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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 plays the primary role in 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 primary aim is to provide a useful reference document to help inform the development of the framework for delivery of retirement solutions in Australia. In this regard, we focus on the broader features of each pathway without delving too far into the specifics of their design and operation. Our main policy recommendation is that the trustee direction pathway should be facilitated in some form as the key missing piece. This recommendation flows from two concepts. First, as discussed in Bell and Warren (2021), retirees differ significantly in how they engage with retirement decisions. Further, a large group of retirees are not receiving financial advice but are not well positioned to make decisions for themselves. Second, trustee direction offers the potential to provide guidance to this group in a scalable and low-cost way – provided it is designed appropriately. Our overarching point is that all pathways have a potential role to play.

[1] We thank the following for their helpful comments: Phil Anderson, Anthony Asher, Neville Azzopardi, Greg Black, Annika Bradley, Benedict Davies, Jeremy Duffield, Lee Forde, Colin Grenfell, James Gunn, Jim Hennington, Tim Jenkins, Jeremy Lubrano, Aaron Minney, Anthony Saliba, Benjamin Walsh and Shang Wu.

Exhibit 1: Overview of Pathways to a suitable retirement solution

<table>
<tr><th rowspan="2">Pathway</th><th>Self-direction</th><th>Adviser direction</th><th colspan="3">Trustee direction</th></tr>
<tr><th>Member choice</th><th>Personal financial advice</th><th>Trustee recommendation</th><th>Trustee assignment</th><th>Default</th></tr>
<tr><td>Main features</td><td>Member chooses solution, drawing on decision support services</td><td>Member is directed to a solution by a financial adviser through:
(a) limited advice, or
(b) comprehensive advice</td><td>Trustee recommends a solution to member, who then opts-in or opts-out</td><td>Member requests trustee to assign them to a solution; but can opt-out</td><td>Trustee defaults member into a (probably basic) retirement solution</td></tr>
<tr><td>Member type most suited for</td><td>Members who want to choose for themselves</td><td>Members who desire a personalised recommendation and are willing to pay</td><td colspan="2">Members looking for direction, but:
• Do not want to seek a financial adviser
• Not well-prepared to choose for themselves</td><td>Highly disengaged members who take no action</td></tr>
<tr><td>Currently facilitated</td><td>Yes</td><td>Yes, but under review</td><td>Possibly?
• Trustees wary of breaching advice rules
• Might be facilitated by infra-fund advice?</td><td>No</td><td>No</td></tr>
<tr><td>Key issues</td><td>• Literacy, behavioural and cognitive limits
• Complexity of decisions and products
• Decision support needs further development</td><td>• Trade-off between complexity and cost
• Capacity of financial advisers is constrained</td><td colspan="2">• 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 at low cost for pathway to operate effectively
• Members may place reliance on trustees, limiting access to independent perspectives and competitive tension</td><td>• Satisfying conditions for default to occur
• Risk of assigning members to unsuitable solutions in absence of any engagement</td></tr>
</table>

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 the 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. However, a thin line exists between self-direction and trustee direction to the extent that the output might be viewed as a form of recommendation. If the digital tool went the extra step of actually recommending a solution to the member, this would clearly come under trustee direction. Second, we interchange between the terms 'member', 'retiree', 'individual', 'client' and 'consumer' depending on the context.

The next section sets the background for this report by highlighting some key concepts and issues that impact on how we frame the discussion. We then provide 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[2].

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 approach to investing the member's assets and then generating income through drawdowns. Retirement solutions may utilise various investments and products to form up the investment strategy. A plan is also needed for how to draw from any accessible funds to shape up the desired income stream, after allowing for other income streams including the Age Pension. Retirement solutions are not a menu of products, but a set of strategies for delivering income to members who have differing needs and wants.

This report discusses the mechanisms by which members may find their way to a solution that is suitable for their needs. The pathways listed under trustee direction directly address 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. Superannuation fund trustees may help to facilitate these two pathways.

All pathways have a role to play

We do not endorse one pathway as 'preferred', but rather view each pathway as having a potential role to play. Bell and Warren (2021) discuss the rationale for making a range of pathways available. The underlying driver is that individuals differ significantly in how they approach financial decisions, and these differences should be catered for. Fund members differ in how they want to engage with retirement decisions. For instance, 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.

Furthermore, certain members may be better off under particular decision modes. For example, some members may be poorly positioned to make informed decisions for themselves and would benefit from expert assistance say from their superannuation fund or a financial adviser.
Exhibit 2 (see over) presents results from a survey conducted by Frontier Advisors[3], and provides a sense of the diversity in how members prefer to engage with choosing a retirement solution. While a limited sample, the responses suggest that something in the order of 70% of members might prefer some form of assistance from their superannuation fund. Here the trustee direction pathway 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. The next section delves into the issues surrounding trustee direction.

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

[3] Frontier surveyed 3,500 members that were nearing retirement from five profit-for-member funds. This survey thus does not capture retail funds, where the portfolio of advised members is much higher.

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

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. Fund trustees could apply for an AFSL to provide personal financial product advice and operate under the associated laws and regulations. However, they would face the same challenges around compliance, cost and supply constraints as do other providers of personal financial product advice. Currently, alternative approaches whereby fund trustees attempt to marry up members with suitable solutions carries significant risk that it could be determined by regulators to be personal financial product advice.

Fund trustees are currently developing RIS to meet their obligations under the RIC. However, it is unclear how they can satisfy the obligation to assist members to identify a suitable retirement solution in a way that provides affordable retirement guidance across a broad base of members.

We thus see it as important that a trustee direction pathway is enabled by policymakers in a way that can operate in a low cost and scalable manner. Trustee direction holds the most promise to cater for what is a large group of members that cannot be effectively serviced by the financial advice industry and are not well-placed to identify a suitable solution for themselves. Here a trade-off exists between a large-scale trustee-directed solution that offers affordable advice to retirees who might otherwise get none; and the likelihood that the guidance will be of lower quality than could be provided by a financial adviser. Protections against members being directed into poor retirement solutions are also needed. In this report we make no recommendations on how policymakers should balance these important trade-offs.

