

Thought Pieces with The Conexus Institute

Retirement transition support that is safe by design

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Introduction¹

This paper introduces and explores a standardised tool that provides low-cost, tailored support services to people who are moving from accumulating (saving) to decumulating (deploying) their superannuation. We will refer to those people as ‘pre-retirees’.

The tool would be accessed through approved providers (initially, APRA-regulated entities and AFS-licensed financial advisers). The tool would standardise and streamline key elements of the retirement transition decision. Standardising these elements allows for the tool to be safely carved-out of many of the existing regulatory arrangements for ‘personal financial product advice’ that add to the cost and complexity of that advice.

This paper isn’t written as a hypothetical thought bubble. More than 250,000 Australians with superannuation accounts are retiring every year; most are receiving no targeted and reliable guidance on the level and security of their retirement income. Three decades into the compulsory superannuation system, choice support at retirement remains the missing piece of the jigsaw.

¹ Our thanks to the following people for very helpful comments and suggestions: Jeremy Cooper, David Knox, Deborah Ralston, Nicolette Rubinsztein and Xavier O’Halloran.

Individual firms in the superannuation and financial services ecosystem have not been able to produce it. We think a more ambitious solution is indicated.

The proposed tool is intended to be safe by design, rather than safe by regulation, reducing the cost and risk to approved providers in offering that targeted support at transition, and encouraging them to make it widely available to pre-retirees. It is intended to bridge the gap between generic self-service solutions and full personal financial product advice. It will not displace regulated financial product advice for those who value it. Instead it provides a cost-effective and scalable alternative for those who do not want or cannot readily access that option.

Throughout, we adopt a “90-for-90” philosophy: develop a process that can provide quality support (90% of the functionality of good full-service financial advice) which addresses the retirement transition choices faced by 90% of the relevant population.

We explore the case for greater retirement transition support, detail the proposal for the standardised tool, and then mention some limitations and barriers. While every idea brings associated negative impacts, we believe the positive benefits for pre-retirees and the economy outweigh the negatives. Our primary goal is to assist those currently retiring without support to navigate the transition to retirement with the confidence to consume appropriately. This in turn might narrow the retirement spending gap (between what could be safely spent and what is actually spent), delivering societal and economic benefits, identified in the [Retirement Income Review](#) (RIR). The proposal should not be viewed as excluding other solutions: instead we see it as providing the impetus for other (necessary) reforms to the delivery and regulation of financial advice more broadly.

Regulated financial advice is not delivering for most retirees

People who have accumulated savings in the superannuation system need support, as they approach retirement, in deciding how to manage the decumulation phase to optimise their household financial outcomes in retirement. For most people, this includes having a regular and reliably predictable income that lasts their whole life and having some accessible savings to meet unanticipated expenses. Housing security, future health and aged care needs and costs, family structure and commitments, the possibility of part-time work, tax, and social security are relevant considerations.

Pre-retirees need support because the system is complex. As the RIR observed, reducing complexity might reduce the need for support, but under current policy settings (which include no default option for decumulation) it cannot be eliminated. Expert support is important because the decisions about transition to retirement require technical knowledge and expertise that cannot realistically be met by ‘self-help’ solutions, generic guidance or improved financial literacy (although this is important too).

Meaningful support can only be provided having regard to the pre-retiree’s attributes and financial situation. Under existing legal and regulatory settings, this means support is usually classified as ‘personal financial product advice’, which carries with it complex regulatory requirements for providers. The prevailing view is that the regulatory requirements make (or substantially contribute to making) it too cumbersome or expensive, and too risky from a compliance perspective, to provide support in a form and at a price that is attractive to most pre-retirees. We do not necessarily subscribe to that view, but it is clear that the market is either unwilling or unable to provide widespread support under the existing settings.

If we cannot reduce the complexity of transition (for example, through strong defaults) to eliminate the need for support, then we need to look at ways to encourage and enable the provision of that support. We are interested in ways to reduce the cost, increase the supply and improve the consistency and reliability of the support available. We propose doing this through a standardised support tool that can be accessed through existing financial channels and that removes significant compliance risk and cost at the tool design stage.

