

Thought Pieces with The Conexus Institute

Enabling contingency accounts

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1. Overview

A 'contingency account' is a retirement account that members can draw from as and when they desire rather than being subject to minimum drawdown requirements. The intent is to provide a funding source for occasional spending needs rather than generation of regular income. This 'thought piece' discusses the nature, benefits, downsides, implementation, provision and policy enablement of contingency accounts. Our position is that the retirement phase of superannuation (super) would be enriched if contingency accounts were made available as a standard feature of retirement solutions with an easy opt-out route.

2. Nature of contingency accounts

Our third retirement explainer¹ on the '[flexible access to funds](#)' objective under the Retirement Income Covenant (RIC) makes a case for incorporating contingency accounts within retirement solutions as a source of accessible funds, including for meeting spending needs not covered by regular income and as a form of precautionary savings. In line with the latter motivation, contingency accounts have also been called 'rainy day' or 'sidecar' accounts. The

retirement 'account'² envisaged would ideally be exempt from the minimum drawdown rules (MDRs), facilitated through policy change.

Relatedly, the Appendix to Treasury's retirement discussion paper of December 2023 presented an 'example bundled retirement product' including what was called a 'capital reserve'. Treasury's conceptualisation of a capital reserve is described in the box below, noting that their example bundled product envisaged retiree assets being run off by certain age after which income is funded by a deferred annuity.

Capital reserve

"The account-based pension would have an indexed capital reserve which is exempt from minimum drawdown rates. This provides you with a reserve to use for any large unanticipated expenses during retirement without affecting your expected annual income. You can still take a lump sum from your account-based pension but this will reduce the income from this component in future years. If a member dies before reaching their annuity age, any remaining amounts in their account-based pension or capital reserve will be paid out as a death benefit."

[Retirement phase of superannuation: Discussion paper](#), Treasury, December 2023, page 28

¹ The [retirement explainer series](#) is an education series covering a broad range of retirement-related topics.

² While we refer to 'account', the structure could potentially entail a sub-component within an account-

based pension or a specific type of product. Structural form is discussed in Section 5.1.

Another perspective on contingency accounts draws on the intuition behind ‘goal-based investing’³ or bucketing approaches, whereby available assets are ‘carved up’ into components that are directed towards achieving particular objectives. We envisage the investment component of a retirement solution being divided into an income account that is mainly directed towards the RIC income objectives and a contingency account that is directed towards the flexible access to funds objective.

3. Benefits for members

Trustees are required under the RIC to provide flexible access to funds through the retirement solutions they supply to members. Our explainer on flexible access to funds raises two issues that are relevant in the context of this thought piece:

1. *The motive for having flexible access to funds will govern how accessible funds should be provided.* The explainer identifies four possible motives, including: (a) meeting unplanned spending needs, i.e. a precautionary motive; (b) providing bequests⁴; (c) funding of aged care; and (d) flexibility to adjust. We envisage contingency accounts as intended to largely satisfy (a) precautionary savings motives while supporting (d) flexibility.
2. *Trading-off income and accessible assets is complex* – Currently the account-based pension (ABP) performs a dual role of income generation and providing flexible access to funds. Current ABP design comingles the analysis of income over time and accessible funds made available at a point in time. Introducing a contingency account would help address this complex trade-off by introducing a degree of separation between accessible funds and conversion of assets into income.

Separating the provision of flexible access to funds from income offers a number of benefits:

- **Simplifying retirement solution design** – Initially carving out assets into a contingency account allows the remaining assets to be directed towards achieving income objectives, without the need to give undue consideration to whether the income solution is leaving intact sufficient accessible funds. This does not mean

that access to funds via the assets designated for income generation should be ignored, as this access would still be of value. However, the existence of a contingency account would make the need to provide accessible funds through these assets less of a primary consideration in the design of the income solution. The need to make ad hoc trade-offs between income and assets would thus be much lessened⁵.

- **Understandable for members** – Individuals should find the creation of separate asset pools to address income and precautionary savings objectives as intuitive as it aligns with the natural propensity towards narrow framing.
- **Providing confidence to draw income and take more risk** – Members may be given more confidence and a sense of ‘permission’ to spend their other assets, knowing that they have something set aside ‘just in case’. Indeed, carving out some assets that are available when needed may even help overcome the reluctance to draw down on savings overall. It could provide scope to increase drawdown rates on other assets on the basis the contingency account could be utilised in the event those assets become exhausted. It may also give members comfort with taking more risk within their remaining assets, where appropriate. In essence, members might view a contingency account as a form of insurance.
- **Accommodating members with low balances** – Our understanding is that some members with low balances prefer to treat their super as a resource they can draw on if required (i.e. a type of savings account), rather than use it to generate regular income – noting that they may be relying on the Age Pension for this purpose. A contingency account would accommodate these (reasonable) desires.

Contingency accounts offer a practical mechanism to embed flexible access to funds in retirement solutions that should be understandable to members, who in turn may feel more inclined to spend their assets knowing they have something set aside ‘just in case’. In the break-out box over, Paul Watson outlines the findings of a UK experiment that underlines the potential benefits.

³ See Brunel, J.L., 2011. “Goal-based wealth management in practice”, *Journal of Wealth Management*, 14(3), p.17.

⁴ Bequest motives could include assisting family members prior to death, e.g. funding children into housing.

⁵ The academic literature uses utility models to help evaluate the trade-off between income and bequests.

However, these models are quite complex and not very intuitive. They also do not capture precautionary demand, as they assume that residual funds are accessed only at the point of death.

How Nest's 'sidecar' savings trial informs the contingency account proposition

By Paul Watson

A trial of 'sidecar' savings accounts by UK's National Employment Savings Trust (Nest), a government-backed workplace pension scheme, provides a test case for contingency accounts. I outline what motivated Nest to pursue the idea, and what the trial revealed about potential benefits for members.

Background

Research by the UK's Money and Pensions Service in 2019 found that only 44% of UK working age adults had £500 or more in savings on hand, while 26% had no savings at all. This starkly highlights that pressing needs such as car repairs, a winter heating bill or a myriad of other financial 'shocks' could leave many struggling to make ends meet. The insight sparked a bold and innovative four-year experiment by the Nest Insights team where 'sidecar' saving accounts – framed as a 'Jar' of readily accessible emergency savings – were provided to 80,000 Nest members.

Confidence to draw down, not just to save

Nest's trial is the closest empirical test of the behavioural thesis that a contingency account may give retirees the 'confidence to draw income and take more risk' with regard to their overall savings because they know a buffer exists 'just in case'. Employees in the Nest trial consistently described their emergency jar as providing peace of mind, reducing their stress and improving their confidence with money. Critically, these positive outcomes didn't require them to draw on the buffer; rather it stemmed from its very existence. This provides support for the idea that contingency accounts may produce behavioural 'insurance' effects as argued in Section 3 of this report.