For the trustee direction pathways to be low cost and scalable, trustees need to be able to efficiently collect and use personal information to identify the solution that meets the member's needs. A wide range of personal information can be influential for designing and identifying suitable solutions, yet most fund trustees do not possess the required information to cater for key member differences. This includes, for instance, member attributes such as partnered status, financial assets outside of super, homeownership, preferred type of income stream, and desire flexible access to funds.

The conundrum is that the collection and use of personal information to recommend a retirement solution to a member amounts to provision of personal financial product advice, thus triggering weighty legal and regulatory obligations. The status quo is thus to generally avoid trustee recommendations (or assignments) of the nature we describe. An alternative could be for fund trustees to offer a menu of solutions and information and let the member chose for themselves, i.e. self-direction. This alternative raises issues around capability of members to make informed choices. Another alternative is trustees assisting members to access personal financial advice, which could be provided either directly through establishing an appropriate ASFL or referral to external financial advisers. However, personal financial advice is difficult to provide in a low cost and scalable way.

The Government's response[4] 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 mechanism. How this might operate is quite unclear, especially given that the rules around intra-fund advice are currently framed around charging mechanisms. In any event, intra-fund advice is still personal financial product advice, so it is hard to see how this will resolve the need to offer effective and affordable guidance at scale. The Government is currently conducting further consultation around financial advice. Whether and how the advice laws and regulations might be adjusted to accommodate the trustee direction pathways remains to be seen.

Attention has also shifted to whether some form of default mechanism[5] 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[6]. Consumer protection provides a motivation for establishing the capacity for trustees to assign members to a solution without prior assent. Substantial assets are invested in accumulation accounts by members of retirement age[7]. While this may be by choice for some members, it is likely that a substantial portion could be remaining in accumulation due to high disengagement, inertia or confusion. Such members may be missing out on income and incurring unnecessary tax. Defaults are discussed 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.

In summary, we see a strong case for facilitating trustee direction in some form. The challenge for policymakers will be to do so in a way that supports superannuation funds to provide retirement guidance that is both affordable and scalable, and hence can service members across a broad front, while ensuring that member protections are not compromised.

Establishing the member's preferred pathway

Initial engagement at retirement could act as a gateway to triage members towards a 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 personal financial advice; or,
(4) State an intention to choose 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 with assistance or permission from the member, identification of a suitable solution, 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.

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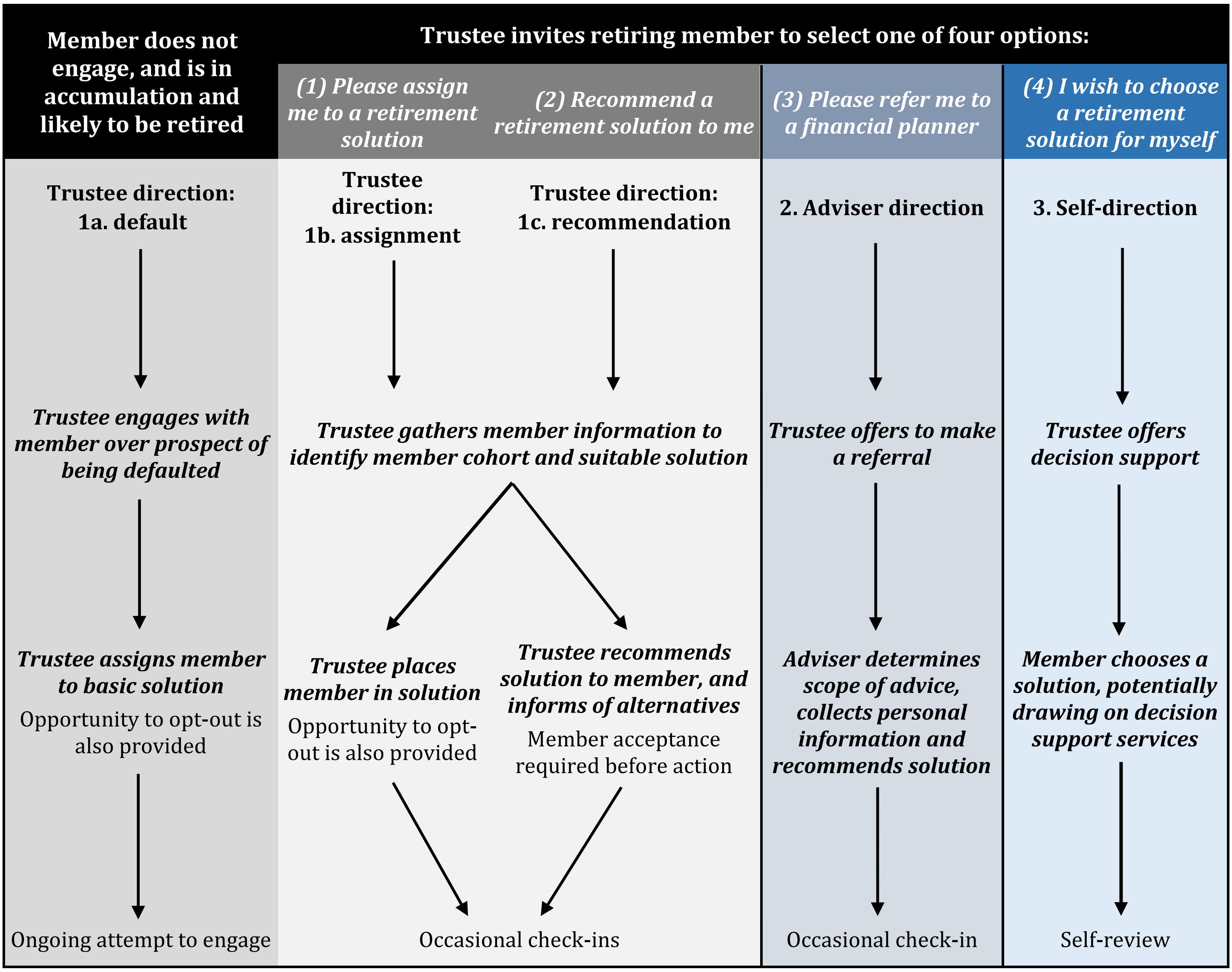
[4] [Delivering Better Financial Outcomes - detailed overview (treasury.gov.au)](https://treasury.gov.au).

