the conexus INSTITUTE

Improving consumer experiences, choice, and outcomes in Australia's retirement system

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About The Conexus Institute

The Conexus Institute is an independent, not-for-profit research institution focused on improving retirement outcomes for Australian consumers. Philanthropically funded, the Institute is supported by the insights of a high-quality advisory board, who work on a pro-bono basis. The Institute adopts a research-for-impact model and frequently collaborates with researchers from academia, associations, and industry. Where possible research is made open source to assist industry and create transparency and accountability. Further information here.

About David Bell

Dr David Bell is Executive Director of The Conexus Institute. Bell's career has been dedicated to the investment and retirement sector. He has worked with both commercial and profit-for-member firms, and ran his own consulting firm. Bell worked with APRA in the development of the APRA Heatmap. Academically, Bell taught for 12 years at Macquarie University and in 2020 completed his PhD at UNSW which focused on retirement investment problems. Full bio here.

About Geoff Warren

Dr Geoff Warren is a Research Fellow with the Conexus Institute and an Honorary Associate Professor at the Australian National University, as well as a member of various investment and research advisory boards. Warren's research focuses on investment-related areas specially including superannuation and retirement, and is widely published in leading journals. He has a prior career in the investment industry spanning over 20 years. Full bio here.

1. Overview

We much appreciate the opportunity to comment on issues and options for policy for Australia's retirement system. Our submission focuses on the following four of the matters listed in the Terms of Reference (TOR) where we believe that we can assist the Committee in their deliberations:

a. regulatory and tax impediments to innovation and uptake of insurance products in retirement;

b. the economic costs and opportunities of innovation in our retirement income system;

e. policy options to support greater choice and quality of life in the retirement income system, including but not limited to the aged pension, financial advice, home ownership and downsizing, and insurance;

f. progress on implementing the Retirement Income Covenant

We decline to comment on the other matters listed the TOR as they do not align with our research. The approach we take in this submission is to provide high-level comments on each of these areas in Section 2, supported by 'essays' on selected topics appearing in Section 3. The essays are designed to be read as individual pieces that provide further detail, background and context for the commentary in Section 2.

2. Comments on selected matters (a, b, e, f)

2.1. Regulatory and tax impediments to innovation and uptake of insurance products in retirement

We are interpreting this matter as referring to the development and use of lifetime income streams (i.e. annuities) as the key 'insurance product' for retirement. We also note that the Australian Treasury has been running a consultation on *Superannuation in Retirement* requesting input on this matter, including the potential for the Government to intervene in the market through underwriting longevity risk to assist superannuation (super) funds in developing and delivering lifetime income products.

We make a number of observations on this matter below. Our overarching theme is that the main impediments to the take-up of lifetime income streams DO NOT relate to supply and pricing. Rather, they relate to spurring demand for lifetime income streams from consumers. While changes to the regulatory and tax settings may assist to make these products 'cheaper' for members (i.e. offer higher income per dollar invested), the impact on overall uptake is likely to be at the margin and modest.

- Essay #1 provides an overview of the potential barriers to the take-up of lifetime income streams. These are many and varied, and multiple influences may be at play.
- Essay #1 further argues that the main barriers relate to how lifetime income streams are offered and perceived by consumers. The major way of increasing take-up of lifetime income streams in our view is to position them as integral components of comprehensive retirement solutions that are either being offered by superannuation funds or recommended by advisers. That is, they need to present in the form of a strong nudge or (better still) a default. Framing is also a key issue, with consumers tending to view lifetime income streams as investment rather than income products that guarantee income for life. Hence policy measures might be aimed at supporting the ability of super funds to offer comprehensive retirement solutions to their members and influencing how lifetime income streams are being framed.
- Access is not a constraint. Lifetime income streams are already readily available in the market, and many more options will become available in due course. Current providers include AMP North, Allianz Retire+, Australian Retirement Trust, Challenger, Generation Life, Resolution Life and Unisuper. Some of these products offered are quite innovative. Meanwhile, many super funds are in the process of developing their lifetime income streams offerings, either in-house or through outsourcing arrangements with life insurance companies which are currently active in vying for this business.

- Cost and price is not in itself a major barrier to take-up in our view. Most consumers appear to see lifetime incomes streams as an investment product that offers a kind of income yield. It is doubtful that members understand the pricing and value of annuities sufficiently for it to impact their decisions. At most, the level of interest rates may have an effect through impacting the perceived yield. This is largely determined by market rates. Adjusting regulatory or tax settings will have some effect on the perceived yield, but the impact is of much lower magnitude than what happens to interest rates.
- Not all consumers would benefit from lifetime income streams. Whether they should be encouraged to take them up is very much a function of personal circumstances. Hence the issue is lack of take-up from those consumers who would benefit. These are often those with a moderate amount of wealth. Those with minimal wealth may rely on the Age Pension to supply an element of guaranteed income for life; while the very wealthy that can readily support their desired lifestyle do not need guaranteed lifetime income for as a form of insurance.

In summary, adjusting the regulatory and tax settings is likely to have a marginal impact on take-up, i.e. it is not a game-changer. The measure with highest potential to impact the take-up of lifetime income streams would be to facilitate super fund trustees to offer or direct members to comprehensive retirement solutions that contain lifetime income streams (when appropriate to do so). This is in turn dependent on what fund trustees are able to do in directing their members to retirement solutions within the financial advice rules, which are currently under review under the *Delivering Better Financial Outcomes* (DBFO) reforms. Section 2.3 expands on this issue. Steps to influencing the framing of lifetime income streams as an income or 'consumption' product rather than an investment product may also assist, e.g. through required disclosures and provision of education and information.

2.2. Economic costs and opportunities of innovation in our retirement income system

We offer a few observations from the perspective of researchers that focus on the design and delivery of solutions, products and services by superannuation funds while noting we are not technology experts. In our view, the opportunities to innovate in the retirement income system that have the potential to most benefit consumers relate to improving the ability of providers to understand and assist retirees through personal tailoring, rather than product innovation. Below are four examples of areas where innovation should be beneficial:

- **Capacity of super funds to collect and use personal information** – A major hurdle in super funds assisting their members is they often know little about the customer, except their age and balance. However, they are inhibited from collecting and using personal information to better serve their members by a range of factors, including: the personal financial advice rules (currently under review through the DBFO reforms); lack of effective infrastructure for collecting, using and maintaining personal data; and access to limited data sources. We discuss the issues around personal data for super funds in Essay #2. Solving this problem requires innovation by both policymakers and funds.
- **Retirement solutions** – We define a 'retirement solution' as a strategy for deploying assets into investments and products (including potentially a lifetime income stream) and them drawing down from those assets to generate income. The ability to tailor to retirees with widely differing needs is a ***major*** area where innovation in required, particularly by super funds. This is a technology and systems challenge, and could ultimately lead to individual tailoring in due course.
- **Communications** – The manner in which the industry communicates and hence guides consumers leaves a lot of room for improvement. Technology may be able to assist in this regard, e.g. use of generative AI, conducting advanced consumer testing and profiling.
- **Stochastic modelling –** Most retirement income calculators used in the industry project a single income path based on inputted assumptions (i.e. they are deterministic), and hence do not speak to risk. The industry needs an upgrade to stochastic modelling and calculators in order to assist consumers to better understand and hence manage the risks around projected outcomes.

Product innovation is an area where innovation could prove detrimental. Complexity of financial decisions is a major issue, particularly in the retirement phase where members with widely differing needs are required to select a retirement solution under high uncertainty over how long they might live as well as investment returns. Innovation in the product arena runs the risk of generating a proliferation of disperse offerings that only add to this complexity, and make products hard to compare. This issue is already evident for lifetime income streams, where products display a wide variety of features and this dispersion seems only likely to get worse. Complexity and lack of comparability can hamper both the ability of consumers to make decisions and competition in the market. It also opens the possibility of providers could weaponise complexity and obfuscation in order to exploit consumers. Arguably simple products that are easily understood and can be readily compared are more appropriate for use as building blocks in designing retirement solutions.

Investment innovation is an area we encourage. In a Conexus Institute paper titled *Investing for retirement* (November 2023) we explore the substantial differences between accumulation and decumulation (decumulation is far more complex), the benefits of implementing tailored retirement investment strategies, and approaches to implementation. Unfortunately the potential for the Your Future, Your Super (YFYS) performance test to be extended to the retirement phase acts as a strong deterrent to investment innovation. This is explored further in Essay #3.

2.3. Policy options to support greater choice and quality of life in the retirement income system (Age Pension, financial advice, home ownership, insurance)

The matter being raised as point (e) in the TOR is extremely broad in scope, and strikes at the overall design of the retirement income system. In responding, we focus on one of the major policy suggestions that the Conexus Institute has been advocating which relates to the 'choice architecture' for the retirement phase. We hence address the matter of "options to support greater choice", albeit possibly not in the manner envisaged when this discussion point was framed up.

One of the key propositions underpinning our research has been that the retirement income system should ***cater for the range of ways that consumers engage with retirement decisions*** (for instance, see *Ensuring all retirees find a suitable retirement solution*, August 2021). That is, consumers should have a choice over how a retirement solution that is suitable for their needs is identified and delivered. In essence, we are arguing that choice does not just relate to choice of product or provider, but also has another dimension related to the mode in which decisions are made that should be accommodated. The choice architecture is summarised in the table over page.

Overview of pathways to a suitable retirement solution

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

Our main recommendation in this regard is that the 'choice spectrum' should extend to providing consumers with a ***capacity to request that their super fund chooses a retirement solution on their behalf***, and offers that solution to them via a recommendation or assignment. We refer to this as "*trustee direction*". The key aspect that distinguishes trustee direction from other choice mechanisms is that fund trustees would be choosing *for* the requesting member, rather than just playing the role of being a provider of solutions, products and services that the members can use in choosing for themselves. We also see a role for personal financial advice for those consumers who want to use (and pay for) a financial planner. This we see three broad pathways – self-direction, adviser direction and trustee direction – of which only two out of three are currently available.

Further, we argue that there is a class of consumer that is neither capable nor willing to make financial decisions in retirement for themselves yet cannot be reasonably serviced by the financial advice industry due to cost and capacity constraints. Such consumers may be better off if fund trustees could choose a retirement solution on their behalf. Further, many of these consumers might welcome their super fund providing this service. We suggest that these consumers should be given the ability to choose the trustee direction pathway.

Essay #4 explores the potential choice architecture in the retirement phase, and outlines the reasons for facilitating trustee direction.

2.4. Progress on implementing the Retirement Income Covenant (RIC)

The RIC places a clear obligation on *all* super fund trustees to develop a retirement income strategy (RIS). Policymakers and regulators have clearly been disappointed with the progress so far, as indicated through the APRA/ASIC joint thematic review of July 2023 titled *Implementation of the retirement income covenant* and subsequent public comments. We do not intend to document the progress in RIS development so far. Rather we set out to explain why RIS development has been slower than hoped, and what policy measures may assist in moving it forward.

