Draft – comments welcome

Pathways for directing members into retirement solutions

Who decides - fund trustee, adviser or member?

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Introduction

We explore the pathways through which members could find their way to a retirement solution that is suitable for their individual needs. Our organising structure is based around which of three parties hold the primary responsibility for identifying the solution – a fund trustee, a financial adviser or the member themselves. Exhibit 1 (see over) outlines five potential pathways, summarising the nature of each pathway, the member type for which it is most suitable, whether it is facilitated under the current system configuration, and key issues that arise under each pathway. The body of this report expands further on each pathway including discussing strengths and opportunities, weaknesses and challenges, and what needs to happen for each pathway to operate effectively. Our aim is to provide a useful reference document to help inform the development of the framework for delivery of retirement solutions in Australia.

Two opening comments are in order. First, the various pathways sit along a spectrum with blurry boundaries and scope for overlap. For instance, trustees might provide a digital tool into which member can input their personal details and explore the potential outcomes arising from various retirement solutions. Under the taxonomy used here, this would be categorised under self-direction on the basis that the member is making the final choice based on the advice and information provided. But clearly there is a thin line between self-direction and trustee direction to the extent that the output might be viewed as a form of recommendation. Second, we interchange between the terms 'member', 'retiree', 'individual', 'client' and 'consumer' depending on the context.

Exhibit 1: Overview of Pathways to a suitable retirement solution

Pathway	**Self-direction**	**Adviser direction**	**Trustee direction**		
	Member choice	Personal financial advice	Trustee recommendation	Trustee assignment	Default
Nature	Member chooses solution, drawing on decision support services	Member is directed to a solution by a financial planner through: (a) limited advice, or (b) comprehensive advice	Trustee recommends a solution to member, who then opts-in or opts-out	Member requests trustee to assign them to a solution	Trustee defaults member into a (probably basic) retirement solution
Member type most suited for	Members who want to choose for themselves	Members with desire for a personalised recommendation and are willing to pay	Members looking for direction, but: • Do not want to seek a financial adviser • Not well-prepared to choose for themselves		Highly disengaged members who take no action
Currently facilitated?	Yes	Yes, but under review	Possibly? • Trustees wary of breaching advice rules • Might be facilitated by infra-fund advice?	No	No
Key issues	• Literacy, behavioural and cognitive limits • Complexity of decisions and products • Decision support needs development	• Trade-off between complexity and cost • Capacity of financial advisers is constrained	• Reliance on funds to be able to offer range of solutions suitable for all members • Trustees need to be able to readily access and use personal information for pathway to operate effectively • Members may place reliance on trustees, limiting access to independent perspectives and competitive tension		• Satisfying conditions for default to occur • Risk of assigning members to unsuitable solutions in absence of any engagement

The next section sets the background for this report by highlighting some key concepts and issues that impact on how we frame the discussion. The section that then follows provides a brief overview of the main challenges that the superannuation industry at large faces in developing retirement income strategies. The subsequent sections discuss each pathway in-depth. An appendix provides some thoughts on the possible role of technology looking forward.

Key concepts and issues

Defining retirement income strategies and retirement solutions

What constitutes a 'retirement income strategy' (RIS) and a 'retirement solution' needs to be clearly established for context. We interpret a RIS as a holistic strategy that trustees put in place to assist their members to achieve their retirement goals. The Retirement Income Covenant (RIC) requires fund trustees to develop RIS that balance three objectives that might be summarised as (a) maximising expected income, (b) managing income risk and (c) providing flexible access to funds. The RIC also envisages that trustees provide guidance and support to members. RIS might thus be seen as comprising two components: a set of retirement solutions that address the three objectives, and mechanisms to assist members in identifying a solution that is suitable for their needs[1].

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[1] Bell and Warren (2022) for a discussion.

Retirement solutions are the process by which the assets of a retired member are deployed to deliver an income stream. To do so requires an integrated strategy to invest the member's assets and then generate income though drawdowns. Retirement solutions may draw on various investments and products to form up the investment strategy. However, they also need to contain a plan for how to draw from any flexibly accessible funds to shape up the desired income stream. Retirement solutions are not a single product, but a strategy for delivering income to members.

This report addresses the mechanisms by which members may find their way to a solution that is suitable for their needs. In discussion the pathways under trustee direction, we are largely addressing the guidance and support component of RIS. The adviser direction and self-direction pathways round out the range of mechanisms by considering financial advice and self-choice.

Framework for accommodating trustee direction is an outstanding matter

While both the adviser direction and self-direction pathways are accommodated within the current system configuration, a clear framework does not currently exist for how fund trustees could direct members to a retirement solution in a way that is scalable, efficient and low-cost. Specifically, there is a lack of clarity over how fund trustees could effectively marry up members with suitable solutions without providing personal financial advice, which then requires a statement of advice (SOA) and related compliance processes and gives rise to regulatory and liability risk. This situation sits against the background where superannuation funds are currently developing RIS to meet their obligations under the RIC. Trustees are under an obligation to assist members to identify a suitable retirement solution, but have limited clarity around what they are able and expected to do to meet this component of their RIS offerings.

For the trustee recommendation and trustee assignment pathways to operate in an effective and scalable way, it is necessary that trustees are not overly inhibited in the collection and use of the personal information that is required to assign members to cohorts and identify the solution that suits their needs. Personal information that can be influential for designing and identifying suitable solutions are relatively broad, and often extends to information that most fund trustees do not currently possess. For instance, the form of a suitable retirement solution can be significantly impacted by member attributes such as partnered status, financial assets outside of super, homeownership and the type of income stream and flexible access to funds that they desire. Trustees need to be able to access and use this type of member information with only minimal constraints for these pathways to operate efficiently.

The Government's response[2] to the Quality of Advice Review (QAR) and subsequent statements point towards an intent to accommodate the capacity of superannuation fund trustees to provide more guidance to members around retirement matters, with mention of using intra-fund advice as the vehicle. How this might operate is quite unclear, especially given that the rules around intra-fund advice are currently framed around charging mechanisms. The Government is currently conducting further consultation around financial advice. Whether and how the advice rules might be adjusted to accommodate the trustee direction pathways yet remains to be seen.

Attention has also shifted to whether some form of default mechanism would be helpful for retirees. For instance, the ability to default or assign members appeared to be raised by Paul Schroder of AustralianSuper at an ASIC conference in November 2022[3]. Consumer protection provides a motivation for establishing the capacity for trustees to assign members to a solution without prior

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[2] Delivering Better Financial Outcomes - detailed overview (treasury.gov.au).

[3] The Sydney Morning Herald quotes Schroder as saying: *"policymakers should turn their minds to how members could be moved automatically into products that paid an income, without the need to pay for financial advice*", see https://www.smh.com.au/business/banking-and-finance/australiansuper-floats-radically-different-model-for-retiree-income-20221103-p5bvdz.html.

assent. Substantial assets are invested in accumulation accounts by members of retirement age[4] that could be as a consequence of high disengagement, inertia or confusion, leading to these members potentially missing out on income and incurring unnecessary tax. Of course, retirement defaults have been discussed many times, including important contributions in the Super System 'Cooper' Review (Australian Government, 2010), the Financial System 'Murray' Inquiry (Commonwealth of Australia, 2014) and the linked consultation on 'comprehensive income products for retirement' (CIPRs, see Commonwealth of Australia, 2016).

Defaults are discussed in this report under trustee direction as a form of 'backstop' that caters for highly disengaged members, rather than as a primary mechanism for directing members to solutions. Note that we mainly address the mechanism by which members might be assigned to a default solution, and only briefly comment on the design of those default solutions.

All pathways have a role to play

We make no recommendation on preferred pathways. Indeed, we see each pathway as having a role to play. One reason is that members differ in how they prefer to engage with retirement decisions. Some members are willing to take and pay for financial advice; some prefer to choose for themselves; while others are looking towards their superannuation fund to assist or direct them to a solution. Some may even do nothing due to total disengagement or confusion. Exhibit 2 provides a sense of the diversity in how members want to engage with choosing a retirement solution by presenting results from a survey conducted by Frontier Advisors[5]. While a limited sample, the responses nevertheless suggest that something in the order of 70% of members might prefer a type of trustee directed pathway.

Exhibit 2: Frontier Advisers member survey

When I retire I would like my fund to...	
Assist me to choose a suitable retirement income solution for me	50%
Recommend a retirement income solution for me	21%
Leave it to me to choose a suitable retirement income solution for me	20%
Refer me to a financial adviser to advise me (for a fee) on a suitable retirement income solution for me	9%

Source: Frontier Advisers, "Understanding member retirement needs", The Frontier Line, Issue 191, April 2022

A further reason to make a range of pathways available is that some members may be better off in particular pathways. As discussed above, trustee direction appears to be a missing link as a means of catering for members who will not seek financial advice and might make a poor or no decision if required to choose for themselves.

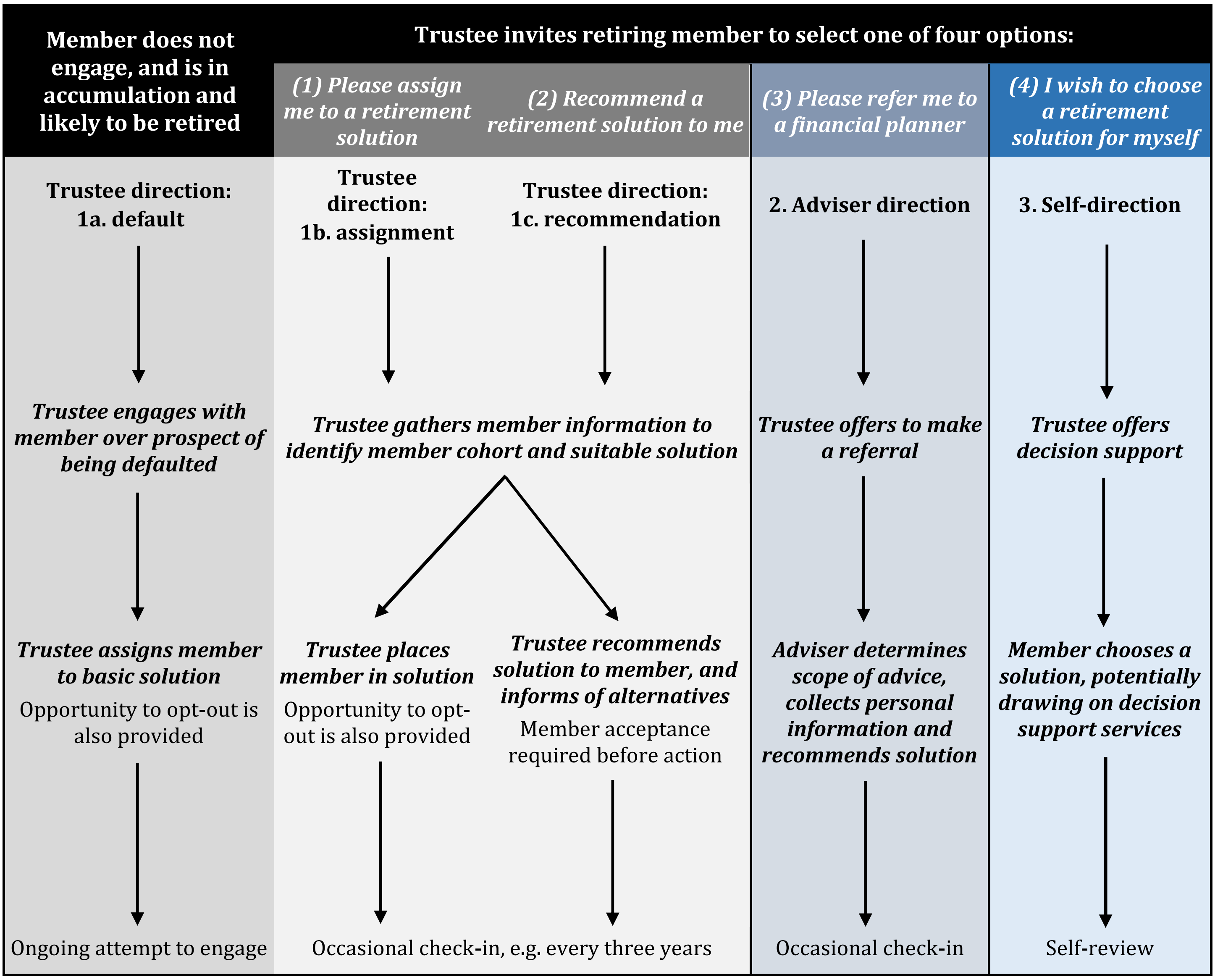
Our aim in this report is to help inform how the superannuation industry might be configured to accommodate the range of modes for making retirement decisions that members may prefer or could benefit from. See Bell and Warren (2021) for further discussion on the rationale for making a range of pathways available.