[5] 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).

[6] 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.

[7] 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.

Exhibit 3: How trustee engagement with retiring members might operate

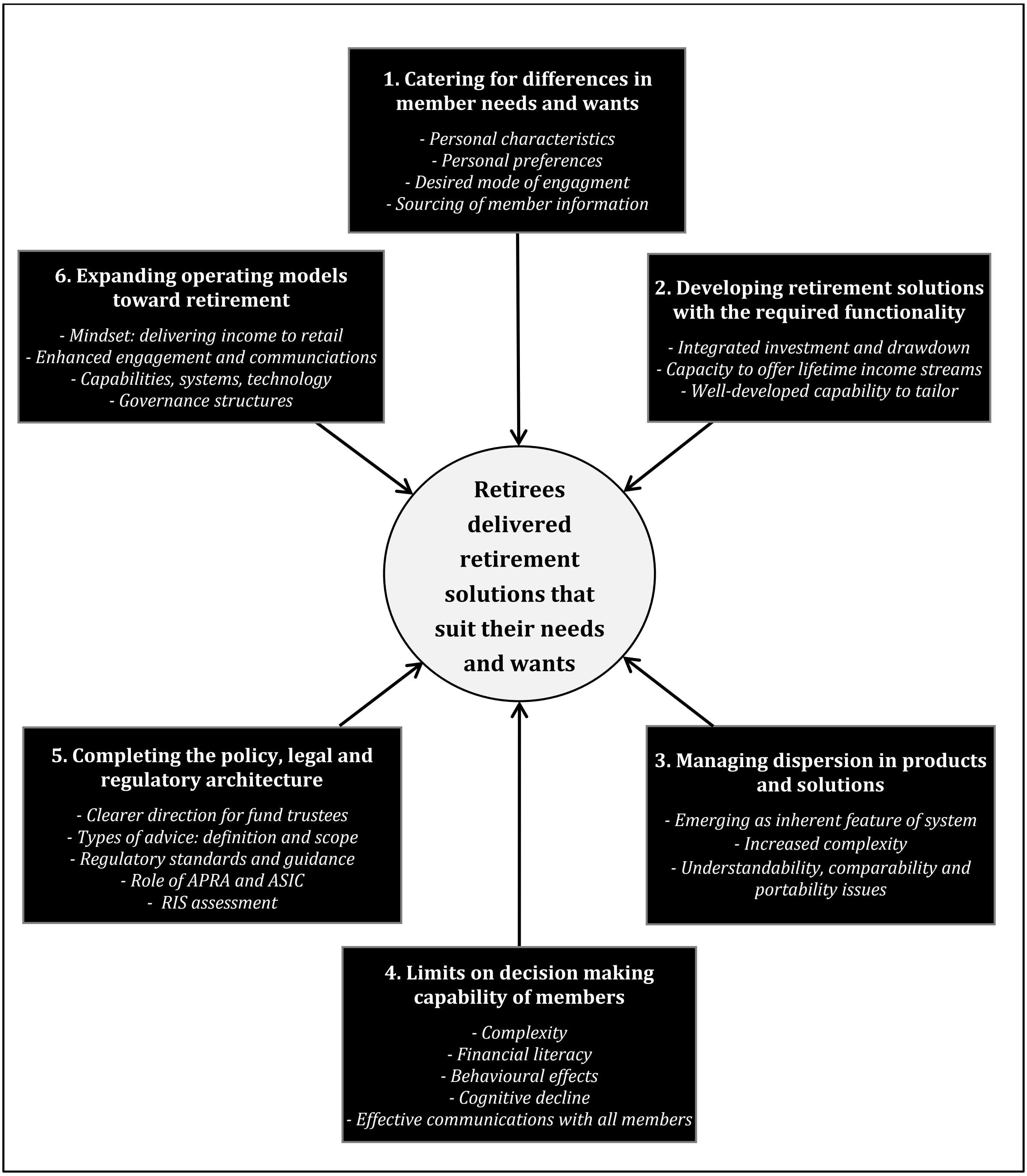


The retirement income challenge

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 draw down on those assets to generate income. All this occurs under 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.

Multiple challenges face the industry. The technicalities of both solution design and member engagement and communications need to be addressed. The policy, legal and regulatory framework will likely evolve. Superannuation fund operating models will need to be reconfigured to deliver retirement solutions to members that can differ significantly in their personal characteristics and preferences. Six of the biggest challenges are summarised by Exhibit 4 and discussed afterwards. The task of developing pathways through which members are matched to suitable solutions – the topic of this report – runs into all six challenges.

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



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 engage with retirement decisions, i.e. they differ in the pathway they prefer, or would deliver them the best outcome. 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 mechanisms 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, the differing ways that members engage with retirement decisions are not being facilitated.

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 effectively cater for wide differences in member needs and wants. 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. A number of providers have developed lifetime income streams that address longevity risk[8], and more are expected. However, these products have typically not yet been integrated into retirement solutions. Drawdown strategies require far more attention from the industry. Solution design does not yet take into account all the member differences that matter[9], let alone the ability to respond to changes.

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[10], various behavioural influences[11] and cognitive decline with age. Limited decision-making capacity is most relevant where members are required to choose in some way. It is hence more poignant under the self-direction pathway, where members select from a range of products or solutions and may be required to determine their own drawdown strategy. In these cases, members can be exposed to

[8] At the time of writing, providers of publicly available lifetime income products include Allianz Retire+, AMP North, Australian Retirement Trust (QSuper), Challenger, Generation Life and Resolution 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.
[9] For example, fund trustees 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.
[10] For example, see Agnew, Bateman and Thorp (2013).
[11] Authors that discuss behavioural effects in a retirement savings context include Mitchell and Utkus (2006) and Benartzi and Thaler (2007).

anchoring and framing biases (e.g. following minimum drawdown rules), or follow uninformed recommendations from friends, family or social media.[12] Addressing the limits on decision-making capacity requires effective engagement and communication approaches, and 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, the industry is currently in 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 regulatory standards and guidance; and,
(e) how RIS will be assessed[13].