Narrow framing works as intended, not against it

Section 3 also argues that contingency accounts will feel intuitive to members. Nest's data backs this up. Users spontaneously treated their jar as three distinct things: a cash-flow buffer, an emergency fund, and a goal-saving pot. Interestingly, and without signs of confusion, users were able to consciously move between these three framings as their circumstances changed. This would appear to support that a 'carve-out' of some assets is likely to work as intended, rather than becoming a confusing sub-account to members.

Deposit, withdraw, top-up = engagement, not failure

A risk flagged in Section 4 is that contingency accounts could inflate unintended bequests if members never draw on them. Nest's trial suggests this is unlikely, with 60% of users withdrawing some money from their jar within the first year, followed by persistent 'withdraw-and-refill' behaviour. This suggests that the sidecar mechanisms will be used for what they were designed. If Australian retirees behave similarly, contingency accounts are more likely to see genuine, repeated, and cautious use of such a facility, rather than leaving the account untouched until death.

Strongest transferable insight: choice architecture may be a key factor

Nest's most decisive finding relates to the gap between attitude and action. Although 46% of eligible employees thought a sidecar account would help them, only around 1% opted-in. When Nest later switched to an opt-out default approach, participation lifted to 50–70%. This appears to validate and support Section 6's recommendation for contingency accounts to be positioned as a "standard feature" of retirement solutions rather than choice options.

Some elements may not transfer

While Nest's experiment serves up real-world behavioural insights and learnings, caution is needed in transferring the findings to an Australian retirement setting. Jars operated in the accumulation phase with no preservation or drawdown requirements and thus do not directly test potential impacts during the decumulation phase. Another proviso is that the sample was skewed toward users with lower levels of financial literacy and security than might be expected for many Australian retirees. While Nest's findings support the behavioural mechanisms put forward in this report, these cannot be confidently extrapolated. Nor does Nest's trial validate the \$100,000 threshold suggested in Section 5.3. These Australia-specific elements require Australia-specific examinations and testing.

The bottom line

Nest's ground-breaking sidecar trial helps to inform the case for considering contingency accounts. It provides real-world evidence of how actual people, in real life situations, over a multi-year timeframe, actually behaved once provided access to a liquid, purpose-built, contingency pot alongside their otherwise principally preserved retirement savings. A central finding is that the mere existence of a buffer changes how people feel about drawing down on their savings. Overall, Nest's innovative experiment amounts to solid indication that a contingency account might prove beneficial within the distinctive environment of the Australian retirement system.

Sources: Nest Insight, Workplace sidecar saving in action (April 2023); Nest Insight, Opt-out autosave at work (September 2023); Nest Insight, Savings for All (2025); Conexus Institute, Enabling contingency accounts (2026).

4. Downsides

The downsides to contingency accounts seem minor relative to the potential benefits. Nevertheless, we see two potential issues:

- **Unintended bequests could be boosted.** Bequests might be boosted if members fail to access their contingency account. However, this is far from a forgone conclusion. This risk partly depends on implementation, in particular whether the MDRs are adjusted to ensure that retirees with medium-high balances still draw a comparable amount of income (see Section 7.3). As discussed in Section 3, it is also possible that the confidence and a sense of ‘permission’ to spend provided by contingency accounts might encourage higher drawdowns overall.
- **Cost and complexity may increase.** Managing contingency accounts and their inclusion within retirement solutions could add governance and operational cost and complexity, depending on how these accounts are structured (see Section 5.1 and Section 7). Impacted entities could include super funds, administrators, Services Australia (Centrelink) and the Australian Tax Office⁶. Some costs would flow back to members.

5. Implementation

We discuss a range of implementation issues including structural form, operating rules, amount that may be allocated and investment strategy.

5.1. Structural form

We discuss three possible structures for contingency accounts, with the key distinction being whether and how any exemption from the MDRs is enabled by policy changes:

Structure A: Virtual contingency account under existing policy framework – This structure entails notionally dividing an ABP into income account and contingency account sub-components. It would amount to an accounting artifice that allows notional reporting of regular

income being drawn from an income account and irregular drawdowns being taken from a contingency account. The key issue with this structure arises from the MDRs being applied to the total ABP balance. As a result, drawdown rates on the income account would accelerate as it reduces in value⁷ as income is drawn. Further, a requirement to draw from the contingency account would arise if the income account became exhausted, thus undermining the rationale for its creation in the first place.

Structure B: Functionally separate options within an ABP – This structure can be enabled through the MDRs being adjusted so they apply to assets in excess of a threshold, which in turn reflects the maximum permitted allocation to a contingency account. The member’s investment in an ABP would be allocated across two options with their own investment strategies, operating procedures including treatment of drawdowns and reporting arrangements. While housed within an ABP, the two accounts would effectively operate as functionally separate components⁸.

Structure C: Functionally separate products – This structure requires policy enablement of a new type of retirement product that is exempt from the MDRs while being subject to a limit on the amount that can be invested. The member would allocate the assets to be invested at retirement across an income account in the form of an ABP and a contingency account as a distinct option.

Structures B and C effectively achieve similar outcomes through different routes. The common thread is they both require policy change (further discussed in Section 7) to exempt some level of assets from the MDRs. Without policy enablement, functional separation would not be possible because the MDRs will apply to the total balance. This would require adopting structure A or some variation thereof, which would amount to an untidy arrangement that is unlikely to fully capture the potential benefits.

The diagram over the page outlines the three structural forms.

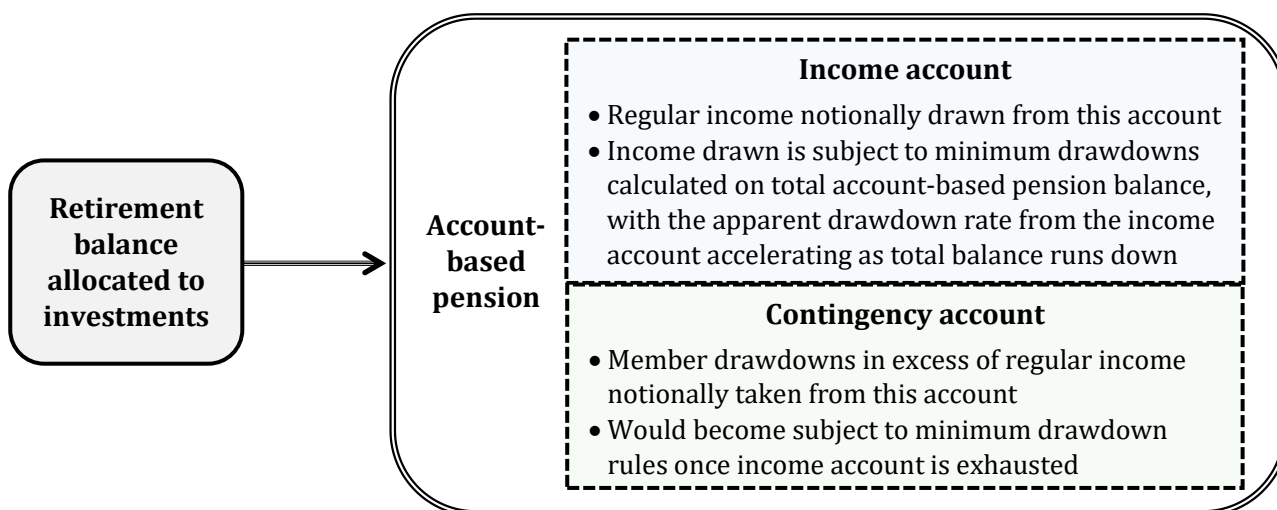
⁶ Impacts on the government’s budget would reflect a mix of effects on Age Pension eligibility (depending on changes in asset values), balances being shifted into retirement that may otherwise have remained in accumulation and higher administration costs. The net impact is unclear.