The standardised tool would do four things:

- (1) Collect prescribed information about the individual or household (this is known as a ‘fact-find’);
- (2) Map the features of a defined universe of available financial products that might be suitable for people in retirement;
- (3) Algorithmically match the individual or household to suitable products; and
- (4) Produce a retirement plan for the individual or household.

These features of the tool are explained below. For the proposal to work, the tool would need to be – and be accepted as – adequate in its design to achieve a sound outcome for most pre-retirees, without the need for further regulatory controls.

Transition to retirement: the case for support

For most working households, wages fund consumption and the Superannuation Guarantee underpins savings for retirement. Australian’s longstanding affinity for home ownership represents an additional (tax-effective) savings mechanism which provides accommodation and a potential source of both accessible capital and retirement income.

Analysis presented in the RIR demonstrated that these arrangements, accompanied by the age pension, voluntary savings, and hypothetically efficient retirement solutions should, in theory, deliver (for most households) a level of retirement ‘income’² considered to be adequate.³ An important exception here is the case of single renters.

But pre-retirees face two challenges, and both are confronting. These challenges, and the aggregate impact are summarised in Figure 1.

The first challenge is the significant change to how household consumption is funded. During their working lives, employment has been the foundation of their livelihoods; now it is achieved through the management of financial assets, supported by the age pension. As a result, many households will experience a loss of control, uncertainty, and likely a degree of anxiety because, putting aside the age pension, those financial assets do not provide anything remotely like a retirement ‘pay cheque’.

The second challenge is the complexity of the retirement financial problem. Nobel laureate William Sharpe describes this as the *“nastiest, hardest problem in finance”*⁴. Complexity is

² Consumers, and to a degree, industry participants, have different interpretations of retirement ‘income’. We use the definition provided in the RIR: *“Income during retirement, including income streams and withdrawals from superannuation, the Age Pension, and drawdown of non-superannuation assets.”*

³ When it comes to ‘adequacy’, we again stay close to the RIR: that *“The system should ensure a minimum standard of living for retirees with limited financial means that is consistent with prevailing community standards”* and *“The system should facilitate people to reasonably maintain their standard of living in retirement.”*

⁴ *“Tackling the ‘nastiest, hardest problem in finance”* by Barry Ritholtz.

underpinned by two sources of uncertainty: we don't know how investments will perform nor how long we will live. Academics and other researchers have been exploring this problem for decades, using advanced modelling techniques beyond the grasp of non-specialists. Yet these solutions, for tractability reasons, are nearly always developed in a simplified setting that places aside practical yet important considerations.⁵

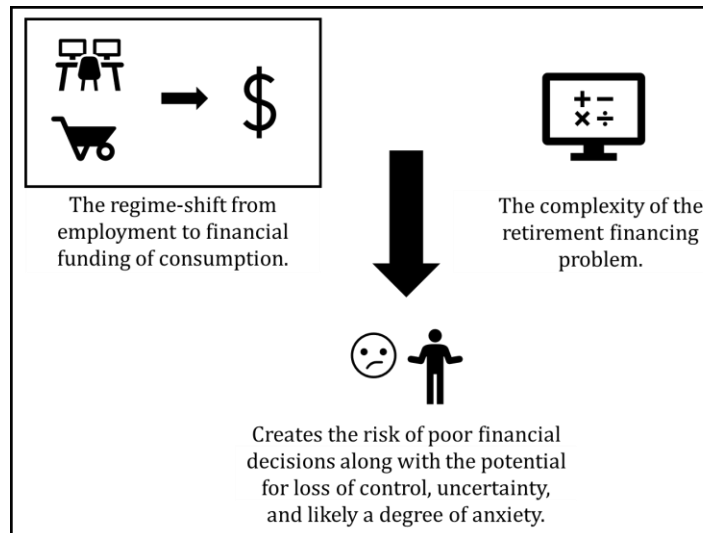


Figure 1: Challenges faced by households as they enter retirement.

The complexity of the problem exacerbates the concerns households might have when they retire. Households are exposed to a range of behavioural biases in retirement and a common outcome is that they spend too conservatively. The RIR summarised this finding:

“Retirees are generally reluctant to draw down their savings in retirement due to complexity, little guidance, reluctance to consume funds that are called ‘nest eggs’, concerns about possible future health and aged care costs, and concerns about outliving savings.”

