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9 February 2024

Ms Lynn Kelly
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Retirement, Advice and Investment Division
The Treasury
Langton Cres
Parkes ACT 2600
Via email: retirement@treasury.gov.au

Dear Ms Kelly

RE: Retirement phase of superannuation discussion paper

Thank you for the opportunity to submit Challenger's views on the Government's Retirement phase of superannuation discussion paper.

We strongly support the Government and Treasury's work to enhance Australia's superannuation system, addressing the risks Australians face through retirement to help make the most of their superannuation savings. We support many of the concepts raised in the discussion paper including the need for Australians to have better access to information, advice and well-rounded retirement income products. Progress on all these fronts will contribute to a stronger and world-leading retirement system that delivers all Australians the income they need for a dignified retirement.

Challenger for many years has been an advocate of retirement income reforms that will significantly enhance the lives of retirees. With Australians retiring in record numbers and living longer, and the superannuation system forecast to triple in size over the next two decades, acting now to strengthen the retirement phase is critical, and should build on the recently announced financial advice reforms.

Our submission contains five key recommendations:

1. Government and industry should contribute to better understanding of retirement income products;
2. retirees should have access to a range of retirement income solutions;
3. superannuation funds and advisers should be strongly encouraged to recommend lifetime income solutions combined with an account-based pension that meet the needs of retiring members;
4. regulatory and legislative settings need to be better calibrated to boost competition and innovation in the lifetime income market and increase the uptake of longevity solutions; and
5. private sector participants should be allowed to provide longevity risk cover without the Government entering the market.

Challenger welcomes the opportunity to be involved in this consultation and looks forward to ongoing discussions with Government and Treasury to further develop policy settings for the benefit of Australian retirees and the broader economy.

Nick Hamilton
Managing Director and Chief Executive Officer, Challenger

Retirement Phase of Superannuation

Challenger submission

Date: 9 February 2024

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Challenger's Key Recommendations

Recommendation 1

The Government and industry should contribute to better understanding of retirement income products to facilitate better outcomes for retirees.

- The Government should launch a national education and awareness campaign to shift Australians' mindset from building a 'nest egg' to providing a regular income in retirement, ensuring Australians are properly informed on the retirement income choices available.
- Retirees face different risks than those in the accumulation phase and these risks (longevity, market, sequencing and inflation risks) must all be considered in tailoring comprehensive retirement solutions.
- The Government should facilitate a simple, one-page Fact Sheet on lifetime income products enabling Australians to easily compare their benefits, risks and costs.
- Financial advisers should be required to inform clients nearing or in retirement on the risks relating to potential income variability, including longevity and sequencing risks.
  - It is critical that the Delivering Better Financial Outcomes reforms are implemented effectively and in consultation with the industry.
  - Advisers' education requirements should ensure they can outline how risks during retirement (the decumulation period) differ from risks during the accumulation period.

Recommendation 2

Retirees should have access to a range of retirement income solutions that best meet their needs.

- We do not support the use of a single standardised or pre-packaged default 'product' for all superannuation members. Retirees need solutions that address their needs, reflecting their portfolio of superannuation and other assets, risk preferences, life and health expectancy and other personal characteristics.
- Retirees should have access to a range of 'retirement product features' – either through an umbrella product that allows a customisable mix of key features (such as an account-based pension, a market-linked lifetime income stream and an inflation-indexed guaranteed lifetime income stream) or an adequate range of component products (each providing access to one or more features).
- Funds have demonstrated strong capabilities in managing investment risks in the accumulation phase and should now be supported to offer a range of solutions to address longevity, sequencing and inflation risks, including through partnering with private market providers and insurers.

Recommendation 3

Superannuation funds and advisers should be strongly encouraged to recommend retirement income products that are comprised of a lifetime income stream combined with an account-based pension that meet the needs of retiring members.

- Funds should:
  - encourage retiring members, including those seeking guidance from their fund, to take at least a portion of their superannuation balance as an income stream (subject to minimum balances) to help ensure income security in retirement;
  - present members with income projections that adequately communicate the risks relating to potential income variability, including the impact of sequencing risks; and
  - consider individual circumstances including risk preferences to ensure members are recommended retirement solutions that are suitable for them.

- Consideration should be given to addressing the conflict of interest that exists for advisers and superannuation funds where recommending a lifetime income stream can reduce the size of funds under advice or management.

Recommendation 4

The Government should ensure that regulatory and legislative settings are better calibrated to boost competition and innovation in the lifetime income market and increase the uptake of longevity solutions, including by:

- aligning life insurance prudential capital settings with international norms to improve returns available to retirees and support the development of innovative retirement income products to meet the needs of retirees;
- updating the Capital Access Schedule so product providers can compliantly offer a 'money-back guarantee' on lifetime income products; and
- adjusting social security income means testing rules to ensure lifetime income streams are treated equivalently to account-based pensions.

Recommendation 5

Private sector participants should be allowed to provide longevity risk without the Government entering the market as there is sufficient market capacity, capability and willingness to meet future demand.

- The small share of retirees' superannuation balances invested in a longevity solution is a consequence of regulatory and legislative settings and retirees not receiving appropriate information to guide their retirement decisions. There is no market failure in the creation of lifetime income products.
- The Australian Government already has significant exposure to longevity risk via the Age Pension and health care expenditure. More exposure would add to risks for taxpayers.
- Private providers continue to develop a broad range of lifetime income products that address longevity risk for retirees, and stronger demand would no doubt spur further innovation and competition.
- If the Australian Government did enter the longevity market, it should be done in a way that is consistent with the Australian Government's competitive neutrality policy.
  - The Government would have an unavoidable advantage competing against private providers due to its AAA-rating and absence of needing to hold regulatory capital. Financial advisers would struggle to recommend private providers lifetime income products over a similar Government-backed alternative.
- Challenger does not believe Government intervention in the longevity market is required. If it was deemed necessary, a more appropriate initiative would be for the Government to back the lifetime income products of private providers that are well-capitalised and regulated by APRA using the Financial Claims Scheme (FCS), akin to the backing provided to bank deposits provided by APRA-regulated Authorised Deposit-taking Institutions.

Supporting better retirement outcomes

Challenger supports reforms that will result in better outcomes for all Australians in retirement. We agree with the discussion paper's assessment that the retirement phase adds a level of complexity to the decisions of superannuation fund members, with financial uncertainty among retirees continuing to worsen. Unfortunately, this leads many retiring Australians to 'under retire', and unnecessarily reduce their quality of life in retirement.

The fear of outliving savings is also a growing concern among older Australians. Recent research by National Seniors Association and Challenger[1] noted that to manage this concern, 83% regard money lasting for life as very important and 91% view regular income for essentials as very important. Research published by Capital Preferences, and supported by Challenger, also reinforces this point – it is estimated that over $145 billion of superannuation monies should be transferred into a guaranteed lifetime income product to meet members' preferences for long-term income certainty.

Providing retirees with the confidence to convert their accumulated retirement savings into income can materially improve their quality of life, supporting better retirement outcomes as well as benefiting broader society and the Australian economy.

Generating retirement income from a pool of savings involves different and more complex risks than the accumulation of those savings. The Retirement Income Covenant[2] implemented in July 2022 notes that the main risks in retirement include longevity, investment (including sequencing) and inflation risks.

Accordingly, retirees need products to help them manage these risks, with associated guidance and assistance around product selection, in order to maximise their retirement income potential. The gaps in achieving this have been noted for some time[3], and while some progress has been made, much more needs to be done.