We suggest that a key piece of the puzzle relates to the business barriers faced by super funds in developing RIS. This is the subject of Essay #5, which points out that the business case for RIS development can be weak for some funds (e.g. those with a small amount of assets in the retirement phase) while development times are long. Our concern is that retiring members will bear the impact of this conflict through funds delaying and/or under-developing their RIS. The main message is that an appreciation of the business case that is being faced by super funds is important for understanding what has been happening within the super industry with respect to RIS development, as well as for formulating policy. We hence strongly suggest that the Committee should read Essay #5 for further details as it deals with some influential matters.

With regard to potential policy measures to address the situation, the most effective would be establishing a retirement licensing regime. A licensing regime would require super funds to meet certain licensing conditions within a reasonable time frame (say 2-3 years) in order to operate in the retirement market. While a retirement licensing may appear to be a somewhat heavy-handed policy initiative, it should prove quite effective by having the following effects:

a) spurring super funds to get moving in developing their RIS within a specified time frame;
b) providing direction to fund trustees on what they are required to do in developing a RIS;
c) protecting members through setting minimum standards of delivery;
d) helping to reduce dispersion across the industry in the quality of retirement offerings;
e) forcing fund trustees to confront the business case for participating in the retirement market; and,
f) providing an exit route for those funds that decide the business case is tenuous.

An issue with the RIC is that it places a hard obligation on super funds to develop a RIS, irrespective of whether there is a good business case or whether they are able to do so effectively. The RIC does this without providing any prescription around what is required to meet the obligation. A licensing regime may hence be financially sympathetic for those funds (and their members in the case of profit-for-member funds where development costs are ultimately funded by members and hence involves a degree of member cross-subsidisation) where the strength of the business case is far weaker than the obligation to develop a RIS, providing a ready mechanism through which these funds may choose not to participate in retirement. As the majority of funds will probably want to participate in the retirement market, the need to satisfy licensing requirements should get the industry at large moving, with greater clarity of requirements. But for those that do not, there would be a ready way out.

3. Essays

Essay #1 – Barriers to take-up of lifetime income streams

Main points

1. While changes to regulation and tax may be helpful at the margin, we do not expect it to have a major impact on the take-up of lifetime income streams.
2. Measures with high potential to impact the take-up of lifetime income streams include:
   - Facilitating super fund trustees to offer or direct members to comprehensive retirement solutions that contain lifetime income streams. This is in turn dependent on what fund trustees can do to direct their members to retirement solutions under the financial advice rules, which are currently under review under the *Delivering Better Financial Outcomes* (DBFO) reforms.
   - Influencing the framing of lifetime income streams as an income or 'consumption' product rather than an investment product may also assist.

Introduction

This essay sets out to provide the Committee with useful context for their deliberations through summarising factors that may be inhibiting the take-up of lifetime income streams, and offering thoughts on the policy measures that might have the greatest impact.

Overview of factors that may limit use of lifetime income streams

The table over summarises 36 factors that may contribute to the limited use of annuities as identified in a comprehensive literature review by MacDonald et al. (2013). The list is broken down into 12 rational decisions factors related to personal preferences and circumstances, 8 rational decision factors arising from environmental considerations, and 16 behavioural biases. In the third column, we have added some notes on the application of selected factors to Australia, including how different parts of the policy agenda might help to address some of the factors listed. We expand on the latter after the table.

MacDonald et al. comment that retires could feel disinclined to annuitise for a single reason or a combination of reasons. The fact that multiple influences may be at play suggests there is no silver bullet. We also note the existence of various rational reasons not to take up lifetime income streams. This implies the aim should be to encourage the take-up of lifetime income streams only where of benefit to a retiree.

MacDonald et al. note that some of the factors listed are not strongly supported by evidence from surveys or observed behaviours[1]. It should also be borne in mind that this review article is now over a decade old, and there would have been subsequent research and developments that the authors have not considered. In particular, it has become common practice to offer some access to capital in order to overcome factor 1a (loss in liquidity) and factor 1b (bequest motives), although this access is more often restricted to the nominal value of the purchase value that has not been paid out as income, and typically ends at life expectancy[2]. Nevertheless, the list provides a good launching pad for discussing what might be done to enhance the use of lifetime income streams.

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[1] This includes 1b (bequests), 1c (benefit to delay), 1g (family pooling), 2a (pricing) and 2c (lack of inflation protection, referring to the fact that annuity take-up is low in countries where real annuities are unavailable).
[2] A notable exception is Allianz's AGILE product, which offers access to capital throughout albeit at some cost.

Potential contributing factors limiting the use of annuities

Adapted from: MacDonald, B.J., Jones, B., Morrison, R.J., Brown, R.L. and Hardy, M., 2013. "Research and reality A literature review on drawing down retirement financial savings", North American Actuarial Journal, 17(3), pp.181-215

Factor	Summary	Additional comments on application to Australia
(1) Rational decision factors arising from personal preferences and circumstances		
(1a) Loss in liquidity	Annuitisation is a non-reversible decision: individuals cannot cancel an annuity and recover the principal.	Many annuities provide some access to capital, albeit often limited by capital not paid out as income, and life expectancy.
(1b) Loss of bequest	Annuitised wealth cannot be left as a bequest.	Many annuities provide death benefits, albeit limited by capital not paid out as income, and life expectancy.
(1c) Benefit to delay	Steeply increasing 'mortality premium' creates more advantageous annuity pricing as the retiree ages; hence may defer annuitisation to obtain a better price.	Somewhat overcome through purchasing a deferred annuity.
(1d) High risk tolerance	Retirees with high risk tolerance may be more willing to accept a volatile income stream and place less value on the stability offered by an annuity (reverse is also true).	
(1e) High personal discount rate	Individuals who place little value on future versus current consumption would have lower demand for annuities.	'Fear of running out' seems more important and runs in other direction.
(1f) Short life expectancy	Retirees in poor health could be averse to annuities as they do not anticipate a long future lifetime and view them as expensive.	
(1g) Ability to pool risk within families	May be expectation of inheritance from aging parents; in some cultures, the elderly are financially supported by their adult children.	
(1h) Confidence in personal financial abilities	Retiree may believe they will obtain a higher consumption by maintaining control of assets and investing them personally.	
(1i) Other sources of guaranteed income	Need to annuitise reduced by defined benefit pension plan or social security.	Age Pension is particularly important in Australia, especially for retirees with low wealth.
(1j) Sources of household wealth	Retirement savings may be illiquid (e.g. in property or businesses) and not available for annuitisation without tapping into the equity (e.g. reverse mortgage).	Majority of Australian retirees have superannuation, although not all do.
(1k) Insufficient personal savings	Annuitisation can be unattractive for retirees with trivial balances.	Reinforced by existence of Age Pension in Australia.
(1l) Debt	Reducing debt using financial savings makes more financial sense than purchasing an annuity.	
(2) Rational decision factors arising from environmental limitations		
(2a) Expensive pricing	Annuities are overpriced from an actuarial perspective due to insurer costs and profit margin, including pricing for adverse selection.	Government underwriting of longevity insurance or adjusting capital requirements would address this hurdle, as would group self-annuitisation. Industry has raised issues of high capital requirements.
(2b) Poor financial market environment	Retirees could be dissuaded from annuitising because of poor market conditions, e.g. low interest rates or a drop in the value of their wealth.	Less of an issue following rises in interest rates; potential implications for investment-linked annuities.

(2c) Incomplete annuity market	Payment stream available may not match the desired consumption path, e.g. most annuity products sold in the US are fixed in nominal terms; retiree could intend to reduce consumption with age.	Real annuities available in Australia; innovative products accommodate tilting the income stream through a reference rate.
(2d) Access	In the US, annuitisation as a distribution option is relatively rare in retirement savings plans.	Live issue in Australia: super funds traditionally have not offered annuities to members, but many are considering doing so.
(2e) Seller incentives	Annuities fall into the same mental category as life insurance, which is sold not bought. Financial advisors may be averse to sell annuities where they lose future access to the funds and rollover commissions; non-affluent consumers may not get financial advice that might suggest an annuity.	Potential to address through DBFO reforms by expanding advice through super fund trustees. A related issue is that super funds have little experience in offering and communicating retirement income streams.
(2f) Distrust of annuity providers	Lack of trust or confidence in insurance companies and financial institutions; risk of insurer default.	Government underwriting of longevity insurance and group self-annuitisation might help overcome this hurdle.
(2g) Sex-distinct mortality assumptions	Use of sex-distinct mortality tables leads to higher prices for females than males, discouraging women from annuitising as 'unfair'; unisex annuities could similarly discourage men.	Government underwriting of longevity insurance might help overcome these issues.
(2h) Tax treatment	Depending on the country, tax treatments could be relevant; complexity of tax impacts may also act as a discouragement.	Tax irrelevant in Australia; treatment for Age Pension eligibility aims at neutral treatment of annuities.
(3) Behavioural biases		
(3a) Decision framing	Viewing annuities through an 'investment frame' rather than 'consumption frame can make them look like a risky and unattractive investment given positive probability of losing entire amount (upon death); manner in which annuities often presented to retirees exacerbates this issue.	Super funds may assist in overcoming this hurdle if DBFO reforms expand their capacity to give advice. Government might further assist through providing information and influencing framing via disclosure.
(3b) Longevity gamble	A life annuity could be viewed as a 'bet with the insurance company' that a retiree will exceed median life span; the odds in this gamble may be perceived to favour the insurer.	Government might further assist through providing information and influencing framing via disclosure.
(3c) Perception of insurance	View of insurance as only for 'bad' events, and since living a long time is not considered 'bad', the value of longevity insurance is not well-perceived.	Government might further assist through providing information and influencing framing via disclosure.
(3d) Absence of comprehensive plans	Retirees may apply rules of thumb, social norms and intuition in managing their wealth in retirement rather than developing a comprehensive retirement consumption plan, and hence may not contemplate annuities.	Funds are developing comprehensive retirement income strategies to offer to retirees (albeit slowly). Potential to address through DBFO reforms and hence access to advice. Government might further assist through providing information.
(3e) Control	Handing control over assets could be intimidating; some retirees may be attracted to managing their own income, and be subject to the 'illusion of control'.	
(3f) Buyer's remorse	Fear of regret if interest rate or mortality assumptions change so that annuity could have been purchased at a better price, leading to purchase being delayed or not occurring.	
(3g) Regret aversion	Desire to avoid the regret of purchasing an annuity, for instance, in case of being diagnosed shortly thereafter with a fatal disease.	