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 contributing to the slow pace of RIS development.

***Challenge #6:* Expanding 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[14]. 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 individualised and complex nature of retirement;
(c) enhancing capabilities, systems and technology to deliver retirement solutions to members that vary in their circumstances and preferences; 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.

[12] Hirshleifer (2020) discusses social transmission bias.
[13] Bell and Warren (2022) and Bell, Khemka and Warren (2023) discuss how RIS assessment might be done.
[14] 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 the fund trustee identifies then directs 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 underlying process. The key difference between these two pathways is the manner in which members receive the direction from the trustee and hence 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 should be willing to use the other pathways 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 were in the accumulation phase for members of age 65 and over at June 2022.[15] While there is a range of factors potentially at play[16], 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 and that 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[17]. 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

[15] This estimate arises by comparing Tables 7c and 8a in the APRA Annual Superannuation Bulletin, 2022.
[16] Explanations include: accounts over the $1.9 million cap; members still working beyond 65, or expecting to be temporarily 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.
[17] 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.

establishing a default mechanism. However, an element of trustee discretion rather than 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 highlights 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. The Consumer Data Right might be used. *(Issue: what happens if information is not provided.)*
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 are sent to the member to check that they are satisfied with the default arrangement, and to invite them to enter into further engagement.

Another possibility worth mentioning, but which we don't explore, might be for totally disengaged members to be transferred to a Government fund. This might occur if the member appears to be retired, but does not respond to multiple attempts by the trustee to engage with them over their status and wishes. The option would be kept open for the member to transfer out of the Government fund.

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 incurring unnecessary tax on investment earnings. It avoids welfare losses that would compound the longer that their balance remains in accumulation.

Weaknesses and challenges

The main issues with the default pathway stem from trustees making decisions on behalf of members who may be highly disengaged. The likelihood that operational requirements require input from the member themselves further challenges the feasibility of a default pathway given that is primarily intended for highly disengaged members.

- **Ensuring that defaulting is appropriate** – It may be difficult 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[18]; 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. One possibility is making use of the Consumer Data Right[19] where the member gives the trustee permission to access personal information. Nevertheless, this still requires some level of member engagement, which may be problematic for 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.)

[18] 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.
[19] See Homepage | Consumer Data Right (cdr.gov.au).

- **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 will be relying on regulatory protections.
- **Lack of independence and constrained competition** – Defaults imply no choice and hence tie the member into the fund. This would contribute to embedding an element of vertical integration[20] in the system, and lead to an absence of competitive tension. However, the latter effect 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.
- **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.

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

[20] We discuss vertical integration in more depth under the trustee recommendation and assignment pathways, where we see it as more relevant due to the potential for these pathways to have a larger footprint.

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[21]. 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[22], with drawdowns probably based on the minimum drawdown rules[23]. Consideration also needs to be given to what measures are required to protect trustees from potential liability claims.

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 would 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[24] 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.

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[21] Defaulting a low-balance member into a lifetime income stream may be inappropriate for two reasons. First, they may not need longevity insurance if they have access to the Age Pension as a base level of income for life. Second, it would limit access to funds and thus diminish savings that are readily available to meet unexpected needs and inhibit transfer to a more suitable retirement solution if the member becomes engaged.

[22] One possibility might be to apply the same growth/defensive mix as the member had in accumulation.

[23] This recognises that members with smaller balances may use them as precautionary savings. An alternative might be to apply age-based drawdown rates aimed at delivering a higher yet affordable income stream, although this might be more suitable where the defaulted member has a substantial balance.

[24] 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.

Exhibit 6: Overview of the default pathway

Main features	• 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 implements the assignment
Member's role	• Fails to engage with super fund despite entering retirement • Given opportunity to opt-out • Provide operational information, e.g. bank account details, 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 • Lack of independence and constrained competition (marginal) • Might entrench disengagement
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 would be 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

Pathway 1b and 1c: Assignment and recommendation

We discuss the trustee assignment and trustee recommendation together as the process used by the trustee to identify a suitable solution for the member would be equivalent[25]. It is envisaged that these 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 – The fund trustee assigns the member to a retirement solution at the member's 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 – The fund trustee recommends 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.

[25] In Bell and Warren (2021) we had these two pathways sitting under the banner of "fund-guided choice". We changed the name to consolidate the three trustee direction pathways under the same heading. Fund-guided choice might be seen as a better descriptor for the recommendation pathway.

If the member does not accept the solution proposed by the trustee they would switch to either the self-direction or adviser direction pathway or another superannuation fund. The recommendation pathway in particular should be accompanied by the trustee offering decision support services to the member including information on the recommended solution and alternative solutions in case the member sees the proposed solution as unsuitable, as well as access to tools 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 assent to assignment versus giving consideration to a recommendation that is either accepted or rejected. The second distinction is that different legal mechanisms may be required, with trustee assignment akin to a type of defaulting process and trustee recommendation in the nature of financial advice. Legislative requirements are discussed further below.

The trustee assignment and recommendation pathways could operate in a number of ways. One possible approach is to build the process around member cohorts for which retirement solutions are tailored. The trustee would then undertake a 'matching' procedure where they seek the personal information needed to identify the cohort to which the member belongs and assign or recommend them the solution designed for that cohort. Another possibility is individual tailoring based on the information that the trustee has about the member[26].

In the absence of the trustee recommendation and assignment pathways being accommodated in the manner we discuss, an alternative might be for trustees to offer a menu of options from which members may select. We would categorise this under self-direction as the member is choosing for themselves. However, trustees could present options in a way that suggests one retirement solution over others. For instance, trustees might provide personas with which the member can self-identify and offer 'defaults' for those personas. This would only be one step away from a trustee recommendation, and hence represents a potential grey area between self-direction and trustee direction[27].

Strengths and opportunities

A capacity for fund trustees to make either an assignment or recommendation offers a variety of potential benefits that are discussed below.

- **Catering for diverse members in a scalable and affordable way** – The potential for trustee direction to assist members in a scalable and affordable way was discussed earlier on pages 4-5. 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. The legal and regulatory framework would also need to be supportive.
- **Provides direction to members who might otherwise miss out** – There is an overarching opportunity 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. Direct involvement by superannuation funds is arguably the strongest candidate for providing some guidance and hence improving outcomes for this type of member.