Challenger welcomes this consultation, and we believe the recommendations contained in this response can help make a significant positive impact on the financial security of retirees, helping to ensure they make the most of their superannuation in retirement. Our recommendations address the three areas outlined in the discussion paper:

1. ensuring the right products are available to manage risks in retirement;
2. supporting superannuation funds to offer better retirement income strategies to their members; and
3. providing appropriate education, guidance and advice so retirees can be confident in their choice of retirement income solution and enjoy a dignified retirement.

[1] National Seniors Australia and Challenger (2023) *The cost of living and older Australians' financial wellbeing*.
[2] Superannuation Industry (Supervision) Act 1993 Section52AA.
[3] The Financial System Inquiry in 2014 raised many of the issues noted in the discussion paper.

Recommendations for a better retirement phase

Recommendation 1: The Government and Industry should contribute to better understanding of retirement income products to facilitate better outcomes for retirees

Providing retirees with peace of mind

Australians are increasingly worried about the risk of running out of money and consequently many are living more frugally than they could. Ensuring the availability of products to manage that risk and having appropriate retirement income strategies in the member's superannuation fund will not be sufficient to ensure optimal retirement outcomes for the bulk of members – appropriate education, guidance and advice will also be critical.

We are supportive of Treasury's suggestions of product comparisons, use of guidance and improved education. The Delivering Better Financial Outcomes reforms should help members select more appropriate retirement products as superannuation funds and other industry participants will be able to assist with nudges and guidance (assuming members have access to products with appropriate features).

Alignment with superannuation's purpose: shift the nest egg mind-set to providing income

Superannuation funds, other industry participants and the Government can do more to shift Australians' mind-set of superannuation being a 'nest egg' to a system for 'providing income' in retirement – the now-legislated purpose of the system. Challenger supports greater use of income projections as well as linking these to how income levels could vary under different market conditions and different actual lifetimes, not just the current practice of assuming average investment market returns and average life expectancy. One of the clearest income projections comes from defined benefit pension schemes. Members know the income they will receive in retirement. While schemes typically have the ability to opt-out of the pension and take the lump sum, most members take-up the income stream.

Improve awareness and address misconceptions

Some of the barriers to the take-up of lifetime products relate to out-dated perceptions and a lack of understanding by retirees, which is perpetuated by information provided by some market participants. As the discussion paper notes, there can be a perception that purchasing an annuity will lead to a 'wasting' of capital if the retiree dies early, but most lifetime annuities in Australia are sold with a death benefit, ensuring capital is not 'wasted' on early death. This misconception among some Australians in or approaching retirement and their advisers could be removed through the 'money back guarantee' recommended in our response.

The Government is best placed to undertake a comprehensive and impartial information campaign on the benefits of a lifetime income streams in a retirement portfolio. This has the potential to deliver a wide range of benefits, helping to inform individuals on how to manage risks in retirement, and reduce the potential cost to the Government from retirement risks not being effectively managed. Such a campaign could include a simple, one-page Fact Sheet enabling Australians to easily compare the benefits and costs of a range of lifetime income products, similar to the single page comparison included in the 2010 Competitive and Sustainable Banking Reform Plan to help borrowers easily compare their future mortgage payments and fees.

The proposals flowing from the Quality of Advice Review to increase the levels of advice and assistance to superannuation fund members in retirement will also be beneficial and the Government should ensure that the final regulations help promote optimum outcomes for members in retirement.

The growing lifetime annuity market in Australia

The paper notes that Australia's annuity market is relatively small and the number of annuities held has declined over the past five years. The APRA data on annuity provision includes the payments of defined benefit pension payments so the decline in payments reported is actually a decline in defined benefit pensions. This is unsurprising with many defined benefit pension schemes in run-off.

According to Plan for Life data, the lifetime annuity market is not in decline.[4] Sales of lifetime annuity products declined between 2017 and 2021 but have since increased.

The small size of the market relates to a range of other factors, including the regulatory and legislative constraints outlined in this submission and retirees not receiving appropriate information to guide their retirement decisions in the superannuation system.

Recommendation 2: Retirees should have access to a range of retirement income solutions that best meets their needs

Different people have different requirements in retirement. For example, some fund members will prefer an absolute guaranteed lifetime income stream, as they will not want to be exposed to market risk across their entire retirement portfolio. Members with different expectations about their life expectancy may want different levels of longevity protection. A strong and competitive life insurance market will ensure funds can deliver a range of lifetime income products that are relevant for the breadth of funds' members and allow funds to differentiate their offering in retirement, providing consumers with more choice. Given the different composition of membership, not all funds will necessarily want to offer the same range of features in retirement income products. Nevertheless, we expect that the range of members within most funds will be much wider than the range of the 'average' members across funds. Consequently, funds should offer a broad range of retirement income product features, or else clearly communicate to members where they can access particular components of the retirement income solution that may be right for them.

A single, standardised default product would be unsuitable for many retirees

Trustees should be able to offer and recommend longevity products that best suit the needs of their diverse membership and take account of an individual's personal circumstances. Retirees need solutions that reflect their individual needs, given their portfolio of superannuation and other assets, risk preferences, life and health expectancy and other personal characteristics. This is very unlikely to be met with a mandated single, standardised default product for all superannuation members. This would be unlikely to meet the wide range of needs of those in retirement, and also has the potential to further disengage members, particularly given they may be locked into it for life.

Retirees needs and wants will change over their retirement, for example appetite for market risk will most likely be different as they age and draw on their superannuation balance and changes in the mix of spending between both essential needs and discretionary wants. A retirement solution needs the flexibility (as noted in the Retirement Income Covenant) to accommodate these changes over time.

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[4] Plan for Life data to September 2023.

Retirees should have access to a wide range of 'retirement product features' – either through an umbrella product that allows a customisable mix of key features (such as an account-based pension, a market-linked lifetime income stream and an inflation-indexed guaranteed lifetime income stream) or an adequate range of component products (each providing access to one or more features).

Develop innovative retirement income products supported by regulatory settings

Funds have demonstrated strong capabilities in managing investment risks in the accumulation phase and should now be supported to offer a range of innovative solutions to address longevity, sequencing and inflation risks, including by partnering with private market providers and insurers.

Recommendation 3: Superannuation funds and advisers should be strongly encouraged to recommend retirement income solutions comprised of a lifetime income stream combined with an account-based pension

The Retirement Income Covenant provides a strong principles-based approach to encourage superannuation funds to develop better retirement income strategies for their members.

Allocating a portion of a retiree's superannuation balance as an income stream

Mercer's CFA Institute Global Pension Index 2023[5] rates Australia as a B+, behind countries including the Netherlands and Denmark, with Australia held back because there is no requirement at retirement for at least some allocation to an income stream from superannuation.[6] Allocating a portion of a retiree's superannuation balance (for those with a reasonable balance) as an income stream[7] would help move the mindset from building a nest egg to providing income in retirement and increase the likelihood that the superannuation system will meet its intended purpose. This would also address the needs of those members seeking guidance from their funds.

Ensuring lifetime income products are offered by all superannuation funds

Combining an account-based pension and lifetime income stream (subject to minimum balances) has the potential to improve outcomes for retirees and provide financial security in retirement. While there is widespread industry support for this policy, there are uncertainties and different perspectives on how to best design and implement such a solution. The pending financial advice reforms will help address some of these concerns.

Challenger's retirement income partnerships with TelstraSuper and the Commonwealth Super Corporation (CSC) are examples of solutions that provide superannuation fund members with guaranteed income in retirement, without fear of their retirement savings running out. Importantly, these partnerships also demonstrate how superannuation funds can design and implement lifetime income offerings that are low cost to implement, allow funds to avoid legacy product risk and provide superannuation funds with flexibility to test and learn with members.