(3h) Misinformation	Imperfect information, such as ignorance of the features and availability of annuities.	Potential to address through DBFO reforms and facilitating trustee direction. Government might further assist through providing information and influencing framing via disclosure.
(3i) Financial illiteracy	Poor financial literacy may affect the ability of some individuals to appropriately plan for retirement, impacting the decision to annuitise.	Potential to address through DBFO reforms and facilitating trustee direction. Government might further assist through providing information.
(3j) Individuality	Social trend towards individuality, rather than working as a collective, works against the risk-pooling spirit of annuities.	
(3k) Default options	Default payout option of an employer's pension plan has a strong effect; when annuities are not the default option, the propensity not to annuitise is lessened.	Potential to address through DBFO reforms, in particular facilitating trustee direction.
(3l) Historical view on personal retirement savings	Shift from the traditional defined benefit pension schemes toward individual savings (defined contribution) is a relatively recent phenomenon, implying potential lag in understanding annuities.	Australia's defined contribution system is well-established, but system still immature. Retirement phase has only recently come under close focus.
(3m) Procrastination	It is easier to do nothing than something, particularly with regard to important decisions like purchasing an annuity.	
(3n) Other	Other feasible behavioural biases include: (i) aversion to thinking about unpleasant events such as dying or being old and poor (ii) ignorance on the probability of survival (iii) fear of being viewed negatively as annuities unpopular	

Factors that could be addressed by the policy measures currently under discussion

There are three groups of policy measures that are currently being discussed that have potential to impact on the take-up of lifetime income streams.

- **Delivering Better Financial Outcomes (DBFO) reforms** – The aim of these reforms is to expand the availability of financial advice, including potentially through super funds. These reforms offer scope to address a number of the behavioural factors that could be restricting the use of lifetime income streams via recommending them within the advice that is given. Advice can act as a vehicle to address a number of the factors in the above table, including decision framing (3a), the absence of comprehensive plans (3d), misinformation (3h) and financial illiteracy (3i). In addition, super funds may suffer to a lesser degree from the disincentives to not recommend lifetime income streams (2e) that relate to giving up control over the assets. The idea of issuing 'nudges' as part of the DBFO reforms may also help assist in uptake, depending on what nudges are accommodated.
- **Recommendations and defaults** – The strongest mechanism for prompting individuals to take up lifetime income streams would be to include them within a default retirement solution, as noted under factor (3k). The next strongest mechanism would be to include a lifetime income stream within a recommendation for a comprehensive retirement solution, of which it forms an integral part. In this regard, in a Conexus Institute paper titled *Pathways for directing members into retirement solutions* (November 2023) we argue that 'trustee direction' should be facilitated, under which fund trustees may identify a suitable retirement solution for a member and either make a recommendation or assign them accordingly. We believe trustee direction could and should form part of the policy agenda through the DBFO reforms. Doing so would amount to the strongest policy action that could be taken to encourage take-up of lifetime income streams, where appropriate to do so. The Treasury suggestion for providing default (i.e. recommended) solutions for member sub-classes and default (i.e. recommended) settings could be used to a similar effect, but probably with lesser impact. All these measures would also address the factors mentioned in the above dot points, i.e. (2e), (3a), (3d), (3h) and (3i).

- **Regulatory and tax measures** – Adjustments to the regulatory and tax settings would largely make lifetime income streams better value for consumers through addressing the expensive pricing factor (2a) and the tax factor (2h). This may in part occur through reducing costs for providers – here the capital requirements appear to be a key issue. The Government underwriting longevity risk as raised in the *Treasury retirement discussion paper* of December 2023 should also make some difference for similar reasons, but would also address distrust of provider (2f) and potentially issues related to sex-distinct pricing (2g).

  Nevertheless, we do not expect these initiatives to have any major impact on the use of lifetime income streams. The extent to which pricing is a major inhibiting factor on the use of lifetime income streams is debatable. MacDonald et al. refer to some evidence that pricing may not be an inhibiting factor in the take-up of annuities[3]. Further, it is doubtful that members understand the pricing and value of annuities sufficiently for it to impact on their decisions.

Policymakers might also assist with addressing behavioural factors

We view the behavioural factors as particularly important in limiting the use of lifetime income streams. Many of the behavioural hurdles reflect a lack of knowledge and understanding of lifetime streams and their benefits, including the tendency to frame them as an investment rather than as a means of underwriting a level of income for life and hence insuring against the 'risk of running out'. Policymakers might play a role in addressing behavioural factors in two ways:

- Providing more education and information on lifetime income streams, say through ASIC MoneySmart (which currently provides only basic information).
- Encouraging a reframing of lifetime income streams as a mechanism to guarantee some amount of income for life and emphasising their role within integrated retirement solutions. One mechanism could be through standardised disclosures, as raised in the Treasury retirement discussion paper on pages 17-18.

[3] MacDonald et al. refer to a paper (Babbel, D.F., 2008, "Lifetime income for women: A financial economist's perspective", *Wharton Financial*) showing that pricing could not completely explain the aversion to annuitisation, and referring to another study where the vast majority of retirees chose a lump-sum payment over an annuity even though the annuity was priced based on a guaranteed interest rate that was nearly three times the prevailing market rate and approximately twice as high as the expected return on risky assets at that time.

Essay #2 – Personal information that super fund trustees require to effectively cater for member differences

Main points

1. Policymakers should facilitate superannuation fund trustees to collect and use personal information for the design and offering of retirement solutions that cater for important member differences.
2. We support extending the use of the Consumer Data Right (CDR) by superannuation funds and giving fund trustees access to certain member data held by government agencies. However, we refrain from making recommendations over the details, as this is outside of our expertise.
3. The personal information that trustees are able to collect and use without triggering the full obligations under the personal financial advice rules might be defined as part of the Delivering Better Financial Outcomes (DBFO) reforms. We recommend the scope of this information be set with reference to that needed to match members to a suitable solution that is offered by the fund.

Introduction

The Conexus Institute paper of November 2023 titled *Pathways for directing members into retirement solutions* noted that one of the key challenges was to find a way that superannuation funds could deliver retirement solutions that cater for members with differing needs in a scalable and efficient manner. For this to be achieved, fund trustees require the capacity to collect and use a *sufficient yet manageable set of personal information* on their members. In this essay, we consider the core set of member personal information needed by superannuation funds to provide solutions at scale, without having to undertake a comprehensive fact-find (as currently required under the personal financial advice rules) or requiring members to pay for a financial adviser. We also explore the potential actions that policymakers might take to facilitate the collection and use of such personal information.

Key member characteristics

In other research (which can be provided on request), we discuss retiree characteristics and how they impact on retirement solution design. We nominate eight 'major' characteristics deemed of high importance for determining the retirement solution that is suitable for a member (see table below). The selection of these characteristics is informed by the academic literature and our own research, and is based around two criteria:

- The characteristic makes a significant difference to retirement solutions; and,
- The characteristic forms an important point of distinction between members for most funds.

These eight characteristics are a 'need to know' list for trustees to design retirement solutions that effectively cater for key differences across their member base, and to match members with suitable solutions.

Key member characteristics

Personal attributes	*Objectives and preferences*
1. Age 2. Total net financial assets a) inside of super b) outside of super 3. Homeownership 4. Partnered status (potentially expanding to household level)	5. Type of income stream desired 6. Preferences over income risk and related trade-offs 7. Tolerance for return volatility 8. Requirement for accessible funds

We are not suggesting that the characteristics listed above are the only ones that may be relevant[4]. However, we believe the list amounts to the core set of personal information that trustees should be aiming to collect in order to inform both member cohorting and retirement solution design, and to match individual members to retirement solutions (subject to the constraints of the personal financial advice rules). The list provides an aspirational objective for both superannuation funds and policymakers.

Potential sources of personal information

We now identify potential sources of the eight key member characteristics. The table below provides a roadmap by listing six possible sources, which are discussed after the table.

Potential sources of member personal information

Type	Characteristic	Already available to trustees	Potential sources				
			Member engagement	Consumer Data Right	Government databases	Internet search	Trustee assumptions
Attributes	1. Age	✓					
	2. Total financial assets						
	a) with the super fund	✓					
	b) outside of the super fund		✓	✓	**Limited**	**?**	
	3. Homeownership		✓	✓	✓	**Probably**	
	4. Partnered status	**?**	✓	✓	✓	**Limited**	
Objectives and preferences	5. Type of income stream desired		✓				**Limited**
	6. Preferences over income risk and related trade-offs		✓				**?**
	7. Tolerance for return volatility		✓				**?**
	8. Requirement for accessible funds		✓				**?**

Below we offer comments for each of the potential information sources based on our understanding. We do so with the caveat that we may have incomplete or possibly incorrect knowledge of the details of the data held by some sources and its accessibility.

a) **Existing information held by fund trustees** – This may be limited to just age and balance held with the superannuation fund, unless the member has provided information that may allow trustees to establish other characteristics, e.g. death nominations may indicate the existence of a partner.

b) **Member engagement** – Asking the member could potentially supply all the required information. Caveats include that the member may be unwilling to provide personal information to their superannuation fund, or they could supply incomplete or incorrect information if provided on a 'what comes to mind' basis.

c) **Consumer Data Right (CDR)** – The CDR is already available for accessing data held by banks, but might be expanded to permit trustees to collect information from government agencies (see point d) or perhaps other financial service providers that hold relevant personal information. The CDR might supply 'hard' information that is more reliable in some instances than that sourced directly from members. One issue with the CDR is that it would provide insights only into member attributes, and

[4] Other member attributes we acknowledge include life expectancy, health, personal network (e.g. expecting a bequest), Age Pension eligibility (e.g. residency) and gender (albeit effect mostly captured by other attributes).

not objectives and preferences. It hence would provide incomplete understanding of a member's needs and wants so they may be matched to a suitable retirement solution.

d) **Government databases** – Information on homeownership and partnered status is held within government databases, although homeownership would be at the state level. The Australian Tax Office (ATO) has complete knowledge of any superannuation of both a member and their spouse that could be held across multiple funds, and some information on investments. Access to information from these sources may allow trustees to paste together a more accurate picture of member attributes, even if incomplete. If the member receives the Age Pension or other social security benefits, then Services Australia (Centrelink) would have all the major member attributes we list above.

   Providing trustees with access to information held by government agencies might be achieved through the CDR (point c), or the Government mandating that certain information is made available to fund trustees. The latter may be politically difficult, especially with respect to personal information on individuals. It may be easier for government agencies to supply de-identified data to facilitate cohorting and solution design; although unidentified data would not help trustees to match members to suitable solutions. Again, a limitation is that information sourced from government databases only provide insights into member attributes but not member objectives and preferences.

e) **Internet search** – Trustees could feasibly source some personal information from the internet, noting this is done by many businesses. However, there could be issues with breaching trust with members in doing so. Establishing homeownership and partnered status may be feasible online, although this may only yield that a partner exists and not relevant information such as their assets or income. Similarly, ability to source information on any other financial assets that the member holds outside of the super fund may be limited. Again, the internet will probably not provide insights into member objectives and preferences, unless it can be imputed from observed member actions.

f) **Trustee assumptions** – The most problematic information to collect relates to the objectives and preferences of a member. Here an alternative approach may be for the trustee to make assumptions for the purpose of retirement solution design. Assumptions about objectives and preferences might be formed in a number of ways, which we mainly explain through examples.