[26] We suspect that a cohort-based process could be adopted by most funds for starters, with the granularity of the cohorts and the information on which they are based being enhanced over time. Use of individual tailoring might expand over time.
[27] While a similar process might underpin the approaches being discussed here, there could be significant differences in the laws and regulations that may apply.

- **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 clear from the survey results reported by Frontier (see page 4), which indicated over 70% of members were looking towards their fund to assist them in some way. Findings from various studies[28] 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 are averse to making financial decisions for themselves and would prefer someone to make them on their behalf.

- **Overcoming behavioural and cognitive limitations through nudges** – Trustee direction provides scope for introducing nudges[29] into the decision process that could lead to better outcomes for retirees[30]. 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)[31]. In addition, some retirees arguably invest too conservatively[32]. 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 offered 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 the trustee.

  While nudges could also be provided through how options are presented (e.g. as default drawdown rules, or solutions), these represent 'soft' nudges. They are likely to be much less effective than a definitive recommendation (let alone assignment) of a retirement solution.

- **Substantial member protections already in place** – Trustees are already 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[33]. Protections are also afforded to members through the regulatory oversight activities of APRA and ASIC. Further, media scrutiny on superannuation funds has also heightened as the industry has grown in size and importance. These elements establish clear expectations and provide checks and balances as well as an incentive for fund trustees to act in the best interests of members.

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[28] See Bateman et al. (2014), Butt et al. (2018) and Deetlefs et al. (2019).
[29] See Thaler and Sunstein (2009).
[30] 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.
[31] These tendencies are documented in the Retirement Income Review (Commonwealth of Australia, 2020).
[32] 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 with longevity insurance through annuities for defensive exposure.
[33] The standards and guidance are currently general but may be extended in due course to apply specifically to RIS. APRA is currently revising *SPS 515 Strategic Planning and Member Outcomes* (see [Strategic planning and member outcomes: proposed enhancements | APRA]), with plans to explicitly include retirement.

Presently, trustee direction as discussed here would represent personal financial product advice, which brings with it additional obligations. We discuss the policy ramifications of this issue further below. The question that arises is the extent to which the existence of the member protections described above limit the need for these additional obligations.

- **Scope for better connection between accumulation and decumulation** – A flaw of the current superannuation system is that there are multiple disconnects between the accumulation and decumulation phases. Some of these flow from the legal framework, e.g. the application of MySuper to accumulation, and the requirement to establish a new account for retirement. This acts to disrupt planning over the entire life-cycle and adds friction to the process of transferring from accumulation to retirement. Trustee direction may help reduce these disconnects by placing funds in a better position to address whole-of-life strategies with members, and to guide members through the process of shifting their funds in a retirement solution.
- **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 offering 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 trustees 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[34]. 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 superannuation funds in the position of providing both the guidance and the underlying products that comprise the solution, thus embedding an element of vertical integration in the industry. 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[35]. Funds may recommend their own products even if they happen to be not best-in-class or unsuitable for the member, creating the potential for some members to be worse off than they might otherwise be. These potential conflicts of interest, whether real or perceived, would need to be managed.
- **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 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,[36] and

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[34] Nonetheless, Commissioner Hayne did not recommend a banning of vertical integration, stating: "I am not persuaded that it is necessary to mandate structural separation between product and advice".

[35] 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.

[36] 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

through the influence of product complexity[37]. 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 remaining focused on member benefit. Here we have two concerns. The first is that funds may be incentivised to offer generic or commoditised solutions, rather than innovative and tailored solutions[38] 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. The second 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.

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 the legislative and regulatory architecture as well as fund operating models.

Legislation and regulations

The process envisaged under trustee direction would represent personal financial product advice under the current legal and regulatory framework. If trustees were to provide financial advice under the trustee recommendation pathway they would be subject to the same obligations as other providers of personal financial product advice, including needing an AFSL and operating under the associated laws and regulations. These include: a best interest duty to the member; obligation for the advice to be appropriate; the need to consider all issues relevant to the scope of the advice; obligation to prioritise the member's interests and the conflicted remuneration provisions; and a requirement to provide a statement of advice (SOA).

As discussed earlier, if fund trustees face the same compliance, cost and supply constraint challenges as other providers of personal financial product advice, then the potential for trustee direction to provide affordable guidance at scale would likely be unrealised. However, there is a trade-off between a large-scale trustee-directed solution and the likelihood that the advice would not match all the qualities of the personal financial product advice provided by a financial adviser.

How to strike this balance is an important consideration for policymakers. Any allowance for fund trustees to provide retirement advice in a framework that sits outside the existing licensed provider framework should not sacrifice appropriate protections that ensure members are not directed into poor retirement solutions. This in turn raises the issue of how the obligations on fund trustees can be framed under the trustee assignment and/or recommendation pathways in a manner that supports provision of scalable and affordable guidance while ensuring members are protected.

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access to capital, and one only provides a death benefit. Exit can incur transaction costs and sacrifices the longevity insurance that the member has implicitly been paying for through leaving the pool. It is worth noting that making access to capital available also reduces the income that is paid out.

[37] High dispersion and design complexity is emerging for lifetime income products, and acts to increase the effort required to switching from one product to another even if it is possible to do so.

[38] This extends to a diminished incentive to dynamically adjust the solution offered to members as their circumstances change.