Pre-retirees would benefit from competent and disinterested support to guide them away from poor retirement finances choices. It could engender a sense of control and provide reassurance as they face the confronting switch from wage-funded to asset-financed consumption and the associated complexities. If pre-retirees are provided quality retirement support, we believe they are likely to have greater confidence, experience less anxiety, and consume at a level appropriate to their financial situation.

High net worth households are well served by the existing private wealth management and financial planning sectors. Those retiring with no or very low superannuation balances who qualify for a full aged pension have different needs, including different support needs. We are looking for a scalable solution to current lack of support for pre-retirees in the middle.

⁵ Examples include Australia’s means-tested age pension, mortality modelling, large product menus, scenarios for healthcare and aged care problems.

The case for a tool that sits outside the existing regulatory framework

Existing regulatory requirements have impeded the development of an affordable and scalable mechanism of the kind we propose. This is because the actual and perceived legal risks associated with giving personal financial product advice are difficult for providers to manage outside a full-service advice relationship (and, arguably, within it too).

Personal financial product advice attracts a range of legal obligations. Some prescribe processes or mandate disclosure; others require the provider to meet open-textured standards such as 'efficient, honest and fair' (s 912A) or 'best interests' and 'reasonable investigation' (s 961B). Providers see these as expensive and difficult to comply with.

Solutions that are usually proposed as a means of improving the accessibility of personal financial product advice – expanded intra-fund advice, fintech enabled digital advice, or 'scaled' advice – have not successfully addressed this problem so far. Each is inhibited by a combination of legal, regulatory, behavioural and operational factors.

Often, industry-led proposals for reform of the financial advice laws focus on reducing regulation as a means of reducing cost and making financial advice more accessible. We agree that there is an urgent need to revisit the current financial services laws, which are poorly constructed, often obscure, overly particularised and prescriptive, and lacking in normative force. However, winding back consumer protections is no solution if the need for those protections remains. The standardised tool is intended to reduce the need for those protections by reducing the opportunities for a provider to adversely impact the process through which the support is provided. Personal financial product advice is highly regulated because it creates agency-type risks for clients – including that the adviser is not adequately skilled or operates under a business model that places other interests ahead of the clients' interests.

Regulation is one way of addressing these risks. However, if these risks can be addressed in a different way – by baking the protections into the design of the tool itself – the need for regulation reduces. It might also send an important price signal to the market. By standardising the client fact-find, the reasonable investigations into available products, and the matching of client attributes to product choices – and treating all three standardised elements as adequate by design – the need to regulate for those elements (and for expensive compliance – and a compliance risk premium – to be built into the cost of the service by the provider) is removed.

The financial services industry has traditionally eschewed standardisation as part of a 'we are different' or 'we are better' value proposition. The mass market simply cannot afford this level of re-inventing the wheel.

The standardised tool would not be able to accommodate individual preferences in the same way as personal financial product advice. This is a necessary trade-off. Instead, at the product matching stage, it would make assumptions about what the person's preferences might be based on the information collected in the fact-find. Also, it would not cover all possible financial products (for example, it would exclude wholesale products and products for which retirees are not in the target market under the product's target market determination (TMD)).

The elements of the standardised tool will determine whether it can be made 'safe by design'. Relevant considerations include those detailed in Table 1.

Client fact-find	Can collecting all (and only) the same information about all users be a sound basis for making a recommendation on which an individual or household can confidently act?
Product mapping	Can the universe of products to be mapped be determined, and a sensible basis for mapping them be devised, so that the mapping is a sound basis for understanding and comparing products? Should mapping be at the product class level, or the individual product level?
Product matching	Can product matching be systematised and soundly achieved? Should matching be to a product class or an individual product?
Retirement plan	Can the retirement plan be easily explained and readily implemented?

Table 1: Considerations for a standardised retirement transition support tool.

The discussion below considers two options for setting the universe of products to be mapped (and, therefore, matched) by the tool. We refer to these as the ‘universal model’ and the ‘tied model’. Under the universal model, the tool would map and match to all retail financial products that include retirees in their TMD. Under the tied model, the tool would map and match only to the retail financial products that include retirees in their TMD and that are offered or selected by the approved provider through which the person accesses the tool.