   - *Imputing from existing information on the member* – An income target might be calibrated as an income replacement rate based on earnings prior to retirement, which in turn might be imputed from contributions. Homeowners could be assumed to need lower income and have less requirement for flexible access for funds[5] than renters. Tolerance to take risk might be imputed from investment options used in accumulation.
   - *Cater for a 'typical' member* – An income target could be set with reference to an income standard, such as those compiled by ASFA or Super Consumers Australia. Members might be assumed to have some base level of demand for flexible access to funds, and be provided with a modest precautionary or contingency account. (A 'capital account' of $50,000 is suggested as part of the 'example bundled retirement product' in the Appendix of the *Treasury retirement discussion paper* of December 2023). Members could also be alerted that the solution has been designed for a 'typical' member, and invite them to pursue another solution if they differ significantly from the average person.
   - *Minimise potential for harm* – In the absence of solid information on income needs, an income optimisation objective might be pursued rather than make tenuous assumptions about an income target. Low risk tolerance might be applied as a default assumption, thus limiting exposure to risky assets and setting drawdowns for lower income to reduce the risk of running out. Another example might be to limit the amount allocated to lifetime income streams to provide the member with an

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[5] A home is an asset that can be accessed through home equity release or downsizing if need arises and can be used to fund bequests and entry into aged care.

element of flexibility. Members could be alerted that the solution has been designed conservatively, and invited to pursue another solution if this is unsuitable for their needs.

The information sources discussed above are not mutually exclusive. Indeed, there may be benefit in trustees drawing on multiple information sources for cross-validation.

Potential policy actions

We see three sets of actions that policymakers might take to support trustees to collect and use personal information on their members. Our level of expertise on the first two action points related to the CDR and data held by government agencies is relatively low, and thus we largely offer support for investigating what might be done in these areas. We consider the third action point related to the personal financial advice rules to be of high importance. We initially raise the relation to the advice rules below, and then expand on how this matter could be addressed in the next section.

a) **Application of the CDR to superannuation** – We see the CDR as a potentially effective mechanism for collecting personal information. Accordingly, we support policymakers looking at ways to encourage super funds to make use of the CDR, and investigating how the CDR might operate with respect to data held by government agencies and other financial service providers.

b) **Provide direct access to data held by government agencies** – We also support exploration of this possibility and offer a few general comments. First, providing access to unidentified data is likely to be of modest benefit. Much greater benefit would arise from finding a way of supplying personal data on individuals to facilitate understanding of the member for use in matching them to a suitable retirement solution. Second, even just supplying some high-level information that allows trustees to better understand their members would be helpful. For instance, it might assist trustees to know whether an individual is also a member of another superannuation fund, has a spouse, is receiving an Age Pension, or is not earning any wage income and hence may be retired. Third, the major pieces of personal information required would be supplied if trustees were also acting as agents for the member in applying for, or even collecting, the Age Pension. Thus, the idea of super funds playing this role as mentioned in the Treasury discussion paper would have the ancillary benefit of providing trustees with a core of key personal information on members[6].

c) **Reframe personal financial advice as applied to superannuation funds** – The personal information that super fund trustees are able to collect and use without triggering the full obligations under the personal financial advice rules should be defined as part of the DBFO reforms. The Government has already indicated the intention to reformulate advice rules to expand provision of advice through super funds. We propose that facilitating the ability of funds to deliver suitable solutions to members in an efficient and scalable manner should be a key aim of these reforms. As mentioned above, we believe this requires a capacity to collect and use a sufficient yet manageable set of personal information without having to undertake a comprehensive fact-find or requiring members to take paid financial advice. The next section makes a suggestion for defining the scope of the information that may be collected and used by fund trustees.

Suggestion: Permission to collect and use certain personal information

The principle underpinning this suggestion is that trustees should be able to collect and use the personal information required to match members to a suitable solution amongst those offered by the fund without triggering the need to meet all the rules and requirements of personal financial advice. This framing would define the scope of advice and personal information that may be collected on the topic of identifying a retirement solution that is suitable for a member. It also ties the information that trustees are permitted

[6] We also note that super funds acting as a 'Age Pension' agent for members may also imply an ongoing obligation to monitor the status of member information that is relevant for Age Pension eligibility, including total financial assets and income for the purpose of the pensions means-test. Doing so would not be far from trivial.

to collect to design retirement solutions. For example, if trustees have designed their solutions to cater for members that differ by age, total financial assets, homeownership and partnered status, they would be permitted to collect information on all these characteristics and related key data (such as the assets and any income of a partner) for the purpose of identifying a suitable solution. Note we are not trying to rule out additional advice topics being addressed or services being supplied by trustees under other arrangements, e.g. applying for the Age Pension, or entering aged care. We leave this matter to the DBFO reform process. Rather, our intent is to propose a way that assists trustees in designing and matching members to retirement solutions in an efficient and scalable manner.

To give effect to the approach, a set of "prescribed factors" might be specified within legislation (or perhaps under delegated legislation to retain flexibility) that defines the personal information that trustees are permitted to collect and use for the purpose of design and provision of financial advice on retirement solutions. A similar approach is used within the MySuper legislation with respect to the 'lifecycle exception', which gives permission for RSE licensees to take into consideration (in addition to age) a member's account balance, contribution rate, current salary, gender and expected remaining time to retirement in designing lifecycle products.

A potential list of prescribed factors that might apply to retirement solutions appears below. The list covers the major characteristics with the objectives and references collapsed to a single general factor, and an explicit mention of the Age Pension being added given its importance to retirement solution design. The list below is for illustration purposes, and the factors included might be expanded on or extended (probably after industry consultation).

Potential prescribed factors for provision of advice over retirement solutions
• Age • Balance with the fund • Financial assets held outside of the fund • Homeownership • Existence of a partner, and their financial resources that are available to the member • Eligibility for the Age Pension and other social security benefits • Member objectives and preferences

We envisage that trustees would be able to collect and use personal information that is required to identify the factor of interest. For example, to ascertain the resources that a partner brings to the party, the trustee may need to collect information on their assets and possibly their income. Use of any of these prescribed factors by trustees might be subject to the condition that the factor is incorporated into the fund's retirement solution design.

Essay #3 – A brief note on the YFYS performance test and retirement product assessment and comparisons

Main points

1. Extending the tools for comparison and performance assessment of accumulation products - such as the YourSuper comparison tool and the YFYS performance test - to retirement will be very difficult and could lead to significant unintended consequences. At best, the YFYS performance test might be applied to return-generating components of retirement solutions, such as account-based pensions (ABPs). These assessment tools are quite unsuitable for other retirement products or retirement solutions.

Introduction

The Treasury retirement discussion paper raises the idea of developing counterparts to the YourSuper comparison tool and the YFYS performance test for retirement products. We counsel caution over extending these evaluation processes to retirement on any more than a very limited scale. For instance, the YFYS performance test could be extended to return-generating retirement products such as ABPs, ideally with adjustments to account for unique considerations associated with managing retirement investment portfolios. In this regard, there is a case for incorporating risk adjustments in to the YFYS test, which would be problematic in retirement as the nature of risk is complex and nuanced. In any event, we have strong reservations around introducing performance testing into the retirement phase for various reasons, included those covered in the dot points below.

Even if the YFYS test was applied to the return-generating components of RIS, we recommend that no attempt is made to extend the YFYS test to other retirement products or retirement solutions, or to provide comparison tools for use by members. Rather, RIS member outcomes assessments of the type outlined above should form the foundation of assessment in retirement. These assessments could incorporate the effectiveness of individual products as one of the items that needs to be assessed.

Variety of issues inhibit effective translation of the YFYS performance test to retirement products

A variety of issues inhibit effective translation of the YFYS performance test to retirement products, and the potential use of its output as a basis for comparisons made by members:

1. **Income delivered matters most, but is unobservable** – The central concern in retirement is generation of income over an extended horizon into the future. As the income stream delivered is unobservable, it is virtually impossible to conduct ex post assessment of the primary member outcome of concern on an ongoing basis. This insight leads to the conclusion that ex ante assessment is required, as discussed in the Conexus Institute RIS assessment paper of December 2022[7].
2. **Retirement solutions comprise a combination of building blocks** – Income is often likely to be delivered through retirement solutions that combine investments, products and strategies (notably including a drawdown strategy), rather than through individual products. Any assessment of individual retirement products would thus be evaluating one component of a broad solution that could be only weakly connected with the outcomes delivered. How the various building blocks are combined is more important, and can only be assessed by examining the overall outcomes expected to be delivered. For instance, performance evaluation of ABPs does provide some insights, noting that higher returns boost the income delivered to members. However, this exercise does not speak to whether members are being delivered income streams that are suitable for their needs, whether

[7] Bell, D. and Warren, G., "Assessing retirement income strategies … when outcomes are but a promise", 2 December 2022

risks to income are being managed appropriately, or whether an appropriate level of access to funds is being provided. Only examination of the overall solution can speak to these matters.

3. **Assessing lifetime income streams is problematic** – Products that deliver lifetime income streams cannot be comprehensively assessed in isolation, but rather should be assessed in light of the role being played within a retirement solution. It is the particular characteristics of the product and how it is being used that matters. At best, it might be possible to undertake an analysis of fees and pricing (i.e. rate of income offered) for a product. However, doing so is complicated as the fees and pricing can reflect the cost of providing certain features, e.g. providing access to funds, either directly or as a death benefit.

4. **Comparison tools are likely to be ineffective in retirement** – Providing members with comparison tools is unlikely to yield meaningful benefits. The complexity of retirement makes it extremely difficult to generate simple comparison metrics that can be understood by members, who are often limited in their cognitive abilities (see Essay #1). Further complicating matters is that the appropriate retirement solution for a particular member varies depending on their personal needs and circumstances. For instance, members may differ in their preferences over expected income, income risk and flexible access to funds; the desire for front-loading versus restricting income so it is more likely to be sustainable; and their Age Pension entitlements. It is hard to consolidate these various dimensions into basic metrics. There is also a risk of unintended consequences due to members misinterpreting or misusing metrics. For instance, comparing ABPs based on performance might encourage take-up of retirement solutions offered by funds with the highest returns, without consideration of whether those solutions lack crucial features or do not suit the particular member.

In summary, we concede that a version of the YFYS performance test might be applied to return-facing components of retirement solutions such as ABPs, and then used within RIS assessments. We recognise this possibility by including "investment performance of market-exposed building blocks" and "fees/prices" on the previous list of areas to be assessed. Our overarching point, though, is that any product assessment should be subsumed within broader RIS member outcomes assessments.

Essay #4 – Role of superannuation fund trustees within the choice architecture for retirement solutions

Main points

1. The role that superannuation fund trustees are expected to play within the choice architecture for retirement is a foundational issue for policy, and feeds directly into including the *Delivering Better Financial Outcomes* (DBFO) reforms.
2. The potential 'choice spectrum' ranges from consumer self-direction, to personal advice from a financial adviser, to various forms of trustee direction where the trustee identifies a comprehensive retirement solution for a member. We see benefit in enabling trustees to span much of the spectrum, including some form of trustee direction under which trustees identify a comprehensive retirement solution for members who are not capable or willing to make financial decisions for themselves.

