A roadmap for Australian Retirement Income Policy

- Prepared for the Financial Services Council

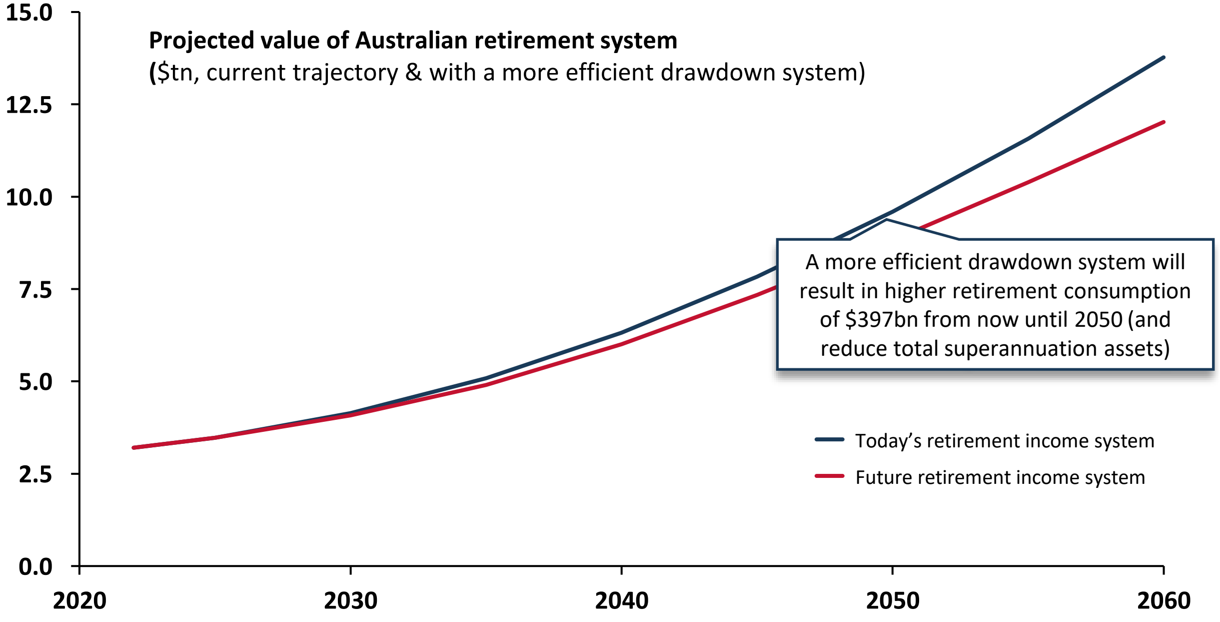
April 2023

Executive Summary: As the superannuation system matures, policy must shift focus to helping people draw down for their retirement

To drive further policy action beyond the Retirement Income Covenant, the FSC engaged NMG to develop a policy 'road map' focused on the drawdown phase of the superannuation system drawing on learnings from other jurisdictions. Implementing this roadmap is estimated to increase total spending from the superannuation system by $397bn between now and 2050

Today's retirement income system:
Current policy settings are not helping to reverse entrenched behaviour where retirees consume less of their super than they could:

- No disclosure framework makes it difficult for people to effectively compare 'like for like' retirement income products.
- Anti-hawking rules hamper superannuation funds from having real-time conversations about retirement income products at scale, with 1.3 million people expected to retire over the next decade without financial advice.
- No effective mechanism to rationalise legacy retirement income products discourages ongoing innovation of retirement income products.
- Complex interactions of social security and superannuation tax rules stifle effective decision making around optimal drawdown behaviour.



A full package of reform is required:
A policy roadmap, informed by global observations from other retirement income systems, should focus attention on three areas which the government is not currently actively progressing:

1. Shifting focus to retirement drawdown so superannuation is primarily spent during retirement
2. Removing regulatory inhibitors to promote more innovative retirement income products
3. Improving the cohesion of superannuation with other parts of the Retirement system

Future retirement income system:
Optimising the drawdown phase would improve retirees' retirement income by 15-20%, benefiting individual Australians and help manage budgetary pressures from the Retirement system:

- Around 100,000 more people would draw down on average an extra $10,000 in increased retirement incomes per individual every year on average.
- 10% more in annual benefits paid by superannuation as retirement income, increasing to $38bn more in 2050 (and a total of $397bn through to 2050), providing significant relief for other components of the Retirement system like the Age Pension, Aged Care and Health.
- Halve bequests from superannuation by 2060, ensures superannuation is primarily used up as income for retirement.
- Retirement phase assets reach 30 per cent of total system assets and total system assets would be 12 per cent lower by 2060, which would help maintain long-term sustainability of superannuation tax concession settings.

About NMG Consulting

- NMG Consulting is a multinational specialist financial services consultancy focused on the insurance, reinsurance, and investment markets
- NMG provides strategic consulting services to financial institutions operating in Australia and across major international markets (including those covered in many of the international market studies referenced in this Report).
- NMG runs research and analytics studies including in relation to consumer, adviser and corporate attitudes to life insurance, wealth management and asset management; and undertakes analysis of industry stock/flow and profitability metrics (both internationally and in Australia) across asset management, wealth management and insurance. The NMG Super Assets Model is a key component of the analysis in this report.

Context, Objective & Scope

The FSC engaged NMG to help frame the policy focus on the efficient use of Australia's superannuation savings during the drawdown phase of the retirement income system, including observations from a review of targeted global markets

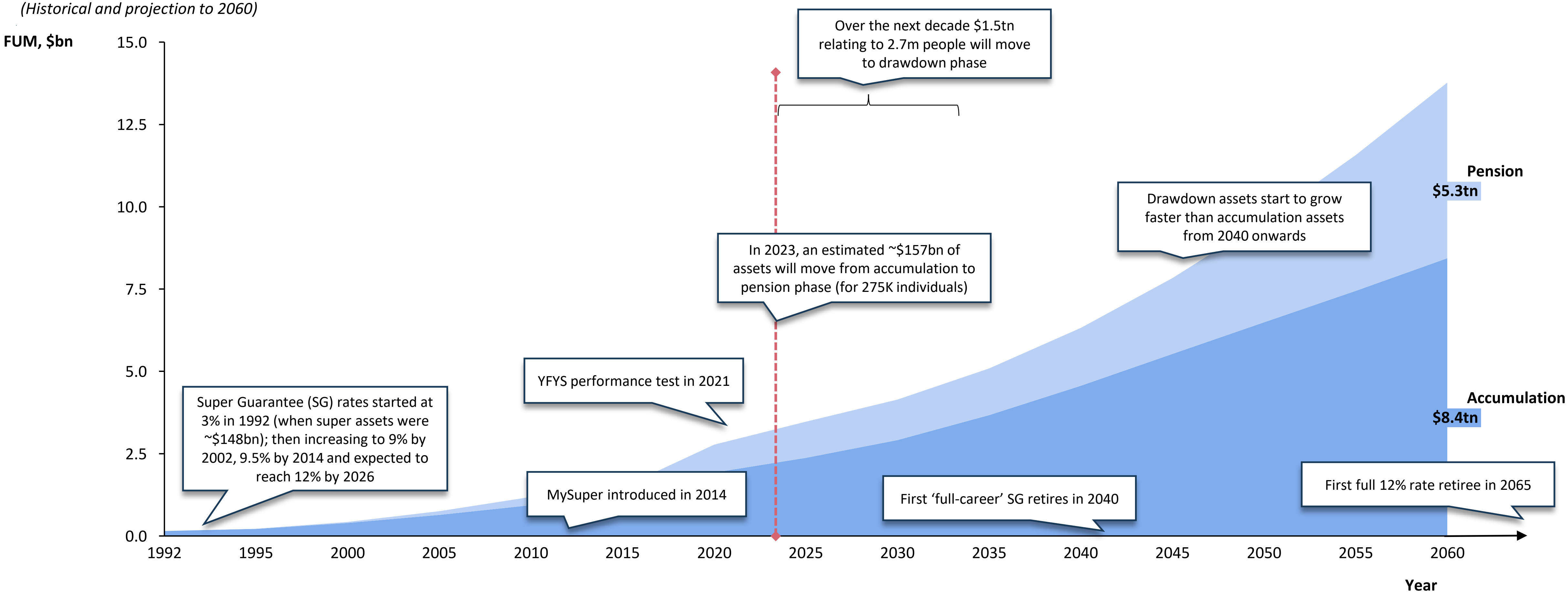
- Australia has one of the world's leading retirement income systems. However, as a defined contribution system, it is still relatively young and has yet to develop an effective drawdown phase; and policy settings to date have largely focussed on the accumulation phase.
- To enhance focus on the drawdown phase, the FSC wanted to identify global approaches and thinking to guide policy framework within the drawdown phase. While there are many differentiating characteristics within the retirement income systems of many countries which makes direct comparison (or a 'plug and play' type approach) ill-suited, there are observations that can support and inform future policy settings.
- NMG was engaged to develop a policy 'road-map' to drive focus on the drawdown phase and provide for a more effective drawdown system, via a review of various global jurisdictions and approaches. The countries chosen for review were deliberately broad and take different approaches to their retirement income system to provide broad coverage and identify opportunities for Australian policy.
- With different backgrounds, most features and approaches from different countries are unlikely to be able to be directly applied to the Australian market. However, the observed intent behind settings and the way countries tackle different issues can provide guidance and a road map for development of future Australian drawdown phase settings.
- This report does not specify exact outcomes in policy framework, recognising that broad discussions across stakeholder groups are needed to agree and finalise exactly where to land on these. Instead, the intent is to guide discussion and focus on important characteristics to achieve a more efficient drawdown phase.
- NMG also undertook modelling to identify the impact that changing these settings could be expected to have on the Australian market and Australian retirees (within a range, given report doesn't have specific policy recommendations / settings)

Thirty-one years since the introduction of compulsory superannuation, Australia's retirement income system is still maturing…

While accumulation settings are now largely in place and enhancements underway to improve adequacy and equity (gender, lower socio-economic, etc), system changes take many years to fully play out. Policy focus therefore now needs to shift to the post-retirement phase.