[4] Using data from the APRA *Annual Superannuation Bulletin* (tables 7c and 8a), we estimate that members aged 65 and over had $226 billion related to 1.37 million accounts in the accumulation phase at June 2022.
[5] Frontier surveyed 3,500 members that were nearing retirement from five profit-for-member funds.

Establishing the member's preferred pathway

Initial engagement by superannuation fund trustees with members at retirement could act as a gateway to triage members towards their preferred pathway. The triaging process might be implemented by trustees by putting four options to the member: (1) request that the trustee assigns them to a solution, (2) ask the trustee to recommend a solution; (3) indicate a willingness to take financial advice, or (4) state an intention of choosing for themselves. Exhibit 3 below sets out how member engagement might be structured from the fund trustee perspective. The process envisages initial engagement to discover the member's preferences, collection of personal information from the member and follow-up engagement over time. The default pathway shown at the left would apply to members who do not respond to engagement, and are identified by the trustee as an accumulation member who is highly likely to be retired.

Exhibit 3: How trustee engagement with retiring members might operate



The retirement income challenge

Developing retirement income solutions and matching members to suitable solutions is a (the?) major challenge currently facing the superannuation industry. Designing and selecting retirement solutions requires addressing a complex multi-dimensional problem. Solutions need to allocate assets across investments and other products that can be quite complex (e.g. lifetime income streams), and determine how to draw down on those assets to generate income. All this occurs under the conditions of high uncertainty over both investment returns and how long the member might live, as well as the possibility that member circumstances and market conditions change over time. Many retirees do not have the capacity to solve this problem without assistance. Further, substantial differences exist in member needs and capability to engage with retirement decisions. The multiple challenges for industry are to address the technicalities of both solution design as well as member engagement and communications. Additionally, the policy, legal and regulatory framework will likely evolve as the focus on retirement increases. Finally, fund operating models will need to be reconfigured to deliver retirement solutions to members with differing needs.

A number of significant challenges have to be overcome. Six of the biggest challenges are discussed below and summarised in Exhibit 4 over the page. The task of developing pathways through which members are matched to suitable solutions – the topic of this report – runs into all six challenges.

Challenge #1: **Catering for significant differences in retiree needs and wants** – Retirees differ in meaningful ways, i.e. heterogeneity abounds. Attributes that can make a significant difference to the solution that a retiree requires include: age, balance, financial assets outside of superannuation, homeownership, partnered status, and preferences over the type of income stream desired and flexible access to funds. Members also differ in how they want to engage with retirement decisions, i.e. which pathway they prefer. The superannuation system should ideally cater for all these differences. Doing so requires the capability to design *and* deliver a wide range of solutions, supported by various mechanism to enable the matching process.

Current situation: While the adviser direction and self-direction pathways provide avenues for addressing member differences, three major hurdles remain. First the industry is yet to develop a set of products or solutions that can cater for all member needs (see challenge #2). Second, superannuation funds only have limited information about their members. Third, not all modes by which members might prefer to identify a suitable retirement solution are catered for. As mentioned, the trustee direction pathways that we discuss are currently unavailable.

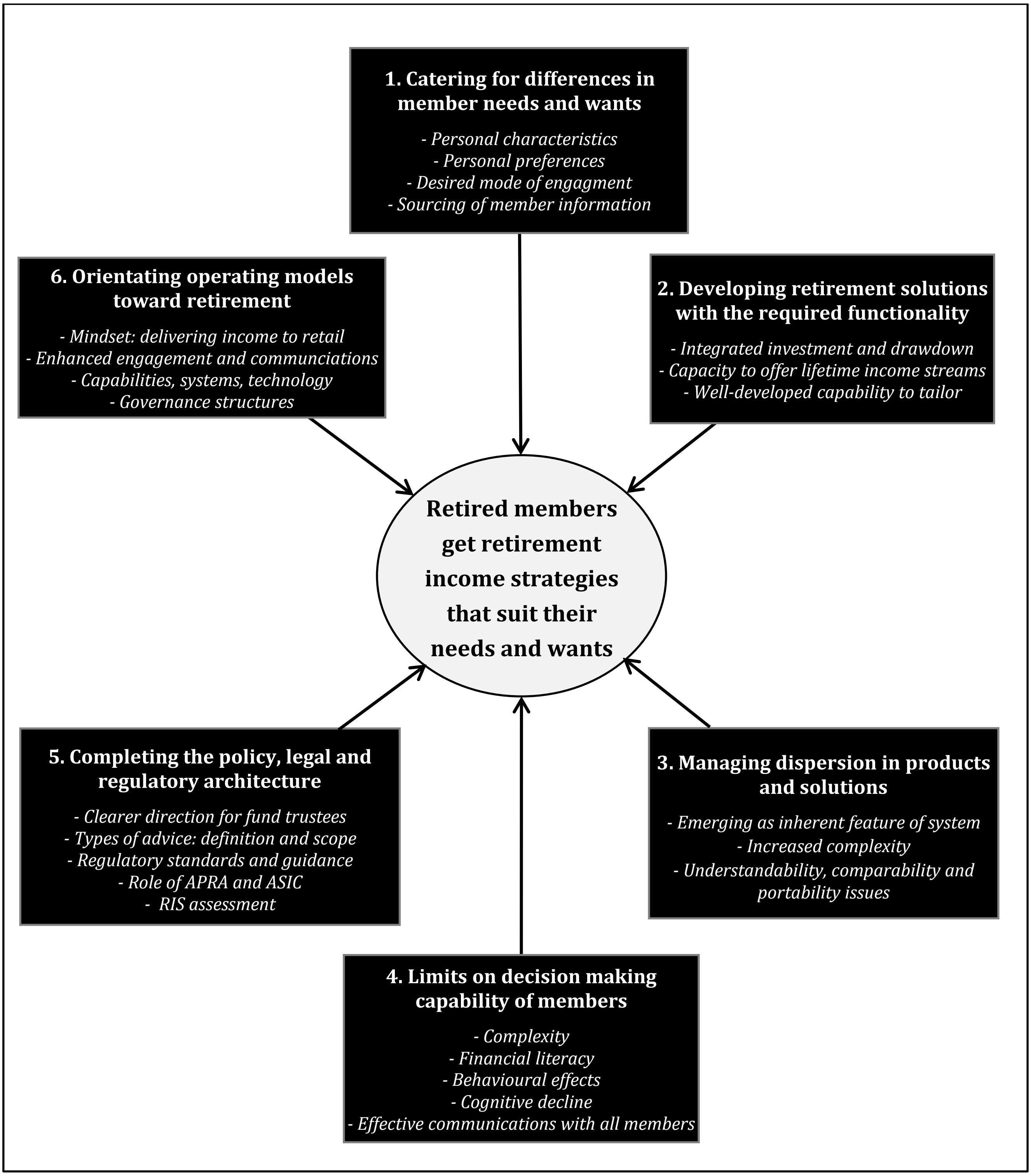
Challenge #2: **Developing retirement solutions with the required functionality** – It is a substantial challenge to deliver retirement solutions involving an integrated investment and drawdown strategy that cater for wide differences in member needs and wants in an effective way. Doing so requires accounting for the Age Pension, offering lifetime income streams for members who need them, and forming well-developed cohorts (or implementing individual tailoring). Solutions should address various risks, the two most notable being uncertainty over investment returns and time of death. There should ideally be the capacity to respond to changes in member circumstances or market conditions over time. This complexity is recognised in the classic quote by Nobel prize winner Bill Sharpe describing retirement as “the nastiest, hardest problem in finance”.

Current situation: The industry has a long way to go. Focus has tended to be placed on products that could form up the investment strategy. Development of products to help address longevity risk is nascent[6]. Drawdown strategies require far more attention from the industry. Solution design does not yet take into account all the member differences that matter[7], let alone the ability to respond to changes.

[6] At the time of writing, providers of publicly available lifetime income products include Allianz Retire+, AMP North, Australian Retirement Trust (QSuper), Challenger and Generation Life. The TAL offering is not directly available in the market to members, but can also assist funds to develop their offering. There may be other providers of which we are unaware.

[7] For example, funds are typically unable to determine a member’s eligibility for the Age Pension as they lack visibility on assets outside of superannuation or partnered status.

Exhibit 4: Six challenges for the development of retirement income strategies



Challenge #3: **Managing the dispersion of products and solutions** – Dispersion in retirement products and solutions is emerging as a feature of the Australian retirement system. Examples include a wide range of design features for lifetime income streams, and development of solutions that differ in key ways such as the type of income stream delivered and member attributes taken into account. High dispersion in products and solutions increases complexity, and creates challenges around understandability, comparability and portability. Dispersion makes it harder for members to identify a suitable retirement solution; for financial advisers to offer well-informed advice on the range of offerings in the market; and for external reviewers such as research houses and regulators to compare and assess those offerings. The risk of legacy products is also increased.

Current situation: Diversity is being encouraged by the principles-based RIC and the regulatory framework as it currently stands. There are currently no measures in place to mitigate the spread, and little assistance available to help understand and compare products and solutions.

***Challenge #4:* Limits on the decision-making capacity of some members** – Many members have limited capacity to make informed choices around managing finances during retirement. Hurdles include the complexity of retirement decisions and solutions, low financial literacy[8], various behavioural influences[9] and cognitive decline with age. Limited decision-making capacity is most relevant where members are being required to choose in some way. It is hence most poignant under the self-direction pathway, where members need to select from a range of products or solutions and can be required to determine their own drawdown strategy. In these cases, members may be exposed to anchoring and framing biases (e.g. following minimum drawdown rules), or follow uninformed recommendations from friends, family or social media.[10] Addressing the limits on decision-making capacity requires effective engagement and communication approaches or techniques to overcome behavioural or cognitive issues such as nudges (see Thaler and Sunstein, 2003, 2009).

Current situation: The superannuation industry seems well aware of this challenge and is working towards addressing it. However, it currently sits within a learning and development phase.

***Challenge #5:* Completing the policy, legal and regulatory architecture** – The policy, legal and regulatory framework around retirement needs to be formed up. Areas that need attention include: (a) finalising the rules around financial advice, including how the new regime will apply to superannuation funds; (b) clearer direction on what fund trustees can and should be doing to deliver retirement solutions under the principles-based RIC; (c) how RIS fit within regulatory requirements such as member outcomes assessments, the design and distribution obligations (DDO) and the anti-hawking rules; (d) clarifying the role of APRA and ASIC, including whether RIS require separate standards and guidance; and (e) how RIS will be assessed[11].