⁷ This would occur because the minimum drawdown rules would still apply to the total ABP balance. For example, a retiree of age 85 with \$100,000 in an ABP is required to

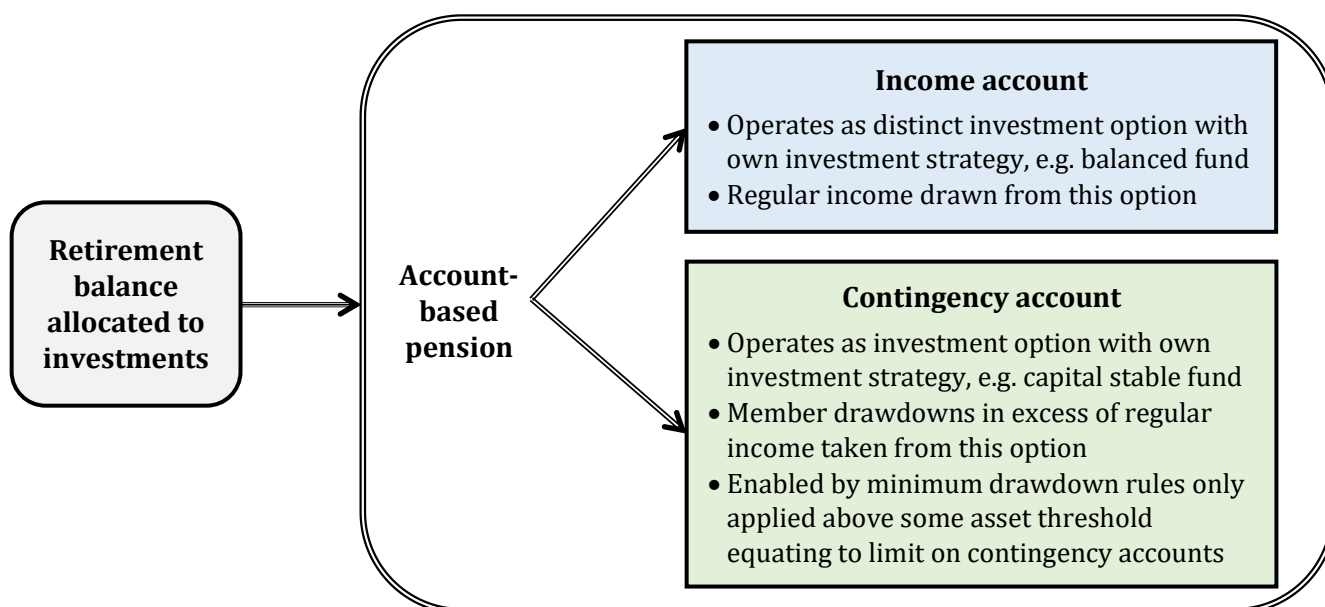
draw \$9,000. If the ABP is notionally divided into \$50,000 each within the income and contingency account, the apparent drawdown rate from the income account would be 18% and would accelerate further as the income account diminishes.

⁸ Functional separation may be incomplete where the contingency account sits below the threshold as this will impact on income account drawdowns (see Section 7.4).

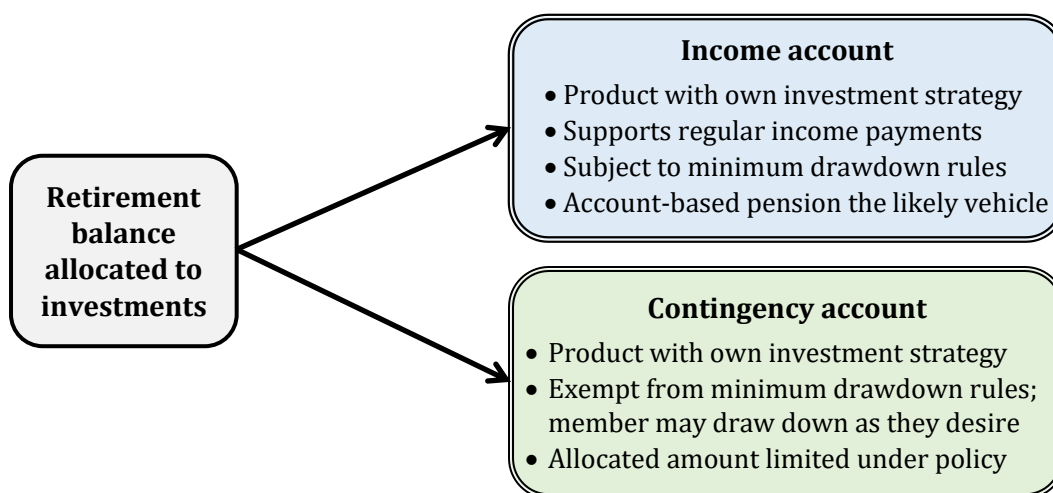
Structure (A): Virtual contingency account operating under existing policy framework



Structure (B): Functionally separated options within account-based pension (policy-enabled)



Structure (C): Functionally separate products (policy-enabled)



5.2. Operating rules

A contingency account could operate by applying the following steps:

1. Determine the amount of accessible funds to be made available, subject to any limit. We discuss the amount that may be allocated in Section 5.3.
2. Funds are placed in the contingency account and tracked separately to income-generating assets.
3. Funds are ideally invested in line with the motivation for creating a contingency account. We discuss investment strategy in Section 5.4.
4. Members are facilitated in drawing from the contingency account as they desire⁹. This would require establishing a member interface to accommodate and process withdrawal requests and allocate the related drawdowns to the contingency account.
5. Procedures are established to:
 - Adjust the allocation if the contingency account exceeds the limit.
 - Facilitate top-ups (if permitted) following the contingency account being reduced by withdrawals or poor performance, which may be useful where excess assets become available elsewhere say due to good investment returns or upon income needs turning out lower than initially anticipated.
 - Adjust drawdown rates on the income account under structures B and C if need be (see discussion in Section 7.3).

