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Retirement Advice and Investment Division

Treasury

Parkes ACT 2600

By email retirement@treasury.gov.au

Retirement Phase of Retirement

Thank you for the opportunity to contribute to this important topic.

I retired as CEO of Rice Warner a few years ago. During my career, my colleagues and I worked extensively in superannuation and assisted many superannuation funds in developing retirement products, building financial advice models, and working with strategies in investments, life insurance, and member engagement. Thus, I am familiar with all the issues facing superannuation funds today.

Funds have been much better at accumulating wealth for their members, than showing them how to utilise their benefit efficiently in retirement. The findings of the *Retirement Income Review* and the launch of the *Retirement Income Covenant* are a strong catalyst for change and all funds need to build options which can assist members to set up suitable retirement strategies.

Yet, there are many challenges ahead, the biggest of which is defining the role of a superannuation fund. At present, these organisations build and protect their member's assets, and they are heavily regulated to ensure good governance, legal compliance and to allocate all transactions accurately and on a timely basis.

Superannuation funds are like banks and insurance companies in that they provide good products. However, none of these institutions provide strategic services to their customers. They could be said to operate as an airline rather than as a travel agent. In other words, they provide a good product, but they do not help members to select the best route to travel in retirement.

The Retirement Income Covenant requires funds to move away from their core business activities into new fields. Do they have the skills and desire to shift in this direction, or would they be better off partnering a range of experts which are better suited to the required services? And, how do they find and vet these service suppliers?

I have responded to the submission by elaborating on these thoughts within the specific questions you have framed.

I wish you well in progressing this important issue for all Australians.

Regards,

A handwritten signature in black ink that reads "Michael J. Rice". The signature is written in a cursive style with a large, stylized 'J'.

Michael Rice AO FIAA

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The Challenges for Members in Managing their Superannuation.

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

Most members approaching retirement are ignorant of the superannuation system and the range of choices available to them. The lay person is ignorant about superannuation, unable to understand personal taxation (which is why so many Australians use tax agents to lodge their annual return), do not understand investments, and do not know if their fund is the right vehicle for retirement.

Furthermore, they do not know whether they have enough money to retire, the rules for the Age Pension (which are far too complex and are incomprehensible for most people), how much they can spend each year, and where they should invest their benefit. Worse, they do not know where to obtain this advice. Some will find a licenced financial adviser, but their services are too expensive for most due to the extraordinary complexities built into that industry. So, most plod on and often make poor decisions due to ignorance and lack of support.

A small percentage of members will pay for financial advice, and they will be better informed, but many of them do not obtain this advice until they are close to retiring, so they don't optimise their retirement strategy during their working life.

Superannuation funds hold and protect members' assets and they provide the investment products to grow these assets. However, funds do not provide any strategic services for members as they do not know enough about their personal circumstances or desires.

Consequently, they can only provide a generic solution. Sometimes these solutions are inadequate; for example, many funds provide members with calculators generating Retirement Income Forecasts to assist them consider their retirement strategy. However:

- The default projection is based on the member as a single person. As nearly 70% of Australians have a partner at the point of retirement, the numbers are wrong for most users.
- Calculators are usually deterministic with a simple expected outcome. This provides a guide but does not assist with the range of potential outcomes. Stochastic calculators are necessary, but they need explanation or members will be confused.

As superannuation funds do not know enough about their members, they can only provide generic advice. They need to segment members into broadly similar cohorts so that advice and service can be tailored to them. They are now compelled to do this under the *Retirement Income Covenant*, but most funds have not set up cohorts as they don't have the data (or wherewithal?) to do so.

Finally, superannuation funds do not provide a good strategic service for members. They are focused on good governance, legal compliance, and product management. They are not geared to deal with member issues! As an example, funds set up account-based pensions and are good at making the required regular pension payments. They will also alert members towards the end of the financial year if they have not received the minimum annual withdrawal amount. However, they usually have no other communication with existing retirees and do not keep up to date with any of their changing circumstances.