Funds under management (FUM), by phase

(Historical and projection to 2060)



Source: APRA, ATO, ABS, NMG Super Assets Model

… with further policy focus required on the Australian super system's drawdown phase – this research is focused on post-retirement elements

While the Retirement Income Review identified policies must address both drawdown and accumulation issues, this research is focused on post-retirement issues and how policy can support effective drawdown in retirement

	Objective	Key elements	
1 **Adequacy**	▸ An adequate system provides income that **supports living standards** in retirement ▸ It does this **without unduly compromising** individuals' living standards **pre-retirement**	**2 key elements help to deliver adequacy:** 1. A 'safety net' ensuring a minimum standard of living for retirees with limited financial means 2. Policies and incentives to save and productively invest, thereby supporting individuals' standard of living in retirement	***Recommendations to date have been focused on pre-retirement, driving increased balances at retirement and providing a safety net for those who fall short***
2 **Equity**	▸ Retirement **incomes are primarily driven by factors outside** the retirement income system, particularly pre-retirement income and investment returns ▸ The **Age Pension** acts to **offset some of the inequities individuals faced pre-retirement**, which affected their ability to generate a large super balance	**2 key elements of equity should be upheld:** 1. System support should be targeted most at those who need it 2. People in similar circumstances should have similar retirement outcomes	
3 **Sustainability**	▸ To drive fiscal sustainability, **system costs must be aligned with Australia's economic capacity** and the community's willingness to pay ▸ **Government expenditure should support** a cost-effective system	**2 key elements of system sustainability should be maintained:** 1. Cost-effectiveness, enabling taxpayers to achieve adequate outcomes 2. Robust to predictable demographic, economic and social changes	
4 **Cohesion**	▸ **All components of the system should be complementary** and contribute to achieving the overarching objective ▸ **Policy settings should support smooth consumption** over individuals' lifespans i.e. optimal spending and saving both pre- and post-retirement	**3 key elements of system cohesion should be enhanced:** 1. Effective incentives to smooth consumption, including some compulsion to save pre-retirement and drawdown post-retirement 2. The retirement income system is not stand-alone and must interact effectively with other systems (e.g. health, aged care) 3. System complexity should be minimised, with mechanisms to support consumer understanding when navigating the system	***This roadmap is focused on post-retirement and how policy can support effective drawdown to deliver income in retirement***

Source: Retirement Income Review

The Retirement Income Covenant is a significant first step, but the system needs an optimised framework to support trustee action for the drawdown phase

The Retirement Income Covenant (RIC) was a first step in getting trustees to consider drawdown issues within today's framework; however, it has seen limited change – an optimised framework will provide trustees with more options and guidance to generate effective drawdown solutions

Historically, the focus has been on accumulation

ACCUMULATION FOCUS		DRAWDOWN FOCUS
1992: Introduction of SG at 3%	92	
1999: Introduction of SMSFs		
2002: SG gradually increased to 9% per annum	02	
2005: Transition to Retirement pensions established		
2005: 'Choice of Fund' introduced		
2007: $1m contributions		**2007:** 0% tax on pensions introduced
2011: Strong Super reforms	12	
2014: MySuper introduced		
2016/17: Productivity Commission & Royal Commission into Super		**2017:** Pension caps introduced to reduce tax concessions to HNW
2022: Removal of minimum salary for SG		
2022: YFYS Performance Test	22	**2022:** Retirement Income Covenant
SG to 12% by 2025		

The RIC requires trustees to consider drawdown

Since first proposed in the Murray Report in 2014 (in the form of a Comprehensive Income Product for Retirement), and the 2018 budget announcement of a retirement income covenant (followed by a Treasury consultation process in 2021), the Retirement Income Covenant finally took effect from 1 July 2022.

The Retirement Income Covenant requires trustees to define a strategy to balance the following three objectives:

- Maximise members expected retirement income
- Manage risks to the sustainability and stability of their expected retirement income; and
- Have flexibility in access to capital during their retirement.

To date, trustees have generally responded with a documented strategy detailing what they offer members within the current drawdown framework (i.e. the offer of account-based pensions and other support material, tools and calculators).

And whilst the first trustee triennial review of their documented retirement strategy is due by 30 June 2025, there is still a way to go before we see significant improvements in many retirement propositions.

However, improvements in retirement income strategies are tied to lifting the legal and regulatory barriers that are inhibiting effective drawdown strategies, including:

- The cost of comprehensive financial advice is prohibitively expensive for most retirees, preventing most receiving the help and guidance they need
- Anti-hawking rules currently make it difficult for trustees to engage members on retirement products prior
- The lack of a retirement disclosure framework makes comparisons even more difficult for retirees
- The lack of effective rationalisation mechanism for legacy products is a constraint to ongoing product innovation

An optimised drawdown framework will help trustees to develop innovative solutions to support members

- Helping members better decide how much they can confidently consume and drawdown during retirement
- Increasing member confidence in not running out of retirement income
- Providing members with the ability to use retirement savings to help if and when they need to draw on savings for late life care costs

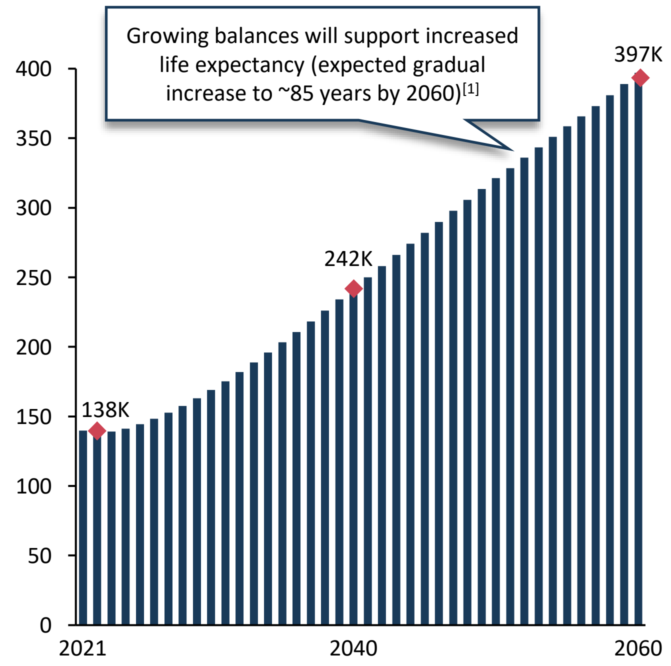
Source: Retirement Income Review, Treasury, APRA

And as the system matures, retirement outcomes will naturally improve based on accumulation settings in place and likely consumer behaviour

With people having super contributions for more of their working life, retirement balances will naturally rise which even under current behaviour will see higher use of drawdown phase and a lower reliance on the Age Pension (helping to address people living longer & better in retirement)

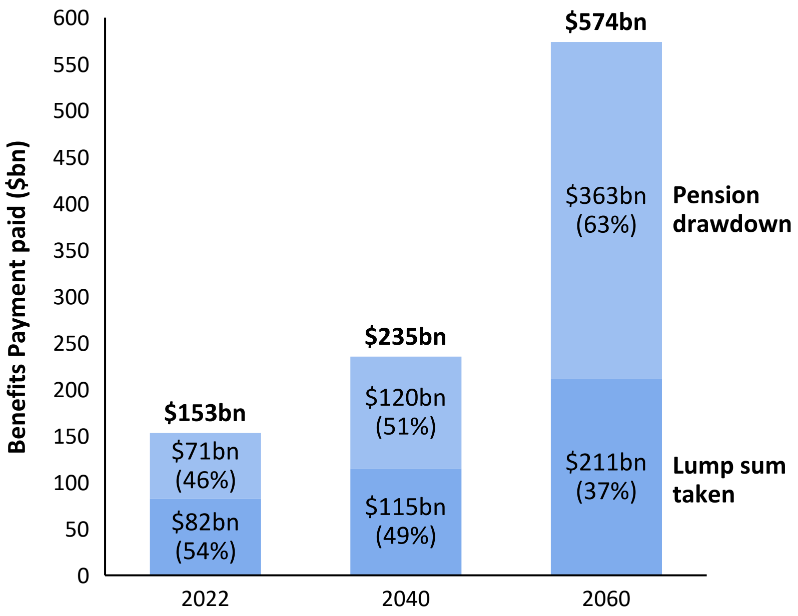
Average retirement balances continue to rise