Introduction

We have two primary aims in writing this essay. First is to make the point that consumers should be given a choice over how they engage with decisions in retirement. They should be able to choose whether they decide for themselves, seek out a financial adviser or have their super fund identify a suitable solution on their behalf – which we call "trustee direction". The second is to argue for the need for trustee direction in the retirement income system. Here the motivation is concern there exists a class of members who are not well placed to make informed decisions over financial matters for retirement, and that the policy debate is not directly addressing how to best cater for these members. The type of member we have in mind may lack the cognitive ability or motivation to engage with retirement decisions. We suspect that some members in this group are traumatised by the idea of making financial decisions, and would actually *prefer* that somebody provide them with clear direction rather than make *any* choices for themselves. While financial advisers can play this role, financial advice is expensive and capacity constrained. It cannot cater for all consumers that need assistance. We consider super fund trustees as the other natural party to assist such members by selecting a comprehensive retirement solution on their behalf, and offering it to them.

Our overall position regarding the role of super funds within the choice architecture is that we see benefits in fund trustees playing multiple roles, thus catering for the variety of ways in which members engage with retirement decisions. Within this, we consider it important that the role extends to making choices on behalf of members who are incapable or unwilling to make financial decisions.

Background

The role that superannuation fund trustees might play in guiding members has become a central policy issue. In a speech on 7 December 2023, Minister Stephen Jones indicated the intent of the Government to "expand the role of superannuation funds in providing advice to their members" under the DBFO reforms. He referred to various potential adjustments to the advice framework including a new class of financial adviser, defining the topics that may be addressed under collective charging, and allowing funds to 'nudge' members. The issue of providing better guidance and assistance to members also emerges in the *Treasury retirement discussion paper* of December 2023. This includes mention of nudging members through 'default' settings, or 'default' solutions for sub-classes of members (which we refer to as member 'types'); simplifying the retirement system so it is easier for members to navigate; and standardising product disclosures so they can be more readily understood and compared by members.

The role that trustees might play in guiding members was addressed in a Conexus Institute paper of November 2023 titled *Pathways for directing members into retirement solutions*, denoted here as our 'pathways paper'. This paper discussed the mechanisms through which members might find their way to a suitable retirement solution. We delineated the pathways according to the party responsible for identifying the retirement solution. This included the member themselves (self-direction), a financial

adviser (adviser direction) or a super fund trustee (trustee direction). The latter comprised three pathways of trustee recommendation, trustee assignment and default. We envisaged the trustee direction pathways entailing trustees identifying comprehensive retirement solutions for individual members, with members required not to make any choices other than whether to request trustees to provide direction and then whether to accept the retirement solution they were offered. That is, we assumed that the member would not be forced to make any financial decisions unless they wanted to.

This essay builds on our pathways paper in focusing on the role that super fund trustees might play in the choice architecture for retirement solutions. We revisit and hone the choice structure presented in the pathways paper in light of the stated intentions of the Government with regard to the DBFO reforms and the Treasury retirement discussion paper, particularly around the mention of 'nudges' and 'defaults'. We also point out the need for policymakers to establish a clear position on the role (or roles) that they envisage trustees playing, and then look to enable trustees to perform their role(s) through the policy framework.

Framing the policy discussion

In our view, the current framing around the DBFO reforms as well as the recent Treasury retirement consultation on the retirement phase limits the scope of the policy discussion in some areas:

1. **Presumption that members are willing and able to choose on some level** – The current policy discussion continues to be based around a presumption that members are willing and able to choose on some level in identifying the retirement solution that is suitable for their needs (or otherwise seek out paid personal financial advice). The matters being raised by policymakers seem directed at assisting members to make better decisions. For example, the Treasury retirement discussion paper refers to nudges in the form of 'default settings' or 'default solutions' designed for member types (i.e. sub-classes). Engaging with these nudges still requires some level of choice by the member. For instance, members would still need to decide if the default settings are suitable, while making choices around solution components not covered by the nudge. Default solutions for member types require the member to exercise much less choice, but still require them to understand and self-identify with their member type. The framing does not seem to address members who may be unwilling or incapable of making financial decisions for themselves on any level.
2. **Trustee direction is not directly contemplated** – Trustee direction as discussed in our pathways paper involves the trustee identifying a retirement solution that is suitable for the member *on their behalf and offering it to them directly* – either through recommendation, assignment or default. The possibility of facilitating some form of trustee direction appears to sit outside the current discussions. Policymakers should give strong consideration to providing trustees with the capacity to identify a suitable retirement solution and offer it to individual members, thus playing a role that extends beyond presenting options to members and assisting them to make choices.

Note we adopt slightly different terminology to that used in the Treasury retirement discussion paper. First, we prefer member 'types' rather than 'sub-classes', noting that the latter seems to presume a cohorting process. Second, we suggest that the word 'default' should only refer to situations where the member is not required to make any choice in identifying a retirement solution or its settings; and 'recommendation' is used where an element of choice is involved.

Choice spectrum

To assist the policy deliberations, we first present a 'choice spectrum' to delineate the range of roles that could be played by super fund trustees versus members in choosing suitable retirement solutions. The table below describes this choice spectrum as ranging from self-direction where a member chooses for themself, to three types of trustee guidance where the trustee offers some form of recommendation, through to default mechanisms where the trustee assigns a member to a solution. The spectrum captures the degree to which the member or the trustee is responsible for identifying either a suitable retirement solution or certain solution components.

The table adjusts the delineations in our pathways paper. We have excluded the adviser direction pathway in order to focus the table on the nature of the engagement between trustees and their members. We have also combined trustee assignment and default, denoting them as types of default in the sense that both entail the trustee assigning the member to a solution. The key difference is that trustee assignment occurs at the request of the member, while default occurs without member assent.

The choice spectrum appearing in the table captures the varying roles that might be played by trustees in guiding members towards retirement solutions. It thus maps out potential divisions of responsibilities for making decisions around retirement solutions between trustees and members. On the left side, trustees act as providers of products and services to members, who might be considered customers and primarily responsible for making decisions. On the right side, trustees act as fiduciaries who are looking after their members as beneficiaries and are carrying the decision-making load.

Choice spectrum for retirement solutions: Roles of members and trustees

Self-direction *(member choice)*	Recommended settings *(limited nudges)*	Recommended solutions for member types *(firm nudges)*	Trustee recommendation of a comprehensive solution *(strong nudge)*	Trustee assignment and trustee default *(forms of default)*
Member initiates action and makes decisions	*Trustee directs member in some way* →			*Trustee assigns member*
Trustees as providers; members as customers	← →			*Trustees as fiduciaries; members as beneficiaries*
• Trustee provides solutions, products and services, e.g. decision tools, information • Member engages with fund offerings and makes choices • Accommodated by current financial advice rules; amounts to the *status quo*	• Trustee provides solutions, products and services that include recommended default settings (perhaps for particular member types) • Member engages with fund offerings and makes choices cognisant of default settings • Examples of default settings: - recommended drawdowns - lifetime income streams for certain balances - asset mix within account-based pension • DBFO reforms might consider allowing personal information to be used in directing nudges	• Trustee offers set of recommended default solutions designed for member types (sub-classes) as defined by cohorts or personas • Member engages with options offered; may adopt solution based on self-identified member type, or choose from other solutions and products on the menu • DBFO reforms might consider allowing personal information to be used in assisting members to identify their member type, or in directing any nudges	• Trustee collects personal information and uses it to recommend a retirement solution to the member • Could be based around either member cohorts or personal tailoring • Member only required to request recommendation, which they may then accept or reject • DBFO reforms would need to permit personal information to be collected and used to ensure recommendation is appropriate for member	• Both entail direct assignment to a solution by trustee, either on request or upon member taking no action • Trustee attempts to collect personal information to effect assignment • Legislation would be required to enable trustees to assign members

The three middle columns of the table capture the forms of recommendation that might be made by trustees. The second and third columns cover what the Treasury retirement discussion paper refers to as 'default settings' and 'default solutions', where the latter entails recommended solutions for member types (or sub-classes) as defined by cohorts or perhaps personas. As mentioned above, both these forms of recommendation require engagement from members with what is being suggested, and hence entail some element of member choice or self-direction. The fourth column is trustee recommendation as described in our pathway paper, where trustees identify and recommend a comprehensive retirement solution to the member. A key point of distinction is that trustee recommendation *does not force the member to make any financial decisions*, apart from asking the trustee for a recommendation and accepting it. We view all three recommendation-based mechanisms as nudges to varying degrees, ranging from a limited nudge for recommended settings through to a hard nudge for trustee recommendation where the member is not required to exercise any choice in identifying a solution.

We envisage opt-outs being provided under all mechanisms. Trustees would also make decision support services available to all members regardless of the mechanism.

Policy implications

The positioning of super funds across the choice spectrum as outlined in the above table has a range of implications for the superannuation industry and related policy, legislation and regulations. Below we highlight and discuss three implications that are important at the current juncture.

Consumer choice

Allowing super funds to span the choice spectrum would provide maximum choice to members over how they engage with financial decisions in retirement. Fund trustees might provide decision support services such as tools and information to assist self-directed members in building or choosing their own retirement solution; selected nudges to members who might want to choose for themselves but require assistance; and trustee direction for those members who would prefer the super fund to make decisions on their behalf. Super funds would also provide access to paid financial advice for those members who would prefer this pathway.

Trustee obligations

Establishing the positions on the choice spectrum across which super funds are expected to operate would inform the issue of trustee obligations. A flash point is the degree to which trustees are acting as product and service providers or fiduciaries. The provider role implies an obligation to supply an effective range of products and services that members may use. The fiduciary role implies a concern with the best interests of all members, and notably involves duties of care, loyalty, good faith, confidentiality, prudence, and disclosure. It suggests that trustee obligations might include a requirement to take positive steps to ensure that all members are looked after.

Need for trustees to collect and use personal information

The requirement for personal information about *individual members* increases in moving along the choice spectrum to the right. Under self-direction (which amounts to the *status quo*), trustees provide products and services without needing to access personal information. In this case, collecting general information about the member base would be useful for RIS design (e.g. forming cohorts), and amounts to one of the areas for improvement highlighted in the APRA/ASIC joint review. Recommendations of retirement settings or retirement solutions for member types does not strictly require access to personal information on individual members. However, access to personal information would assist trustees to gauge whether the recommendation might be suitable, i.e. whether to provide the 'nudge'. For instance, knowledge of member characteristics such as total financial assets, homeownership or existence of a partner may inform trustees on whether to recommend considering a lifetime income stream or honing the member types or personas to present to the member.

Recommending or assigning members to a comprehensive retirement solution – as envisaged under trustee direction – necessitates the collection and use of personal information on individual members to be effective. For example, trustees cannot identify the cohort to which a member belongs without knowledge of how the member lines up against the personal characteristics on which the cohorts have been defined. Essay #2 discussed this issue in some depth. The requirement for access to personal information on individual members has important implications for the DBFO reforms.

Case for and against accommodating trustee direction

The key policy question at hand is how far along to the right of the choice spectrum should super funds be allowed to operate, noting that trustee direction as we envisage it is not being contemplated. We now unpack this issue a bit more.