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[5] *Mercer CFA Institute Global Pension Index 2023.*

[6] The Australian scores across the three categories are Adequacy 70.1; Sustainability 78.4 and Integrity 86.1. An A rating is given to countries with a weighted average score above 80. Australia scored 77.3. Other recommendations include means test adjustments, providing annual benefit projections and paying super on carers leave.

[7] It would be equivalent to the approach in the UK to limit the amount that can be taken as a lump sum over a lifetime.

TelstraSuper's lifetime pension, designed in partnership with Challenger, provides members with a guaranteed income for life, with the option of being indexed for inflation or market-linked, and is combined with a member's existing account-based pension.

Through Challenger's partnership with CSC, members have access to a longevity solution that can be combined with their existing account-based pension as part of the fund's wider retirement income strategy. This approach of partial annuitisation has also been successfully implemented in the advice community for many years.

Use of cohorts

To efficiently deliver retirement options to members in a scalable way, funds should be able to guide members to products with a range of features that meet their personal needs. This can be done with the use of 'cohorts' that reflect the characteristics of different types of members. To select the appropriate cohort for an individual needs, it is essential to consider that member's risk preferences. Members will need additional guidance to confirm that any recommended cohort solution is suitable for their needs. Importantly, members should be able to adapt the features of the recommended product to reflect their individual circumstances, including for personal characteristics that their fund does not know about them.

Investment allocation cannot manage inflation risk in retirement

The discussion paper notes that inflation risk can be managed within an investment mix, however, this approach would leave a member drawing retirement income still exposed to inflation risk. While the investment mix can hedge inflation during the accumulation phase because of the long investment horizon, in the decumulation phase the risks from inflation come from when income is drawn. If there is a jump in inflation, and nominal asset values have yet to catch up to the higher price level, then drawing income at that time will leave the retiree with less spending capacity from their income. Removing inflation risk to income requires an exact inflation hedge, which is possible with inflation-linked bonds or swaps, but because of limited maturities for these instruments is best managed with a specific inflation hedging strategy. A 2022 Challenger research paper details the issues with inflation in retirement and provides appropriate ways to manage the risk.[8]

Provide members with income projections

Superannuation funds should present members with income projections that adequately communicate the risks relating to potential income variability, including the impact of sequencing risks. Income projections should consider how income levels could vary under different market conditions and different actual lifetimes, not just the current practice of assuming average investment market returns and average life expectancy.

Recommendations should be appropriate to a member's circumstances

Regardless of whether cohorts are used, or 'personas' are developed to represent a typical type of retiree, or an individual-level ('cohort of one') approach is adopted, the specific circumstances of the individual members need to be taken into account to ensure members are recommended retirement solutions that are suitable for them.

Research undertaken by Capital Preferences[9] demonstrates retirement income preferences are highly individualised and the circumstances of individual members need to be taken into account to ensure the retirement income strategy for them is fit-for-purpose. This is particularly relevant when considering how best to cohort members.

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[8] Inflation risks and retirement innovations, October 2022.
[9] Revealing Member Income Preferences: A Scientific Path to Retirement Personalisation. Capital Preferences February 2024.

Barriers from inherent conflicts

Some of the barriers to the uptake of lifetime income streams relate to inherent conflicts in the financial system that are difficult to directly address including:

- Financial advice to retirees is generally provided on an on-going basis, providing advisers with on-going fees. A lifetime income stream involves a one-off purchase that eliminates the need for advice on that portion of assets, creating a disincentive for financial advisers to recommending a lifetime income stream;
- Insuring risks requires that assets are maintained in a separate (statutory) pool as part of prudential regulation. This requires a transfer of assets from the superannuation fund to the insurer, creating a conflict with many superannuation funds that prefer to manage assets in-house.

Recommendation 4: The Government should ensure that regulatory and legislative settings are better calibrated to boost competition and innovation in the lifetime income market and increase the uptake of longevity solutions

The Government, in conjunction with APRA and the industry, has a critical role in creating a regulatory environment that supports an innovative and competitive industry to develop a range of lifetime income solutions at prices that are compelling to customers and encourages take-up amongst those approaching and in retirement.

Enhance lifetime income market by adjusting prudential settings

Compared to global standards, Australia has a particularly conservative prudential capital treatment of long-term insurance liabilities, which results in relatively high regulatory capital levels, but more significantly, regulatory capital requirements that spike up during times of market stress. This is primarily due to the manner in which illiquid liabilities (such as annuities) are valued for capital purposes. APRA requires all assets to be valued at market value – which is appropriate – and liabilities to be valued using risk-free discount rates with an allowance for “illiquidity”. It is this allowance that is small and quite static in Australia relative to other markets. There are multiple ways that this could be addressed, such as retaining the current framework but setting a more market-sensitive illiquidity premium, or changing the framework to incorporate a “matching adjustment” as occurs in Europe. A matching adjustment recognises that assets are held to match long duration liabilities given that life insurers are effectively long-term buy-and-hold investors, and are not economically exposed to spread movements, only default risk.

A market-sensitive illiquidity premium or matching adjustment would have two effects:

1. levels of required capital for longer term liabilities would be lower, due to a more appropriate credit spread shock component of the capital requirement; and
2. capital volatility would be reduced, through closer alignment of asset and liability valuations for capital purposes.

These effects would allow insurers to hold asset portfolios that more closely match the liabilities and improve the pricing offered to consumers, all while retaining a robust and secure capital framework.

Applying this approach to all relevant lifetime income stream products in the market would result in the following benefits:

- maintaining the level of security targeted in APRA’s capital standards;
- more options for insurers seeking to construct asset portfolios that support long-term liabilities, improving the resilience of the industry through market cycles;
- improved pricing / higher returns for those buying lifetime income stream products;

- a more competitive lifetime income market attracting new entrants and creating a stronger and more dynamic industry; and
- broader benefits to the Australian economy with a greater pool of capital supporting the economy, which could include:
  - debt-funding of longer-term and less liquid investments, such as infrastructure and the energy transition; and
  - helping to grow and develop the domestic longer-term corporate bond market, noting the Australian corporate bond market currently has a much lower tenor than jurisdictions overseas that have a matching adjustment for life insurance companies For example, in the United Kingdom (which has a matching adjustment) the corporate bond market has an average duration twice that of Australia, with the long duration bond market supported by demand for less liquid long term assets by insurance companies.

"Money-back guarantee" to provide retirees with confidence

The take-up of lifetime incomes has been constrained by customers' concerns that they could lose their capital and not receive their purchase price back from the lifetime income stream product. Adjusting the Capital Access Schedule to ensure product providers can compliantly offer a "money-back guarantee" so that customers can be confident they will receive at least their initial purchase price back, could increase take-up of retirement lifetime income streams. The current Capital Access Schedule goes close to allowing this, but some scenarios exist where amounts received back from a product offering maximum Capital Access Schedule benefits might be slightly less than the purchase price. The current arrangement is much more difficult to communicate to customers, compared to the simple promise of "you will always receive back at least your purchase price".

Alignment of means testing for lifetime income streams

Retirees often take guidance from regulatory settings in selecting their investment options. Currently, there is a distortion in the income test for Age Pension purposes. Adjusting social security income means testing rules so that income from lifetime income streams is treated equivalently to account-based pension income would support the take up of lifetime income products.