Average balance at retirement ($K)



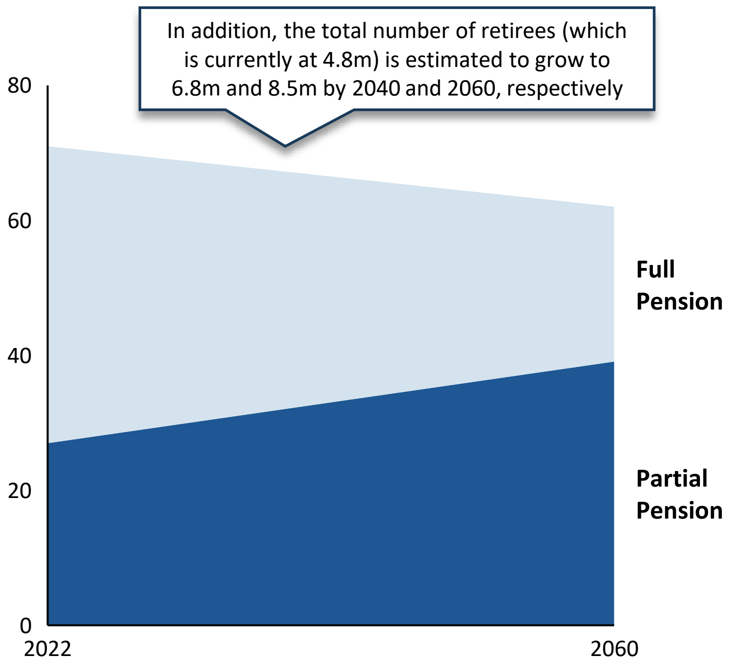
Higher use of Drawdown phase

Type of benefits paid from pension phase over time ($bn)



Reducing reliance on Age Pension

Proportion of retirees relying on Age Pension (%)



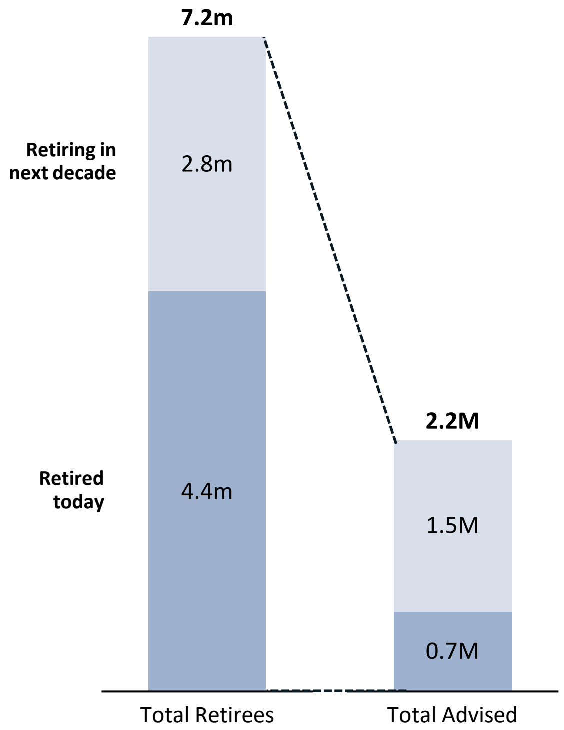
Source: APRA, NMG Super Assets Model, Retirement Income Review
Notes: [1] refers to life expectancy averaged across males and females

However, issues specific to the drawdown phase will remain unaddressed

Current post-retiree behaviour results in several characteristics which are not aligned with the principles of cohesion - including retirees not being adequately advised, drawdowns being based on minimum requirements, low take-up of retirement product and large death benefits

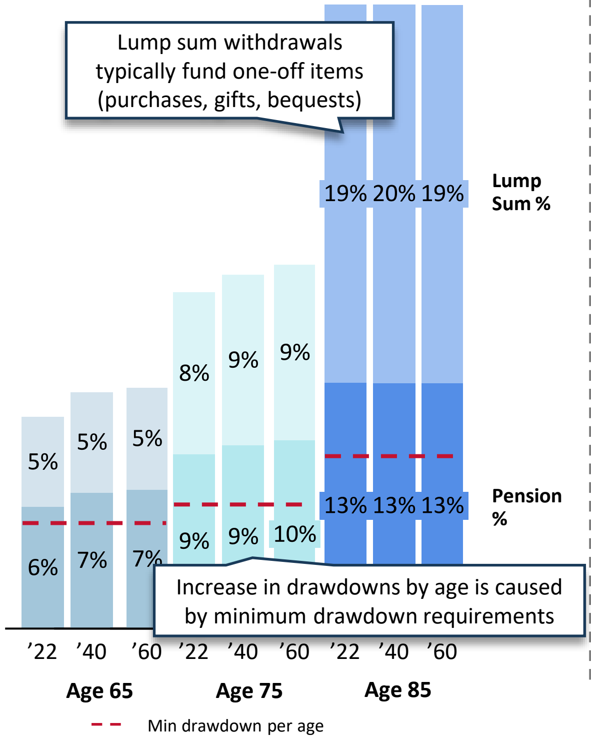
1 Less than a third of retirees will get advice in the next decade

Number of retirees and advised retirees
(#m, current policy settings)



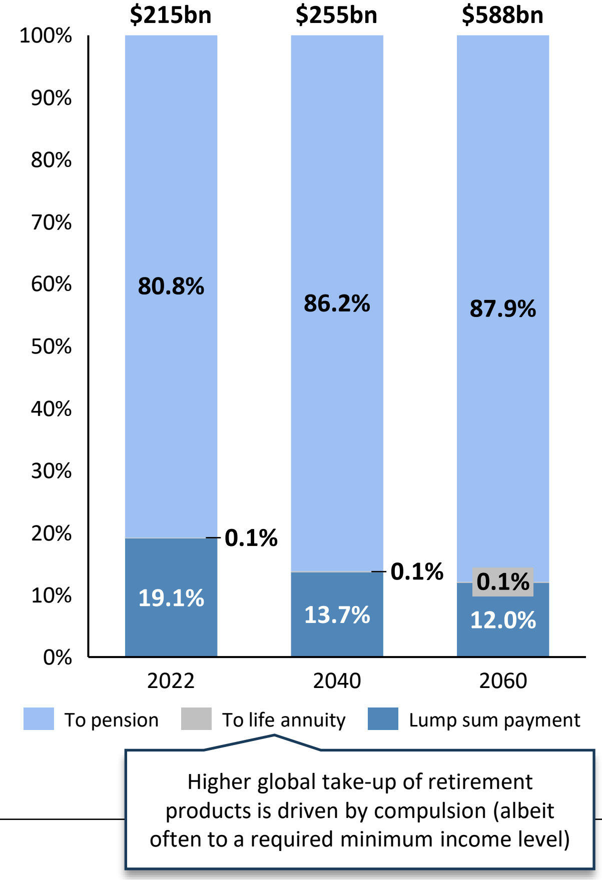
2 Currently, most retirees draw down is framed by the minimum requirements, with lump sums

Ave proportion of pension assets withdrawn each year, by age[1] (%, current policy settings)



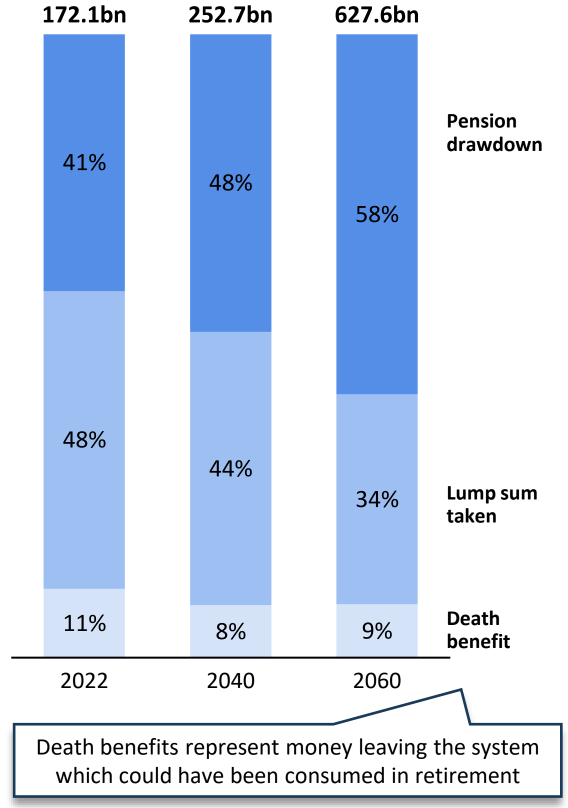
3 The current take-up of retirement product is low (both absolute and in global sense)