Substantial changes will thus probably be required to the legislative and regulatory architecture to enable the trustee assignment and/or trustee recommendation pathways. 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. Policymakers could consider the scope of advice activities (e.g. ability to offer limited advice on specific retirement-related topics) and the degree of prescriptiveness around processes such as the scope of personal information that may be collected by fund trustees[39]. 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 privacy and confidentiality[40].
- **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 retirement 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 satisfaction of the required conditions. This potential measure could protect trustees from potential future liability claims: an area that would require further consideration.
- **Facilitate trustee recommendation –** A legal framework would be required that distinguishes the trustee recommendation pathway from existing personal financial product advice while maintaining member protections. Central to this framework should be a capacity for trustees to collect and use member information (see first dot point) without triggering the obligations around personal advice that inhibit provision of affordable guidance at scale. One possibility is a 'safe harbour' approach that is made available subject to the trustee satisfying certain obligations (see next dot pot). Another might be a separate licensing regime (also see below). In its response to the QAR, the Government suggested that the intra-fund advice framework could be expanded to deliver retirement advice to members. For reasons set out previously at the top of page 5, we do not see this approach delivering quality, relevant and affordable guidance at scale.
- **Trustee obligations** – In addition to enabling the trustee assignment and/or trustee recommendation pathways, obligations may need to be placed on fund trustees to implement in a way that benefits members. Obligations could be detailed prescriptively, and might include to:
  - 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[41], and then deploy this information into solution design and guidance;

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[39] As an example, trustees might be permitted to source and act on information that is critical to assign members to a cohort under their cohorting process. For instance, a detailed cohort-based process that considers assets outside of super, homeownership, partnered status and the member's preferences might be permitted to collect information on all these aspects, but not go beyond.

[40] Possibilities might include these agencies making personal data available to trustees with member permission (e.g. expand the application of the Consumer Data Right); or providing some information to trustees 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.

[41] The personal information that trustees are permitted and expected to collect could be specified.

- 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 RIS assessment as discussed in Bell and Warren (2022).
  - Member outcome assessments for retirement conducted 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, noting that the DDO is currently framed around financial products. 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 and hence translated into retirement *solutions*.
  - 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[42].

Fund operations

Fund operations need to be configured with the functionality to understand the circumstances, needs and wants of members; and then deliver solutions that 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 6) sets out how the member engagement process might operate incorporating 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[43]. 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.

- **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 in order to effectively direct a member to a suitable solution. While de-identified data could inform cohort-based solution design, personal information collected with member permission would be required to assist the matching of members to cohorts and individually tailored solutions.

  As noted in discussion of challenge #1 (see Exhibit 4), funds should ideally be considering certain key member attributes in order to span important member differences. These include age, total financial assets including funds outside of superannuation, homeownership, partner status, and

[42] 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.
[43] See Warren (2022) for a suggestion of how recommendations made by trustees could be accompanied by highlighting the existence of alternatives.

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:

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 the solution that is most suitable for them, while providing 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) 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. Access to these data sources might be facilitated by expanding the Consumer Data Right framework to superannuation to support collection of personal information required to match members to suitable solutions.

- **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 drawdown strategies that meet differing income 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 design and delivery of retirement solutions. Funds need to build out and maintain these capabilities.

Exhibit 7: Overview of the trustee assignment and recommendation pathways

Main features	• Acts as both fiduciary and service provider • 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 an assignment or provide a recommendation • Either accepts solution offered or seeks an alternative, i.e. enters adviser direction or self-direction pathways, or switches to another super fund • Provides personal information to support guidance
Strengths and opportunities	• Potential to cater for diverse member needs in a scalable and affordable way • Provides guidance to members who would otherwise miss out • Caters to the engagement preferences of a substantial group of members, many of whom are looking towards their fund to provide guidance • Helps overcome behavioural and cognitive limitations through nudges • Substantial member protections already in place through trustee obligations • Accommodates connecting accumulation and decumulation • Supports trustees to fulfil their RIC obligations
Weaknesses and challenges	• Lack of independence, embedding more vertical integrated in the industry - Risk funds offer members solutions that are not best-in-class or unsuitable - Potential conflicts of interest need to be managed • 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	• 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 members or recommending a retirement solution - Fund assignment pathway would need to be created - Fund recommendation pathway enabled in way that trustees can provide guidance without triggering obligations that inhibit the provision of affordable guidance at scale, while maintaining member protections - Impose obligations on fund trustees - Establish member protections • 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

Pathway 2: Adviser direction – Limited and comprehensive advice

To delineate between adviser direction and other pathways, we write as if the individual chooses to directly pay for what we refer here to as "personal advice" that likely (but not necessarily) involves a financial adviser. This is an imperfect distinction as it is possible that trustee direction might also involve a modest payment, and personal advice can be supplied in purely digital form.

Legally, all these mechanisms fit within the definition of "personal financial product advice", as the advice will almost certainly refer to financial products and account for a "person's objectives, financial situation or needs"[44]. This is as opposed to general advice[45] that is simply defined as "financial advice that is not personal advice".

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 also be provided on an in-person, digital 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.

Types of Advice

Adviser direction entails two advice types: (1) 'comprehensive advice' where a holistic financial plan is developed for the client that covers all advice topics; and (2) 'limited advice' whereby the client is provided advice that is constrained in scope by agreement. Limited advice is directed towards a single or subset of advice topics, potentially including identifying a retirement solution.

Though undefined in legislation, ***comprehensive advice*** is personal advice that considers all topics relevant to the client. 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* – Potentially effective for gauging 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.

Limited advice is also known by a range of other names including scaled[46], 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 is that the scope

[44] 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".
[45] Corporations Act 2001, S766B(4).
[46] Note that ASIC (Information Sheet (INFO 267)) state that all types of personal advice, not just limited advice, can be scaled.

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[47] warns that the scope of advice should not be reduced to exclude critical issues that are relevant to the subject matter[48]; and makes it clear that limited advice should not be of lesser quality advice than comprehensive advice. Of the points listed above, it is only (4) that clearly differentiates comprehensive from limited advice. However, there may be situations where the provision of limited advice does not require all of (1), (2) and (3). An example is investment advice on the selection between two investment trusts investing in the same asset class.

The client fact find is central to the relevance and hence quality of both forms of advice. A thorough fact find provides the foundation for a comprehensive financial plan, and ensures appropriateness when determining the reduction in scope for limited advice. An in-depth fact find reduces compliance risk by ensuring that all relevant issues are captured, but contributes to the cost of advice provision.

Accessing personal advice

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[49]. It is estimated that around 18% of the population have engaged a financial adviser at some point, while 10% currently use a financial adviser[50]. There also exists a developing digital financial advice services sector. While market research[51] identifies at least sixteen digital providers, hard data on the number of members receiving digital financial advice is unavailable given the B2B nature of many of these businesses. It is also difficult to identify the advice topics that members actually access.