While our pathways paper was largely written as a reference document, we nevertheless argued that trustee direction should be facilitated in some form (see pages 3-4 in particular). However, our pathway paper was written as if a clear delineation exists between self-direction and trustee direction. As highlighted in the prior table, we are actually dealing with a more nuanced spectrum where there is potential for trustees to make recommendations on a lesser level than suggesting a comprehensive retirement solution, e.g. presenting recommended solutions for member types. We revisit the debate of the role for trustees in this light. That is, could nudges of a more restricted form suffice? Or is trustee

direction as envisaged in our pathways paper required? Here we reiterate that the key distinction is the degree of engagement over financial decisions that is required from members, noting that it is minimised under trustee direction.

- **Effectiveness of nudges** – One argument for facilitating trustee direction is the relative strength of the nudge that it affords. A definitive recommendation (or assignment) for a comprehensive retirement solution presents as a strong offering on which the member might anchor, relative to presenting a choice menu or recommendations over particular solution settings. The advantage of a definitive recommendation is that it should increase the probability that members will adopt beneficial solution features that could otherwise face resistance. For instance, members may be more likely to purchase lifetime income streams or apply higher drawdown rates if presented as part of an integrated solution. This issue is particularly relevant given the interest expressed in the Treasury retirement discussion paper in making lifetime income products more accessible and improving drawdown behaviour. Trustee recommendations should provide a more effective means of shifting member behaviour than recommended solutions for member types, which in turn may be more effective than recommended settings. Trustee assignment and trustee defaults would be even more powerful. We see nudge strength as an important reason to facilitate trustee direction.
- **Supporting a class of member that might otherwise be left behind** – Perhaps the strongest argument for facilitating trustee direction is the existence of a class of member who is unwilling and incapable of successfully engaging with retirement decisions on any level, as highlighted in the 'motivation' section and initially discussed in Essay #1. For example, these members may have very low financial literacy, poor comprehension (e.g. migrants with poor English), low cognitive ability, 'fear of finance' or be suffering cognitive decline. Such members should benefit from being 'looked after' by trustees. Such members may be left behind in the absence of scope for trustees to select a retirement solution on their behalf.
- **Accommodating member preferences** – Providing a wide range of pathways accommodates differing preferences for how they want to engage with retirement decisions. This argument suggests allowing superannuation funds to span the entire choice spectrum, thus supporting members to choose their own pathway.
- **Legislative change that is required** – The extent of change required to the regulatory framework tends to increase as the choice architecture moves further from the *status quo* based around self-direction (and personal financial advice as currently defined). For example, facilitating trustee direction necessitates permitting trustees to collect and use relevant personal information, which in turn would be wider in scope than that required to support other forms of nudges. Trustee assignment would require additional legislation to enable trustees to make an assignment. Trustee default would require even further legislation around the default process.
- **Demands on trustees and regulators** – The demands placed on both trustees and regulators increases in moving from the left to the right of the choice spectrum, although the demands on the members simultaneously decrease. The more territory that is spanned by trustees and regulators, the greater the complexity and the more work they will need to do. For example, it is much easier for trustees to provide a range of products and services for use by members than it is to also understand and tailor for individual members. The burden on regulators also increases due to the need to assess whether trustees are operating in the best interests of members who may be disengaged. Meanwhile, the need for financial product regulation remains. In this regard, trustee direction would entail a step-change in the demand placed on trustees and regulators, and hence should be more costly. A consideration in this regard is whether super funds and regulators can build the required capabilities to span the choice spectrum effectively.
- **Impacts on competition and reliance on trustees** – Competitive tension reduces and reliance on trustees increases in moving toward the right of the choice spectrum. Risks relate to embedding more vertical integration into the system, and the possibility that some trustees could fail to implement effectively and act in a member-aligned way. We discuss the limits on competition in Essay #1, where we argue that competitive forces are likely to be weak in retirement in any event.

After balancing these considerations, we conclude there is a relatively strong case for facilitating some form of trustee direction, i.e. the role of trustees extending into the right side of the choice spectrum. Establishing a mechanism for looking after members who are poorly placed to make decisions for themselves is our primary reason for forming this conclusion; although the ability to issue strong nudges is also a substantial consideration. We consider the benefits large enough to justify the greater effort and costs involved.

Facilitating trustee direction in the form of trustee recommendation should achieve most of the benefits, and may suffice while not requiring the same degree of legislative change. However, if trustee recommendation were to be accommodated, trustee assignment would then become relatively straightforward for funds to implement given the underlying mechanism for identifying a solution for the purpose of making an assignment is very similar to that required to offer a recommendation. Hence legislative change to permit assignment might also be contemplated. Defaults are more problematic for reasons outlined in our pathways paper, and might be considered at a later time.

Concluding comments

We have framed the issue of the role of super fund trustees in assisting retired members as related to the choice architecture around retirement solutions. The policy question at hand is how far should trustees be permitted and expected to go in guiding members to a suitable retirement solution, i.e. how much of the choice spectrum should be spanned by superannuation funds? Should super funds largely play the role of providers of solutions, products and services to members, including assisting members to make better decisions? Or should their role extend all the way to identifying a suitable retirement solution on behalf of individual members?

We recommend giving strong consideration to facilitating trustee direction in some form. Here the central question is whether it suffices to rely on members to take action and make choices with regard to retirement financial decisions on some level? Or should trustees be given the scope to recommend or assign members to a retirement solution to assist members who are incapable or unwilling to make decisions for themselves? We see a strong case for accommodating this group of members through establishing the capacity for trustees to identify and offer comprehensive retirement solutions on the basis that there exists a meaningful group of members who would benefit. We also view accommodating such members in this way as consistent with maximising choice for consumers over how they prefer to engage with financial decisions in retirement.

Essay #5 – Business barriers to developing retirement income strategies (RIS)

Main points

1. Super funds face a range of barriers that challenge the business case and act to delay the development of RIS. For many funds there is likely a strong conflict between the rational business case to develop a high-quality RIS and the obligation to do so. Our concern is that retiring members will be the release valve through funds delaying and/or under-developing their RIS. Policymakers should allow for these business barriers in framing policy and setting expectations around delivery times.
2. A policy measure that might address these business barriers could be to enact a licensing regime for the retirement phase (see Essay #6). It would reconcile some of the issues by providing clarity of requirements and a choice for trustees to not participate in the retirement market. Other measures might include imposing additional obligations on trustees or introducing a retirement members outcomes assessment framework.

Introduction

Policymakers and the regulators are clearly concerned that the progress made by super funds in developing their RIS has been less than hoped. However, we feel that there are some genuine business barriers around the development and delivery of a RIS which should be recognised. Further, we believe they are grating against trustees delivering on their obligation under the Retirement Income Covenant (RIC) to assist members with their retirement needs. The Conexus Institute has been aware of the existence of business hurdles[8], but to date there is little analysis on the topic. This essay describes these business barriers so that policymakers (and regulators) may take them into account.

Barrier 1: Financial case for RIS development can be tenuous for some super funds

The first business barrier is that the financial case for developing RIS may be weak for some funds. We discuss this issue through the lens of analysing the commitment of resources to developing a RIS as an investment project. The table below sets out some of the key considerations in building a financial case through this lens, along with examples of specific matters that might be addressed in RIS development.

We note that the financial cases for profit-for-member funds and for-profit funds may differ. One key point of differentiation is how projects are funded. Profit-for-member funds finance projects through spending members funds (sourced through operational fees), while for-profit funds finance their initiatives through external shareholder funds. This may flow through to differences in the business case analysis in two main ways:

- Areas such as improving members outcomes can be captured more directly in a profit-for-member fund, whereas for a for-profit fund member outcomes do not directly impact financial outcomes to shareholders (though there is likely a strong indirect impact via member experience / retention).
- Profit-for-member funds and for-profit funds may use different discount rates in their business cases. For profit-for-member funds, the opportunity cost might be set in line with the expected investment return of the portfolio[9], whereas for-profit funds may apply a discount rate reflecting the required return-on-equity for shareholders.

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[8] For example, see *"Business case for retirement needs to stack up"*, Investment Magazine (2021).

[9] Projects in profit-for-member funds can be funded through strategic reserves (which would otherwise generally participate in investment portfolio returns) and/or through higher operational fees. When the member bears the

Overview of considerations in constructing a financial case

Business case feature	Applied to retirement
1. Investing in a business opportunity may be analysed as the **net present value (NPV)** of operating cash flows = revenues less costs, and investing cash flows, such as capital spending. For example: *NPV = Discounted value of (revenues – costs – capex)*	*Examples of benefits include:* • Attracting new members • Member retention • Improved member outcomes *Examples of costs include:* • Staff employed by the retirement function • Member servicing • Governance and compliance *Examples of capex include:* • Establishing systems to tailor towards, and service, individual retirees • Retirement solution and product development
2. The NPV is impacted by **timing of cashflows**, with the discounted value of cash flows further into the future being lower.	*Examples:* • The benefits for members span out over retirement • Fund demographics, and a super system that is still maturing, may act to delay the benefits • There would be a time lag in attracting new members
3. The NPV of a business case is impacted by the **discount rate** used to value future cashflows, which is affected by cost of capital and project risk.	*Example:* • The discount rate might be set as a hurdle rate, such as the expected portfolio rate of return in a profit-for-member fund or the shareholder's required return on capital in a for-profit fund.
4. **Risk and uncertainty of outcomes** can be reflected in the discount rate, or captured by considering different scenarios and applying a probability weighting.	*Example:* • Policy uncertainty may require a return premium or give rise to potential scenarios where an initiative fails and needs to be unwound or modified • Specific examples include longevity product legacy costs and advice process re-engineering.