Lifetime income streams are assessed with 60% of payments included as income. Payments from lifetime income products to members also reflect a return of capital, which is often much more than 40% of the regular payment. By comparison, account-based pensions are income tested at a current rate of 2.25% of the balance. With drawdowns of at least 5% for those over the age of 65, this includes only 45% or less of the payment as assessable income for means testing purposes. This provides a bias against lifetime income streams. For example, at present, a 67-year-old retiree with $300,000 in superannuation would receive $1,400 less in annual Age Pension entitlements if they invested one-third of their superannuation into a lifetime income stream compared to having the whole amount in an account-based pension. This reduction in their Age Pension entitlement is equal to approximately one-quarter of the CPI-linked lifetime income stream payments that they would receive.[10] While a lifetime income stream receives an assets test benefit at the start of retirement, the benefit declines over time. The income test differences increase at older ages, raising the barrier further. As at September 2023 only 13% of Age Pension recipients were asset-tested[11] so few can benefit from the reduction in assessable assets.

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[10] Based on CPI-linked lifetime annuities as at 22 Jan 2024.
[11] DSS Benefit and Payment Recipient Demographics - quarterly data | Datasets | data.gov.au - beta.

Recommendation 5: Private sector participants should be allowed to provide longevity risk cover without the Government entering the market

There is no evidence of a market failure in the lifetime income market. However, as discussed in this submission, there are many barriers within the retirement eco-system which have reduced the take up of lifetime income streams. Addressing these barriers would ensure greater take up, irrespective of who provides and manages the lifetime income stream.

The Government does not need to, nor should it, become a national provider of longevity insurance or become a longevity product manufacturer. With greater education and promotion of lifetime income streams, as well as better calibrated prudential and regulatory settings, a strong competitive and innovative longevity market would not only endure but would grow.

Government provision of longevity protection would also increase the risk for current and future Australian taxpayers, who already bear significant longevity risk assumed by the Government through the existing age pension system and increasing healthcare spending for an aging population.

If Government support was deemed necessary, this would best be achieved by implementation of a government backstop for APRA-regulated entities via the Financial Claims Scheme, similar to the Government backing for deposits with APRA-regulated Authorised Deposit-taking Institutions. This would provide retirees with additional peace of mind and support the development of a broader range of retirement income products.

Across the financial industry, and in other industries, the private sector demonstrates significant ability for innovation and efficiency in part driven by competition, guided by an appropriate regulatory environment. In the superannuation system, this competitive environment can better meet the needs of members and facilitate higher returns, and at the same time reduce pressure on the Australian taxpayer.

Globally there is a very strong Pension Risk Transfer (PRT) market, with defined benefit funds regularly converting capital sums (akin to a superannuation balance) into regular and reliable retirement income for their members through the private insurance market. For example, in the United Kingdom there is a £40 billion annual PRT market with domestic and offshore providers serving a very developed retirement income market. With the right prudential capital settings (refer above) and a superannuation market more focused on income and risk management, there is a significant opportunity to develop a vibrant Australian lifetime income market providing more choice and better outcomes for retirees.

Appendix A

Additional detail and response to specific questions

This appendix provides additional details on the submission referencing the specific questions asked in the discussion paper.

A1.1 Please provide comments on the issues facing members identified in this section.

The biggest challenge in the accumulation of savings for retirement has been addressed for members through compulsory contributions, MySuper and performance measurement. There are more challenges for members to navigate in retirement, as noted in the discussion paper.

In broad terms there are additional risks in retirement that members need to manage. Our submission details these risks and outlines what can be done to help members address this challenge, namely:

1. Ensure that there is a competitive market for products that can manage the risks and provide the income that retirees need;
2. Assist superannuation funds to deliver suitable products to all members; and
3. Provide guidance and advice so that retired members select the product mix that meets their retirement needs.

Another challenge is that many retirees are not aware of the options available in retirement. This leaves many to remain in the accumulation phase, paying tax, when they could be utilising their super in retirement. While there are some reasons that members optimally choose to do this, it is likely that low engagement and a lack of awareness are the main reasons. As at June 2023, there were more than 1.4 million accounts with $255bn of member benefits with members over 65, not in the pension phase.[12] A recent survey for Epic Retirement reported that 35% of respondents did not grasp the intricacies of the retirement phase.[13] A documented challenge for retirees is appropriately valuing a lifetime income stream. Brown et.al. (2017) report that people find it difficult to appropriately value a lifetime income stream, and that this can lead to inaction by retirees.[14]

A1.2 What actions are industry or other participants in the community taking to address the issues identified in this section (supporting members to navigate retirement income)?

There are many actions that the industry has taken to assist members to navigate retirement income. These include:

- Member & consumer tools
  - Challenger's life expectancy calculator *Retire with Confidence Tool | Challenger*
  - TelstraSuper has developed an online tool to help educate members about retirement income *Retirement Lifestyle Planner | TelstraSuper*
  - Aware Super's My Retirement Planner *My retirement planner | Australian Superannuation Fund (aware.com.au)*
- Inclusion of retirement income projections on statements.
  - The impact of this for Cbus members has been part of an academic study.[15]They show that including income projections increases member engagement and improves retirement outcomes through increased contribution rates.

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[12] Calculated from APRA Annual Superannuation Bulletin June 2022.
[13] *Superannuation: Retirees' top concerns and how to fix them (smh.com.au).*
[14] Brown, J. R., A. Kapteyn, E.F. Luttmer, and O.S. Mitchell, 2017. Cognitive Constraints on Valuing Annuities. *Journal of the European Economic Association*, 15(2):429-462.
[15] Smyrnis, George and Bateman, Hazel and Dobrescu, Loretti Isabella and Newell, Ben Rhodri and Thorp, Susan, Motivated Saving: The Impact of Projections on Retirement Saving Intentions (October 5, 2019). Available at SSRN: https://ssrn.com/abstract=3464813.

- Many superannuation funds run retirement seminars for members to help them navigate retirement.
- Many retirees navigate retirement with their adviser, and Challenger assists by providing a significant amount of CPD-assessed adviser training each year with more than 200 presentations to more than 4,000 advisers in 2023, focused specifically on retirement.

A1.3 Of the approaches identified (supporting members), what should be prioritised and what risks should be considered as policy is developed?

The three approaches identified would all be beneficial and should be implemented. In terms of priority, it will be more important to educate and guide retirees than assisting through a default structure. Retirees seeking income are more likely to be at least partly engaged, so if they are defaulted into a solution and not educated they might make changes that are detrimental to their outcomes. Simplicity can, and should, be a goal at every priority.

A1.4 What other approaches, if any, should the Government consider?

A simple, one-page Fact Sheet for lifetime income products would help Australians easily compare the benefits and costs of competing products, similar to the single page comparison introduced for mortgage products under the Australian Government's Competitive and Sustainable Banking System[16] reforms (2010-2012) that was intended to help borrowers easily compare their future mortgage payments and fees.

The Financial Services Regulatory Authority of Ontario has recently issued guidance on different decumulation products for retirees.[17] This can help retirees compare products that operate differently despite similar names. This guidance is detailed and 12 pages long, but a simple one-page guide would be preferable.

A1.5 What does 'good' look like for how funds support and deliver products to their members in retirement?

'Good' support and delivery is a process that makes it simple for the member to invest in an appropriate retirement product. This will include information and guidance around retirement at appropriate points across the lifetime of the member. There are different ways that members want to engage with their fund[18], and the fund needs some flexibility to deliver what different members need and want.