Current situation: While the RIC and QAR process are positive initial steps, the outstanding matters listed above still require a substantial amount of work that will probably take some years. In the meanwhile, we are hearing comments from the industry that uncertainty over policy is currently contributing to the slow pace of RIS development.

***Challenge #6:* Orientating operating models to deliver retirement solutions** – Many superannuation funds are still early in their journey of developing RIS in response to the RIC, as highlighted by the joint APRA and ASIC thematic review into the Implementation of the RIC[12]. Four issues worth highlighting include: (a) shifting the mindset from accumulation where balance is the focus and products are provided on a wholesale level, towards delivering income streams to retired individuals with differing needs and wants; (b) taking member engagement to a new level to address the more 'retail' and complex nature of retirement; (c) enhancing capabilities, systems and technology to deliver retirement solutions to members with differing needs; and, (d) adjusting business priorities and governance structures to elevate retirement in importance.

Current situation: The industry has a way to go in adjusting their operating models to progress efforts in the retirement space. Moves to develop RIS and the appointment of a retirement head by many superannuation funds is a good start.

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[8] For example, see Agnew, Bateman and Thorp (2013).
[9] Authors that discuss behavioural effects in a retirement savings context include Mitchell and Utkus (2006) and Benartzi and Thaler (2007).
[10] Hirshleifer (2020) discusses social transmission bias.
[11] Bell and Warren (2022) and Bell, Khemka and Warren (2023) discuss how RIS assessment might be done.
[12] See Information report - Implementation of the retirement income covenant: Findings from the joint APRA and ASIC thematic review | APRA.

Pathway 1: Trustee direction – default, assignment, recommendation

Trustee direction encapsulates three pathways: default, assignment and recommendation. The common trait across these pathways is that fund trustee identify then direct members towards a retirement solution. Trustees are thus matching members to solutions, rather than offering a menu of retirement options and decision support services while leaving members to either identify their own solution or combine options and impose a drawdown strategy to shape up the income stream. We first discuss the default pathway. We then address assignment and recommendation together in recognition of the considerable overlap in the process that underpin these two pathways. Key differences between these two pathways are the manner in which members receive the direction from the trustee, and potentially the legal and regulatory mechanisms that are required.

1a: Default

The default pathway entails a superannuation fund assigning a member to a retirement solution without their explicit assent. While the vast majority of members will be willing to use other pathways as discussed in this report, the question arises whether a mechanism should also exist for defaulting a member who has retired but has taken no action due to being highly disengaged. This group could be a substantial. As noted previously, $226 billion and 1.37 million member accounts in the accumulation phase for members of age 65 and over at June 2022.[13] While there is a range of factors potentially at play[14], it is likely that this group contains a significant number of retirees that are inadvertently remaining in accumulation and could be better off if their balance was transferred into a retirement account.

Under the default pathway, fund trustees are playing the dual role of fiduciary and solution provider while dealing with largely disengaged members that will be highly reliant on trustee actions. It is hence necessary that compulsory defaulting into retirement phase is handled with care with strong member protections in place. Three hurdles need to be overcome:

a) **Confirming it is appropriate to default the member into a retirement solution** – At a minimum this entails establishing that the member is highly likely to have retired[15]. It is also desirable to confirm if possible that the member is not remaining in accumulation for a genuine reason or personal choice, and is willing to be defaulted into a retirement solution.

b) **Overcoming operational challenges** – Certain personal details are required for a pension account to operate, including a 100-point identity check to create the account and bank account details to facilitate income payments.

c) **Managing the risk of defaulting members into unsuitable solutions** – Defaulting a member into an inappropriate solution could do more harm than good. A plan to minimise potential harm from the default is required.

Exactly how the default mechanism would operate is an open question. One issue is whether trustees should be given the *capacity or obligation* to default members under certain conditions. An obligation to default would seem in accordance with the member protection motivation for establishing a default mechanism. However, an element of trustee discretion rather than

[13] This estimate arises by comparing Tables 7c and 8a in the APRA Annual Superannuation Bulletin, 2022.
[14] Explanations include: accounts over the $1.9 million cap; members still working beyond 65, or expecting to temporality unemployed; deliberate decisions to retain the funds in retirement to avoid drawdown; and failure to take action to switch into the pension phase due to lack of knowledge or apathy.
[15] Being over a certain age while not contributing to superannuation may provide an initial flag. However, it does not provide reliable evidence of retirement as some members could be earning an income and contributing to another fund, or may not be contributing due to being temporarily unemployed.

compulsion may be valuable, to give trustees the opportunity to consider whether defaulting is appropriate in light of the three hurdles listed above. Another issue is whether there should be a single default solution or a small set of default solutions. The single default solution would deliver simplicity by providing a basic, generic solution designed to improve member outcomes (relative to an accumulation account) that is easy to administer and understand. However, a small set of default solutions could accommodate a limited degree of tailoring, e.g. by balance.

Exhibit 5 provides a sense for how trustees defaulting members into a retirement solution might work. It sketches a possible process whereby fund trustees identify members who have retired but remain in accumulation, attempt to engage, and then default the member upon no response and the satisfaction of certain conditions. Exhibit 5 assumes that the three hurdles listed above can be successfully addressed; and highlight mechanisms that are not currently available in grey italics.

Exhibit 5

Possible process for defaulting members into a retirement solution

1. ***Superannuation fund trustee establishes that a member is still in accumulation but likely to have retired***
   - Possibility of retirement might be indicated by a combination of attaining an age at which retirement is a high probability (e.g. over age 60, age 65, etc) and contributions have ceased.
   - Trustee seeks confirmation from the Australian Tax Office (ATO) that the member is no longer receiving regular income and has a total superannuation balance in accumulation accounts that sits below the transfer balance cap ($1.9 million at present). *(Ideally: not currently available.)*
   - Additional confirmation could be sought from Services Australia on whether the member is receiving the Age Pension where they are age 67 or over. *(Ideally: not currently available.)*
2. ***Trustee makes initial attempts to engage with the member***
   - Initial engagement might follow the format of Exhibit 3, with the aim of soliciting a response on how the member would like to approach transferring their accumulation balance into a retirement solution.
   - The member would also be informed as part of the initial engagement that they may be assigned to a default retirement solution if there is no response and certain conditions are met.
   - An initial opportunity to opt-out of the entire process is offered at this stage. In the event of opt-out, default is not contemplated and the trustee takes no further action.
3. ***Trustee identifies a suitable retirement solution if there is no response***

   The solution to which the member is to be assigned might be identified under the following principles:
   - Assignment is made at trustee's discretion. *(Currently there is no provision for this type of trustee discretion.)*
   - Members should be defaulted into a retirement solution that minimises potential harm, and maximises the flexibility to adjust if the member happens to engage in future.
4. ***Trustee engages with member over the default process***
   - Member is informed of the intent to assign them to a default retirement solution.
   - A second opportunity to opt out is provided.
   - Operational information collected to give effect to the assignment, i.e. bank account details and 100-point identity check. *(Issue arises of what happens if not provided by member.)*
5. ***Member is assigned and informed*** *(Legal mechanism would need to be made available.)*
   - Assignment is made subject to required conditions being met, e.g. operational requirements being satisfied; trustee is sufficiently confident that the member is eligible and would benefit from default.
   - Member is informed that assignment to a default retirement solution has occurred.
6. ***Ongoing attempts to engage***
   - Occasional communications (say every 2-3 years) are sent to the member to check that they are satisfied with the default arrangement, and to invite them to enter into further engagement if they wish.

Strengths and opportunities

The primary strength of a default mechanism is that it would provide consumer protection to retired members who take no action due to being either highly disengaged, suffering from very low financial literacy or may be unaware or confused. Such members might also appreciate a pathway to a retirement solution that does not require making decisions or taking any significant action, apart from perhaps providing operational details. The advantages for such highly disengaged members is that it ensures that their superannuation savings are converted into retirement income, while avoiding unnecessarily incurring tax on investment earnings. It avoids welfare losses that would accumulate the longer that their balance remains in accumulation.

Weaknesses and challenges

The main issues with the default pathway stem from placing trustees in the position of deciding on behalf of members who may be disengaged. In particular, some of the operational challenges appear difficult to overcome without input from the member themselves. This challenges the feasibility of establishing a default pathway that is primarily intended for highly disengaged members.

- **Ensuring that defaulting is appropriate** – It may be challenging to establish that the member is eligible to transfer their balance into the retirement phase and that doing so is not contrary to their wishes. This requires confirming that the member has actually retired, and that the failure to transfer funds out of accumulation is not occurring for reasons such as: being over the $1.9 million transfer cap; the member being employed but contributing to another fund; being temporarily unemployed[16]; or personal preference. Attempts should thus be made to engage with the member to check that they are willing to be defaulted and offer an opt-out. There is no guarantee that such engagement will succeed if the member is highly disengaged.

- **Multiple operational challenges impact auto-enrolment** – Requirement for a 100-point identity check and bank account details currently restricts the automatic creation of retirement accounts without some member engagement. Solutions to these problems may be needed for the default pathway to successfully service highly disengaged members. Auto-enrolment also reaches into taxation policy by switching members from tax-paying to tax-free accounts.

- **Risk of assigning members to inappropriate solutions** – The risk of assigning members to inappropriate solutions is compounded in the case of highly disengaged members that trustees may know little about. The challenge may be partly met through offering the ability to opt-out at the initial instance, and then defaulting members into a basic retirement solution that minimises the potential for harm and makes it easy for members to switch out at a later date. (Design of such solutions is discussed below.)

- **Defaulted members entirely reliant on trustees** – Defaulted members are placing their reliance in trustees to operate in their best interests and provide effective solutions at a reasonable cost. The member is thus exposed to the risk that the trustee does a poor job, and/or will be relying on regulatory protections.

- **Might entrench disengagement** – Offering defaults could encourage some members to just rely on their fund and take no interest in the way their retirement savings are being deployed.

- **Competition constrained** – Defaults imply no choice and hence an absence of competitive tension. However, these effects should be marginal given that defaulted members are likely to be in a small minority and highly disengaged, and thus unlikely to drive competition in any event.

[16] Both the member and their fund would incur cost to re-open an accumulation account. These potential costs make it inappropriate to default members experiencing what could be temporary unemployment.

Required for the default pathway to operate effectively

We first consider how the three hurdles identified earlier could be addressed. We then discuss the legislation that may be needed to enable the default pathway and provide member protections.

Confirming that default is appropriate

Two main requirements to be eligible for default into a retirement solution include being retired and not exceeding the transfer cap (currently $1.9 million). As mentioned, trustees should be able to identify accumulation members that *could* be in retirement through a combination of age and the ceasing of contributions. However, this evidence is insufficient as they might have an account with another fund to which they are contributing or takes them over the transfer cap. One way around the problem of accounts with multiple funds might be for the Government to facilitate an ability for the trustee to confirm that the member is not over the transfer cap or contributing to another fund (e.g. via the ATO), which could be done without divulging personal information. This avenue might be investigated if the default pathway is to be accommodated.

Establishing whether the member has personal reasons for remaining in accumulation, including being temporarily unemployed, can only be resolved with confidence through engaging with the member. This cements the importance of requiring trustees to offer ample opportunity to opt-out to minimise the possibility of defaulting members against their desires.

