KPMG Observations

Retirement Income Disclosure Consultation Paper – Stage Two of the Retirement Income Framework

March 2019

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28 March 2019

Retirement Income Disclosure Consultation Paper: Stage Two of the Retirement Income Framework

KPMG welcomes the opportunity to respond to the government's Retirement Income Disclosure Consultation Paper, to provide input into the shaping of a future Retirement Income Framework and how key information may be presented and disclosed to consumers.

KPMG supports the government in the establishment of a Retirement Incomes Framework which aligns to the objective of superannuation. Further KPMG supports measures which will aid consumer comparability and comprehension and assist in enabling Australians to make more informed decisions with regards to investing their retirement savings.

Key matters we support include:

- It is a fact that financial services and tax law is complex. Measures to aid comprehension and decision making are welcome.
- Making the complex simple whilst needing to comply with current disclosure and other legal obligations is a challenge for product manufacturers and super funds. The addition of a fact sheet to supplement the Product Disclosure Statement is a welcome proposal.
- Ideally, consideration to making the fact sheet permissible in a digital form, including allowing the consumer to interactively input their relevant information, may also aid comprehension and aid decision making by enabling consumers to learn how variables do change the results highlighting that trade-offs are required.

Key areas of concern:

- The measures should aid understanding of the trade-offs (the consequences of choosing one product over another) in addition to decision making.
- Static representation of information which is a trade-off may not aid comprehension and decision making.
- Only focusing on downward risks associated with expected income will potentially mislead a consumer to assume that only less negative/downside exposure should be their objective.
- Sequencing risk is treated too simplistically to inform a consumer to make the best investment decision.
- The requirements should compel the provider to include all retirement income products they offer to be included in the fact sheet for comparison not just limited to Comprehensive Income Products for Retirement (CIPRs).

KPMG provides more detailed comments to the Retirement Income Disclosure Consultation Paper in the following section *KPMG Observations*.

KPMG would be pleased to provide further information to assist. Should you require further information or have any questions please do not hesitate to contact Peter Bentley on (02) 9455 9654 or at pbentley1@kpmg.com.au

Yours sincerely,

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KPMG Observations

The Australian Government is seeking to introduce a Retirement Incomes fact sheet to accompany Retirement Incomes offer document disclosure to facilitate informed decisions about key characteristics of retirement incomes and the core trade-offs between income, longevity, access to capital, and risks between different products.

1. Key Components of the proposal

The proposed Retirement Incomes fact sheet is to include:

- Expected amount of periodic income the product is expected to provide;
- The likelihood that the income may fall short of the expected amount over a given period;
- What protection the product offers against the monies running out; and
- Level of access to capital on death and or ability to access monies for other consumption needs.

2. Presentation of information and standardised metrics

The Behavioural Economics Team of the Australian Government (BETA) *Supporting retirees in retirement income planning* (the BETA Report) provides a range of powerful insights to inform the presentation of complex information and the development of standardised metrics.

The Report finds that simplified presentations of information increase comprehension and the likelihood to choose a Comprehensive Income Product for Retirement (CIPR). The research found that the inclusion of text tables comparing key features were more effective than tables and graphs presenting key numerical information. We note and concur that there is limited value added by including a star rating system as there was no significant difference for consumer comprehension, clarity, or ease in decision making between text tables with and without stars, as the BETA Report showed.

This is in addition to avoiding the complexity in defining rules for how to set the star ratings and also how to regulate them. Noting it would be as challenging to create a star ratings system to demonstrate the comparable strengths of particular products, e.g. strong star ratings for access to capital for an Account Based Pension (ABP) vis a vis a lifetime annuity where industry wide consensus would be easily reached or set by the regulator.

We make the additional observations regarding how to present the information:

- What evidence is there to suggest that it is better to use a single format for presentation of information vs giving consumers a choice of the way in which information is presented? While text tables comparing features in words may improve overall comprehension, is there an understanding of the differences for people with different preferences (i.e. some people prefer numbers, others visuals and others words). Presenting both options may allow for greater comprehension across all groups.