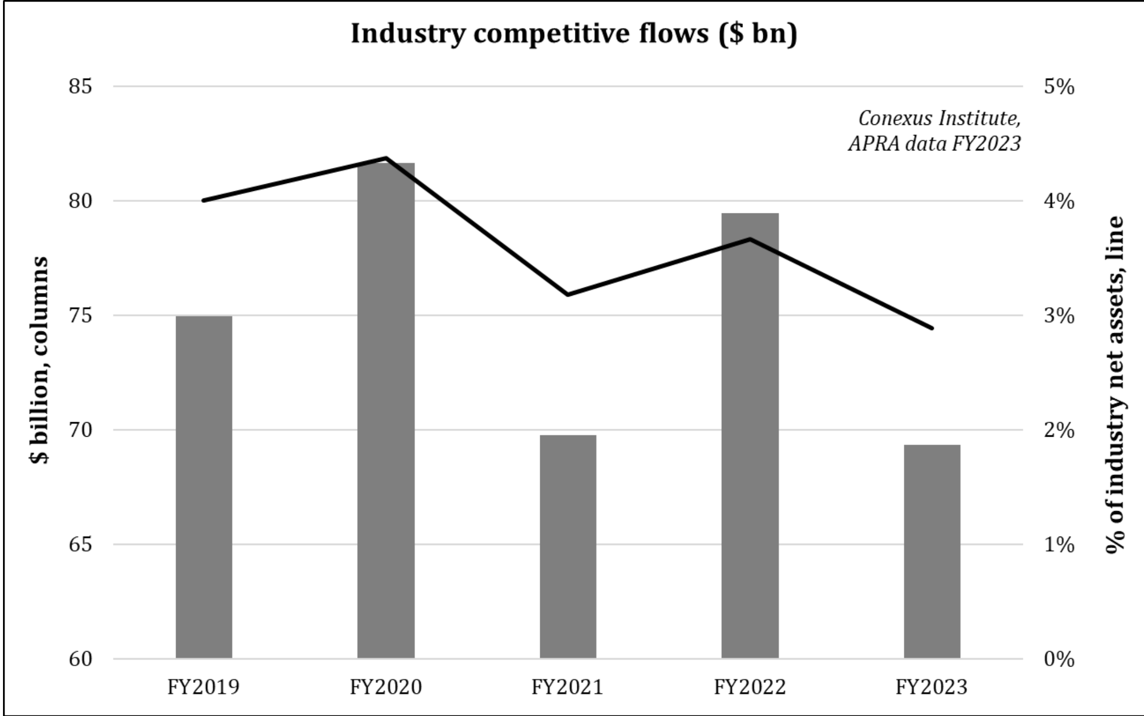
Within the NPV framework, a range of issues impact on the financial case for committing resources to developing a RIS retirement:

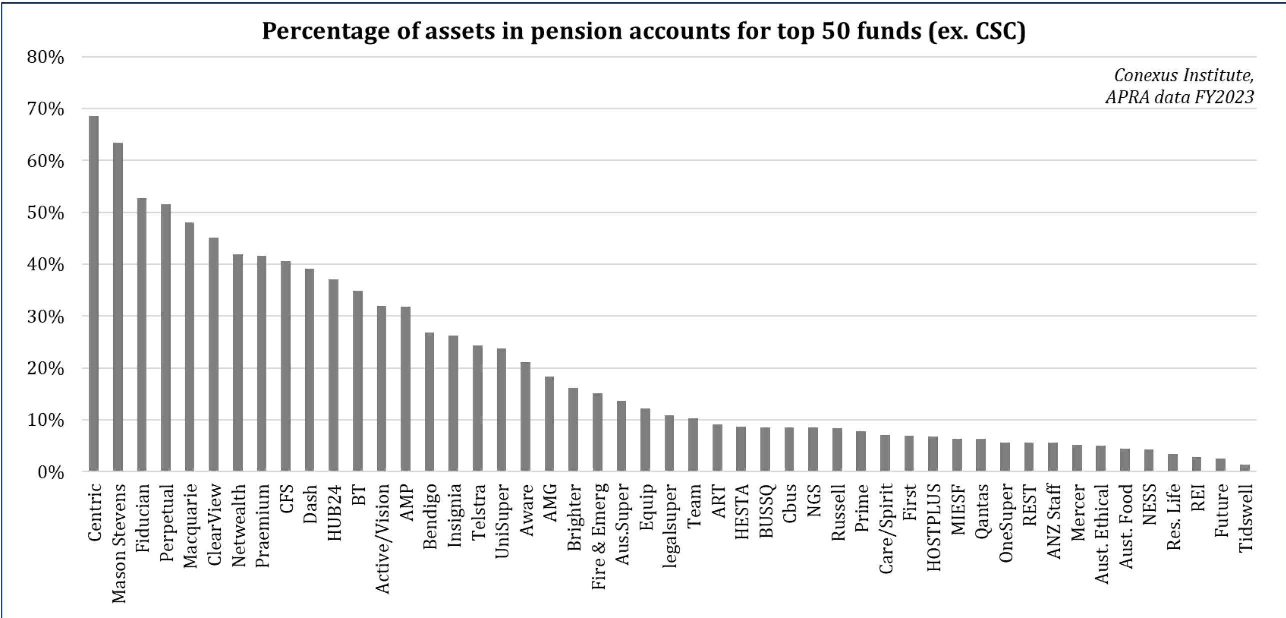
1. **The revenue opportunity is unclear, but appears weak** – Rates of member switching between funds are relatively modest (see chart over); and in any event it is difficult to identify whether switching rates are higher or lower during the retirement phase. We see little evidence of a competitive marketplace for the retirement offerings provided by funds, with the potential exception being fund platforms used by financial advisers. Rather, we consider it likely that a strong incumbency effect exists in retirement.
2. **Costs and capex should be high for retirement** – Key drivers of higher cost in the retirement phase include the need to cater for members with differing circumstances, needs and wants; the complexity of delivering retirement solutions that comprise a combination of investments, products and drawdown strategies; and the greater call for offering guidance to members who are retired or contemplating retirement. These features create a need for an expanded capacity to tailor and service individual members. This can be quite costly, including raising the bar on member information and

cost through fees, the trustee takes assets away from the member that would otherwise have participated in investment returns.

systems in particular. In contrast, there is greater opportunity in accumulation to offer products and services that are more generic in nature, while member servicing requirements are lower.

3. **Significant dispersion in the demographic profiles of super funds** – Assets and members in retirement is a small component for some funds (see second chart below). This can make the financial case for RIS development less attractive through both reducing the number of members who would benefit or generate revenues for the fund. It may also delay the timing of benefits relating to improved member outcomes to the extent that a trustee may have a preference to invest in retirement until there is a substantial cohort of retirement members.





4. **Uncertainty over the policy and regulatory environment is significant** – While the message from Government and regulators is clear ('deliver a strong retirement offering!'), the policy environment is less clear and highly contested in some areas. The uncertainty can give rise to downside risk scenarios that reduce expected NPV. Key areas of policy uncertainty include:
   - Though the Government has outlined its intention around provision of financial advice, the Delivering Better Financial Outcome reforms process is not yet complete, nothing has been

legislated, and regulatory structures to complement the legislation have not been developed. Indications are that this will be a contested policy area.

- Frameworks for assessing the RIS developed by super funds by APRA and other groups such as research houses have not been developed. Assessment may impact the nature of what funds need to deliver through their RIS, and hence adds to the uncertainty.
- The Treasury retirement discussion paper indicates that the Government is considering provision of longevity pooling, which could disrupt existing product development activities.

Barrier 2: Other business case considerations may not line up

The considerations in forming a business case typically go beyond financial analysis. For example, the following might be influential:

- **Business strategy** – Businesses can decide to address a market to either exploit or build competitive advantage. From this perspective, some funds might form the view that retirement is not a market they are well-positioned to address. This could be due to a member base that is highly skewed to younger members, lack of the scale required to offer an effective RIS, or an intention to pursue mergers first in order to build scale for the future. Funds with a smaller number of members in the retirement phase will also face heightened considerations around cross-subsidisation, given that all members would in effect be incurring the RIS development cost.
- **Keeping open your options** – Developing a RIS represents a commitment to a certain course of action. The concept behind real options suggests that it is often more valuable to keep a business option alive than to exercise it. In addition, it may make sense from a business perspective to be a follower than sit at the 'bleeding edge', especially when uncertainty exists over policy and technologies.
- **Legacy risk** – Related to the above, developing retirement solutions, products and services when considerable uncertainty exists gives rise to legacy risk. Legacy risk with respect to products can be a substantial business consideration, as products can be quite difficult to wind up once members have invested. This risk might be particularly meaningful for lifetime income streams.
- **Personal incentives of business leaders** – While arguably not a good excuse, personal incentives to put a lot of effort into RIS development may be weak for the boards and management of some super funds. Developing a RIS is hard work and would make life more difficult for the leadership; and it is not always obvious that personal financial rewards exist for taking on the challenge (apart from a sense of mission and purpose). Career risk – or the fear of making a mistake and being held accountable – may also be at play.
- **Capacity and competing projects** – Funds have a limited capacity for how many projects they can take on. While some projects will be board or executive team initiatives, many will be in response to policy and regulatory requirements. As an example, APRA has released its policy and supervisory priorities[10] for 2024 listing a very broad range of areas requiring attention, including (in addition to retirement) cyber resilience, operational resilience, climate risk, the Financial Accountability Regime, GCRA (governance, culture, remuneration and accountability), recovery and resolution, investment systemic risk and investment governance, system transparency and financial resilience.

The principles-based nature of the RIC provides an 'out' for funds where the business case and incentives for RIS development is weak.

Barrier 3: Development time frames

The time frames involved in developing a RIS are substantial. Even funds that started on the retirement journey in earnest many years ago are still firmly in the development phase. We hear of time frames like 2-3 years to develop new products and bring them to market. Systems are critical, where development

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[10] APRA – Interim Policy and Supervision Priorities update (January 2024).

times can be long, and delays and cost below-outs are commonplace. We heard one anecdote that post-merger system integration was acting as a pre-requisite to enable the offering of retirement solutions. Meanwhile, organisational resources that are being absorbed by other initiatives including the need to respond to policy change and meet an increasing regulatory load (discussed above) and bed down mergers are reducing the bandwidth to deal with retirement. Finally, some funds face criticism over their administration and customer service, which will likely need to be resolved first (or at least in parallel) to enable effective development and implementation of a RIS.

We feel that the policymakers and regulators (and the media) may not have made sufficient allowance for such development lags and hurdles in criticising the industry for insufficient progress. While there are some funds that may deserve the criticism, other funds are making genuine efforts to develop their RIS but are facing some genuine hurdles. It is also an unfortunate but an irreversible fact that many funds delayed developing their RIS until the RIC was in place. These funds cannot be reasonably expected to turn the situation around quickly.

Implications for super funds – clear directive, conflicted business case

The business case for retirement is uncertain and, in our estimation, does not stack up for some funds through a purely commercial lens. Meanwhile, the RIC has created a non-negotiable obligation on trustees to develop RIS. Many trustees will find themselves conflicted. This situation could motivate a range of activities that might be considered rational but are counter to the spirit of the RIC, such as:

- ***Proceeding slowly*** – Doing so should not overly affect the revenue opportunity, and may provide an opportunity for some policy and regulatory risks to moderate.
- ***Do not lead*** – There is little revenue upside but many risks in taking the lead. Risks in being a leader relate to uncertainty over the policy and regulatory framework, the possibility of developing what turns out to be a legacy product or service, and possibly career risk.
- ***Focus on areas that align with other business functions*** – An example might be improving member administration and data, which will also assist to service accumulation members.

In identifying and acknowledging the pressures created by the conflict between the obligation versus the business case to develop RIS, we are concerned that retiring members will be the release valve through funds delaying and/or under-developing their RIS.