Operational challenges

The operational challenges regarding bank account details and identity checks seem difficult to overcome in the absence of member engagement, unless the Government makes alternative means available to trustees to gather the required member information. Ways that this could be facilitated might also be investigated if the default pathway is to be accommodated. In the absence of trustees being able to overcome the operational hurdles for members who do not engage, the effectiveness of the default pathway would be diminished significantly as it would then fail to accommodate highly disengaged members who might benefit the most.

Managing the risk of inappropriate defaults

The adverse impact of assigning members to inappropriate solutions can be partly managed through providing members with an opportunity to opt-out. However, this should not be relied upon in a pathway that is intended for disengaged members. It is hence also important that defaults are designed to minimise the potential for harm, and make it easy for the members to switch out if the member becomes engaged. This suggests that defaults should be basic in nature. Basic defaults might spurn lifetime income streams in order to facilitate full flexibility to adjust. They should avoid delivering towards income targets that make implicit assumptions about the member's income needs. A basic default retirement solution might invest in an account-based pension, with drawdowns based on either the minimum drawdown rules or age-based drawdown rates aimed at delivering a higher yet affordable income stream.

Legislation

Legislation would be required to both enable trustees to default members and provide member protections. Some preliminary suggestions appear below.

- **Legislative safe harbour** – This could be granted to trustees subject to establishing that conditions for default are met and that any trustee obligations are satisfied (see below).
- **Conditions for default** – The trustee will be required to establish that the member meets the conditions to be defaulted. This might include that the member is invested in an accumulation

account; is highly likely to be retired; and has not responded to attempts by the trustee to engage over their intention relating to choosing a retirement solution. Finally, conditions might be imposed for the minimum age and balance[17] at which default may occur.

- **Trustee obligations** – Trustee obligations would be aimed at protecting members. A central issue is whether an obligation should be placed on trustees to attempt to ascertain if a member meets the conditions for default, and then default them if this is found to be the case. Regardless of whether the default pathway is established as a capacity or an obligation to default members, the following obligations might be imposed
  - undertake due diligence to establish that the member is eligible to transfer their balance into a retirement account
  - engage with the member over their intentions regarding selecting a retirement solution
  - inform the member of the intent to default them into a solution, and offer an opt-out
  - minimise potential harm in assigning the member to a retirement solution.

Exhibit 6: Overview of the default pathway

Nature of pathway	• Fund trustee assigns member to a solution without assent
Trustee's role	• Acts as both fiduciary and solution provider • Establishes that member is eligible for default • Attempts to engage with member, both pre- and post-assignment • Selects solution for member and then makes assignment
Member's role	• Fails to engage with super fund despite entering retirement • Given opportunity to opt-out • Provide operational information re bank account and identity check
Strengths and opportunities	• Accommodates and protects highly disengaged members by providing a pathway to a basic retirement solution that avoids paying unnecessary tax
Weaknesses and challenges	• Ensuring that defaulting is appropriate • Operational challenges, i.e. bank account details, identity checks • Risk of assigning members to inappropriate solutions • Defaulted members entirely reliant on trustees • Might entrench disengagement • Competition constrained (marginal)
Required for the pathway to operate effectively	• Capacity of trustees to determine that member is eligible to transfer their balance into a retirement account - Assistance from ATO and Service Australia desirable • Resolve the operational barriers to auto-enrolment • Mechanisms to manage risk of assigning members to inappropriate defaults – opt-outs; basic default solutions • Legislation enabling defaults and providing member protections - Legislative safe harbour - Conditions for default - Trustee obligations

[17] This recognises that there will be little benefit to be gained for transferring small balances. Further, many retirees may prefer to take smaller balances as a lump sum than convert them into an income stream.

Pathway 1b and 1c: Assignment and recommendation

We discuss the trustee assignment and trustee recommendation together that the trustee process for identifying a suitable solution for the member would be equivalent under both pathways. It is envisaged that both pathways would be triggered at the request of the member, thus involving an element of member choice. The member would ideally assist the trustee by volunteering personal information. The two pathways operate as follows:

> **1b. Assignment** – Fund trustees assign the member to a retirement solution at their request. The assignment pathway might be considered the equivalent of a tailored defaulting process that occurs with the permission of the member. An opportunity to opt-out would be provided. Fund trustees play the role of both a fiduciary and the solution provider.
>
> **1c. Recommendation** – Fund trustees recommend a retirement solution to the member, which they decide whether to accept or reject. This pathway amounts to a form of financial advice, and might also be considered a soft default or a nudge. It aligns with the original concept for CIPRs as raised by the Murray Review (Commonwealth of Australia, 2014). Trustees play the role of offering personal financial advice while acting as the solution provider.

If the member does not accept the direction provided by trustees, they would either shift to an alternative pathway of either self-direction or adviser direction, or perhaps decide to switch to another superannuation fund. The recommendation pathway in particular should be accompanied by trustees offering decision support services to the member in terms of information on the recommended solution, information on alternative solutions in case the member sees the proposed solution as unsuitable, and various tools to assist the decisions such as basic retirement modelling. These support services could also be made available under the assignment pathway.

There are two key points of distinction between the trustee assignment and trustee recommendation pathways. First is how the direction is received by members, i.e. deciding whether to accept an assignment versus giving consideration to a recommendation that is either accepted or rejected. The second distinction is that different legal mechanisms may be required to facilitate each pathway, with assignment akin to a type of defaulting process and recommendation in the nature of financial advice. Legislative requirements are discussed further below.

Strengths and opportunities

A capacity for fund trustees to make either an assignment or recommendation offers a variety of potential benefits, as listed and discussed below.

- **Catering for diverse members in a scalable way** – Trustee direction offers the opportunity to assist members with diverse needs in a scalable way. To grasp this opportunity, trustees will need to develop a range of retirement solutions that cater for important member differences along with efficient mechanisms to identify member needs and hence direct members to a suitable solution. Well-developed systems and processes would aid success.
- **Provides direction to members who might otherwise miss out** – An overarching opportunity is the potential to offer retirement guidance to a substantial group of members who might have otherwise not received any direction. In particular, the trustee direction pathway should assist members who are unwilling to pay for personal financial advice and do not wish to choose a retirement solution for themselves. Arguably direct involvement by superannuation funds is the only practical way of improving outcomes for this type of member, many of whom are currently using account-based pensions and often adopt simplistic solutions such as anchoring on the minimum drawdown rules and may invest in an overly defensive manner.

- **Caters to decision preferences of a member sub-group** – Some retirees might *prefer* that trustees direct them to a retirement solution. Many members will view their fund as a natural place to seek direction on how to manage their financial affairs in retirement. This is very clear from the survey results reported by Frontier (see Exhibit 2) indicating that over 70% of members are looking to their fund to assist them in some way. Findings from various studies[18] suggest that a substantial portion of members trust their fund; and that many members embrace defaults because this trust coincides with lack of self-confidence to make financial decisions rather than due to disengagement. Such retirees might welcome the opportunity to receive guidance from their fund, rather than choose for themselves or seek out and pay for financial advice. This might be particularly the case for members with very low financial literacy, who probably just want someone to tell them what to do.

- **Overcoming behavioural and cognitive limitations through nudges** – Trustee direction provides scope for introducing nudges[19] into the decision process that could lead to better outcomes for retirees[20]. Both the Murray Inquiry (Commonwealth of Australia, 2014) and the Productivity Commission (Commonwealth of Australia, 2018) explicitly suggested putting recommendations to retiring members for this reason. Two choices made by many retirees that limits the value extracted from their retirement savings include lack of willingness to draw down on savings to the extent affordable and minimal take-up of lifetime income products (i.e. longevity insurance)[21]. In addition, some retirees arguably invest too conservatively[22]. Trustee direction can assist to overcome these hurdles by offering members a solution that embeds a mix of higher drawdowns, growth asset exposure and longevity insurance as appropriate. Even if done on an opt-out basis, many members will nevertheless anchor on the proposed solution as a baseline. The notion that many members trust their fund (see prior dot point) enhances the likelihood that members will accept guidance from their fund.

- **Member protections in place** – Fund trustees are subject to a wide range of legal and other obligations to act in both the collective and individual best interests of members.

  Trustees operate under fiduciary duties under common law and the best financial interest obligation under the SIS Act. This is backed up by regulations such as requirements to adhere to regulatory standards and guidance including conducting member outcome assessments[23]. While these obligations offer no guarantee that fund trustees will always act in the best interests of members, they provide a clear incentive to do so. Protections are also afforded to members through the regulatory oversight activities of APRA and ASIC.

  If trustees were to provide personal financial advice under the trustee recommendation pathway they are subject to the same obligations as other providers of personal financial advice. These include a best interest duty to the member, obligation for the advice to be appropriate, the obligation to prioritise the member's interests, and the conflicted remuneration provisions.

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[18] See Bateman et al. (2014), Butt et al. (2018) and Deetlefs et al. (2019).
[19] See Thaler and Sunstein (2009).
[20] Nudges might also be included in automated forms of advice. However, nudges under trustee direction might have more force due to a pre-existing relationship with the member (see next dot point).
[21] These tendencies are documented in the Retirement Income Review (Commonwealth of Australia, 2020).
[22] Commonwealth of Australia (2020, p516) assumes in their modelling that growth asset exposure declines from 74% in accumulation to 58% in retirement with reference to observed behaviour. Butt, Khemka and Warren (2022) show that retirees would be better off with high growth asset weights (typically 100%) and combining this will longevity insurance through annuities for defensive exposure.
[23] The standards and guidance are currently general, but may be extended in due course to apply specifically to RIS. APRA has stated that they have plans to revise *SPS 515 Strategic Planning and Member Outcomes* to include fundamental aspects related to retirement, see https://theconexusinstitute.org.au/wp-content/uploads/2023/08/Retirement-Conference-2023-Review-Reflections.pdf.

- **Scope for better connection between accumulation and decumulation** – A flaw of the current system is that different regulatory frameworks are applied in accumulation and decumulation, which acts to disrupt planning over the entire life-cycle. Fund guidance may help reduce this disconnect by placing funds in a better position to address whole-of-life strategies with members.

- **Supports trustees to fulfil their RIC obligations** – The RIC requires trustees to "provide assistance" to members in meeting their retirement needs. Meeting this obligation would be achieved more effectively if funds were positioned to explicitly guide members towards specific solutions, rather than just playing the role of a provider that offers a menu of options accompanied by decision support services such as information, tools and general advice.

Weaknesses and challenges

The main weaknesses of trustee assignment and recommendation pathways relate to risks arising from the lack of independence and absence of competitive tension when members place their trust in their fund to guide them to a solution that the fund itself supplies. This issue is often referred to as 'vertical integration', which the Hayne Royal Commission *(*Commonwealth of Australia, 2019) highlighted as a source of problems in the financial advice sphere[24]. There are also challenges related to the incentive and capacity of superannuation funds to supply a range of solutions that adequately cater for differing member needs.

- **Lack of independence** – Trustees directing members to a solution that they themselves offer places funds in the position of providing both the guidance and the underlying products that comprise the solution. The risk is that allowing superannuation funds to occupy such a position could dull or even negate the incentive to pursue the best interests of members[25]. Funds may recommend their own products even if they happen to be unsuitable for the member, creating a risk that some members could be left worst off than they might otherwise be.