The Retirement Income Covenant provides a good framework for funds. They should have:

- Retirement products available that can deliver income to members and manage their risks in retirement. These can be either internally or externally managed and should consider entitlement to the Age Pension;
- An easy way to combine the products that can be explained, simply, to members;
- Guidance through the accumulation phase that can help members to select appropriate retirement solutions. This should include income projections and online tools for member engagement; and
- Advice options available for members who want or need greater assistance.

A1.6 What basic information do members most need to assist their understanding and simplify decision-making about retirement income?

The key decisions for retirees regarding their retirement income relate to the trade-offs that impact income, returns and risks in retirement. The information required by members will depend on how the

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[16] Competitive and Sustainable Banking System | Treasury.gov.au.
[17] Understanding Decumulation Products | Financial Services Regulatory Authority of Ontario (fsrao.ca).
[18] See Bell and Warren (2023) Pathways for directing members into retirement solutions: Who decides- fund trustee, adviser or member? Conexus Institute 27 Nov 2023.

key decisions are made. Basic information should enable a member to understand any solution that is offered to them by their fund. This would include:

- Their entitlement to the Age Pension;
- How much income the retiree can spend over, say, this year, based on their level of savings;
- How that income will change over time;
    - The risks the income is exposed to; and
    - Clear descriptions of product characteristics.[19]

Members would be able to consider if the offer is appropriate for them, and select an alternative solution that better met their goals.

A1.7 Where can government and industry reduce complexity in the retirement income system, and provide simpler consumer experiences?

Government has an important role in ensuring people have access to accurate, informative and impartial material to improve financial literacy regarding retirement and in particular what risks they face (longevity, investment and inflation) and their options for having a retirement income that best suits their needs.

Providing guidance for retirees in or approaching retirement, similar to the UK's PensionWise service[20], could improve the consumer experience in retirement. Care is needed in providing simplified education so that issues around risk are not ignored in the pursuit of simplicity.

A1.8 How might funds utilise guidance, nudges, defaults and other actions to assist members into better solutions for their retirement income?

Work in behavioural economics has shown how important and effective defaults and nudges can be, particularly in areas where decisions are complex and people are prone to procrastinate such as saving for retirement. Defaults can be problematic when there is a wide variation in the goals of the endeavour. Setting a retirement product by default is harder than setting an accumulation product by default because the risk and cost of locking a member into an inappropriate product can be high.

It would be better for members to be provided guidance and nudges to the solutions that might be appropriate. This will reduce the risk of an inappropriate placement and improve member engagement. For example, in the years before retirement people could commit to or be directed to an intended retirement income plan. The decision may seem less daunting if it is made prior to retirement, and the opportunity to review it could be retained for when they retire. Making the decision progressively in the years before retirement could also enable people to smooth their exposure to markets and interest rates by say purchasing lifetime income streams at market rates across several different years.

There are a range of providers in the Australian market that are seeking to help funds implement solutions to help guide their members into retirement. Some of these, such as Ignition Advice and Otivo, use a digital advice solution, while others focus more on member education, e.g. SuperEd. SuperEd's Retirement Essentials product has been particularly helpful in assisting retirees to access the Age Pension.

Funds can also provide tools to help their members understand and take up better solutions for their retirement income. TelstraSuper has developed a retirement lifestyle planner[21] that educates members about retirement income and helps them to determine an appropriate mix of retirement product that best

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[19] This point is also made in H. Bateman; Eckert C; Iskhakov F; Louviere J; Satchell S; Thorp S, 2018, 'Individual Capability and Effort in Retirement Benefit Choice', *Journal of Risk and Insurance*, 85, pp. 483 - 512, http://dx.doi.org/10.1111/jori.12162.
[20] Pension Wise: free pension guidance | MoneyHelper.
[21] Retirement Lifestyle Planner | TelstraSuper.

suits their needs. After engaging with a financial planner, members are better placed to decide and select a mix of income products that best meet their needs through retirement.

A1.9 What are the barriers to funds being more active in these ways?

One barrier is the low levels of information that superannuation funds know about their members. Using an expanded Consumer Data Right, fund members could tick a box to enable their fund to bring in tax and banking data to provide members with a basic outline of their financial position (assets, liabilities etc, they could have the option to add more information) and show how a retirement income would compare to their working income. The more information a fund knows about its members, the more its guidance can be tailored to the member and therefore be more effective.

A1.10 Data is a critical input for funds to provide better retirement income strategies. What processes are funds undertaking to collect, analyse, and apply data analysis to understand their membership?

Superannuation funds are undertaking a range of activities to better understand their members. From our interaction with funds, there are significant differences in the amount of activity and processes employed by funds in gathering data on members. Processes include, member surveys, reviews of population data and collecting data from engagement and advice tools.

A1.11 What barriers are there to better practices, and what policy approaches could help achieve better data use?

One of the barriers to better use of data is the need for information at the household level. Consumption typically occurs at a household, rather than personal level, so the best retirement outcome for a member will depend on their household's situation. While inferences can be made from assumptions, capturing some information about the household will provide better outcomes. This is more complex as it can require consent from the member's partner who might not be a member of the same superannuation fund. Digital advice tools could be helpful with this data collection.

Another barrier has been limited internal resources to collect, review and use the member data. Many of the larger superannuation funds have prioritised retirement strategies with the creation of a Head of Retirement, or similar role indicating an increase in resources and effort to find solutions for members. This should lead to improved outcomes over time.

A1.12 The retirement income covenant does not apply to SMSF trustees. What approaches do SMSF trustees take to manage risk, ensure they have access to savings, and maximise their income? Are there barriers to improving how SMSF trustees achieve these objectives, and what role can government or industry play to improve these outcomes?

SMSF trustees are also the members of the fund and can tailor their investments for their own needs.

A2.1 Please provide comments on the need to support competition and product comparison across the services and products funds provide in retirement, or the need for greater consumer protection

Retirees should have access to a range of retirement income solutions that best meet their needs. Different people have different requirements in retirement. For example, some fund members will prefer an absolute guaranteed lifetime income stream, as they will not want to be exposed to market risk across their entire retirement portfolio. Members with different expectations about their life expectancy may want different levels of longevity protection. A strong and competitive life insurance market will ensure funds can deliver a range of lifetime income products that are relevant for the breadth of funds' members and allow funds to differentiate their offering in retirement, providing consumers with more choice. Given the different composition of membership, not all funds will necessarily want to offer the same range of features in retirement income products. Nevertheless, we expect that the range of members within most funds will be much wider than the range of the ‘average’ members across funds.

The Government, in conjunction with APRA and the industry, has a critical role in creating a regulatory environment that supports an innovative and competitive industry. This can enable the industry to develop a range of lifetime income solutions at prices that are compelling to customers and encourages take-up amongst those approaching and in retirement.

A2.2 What role should industry or other groups in the community play to support consumer protections and competitive products and services in retirement?

Consumer protection is a Government and industry responsibility. Industry and other groups can support the protections by providing clear and accurate information. This extends to clear language so that consumers are not misled by industry terminology and jargon. For example, some retirees in survey responses think that an account-based pension operates like the Age Pension because of the similarity in the term ‘pension’. Many people think that their payment will last for life when there is no longevity protection. Reducing the opportunity for consumers to be mis-informed will help protect consumers.

A2.3 What actions are being undertaken already?

The retirement income market in Australia is competitive. In recent years, superannuation funds and other participants have developed innovative income stream products to meet the varying needs of retirees. Challenger has partnered with a number of superannuation funds and platforms in recent years for the fund to deliver a longevity management solution to their members. These partnerships include those set out in the table below.