5.3. Amount allocated

We assume that the contingency account is primarily intended as a form of precautionary savings that members can flexibly access to meet spending needs not covered by regular income. Considerations in setting the limit include:

- The balance would need to be sufficiently meaningful to secure the behavioural benefits arising from having confidence that unexpected expenses are covered. This may be considered in light of the cost of the type of spending items that a contingency account might support. Examples include home repairs and refurbishment, healthcare costs not covered by social security,

asset purchases such as a new car or mobility support and perhaps the occasional holiday.

- A key rationale for contingency accounts is accommodating lower-balance members that want to rely on the Age Pension, while using their super as a funding source ('bank account') as and when needed. This consideration suggests setting a limit that supports low-balance members to adopt this strategy.
- There is scope to trade off the limit imposed on contingency accounts with higher drawdown rates under the MDRs applied to income accounts to ensure that balances are run down by members with higher balances. We explore this trade off in Section 7.3.
- It is envisaged that the limit would be indexed, probably to the Consumer Price Index, to maintain the real value of supported spending.

Considering the above, we feel that \$100,000 might be a reasonable limit on contingency accounts that are exempt from the MDRs. This amount should be meaningful to low balance members who wish to use the account as a flexible source of funds while relying on the Age Pension for regular income, while balancing the need to ensure that retirees with medium-high balances are still required to draw significant income.

5.4. Investment strategy

Contingency accounts would be best managed towards their objectives, rather than being comingled with other funds that may have differing objectives (such as multi-asset options directed at generating higher returns in support of higher income). A suitable primary objective for a contingency account might be to maintain the real value of capital and thus spending power. To this effect, we discuss using 'capital stable' funds for this purpose in our [Investing for retirement](#) report. An alternative may be a fixed income option, ideally with low duration. Establishing a dedicated investment strategy would be more readily accommodated within a functionally separated account, especially if ABPs are eventually to be performance-tested.

Another consideration is whether the presence of a contingency account invested in low-risk assets offering lower returns should be accounted for in setting investment strategy for the income

⁹ The member might prefer to first use funds available outside of super rather than the contingency account.

account. A case exists to focus on the overall portfolio by adjusting growth exposure upwards for the income account to recognise the defensive exposure within the contingency account. The extent to which this is done, however, might be limited by the tendency of members to be resistant to holding high growth exposure within the income account due to narrow framing.

6. Provision to members

A key issue is whether contingency accounts should be positioned as a standard feature of retirement solutions or a choice option. We are inclined to support offering them as a standard feature coupled with making it easy for members to opt-out. This could be achieved in various ways:

- Under structures A and B where income and contingency accounts are both embedded within an ABP, adoption of a contingency account could be presented as the 'preferred' option through ABP disclosures and application forms (similar to AustralianSuper's [Smart Default](#)).
- Contingency accounts could be included as a standard component within pre-set retirement solutions being made available to members.
- Advice processes could initially ask whether the member wants to carve out some assets to place into a contingency account before proceeding to address the income account.

These approaches would nudge members towards taking up a contingency account while providing scope to opt-out through either choosing another option or solution from the available menu or during the course of taking financial advice.

Another issue is whether contingency accounts might provide a mechanism to encourage members to move their super into the retirement phase. It has been suggested that some retirees are remaining in accumulation due to a desire not to be forced to draw down. While contingency accounts may assist in addressing this issue, in the breakout box we argue against overstating this aspect.

Would contingency accounts help solve the problem of retirees remaining in accumulation?

Many apparently eligible Australians remain in accumulation accounts, missing out on the zero-tax on investment earnings in ABPs. This 'pension puzzle' is a prominent issue for policymakers and industry.

There could be a temptation to suggest that contingency accounts could directly solve this problem. However, we think that contingency accounts are a moderate part of the solution to what is a multi-faceted problem.

A large part of this issue relates to member engagement around retirement age. Research suggests that many members are unaware of ABPs and their benefits, notably that they are tax-free and readily accessible. Solutions to this engagement challenge range from education to the use of default settings through to personalised nudges.

There are also rational reasons deterring some eligible individuals from transferring into an ABP. Most prominent is inability to contribute to ABPs, which can impact those still working or intending to work in the future. For these members some form of contributory ABP would be beneficial.

There are also those members with smaller balances who may wish to use their super savings in a contingency style manner, the focus of this paper. A contingency account has higher relevance here, although we note that ABP holders are not forced to spend income paid and could choose to leave it in the bank for access as desired.

Overall, enabling contingency accounts addresses one shortcoming for a particular cohort of retirees who may misunderstand how ABPs operate. In that sense it is not a silver bullet. Addressing member disengagement and indecision is more critical, along with providing a mechanism that allows members to contribute into ABPs.

Contingency accounts could prove useful if opt-out retirement defaults were enabled.

We discuss this issue in [Views from super funds on retirement defaults pre-set solutions and pathways](#). While we encountered only limited support for opt-out retirement defaults amongst super funds, one participant commented that contingency accounts could provide a mechanism to move low balance members into the retirement phase without needing to collect bank account details:

"If you could have an account-based pension with a \$100k contingency balance, you could default every single accumulation member below \$100k straight into that. (This gets over) the problem that, once you've got to do drawdowns, you (need) bank account details. For the small balance members, bang, there's your solution."

A further consideration is how contingency accounts might be presented to members. The opportunity arises to exploit narrow framing through presenting a contingency account as a “*carve-out of funds you can draw upon anytime that you need some extra cash*”, or similar. We also feel that member communications should use a name other than ‘contingency account’. We asked AI (Claude) for a range of options. An edited version of the response appears in the box below.

Renaming the contingency account

Safety/security framing; playing to the ‘just in case’ and ‘fear-of-running-out’ motives

- Safety net account
- Peace of mind account
- Buffer account
- Emergency fund/account
- Security reserve

Familiar language; echoing household budgeting terms

- Rainy day fund
- Just-in-case fund
- Nest egg reserve
- Top-up fund

Purpose-neutral, but warmer than ‘contingency’

- Flexible funds account
- Access account
- Personal reserve / My reserve
- Set-aside account

Observations:

- ‘Contingency’ and ‘Capital reserve’ (per Treasury discussion paper) sound institutional and actuarial, and hence unlikely to land with members.
- ‘Rainy day account’ already does a lot of work because it’s a well-worn idiom people use.
- If the design intent is to reduce under-spending caused by ‘fear of running out’, something like ‘Peace of mind account’ or ‘Safety net’ most directly speak to that psychological driver.
- Names covering multiple motives without leaning too much on any single one include ‘Flexible funds account’ or ‘My reserve’ as neutral umbrella terms.