Destination of funds at retirement ($bn)



4 Consequently, drawdown of retirement income is low and bequests remains high

Total benefits paid (incl. death), per year
($bn, %, current policy settings)

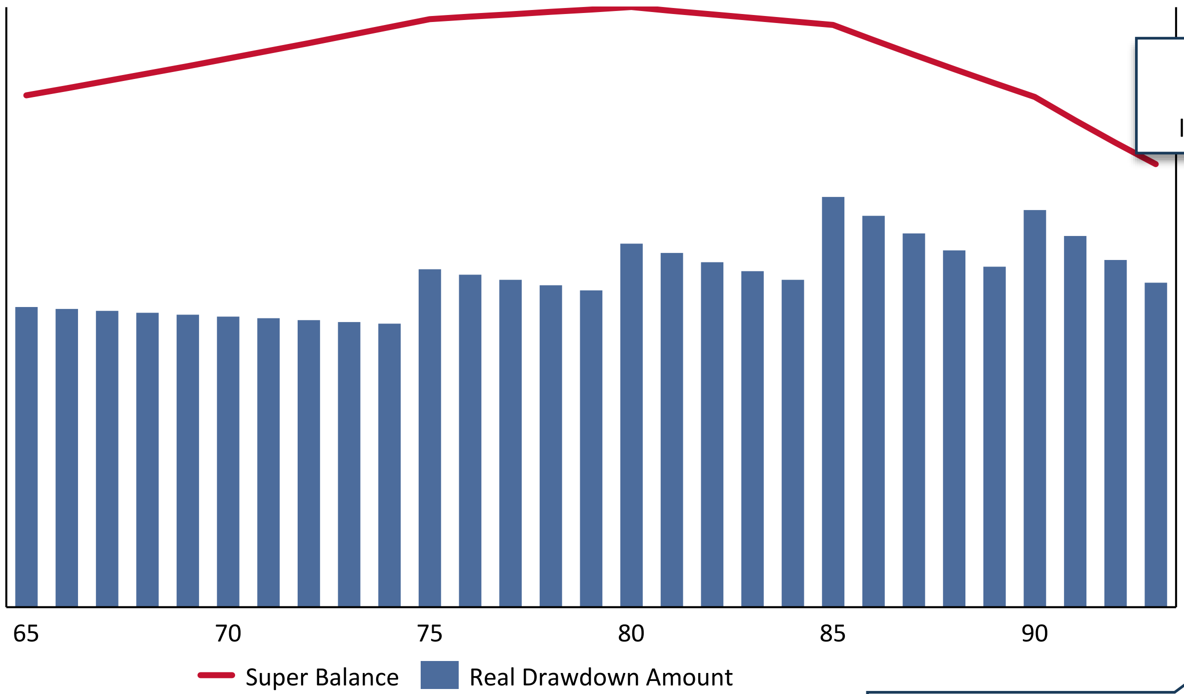


Source: NMG Super Assets Model, Retirement Income Review
Note: [1] includes payments from life-time annuity products

A more effective retirement income system will see retirees confidently draw down more of their superannuation capital during retirement phase

An ***effective*** retirement income system would see retirees use retirement products appropriate to their needs, and confidently use their superannuation savings for consumption during retirement with a higher drawdown from their superannuation

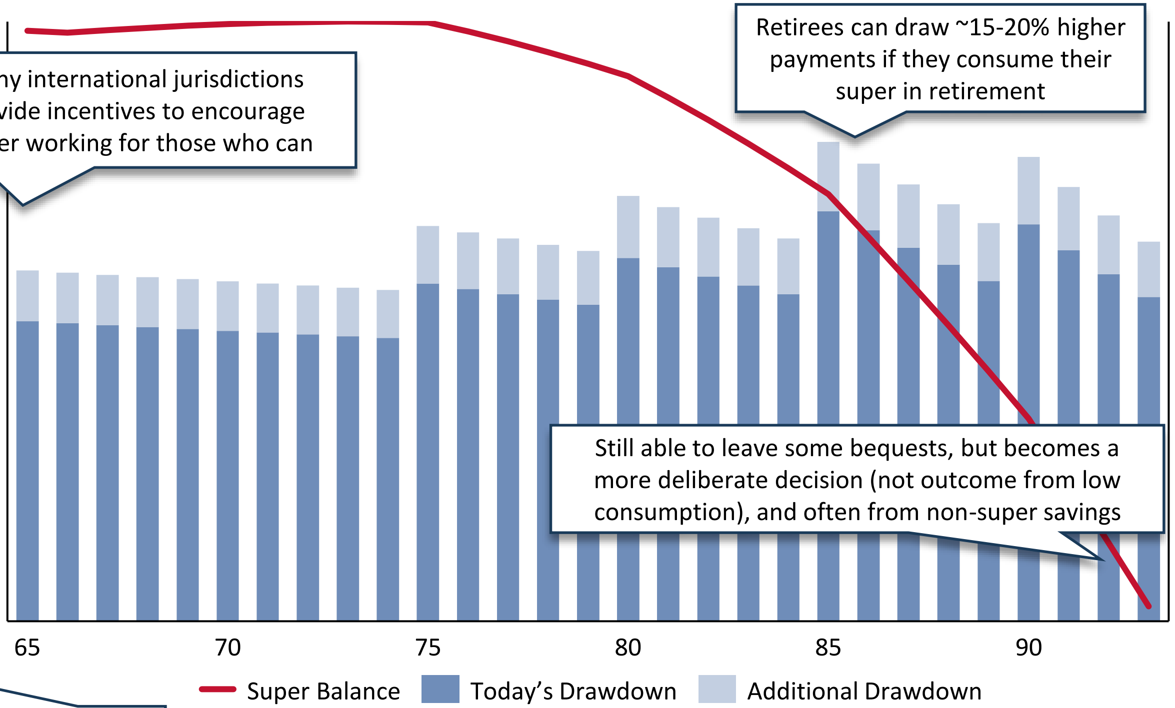
Typical Experience Today



Many international jurisdictions provide incentives to encourage longer working for those who can

International jurisdictions provide better support for ability to purchase retirement income pre- retirement, e.g. via instalments

A More Effective System



Retirees can draw ~15-20% higher payments if they consume their super in retirement

Still able to leave some bequests, but becomes a more deliberate decision (not outcome from low consumption), and often from non-super savings

International systems still provide some flexibility (especially above a minimum level) to cover unexpected costs (e.g. health costs / aged care etc), for below expected returns and/or for increased longevity

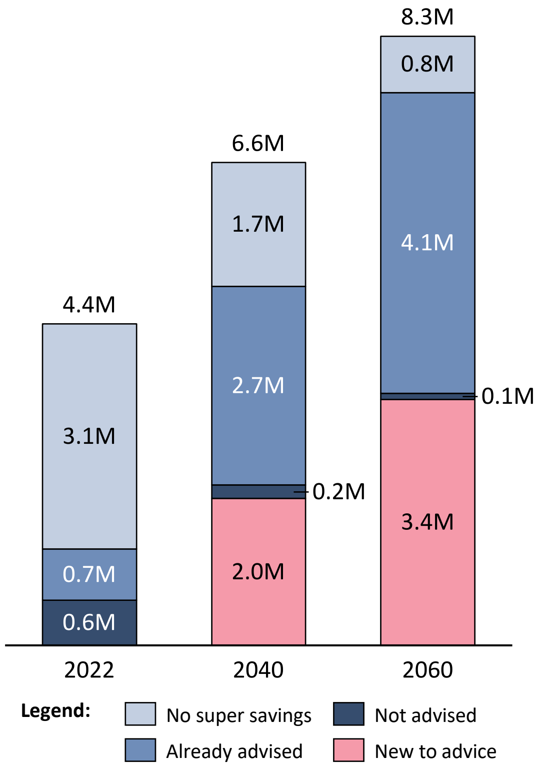
Notes: Conceptual, hypothetical example of real drawdown levels, based on home-owning couple starting retirement at age 65 with combined $400K in account-based pensions, on full age pension, drawing down & consuming full drawdown levels today (and consuming 17% higher in a more effective system)

Impact: improved retirement spending for retirees

If drawdown reforms, including those recommended by the *Quality of Advice Review*, are implemented, by 2040 an additional 2 million retirees will have received retirement advice and will collectively drawdown an additional $20+bn from super per year[1] – leading to a 'more effective' retirement system