- **Competition constrained** – Members who rely on their fund by accepting trustee direction on retirement solutions may be less likely to consider the products or solutions offered by other providers. Further, members could also become effectively 'locked-in' to the products offered by their fund for various reasons, including trust, inertia, difficulty of searching for alternative products available in the market and cognitive decline with age. Lifetime income products also tend to entail barriers to exit, both technically through limits on access to capital or exit costs,[26] and through the influence of product complexity[27]. Any lack of competitive discipline would reduce the incentive for fund trustees to improve their solutions. A further concern is that the mechanisms for shifting members out of 'underperforming' funds may be dulled under trustee direction relative to the adviser direction and self-direction pathways.

- **Reliance on funds to implement effectively and remain member-aligned** – Placing members in the position of relying on trustees raises the importance of funds implementing effectively and

[24] While the Hayne Royal Commission highlighted the dangers of vertical integration with respect to advice, care needs to be taken in extrapolating this experience across the entire superannuation industry, in particular to not-for-profit funds that lack a direct profit motive.
[25] For instance, to the extent that the industry is focused on collecting assets and members, this can act as an incentive to pursue asset and member retention and growth even where not to the benefit of members.
[26] We reviewed the existing longevity products and found that all provide some degree of access to capital, although this is typically limited to either the nominal residual value not paid out as income until the age of life expectancy and/or a death benefit that can be paid earlier in retirement. Only one product provides full access to capital, and one only provides a death benefit. Exit where available incurs costs. In addition to transaction costs, more importantly exit sacrifices the longevity insurance that the member has implicitly been paying for. It is worth noting that access to capital also reduces the income that is paid out.
[27] High dispersion and complexity in design is emerging in lifetime income products, which increases the effort involved in switching from one to another even if it is possible to do so.

remaining focused on member benefit. One concern is that funds may be incentivised to offer generic or commoditised solutions, rather than innovative and tailored solutions[28] that better meet diverse member needs. Offering a handful of basic solutions or products is easier and cheaper than catering for more granular cohorts or tailoring to individual retirees. Tailoring requires leading-edge processes and systems for building highly functional solutions, collecting member information and engaging with members. Comfort that most members may accept the retirement solution that they are offered may also encourage ongoing inertia. Another concern is that some funds may struggle to build the capacity to offer retirement solutions and guidance to the required standard. This may be particularly the case for smaller funds that have less resources to dedicate to developing their RIS. Another hurdle may be delivering effective, scalable advice and guidance given the complexity of retirement, and possibly also limitations imposed by the rules around financial advice[29].

Required for the assignment and recommendation pathways to operate effectively

For the assignment and recommendation pathways to operate effectively, adjustments need to be made to operating models for superannuation funds and the legislative and regulatory architecture.

Fund operations

Fund operations need to be configured so that trustees can understand member needs and wants and then deliver solutions with the functionality to cater for key member differences in a scalable way. The main components are listed and discussed below.

- **Ability to engage with members to establish intentions** – Exhibit 3 (see page 5) sets out how the member engagement process might operate including under the trustee assignment and recommendation pathways. To summarise, once trustees establish that a member wishes to transfer their balance into a retirement solution with the fund, they need to ascertain whether the member would like to use either the assignment or recommendation pathways. They will then need to collect member information (discussed next), and communicate the solution that is identified. At this point, members that request being assigned to a solution might be given the opportunity to opt-out; while those asking for a recommendation might be asked if they accept or reject the solution while being informed of alternative solutions that are available if they are not satisfied[30]. There could also be occasional check-ins to gauge if anything has changed that might lead to an alternative solution being more appropriate. Funds would need to reconfigure their operating models for this engagement process to occur. The rules and regulations would also need to be set to enable the process (discussed below).

- **Ability to collect, use and manage personal member information** – Having established that the member prefers either an assignment or a recommendation, the trustee would need to obtain and use personal information to effectively direct a member to a suitable solution. As noted in discussion of challenge #1 (see Exhibit 4), funds should ideally be considering certain key member attributes *at a minimum* in order to span important member differences including age, total financial assets including funds outside of superannuation, homeownership, partner status, and preferences relating to both income and access to capital. Failure to access member information on any of these attributes could result in directing members to a solution that is quite unsuitable. Again, funds need to configure their operating models to support the collection, effective use and governance of personal member information. Two possible sources include:

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[28] This extends to a diminished incentive to dynamically adjust the solution offered to members as their circumstances change.
[29] For instance, extending infra-fund advice to accommodate the fund-directed pathway will be challenging.
[30] See Warren (2022) for a suggestion of how a recommendation could be made accompanied by highlighting the existence of alternatives.

a) ***Ask the member*** – This seems the most straightforward approach. The request for information could be accompanied by pointing out to the member that the information will significantly improve the ability to identify a suitable solution for them, as well as assurances over data security. At the very least, some input from the member is required if their preferences over income and access to capital are to be gauged.

b) ***External sources*** – Some information could be sourced from publicly available databases or external providers (e.g. banks), probably with member permission. Alternatively, the government might consider providing an avenue for funds to access member data from sources such as the ATO or Services Australia. However, this could be controversial.

- **Solutions with functionality to cater for significant member differences** – The importance of superannuation funds being able to offer solutions that can cater for significant member differences was discussed earlier as challenge #2 (see Exhibit 4). To do so requires having access to a range of investment or product building blocks including lifetime income streams, the capability to craft different drawdown strategies in accordance with member preferences, and ideally an ability to adjust solutions in response to changed circumstances. It also requires sophisticated processes for either forming cohorts or individual tailoring, and systems to support both solution design and delivery. Funds need to build out these capabilities.

Legislation and regulations

Substantial changes will probably be required to the legislative and regulatory architecture to enable the trustee assignment and/or trustee recommendation pathways. Strong member protections are essential, especially under the assignment pathway, in light of the earlier arguments that effective competition will be hard to foster and the likelihood that many members may end up relying on fund trustees and commit to the solution that they are provided. Some areas where major changes are required are listed and discussed below.

- **Remove barriers to trustees seeking personal information and then using it to assign members or recommend a retirement solution** – Major hurdles are the current laws around personal financial advice and the anti-hawking provisions. While the extent to which these actually prevent funds from taking action is debatable, their very existence and some uncertainty over the legal interpretation of these provisions act as a barrier. One solution might be to explicitly exempt superannuation funds from these rules when engaging with their members over retirement solutions. In any event, it would be useful to define the scope of what personal information trustees can collect and how it may be used. Consideration might also be given to ways in which useful information on members that is held by the ATO and Services Australia could be made available to superannuation funds while honouring confidentiality[31].

- **The trustee assignment pathway would need to be created** – Similar to the default pathway, there is currently no legal mechanism through which a trustee could assign a member to a solution. Legislation would be required to permit trustees to assign members to a solution upon certain conditions being satisfied, in particular that the member has requested the trustee assign them to a retirement solution as well as certain trustee obligations (see below). Legislative safe harbour might be granted to trustees subject to the conditions being satisfied.

- **Facilitate trustee recommendation as a form of advice –** The trustee recommendation pathway might be positioned as a specific type of personal financial advice. Here the aim should be to facilitate trustees to collect member information and use it to identify and recommend a suitable solution in a way that is efficient and scalable and provides a clear legal mandate. The

[31] Possibilities might include these agencies making personal data available to fund trustees at the member's request, or providing some information in general form, such as flagging whether a particular member has multiple superannuation fund accounts, receives the Age Pension in part or full, or has a spouse.

Government could set out to facilitate the recommendation pathway through its final response to the QAR; and has suggested that intra-fund advice frameworks could be expanded to deliver retirement advice to members[32]. While potentially feasible, intra-fund advice is configured as a collective charging mechanism and will require a clear line to be drawn to what trustees might do under this mechanism. Consideration might be given to other legal mechanisms to support an effective trustee recommendation pathway. For example, see the proposal by Hanrahan and Bell (2021) for a standardised advice tool that is deemed safe by design. In any event, the various forms of advice such as general, intra-fund and comprehensive advice need to be clearly defined and their scope specified to support the trustee recommendation pathway.

- **Trustee obligations** – In addition to enabling the trustee assignment and/or trustee recommendation pathways, obligations may also need to be placed on fund trustees to implement in a way that benefits members. Obligations that might be considered include:
  - Engage with members at retirement to establish their preferred mode for identifying a suitable retirement solution, and then accommodate those preferences;
  - Provide appropriate decision support services to members;
  - Attempt to collect member information that is sufficient to understand key differences in member needs, and then deploy this information into solution design and guidance;
  - Offer a retirement solution to members that is suitable for their individual needs;
  - Provide members with the opportunity to opt-out before assigning them to a solution;
  - Undertake on-going engagement to ensure that retirement solutions remain suitable.

- **Establish member protections** – A strong member protection regime might include:
  - Focused APRA oversight, perhaps based around assessment of RIS as per Bell and Warren (2022).
  - Member outcome assessments for retirement undertaken separately to accumulation, operating under retirement-specific regulatory standards and guidance.
  - ASIC review of how the DDO might be applied in the context of retirement solutions being offered by funds. The focal point might be linking target market determinations to the meaningful ways in which members can differ, and how these differences are captured in cohort formation or tailoring processes.
  - Licensing to offer retirement solutions might be considered, as applies for MySuper. The aim would be to ensure that fund trustees have in place an adequate range of solutions and the capabilities to match members to suitable solutions[33].

[32] In its response to the Quality of Advice Review Final Report the Government stated: *"The restrictions on collective charging will be amended to allow superannuation funds to provide more retirement advice and information to their members."* See Delivering Better Financial Outcomes.
[33] Any licensing regime might come into effect in a few years, after providing trustees with ample opportunity to develop their RIS. A licensing regime would have the additional benefit of generating a strong incentive for trustees to make progress in developing a RIS of the required quality.

Exhibit 7: Overview of the trustee assignment and recommendation pathways

Nature	• Fund directs member to solution via either: 1b. Assignment, with ability to opt-out 1c. Recommendation, with choice to accept or reject the solution
Trustee's role	1b. Assignment – acts as fiduciary and the solution provider 1c. Recommendation – acts as advisor and solution provider
Member's role	• Requests trustee to make assignment or recommendation • Either accepts solution offered, or otherwise seeks comprehensive advice or enters self-direction pathway • Provides personal information to support guidance
Strengths and opportunities	• Opportunity to cater for diverse member needs in a scalable way • Provides guidance to members who would otherwise miss out • Caters to the engagement preferences of a substantial group of members • Helps overcome behavioural and cognitive limitations through nudges • Member protections in place, e.g. best interest duties, regulatory oversight • Larger funds well-resourced to develop quality solutions and guidance • Accommodates connecting accumulation and decumulation • Supports trustees to fulfil their RIC obligations
Weaknesses and challenges	• Lack of independence, embedding more vertical integrated in the system • Competition constrained (to extent member relies on their fund) • Reliance on fund to implement effectively and remain member-aligned - Incentives to offer generic rather than tailored solutions - Some smaller funds may have difficulty in reaching the required standard
Required for the pathway to operate effectively	• Superannuation funds need to configure their operations to: - Engage with members to establish intentions - Collect, use and manage member information - Provide solutions that cater for significant member differences • Legislation and regulations to enable the trustee assignment and/or trustee recommendation pathways and provide member protections: - Remove barriers to trustees seeking personal member information and then assigning or recommending members to a retirement solution - Fund assignment pathway would need to be created - Fund recommendation pathway facilitated as personal financial advice - Impose obligations on fund trustees - Establish member protections

Pathway 2: Adviser direction – Limited and comprehensive advice

The adviser direction pathway is premised on an individual seeking personal financial advice (henceforth 'personal advice') that takes into account a "person's objectives, financial situation or needs"[34]. This is as opposed to general advice[35] that is simply defined as "financial advice that is not personal advice". To create a clear line of delineation between adviser direction and other pathways where the member may use some form of personal advice, we assume that the individual chooses to directly pay for the financial advice.