Finally, introduction of contingency accounts that are exempt from the MDRs creates potential for interaction effects between the contingency account, regular income drawn from the income account and the evolution of total drawdowns and balances over time, especially under structure B where the MDRs are applied above a threshold (to be discussed in Section 7.3). This can create a need to calibrate the income drawn from the income account to ensure total income aligns with that desired by the member.

7. Policy enablement

Enablement of structurally separate contingency accounts requires action from policymakers. We discuss policy motivation, enablement under the legal framework and adjusting the MDRs.

7.1. Motivation

Consumer benefit was discussed in Section 3 and provides the primary motivation for enabling contingency accounts. In effect, a contingency account might be viewed as supporting super funds to more effectively assist their members in meeting the ‘flexible access to funds’ objective under the RIC. We assume the policy intent would be to enable contingency accounts primarily for precautionary saving motives rather than other purposes such as funding of bequests or aged care.

Also relevant is that super funds are calling for enablement, largely because they anticipate significant member benefit. This view was evident during our interviews of sixteen funds as reported in [*Views from super funds on retirement defaults pre-set solutions and pathways*](#). Eight funds expressed explicit support for contingency accounts during interviews, even though not a nominated topic. We received clear support for the contingency account concept whenever raised in conversation.

7.2. Enablement under the legal framework

We investigated the enablement of a retirement account or product that is exempt from the MDRs with the assistance of AI, posing the same query to ChatGPT, Claude and Perplexity in order to cross-validate the responses. The responses indicate potential to facilitate contingency accounts that are exempt from the MDRs through regulation rather than legislation. All three LLMs suggest that it should be relatively straightforward to adjust the MDRs to be applied above some asset threshold and thus enable structure B under which contingency accounts are embedded within ABPs. Responses were more mixed on structure C where a new type of retirement product is created that is exempt from the MDRs, indicating that this is a more contentious and difficult route.

The key considerations highlighted by AI were:

- **MDRs** – These are set under Superannuation Industry (Supervision) Regulations 1994 (SISR)

as a 'pension standard' an income stream must satisfy in order to qualify for tax exemption¹⁰.

- **Enablement through ABPs (i.e. structure B)** – A contingency account carve-out inside the existing ABP structure might be implemented as a formula edit so that percentage drawdown rates apply to the account balance less a defined amount, which would equate to the upper limit on the contingency accounts. This would need to be carefully designed to preserve the tax-free status of the account, noting that the pension standard is currently set up to require drawing of some income to maintain the tax-free status.
- **Distinct product category** – Establishing a distinct product category could be possible under regulation but might require legislation. Claude suggests that enablement of innovative retirement income streams (IRIS) provides a precedent for creation of retirement products with a different drawdown logic while retaining the tax exemption. IRIS were established by Regulation 1.06A being inserted by the Treasury Laws Amendment (2017 Measures No. 1) Regulations 2017. The tax exemption in this case is subject to the Capital Access Schedule rather than a minimum payment requirement. A contingency account product might be built in an analogous way by defining a product where a quarantined reserve is exempt from minimum payments under its own governing requirements. ChatGPT, however, suggests that legislation would be required.
- **Allocation limits** – As discussed in Section 5.3, we would envisage that the amount allocated would be limited and indexed, probably to the Consumer Price Index to maintain the spending power supported by the account.
- **Allocation adjustments over time** – Two developments that might call for adjustment of the assets allocated to a contingency account that is subject to a dollar limit should be considered in formulating policy. The first is top-ups where the account has fallen below the limit due to either withdrawals or poor investment performance. Second the asset limit being exceeded due to investment returns. It would be relatively straightforward for a super fund to

facilitate these requirements through transfers between the contingency account and income account as a reallocation between investment options. Top-ups might be done at either member request or automated. Switches to the income account when the contingency account exceeds the limit might be treated as a mandatory transfer¹¹.

Further considerations

Two further considerations with regard to policy enablement include the following:

- **Limited access** – One policy option might be to limit access to contingency accounts to members in a position to rely on the full Age Pension for regular income. Merits of limiting availability in this way include targeting access toward members with a good reason for having a pool of funds they can flexibly access. Further, the need for adjustments to the MDRs may be less pressing for full Age Pensioners on the basis of lesser policy imperative to ensure super assets are used by low-wealth retirees. Downsides include that enablement might require legislation to the extent it creates an exemption from paying any income, and potential loss of the behavioural benefits from having an accessible pot of funds for those members with assets above the eligibility threshold.
- **Multiple accounts across funds** – A mechanism would be needed to identify member accounts held across multiple funds and respond accordingly to ensure that the contingency account limit is not exceeded in aggregate. Otherwise, members may be able to avoid drawing any income by holding contingency accounts with a number of funds. The Australian Tax Office may need to be involved.

7.3. Options for adjusting the MDRs

The question arises of how the MDRs might be adjusted in conjunction with the introduction of contingency accounts under either structure B or structure C. Our aim in this sub-section is to highlight considerations for policymakers and the industry, rather than offer recommendations.

¹⁰ Operative provisions are SIS reg 1.06(9A) covering the standards for an ABP, with paragraph (9A)(a) requiring that at least the minimum amount be paid each year. The equivalent for annuities is reg 1.05(11A). Schedule 7, clause 1 sets out the rates and formula. Any changes under

regulation would thus need to be designed to ensure that qualification for the tax exemption is maintained.

¹¹ Another possibility is to permit contingency accounts to exceed the limit if solely due to positive real returns. However, this would create unnecessary complexity.

The policy case for adjusting the MDRs applying to income accounts upwards would be to avoid the introduction of contingency accounts leading to a net reduction in minimum drawdowns, which could exacerbate failure of some members to convert assets into income during retirement. A related consideration is that introduction of contingency accounts exempt from the MDRs will create potential for interactions between the contingency account and regular income drawn from the income account. This could have a range of implications, two of which are particularly notable:

- **Contingency account usage will impact effective minimum drawdowns** – A member who allocates an amount to a contingency account below the permissible threshold will be subject to higher effective minimum drawdown rates across their total balance than a retiree who makes full use of the contingency account. The issue that arises is whether members that have elected not to use the contingency account find the requirement to draw more income as acceptable, or whether it could give rise to some inadvertent and undesirable effects.
- **Contingency account withdrawals impact subsequent income under structure B¹²** – A member applying the MDRs who withdraws from their contingency account would subsequently see a decline in the regular income being drawn from the income account reflecting the interaction between the ongoing presence of the threshold and a reduced total ABP balance¹³. The issue then arises as to whether the member might view a reduction in regular income as undesirable¹⁴, and the income drawn from the income account might need to be adjusted upwards to compensate.

Against this background, policymakers face two main options regarding adjusting the MDRs applying to income accounts upwards in the presence of contingency accounts:

- a) *Set the rules and leave it to funds and members to work within them* – This approach would involve adjusting the MDRs upwards on

income accounts on the assumption that contingency accounts are available for use by all and leave it to funds and their members to work within the rules in delivering income as desired. While the simplest option, the issue is that it could have some unintended consequences as discussed above if members chose to apply the MDRs without adjustment.

