THE Frontier Line

Thought leadership and insights from Frontier Advisors

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Framework for MyRetirement Products

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Framework for MyRetirement Products

The current Australian retirement product market is underdeveloped, with the majority of superannuation funds offering the same products in accumulation and retirement phase. There is a limited range of products designed specifically for retirees wishing to convert their superannuation into an income stream.

The Cooper Review[1] (which proposed MySuper in 2010) and the subsequent Murray Inquiry[2] both recommended some form of default retirement product be introduced. In 2015, the Federal Government agreed to facilitate this, and as such released a discussion paper[3] that sets out a framework for the introduction of default MyRetirement products.

There is much to like about the proposed framework:

- It encourages income streams, aligning with the new objective of superannuation of providing income in retirement.
- It recognises the benefit of longevity risk protection, highlighting the current "cost" of retirees self-insuring the risk of living longer than expected.
- It provides an "anchor" for those members who find the task of choosing an appropriate retirement product overwhelming.

However, we believe that the framework can be improved with a number of modifications:

- It proposes that funds will only offer one MyRetirement product, aimed at meeting the needs of the "average" member. Retirees needs from their superannuation will vary depending on a number of factors, including whether they receive the Age Pension. We believe trustees should be able to offer multiple MyRetirement products (in a similar way that they can offer lifecycle MySuper products) which are tailored to distinct member cohorts.
- By failing to recognise that in most cases superannuation is used to provide retirement income for a household, rather than just an individual, the framework implicitly devalues legacy benefits. Often these will be used to pay retirement income to the remaining spouse. While the framework doesn't prohibit bequests, greater recognition of the value to the surviving spouse (often female) is warranted.
- The framework understates the desire and need for flexibility in the use of superannuation in retirement. Retirees needs in retirement change, and can't be foreseen at retirement.
- It misses the opportunity to encourage greater education and understanding of retirement issues. While most superannuation members don't seek advice, as they approach retirement, member engagement increases. Most superannuation funds offer retirement seminars in an effort to better engage with their members.

Overall, the framework is a step in the right direction, reflecting the recommendations of the Murray Inquiry. Allowing funds to tailoring the default to specific member cohorts, and encouraging more member education, we believe will lead to a more effective retirement system.

1. Super System Review (Cooper Review), 2009 - 2010
2. Financial System Inquiry (Murray Inquiry), 2013 - 2014
3. Development of the framework for Comprehensive Income Products for Retirement, 2016

Introduction

On 15 December 2016, Treasury released a discussion paper entitled "Development of the Framework for Comprehensive Income Products for Retirement". The paper seeks feedback (by 28 April 2017) to assist the development of the Comprehensive Income Product for Retirement (CIPR) framework.

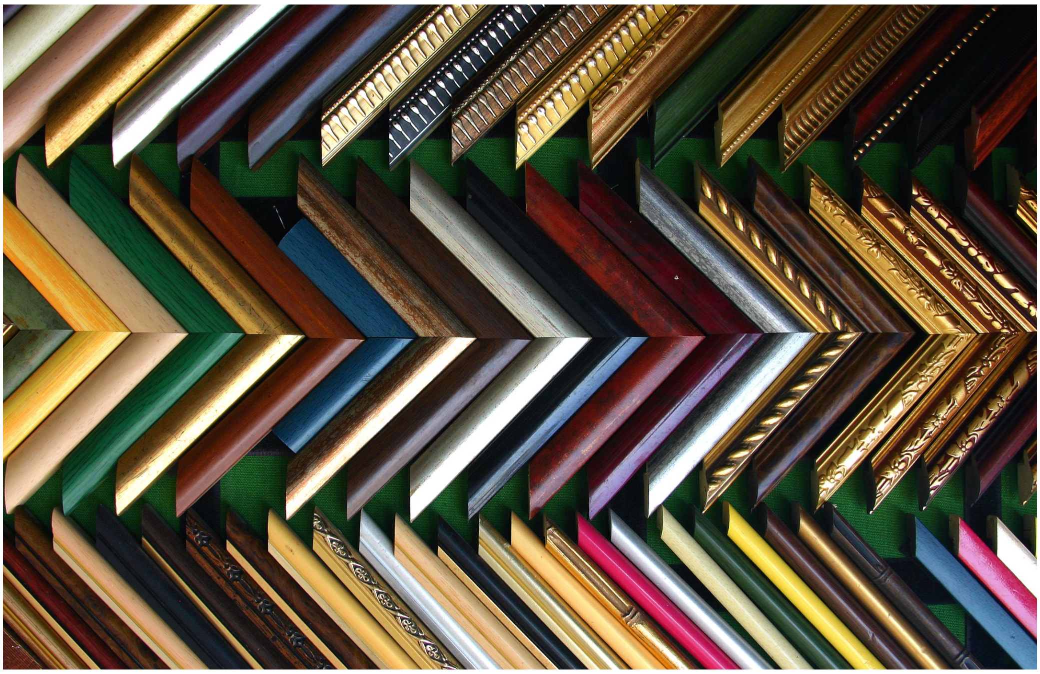
In particular:

- *The structure and minimum requirements of CIPRs;*
- *The framework for regulating CIPRs; and*
- *The offering of a CIPR.*

The specific discussion questions raised in the Treasury discussion paper are listed in at the back of this paper.

One of the discussion questions raised is whether "MyRetirement" is a more appropriate label for a CIPR. MyRetirement will be used throughout the remainder of this Frontier Line to reference these retirement products.

The Treasury discussion paper envisages that the MyRetirement framework would not commence until trustees and other product providers have had sufficient time to develop appropriate products. With the commencement of the new income stream product rules from July 2017, Treasury is not expecting the MyRetirement framework to commence before mid-2018.



Background

2010 Cooper Review

The Cooper Review introduced MySuper as the pre-retirement default option. The final report also recommended:

- MySuper products must include one type of income stream retirement product;
- Trustees should be required to offer intra-fund advice proactively to MySuper members as they approach retirement age;
- Trustees should offer intra-fund advice proactively to MySuper members in the retirement phase at periodic intervals; and
- Trustees must devise a separate investment strategy for members in MySuper retirement.

In its response to the Cooper Review, the Government "noted" these recommendations but decided to "consult with relevant stakeholders on whether post-retirement products should be mandated for MySuper products at some time in the future"[4].

2014 Murray Inquiry

The Murray Inquiry released its final report in December 2014. Recommendation 11 was:

"Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed."[5]

In particular, the report recommended that CIPRs should be low-cost and should include features such as a regular and stable income stream, longevity management and flexibility. The design could vary with the member's known characteristics, such as the size of their superannuation benefits, and take account of the possibility of cognitive impairment at older ages.

The objectives were to:

- Better meet the needs of retirees, including those who are disengaged or less sophisticated, and provide a more seamless transition to the retirement phase of superannuation.
- Achieve the objectives of the superannuation system by strengthening the focus on providing retirement incomes.
- Improve Australian's standard of living during their working lives and retirement through greater risk pooling.

In 2015, the Government agreed to support the Murray Inquiry recommendations to facilitate the development of retirement products and facilitating trustees pre-selecting these products for members.

4. Government decision on the key design aspects of the Stronger Super reforms, 2011
5. Financial System Inquiry, Final Report 2014

2016 Treasury discussion paper

Framework objectives

Treasury's discussion paper explores a potential framework for the development of MyRetirement products, envisaging a greater role for trustees in the guiding of their members at retirement.

The development of the framework has four policy objectives:

- To enable individuals to increase their standard of living in retirement through the use of longevity risk pooling;
- Increase the availability and choice of products that efficiently manage longevity risk;
- To enable trustees to provide individuals with an easier transition to retirement; and
- Increase the efficiency of the superannuation system so that it can better meet its objectives.

Importantly, the Treasury discussion paper reiterates the government will facilitate trustees offering a MyRetirement product for its members, but there would be no obligation on trustees to offer such a product.

Designing a MyRetirement product

Treasury proposes trustees would design a single MyRetirement product which would be in the best interests of the majority of members. Trustees would be expected to take into account:

- The information they have about their membership such as the average retirement age, gender, average account balance, occupation, life expectancy and average income;
- The income needs of their members;
- The trade-offs between income, risks and flexibility, including which elements are more important for the majority of its membership; and
- The fund characteristics, including the fund's scale and the trustee's capability and skill set.