[34] Corporations Act 2001, S766B(3) defines personal advice as "advice where a person's objectives, financial situation and needs have been taken into account; or where a reasonable person might expect the provider of advice to have considered one or more of those matters".
[35] Corporations Act 2001, S766B(4).

There are two subsidiary pathways within adviser direction, to be discussed as pathways 2a and 2b. Pathway 2a entails 'limited advice' whereby the client is provided advice that is constrained in scope by agreement. Limited advice may be directed towards a single or small number of issues, and may not consider all elements of the client's personal situation. Pathway 2b is 'comprehensive advice' where all elements of the personal situation that may be relevant are taken into account.

Personal advice may be sourced from independent providers or aligned providers such as financial advisers that are connected to a superannuation fund. Personal advice can be provided on an in-person, digital (sometimes called 'robo-advice') or hybrid basis where elements of in-person and digital advice are combined. We adopt an agnostic perspective regarding delivery mechanisms in this section, accepting that personal advice may take many forms.

Exhibit 8 considers two dimensions: the scope of the advice in terms of limited versus comprehensive advice, and whether the advice is one-off or ongoing.

Exhibit 8: Adviser direction pathway: Matrix of possibilities

	One-off	Ongoing
Limited	Limited in scope and does not cover all possible topics relevant to the client *Example: recommendation of a retirement solution for superannuation assets at the point of retirement*	Limited advice can be updated periodically *Example: updating the investment and drawdown strategy of an implemented retirement strategy*
Comprehensive	Comprehensive financial plan that covers many aspects of retirement *Example: household financial plan covering all assets, wills, aged care considerations, and so on*	Regular review of comprehensive financial plan to account for changes in financial situation, health, preferences, etc *Example: Periodic updates of the household financial plan*

While financial advice is a long-standing industry, registered adviser numbers have fallen from a peak of over 26,000 in 2018 to around 16,000 recently[36]. It is estimated that around 18% of the population have engaged an financial adviser at some point, and 10% currently use a financial adviser[37]. There also exists a developing digital financial advice services sector. While market research[38] identifies at least sixteen digital providers, it is difficult to access hard data on the number of members receiving digital financial advice because of the B2B nature of many of these businesses. It is also hard to identify the advice topics that members actually access.

2a: Limited advice

Limited advice can accommodate a financial adviser directing a client to a retirement solution, perhaps through the client paying for advice on their financial plan for retirement only. Limited advice is also known by a range of other names including scaled[39], single-issue, narrow-scope, modular, piece-by-piece or episodic advice. Each name provides an insight into the nature of limited advice. Central to distinguishing limited advice from comprehensive advice (discussed under 2b) is

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[36] Rainmaker and riskinfo.
[37] 'Transforming Financial 'Advice' Report' by Core Data and The Conexus Institute, September 2022.
[38] 'Digital Financial Advice Market Scan' by AMP and KPMG, March 2023.
[39] Note that ASIC (Information Sheet (INFO 267)) state that all types of personal advice, not just limited advice, can be scaled.

that the scope of the advice is limited in some way. This doesn't preclude providing more complex forms of advice, providing that the subject matter is scoped appropriately. Limited advice can include advice on a single topic or multiple topics. ASIC[40] warns that the scope of advice should not be reduced to exclude critical issues that are relevant to the subject matter[41].

Intra-fund advice is a special example of limited advice. The term 'intra-fund advice' does not have a legal definition but rather relates to the charging mechanism. Specifically, intra-fund advice is considered to be advice that is paid for through the collective fees of fund members rather than by the individual member. In the context of this report, intra-fund advice is treated as a potential mechanism to facilitate the trustee recommendation pathway. It is not considered within the adviser direction section because the retiree is not directly paying a financial adviser to provide the advice. As well as intra-fund advice possibly acting as a vehicle to facilitate the trustee recommendation pathway (1c), it could potentially be a requested input into the self-direction pathway (3). As noted earlier, collectively charged advice is currently under review as a result of the Government's response to the QAR[42].

The cost of limited advice depends on scope. Investment Trends 2022 Financial Advice Report[43] indicates that average charges for limited advice were around $2,000. These costs are lower than those estimated for comprehensive advice ($3,500 - $4,000, explored further under 2b), although some may consider the magnitude of savings as less than expected. At least three factors can help to explain the modest difference. First, this number appears to be drawn from adviser-provided advice and not digital providers, which may provide limited advice at a much lower price (albeit on perhaps a smaller, more tightly scoped list of topics). Second, limited advice has to meet the same regulatory requirements as comprehensive advice, including production of a SOA. Third, there are indications that the fees charged on an SOA for comprehensive advice are loss-leading, with cost recovery expected as the advice relationship extends. It is difficult to ascertain whether the same dynamic applies to limited advice.

Strengths and opportunities

The strengths of limited advice relate to its status as personal advice that is more affordable than comprehensive advice by design. It also lends itself to a range of delivery mechanisms.

- **Limited advice accounts for personal circumstances** – Limited advice may account for personal circumstances, such as the broader financial and household situation.

- **More affordable than comprehensive advice, hence broadens the candidate recipient universe** – By operating on a reduced scope, limited advice should be more affordable than comprehensive advice. This may make it economically viable for a broader universe of retirees.

- **Range of delivery mechanisms is possible** – Limited advice can be provided on an in-person, digital, and hybrid basis. Limited advice lends itself particularly well to digital advice under which the module defines the scope of the advice provided (subject to the requirement that the module cannot exclude critical issues relevant to the subject matter[44]). This creates potential to service a broader universe of retirees at substantially lower prices.

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[40] ASIC (Information Sheet (INFO 267))
[41] Advice providers must explain what advice is being provided and what advice is not being provided.
[42] See Delivering Better Financial Outcomes.
[43] Investment Trends: "Advice costs continue to rise as affordability remains main barrier to Australians seeking financial advice"
[44] ASIC (Information Sheet (INFO 267))

Weaknesses and challenges

The key weaknesses and challenges of limited advice centre on the degree to which operating on a reduced scope restrict the quality of retirement advice. There is also a question mark over whether the cost of non-digital limited advice will limit its uptake.

- **Reduced scope may limit the utility of retirement advice** – While ASIC is clear that limited advice does not imply lesser quality advice[45], there is a question around the utility of limited advice relative to comprehensive advice in a retirement context where client situations and preferences can be varied and complex. While the advice can be highly relevant, in some circumstances limited advice could provide inappropriate recommendations due to the scope failing to account for all the personal circumstances such as the full financial situation, household or individual preferences, or failing to give adequate consideration to retirement product or solution designs. In this situation, there is a high risk of inappropriate advice resulting in poor outcomes because the client relies on the advice as provided and fails to properly integrate it into their overall financial situation by making the required adjustments. The potential for providing limited advice of little value as it poorly integrates with the broader financial situation is higher for retirees with more complex arrangements.
- **Limited advice may not engender confidence to follow the plan** – Compared to comprehensive advice, limited advice may leave uncertainties in the minds of retirees. This may mean that they do not feel as confident to implement the plan, including aspects such as purchasing a recommended lifetime income stream and spending at an appropriate level.
- **Cost may still be too high to attract significant interest** – The cost of in-person limited advice may remain too high for some retirees, potentially due to the fixed cost component of SOA production, but also due to an inherent reluctance to pay for advice. This may mean the candidate universe of retirees that make use of this pathway may remain modest.

Required for the limited advice pathway to operate effectively

Identified below are some areas where further developments could enhance the effectiveness of the limited advice pathway.

- **Safety mechanisms to ensure limited retirement advice is appropriate** – Ideally there would be mechanisms to protect retirees from obtaining limited advice that may be inappropriate for their circumstances. Sound process governance entails triaging or pre-screening mechanisms to ensure that limited advice is presented only to retirees with circumstances that align with the scope of the advice. Process controls could be established to ensure that these retirees are protected from being provided with limited advice that is inappropriate for their situation. One example might be an initial assessment of the complexity of the client's circumstances.
- **Regulatory frameworks that lower the fixed cost of producing an SOA** – Anything that could be done to reduce the baseline fixed cost of advice production, while not detracting from advice quality or consumer protections, would be beneficial. While lower costs would benefit all who pay for financial advice, lower fixed costs would more proportionally reduce costs for those with simpler financial situations that may benefit most from limited advice. This would help extend the availability of financial advice to a broader population by making it more affordable.
- **Enhancements to deal with product and solution complexity** – Financial planners and digital advice providers will likely find themselves challenged by the emerging complexity of retirement products and solutions. Areas that may need to be addressed are the incorporation of stochastic

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[45] ASIC (Information Sheet (INFO 267))

modelling frameworks into advice provision, enabling the ability to assess retirement income solutions that may combine multiple products and associated features (such as investment mix and drawdown strategy for an account-based pension).

Exhibit 9: Overview of the limited advice pathway

Nature	• Financial advice service that directs retiree to a suitable retirement solution for a fee. Advice will be limited in scope and may not consider all aspects of the retiree's personal situation.
Trustee's role	• May make limited financial advice available to members on an individually charged basis. Note that intra-fund advice is detailed under the trustee recommendation pathway (1c). • Provides products to assist financial advisers to build solutions. • Implements financial plan (or allows adviser to coordinate implementation)
Member's role	• Seeks and pays for limited advice • Agrees to scope of limited advice (may or may not be an explicit discussion) • Either accepts advice offered, or enters another pathway • Provides personal information to facilitate the advice
Strengths and opportunities	• Limited advice may account for personal circumstances, including the broader financial and household situation • More affordable than comprehensive advice, hence broadens the candidate recipient universe • Range of delivery mechanisms possible, including in-person, digital, or hybrid • Limited advice can facilitate periodic check-ins
Weaknesses and challenges	• Limited scope may reduce utility of retirement advice, and gives rise to the risk of inappropriate limited advice being relied on and poorly integrated into the retiree's overall financial situation • Limited nature of advice may not engender confidence to follow the plan • Cost may still be too high to attract significant interest
Required for the pathway to operate effectively	• Safety mechanisms to ensure limited retirement advice is appropriate • Regulatory frameworks that lower the fixed cost of producing an SOA • Enhancements to deal with product and solution complexity

2b: Comprehensive advice

Though undefined in legislation, comprehensive advice is personal advice that considers all topics relevant to the client. Comprehensive advice can be provided in-person, digitally or on a hybrid basis. To be truly comprehensive, all relevant advice topics need to be addressed through either processes (for in-person advice) or modules (for digital advice), otherwise the advice is limited in nature. Through the lens of retirement, comprehensive advice:

1. *Accounts for the full financial situation* – Can make recommendations for assets both within and external to superannuation, and account for Age Pension eligibility in doing so.
2. *Considers the full household situation* – Can readily account for aspects such as all assets, income sources and needs, dual life expectancy and Age Pension eligibility; and provide recommendations for each member of the household in an integrated manner.
3. *Acknowledges trade-offs and establishes preferences* – Offers the potential to gauge preferences over trade-offs such as: willingness to take investment risk in pursuit of higher income; desire for certainty versus tolerance for variability in income; and between flexible access to funds and bequests versus income level and security.

4. *Can offer a holistic set of recommendations* – Recommendations could extend beyond the retirement plan for deploying financial assets to consider other areas such as aged care, health scenarios, bequests, donations, etc.

Comprehensive financial advice has a higher cost. The average cost of an initial comprehensive SOA is currently around $3,500 - $4,000, and can increase with more complex circumstances[46]. Research[47] suggests that production costs are higher for comprehensive advice.