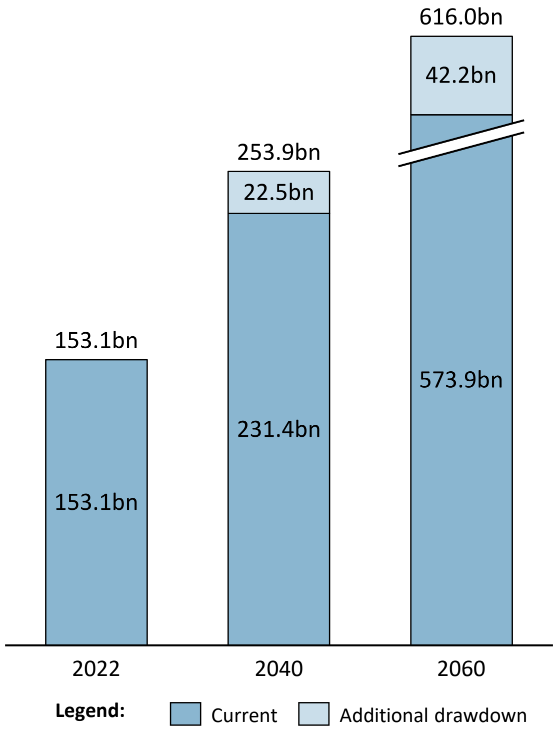
In an effective retirement system, more retirees will seek and get advice …

Total number of retirees, by year
(#m, 2022 – 2060)



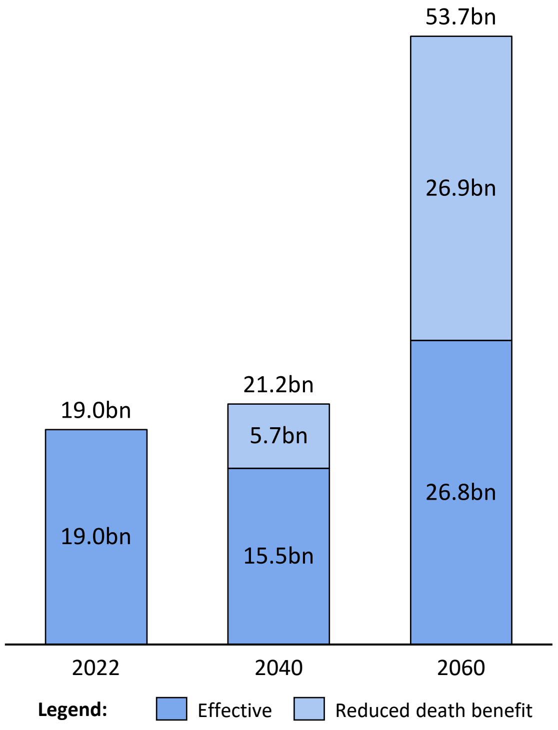
… retirees drawdown more of their assets for consumption in retirement each year

Total benefits paid (excl. death), per year
($bn, 2022 – 2060)



… resulting in a lower level of unintended bequests left at death

Total death benefits paid, per year
($bn, 2022 – 2060)



Whilst higher drawdown is a key benefit of a better, more efficient retirement income system (as identified by the Retirement Income Review), **there are additional elements that arise from improved information, guidance and/or advice to individuals**:

1. Better trade-off between lifetime and non-lifetime income stream products
2. More efficient interaction with Centrelink (and better understanding of entitlements)
3. Management of non-super assets across different products and tax scenarios
4. Consideration of aged care for both parents and self
5. Tax and estate planning issues more deliberately considered by individuals (and more efficient use)
6. Investing tailored to investors' circumstances

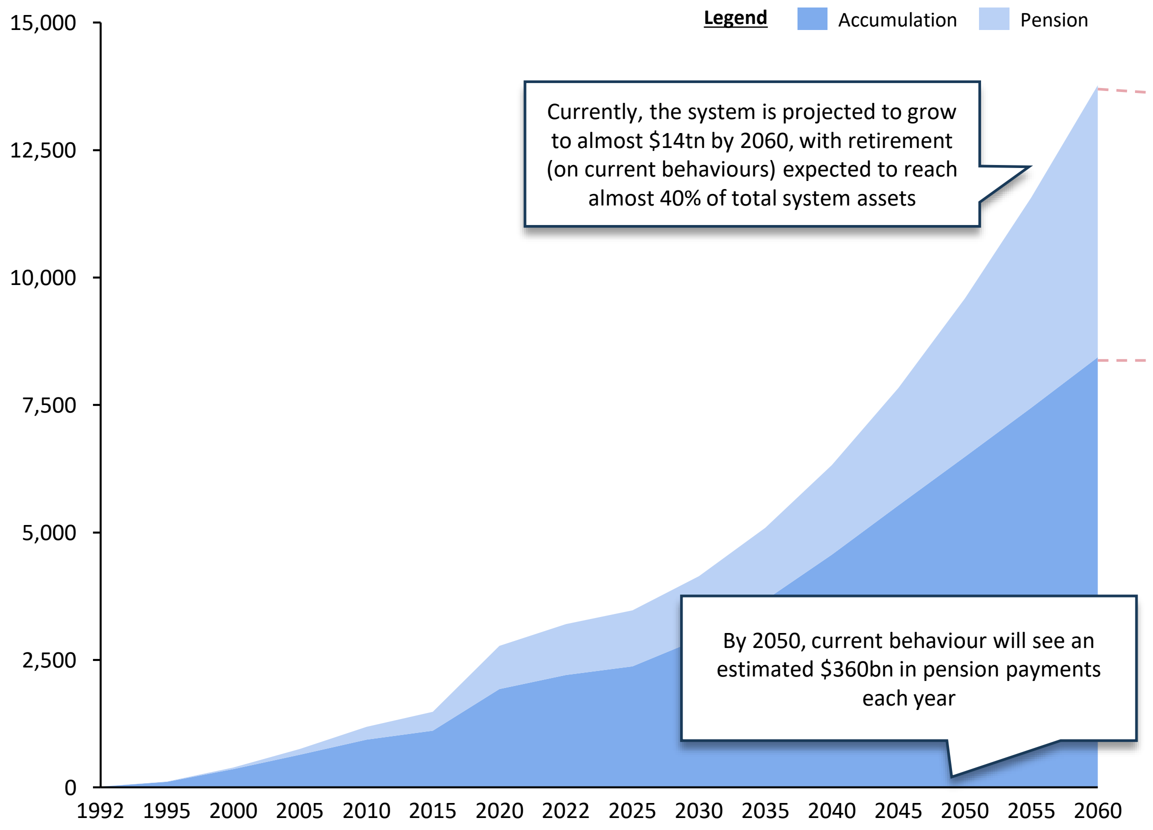
Source: NMG Super Assets Model
Note: [1] includes individuals who would otherwise have withdrawn their entire super balance and those who draw additional pension with higher confidence in not running out of funds

Future state of the system

As the system matures and policy changes lead to a more effective drawdown system where retirees spend more in retirement, system assets will grow slightly less rapidly than currently expected