Treasury refer to this as "mass-customised – a standardised product that is designed to be in the best interest of the majority of fund members".

This should not be confused with mass-customisation – "a production process that combines elements of mass production with those of bespoke tailoring. Products are adapted to meet a customer's individual needs, so no two items are the same"[6].

The Treasury discussion paper states that a single MyRetirement product is consistent with the MySuper framework, where generally only one MySuper product is offered (although a lifecycle products are allowed). The rationale for this is to limit costs.

They contend that limiting the number of MyRetirement products to one would:

- Reduce confusion and complexity for members;
- Facilitate comparisons between funds MyRetirement products;
- Provide an "anchor" for member's decision-making;
- Avoid the risk that the product would be presented as a product tailored to the individual's needs; and
- Avoid the appearance that it is personal financial advice.

Trustees would not be prevented from offering tailored or bespoke retirement income products, and could certify them as MyRetirement compliant if they meet the minimum requirements. However, these products would only be available through advice or direct channels.

Treasury considered the alternative of allowing trustees to develop multiple MyRetirement products and offering them to members based on their characteristics. This would result in more tailored products which may be more beneficial to members, especially for funds with less homogeneous membership.

However, the Treasury discussion paper states:

- It is not clear on what basis the customised MyRetirement products would be tailored and matched to specific members; and
- It is likely to be difficult for trustees to tailor the product without "significant" additional personal information, such as assets and liabilities outside of superannuation, risk preferences and spousal details.

6. The Economist, Mass customisation, 22 October 2009

Designing a ‘mass-customised’ MyRetirement product

Creating a MyRetirement product to be “in the best interests of the majority of the members of a fund” will be no easy task, even for those funds which have members with very similar characteristics. The MyRetirement framework expects the trustees to take into account information they have available on their membership.

Longevity protection typically varies by gender (males would receive more as they are expected to live shorter lives), and gender is a known characteristic of superannuation members. A number of funds also offer different insurance rates based on occupation. Therefore it would be expected that MyRetirement products would vary by gender and occupation.

Marital status is also an important factor in longevity protection. If a member is married, when they die their balance would often be used to support their spouse in their retirement. However, marital status is not usually collected by super funds – although around 70% of Australians aged 65-74 are married[7].

Should trustees include a reversionary element to their MyRetirement product? If they do, then single members will be disadvantaged. If they don’t, married members’ spouses (typically females) will be worse off.

MySuper lifecycle products can vary, based on the member’s age, account balance, contribution rate, current salary, gender and time to retirement. On a similar basis, we recommend that a default MyRetirement product could vary based on the member’s:

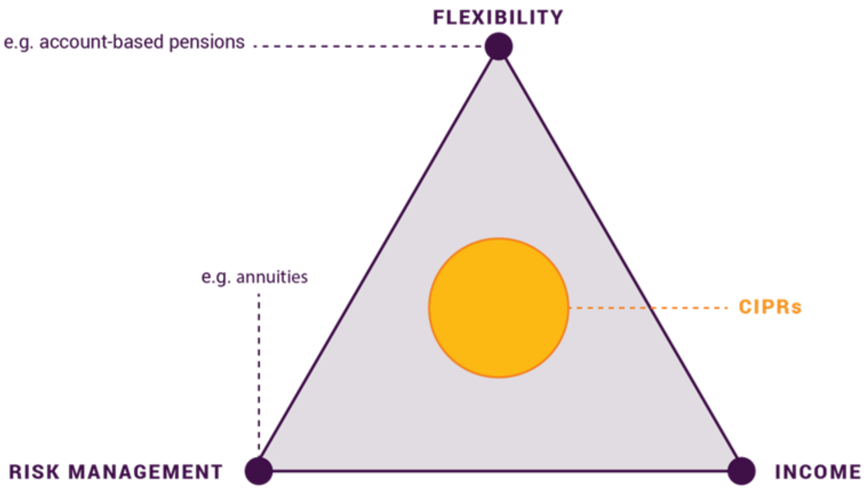
- Age,
- Account balance,
- Current salary,
- Gender,
- Occupation/health, and
- Marital status.