Strengths and opportunities

The foundational strength of comprehensive advice pathway relates to the ability to offer highly personalised advice with breadth of scope.

- **Comprehensive advice can deliver greater utility for retirees** – By accounting for considerations that may be relevant to the retiree (encapsulating the four items listed above), well-executed comprehensive advice can potentially provide greater utility than any other pathway in the vast majority of cases. For example, comprehensive advice can assist retirees optimise tax and government benefits. It can also consider a range of life scenarios such as health, aged care and estate planning.

- **Comprehensive advice can provide assurance and engender confidence** – By ensuring that all relevant issues have been considered, a retiree can be more assured and more confident to follow the plan[48]. Linked to this are notable wellbeing benefits attributed to the receipt of financial advice[49].

- **Periodic check-ins more readily incorporated under comprehensive advice**[50] – A comprehensive advice relationship is more amenable to formalising periodic checks-in than the trustee direction and self-direction pathways, as regular reviews can be scheduled under an ongoing advice arrangement and is a natural component of the service offering of financial planners. It is also more amenable to check-ins than limited advice, to the extent that the limited advice may be based around specific subjects, e.g. single issue advice on a plan at retirement.

- **'Best of breed' opportunity** – Independent advisers can theoretically access the full range of retirement products. This could afford a 'best of breed' approach on behalf of their clients, assuming they can navigate complexity in the retirement product space.

- **Source of competition amongst product providers** – Advisers with access to the full range of retirement products and pre-packaged solutions contribute to marketplace competition. This could be through their own research activities or through subscription to research houses that undertake specialist research.

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[46] According to Adviser Ratings, in 2021 the median fee for advice was $3,529, the average was $4,000, and the range was $800 to $12,000, see New Year, New Prices: Fees To Soar Again In 2023 - Adviser Ratings - Adviser Ratings. More complex forms of advice attract higher fees.
[47] KPMG, "Cost profile of Australia's financial advice industry".
[48] Research undertaken by MYMAVINS for FAAA (Financial Advice Association Australia) shows that advice provided greater confidence in having a comfortable retirement amongst 47% of those surveyed.
[49] Survey-based research by Fidelity, 'The Value of Advice', found that 88.5% of Australians receiving advice believe it has given them greater peace of mind financially, while 49.9% of Australians receiving financial advice say their mental health has benefited.
[50] Ongoing financial advice delivers multiple benefits. Functionally it allows consideration of changed circumstances, be it the financial situation, the market environment, regulations (like Age Pension eligibility rules) or household circumstances. Additionally, re-visiting the plan reinforces the confidence imbued by a quality financial plan by seeing how the plan is constantly refreshed and worthy to follow.

Weaknesses and challenges

The key weaknesses and challenges of comprehensive advice are the degree to which quality retirement advice with unbounded scope can be provided at a cost that will make taking advice attractive to retirees. Scale challenges remain, which limits accessibility.

- **Cost is a barrier, as value of advice not always well understood** – As outlined previously, the typical cost of a basic comprehensive SOA is around $3,500-$4,000, with costs rising in line with complexity. This may be acceptable for the wealthy where SOA costs may represent a small percentage of assets. While SOA costs may be lower for lower wealth cohorts (due to potentially less complexity), the high fixed cost component of SOA production[51] results in a high cost as a percentage of wealth for many retiree cohorts. There is also an inherent reluctance by many people to pay for advice[52].

- **Supply constraints** – The financial advice industry is capacity constrained, which limits the number of retirees that comprehensive advice can effectively cater for. Adviser numbers have fallen significantly, and are unlikely to recover for some time. Providing comprehensive financial advice is time-consuming, which limits the number of clients that an individual adviser can take on[53]. In the current environment (high fixed costs, limited supply) it is rational for advisers to focus their business model on more affluent clients.

  While the financial advice sector does not have the scale to provide a comprehensive in-person retirement advice service to all Australians, there are a variety of alternatives. One is a purely digital solution. Our reservation here is the degree to which digital providers can provide a truly comprehensive advice offering. Other possible solutions are hybrid in nature, combining digital solutions and interfaces with in-person services (possibly adviser, possibly service assistant). The potential for these types of solutions is partly dependent on the outcomes of the Government's final response to the QAR. See the Appendix for discussion of the possibilities associated with automated advice and technology.

- **Quality of retirement advice could develop further** – The quality of retirement advice needs to be raised to account for the range of outcomes a retiree may experience, and the variety of increasingly complex products on offer. Fundamental to this is the widespread incorporation of stochastic modelling tools into advice processes[54], which would improve the quality of the advice and enable advisers to demonstrate to their clients that they have considered and accounted for the expected range of outcomes. This is challenging within a comprehensive advice environment with many factors to consider.

- **Regulatory model does not ensure consistent quality** – As identified in the QAR, the current regulatory approach focuses on the conduct of the provider rather than the quality of the advice provided. There is a risk that a sector compliant with the regulatory framework may deliver a sizable dispersion in retirement advice quality across providers. The regulation of advice is a difficult, controversial area, and there are no easy solutions.

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[51] See, for instance, '[Cost Profile of Australia's Financial Advice Industry]' by KPMG, which estimates the cost impact of regulatory changes to the SOA process.

[52] Based on consumer research undertaken in 2018, Rice Warner (2020) report that 60% of consumers are unwilling to pay anything for advice, and only a very small percentage are willing to pay more than $250. See [Future of Advice - Rice Warner].

[53] An overview of these issues can be found in an article in Professional Planner by Simon Hoyle, found at: \https://www.professionalplanner.com.au/2022/07/dunbars-number-and-kitces-conjecture-underline-advice-challenges/. The article points out there are around 17,000 advisers, most with an average of 150-160 clients, which is more than the 75-125 clients considered ideal by some researchers.

[54] See '[The topsy turvy world of retirement advice and guidance]' (Professional Planner) for background and some detail.

Required for the comprehensive advice pathway to operate effectively

Identified below are two areas where further developments could enhance the effectiveness of the comprehensive advice pathway. We do not believe any solutions exist that will satisfactorily solve the scale and capacity challenges associated with comprehensive advice for the foreseeable future.

- **Regulatory frameworks that lower the fixed cost of producing an SOA** – As per the case of limited advice, anything that could be done from a regulatory perspective to reduce the baseline fixed cost of advice production, while not detracting from advice quality or consumer protections, would be beneficial.

- **Enhancements to deal with product and solution complexity** – Financial advisers and digital advice providers will likely find themselves challenged by the emerging complexity of retirement products and solutions. The financial advice industry needs to tool up to deal with this complexity to enhance its ability to provide high quality retirement advice. As for limited advice, areas that need to be addressed are the capacity to assess and compare diverse and complex retirement products, enhanced abilities to assess a complex range of preferences, and greater integration of stochastic modelling frameworks into advice provision.

- **Enhancements to better assess client preferences and risk tolerances** – The methods used to assess client preferences and risk tolerances need to be developed to address the retirement phase where income is the focus. For instance, standard risk tolerance questionnaires are currently framed around tolerance for investment risk rather than income risk.

Exhibit 10: Overview of the comprehensive advice pathway

Nature	• Financial advice service that directs retiree to a suitable solution via a comprehensive plan for a fee
Trustee's role	• May make comprehensive financial advice available to members on an individually charged basis • May provide a referral service to members to an external financial adviser • Provides products to assist financial advisers to build solutions
Member's role	• Seeks and pays for comprehensive advice • Either accepts advice offered, finds another adviser, or enters another pathway • Provides personal information to facilitate the advice • Implements financial plan (or allows adviser to coordinate implementation)
Strengths and opportunities	• Comprehensive advice can deliver greater utility for retirees by taking into account all relevant considerations, including potentially various life scenarios • Provides assurance and engenders confidence • Periodic check-ins readily incorporated into comprehensive advice relationship • 'Best of breed' opportunity due to potential to source across product universe • Source of competition amongst product providers
Weaknesses and challenges	• Cost is a barrier, as value of advice not always well understood • Supply constraints • Quality of retirement advice could develop further • Regulatory model does not ensure consistent quality
Required for the pathway to operate effectively	• Regulatory frameworks that lower the fixed cost of producing an SOA • Enhancements to deal with product and solution complexity • Enhancements to better assess client preferences and risk tolerances

Pathway 4: Self-direction

The self-direction pathway entails an individual identifying a retirement solution for themselves through either selecting a pre-packaged solution or creating their own solution by combining available investments and products with a drawdown strategy. They could also choose whether to use their existing superannuation fund or consider other providers to either source a solution or the products to build a solution. Exhibit 11 sets out the choice matrix implied by these decisions. A key challenge under the self-direction pathway is satisfying the need for effective decision support services to assist members in making choices, especially given the complexity of retirement decisions and the diverse and widening range of products and solutions becoming available.

Exhibit 11: Self-direction pathway: Matrix of choices

Options available to members	Integrated solution offered by a superannuation fund	Create own solution by combining investments and products with a drawdown strategy
Member's existing superannuation fund	Selection from menu of pre-packaged integrated solutions offered by existing fund	• Choose from investments and products offered by own fund • Determine drawdown strategy
Involve other providers	Selection from pre-packaged solutions available in market	• Choose from investments and products offered by other provider, or combination of providers • Determine drawdown strategy

Strengths and opportunities

The main strength of the self-direction pathway is an increased likelihood that a member will get a solution that they actually want. There should also be benefits related to lower costs and competition, but these will likely be relatively modest by comparison.

- **Members best know their own circumstances and preferences** – A key strength of the self-direction pathway is that members best know their own circumstances and preferences. This both increases the probability that they will land in a solution that they want and are satisfied with, at least to start with. Perhaps more importantly, self-direction substantially reduces the probability that a member will be delivered a solution that is quite unsuitable due to either fund trustees or even a financial adviser misunderstanding their needs.

- **Limits potential costs of decision support** – The cost of servicing members who choose for themselves should be lower than another party trying to understand and cater for member differences, as is required under both the trustee direction and adviser direction pathways.

- **Helps to engender competition** – The very fact that some members will be open to choosing retirement solutions or products offered by multiple providers is likely to result in some level of competitive tension. However, the degree to which such competitive forces are effective in driving innovation and reducing fees may be limited under products and solutions that are highly disperse and often complex, coupled with limits on decision making capability of members as highlighted earlier – issues that are further discussed below. In summary, while self-direction holds out the potential to engender competitive pressure, it may be inhibited by the ability of members to drive effective competition.

Weaknesses and challenges

The weaknesses and challenges discussed below for the self-direction pathway coalesce around the common theme of the difficulties associated with choice under complexity, which relates back to some the major industry challenges discussed previously, specifically the interaction of challenge #4 regarding limited decision making capacity and challenge #3 related to managing dispersion:

- **Decision-making ability limited for majority of retirees** – A major weakness of the self-direction pathway is that many members do not have capacity to make well-informed choices regarding their finances during retirement. Hurdles include the complexity of retirement decisions and also products and solutions, limited financial literacy, various behavioural influences, and cognitive decline with age. There even exists a class of individual that may be incapable of understanding a product or solution in the broadest terms, or of effectively using retirement tools such as an income calculator. For instance, ASIC (2019) points out that people can struggle with interpreting financial disclosures. These aspects increase the risk that members who choose for themselves may make poor or sub-optimal choices.