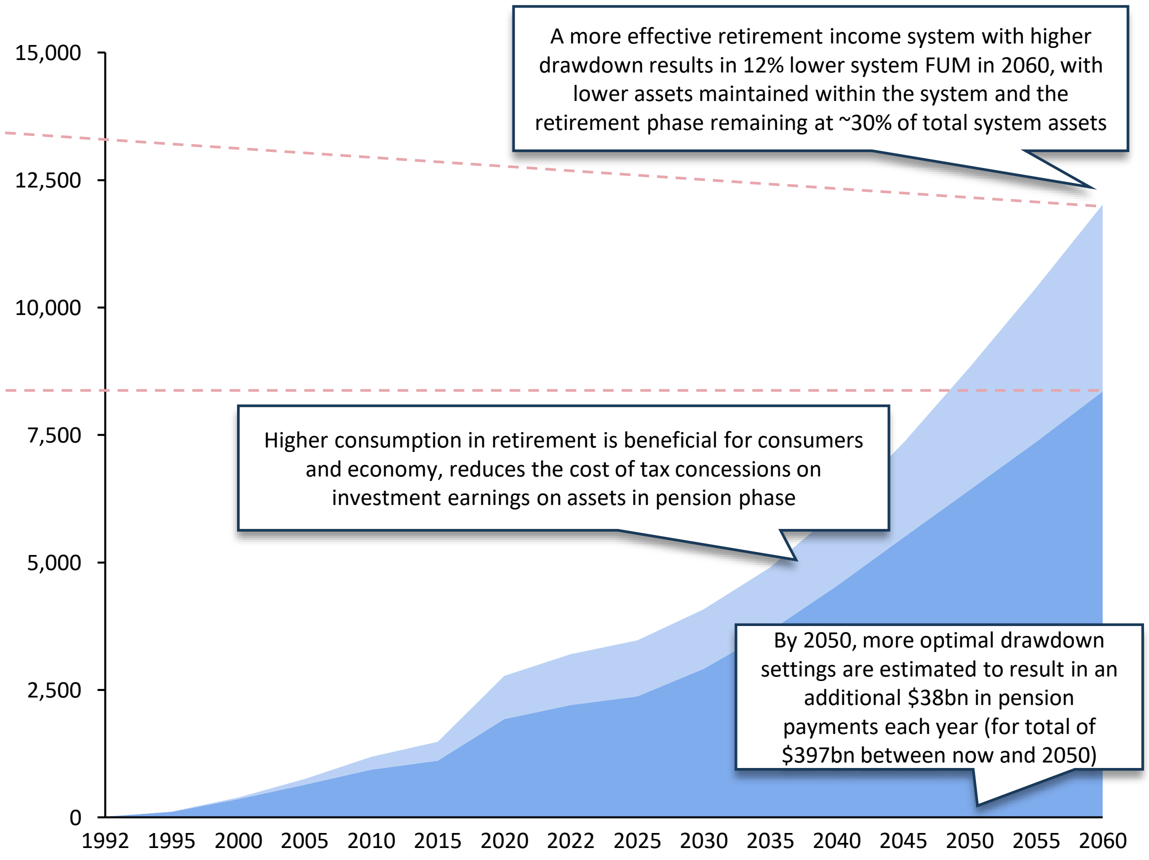
Today's retirement income system

Funds under management (FUM) over time, $b



Future retirement income system

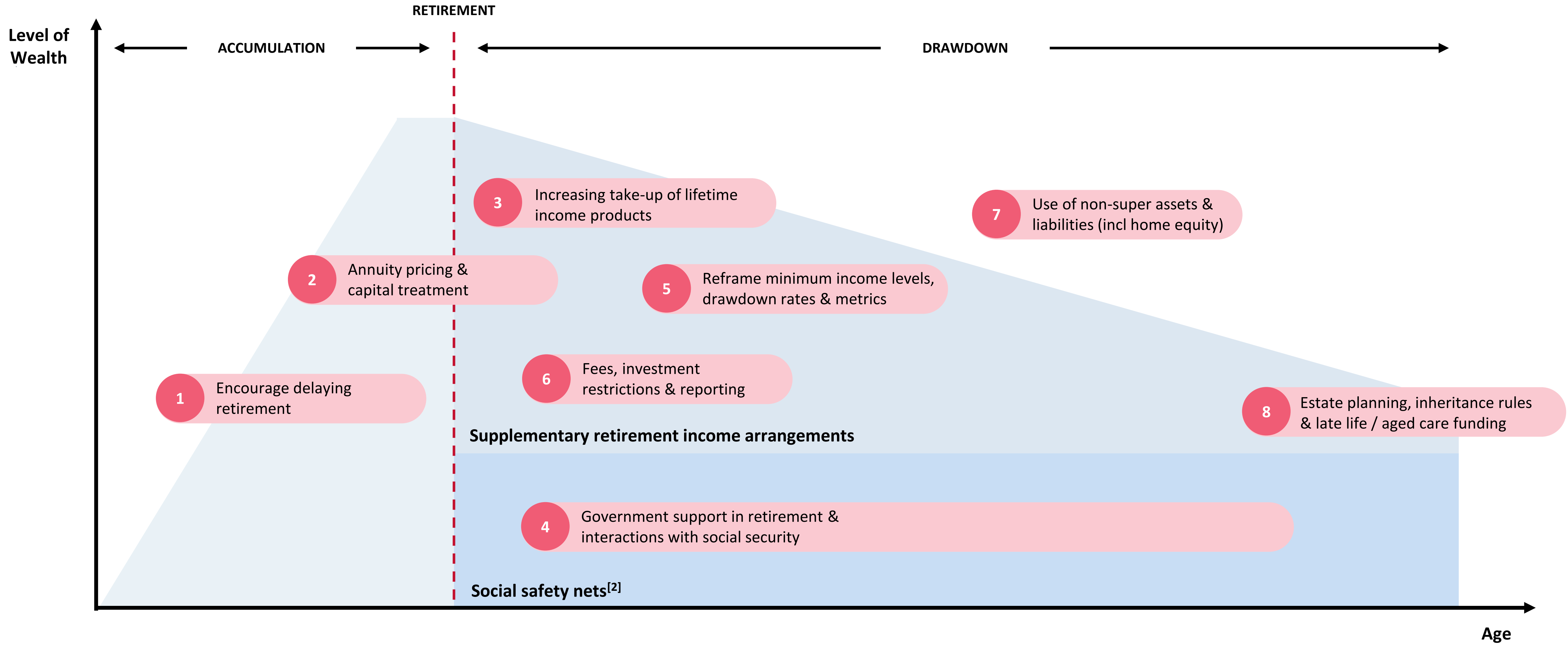
Funds under management (FUM) over time, $b



Source: APRA, ATO, NMG Super Assets Model, Retirement Income Review

While global comparisons are not straightforward[1], there are eight key observations for Australia on how to tackle the post-retirement phase

An examination of global approaches identifies eight areas for Australia to consider as part of its post-retirement policy



Notes: [1] Many jurisdictions are insurance-based, or compulsion-based and cannot be easily transferred to the Australian context; [2] includes state pension plus any universal health, age or disability care arrangements

These global observations and Australians' behaviour creates three core areas of focus for Australian retirement policy to deliver a more effective drawdown phase

Area of Focus	Identified Actions	Outcome
A — **Consumer: Shift the focus of super towards retirement drawdown rather than a 'nest egg'**	1. Define system & member success around retirement drawdown / replacement rate and shift super fund reporting towards retirement estimates and drawdown choices 2. Reframe default drawdown indicators & metrics 3. Enable increased retirement specific advice and member engagement (access to, delivery of, cost of etc.) and encourage acquisition of drawdown products (including potential via instalments, pre-retirement, etc)	**Super seen primarily for consuming during retirement**
B — **Industry: Remove inhibitors to creating a better retirement solutions market**	1. Create mechanisms to avoid legacy products (e.g. transferability of income-for-life products between funds) 2. Review capital requirements for retirement products (to support more innovative & flexible products) 3. Develop a disclosure framework for consumers to easily compare features and fees between comparable retirement income products	**Broad & deep retirement solution market**
C — **Market Cohesion: Address perceived impacts of interacting policy items**	1. Redesign pension means tests rules to encourage higher consumption of capital 2. Remove disincentives to postpone retirement (for those who can and want to) 3. Address the interaction of major (non-retirement) policy levers on retirement spending behaviour, including tax policies (especially inheritance & gifting), home equity release options, and aged, disability & health care	**Enhanced cohesion of system components**

These policy areas can be prioritised by urgency, and all have plenty of work to complete (if they are even started)

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Proposed policy prioritisation road-map:

	Immediate	Soon	Later
A **Consumer: Shift focus to drawdown**	✋ Define system & member success around retirement drawdown / replacement rate and shift super fund reporting towards retirement estimates and drawdown choices ✋ Reframe default drawdown indicators & metrics ✋ Enable increased retirement specific advice and member engagement		
B **Industry: Remove inhibitors to retirement solutions**	☒ Create mechanisms to avoid legacy products	✋ Review capital requirements for retirement products ☒ Develop a disclosure framework for consumers to easily compare features and fees between comparable retirement income products	
C **Market Cohesion: Address interacting policy items**		☒ Redesign pension means tests rules to encourage higher consumption of capital	☒ Remove disincentives to postpone retirement ☒ Address interactions of major (non-retirement) policy levers on retirement spending behaviour, including tax policies

Legend: ☑ Actively in progress ✋ As yet, no clear path to resolution ☒ Yet to be addressed

Appendix 1

Policy areas

Policy requirement A.1: Define system & member success around retirement drawdown / replacement rate and shift super fund reporting to retirement estimates and drawdown choices

Overview: To date, superannuation has been positioned as people's "nest egg", framing it as savings and implying it shouldn't be consumed. Instead, terminology needs to recognise superannuation should be drawn down to pay for retirement consumption (which should be not be materially lower than consumption during a person's working life). In order to support this reframing, super fund reporting should support and encourage these outcomes by shifting focus from "balance" into what level and how long capital drawdowns are likely to last (under common, meaningful and useful assumptions).

Current Status: No clear path to resolution

Priority: Immediate

Action required:

The industry should advance work that has commenced in legislating an objective for superannuation. This should include reframing the phrasing of post-retirement market to support the concept of 'drawdown' (rather than 'income'), including:

- Superannuation / saving should be repositioned as the pool of future assets available to be drawn down to fund consumption during retirement
- Terminology needs to change to drawdown (income is readily interpreted as 'investment income' encouraging individuals to not draw on capital)
- Success needs to be reframed as drawing down sufficient income to live comfortably throughout their retirement and to more completely exhaust their capital

This change needs to be implemented across all super fund communications, by reframing the retirement "income" product outcome definition as "drawdown" (to promote the concept of drawing down capital rather than simply consuming income generated). Reporting standards for super funds further need to evolve to shift annual member statements focus from balances to likely drawdown amounts supported (with range of outcomes and based on key assumptions). This should also cover tools, calculators & other member communications.