- b) *Introduce multiple MDR schedules* – This approach might entail having a range of MDRs schedules where application depends on contingency account usage with the intent of equalising minimum drawdowns imposed across all members. Specifically, a higher MDR would apply to income accounts for members with a contingency account than those without. The issue with this option is that it would add much complexity to the system, and could be open to exploitation.

The **Appendix presents exploratory modelling** that investigates the implications for income drawn and the trajectory of account balance under contingency accounts that continue to be held at the threshold amount along with the application of adjusted MDRs. We calibrate the adjusted MDRs so that a member retiring with a balance of \$500,000 of which \$100,000 is placed into a contingency account reaches age 92 with a similar balance to under the existing MDRs. The modelling highlights how this set-up has differing impacts on both income drawn and residual balance across members depending on their starting balance and over the passage of time.

The modelling set-up leads to higher regular income being drawn earlier in retirement by members with higher balances, while less income is drawn by lower balance members at all times. In addition, income drawn is lower at older ages across all balances due to the interaction between the contingency account and the impact of higher drawdowns on the income account balance.

It is apparent that the modelled outcomes would be sensitive to a range of assumptions. Our modelling assumes no drawdown from the contingency account, which would have additional

¹² The issue being raised does not occur under structure C as the income account is completely functionally separate from the contingency account.

¹³ Consider a member who draws \$50,000 from a \$100,000 contingency account while having \$200,000 in their income account. Under structure B, the total ABP balance would decline from \$300,000 to \$250,000 such that the MDRs are then applied to \$150,000 in assets

versus \$200,000 previously. The result would be lower income being drawn for a member applying the MDRs.

¹⁴ In the absence of making an income adjustment, drawing income from the contingency account acts to increase current withdrawals while lowering subsequent income, which could amount to a significant change in the withdrawal pattern over time.

effects including potentially boosting overall withdrawals and changing their pattern over time. Other key assumptions include the amount allocated to the contingency account, adjustments made to the MDRs and realised investment returns (which we assume are fixed).

In sum, introducing contingency accounts could have a range of effects that would require some deep consideration by policymakers and industry.

8. Conclusion

There are clear advantages of making contingency accounts available to Australian retirees. They

would help overcome the difficulty of combining two disparate objectives, offer a way of satisfying precautionary saving motives that should be intuitive to members, and might even encourage higher spending overall. A range of operational and policy complications exist but we believe these are surmountable.

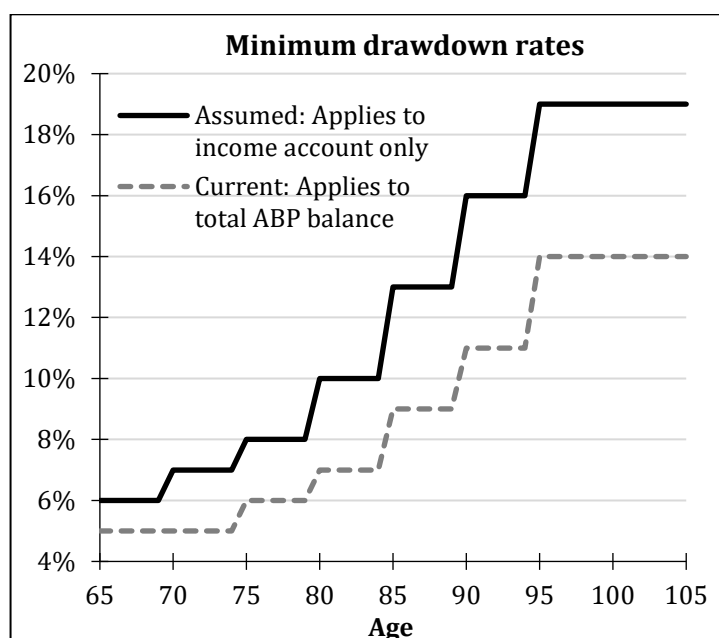
We recommend that policymakers closely examine the potential consumer benefit from enabling contingency accounts exempt from the MDRs up to a specified value. Super fund trustees should also be considering how they might offer contingency accounts as a standard feature of retirement solutions.

APPENDIX

Adjustment of MDRs: Exploratory modelling

We present exploratory modelling to illustrate the potential impacts of combining contingency accounts exempt from the MDRs with adjusted MDRs that apply only to the income account. Key modelling assumptions include the following:

- Analysis is conducted for total super balances upon retirement at age 65 of \$100,000, \$250,000, \$500,000, \$750,000 and \$1,000,000 (denoted as \$100k, \$250k, \$500k, \$750k and \$1 million, respectively).
- Allocation to a contingency account of \$100k on which the member does not draw.
- Real returns of 3% on the ABP and the income account and 0% on the contingency account.
- Calibration of MDRs to generate similar total assets at age 92 under both current and adjusted MDRs for a \$500k balance at retirement. To achieve this outcome, the MDRs were notionally increased by +1% at ages 65-69, +2% at ages 70-79, +3% ages 80-84, +4% at ages 85-90 and +5% from age 91. Current and assumed adjusted MDRs are plotted in the chart below.



The table over reports the matrix of average income and period-end assets for various age brackets and overall (survival weighted¹⁵). Following the table are charts showing the trajectory of income and total assets under balance at retirement of \$250k, \$500k and \$750k. The following patterns emerge:

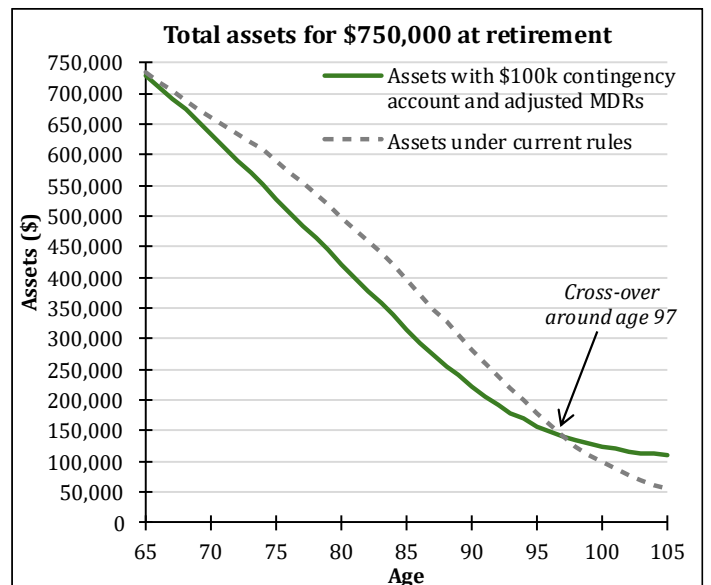
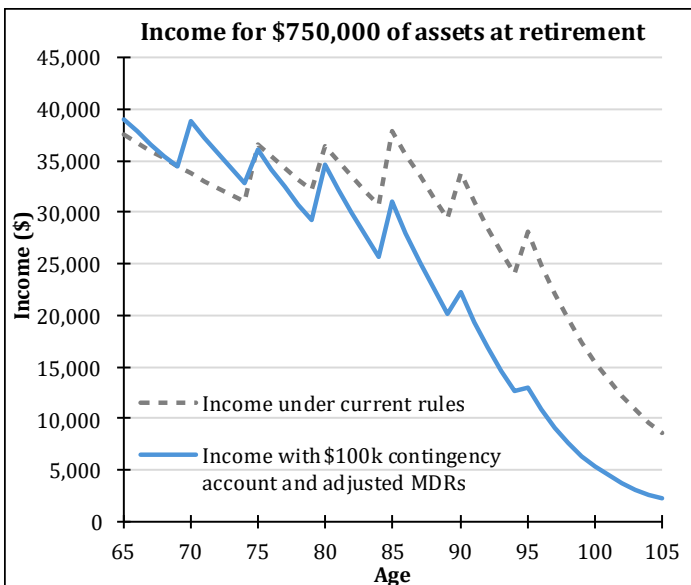
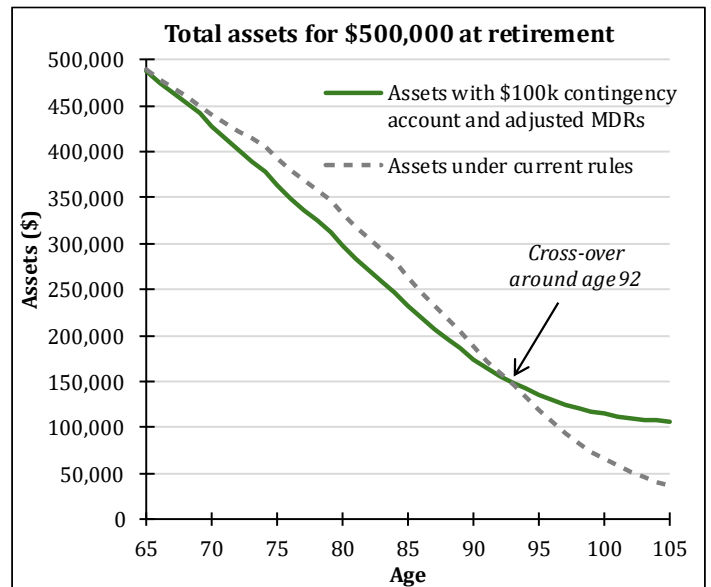
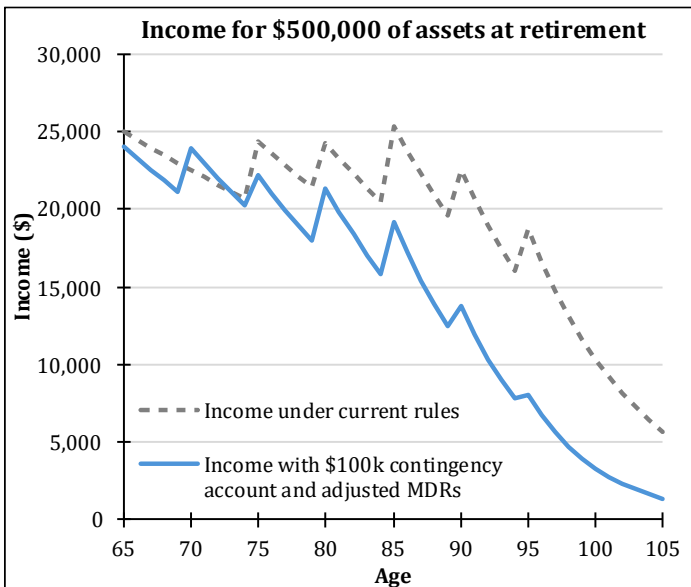
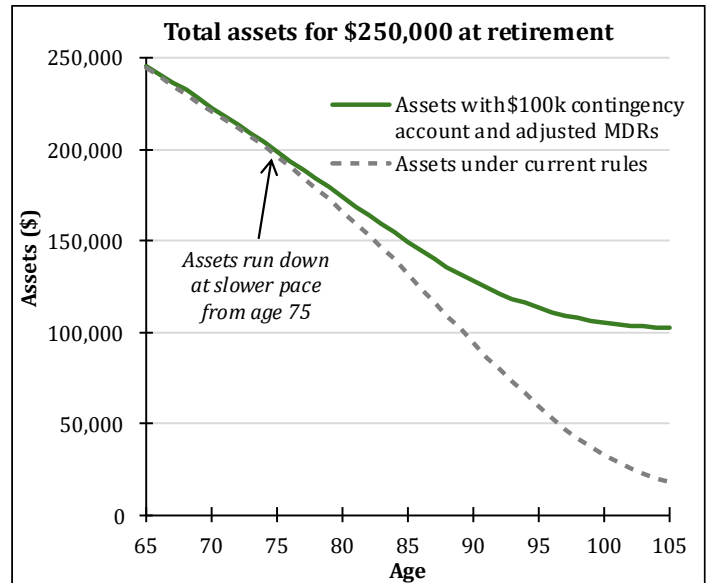
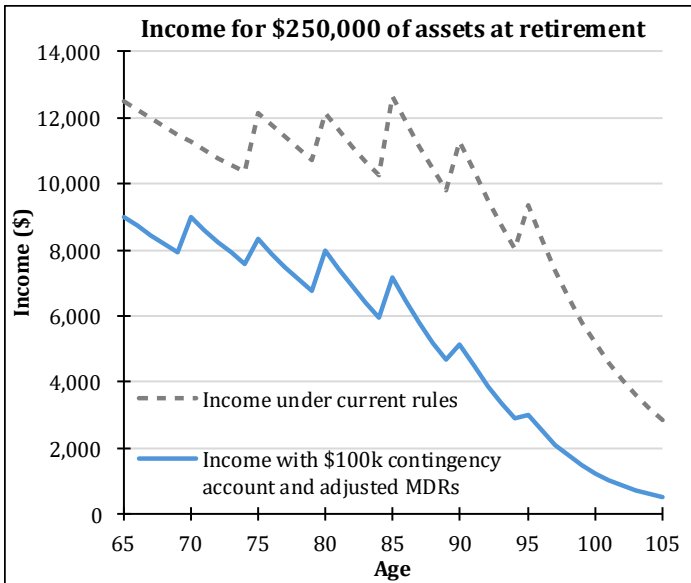
- **Income** – Income is lower on average, with the reduction being greater for lower balances at retirement. Survival-weighted income changes by -100%, -36%, -15%, -8% and -4% as the balance progresses from \$100k to \$1 million. Notably the decline in income is more marked at older ages, while income drawn actually increases for ages 65-74 at \$750k and \$1 million and being little changed for \$500k. The decline in income over time would be buffered by increasing Age Pension income, to the extent that super dominates the member's assets.
- **Total assets** – Total assets tend to converge on the contingency account balance of \$100k as income is drawn over time, as evident from the charts. The impact on total assets over time depends on balance at retirement. Total assets versus those under the current rules are higher throughout for a balance of \$100k. Total assets remain similar until age 75 but are higher thereafter at \$250k. Total assets are initially lower before then becoming higher after age 92 at \$500k, after age 97 at \$750k, and after age 101 at \$1 million.