Superannuation Fund / Platform	**Launch**
VicSuper (now Aware Super)	November 2014
Colonial First State	August 2015
CareSuper	October 2015
Local Government Super (now Active Super)	October 2015
legalsuper	October 2015
AMP	September 2017
BT	August 2018
HUB24	May 2019
Netwealth	June 2019
TelstraSuper	October 2023
CSC	November 2023

A2.4 Of the approaches identified (supporting funds), what should be prioritised and what risks should be considered as policy is developed?

The priority of the identified measures should be to reduce the regulatory barriers to the development, provision, and take-up of retirement products. This includes the Delivering Better Financial Outcomes reforms that will make it easier for superannuation funds to provide advice and guidance to their members.

Maintaining equitable social security treatment is essential for the uptake of better retirement income strategies. Current settings create a skew towards account-based products that are assessed by deeming their income. This creates a favourable income test for an account-based pension, and the percentage of payment that is included in the income test falls with age as minimum drawdowns increase. Income streams receive an initial asset test discount but this discount diminishes over time as the discount is based on the purchase price. The retiree only has access to their capital under the Capital Access Schedule and the discounted present value of future payments decline with age. However, with 57% of part Age Pensioners limited by the income means test,[22] the income test is more often the marginal consideration.

The income test for a lifetime income stream includes 60% of payments, but this is an overstatement in many cases, particularly for products that manage the longevity, investment and inflation risks for a retiree. Using current lifetime annuity rates[23], a 67-year-old female could receive $6,889.92 a year from an initial $100,0000 investment. Based on the Australian Life Tables with mortality improvements[24] she has a life expectancy of a further 22.8 years. Expected payments over a lifetime would be $157,090.[25] Over the lifetime, the total income of $57,090 is only 36% of the payment received by the retiree, with 63% of annuity payments being a return of capital. The actual percentages would vary depending on the length of life, but the population average would be 36% income, well below the current 60% included in the income test. An assessment that includes no more than 40% of the payment as income would more closely align with the actual underlying income payment made on a lifetime product.

It would also be helpful to have more tools available for comparisons. However, there is a challenge to balance the accuracy of the tool with its simplicity to use. For example, Moneysmart's Retirement Planner[26] uses fixed investment returns and a fixed period of retirement. This makes it easier to use, but it does not provide an accurate picture of likely outcomes and ignores the risks to retirement income that are noted in the Retirement Income Covenant.

Better tools would support better retirement income strategies.

A standardised framework has some merits. As noted in the discussion paper, this approach was explored following the Financial System Inquiry in 2014 but the framework did not progress at that stage. The challenge in setting a framework measure that can meet the varying needs of retirees remains.

The Retirement Income Covenant already provides the basis for a framework to balance the need for income with flexibility and managing the risks in retirement. A framework that is used to boost financial literacy around retirement issues and enable comparisons of product features would be beneficial. As the discussion around the proposed Retirement Income Risk Measure highlighted it is difficult to get a standardised measure that captures the relevant needs. A better approach would be the checklist noted in the discussion paper.

A2.5 What other approaches, if any, should Government consider?

The best way to support funds to deliver better retirement income strategies would be to promote a competitive market for income streams and to ensure that funds are meeting the requirements of the Retirement Income Covenant.

A2.6 What are the key characteristics or metrics for comparing retirement income products and services?

The key characteristics for comparing retirement income products are highlighted in the Retirement Income Covenant. Namely:

- Maximising expected retirement income.
- Managing expected risk to the sustainability and stability of retirement income, including:

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[22] DSS demographics data as at September 2023.
[23] Challenger Liquid Lifetime, CPI-indexed flexible option without indexation, as at 5 February 2024. A CPI-linked payment would start lower at $5,068 but would increase with CPI.
[24] ALT2015-17 with 25-year mortality improvements for someone aged 67 in 2024.
[25] A 67 year old male could expect to receive 21.0 payments of $7145.40 = $150,053.
[26] Retirement planner - Moneysmart.gov.au.

   - Longevity risk;
   - Investment risk; and
   - Inflation risk.
- Having flexible access to expected funds during retirement.

A2.7 What approaches could make product disclosure useful for members?

Any disclosure needs to be simple enough for members to understand. To be useful, it needs to highlight the risks that the product does or does not manage. There should also be agreed terminology around product features that are consistently used. This can link with financial literacy initiatives to improve effectiveness and member understanding.

A2.8 How might barriers such as complexity, or individuality of products, be overcome?

Improved financial literacy and agreed terminology will help to reduce complexity. A short checklist[27] or traffic light system can provide the information that members will need to make their decisions around retirement income product.

The key for product comparison is to describe how it will impact the income available to the retiree and how the various risks can impact that income. Highlighting what happens with any residual balance for an estate or reversionary payments will also assist to remove some of the perceived barriers.

A2.9 What barriers are there for product switching in retirement and are there opportunities to make product switching easier?

Consumers should be able to switch when a product is no longer meeting their needs. While it is possible to switch account-based products, the need to roll-back to the accumulation phase to switch products (or funds), manage Transfer Balance Cap credits and debits are barriers. A mechanism for direct switching of account-based income streams between products or funds would make product switching easier.

For non-account-based income streams, including insured products, there are additional barriers to switching. Insured products are subject to adverse selection. Allowing unrestrained switches could undermine the integrity of the product.[28] An alternative would be to enable people to switch their insurance provider and maintain the key benefits. This operates for health insurance, which does not require new waiting periods if the level of cover is the same. This can happen in aggregate through a successor fund transfer or similar group transfer of risk from a superannuation fund. In 2023, Challenger received the largest such transfer in Australian history from Aware Super.[29] There might be a benefit in allowing retirees to switch a retirement income stream, as long as the key features are maintained. An example of this is the ability to exchange annuities in the United States through what is known as a 1035 exchange.

A3.1 Please provide any comment on the barriers in the supply and demand for lifetime income products

As noted in the discussion paper, there are several barriers in the supply and demand of lifetime income products. Some of the barriers to funds making lifetime income products available are compounded by the barriers to take-up by members. The cost of development will be minimised if members take up a

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[27] The Conexus Institute piece by Bell and Warren (*Assessing-retirement-strategies-Final-20221202-Updated.pdf (theconexusinstitute.org.au)*) provides a good example of a checklist.
[28] Home insurance maintains a similar integrity by not allowing people to start insurance when they see the impending peril (fire, flood) about to hit. Insurance needs to be maintained over time for the system to work.
[29] *Challenger announced as Aware Supers partner to provide defined benefit solution | Challenger.*

product. The concern over legacy products is effectively a concern that not enough members will take up the product.

In the Australian market, some of the barriers have already been addressed but the barriers still exist because of the perceptions that remain. For example, most lifetime annuities include a death benefit of the initial purchase price for a number of years after purchase. If someone dies prematurely there is no 'wasting' of capital as it is returned to the estate. However, because of perceptions, there remains a barrier until the death benefit is explained. Challenger's recommendation to allow a 'money back guarantee' would help address this perception.

Concerns over the potential loss of capital act as a barrier for people due to the operation of the Capital Access Schedule. There is a small residual concern as under some market conditions, it is possible that the Capital Access Schedule prevents the return of 100% of invested capital through the combination of income payments and the death benefit. The probability of this happening is very low, but the possibility can be a barrier to take-up.

The discussion paper notes on page 23 that the challenge of comparison can act as a barrier to take-up by members. It is sometimes claimed that annuities are expensive, often without evidence. One reason for this is the difficulty people (and superannuation funds) have in pricing longevity risk. Shu et al (2016) note that this valuation difficulty is one reason why some people dislike lifetime annuities.[30] Sometimes people compare annuity payments to expected returns on growth investments and mistakenly label the two options as substitutes. In practice, a lifetime income stream should be used alongside a growth investment.