7. ABS, 4102.0 - Australian Social Trends, March 2009

MyRetirement requirements

Consistent with the Murray Inquiry, the Treasury discussion paper proposes three principles-based minimum requirements for MyRetirement products:

- Deliver a minimum level of income that would generally exceed the minimum drawdown amount from an equivalent account-based pension. If the level of income was guaranteed, then this would be "recognised".
- Provide (the expectation of) a stream of broadly constant real income for life.
- Include a component to provide flexibility to access a lump sum and/or leave a bequest.



The paper expects that a MyRetirement product will be a composite product, combining a number of underlying products to produce the required features.

Minimum level of income

The Treasury discussion paper references the Murray Inquiry conclusion that incomes from MyRetirement products could be 15 to 30 per cent higher than those from account-based pensions. To ensure that MyRetirement products produce a better outcome than the current situation, Treasury is proposing that a minimum income could be prescribed. They have indicated possible ways to define the required income efficiency include:

- Setting a minimum amount above an account-based pension drawn down at minimum rates; or
- Putting a cap on the total amount of "leakage" from retirement incomes (for example, administration costs, capital costs and bequests).

Whichever methodology is used, it would need to account for risk management features that products giving a guaranteed level of income provide – i.e. lower income may be allowable if it is guaranteed.

Treasury sees setting a minimum income efficiency level as helping avoid individuals paying for unnecessary "bells and whistles" they do not need at the expense of income.

Constant, real income for life

As retirees generally have a preference to maintain a constant standard of living over time, Treasury has proposed MyRetirement products provide a broadly constant stream of income.

This requirement has three separate elements:

- Broadly constant income – this would not preclude individuals withdrawing less or more in any given year (subject to any rules around minimums and the requirements of the underlying component products). Under this approach, retirees whose Age Pension entitlements increases over time (as their superannuation balance decreases) will receive an increasing total income over life.
- Real income – requiring incomes to keep pace with changes in the cost of living. Treasury considered not specifying an inflation requirement, however decided that this would "significantly diminish individuals' ability to compare CIPRs".
- Income for life – this would necessitate a longevity risk management product, such as an annuity or a deferred annuity.

Flexibility

Flexibility within this context could take several forms:

- Access to funds for lumpy or unexpected purchases – either such things as holidays or for health/aged care costs;
- The ability to commute a MyRetirement product (or a component therefor) after its commencement; and/or
- The payment to a beneficiary upon death.

Treasury emphases that the need for flexibility within superannuation should not be overstated. While individuals in retirement may desire flexibility, Treasury contends that the objective of superannuation is to provide retirement income, and flexibility can be provided by assets outside of superannuation.

MyRetirement certification

The Treasury discussion paper considers three alternate methods of certification that a MyRetirement product meets the minimum requirements:

- Regulator authorisation – APRA or ASIC could assess whether a MyRetirement product meets the minimum requirements;
- Third party certification – a third party, such as an actuary, could provide independent certification; or
- Self-assessment – the trustees could self-assess as to whether they meet the requirements.

The paper favours one of the first two options, as self-assessment could lead to non-compliant products entering the market leaving the regulator to take action, which could then undermine member confidence.

Offering a MyRetirement product

Safe harbour

The Treasury discussion paper is proposing a "safe harbour" to trustees to remove legal uncertainty as an impediment to offering a MyRetirement product. This would provide trustees with a legal defence against action that they had not acted in the best interest of an individual member.

It is proposed that the safe harbour would require trustees to:

- Design a MyRetirement product suitable for the majority of members;
- Design a MyRetirement product to meet the minimum product requirements; and
- Follow any other process of disclosure requirements.

Members to be offered a MyRetirement product

The Treasury discussion paper considers whether the MyRetirement product should be offered to all fund retiring members. They consider some possible exceptions:

- Members with terminal medical condition – a longevity product would be unlikely to be in their best interests;
- Members with very low balances – these members may get their longevity protection from the Age Pension. However, the paper states that many members have more than one superannuation account, and would require members to consolidate multiple accounts as a pre-condition; and
- Non-MySuper members – these members may be more engaged and informed and therefore may not need a default product to assist their decision-making.