- **Consequences of diversity and complexity of products and solutions** – High dispersion and complexity renders a self-choice environment far less effective through reducing the understandability and comparability of available products and solutions and increasing the information asymmetry between suppliers and consumers. Dispersion and complexity makes it much harder for members to identify a suitable retirement solution. A good example is the lifetime income streams that are being developed, which so far display a wide range of design features and sometimes seem quite difficult to understand even for the financially literate.

- **Building adequate decision support** – One of the biggest challenges under the self-direction pathway is providing members with decision support services that are effective given the limits on decision making capability (particularly low financial literacy), complexity and product and solution dispersion as highlighted above. Members who are choosing for themselves will need access to a combination of information, disclosures, tools and some advice even if of a limited nature. Delivering decision support services in a form that members can readily understand and use will be a major challenge. This challenge is only heightened if members attempt to construct a personal retirement solutions using products sourced from multiple providers. Potential information providers such as research houses will find it hard to assess and rank products under complexity and dispersion. It is hard to imagine how a service such as ASIC MoneySmart can provide product and solution comparisons in a retirement setting, at least without a major revamp. In the absence of effective decision support, members might resort to using simple rules of thumb, become subject to biases related to information availability and framing effects, or follow uninformed recommendations from friends, family or social media.[55]

- **Exposure to implementation fatigue and cognitive decline over time** – Members who choose for themselves may face an enhanced risk of being invested in an unsuitable solution over the passage of time. One reason might be the failure to review the solution due to implementation fatigue. Another is cognitive decline with age. These factors might lead to members remaining in an existing solution that has become unsuitable, or (more worryingly) switching to an unsuitable solution due to cognitive impairment or the actions of unscrupulous actors.

Required for the self-direction pathway to operate effectively

Requirements for the self-direction pathway to operate effectively mainly relate to addressing the difficulties associated with member choice under complexity. Key themes are enhancing understandability and comparability through providing decision support that members can use,

[55] Hirshleifer (2020) discusses social transmission bias.

while boosting standardisation where possible. Some member protections may also be required. Key to enabling the self-direction pathway is further clarifying the rules around financial advice, including the cross-over between general advice and personal advice as well as the role of digital advice versus calculators (see Appendix).

- **Effective and readily available decision support** – Listed below are some support services that could assist members to make effective decisions. The list is not exhaustive.
  - *Information on available products and solutions* – While information should be supplied by superannuation funds and other providers through mechanisms such as product disclosure statements and websites, the presence of independent parties to assist members to evaluate products and solutions would be helpful. This might include assessment and rankings of products and solutions by research houses, or perhaps assessments by government agencies such as APRA or ASIC.
  - *Tools* – These should include the provision of user-friendly stochastic modelling that can convey the expected income, income risk and accessible funds arising from particular solutions in a way that is interpretable by members.
  - *Education* – This would include services that educate members about retirement concepts and the main features of retirement products and solutions.
  - *Ready availability of limited advice of good quality* – The effectiveness of the self-direction pathway would be significantly enhanced if members had access to good quality advice at low or zero cost, even if more limited than comprehensive financial advice. This need may be satisfied in part by general and intra-fund advice offered by superannuation funds. For members operating outside of a superannuation fund, automated advice might be able to fill some of the advice gap (see Appendix).

  Providers of decision support services could be superannuation funds, financial advice firms, other private sector providers or the Government and its agencies. To be effective, these services need to be widely available at ideally low or zero cost to encourage and support uptake. Decision support services also should be easily usable and understandable to members while encouraging good decision making. These criteria place a premium on effective presentation and communication that members can absorb.

- **Greater standardisation to support comparability** – Standardisation would assist not only the comparability of products and solutions, but also should engender better understandability through building familiarity with standard features. The potential benefits of standardisation need to be balanced against potential costs of complying, adverse impacts on innovation, and reduced ability to tailor to different situations or respond to changes. Areas where some standardisation may be beneficial include: disclosure rules; key product features (especially lifetime income streams); and assumptions used in models where outputs are made publicly available (e.g. common set of investment return and longevity assumptions.) Standardisation could be imposed as a matter of policy or through the industry establishing its own standards.

- **Regulations and obligations of providers** – Providers of financial products and services to individuals are already subject to a large number of regulations and obligations. Additional changes might thus be targeted towards retirement products and solutions. Areas for consideration include:
  - minimum disclosure obligations for retirement products and solutions, perhaps with a requirement to make disclosures understandable
  - clarity around how the DDO will apply to retirement products and solutions
  - regulation of algorithms used to support interactive calculators, recommendations or advice provided to members needs reviewing to better enable innovation while ensuring minimum standards.

Exhibit 12: Overview of the self-direction pathway

Nature	• Member self-direction, ideally underpinned by decision support services
Trustee's role	• Makes decision support available (information, tools, limited advice) • Provides products to allow members to build solutions
Member's role	• Chooses for themselves by selecting a pre-packaged solution or combining products and drawdowns; either from their fund or other provider(s)
Strengths and opportunities	• Members best know their own circumstances and preferences • Limits potential costs of decision support • Helps to engender competition (limited)
Weaknesses and challenges	• Decision-making ability is limited for majority of retirees • Consequences of diversity and complexity of products and solutions, i.e. reduced understandability and comparability • Building adequate decision support • Exposure to implementation fatigue and cognitive decline over time
Required for the pathway to operate effectively	• Effective and readily available decision support, including information, tools, education, and ready availability of limited advice of good quality • Greater standardisation to support comparability, e.g. products, model assumptions • Regulations and obligations of providers, e.g. disclosures, DDO, algorithms

Conclusions

We have investigated the mechanisms by which retired members may be directed towards retirement solutions that are suitable for their needs. Five pathways are considered, including: defaults, trustee assignments and trustee recommendations under the umbrella of trustee direction; adviser direction, where members pay for either limited or comprehensive financial advice; and self-direction, whereby members identify a solution for themselves with the assistance of decision support services.

Accommodating all pathways would have two major benefits. First, it would cater for differing member preferences over how they want to engage with retirement decisions. Second, and more importantly, it could lead to members being better off. In particular, a default pathway would help protect highly disengaged members. Further, the ability for fund trustees to assign or recommend a solution may place those members who are unwilling to pay for advice and poorly positioned to make good decisions into more suitable solutions that might occur if they were required to choose for themselves. In this regard, it is notable that the three pathways under trustee direction are not accommodated within the current system architecture. Strong consideration should be given to pave the way for at least some form of trustee direction to operate, if not all three pathways.

Finally, much needs to be done before the Australian retirement system is primed to direct every member to a retirement solution that is suitable for their needs in the manner they would prefer. Further, developing the pathways for matching members to solutions is only one aspect of a broader challenge faced by the industry to build a world-class retirement system. Superannuation funds, product providers, financial advisers, researchers, policy makers and regulators and a host of other participants have a lot of work to do. Realistically, it is likely to take some years to complete the job at hand.

Appendix: Role of technology

Technology holds the potential to both increase capability and/or reduce costs in many parts of the superannuation industry. It could also assist to overcome the problems created by complexity and dispersion of products and solutions. Three areas of interest are relevant to this report:

- **Automated/digital advice** – Technology could help expand advice and guidance services across all pathways discussed in this report. Of particular relevance is whether technology could assist in matching members to a suitable solution through making advice more widely available at a reasonable cost.

- **Artificial intelligence (AI)** – While nascent, AI could conceivably be used to:
  - *Evaluate and rank* financial advisers, providers, products or solutions by scraping the internet for information, posts, reviews, member behaviours and any other relevant information.
  - *Understand member types* to assist in forming cohorts or tailoring to individuals, via combining member information and evidence of observed behaviours. Learning techniques might be used to further refine member profiles over time.
  - *Form solutions* meeting certain criteria deemed relevant to the member that comprise of products offered by multiple providers. This could occur through conducting an automated internet search to locate and classify products, hence addressing the problems created by product dispersion and complexity.

- **New entrants and disrupters** – Whether technology could facilitate new entrants offering retirement solutions is unclear. While technology might make entry technically feasible, various barriers exist. Trust is a key element, and this may act to protect existing superannuation funds against unfamiliar entrants. Various licensing requirements need to be met in order to offer financial products, or to offer advice. Other barriers include high cost of entry, need to achieve scale and the burden of ongoing regulation, all of which can be problematic for smaller players.

A closer look at automated advice

Automated advice offers potential to both provide scalable advice at a reasonable cost and overcome dispersion and complexity through applying AI techniques to mechanise the profiling of products and match them to individual needs. Different players might use automated tools in differing ways as outlined below. Note that calculators that generate and present outputs arising from a set of decisions as specified by the user (i.e. member) should be distinguished from automated advice that recommends a solution based on stated criteria.

- **Superannuation funds** – It is envisaged that most funds will supply calculators to assist their members. They may also look to provide automated advice. This form of advice might not only form part of a broader advice offering. It could also be used to facilitate the trustee recommendation pathway, which could occur via the process of the member entering information and the algorithm then identifying an appropriate solution.

- **Financial planning** – Advisers might use automated tools to increase the capacity and efficiency of their advice offering. Tools of interest might be calculators, or the use of automated advice to generate a provisional recommendation that is then reviewed and adjusted. Financial planners might benefit from mechanisation of product profiling through scraping the internet and identifying products with desired attributes, and perhaps matching products to individual needs.

- **Other providers** –Other providers of 'robo-advice' have so far had a modest presence. The need to become a registered adviser and provide a SOA in order to recommend solutions entailing financial products has general led to relatively simple digital offerings, e.g. analysis of wealth accumulation. Nevertheless, it is possible that automated advice may be used as a vehicle for disruptors to enter more complex areas of the industry such as retirement sometime in the future, depending on how the rules around financial advice are reframed.

Both automated advice and the related area of calculators require considerable further development before they are effective for identifying retirement solutions by integrating actual investments with a drawdown strategy. Exhibit 13 speculates what the future of digital tools could look like. The exhibit sets out the elements and steps involved in three uses of digital tools:

- A *stochastic calculator*, where the member specifies both the investments and their drawdown preferences and receives information on the expected outcomes.
- *Automated advice provided by a superannuation fund* that is aimed at identifying a suitable retirement solution that the fund itself offers, and provides information on the expected outcomes.
- *Automated advice supplied by an adviser or independent provider* that employs AI to identify suitable products and then uses these products to build and/or recommend a retirement solution. The algorithm may also provide information on expected outcomes.

The two applications of automated advice are interesting for their potential to address issues around scalability, cost, complexity and dispersion. Policymakers might thus put some thought into how the opportunities presented by such tools might be accommodated.

Exhibit 13: Digital tools

Calculator	**Automated advice provided by superannuation funds**	**Automated advice supplied by adviser or independent provider using AI**
Member inputs basic personal information e.g. age, assets	Member inputs more expansive personal information e.g. balance, assets outside super, homeownership, partner details	Member inputs more expansive personal information e.g. balance, assets outside super, homeownership, partner details
Member chooses drawdown preferences e.g. minimum drawdown income target, optimised	Member states detailed preferences e.g. minimum income needs; income target vs. optimisation; flexible access to funds, bequest motives	Member states detailed preferences e.g. minimum income needs; income target vs. optimisation; flexible access to funds, bequest motives
		Algorithm scrapes internet for products that meet certain criteria
Member sets investment mix e.g. growth/defensive mix, lifetime income stream	Algorithm recommends preferred solution provided by the fund	Algorithm recommends solution comprising mix of available products identified plus drawdown strategy
Calculator generates and reports outputs relative to chosen preferences e.g. expected income, income distribution, residual balance	Algorithm generates and reports outputs e.g. expected income, income distribution, residual balance	Algorithm generates and reports outputs e.g. expected income, income distribution, residual balance

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