Considerations to be aware of:

This should be implemented across all super fund communications, including:

- annual member statements,
- annual reports (i.e. proportion of members improving retirement outcome)
- APRA Reporting

Global observations & ideas:

- Most countries (e.g. UK, Singapore, Hong Kong, Israel) already have the notion of retirement income (or at least minimum retirement income) as central components of their retirement income system
- In New Zealand, annual Kiwisaver fund statements provide an estimate showing how much an individual could expect to withdraw before running balance to $0 by age 90, and 'Rules of Thumb Guidance' provide different drawdown options to help promote choice

Proposed policy prioritisation road-map:

A — Consumer: Shift focus onto drawdown

- **Define system & member success around retirement drawdown / replacement rate and shift super fund reporting towards retirement estimates and drawdown choices**
- Reframe default drawdown indicators & metrics
- Enable increased retirement specific advice and member engagement

Policy requirement A.2: Reframe default drawdown indicators & metrics

Overview: Retirees often draw their superannuation at the minimum rates allowed, (i.e. in the absence of better information, the minimums are viewed as an anchor in deciding how to consume capital). The minimum drawdown framework needs to be revisited to support and encourage drawdown of capital throughout individual's retirement.

Current Status: No clear path to resolution

Priority: Immediate

Action required:

The current minimum pension drawdown levels are essentially a mechanism that seeks to manage the level of savings individuals can maintain in a tax-advantaged environment, but they are often too low and see many die with a significant proportion of their retirement balance remaining.

An improved framework should be introduced to guide higher drawdown and for retirees to use their superannuation during retirement.

This could include some redesign of the current minimum drawdown rules, to incorporate:

- Guidance to target to exhaust superannuation savings for individuals at a certain age (but well beyond average life expectancy, say 100 (which would still allow for non-super savings for those who expect to live beyond 100))
- Reframing drawdown into minimum and higher amounts (consistent with other jurisdictions)
- Cater for states of retirement (and late life care costs)

By implementing the Quality of Advice review interim recommendations, this would increase provision of information and 'good advice' to individuals (particularly those who are unable to afford, and unlikely to receive value from, full comprehensive financial advice), further supporting drawdown decisions.

Considerations to be aware of:

- Drawdown rules need to cater for singles and couples, and consider additional capital withdrawals. The drawdown rules should cater for market volatility, and therefore should not be reduced in different market conditions (which reinforces the framing that super should not be consumed).
- Increasing minimums should not prevent all bequests, but shift a higher proportion of bequests outside of the (tax advantaged) superannuation system
- While ASIC Reg Guide 276 provides some guidance and relief, further work is required post Quality of Advice recommendations to finalise key assumptions for drawdown estimates (returns, retirement age, longevity, age pension eligibility, etc) and shifting focus beyond a single point estimate to a range and/or alternative options.

Global observations & ideas:

Many global systems have positioned their systems as a minimum retirement income for life with flexibility for withdrawals above to support higher standards of retirement living if you have sufficient assets (eg UK and Israel focus on flexibility above a minimum level of lifetime income; Singapore and Hong Kong focus on a minimum level income requirement for life before you can receive flexibility). Australia's system does not differentiate for consumers between the minimum and flexibility and could enhance consumer understanding of retirement by implementing this concept across the system

Proposed policy prioritisation road-map:

A — Consumer: Shift focus onto drawdown

- Define system & member success around retirement drawdown / replacement rate and shift super fund reporting towards retirement estimates and drawdown choices
- **Reframe default drawdown indicators & metrics**
- Enable increased retirement specific advice and member engagement

Policy requirement A.3: Enable increased retirement specific advice and member engagement (access to, delivery of, cost of etc)

Overview: There is a lack of common information on what options people have in retirement (including how much Government aged care and health support is available for common scenarios), resulting in people planning "for the worst" and living below their means

Current Status: No clear path to resolution

Priority: Immediate

Action required:

While the Retirement Income Covenant gives trustees some flexibility about member information and engagement, to date it has resulted in limited change (albeit, it has only been in place for 9 months). In theory, it provides trustees some ability to address retiring members, but implementation in practice may conflict with the current advice framework and anti-hawking requirements

The Quality of Advice recommendations allow trustees to better engage & guide members on retirement should be implemented to:

- Engagement (approaching / at / beyond retirement age)
- Tools (illustrate & help to understand)

In addition, review how ASIC's MoneySmart could be enhanced beyond providing information to more commonly-accepted guidance (and rules of thumb, such as in choosing alternative options to achieve that guidance), although stopping short of personal advice.

Considerations to be aware of:

- The anti-hawking rules, which currently constrain trustees' willingness to proactively engage / advise members in relation to retirement, need review to support this recommendation (i.e. super funds are currently unable to engage with retiring members in an effective manner, as it can be seen as being an offer and/or require a PDS to be provided)

Global observations & ideas:

Some global systems require providers to frame their engagement around the choices individuals have in drawing down their retirement income (instead of just on what the individual must do as a minimum), providing clear guidance and more consistent messaging on consumption of their capital. For example the UK requires pension fund trustees to encourage ('nudge') members to make use of the free guidance provided by Pension Wise whenever the member makes an application to use their pension savings.

Proposed policy prioritisation road-map:

A Consumer: Shift focus onto drawdown

- Define system & member success around retirement drawdown / replacement rate and shift super fund reporting towards retirement estimates and drawdown choices
- Reframe default drawdown indicators & metrics (e.g. minimum drawdown rules)
- **Enable increased retirement specific advice and member engagement**

Policy requirement B.1: Create mechanisms to avoid legacy products (e.g. transferability of income-for-life products between funds)

Overview: It is inevitable some retirement products will not succeed (e.g. insufficient take-up, ongoing product innovation, providers exit market, super fund closure, etc). To avoid legacy products, mechanisms should be in place for when products need to be closed / migrated to avoid adverse consequences for individuals and trustees

Current Status: Yet to be addressed

Priority: Immediate

Action required:

Government and regulators need to provide more flexibility for providers to undertake product terminations and subsequently shift individuals to suitable alternatives.

This includes (but is not limited to):

- Regulator guidance on product wind-up and migration
- Flexible takeover arrangements and process to support trustees (and stand-alone product providers) migrating members to similar options (without appropriate member protection & communication)
- Trustee safe harbour where a product is wound-up within a super fund
- Accommodative supporting areas (e.g. social security) for individuals subject to product wind-ups

Considerations to be aware of:

This is a long-standing issue the industry has sought for almost twenty years (with clear recognition tax effective rationalisation will create better consumer outcomes) – most recently including 2021/2 budget announcements (legacy retirement products and product rationalisation) which have yet to be enacted.

- If any wind-up process remains too complicated and difficult to engage with regulators, legacy products will continue and constrain innovation (risk of failure will remain high)
- Government needs to ensure flexible arrangements are consistent with any tax integrity arrangements put in place, i.e. does not lead to excessive tax leakage (though expected dollar value is low given it relates to products which generally failed to gain traction)

Any safe habour will still need appropriate consumer protections so that 'risky' retirement products are not used as the default.

Global observations & ideas:

- While not directly comparable, the UK Pension Protection Fund provides a back-up safety mechanism for members of Defined Benefit schemes which have failed and the U.S.A recently enacted a 401K trustee safe harbour if a lifetime product fails (as part of the SECURE Act)

Proposed policy prioritisation road-map:

B Industry: Remove inhibitors to retirement solutions

- **Create mechanisms to avoid legacy products**
- Review capital requirements for retirement products
- Develop a disclosure framework for consumers to easily compare features and fees between comparable retirement income products

Notes: For example, avoiding the 'Legacy Pension' issues with complying lifetime, market linked & life expectancy pensions

Policy requirement B.2: Review capital requirements for retirement products

Overview: Australia's current capital requirements are not necessarily well calibrated for retirement products, which is creating a barrier to supply of new / innovative retirement products, because certain product features, investment strategies and risk management approaches require special approval by APRA (as they are not catered for in the standard)

Current Status: No clear path to resolution

Priority: Soon

Action required:

APRA to review capital requirements and:

- Where it makes sense, develop codified/prescriptive approaches to address the range of risks likely from product features, investment strategies and risk management approaches likely to emerge from innovative retirement income products; and
- Where it does not make sense to develop a prescribed approach (noting it is possible that developing an approach for a product/risk that is unlikely to ever emerge), consider alternatives such as adopting a principles-based approach

Considerations to be aware of:

- Any review needs to consider both stand-alone and group risk solutions (e.g. within super funds)
- Recent product innovation from retirement providers has been slow, partly due to extended regulator engagement (and will constrain super fund trustee innovation to support ongoing implementation of the Retirement Income Covenant)

Global observations & ideas:

- Global capital requirements (e.g. under Solvency II) for life companies are better suited to retirement income products – for example, Solvency II applies a 40% lapse rate for longevity products, which seems more reasonable than Australia's 100% lapse rate assumption given the nature of retirement income longevity products (and the low propensity to lapse) [directly impacting the pricing Australian retirement providers can offer to consumers]
- Various countries offer a broader range of innovative products (e.g. UK, Netherlands, Chile, Canada with more variations and flexibility in annuity offers and better pricing for consumers) at least partly due to more flexibility in capital requirements

Proposed policy prioritisation road-map:

B Industry: Remove inhibitors to retirement solutions

- Create mechanisms to avoid legacy products
- **Review capital requirements for retirement products**
- Develop a disclosure framework for consumers to easily compare features and fees between comparable retirement income products

Policy requirement B.3: Develop a disclosure framework for consumers to easily compare features and fees between comparable retirement income products

Overview: Consumers find it difficult to know what and how to compare retirement products given the complexity of retirement (e.g. uncertain life expectancy, amount and sequence of investment returns, what they are paying and what they are paying for, potentially large late life care and health costs etc.) and to match products to their needs (reducing take-up of retirement product). While some enhancements have been made (eg DDO), there is still no consistency for consumers to understand this complex area (significantly more complex than accumulation phase)

Current Status: Yet to be addressed

Priority: Soon

Action required:

The industry needs to develop a framework to assess post-retirement phase needs of individuals and compare products that may be suitable; this framework needs to be flexible to be widely adopted.

