks to retirement income?

What is the role for a 'suggested' product in overcoming low take-up of lifetime income products?

What action are funds taking to better manage longevity risk, and what role do funds see guaranteed income products (e.g. annuities, pooled products) playing in the future?

Do the barriers to managing longevity risk in the Australian market necessitate Government action? What Government action could assist funds in offering appropriate longevity protection to members?

Would an industry-standardised product(s) assist funds to develop and offer lifetime income products to their members?

- What features should a standardised product include?
- Should there be a path to more easily transition members to a standardised product?
- Should superannuation funds be required to offer a standardised retirement product, similar to MySuper for accumulation?
- How should a product vary for individual circumstances of the member?

Would a standardised product be cheaper to develop and offer (e.g. compared to a general mandate to offer a longevity product)?

Frontier contends that incorporating longevity solutions into retirement planning can instil retirees with greater certainty, encouraging them to draw down at higher rates than the minimum. The current practice of retirees "self-insuring" against mortality/longevity risk is not only costly for individuals but also inefficient for the overall system.

In contrast, investment risk is both a risk and an opportunity. While higher-risk investments are anticipated to yield better long-term performance, they also introduce sequencing risk. A guaranteed/lower-risk solution reduces both expected risk and return and is not necessarily a better solution. However, we do believe funds can do much more tailoring of their current account based pension products to address the specific investment risks faced by retirees.

The "annuity puzzle" has confounded researchers and practitioners around the world for decades. As identified in the consultation document, there are both a demand and supply issues. Retirees are reluctant to purchase annuity because they are difficult to understand, and providers are reluctant to offer them without clear member demand.

We don't believe there are any easy answers. We are unsure that the two proposed policy responses will provide any immediate improvements:

- While better longevity pricing could be beneficial, we do not perceive pricing as a significant barrier presently.
- A standardised product may help build the necessary scale for offering lifetime income products. However, the relatively few longevity providers in Australia can already operate on a "wholesale scale".

Frontier believes it would be difficult to gain industry agreement as to the features of a standardised product. We believe a simple-to-explain design would be essential. Frontier has created significant research in this area and would be pleased to add contributing our insight to any detailed consultation exercise.

The requirement to provide a longevity product could operate in a similar way to the MySuper requirement. Funds aren't required to offer a MySuper product. However, those funds choosing not to provide such a product should explicitly state their decision, highlighting to members that they do not offer a solution safeguarding against longevity risk. Leveraging the Design and Distribution Obligations and Target Market Determinations requirements could prove instrumental in facilitating this process.