- To what extent is there an understanding of the impact of the visual design on comprehension? Could an improved design of graphs and table improve comprehension? (see Figures 8, 9 and 10 pages 30 and 31 of the BETA Report).

We note that in KPMG's experience using behavioural economic methodologies, we have found that the type of visual representation of graphs has a big impact in comprehension and subsequent decision making. Based on previous form design work KPMG has completed, we would hypothesise that the design of the graphs (Figures 8, 9 and 10) may have triggered some of the negative sentiment in the experiment (p.24 the BETA Report) as the graphs may not convey a message of transparency or accessibility to average consumers

In addition to the behavioural economics principles the BETA Report discusses, we suggest the following additional heuristics could be utilised to benefit the presentation of information:

1) **Picture superiority effect** - usage of graphical representations.
   Re-imagining some of the data sets with clearer, better designed graphs;

2) **Chunking** - breaking down the content into easy to navigate information blocks; and

3) **Incremental commitment** - ordering information in increasing complexity.

3. Comments on the Proposed Standard Metrics

A. Expected Retirement Income

Treasury's Proposed Approach

For all retirement income products, expected retirement income should be presented numerically and with the income graph using real annual income from a $100,000 investment, over the period from retirement (currently age 67) to age 97. Income presented should be net of fees and taxes.

In terms of presentation of "expected retirement income", we make the following comments:

i. Personalisation of income

We believe that whenever possible, facilitated by digital means, that the framework enable consumers to calculate their real income using their own data, rather than simply defaulting to an income product purchased at $100,000.

We believe that best practice for disclosure may instead involve:
- Simple, interactive online calculators; and
- Utilise known consumer data wherever possible (opt-in).

ii. Anchoring of income

The BETA Report does not recommend giving visibility of average required income. We are interested in what the rationale behind this omission is?

We believe that best practice may include a way for consumers to understand the average income in retirement for those in similar income groups or demographic cohorts.

iii. Providing information throughout life stages

In KPMG's research we have found that even highly financially literate and engaged consumers avoid thinking about and planning for their about retirement for as long as possible.

To address these challenges a framework for information presentation can be developed using behavioural economic principles of social norming and personalisation. Through focusing on the creation of lifestyle based goals, informed by realistic objectives and linked to people of a similar age and income, these goals can be converted into retirement income figure estimates. We believe this process sets a more accurate frame to trigger active and informed decision making.

iv. Language

We are of the view that using the term "income" is more appropriate to a consumer and aligns to the language used to describe the very nature of the product – to provide an income in retirement.

v. Impact of inflation on the value of the real income over the 30 year estimates.

We understand the intent of this metric is to show an "income" or "take home pay" real income figure which is an adjustment to the income for expected inflation. We note that the suggested disclosure and use of the words "income" and/or "take home pay" do not in and of themselves convey to consumers whether inflation is considered. Consequently, there is benefit in further testing the nomenclature of this metric with consumers to ensure that this metric conveys meaningfully information for the purposes of decision making.

vi. Presentation of the level and variation of income is limiting and potentially misleading in isolation.

As discussed in the Australian Government Actuary (AGA) paper, "Retirement Income Risk Measure, sequencing risk is not explained as a trade-off (timing of the investment) and may lead to suboptimal investment decision. For example, where interest rates are low, the yield from a guaranteed income stream may also be low at the time of purchase. Similarly, there is risk of market linked investment in super falling significantly just prior to the purchase of an income stream or shortly after the purchase of a market linked income stream.

Making a decision to invest in certain retirement products on the basis of income levels alone may therefore produce a suboptimal result and potentially result in a consumer's balance running out sooner than it may have, had the individual sought professional advice. A professional adviser would be able to explain and demonstrate the impacts the prevailing market/economic situation may have on an investment decision at that time.