Implications for policymakers (and regulators)

The issues discussed in this essay have three main implications for policy and regulation:

- ***Business influences might be considered in framing policy*** – How fund trustees could respond to measures might be considered in framing policy. For example, making the RIC principles-based arguably afforded fund trustees with flexibility to do the minimum required in meeting their obligations around RIS development. This is one of the reasons for considering enacting a licensing regime (see Essay #6), or imposing additional obligations on trustees to deliver a RIS to a minimum standard or introducing a retirement members outcomes assessment framework.
- ***Allow reasonable time frames*** – The time it takes to develop and implement a RIS might be allowed for in formulating any new policies, and also the manner in which regulators engage with the industry over RIS development. It is for this reason that we are suggesting that any policy to introduce a retirement licensing regime should come into formal effect in a few years' time, thus giving the industry time to develop their offerings and processes.
- ***A retirement licensing regime may provide a useful business strategy decision point*** – Introducing a retirement licensing regime would require super fund trustees to address the business case for participating in the retirement market. It would hence establish a connection between retirement policy and business influences, while providing a mechanism that could remove the compulsion for funds to provide a RIS where the business case does not stack up. It could also help resolve the issues around development time frames by setting clear expectations around the timing of delivery.

Essay #6 – Exploring the case for a retirement licensing regime

Main points

1. Policymakers might explore the possibility of introducing licensing for super funds to operate in the retirement market. Licensing should provide a means of spurring action from super funds in developing their retirement income strategies (RIS) to a required standard, while encouraging fund trustees to consider the business case for being in the retirement market.

Introduction

A licensing regime to operate in the retirement market could act as a regulatory instrument that achieves a range of policy goals. Through establishing licensing conditions that need to be satisfied in order to operate in the retirement market, a licensing regime would:

a) spur super fund trustees to get moving in developing their RIS within a specified time frame;
b) provide direction to trustees on what is required in developing a RIS;
c) protect members through setting minimum standards of delivery;
d) reduce dispersion across the industry in the quality of their retirement offerings;
e) prompt trustees to explore the business case for addressing the retirement market; and,
f) provide an exit route for those funds where the business case is tenuous.

A retirement licensing regime – High level overview

Licensing is a well-recognised regulatory mechanism. The box below summarises some of the key features of licensing regimes as outlined by the Bureau of Industry Economics (which was subsequently merged into the Productivity Commission). While this report dealt with business licensing in general, there are numerous precedents for licensing in financial services including banking, financial advice and most notably super through registerable superannuation entity (RSE) licenses and MySuper licences.

Overview of a Government report into licensing

The Bureau of Industry Economics issued a report in 1996 titled *Business licences and regulation reform* that discussed licensing. Listed on the left below are the four reasons provided for licensing. Reasons 2 and 4(a) are the most pertinent for retirement. Listed on the right are characteristics of licensing, which notably includes standard setting. The report also notes the scope for 'negative' licenses, where licenses are given but revoked if certain conditions are not met. It identifies adverse effects on competition as a potential disadvantage. The report also highlights alternative regulatory instruments to licensing, including: minimum standards; codes of practice; relying on notification; optional prescriptive codes; and, compulsory contacts. Establishing minimum standards or codes of practice through regulatory guidance could offer alternatives that might work in a retirement setting, albeit with less force.

Common explanations for use of business licensing	Essential properties of a licence
1. to account for spillover effects or externalities; 2. to address information failures; 3. to restrict competition and enhance market power; 4. paternalism, including: a) purchaser vulnerability b) preference manipulation	• ***notification*** – information is supplied to a specified agency; • ***prior approval*** – approval from a specific agency is obtained before commencing the prescribed business activities; • ***standards*** – minimum standards are to be complied with; and • ***enforcement or compulsion*** – licensing is not voluntary so that conducting the activities without a licence is unlawful, the standards are legally enforceable, and contravention of them may lead to the suspension or revocation of permission to conduct the activity

A comparable regime for retirement might require super funds (RSE licensees) to seek a license to offer retirement solutions, products and related services to retired members. Effectively, it would amount to a license to operate a RIS. Super funds without a retirement license would be restricted to servicing

members in accumulation. Once a member reaches retirement, these funds would have to either return the balance to the member[11], or transfer it to another provider that has a retirement license.

Case for a retirement licensing regime

A retirement licensing regime would amount to something of a heavy-handed regulatory initiative. However, it would offer a number of benefits:

- **Strong incentive to develop RIS** – Most super funds will want to be involved in the delivery of quality retirement outcomes for their members. This goes to the purpose of the superannuation system and thus of the funds themselves. Operating a retirement offering is an important business consideration, with the prospect of losing assets once a member retires likely to be unpalatable for most funds. Further, being unable to offer retirement solutions once a member reaches retirement may have negative impacts on the ability to attract members in accumulation.
- **Introduce a competitive opportunity** – Assuming that not all super funds seek or receive a retirement license, there would be an opportunity for licensed super funds to compete for the retired or retiring members of unlicensed funds. This may improve the financial business case for retirement (explored in Essay #5).
- **Giving effect to policy** – The need to meet licensing requirements should provide a strong catalyst and very powerful incentive for fund trustees to get on with the job of developing RIS to a reasonable standard, thus furthering the policy aim of progressing RIS development in a way that sees funds satisfy their obligations under the Retirement Income Covenant (RIC). It represents a prescriptive hurdle that places an onus on trustees to fully commit to the retirement phase.
- **Establishing minimum standards** – Licensing criteria could be used to establish minimum standards that super funds need to attain in developing their RIS. This could entail placing obligations on fund trustees to deliver retirement solutions, products and services to a minimum standard, along with a commitment to attempt engagement with all members who may be entering retirement. A licensing regime would give considerable force to these standards, as the consequence of not attaining them would be failure to attain (or loss of) a license.
- **Setting expectations and providing guidance to fund trustees** – Framing the regime around certain areas or items that need to be addressed in order to gain a license could go further than just establishing minimum standards. It could also be used to set expectations and provide guidance for fund trustees on what areas need to be covered in developing a RIS. Potential exists to tie licensing to a RIS assessment checklist under member outcomes assessment, as was discussed in the Conexus Institute paper *Assessing retirement income strategies… when outcomes are but a promise* of November 2022. To obtain a license, trustees could be required to demonstrate that they have all the required elements in place. For example, licences could be made conditional on having access to required member information, an ability to form cohorts or tailor, possessing stochastic modelling capabilities, offering a sufficient set of tools and calculators to assist members, the capabilities to engage with retirees and potential retirees, and so on. Finally, there would be an opportunity for policymakers to set clear and realistic expectations around timing of the development and implementation of a quality RIS by super funds.
- **Reducing dispersion** – Through establishing a common set of requirements and minimum standards, the level of dispersion in RIS offerings across the industry might be limited at the margin.
- **A clear decision point for funds** – Currently the RIC requires every fund to develop and maintain a RIS. Margaret Cole challenged funds who cannot deliver good retirement outcomes to their members to consider directing those members to other funds[12]. Some funds may feel they are not well placed

[11] Mechanisms may be required to encourage members to transfer to another fund with a retirement license.
[12] APRA – Margaret Cole and ASIC – Jane Eccleston - Speech to the Conexus Retirement Conference (2023).

to operate in the retirement market, or that they require an extended time period to reach the required standards (perhaps due to membership demographics that influence the business case). It is difficult to rationalise how members of those funds should have to experience a poorer quality retirement. A licensing regime provides a decision point for funds. It presents them with the option to specialise on accumulation through not seeking a retirement licences, or to defer their license application to a later date when there is a stronger business case to enter the retirement market.

Potential disadvantages and risks

Establishing a licensing regime also gives rise to some potential disadvantages and risks.

- **Effects on competition** – A licensing regime effectively establishes a barrier to entry. The main risk is not so much that the number of providers would fall to undesirably low levels. Rather, licensing could act as a barrier for new entrants, most notably smaller but innovative players that could challenge the incumbents and disrupt the retirement market. The dampening impact on competition from licensing may be minimal, however, given that new entrants already face substantial natural barriers to entry due to economy of scale and incumbency effects.
- **Impact on innovation** – There is a risk that providers anchor on the minimum standards to achieve a license, thus inhibiting innovation – although arguably this risk is just as strong in the current state where no requirements are imposed. This risk might be overcome to some extent through coupling licensing with a member outcomes assessment framework that encourages continual improvement. There is also the potential for licensing requirements to be reviewed over time in recognition of innovations in the industry[13].
- **Adverse impacts for members of funds without a license** – There may be negative impacts for the accumulation members of super funds that do not possess a retirement license. Such funds would have minimal incentive to engage and offer services to members over their retirement needs as they approach retirement. Further, members of such funds may be forced into a position of having to choose another provider at retirement (unless some mechanism is created to automatically transfer these members to another fund). As we argue in Essay #1 and Essay #2, some members may be very poorly placed to make this choice. There is also a risk that such members simply transfer their balance into a bank account or retain their superannuation assets in an accumulation account, rather than seek out a suitable retirement solution. Policymakers may need to consider the steps that could be taken to ensure all such members are transferred to a suitable retirement solution.
- **Fund sustainability** – Some funds that are not licensed to operate in the retirement market could suffer outflows and declining assets as members retire, especially as the superannuation system matures. This could be a threat to the sustainability of these funds. While this may have detrimental effects for the members of these funds, it may be better than such funds providing their members with a sub-standard retirement offering as could occur in the absence of licencing. Based on membership demographics, funds (and APRA) would need to establish the business sustainability impact as they contemplate whether to apply for a retirement license.
- **Regulatory load** – Managing a licensing regime would impose considerable load and possibly cost on regulators, especially given the complexity of retirement. This may prove to be a significant one-off effort. Nevertheless, the outcome should be a collection of funds with strong RISs along with less dispersion across funds than might occur under current policy settings, and hence the additional effort and cost may be worthwhile.

[13] Requirements have not been altered for MySuper licensing since its creation.

Implementation issues

Our primary aim in this essay is to explore the case for and against a licensing regime for retirement, rather than scope out the specifics of how it might operate. The implementation details would require investigation if the idea is to be pursued. Nevertheless, we do have a few observations to make.

- **Interaction with the RIC** – The RIC requires all APRA regulated super funds to have a documented strategy to assist members with their retirement needs. Any licensing arrangement would need to work alongside the RIC.
- **Outsourcing and white-labelling** – Consideration might be given to allowing super funds that do not have a retirement license to partner with, or out-source to, another fund with a retirement licensee. This may be one way to avoid the potential adverse impacts for members of funds that lack a retirement license, as discussed further above.
- **Transition to retirement** – The interaction between retirement licensing and transition to retirement arrangements would need to be addressed.
- **Licensing procedure** – It would be open to super funds (or new entrants) to apply for a license at a time of their choosing, including at a later date if development of a retirement offering is deferred. A fund could lose its license if it fails to meet licensing requirements. To allow for such an event, frameworks would have to be developed for how members are transferred to an alternative fund.
- **Management of licenses** – An important issue is the regulatory body that would be responsible for issuing licenses and ongoing monitoring for adherence with licensing conditions. There are various possibilities, including assigning the role to the existing regulators (perhaps in partnership) or establishing a dedicated retirement licensing body.
- **Time frame** – We envisage the industry being given considerable notice of when any licensing regime would come into formal effect, thus giving funds an opportunity to develop their RIS to the required standard. We suggest a couple of years, noting long lead times are required to develop products and services along with supporting resourcing and systems. Nevertheless, the licensing requirements should be released as early as feasible to advise fund trustees what will be expected and hence what they need to work towards.