In particular, the framework should allow assessment of:

- The extent any income for life is certain or variable (to be able to compare different levels of 'guarantee')
- Extent of inflation protection (and how much that matters over time)
- Flexibility to withdraw capital
- A consistent assessment of fees & costs (which recognises the additional costs in retirement associated with the provision of longevity protection in retirement products), so that fees are not a 'race to the bottom' but value for what consumers pay for
- Extent of (and positive and negative impact of) market exposure

Considerations to be aware of:

- The Design & Distribution (DDO) obligations, while useful, do not provide a consistent measure of assessment for consumers (as different providers will emphasise different elements of their solution to sell, instead of support consumers to understand variations and product options)
- Industry should revisit key investor characteristics ('principles based' in budget announcements regarding standardised metrics for retirement products) to identify which should be addressed and disclosed on retirement products (to address low level of financial literacy of retirees)
- Trade-offs are more complex within a decumulation environment, so the framework must adequately outline what investors should expect to give up with comparable fees/costs assessment (eg the government behavioural economic team proposals have not progressed)
- The cost to investors (whether explicitly and implicitly charged) and benefits must be closely aligned to allow investors to decide the benefit of providing a more comprehensive guarantee

Global observations & ideas:

- Most other OECD countries have a higher use of default retirement income arrangements (higher State pensions, higher use of annuities or insurance-based arrangements) such that private sector provision of retirement drawdown products is less required
- Australia is among global leaders in accumulation fee disclosure, but the extensive use of insurance-based systems around the world means there are limited opportunities to learn from global peers

Proposed policy prioritisation road-map:

B Industry: Remove inhibitors to retirement solutions

- Create mechanisms to avoid legacy products
- Review capital requirements for retirement products
- **Develop a disclosure framework for consumers to easily compare features and fees between comparable retirement income products**

Policy requirement C.1: Redesign pension means tests rules to encourage higher consumption of capital

Overview: The current age pension means tests is an outcome of historical aspects of Australian's retirement saving system (where most had no or limited savings), and while it has evolved, it has not been redesigned to capture the new SG arrangements (eg 2017 changes only marginally adjusted focus on households with limited super savings). As the super system continues to evolve, the role of the age pension (and the associated means tests, including eligibility for Commonwealth Seniors Health Care Card) need to evolve to encourage the consumption of retirement savings.

Current Status: Yet to be addressed

Priority: Soon

Action required:

To support reframing superannuation *(the retirement income system)* to be more focused on drawdown during retirement phase, social security rules need to be reviewed so that the shape of Age Pension eligibility encourages more consumption of superannuation funds.

This may include (among other things):

- Broadening applicability of Health Care card to more retirees (to reduce adjustments many retirees make to achieve accessibility of Health Care Card), to separate focus on Health Care card vs age pension
- Create a multi-generational view of how age pension eligibility will change over time, and shift focus of age pension on those who matter (and be less relevant to those who have reasonable retirement savings).
- Re-assess when retirees are eligible for the Age Pension, including re-assessing the income and assets test to support consumption of capital (eg lower assets balance to access, and recognise quicker decline in assets (within boundaries) to access government benefits).

Considerations to be aware of:

- These issues are very politically sensitive topics, and for the purposes of this report, we merely note that consideration of these issues is required as part of any post-retirement review, and do not make any observations about global best practice (other than noting that countries have very different approaches to these points, given different political positioning)
- There will be significant government financial implications.

Global observations & ideas:

Global approach to social security means testing varies from providing universal benefits to all (e.g. Norway), to only the most in need being provided with a basic retirement income, depending on historical and political positioning.

Proposed policy prioritisation road-map:

C Market Cohesiveness: Address interacting policy items

- **Redesign pension means tests rules to encourage higher consumption of capital**
- Remove disincentives to postpone retirement (for those who can and want to)
- Address the interaction of major (non-retirement) policy levers on retirement spending, including tax policies (especially inheritance & gifting), home equity release options, and aged, disability & health care

Policy requirement C.2: Remove disincentives to postpone retirement (for those who can and want to)

Overview: While we have an ageing population, people often retire fully as soon as they reach Age Pension entitlement age when they could otherwise continue working (and saving such that they could consume more during retirement), due to the way social security and part-time income and superannuation tax rules interact.

Current Status: Yet to be addressed

Priority: Later

Action required:

Incentives should be put in place to encourage an increase in those who work beyond retirement age (without disadvantaging those who can't and/or don't).

This may include (but not limited to):

- Improved social security treatment later in life where individuals are entitled to, but don't take government age pension on entitlement (e.g. a higher balance for the assets test)
- Reduced tax / tax offsets for older working individuals (or at least, reduced 'penalty' for working when receiving the Age Pension)
- Enhanced government co-contribution on post retirement contributions

Research needs to be undertaken to identify which incentives are valued and encourage behaviour change in those who can respond, and determine which are most likely to result in positive economic and individual benefits (without significant government expenditure)

Considerations to be aware of:

- Working longer is also likely to have broader positive economic impact through tax benefits and a reduction in social security payments
- Working longer is not for everyone (not everyone will be able to work up to, let alone beyond, age pension entitlement age), and some will work irrespective of incentives [as identified in Retirement Income Review]
- Caution is required to ensure any options are not overly complex

Global observations & ideas:

- Several jurisdictions encourage postponement of retirement through either increased pension payments when commencement is deferred (UK, Norway, Denmark) and/or by enabling people to continue working without penalising their retirement entitlements (New Zealand)

Proposed policy prioritisation road-map:

C Market Cohesiveness: Address interacting policy items

- Redesign pension means tests rules to encourage higher consumption of capital
- **Remove disincentives to postpone retirement (for those who can and want to)**
- Address the interaction of major (non-retirement) policy levers on retirement spending, including tax policies (especially inheritance & gifting), home equity release options, and aged, disability & health care

Policy requirement C.3: Address the interaction of major (non-retirement) policy levers on retirement spending behaviour, including tax policies, home equity release and aged, disability & health care

Overview: Retirement is not just about superannuation – there are other areas individuals also use to fund their retirement, including home equity, non-super investments (especially where people are encouraged to draw down money out of super environment); as well as considerations such as inheritance taxes and late life care costs

Current Status: Yet to be addressed

Priority: Later

Action required:

Retirement policy cannot be set without also:

- Reviewing options for home equity release (both by government and private providers)
- Considering the extent to which super should be used primarily for retirement consumption (and potentially reclaiming some of the tax savings where individuals / couples die with significant amounts of super remaining)
- Defining the role superannuation is expected to play in meeting late life costs (health / aged care), and creating a mechanism to educate and support that within Australia

Of course, these are all highly political areas (and for the purposes of this report, we merely highlight the need for the debate on these issues when considering post-retirement phase, and have not commented further).

Considerations to be aware of:

- Broader tax and social security considerations need to fairly address couples, not just individuals
- Historically, home equity release programmes have had limited success (commercially) and the government scheme is not widely known. Any review needs to identify options to improve the attractiveness of the government and/or commercial options (partly depending on government appetite)

Global observations & ideas:

Australia is one of few global jurisdictions that don't impose any form of inheritance tax (e.g. Denmark, UK) – however, given the highly politically sensitive nature of this topic (and its multiple objectives), for the purposes of this report, we merely note that consideration of these issues is required as part of any post-retirement review, and have not made any observations about global best practice.

Proposed policy prioritisation road-map:

C — Market Cohesiveness: Address interacting policy items

- ☒ Redesign pension means tests rules to encourage higher consumption of capital
- ☒ Remove disincentives to postpone retirement (for those who can and want to)
- ☒ **Address the interaction of major (non-retirement) policy levers on retirement spending, including tax policies (especially inheritance & gifting), home equity release options, and aged, disability & health care**

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- The analysis, observations and opinions set out in this Report are based on NMG's research into different global retirement income system, and NMG's proprietary information resources and consulting experience in Australia and international markets, and on a range of cited third-party sources.

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- This Report is not intended to draw specific conclusions on the industry today or on specific responses. The analysis and findings are complex and require detailed analysis and debate to be finalised. Instead, this report is intended to identify key areas of debate, relative priority and provide a road-map for policy makers to work through.

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