Sequencing risk could either be illustrated by showing how different rates of return can impact a real income level. Alternatively, this risk may be illustrated by showing expected rates of return at different life stages, e.g. after x years, at life expectancy and at life expectancy +10 years.

Consideration of these matters in the fact sheet would enhance the information being provided to the consumer and better equip them to decide.

vii. Default investment option

Given that an account based pension may be one of the retirement income products which will need to comply with this obligation, it is unclear if the provider will be able to stipulate an average rate of return based on a fund of their choice to determine the expected level of income. For example, in the case of a wrap super offering, can a provider choose which investment option to base the calculation on? If it is left to the discretion of the provider, it is our view that comparability (for the investor) between competing providers will be diminished. Will a 'default' investment option be acceptable?

viii. Production of the Fact Sheet

KPMG suggests that however future legislation/regulation is drafted, that it enable the Fact Sheet to be provided in a digital form.

A. Variation in expected income

See our earlier comments regarding the presentation of the information to consumers.

The proposal seeks to provide some level of guidance to consumers on the impacts of risk vs reward by providing the consumers with an indication through a risk metric measuring downside risk, longevity risk and expected inflation risk as defined in the AGA paper, converted to a seven point scale for ease of understanding.

Although the intent of the measure is of sound logic and the proposal by the AGA is a good compromise in presenting a number of complex risk measures in a simple to understand scale format, it is our view the measure does not provide the consumer with all the relevant information needed to make an informed choice between the various characteristics of the different type of income streams and the pros and cons associated with each. By its very nature we note the following observations:

i. The consumer should receive transparent disclosure and the measure should not be limited to just focus on downside risk. If one product has more significant upside and downside risk relative to an alternate product which has little up or downside risk, focusing on the negative or downside risks only is potentially misleading and may sway a consumer to choose the product with the lower downside without appreciating the impact that may have on their monies and income. Further, limiting focus to the downside risk would likely lead to a host of retirement income products being designed to minimise downside risk for relative income and may be counterproductive for consumers (providing lower incomes than could otherwise be generated in an alternate product design) and the economy (more government pension may be called upon).

ii. Sequencing risk for both guaranteed income streams and market linked products does not appear to be contemplated. This is important because it may determine which product type may be better to invest at that time or may highlight that a more flexible strategy is required before investing in a product such as an annuity which may for example, lock the client into a low yielding product in a low interest environment. Not including this information could result in the consumer making an ill-timed decision and significantly impacting their retirement incomes.

iii. Consideration needs to be given to how the information for this metric may influence a consumer to prioritise security of income over level of income and also the trade-off associated between more income earlier on vs more income later on. Using ASFA's Retirement Standard calculator, income requirement for a modest lifestyle is lower for retirees over 85 vs those aged over 65 but less than 85. Based on the proposed metric, the information disclosed may prompt a consumer to invest for example, in a non-indexed annuity, which will pay a higher income initially with diminishing purchasing power which may drive consumers to choose the indexed product for which they are sacrificing often quite sizable income in the earlier years.

iv. It is unclear if the Fact Sheet is to apply to all retirement incomes products or just CIPRs. How would a consumer know that other options exist if only the CIPR option is presented? It may be useful to include a comparison against the different retirement income products as presented in the AGA paper in the table on page 10 or page 12 to provide the consumer with a comparison point.

v. A product rating number in and of itself will not enable a consumer to understand how the income variation may impact their ability to meet their financial needs and goals. Further testing would be recommended to ascertain whether the consumer understands the consequences of their decisions not just to facilitate their ability to make a decision to invest in product A over B.

B. Access to underlying capital

Option B replacing the percentage available on exit with a dollar amount would likely be clearer for consumers to understand. Further, an additional column or statement explaining the exact dollar cost of implications of accessing the capital is imperative:

- any termination or exit fees that the consumer may be liable to pay; and/or
- dollar amount of any capital foregone if applicable.

C. Death and reversionary benefits

We are supportive of the information to be provided for this component.

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