The tied model makes implementation significantly easier but exposes the pre-retiree to the significant risk that they will choose an approved provider whose products are not the best or best value in the relevant class. In the tied model (whereby only the approved service provider’s products⁶ are considered), the conflict exists and is acknowledged – the client knows that by selecting their approved provider they are selecting that provider’s product suite as the default implementation option. As has been said on many occasions, if you go to a Toyota dealer, you know that you are going to be offered a Toyota. This conflict is explicitly acknowledged and drawn to the client’s attention at the beginning of the process; there is no pretence that the provider is independent or disinterested or that they have brokered the whole market.

This conflicts risk could be addressed in three ways. First, by specifying that an approved provider can only use the tool if they have (or have access to) an appropriate product suite that meets the three objectives detailed in the Retirement Income Covenant.⁷ Second, by specifying that, if the tool indicates that the client is not in the target market for the products in the approved provider’s suite, the provider cannot proceed to implementation. Third, by providing a simple facility through which the client can compare matched products with others in the relevant class before agreeing to the approved provider proceeding to implementation.

⁶ For example, a superannuation fund’s retirement product offerings or those products which sit on a financial adviser’s approved product list.

⁷ The [Retirement Income Covenant Exposure Draft](#): *“The retirement income covenant will require trustees to have a strategy to assist beneficiaries to achieve and balance three objectives: maximizing their expected retirement income; managing expected risks to the sustainability and stability of their expected retirement income; and having flexible access to expected funds during retirement.”*

A high-level overview of retirement transition support framework

In Figure 2, we provide an overview of the retirement transition support tool. We explore important elements in further detail.