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

Many funds have developed longevity products, but these need to be sold as part of an overall strategy to the minority of members who would find them useful. Putting the product on a list with other options is not helpful for members without proper advice as to suitability.

Longevity protection is important for some members, but the industry and government overplay its role. Those owning their home can use this to free up equity late in life, and those on a full Age Pension already have a satisfactory annuity.

Of the approaches identified, what should be prioritised and what risks should be considered as policy is developed?

Grouping members with similar needs allows solutions to be developed at scale. Default structures are helpful as they recognise that most members will not receive personal advice.

The biggest risk is grouping members without understanding their personal circumstances or preferences. It is unlikely that funds will ever be able to group members, but they can make use of organisations such as SuperEd to do the grouping for them at the point of retirement. This should be supplemented by a periodic reviews, say every three years or when a member's marital status changes in retirement.

What other approaches, if any, should the Government consider?

Simplification of the Age Pension means testing would be helpful. Frequent reviews are not well understood, and they add complexity and cost. An annual assessment makes more sense.

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

Funds need to look at the holistic circumstances for a member, including the resources of their partner if they have one. As part of this, it is critical to provide information on the Age Pension which most members will receive in full or in part.

Funds need to be ready to assist when a retiree member's circumstances change. Can funds provide a conduit to the other services required – a Will and Estate Planning at the time of retirement or access to Aged Care late in life?

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

Members need to know about their Age Pension entitlements. For most members, superannuation is an add-on to this benefit.

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

- Consider holding a joint superannuation account for married couples¹. Rules can still be set for contributions and benefit payments, but engagement would be higher if the partners had a common interest (and were in the same fund). Note that most couples hold joint bank accounts, and the Age Pension is based on marital status.
- Simplify the rules around Age Pension entitlement.

¹ <https://www.ricewarner.com/joint-superannuation-accounts/>

- Increase the rent assistance component of the Age Pension, and improve means-tests for renters, which are onerous relative to home-owners.

It would be useful to allow members to transfer their retirement benefit into another fund without needing to first revert to an accumulation account and then transfer the benefit. This adds unnecessary complexity.

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?

If funds can group people with similar financial and family circumstances, they can suggest a suitable default strategy. The barrier is the lack of data, and the mindset of funds – which focus on product rather than strategy. Of course, any strategy needs to recognise the different circumstances – or preferences - of members.

On average, members will live more than 20 years in retirement, so a suitable long-term growth investment strategy should be the core. Many funds do not appreciate this and they de-risk members without considering their long-term needs.

Retirees should have three distinct financial ‘buckets’ for their retirement needs:

- A cash bucket out of which regular pension payments are made. Keeping aside 12 to 18 months payments protects against short-term market volatility. There should be a process to top-up the cash periodically, perhaps from skimming money out of the Balanced Fund in months where earnings are high.
- An account (Balanced Fund) which holds most of the fund and which has a target of strong earnings, recognising that the investment horizon will be more than 20 years for most retirees.
- An account to protect against longevity. This could be an annuity or GSA, but most members might better understand a simple Growth Account which will have higher volatility but will also have the potential to out-perform other options over such a lengthy period. Later in life, the proceeds could be used to buy an immediate lifetime annuity.

Members will have their own requirements. Some will want a nest-egg for emergencies. They may well prefer to hold a larger amount in their Cash Fund, though many appear to use their bank account outside superannuation for this purpose.

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?

Most members of an SMSF will be “self-funded retirees”, that is not eligible for any Age Pension at the time of retirement.

These members are likely to receive advice from accountants and financial advisers. Consequently, there is no immediate need for government interference. However, it might be useful to question whether those with small balances (say, less than \$300,000) should remain in these structures. An SMSF will become less efficient as balances fall, and this will happen to many members later in retirement.

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.