Comprehensive financial advice has a higher cost than other forms of financial advice. The average cost of an initial comprehensive SOA is currently around $3,500 - $4,000, and can increase with more complex circumstances[52]. Research[53] suggests that production costs are higher for comprehensive advice. The cost of limited advice depends on scope. Investment Trends 2022 Financial Advice Report[54] indicates average charges for limited advice of around $2,000. While these costs are lower than those estimated for comprehensive advice, the magnitude of savings might be considered less than expected.

At least three factors help to explain the modest difference in the relative costs of limited versus comprehensive advice. First, reported costs appear 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

47 ASIC (Information Sheet (INFO 267))
48 Advice providers must explain what advice is being provided and what advice is not being provided.
49 Rainmaker and riskinfo.
50 'Transforming Financial 'Advice' Report' by CoreData and The Conexus Institute, September 2022.
51 'Digital Financial Advice Market Scan' by AMP and KPMG, March 2023.
52 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.
53 KPMG, "Cost profile of Australia's financial advice industry".
54 Investment Trends: "Advice costs continue to rise as affordability remains main barrier to Australians seeking financial advice"

applies to limited advice. Fourth, the establishment of a comprehensive fact finding process as the foundation would represent a significant cost component common to both types of advice.

Strengths and opportunities

The foundational strength of the adviser direction pathway is the ability to offer highly personalised advice with breadth of scope. While this particularly applies to comprehensive advice, it is also potentially the case for limited advice.

- **Advice provided by a financial adviser can deliver greater utility for retirees** – Well-executed financial advice provided by a financial adviser should provide greater utility than any other pathway in the vast majority of cases as it can account for all considerations that may be relevant to the retiree. For instance, it can allow for their full financial circumstances, the household situation, establish preferences and gauge how the client views various trade-offs. The adviser direction pathway lends itself to addressing a range of related life scenarios such as health, aged care and estate planning.
- **Financial advice provided by a financial adviser can provide assurance and engender confidence** – By ensuring that the situation of the retiree is fully understood, a retiree can be more assured and more confident to follow the retirement plan[55]. Linked to this are notable wellbeing benefits attributed to the receipt of financial advice[56]. (The challenge for purely digital advice services is to engender the same degree of assurance and confidence.)
- **Periodic check-ins readily incorporated through a financial adviser**[57] – An ongoing relationship with a financial adviser naturally lends itself to periodic checks-in, as it is an integral component of their service offering. This contrasts against trustee direction where these processes have not yet been developed, and self-direction where self-discipline is required. Digital advice providers are well positioned to provide periodic reviews.
- **'Best of breed' opportunity** – Independent financial advisers can theoretically access the full range of retirement products. This could afford a 'best of breed' opportunity for clients, assuming the adviser 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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[55] 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.

[56] 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.

[57] 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 the adviser direction pathway are the degree to which quality retirement advice with broad scope can be provided at a cost that is attractive to retirees. Scale challenges also limit accessibility.

- **Cost is a barrier, as value of financial 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. Limited advice costs are also sizable. This may be acceptable for the wealthy where SOA costs may represent a small percentage of assets. The high fixed cost component of SOA production[58] results in a high cost as a percentage of wealth for many retiree cohorts, notwithstanding that SOA costs may often be lower for clients with less wealth due to lower complexity. There is also an inherent reluctance by many people to pay for advice[59].

- **Supply constraints** – The financial advice industry is capacity constrained, which limits the number of retirees that the adviser direction pathway can effectively cater for. Adviser numbers seem unlikely to recover from their decline over recent years for some time. Providing comprehensive financial advice is time-consuming, which limits the number of clients that an individual adviser can service[60]. In the current environment of high fixed costs and 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 in-person retirement advice to all Australians, there are ways that supply might be boosted at the margins. One is a purely digital solution, where there have been some positive developments. However, we have not yet observed digital advice offerings that can capture the same breadth of considerations covered by a financial adviser fact find while accounting for the range of available retirement products. Other possibilities are hybrid in nature where digital solutions interface with in-person services (either adviser or service assistant). The potential from these alternatives is partly dependent on the outcome of the Government's response to the QAR. See the Appendix for discussion of the possibilities associated with technology including automated advice.

- **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. Widespread incorporation of stochastic modelling tools into advice processes is fundamental[61] to improving advice quality and enabling advisers to demonstrate to clients that they have considered and accounted for the range of potential outcomes.

- **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. The risk is that emphasis on process compliance delivers an unidentified but sizable dispersion in retirement advice quality across providers.

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[58] 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.

[59] 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.

[60] 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.

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

- **Simplification hindered by insurance requirements and aversion to legal liability** – An issue identified through feedback on this report relates to pressure being placed on advisers to cover all angles and issue more comprehensive SOAs arising from professional indemnity insurers as well as internal compliance teams due to aversion to potential legal liability. It was suggested that this issue is more pointed under limited advice where the scope of the advice is being narrowed. These influences can act as a barrier to reducing the cost of advice.

Required for the limited advice pathway to operate effectively

Identified below are some areas where further developments could enhance the effectiveness of the adviser direction pathway. We do not believe any solutions exist that will satisfactorily resolve the scale and capacity challenges for the foreseeable future, particularly with respect to comprehensive advice.

- **Regulatory frameworks that lower the fixed cost of advice production** – Anything that reduces the baseline fixed cost of advice production, while not detracting from advice quality or consumer protections, would be beneficial. This could involve lowering the cost of producing SOAs, or making them optional in some situations. It would also help if this were done in a way that addresses potential resistance against reducing the scope of SOAs stemming from professional indemnity insurance and legal liability concerns. Consideration might also be given to how to ease the degree to which insurance and liability concerns act to complicate the advice process. While lower fixed costs would benefit all who pay for financial advice, it would more proportionally reduce costs for those with simpler financial situations. 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 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. Areas to address include capacity to assess and compare diverse and complex retirement products, ability to assess income preferences and risk tolerances in retirement, and greater integration of stochastic modelling frameworks into advice provision. Scenario analysis may also be useful, whereby hypothetical solution outcomes are simulated over selected historical periods.