A lifetime income stream is different to a pure investment product in that it not only provides a return of capital and earnings on that capital, but also provides insurance benefits, being an income paid for life, and for most annuities sold today, a death benefit.

When considering the effective return that an annuity provides to a retiree, it is important to note that this return is net of the cost of the insurance benefits. As noted above, most lifetime annuities currently sold include a death benefit which smooths the effective return to an individual annuity-holder depending on how long they live. Based on current annuity rates, an annuity holder will always get a positive effective return, that can be as high as around 7% per annum.

In considering the barriers to the provision of lifetime income it is worth noting the impact of other regulations on superannuation funds. One that has been raised is a potential impact from the Your Future Your Super (YFYS) performance test. Moving a proportion of member funds to an external provider will have scale impacts on the investment management costs of the other investments. The higher cost can manifest in either the impact of using the same internal resources over a smaller asset base, or potentially paying a higher rate on externally managed funds (as a result of FUM-based fee tiering).

For retired members, the cost saving from having an allocation to the lifetime income stream, might balance this out, but the unit costs will impact all members. The potential impact on the YFYS performance test increases the reluctance of funds to offer a lifetime income stream if they do not have the internal management capability.

A3.2 What actions are industry or other participants in the community taking to assist retirees to better manage the risks for retirement income?

The most commonly used retirement product in superannuation has been an account-based pension which provides flexibility and has the potential to generate high expected investment returns but does little to manage the key risks in retirement. Challenger has been working with a range of funds and advisers to assist retirees to better manage the risks for retirement income. Two recent examples

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30 Shu, S. B., R. Zeithammer, & J.W. Payne, (2016). Consumer preferences for annuity attributes: Beyond net present value. *Journal of Marketing Research*, 53, 240–262.

helping funds to implement their retirement income strategies are TelstraSuper[31] and Commonwealth Superannuation Corporation (CSC).[32]

Common to both TelstraSuper and CSC is the use of a combination of a guaranteed lifetime income stream in addition to an account-based pension to enable members to manage the retirement risks they face. The use of a guaranteed lifetime income stream enables members to manage longevity and inflation risks in a way that was not possible when their only option was an account-based pension.

The two funds' engagement model with members is slightly different with one making a greater use of member cohorts to design a blend of retirement options to suit member needs, while the other will make greater use of advisers to ensure that members get the appropriate blend of products for their individual retirement income strategies.

Other superannuation funds have made lifetime annuities available to their members before the implementation of the Retirement Income Covenant. These included a similar blending of options for members to access. These funds included:

- Vicsuper[33] (now part of Aware Super);
- Active Super (formerly Local Government Super);
- CareSuper; and
- Legalsuper.[34]

QSuper (now part of Australian Retirement Trust) launched a lifetime pension in 2021 which provides a lifetime income that is linked to the performance of their balanced fund investment. While this is not fully guaranteed, it manages the longevity risk for members by pooling their savings across participants in the option.

Other providers (Generation Life, AMP, Allianz Retire+ and Challenger) have also launched investment-linked lifetime income streams in recent years. These manage some of the longevity risk for the retiree but keeps exposure to the market risk for retirees.

A3.3 What policy approaches should be taken to support use of lifetime income products to address the risks to retirement income?

Challenger's recommendations are detailed previously in this submission. These are:

1. Government and industry should contribute to better understanding of retirement income products;
2. retirees should have access to a range of retirement income solutions;
3. superannuation funds and advisers should be strongly encouraged to recommend lifetime income solutions combined with an account-based pension that meet the needs of retiring members;
4. regulatory and legislative settings need to be better calibrated to boost competition and innovation in the lifetime income market and increase the uptake of longevity solutions; and
5. private sector participants should be allowed to provide longevity risk cover without the Government entering the market.

A3.4 What risks should be considered?

The Retirement Income Covenant notes a range of risks to retirement income that superannuation funds trustees must assist their members to manage:[35]

(i) Longevity risks;
(ii) Investment risks;

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[31] TelstraSuper cements its leading retirement offering with innovative Lifetime Pension | TelstraSuper.
[32] CSC announces its Retirement Income Solution with Challenger | Challenger.
[33] VicSuper partners with Challenger (afr.com).
[34] Challenger signs up Local Government Super, legalsuper, CareSuper (smh.com.au).
[35] Superannuation Industry (Supervision) Act 1993 s52AA(2)(b).

(iii) Inflation risks; and
(iv) Any other risks to the sustainability and stability of the retirement income.

For the Government to ensure that there is a sustainable competitive market for retirement income, policy should support the availability of products to manage each of these risks for retirees, while providing income.

Some of the other risks are behavioural in nature, so a Government policy to support financial literacy and education would be beneficial.

A3.5 What product options (or strategies within current retirement products) could better manage risks to retirement income?

As the discussion paper notes, products are available to assist retirees to manage the risk but there are some barriers, both real and perceived, that limit the use of some of these products to manage risk. Reducing and overcoming the barriers as noted in our recommendations would help retirees to better manage the risks to retirement income.

Where some traction has been made, simplicity has been a key element. Breaking down the challenge into manageable targets can help retirees find a solution that works for them. Of current products, the inflation-linked guaranteed lifetime annuity has had the greatest take-up. Other products, such as variable annuities that attempt to deliver market upside while having a lifetime income guarantee have failed to make traction in the Australian market. The complexity and cost in trying to hedge multiple risks while providing upside was difficult for retirees to understand and implement. The simple approach is using one product to target growth, and another product to manage specific risk. This can enable retirees (and their adviser) to select an appropriate blend of the components to meet their needs.

Managing any risk involves a trade-off. Reducing one risk will either increase another risk or reduce the expected reward.

A3.6 What is the role for a 'suggested' product in overcoming low take-up of lifetime income products?

A 'suggested' product might help increase take-up if it is shown to be relevant to the needs of the retiree. Currently, the 'suggested' product that retirees see is an account-based pension with an investment mix that is similar to what they had in accumulation, or with a more defensive asset allocation in some cases.

Developing a framework where it can be suggested to a member that a blended product, which includes an allocation to a lifetime income product, would increase the take-up of lifetime income products.

Highlighting a single product, or a specific mix of products would be counterproductive. A single option is unlikely to meet the needs of all retirees, limiting take-up or worse, resulting in members with products that do not suit their needs.

The following example illustrates how a superannuation fund could use a framework to build a suggested blend of products that might suit different member's needs. XYZ Super has developed a few options for members in retirement:

- An account-based pension that can vary with different risk profiles (ABP)
- A guaranteed CPI-linked lifetime income stream (ILA)
- A market-linked lifetime annuity (MLA)

Using these options, XYZ Super can create different blends that, with the Age Pension, could be suitable for different members. The members are:

- Alex is aged 69, has a balance of $200,000 and XYZ Super has limited other information;
- Leila is aged 67 has a balance of $400,000 and XYZ Super knows that she is married and has a 'balanced' risk profile; and

- Kai is aged 65 has a balance of $1,000,000 and has used the XYZ Super advice team so they know about his partner, household assets of another $600,000 including his partner's super and that he has a conservative risk profile.

XYZ Super might offer the following blends to these members.

	Alex	Leila	Kai
ABP	100% Balanced	80% Growth	70% Conservative
ILA	-	20%	-
MLA	-	-	30% Conservative

The risk profile of the ABP is adjusted to suit the overall risk profile for each member. Alex is likely to receive a full Age Pension while Leila will probably receive a part Age Pension. Kai would not receive any Age Pension at this time.