¹⁵ Survival weights are based on the Australian Life Tables for females with 25-year mortality improvement.

Impact of \$100,000 contingency account with adjusted minimum drawdown rates

<i>Real values; retires on turning age 65; returns of 0% & 3%</i>	Average income at selected ages				Total assets at end of period			
	Current MDRs	\$100,000 contingency & adjusted MDRs	\$ change	% change	Current rules	\$100,000 contingency & adjusted MDRs	\$ change	Change as % of assets at retirement
<u>\$100,000 at retirement</u>								
Age 65-74	4,558	0	-4,558	-100%	81,084	100,000	18,916	19%
Age 75-84	4,521	0	-4,521	-100%	56,203	100,000	43,797	44%
Age 85-94	4,151	0	-4,151	-100%	26,750	100,000	73,250	73%
Age 95-104	2,323	0	-2,323	-100%	8,146	100,000	91,854	92%
<i>Survival weighted</i>	4,434	0	-4,434	-100%	69,056	100,000	30,944	31%
<u>\$250,000 at retirement</u>								
Age 65-74	11,395	8,364	-3,031	-27%	202,710	203,971	1,261	1%
Age 75-84	11,303	7,219	-4,084	-36%	140,507	155,169	14,662	6%
Age 85-94	10,377	4,906	-5,471	-53%	66,874	115,842	48,967	20%
Age 95-104	5,808	1,536	-4,273	-74%	20,366	102,678	82,312	33%
<i>Survival weighted</i>	11,086	7,082	-4,004	-36%	172,639	184,698	12,059	5%
<u>\$500,000 at retirement</u>								
Age 65-74	22,790	22,305	-486	-2%	405,421	377,257	-28,163	-6%
Age 75-84	22,607	19,251	-3,355	-15%	281,014	247,118	-33,896	-7%
Age 85-94	20,753	13,082	-7,672	-37%	133,748	142,244	8,496	2%
Age 95-104	11,617	4,095	-7,521	-65%	40,731	107,142	66,410	13%
<i>Survival weighted</i>	22,172	18,886	-3,286	-15%	345,278	325,861	-19,417	-4%
<u>\$750,000 at retirement</u>								
Age 65-74	34,185	36,245	2,060	6%	608,131	550,543	-57,588	-8%
Age 75-84	33,910	31,284	-2,627	-8%	421,522	339,067	-82,455	-11%
Age 85-94	31,130	21,257	-9,872	-32%	200,622	168,647	-31,976	-4%
Age 95-104	17,425	6,655	-10,770	-62%	61,097	111,605	50,508	7%
<i>Survival weighted</i>	33,258	30,690	-2,568	-8%	517,917	467,024	-50,893	-7%
<u>\$1 million at retirement</u>								
Age 65-74	45,580	50,185	4,605	10%	810,841	723,829	-87,013	-9%
Age 75-84	45,214	43,316	-1,898	-4%	562,029	431,015	-131,013	-13%
Age 85-94	41,507	29,433	-12,073	-29%	267,497	195,049	-72,447	-7%
Age 95-104	23,233	9,215	-14,019	-60%	81,463	116,069	34,606	3%
<i>Survival weighted</i>	44,343	42,494	-1,850	-4%	690,556	608,187	-82,368	-8%

Trajectory of income and total assets for three balances at retirement



The question arises over whether the arising patterns make sense from a policy perspective:

- **At lower balances (\$100k, \$250k)** – Reduced drawdowns and hence increased flexible access to funds for lower balance members through the mechanism of a contingency account is exactly what the policy might be aiming to support.
- **At higher balances (\$750k, \$1m)** – While the adjusted drawdown rates help ensure that substantial super balances are being converted into income, the impact is nuanced. First, income is higher earlier in retirement, after which it declines under the combined influence of the income account having been run down and the presence of a \$100k contingency account. Second, total assets are generally lower but only up to older ages (i.e. to age 97 at \$750k and age 101 at \$1 million). Overall, this pattern seems acceptable as it generates higher income earlier in retirement when it is more likely to be useful thus increasing the likelihood that balances are more fully utilised. The notable caveat is higher balances at death may result for higher balance members that live to older ages, leading to greater bequests for those that survive.
- **At the middle balance (\$500k)** – This balance might be taken as representing a ‘typical’ retiree under a more mature system. Under our analysis, the contingency account leads to a meaningful reduction in income drawn after about age 75 and total assets ending up higher after age 92¹⁶. While this should result in better balance utilisation for retirees who die before age 92, the implications after that age are more debatable. Higher total assets for retirees who live into their 90’s could be used for entry into aged care, health expenses or bequests.
- **Patterns will depend on a range of developments** – The total income drawn and total assets at each age will differ depend on a mix of effects that may unfold over time:
 - Our analysis assumes that the member does not utilise their contingency account. If they

were to do so, this could increase the effective drawdown rate on total assets; however ...

- If the member uses and then tops up the contingency account from the income account, this will tend to decrease the effective income drawn from the income account thereafter. It would thus shift the pattern of total drawdowns towards occurring earlier and being lumpier.
- Investment returns will also have an effect, with the overall level of returns, the return differential between the income and contingency accounts and the sequence of returns all having an influence.
- **Results will be sensitive to assumptions** – The results will be sensitive to key assumptions, most notably regarding the level of the contingency account and adjusted minimum drawdown rates on the income account. Our modelling indicates potential for the level of investment returns assumed and realised to have some meaningful impacts.
- **Members may draw more** – Our modelling assumes that members follow the MDRs while not drawing on the contingency account. It is thus a conservative analysis with a distinct possibility that the presence of a contingency account may lead to higher drawdowns overall.

On balance, we consider the potential impacts from enabling contingency accounts while increasing the MDRs applying to income accounts as likely to be supportive of policy objectives. It could lead to more income being drawn earlier by members with higher balances. It also raises the possibility that greater income is drawn overall **IF** the contingency account is utilised (noting that our analysis assumes it is not).

Nevertheless, some complex effects are involved with scope for a range of potential outcomes. More in-depth analysis than the illustrative and exploratory modelling we have presented would be required to firm up the policy case and calibrate key assumptions.

¹⁶ Recall that our adjusted minimum drawdown rates are calibrated to generate similar total assets at age 92.