If structures are designed for a particular group of members, it should not be compared with other funds unless they have a similar structure to make it comparable. There is a danger that members will chase overall investment returns without understanding the difference in strategies.

Where funds are bucketed, it becomes more difficult to compare them.

In addition to maximising retirement income, the Covenant also requires funds to ***manage risks to the sustainability and stability of their retirement*** and to give members ***some flexible access to savings during retirement***. These objectives are difficult to measure together, and funds will require guidance from government.

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?

Products and services will only be competitive if they are tailored to a member's personal retirement strategy based on their personal circumstances. This requires segmenting members into cohorts with comparable strategies AND monitoring the effectiveness of these strategies over time for each member.

There is no action being undertaken anywhere in the industry to achieve this!

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?

It would be helpful if all funds used similar techniques to separate members into cohorts. For example:

- Home-owners are less likely to need longevity products as they can access the equity in their home in later life.
- Many members will prepare for late retirement without using longevity products. For example, members could place 10% to 15% of their retirement benefit into a high growth asset and not take any pension payments from this account. Over 15 years or longer, this account will provide enough to buy an annuity late in life at much better rates than those purchased at the point of retirement.
- Strategies for part-pensioners need to consider the complexity of the Age Pension.
- Those members on a full Age Pension already have an effective longevity product which has a greater value than their superannuation balance. They have different needs to other members, including desire for an emergency nest egg and to grow their superannuation returns during retirement.

What barriers are there for product switching in retirement and are there opportunities to make product switching easier?

It is desirable that retirement benefit could be transferred directly into another retirement product without the need to first convert back to an accumulation fund.

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

Members do not appear to value Lifetime Annuities. Some of the potential reasons for this:

- Members appear to be reluctant to give up their 'capital' and seem to want to maintain access to, and control of, their benefit.
- Most products provide life insurance to ensure members receive a minimum return of all their capital. Insurance at advanced ages is expensive and this cost reduces the ongoing annuity payments.
- The issuers of lifetime annuities must hold strong reserves as added protection for consumers. The reserves are set in a way that assets should never be lower than liabilities. This contrasts to the approach of a defined benefit arrangement where assets could be lower but with an actuarial approach to bring them back in line over time. Is the current reserving regime too onerous?
- Annuities do not look attractive in an environment where members have the safety net of the Age Pension, and where superannuation funds have delivered strong real investment returns over several decades.

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

Many funds use life-cycle investments to minimise losses at the point of retirement. These are useful for those funds which are needed as a lump sum at retirement (as it protects against 'Sequencing Risk') but are less useful for ongoing pension benefits.

Many funds recommend that retirees keep 12 to 18 months of pension payments in a Cash account. This allows the rest of the balance to be invested longer-term. A weakness is that funds do not have algorithms to top up the Cash periodically.

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?

Consider improving the value of these products, noting the issues set out above.

Analyse membership cohorts and establish where lifetime annuities can add value. Then, explain to members of these cohorts why the products help them.

Further questions:

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

Any strategy must consider other assets, particularly the value of the family home and the Age Pension. Funds which only look at superannuation balances will be unable to develop an optimum solution.

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

First, we must establish which group of members will benefit from these products. Then, the benefit must be communicated. The low take-up rate suggests that the retired population and their advisers remain unconvinced of the merits of these 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?

Some funds have played with Guaranteed Self-annuitisation (GSA) products. Take up has been poor.

It makes sense to make longevity products part of a default package. However, this should only be done for groups where the benefit of these products is clearly established.

Currently, funds have been reluctant to make these products compulsory. Partly, due to their own conviction that they don't add value, and partly in fear of members opting to join other funds at retirement to avoid being forced to take the product.

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?

The Age Pension is an indexed lifetime annuity guaranteed by government. Improving this product is more important than legislating for mandatory longevity products within superannuation.

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

It is more important to determine an industry-wide cohort that might benefit from these products.

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

Probably – but this will remove innovation from the marketplace, and that is undesirable.