Disclosure and competition

The Treasury discussion paper notes that the framework has two, partially competing policy objectives. The first is to ensure individuals take up MyRetirement products. The second objective is to ensure system efficiency, and achieving this "requires adequate competition between trustees. Competition should increase choice, place downward pressure on prices, and help optimise retirement income outcomes for consumers."[8]

To enable this competition, the paper advocates that consumers should be able to make easy comparisons between different MyRetirement products and with other types of products such as account-based pensions.

There are several methods to facilitate this comparability, including disclosure requirements. The paper notes that the more standardised the disclosure is across funds, the more easily members would be able to compare products.

8. Development of the framework for Comprehensive Income Products for Retirement, 2016, page 37

The final word

MySuper was introduced in 2013 as the default product for the superannuation accumulation phase. The Cooper Review (which proposed MySuper) and the subsequent Murray Inquiry both recommended some form of default retirement product be introduced. In 2015, the Federal Government agreed to facilitate this, and as such released a discussion paper that sets out a framework for the introduction of MyRetirement products. Superannuation funds will not be compelled to offer such products.

The core belief throughout the Treasury discussion paper is that an individual's standard of living will be increased in retirement through the introduction of MyRetirement products. This will be facilitated through the use of longevity solutions, which provide lifetime income at the expense of unintended bequests.

The paper lists four problems which the MyRetirement framework is aiming to address. Next to each of these problems we provide our view as how likely the proposed framework is solving them.

Problem Treasury framework is seeking to address[9]	Frontier opinion
Individuals are self-insuring against longevity risk and may be living more frugally in retirement than they need to	The use of longevity protection may increase income payments to the individual, but is also likely to lead to leakages from the system to insurers/third party providers
Individuals face a lack of diversity and choice in retirement income products, in particular an absence of products that efficiently manage longevity risk	New products will be created, however the framework is encouraging comparability of products which will lead to a lack of diversity
The superannuation system is not achieving its objective efficiently due to its over-reliance on account-based pensions	Account based pensions already provide income. Longevity protection will increase the income payments at the reduction of bequests and flexibility generally. Payments to surviving spouses may disappear, potentially disadvantaging females
Individuals face complex financial decisions, a lack of guidance and behavioural biased at retirement, but many are unlikely to seek financial advice	The framework proposes a "one size fits all approach" which overlooks the complexity

9. Ibid, page 5

Whilst Treasury states the framework is not intended to encourage annuities over other products, MyRetirement products will require some form of longevity risk management. Additionally, inflation protection would be required, despite the paper pointing out that studies have drawn mixed conclusions on whether this is preferred by retirees.

In both cases, superannuation funds are likely to require third party providers such as insurers to help provide such products. This will inevitably lead to leakages from the superannuation system, and therefore lower overall retirement incomes to members.

The paper recognises that the decisions individuals need to make at retirement are complex. Treasury believes that a single MyRetirement product (aimed to meet the needs of the majority of members) offered to all members will reduce the confusion for superannuation fund members. It will also provide an anchor against which other products will be assessed.

However, in reducing a complex situation to a single solution, complexity is overlooked and, as a result, we believe that its less likely that a MyRetirement product will be in the best interests of any single individual.

The paper states that the framework seeks to achieve two, partially competing objectives:

1. To ensure individuals take up MyRetirement products which will improve retirement outcomes.
2. To ensure system efficiency, achieving this through adequate competition between product providers.

In balancing these two objectives, Treasury appears to have given greater weight to the competition aspect. This comparability comes at the expense of a more tailored solution to the specific requirements of individuals (or cohorts of members).

Allowing trustees to offer multiple MyRetirement products (in a similar way that they can offer lifecycle MySuper products) which are tailored to distinct member cohorts should, in our view, be given greater consideration.