The small range of options enables XYZ Super to tailor different blends to meet the needs members. While there are some similarities, a single product would not meet the need for different members.

A3.7 What action are funds taking to better manage longevity risk, and what role do funds see guaranteed income products (e.g. annuities, pooled products) playing in the future?

Fund actions to better manage longevity risk are part of the actions noted in 0 to help their members better manage longevity risk. Funds have increased internal resources, with many now having a dedicated 'Head of Retirement' or similar role. While some are considering internally managed options (e.g. QSuper Pension for Life), most are looking to outsource longevity risk management to an outside specialist.

The increased focus, and ongoing member needs, are likely to result in a larger role for guaranteed income products in the future.

A3.8 Do the barriers to managing longevity risk in the Australian market necessitate Government action?

There are barriers that the Government can remove or reduce to help Australians better manage longevity risk. This includes aligning regulatory and legislative settings to support competition and innovation in the lifetime income market.

There is no need for direct intervention into the longevity pricing market. Longevity pricing is competitive with several global life insurers competing for business in the Australian market.

Should some of the recommendations outlined in this submission be adopted, including better understanding of retirement income products, increasing retirees access to a range of retirement income solutions, and superannuation funds and advisers being encouraged to recommend lifetime income solutions, the lifetime income market should further develop. This would be likely to attract additional global and domestic insurance providers into the Australian market.

A3.9 What Government action could assist funds in offering appropriate longevity protection to members?

The Retirement Income Covenant requires funds to manage longevity risk for members. Some of the delay in funds offering longevity protection relates to concerns over the level of member take-up. Some actions that would assist include:

- A broader education campaign around managing retirement income and the risks in retirement, as detailed in Recommendation 2.

- Several superannuation funds already offer longevity protection to their members. The current regulatory environment has the ability to encourage other funds to offer longevity protection to their members.
- The fear of counterparty loss is often cited as a reason not to take up a guaranteed lifetime income stream. While prudential supervision should prevent losses to the owners of a lifetime income stream, including these products in the Financial Claims Scheme would remove this perception of counterparty risk as a barrier to take-up.[36]

A3.10 Would an industry-standardised product(s) assist funds to develop and offer lifetime income products to their members?

Care needs to be taken in promoting an industry-standardised product. Trustees should be able to offer and recommend longevity products that best suit the needs of their diverse membership and take account of an individual's personal circumstances. Retirees need solutions that reflect their individual needs, given their portfolio of superannuation and other assets, risk preferences, life and health expectancy and other personal characteristics. This is very unlikely to be met with a mandated single, standardised default product for all superannuation members.

Retirees should have access to a range of 'retirement product features' – either through an umbrella product that allows a customisable mix of key features (such as an account-based pension, a market-linked lifetime income stream and an inflation-indexed guaranteed lifetime income stream) or an adequate range of component products (each providing access to one or more features).

A framework for delivering the appropriate combination of products to meet the retirement income needs of members would be helpful. The Retirement Income Covenant provides the basis for this framework and some funds are making progress to develop and offer lifetime income products to their members. TelstraSuper, CSC, AMP, and Generation Life have all publicly announced lifetime income products since the Retirement Income Covenant commenced on 1 July 2022.

A3.11 What features should a standardised product include?

The framework should include:

- Options that can provide retirement income to members;
- Options that can manage longevity, investment and inflation risks to retirement income; and
- Options that provide flexible access to capital.

The framework should also note that some products might combine these options in different ways.

A3.12 Should there be a path to more easily transition members to a standardised product?

Yes. It should be easier for a member to transition to a combination of products that meet their retirement income needs. Currently, members are required to choose any retirement income product, either by themselves or with the assistance of a financial adviser. A recent paper by the Conexus Institute[37] highlights alternative pathways that would enable members to more easily transition into a retirement income product. The 'trustee recommendation' and 'trustee assignment' pathways discussed in that paper would be suitable improvements.

A3.13 Should superannuation funds be required to offer a standardised retirement product, similar to MySuper for accumulation?

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[36] This fear plays a large role in annuitisation choices according to Beshears, J., J. J. Choi, D. Laibson, B. C. Madrian, and S. P. Zeldes, 2014, What Makes Annuitization More Appealing? *Journal of Public Economics*, 116: 2-16.
[37] Pathways-to-retirement-income-solutions-Final-Paper-20231127.pdf (theconexusinstitute.org.au).

No. Funds should have component products available so that the member is able to be allocated to a combination of products that is appropriate to their needs. This should not preclude funds that have the capability to offer a retirement product appropriately tailored to the member, or a cohort of members.

A3.14 How should a product vary for individual circumstances of the member?

There are a range of factors that can influence the choice of the combination of products to meet a member's need for retirement income. The optimal combination might need to utilise assets that the member (or their partner) holds outside their superannuation account. Some of the variation in member's circumstances relates to their financial position such as their super balances, other assets, household assets, debt and their entitlement to the Age Pension or any other income source. Member preferences can also affect the choice of the combination of products that best suit their needs. Recent research by Capital Preferences highlights that 50% of Australians aged over 55 value moderate to high certainty in their retirement income and estimates a gap of $145bn that should be transferred into a guaranteed lifetime income stream to meet their preferences for long-term income certainty.[38]

If a superannuation fund has a suitable range of products to provide income and manage the various risks to retirement income, the appropriate outcome for a member will be a combination of those products that meet their needs.

The pathway used could also impact the final combination of products. As the cameos in 0 highlight, different levels of tailoring can provide a different level of matching the needs of the retiree.

A3.15 Would a standardised product be cheaper to develop and offer (e.g. compared to a general mandate to offer a longevity product)?

A standardised product would likely be marginally cheaper to develop and manage. But most of the cost is administration and adjusting guidance and advice. There are alternatives available that funds can use. Mandating a standard product might be notionally cheaper but would likely make it more expensive to meet the needs of individual members as more would need additional intervention and/or advice to address their specific needs.

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[38] *Revealing Member Income Preferences: A Scientific Path to Retirement Personalisation. Capital Preferences February 2024*.

Appendix B

About Challenger

We are an investment management firm focused on providing customers with financial security for a better retirement. Challenger operates three core investment businesses - a fiduciary Funds Management division, an APRA-regulated Life division and an APRA regulated authorised deposit-taking institution. Challenger Life Company Limited (Challenger Life) is Australia's largest provider of annuities and guaranteed retirement income streams. In FY23, we made approximately $6 billion in guaranteed payments to customers. We are active in promoting the importance of retirement income streams, and every year, Challenger runs education sessions on retirement for more than 4,000 advisers. The Funds Management division also supports the superannuation industry, with Australia's top 25 superannuation funds all clients, for whom we provide investment management services supporting outcomes for their members.

We provide customers with the confidence to spend in retirement via our $25 billion balance sheet, that has for decades played a role in supporting the Australian economy.

Challenger’s in-market experience

Challenger is the market leader in Australian retirement incomes according to 92% of financial advisers.[39]

Our guaranteed income offering is distributed via advisers and administrative platforms. We have built longstanding relationships with Australian advisers, working with approximately 8,000 financial advisers.

Challenger also has experience designing and implementing retirement solutions for institutional clients, including superannuation funds, insurers and wealth managers. This includes group annuities that allow a superannuation fund to issue its own guaranteed lifetime income stream to members and insure against longevity, inflation, and investment risks.

[39] Marketing Pulse Adviser Study December 2023.