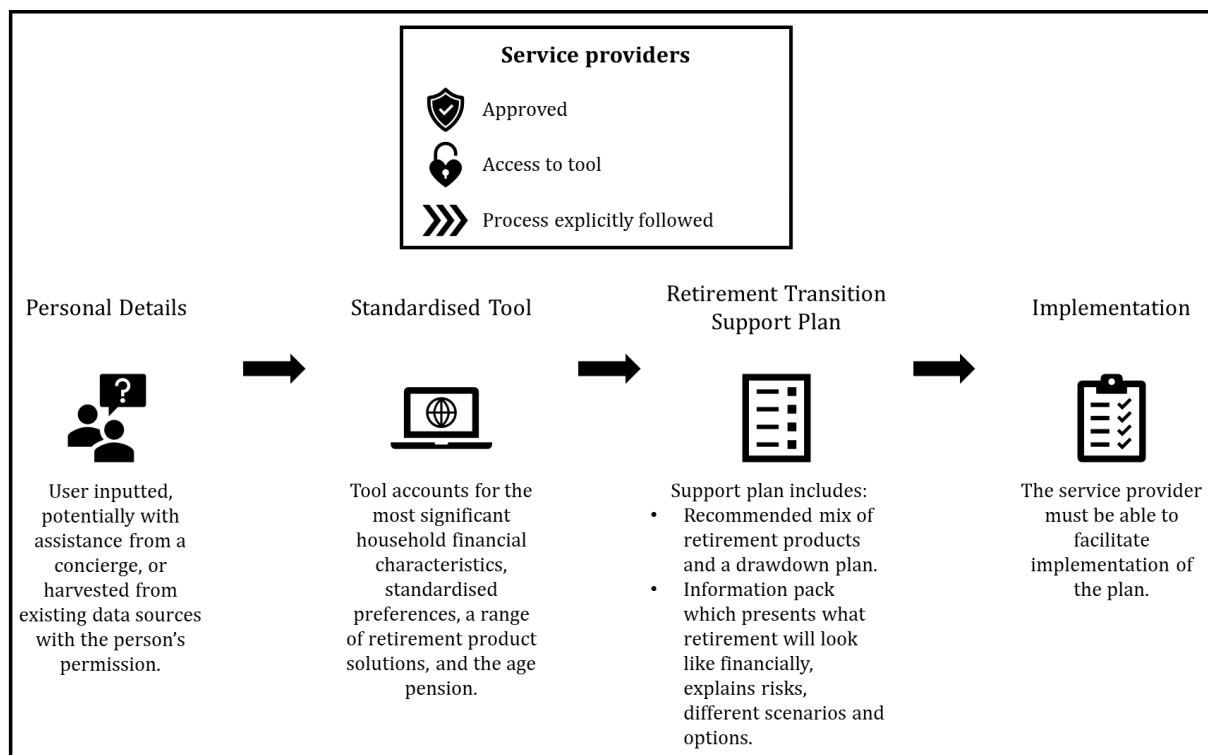


Figure 2: Overview of retirement transition support framework. An example of a recommendation: X% in an account-based pension populated with a balanced option and the following drawdown schedule (...), (100%-X%) allocated to an indexed life annuity.

Accessing the tool

Access to the tool would be through approved providers. Initially, this would comprise APRA-regulated entities⁸ and AFS licensees that are authorised to provide personal financial product advice. There might be merit in expanding this in future to a more open model which could include groups such as accountants, lawyers, and tax agents. It could even be a service provided by employers. However, we do not see it as a 'self-service' or 'self-directed' option.

Timing / frequency of provision

The tool is intended to assist people looking to transition from accumulation to decumulation.

⁸ We acknowledge that this model also has application for non-APRA-regulated superannuation funds (e.g. public sector funds).

Standardised tool

The tool would:

- (1) Collect relevant information relating to their attributes and financial situation;
- (2) Map the features of a defined universe of available financial products that might be suitable for people in retirement;
- (3) Identify suitable products and the optimal allocation of funds between them; and
- (4) Develop a retirement transition support plan. This would consist of two components: (1) a retirement plan; and (2) supporting information which explains the client's retirement finances in appropriate detail (with boilerplate information and financial literacy support provided centrally).

While the plan would account for the household situation, the issue of whether the plan is developed for a single person or a couple requires further consideration. Ideally, the plan should be developed on a household basis, noting that it might involve staged implementation if members of the household retire at different times or choose to use different approved providers.

At the outset, the tool would be designed to deliver a high-quality retirement transition support plan which would be relevant to the retirement situations faced by most of the population. Accordingly, it is intended, by design, to be less detailed than a comprehensive financial plan, and less able to accommodate individual preferences (as distinct from needs).

There are many possible models for the design, development, ongoing maintenance, and governance of the retirement transition support tool. Co-design between industry and government would have the advantage of buy-in for the delivery of retirement transition support in this form.

Information in the initial fact-find might be user inputted, potentially with assistance from a concierge, or harvested from existing data sources with the person's permission. In particular, the tool should be able to access information from the person's superannuation fund, nominated bank or other financial institution, the ATO, and Services Australia, to build an accurate picture of their financial position and household situation. Data collected remain in the standardised tool, allowing for simple updates through time. Approved providers would not be allowed to use or store retiree data in their systems.

The standardised tool would account information relating to the household situation and associated finances. A minimum requirement is to have sufficient information to determine age pension eligibility. The retirement transition support tool would not consider personal 'preferences'. Personal preferences are difficult to accurately discern, are affected by behavioural biases, and are unstable. In this respect, the standardised tool would assume a set of standardised preferences. Nor would it exhaustively model different scenarios.

The retirement transition support plan and underlying model algorithm would be based upon a clearly stated objective, for example, to maximise the level of household retirement income having regard to:

- Likelihood: ensuring a defined degree of income likelihood (confidence interval) through life regardless of how long the user lives or plausible market events.
- Flexibility: providing a level of flexible access to capital.

The tool would account for the means-tested age pension.

Additional comments:

- Bequests: the tool would not account for bequests beyond a reversionary beneficiary. However, it would detail the expected bequest profile through time as part of the information support package.
- Home equity release: the plan is for home equity release to not be considered as a primary source of retirement income (this is the approach adopted in RIR modelling). It would be incorporated into any information relating to a capital access scenario and bequest estimates.