Exhibit 8: Overview of the adviser direction pathway

Main features	• Financial adviser (or advice service) directs retiree to a suitable retirement solution for a fee. Advice may be comprehensive or limited in scope.
Trustee's role	• Makes financial advice available to members on an individually charged basis through either: - Establishing an advice operation, e.g. applying for an AFSL, and/or - Operating a referral service to external financial advisers • Provides products to assist financial advisers to build solutions
Member's role	• Seeks and pays for personal advice • Determines scope of advice service, i.e. either comprehensive or limited advice • Either accepts advice offered, finds another adviser, or enters another pathway • Provides personal information to facilitate the advice
Strengths and opportunities	• Advice provided by financial adviser can deliver greater utility by accounting for personal circumstances, e.g. broader financial and household situation • Provides assurance and engenders confidence • Periodic check-ins readily incorporated into financial 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 • Cost may still be too high to attract significant interest • Regulatory model does not ensure consistent quality • Simplification hindered by insurance requirements and aversion to legal liability
Required for the pathway to operate effectively	• Regulatory frameworks that lower the fixed cost of advice production • Enhancements to deal with product and solution complexity - Capacity to assess and compare diverse and complex products - Enhancements to better assess client income preferences and risk tolerances - Improved modelling frameworks, including stochastic models and scenarios

Pathway 3: 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 9 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 9: 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

Self-choice is a necessary component of any choice architecture, if one accepts that individuals should always be given an option over self-determination. In this regard, the main strength of the self-direction pathway is an increased likelihood that a member will get a solution that they actually want (although there is no guarantee it will be the solution they need).

- **Members best know their own circumstances and preferences** – The fact that members best know their own circumstances and preferences creates potential for self-direction to land the member in a solution that better meets their needs and wants. The caveat is that this requires members who attempt self-direction to know what they need or want, and have the capacity to identify a solution that meets the requirements. This is by no mean guaranteed. Nevertheless, self-direction does provide some protection against the risk that the member will be delivered a solution that is quite unsuitable due to either a fund trustee or even a financial adviser misunderstanding their needs. However, if these other pathways are well designed and are operating effectively, this should be a modest risk.

- **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. Hurdles to effective competition include that fact that products and solutions are highly disperse and often complex, coupled with limits on decision making capability of members – 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. This relates back to 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 capability 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 both retirement decisions and available 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 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 with some being 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 is hard. The challenge is only heightened where members attempt to construct a personal retirement solution 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.[62]

- **Self-evaluation is difficult** – It is difficult for individuals to make an objective evaluation of whether they are in the most appropriate retirement solution. Only a few have the requisite capability, while behavioural influences can also be at play, e.g. overconfidence, status quo bias, biased self-attribution, confirmation bias, etc.

- **Exposure to implementation fatigue, cognitive decline and scammers** – Members who choose for themselves may face an enhanced risk of being invested in an unsuitable solution over

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

the passage of time. One reason might be 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. They may also become more exposed to the actions of unscrupulous actors, including scammers and elder abuse.

- **Relative cost to member** – Retirees managing their own retirement finances may encounter higher product prices than may be available through superannuation funds or financial advisers, e.g. via platform access. In short, they may pay retail rather than wholesale fees.

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, while boosting standardisation where possible. Some member protections may also be required. Key to enabling a more effective 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. (We note that the limitations of the APRA heatmap and the Your-Future-Your-Super performance test will be exacerbated for retirement solutions).
  - *Tools* – These should include the provision of user-friendly stochastic modelling that convey the expected income, income risk and accessible funds arising from particular solutions in a way that is interpretable by the user.
  - *Education* – This would include services that provide education on 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 (if not in the form of trustee direction). For individuals operating outside of a superannuation fund, digital 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 readily usable and understandable while encouraging good decision making. These criteria place a premium on effective presentation and communication that users easily 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 accommodate non-standard needs 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 needs reviewing to better enable innovation while ensuring minimum standards.

Exhibit 10: Overview of the self-direction pathway

Main features	• Member self-choice, ideally underpinned by decision support services
Trustee's role	• Makes decision support available, e.g. information, tools, general advice, potentially limited retirement 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 - Caveat: may not mean they can identify the solution they need • Limits potential costs of decision support • Helps to engender competition (limited)
Weaknesses and challenges	• Decision-making capability 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 • Self-evaluation is difficult • Exposure to implementation fatigue, cognitive decline and scammers • Product cost may be higher due to paying retail rather than wholesale fees
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 cater for differing ways in which members engage with retirement decisions, and thus could lead to more members being better off. In this regard, the absence of any trustee direction pathway is the major missing piece in the choice architecture. The consequence is that those members who are unwilling to pay for advice and poorly positioned to make good decisions for themselves are not well-catered for. We recommend that policymakers pave the way for at least some form of trustee direction to operate, if not all three pathways. In this regard, we see a strong case for facilitating the trustee recommendation pathway and/or trustee assignment pathway as soon as practical. The default pathway is more problematic from an implementation perspective, and hence an investigation to determine its merits might be an appropriate step.

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 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. Of particular relevance is whether technology can assist in matching members to suitable solutions 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 refine member profiles over time.
  - *Form solutions* meeting criteria deemed relevant to the member comprising 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.
  - *Tailored communications* through generative AI allowing for member attributes, e.g. literacy.
- **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 may act to protect existing superannuation funds against unfamiliar entrants. Various licensing requirements need to be met in order to offer financial products or 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. 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 with regard to whether they amount to personal advice.

- **Superannuation funds** – It is envisaged that most funds will supply calculators to assist their members. They may also look to provide automated advice that forms part of a broader advice offering, and could be used to facilitate the trustee recommendation and assignment pathways. This could occur via the process of the member entering information and the algorithm 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 generally led to relatively simple digital offerings, e.g. analysis of wealth

accumulation using generic asset classes. Nevertheless, it is possible that automated advice may be used as a vehicle for disruptors to enter more complex areas such as retirement in 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 can effectively identify retirement solutions that integrate actual investments with a drawdown strategy. Exhibit 11 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. This type of digital tool might support trustee recommendation or trustee assignment.
- *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 could be accommodated.

Exhibit 11: 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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