List of Treasury discussion questions

A. Defining a CIPR	
1.	How can trustees design CIPRs to deliver the best outcomes for their members? What are the trade-offs of different design approaches and features?
2.	Are there any lessons from defined benefit schemes that can be applied to the CIPRs framework?
3.	Do you agree with the proposed three minimum requirements of a CIPR? What are the alternatives?
4.	How important is achieving a minimum additional level of increased income to the introduction of the CIPRs framework?
5.	How should income efficiency be defined?
6.	What minimum level of increased income should be required; that is, what should be the minimum level of income efficiency? How should guaranteed products be accounted for?
7.	Which indexation option best achieves the goal of increasing standards of living in retirement?
8.	Are there comparability benefits from specifying which indexation option would be required of a CIPR?
9.	What elements/types of flexibility are most valued by individuals in retirement, and does flexibility need to be provided for through a CIPR?
10.	To what extent should savings outside superannuation be used to meet unexpected costs in retirement?
11.	Is the proposed structure of a CIPR appropriate?
12.	Are there any risks or issues with trustees partnering with third parties to enable them to offer certain underlying component products of a CIPR?
13.	Should trustees be able to offer one or multiple CIPRs as the mass-customised retirement income product offering to members? Why/Why not?
14.	If funds were able to offer multiple CIPRs as the mass-customised retirement income product, on what basis would CIPRs differ?
B. The regulatory settings for trustees	
1.	What are the key impediments currently preventing trustees from offering a mass-customised CIPR to their members?
2.	Would a safe harbour for their best interest obligations remove a key impediment to trustees designing and offering CIPRs?
3.	Which trustees should consider offering a mass-customised CIPR to their members? Should the safe harbour be made available to all trustees or a certain population of trustees?
4.	After an appropriate transition period, should the Government consider whether there should be an express obligation on trustees to offer a CIPR? If so, what length of transition period would be appropriate?
C. Ensuring that products meet the minimum product requirements	
1.	What process should be used to ensure that a CIPR meets the minimum product requirements?
2.	Would it be appropriate for actuaries to provide third party certification? If so, what, if any, additional regulation of actuaries would be required?
3.	Should there be ongoing re-authorisation/re-certification requirements for CIPRs? If so, how and how often should this be done?
4.	What should the consequences be if a CIPR no longer met the minimum product requirements? Is it possible to avoid creating legacy products?

D. Facilitating trustees to offer a CIPR

1. How can the framework facilitate trustees providing an easier transition into retirement for individuals, and what else can be done to meet this objective?
2. To which members would it be most appropriate for trustees to offer a CIPR? All members or only MySuper members?
3. In what circumstances should trustees not offer a CIPR to certain members?
4. Should the safe harbour only apply to the offering of a CIPR to certain members?

Disclosure

1. What information about CIPRs should be conveyed to members by trustees during the pre‐retirement phase and how often should this occur? Should this information, its form and frequency, be prescribed?
2. When should the pre-retirement engagement between a trustee and a member commence and how frequently should it occur? Should this timing be prescribed?
3. What is the best way to communicate the offer of a CIPR to members? Will warnings/pre‐conditions when offering a CIPR be effective? If so, which warnings/pre‐conditions are necessary? If not, what is the alternative?
4. What is the most appropriate type of disclosure document to provide further information about a CIPR to consumers and intermediaries such as financial advisers?

Competition

1. What is the best way to assist individuals to assess the pros and cons of a CIPR?
2. What is the best way to foster competition in the CIPR market and broader retirement income product market?
3. Should CIPRs be able to be provided via direct channels and financial advice?

Fees and pricing of CIPRs

1. Is there a need for regulation of fees and pricing of CIPRs? What are the options?

E. Products outside the mass-customised CIPR framework

1. Should a retirement income product that meets the minimum product requirements of a CIPR be labelled as such?

F. Other matters

1. Is 'MyRetirement' a more appropriate label for a CIPR in both the product and framework sense?
2. Would portability foster competition between CIPRs as well as other retirement income products? If so, how could portability be built into the design of a CIPR, should portability be mandatory or discretionary for trustees, and what would be the implications of this?
3. Should it be mandatory or left to the discretion of trustees to decide whether to allow for period certain guarantees in the design of CIPRs? What would be the implications of this?
4. What should be the maximum and minimum cooling off periods?
5. Should the CIPRs framework accommodate (and if so, how):
    a. joint CIPRs for couples?
    b. collective defined contribution schemes?
    c. aged care refundable accommodation deposits?