The retirement transition support plan would contain information around expected and possible scenarios that the household might experience during retirement. Scenarios could relate to financial events, such as a market shock, or life events, such as the need for aged care. The design of this component, both the assessment undertaken and the framing of communicated information, is intended to establish credibility in the plan provided and instil confidence. A desirable outcome is that retirees would feel confident to implement the retirement transition support plan and consume according to the plan.

Alternative models

It is important that a retirement transition support plan can be implemented, otherwise it is just a hypothetical exercise. Each implementation hurdle, particularly the identification of appropriate products, represents negative inertia. Richard Thaler and Shlomo Benartzi⁹ demonstrate, through their pioneering Save More Tomorrow program, that creating inertia towards appropriate financial decisions has positive household and societal impacts.

However, here we focus on the micro challenge of individual households. While we consider techniques such as auto-enrolment and pre-commitment as ill-suited tools when it comes to implementation, we are cognisant of creating negative inertia. The more activity-based hurdles to clear, the less likely people will be to implement. How do we balance off the implementation challenge against the complexity challenge, which represents the unique, often complex, products that might be difficult to model?

A retirement plan will likely consist of one or two retirement products: (1) an account-based pension, accompanied by an investment strategy and a tailored drawdown schedule; and (2) a product that provides some dedicated longevity protection. This aligns with how funds are likely to respond to the direction provided by the Retirement Income Covenant, whereby we expect most funds will offer a modular product range.

With this background in mind, we consider two possible implementation models.

Model 1: Universal Model

Under this approach, detailed in Figure 3, a standardised tool accounting for all retirement product types (each in a standardised form) is applied. The tool maps and matches to product types, rather than individual products. Therefore, to facilitate implementation, the approved provider would need to identify and approve appropriate retirement products to populate the product types in the retirement transition support plan as a separate step. One potential outcome is that the universal model might inform product design, which might not be desirable (as the

⁹ [“Save More Tomorrow™: Using Behavioral Economics to Increase Employee Saving”](#), Richard H. Thaler and Shlomo Benartzi, *Journal of Political Economy*, Vol. 112, No. S1, February 2004.

modelling, by design, has its own limitations). Under this model, the implementation pathway is burdensome and might prove costly.

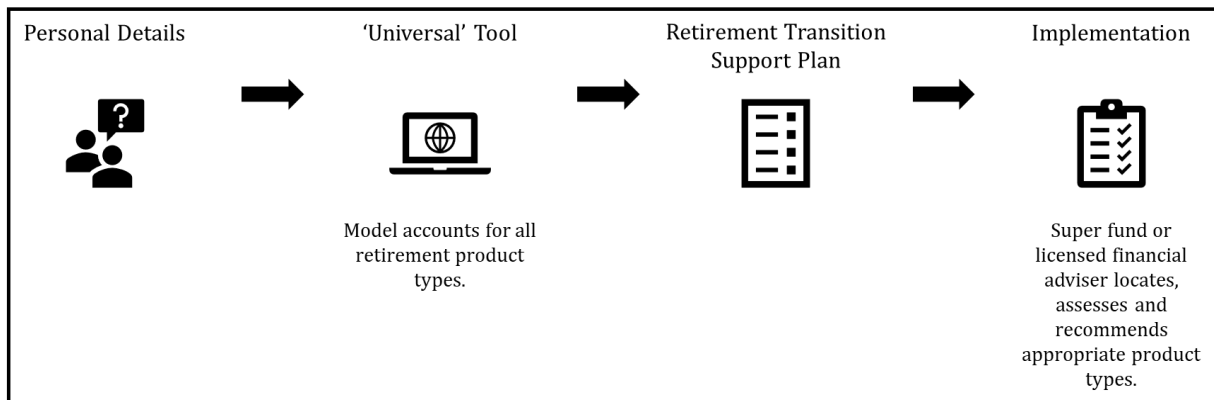


Figure 3: A universal approach to the retirement transition support process.

Model 2: Tied Model

The tied version of the model, detailed in Figure 4, accounts only for the retirement products that the approved provider can readily implement. This would mean that the products would be offered or sourced by the approved provider. The conflicts risk created under this model would need to be managed (at the design stage) in the ways explained above. The risk of a retiree selecting, as their provider, an approved provider who offers poor quality or expensive products (as distinct from unsuitable or overly risky products) cannot be eliminated within the model. These risks would have to be managed (as they are now) through existing regulation for financial product sales (PDS disclosure, design and distribution obligations) transparency and market forces, with the option of greater ‘member outcomes’-type regulation at the product level in future if it is needed.

The retirement support plan developed under the tied model would be straight-forward to implement.

Overall, we incline towards the tied model as having the greater net benefit once we adjust for the identified risks. Under our “90-for-90” guiding lens, we consider the trade-off between reduced optimality of the plan (which sits alongside other sources of ‘slippage’) against the ease, cost, and ultimately greater implementation of plans, to be acceptable. The risk of ending up with a poor-quality product as a result of choosing the wrong approved provider is the same as for a client who chooses a financial adviser with a poorly constructed approved product list. It is not ideal, but the question of whether any form of advice or support can guarantee the ‘best’ product selection is broader than this.

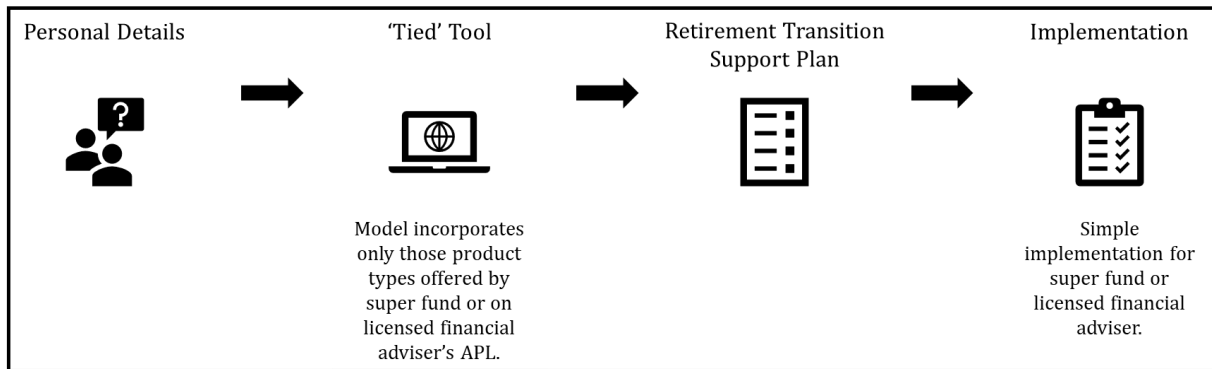


Figure 2: A tied approach to the retirement transition support process.

Self-critique and areas for further work

In this paper, we introduce the idea of a standardised retirement transition support tool, that is cheaper and simpler to provide because it adopts standard processes and requires less intensive regulation than existing forms of personal financial product advice. Further research is required and there are many issues to work through, including:

- (1) The ability to develop a “90-for-90” process into a tool, and the major areas of slippage relative to a benchmark-quality comprehensive advice process. Is 90-for-90 achievable?
- (2) Assessment of how retirement transition support would impact existing advice and guidance activities;
- (3) Data ownership and use;
- (4) Further consideration of universal and tied models; and
- (5) Formalise the economic case for government to explore this idea further. Here, we are confident in the economic merits of this idea. For instance, modelling in the RIR showed that if retirees drew down their savings at more appropriate levels, the resulting increased levels of consumption equated to a 2.5% uplift in the SG rate applying current drawdown behaviour. We expect the economic impact of increased consumption which would result from the support and confidence provided by this solution to be significant.

Closing comments

Every year, more than 250,000 Australians retire, and most of these retirees will receive very little assistance when it comes to their retirement finances. Under the existing legal and regulatory conditions for advice and guidance, it is difficult to see how the present situation will improve significantly. Something needs to change.

This paper introduces and explores the concept of a standardised tool, accessible through approved providers, to provide low-cost retirement transition support services. The proposed tool is made safe by design, rather than safe by regulation. Throughout we adopt a “90-for-90” philosophy: develop a process that can provide quality support (90% of the functionality of personal financial advice), which addresses the retirement situation faced by 90% of the population.

To our initial assessment the positives of the idea far outweigh the negatives.

Please consider the idea and share your thoughts.