Retirement income covenant

Response to July 2021 Treasury position paper on the retirement income covenant

6 August 2021

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1. Introduction

Challenger is an investment management company focused on providing customers with financial security for a better retirement. We operate three core businesses: an APRA regulated life company, Challenger Life Company Limited, which is Australia's leading provider of annuities; a funds management business; and a recently acquired retail bank that offers a range of savings and lending products.

2. Retirement Income Covenant

Challenger welcomes the opportunity to respond to Treasury's July 2021 position paper on the Retirement Income Covenant (**RIC**). We recognise and strongly support the importance of better retirement solutions, to ensure that Australians have financial security for a better retirement. The RIC is an important step towards ensuring the superannuation system meets the needs of Australians in retirement by converting their retirement savings into secure income for life.

In our view, the RIC should seek to achieve five key outcomes:

1. Flexible and fit for the future (principles-based vs prescriptive);
2. Encourage the development of new and innovative retirement income products;
3. Ensure that new products address or mitigate the unique risks that members face in the retirement phase;
4. Facilitate tailored approaches to communicating with members about those products; and
5. Give members the confidence to spend.

Overall, the RIC proposal achieves these desired outcomes. Below we discuss why these outcomes are important and how the current proposal will go a substantial way towards achieving them. We also make some minor suggestions for how the RIC proposal could be improved.

Following discussion of the key outcomes, we outline the critical role of APRA and ASIC in facilitating the successful implementation of the RIC and provide recommendations on initiatives to support this.

3. Key outcomes

(a) Flexible and fit for the future (principles-based, not prescription)

The retirement income solutions of 2030 will be more sophisticated than the ones that first emerge in 2021/2022. Technology and more comprehensive data will play a big part in this. We are also likely to have a significantly enhanced financial advice regime by then, but these things all take time.

A key to the success of the covenant will be that it facilitates enhancements to the retirement phase of the super system into the future. The 2022 regime should allow the industry to evolve over time and enhancements and refinements should also be driven by market competition and the regulators.

For example, in the coming years APRA should require trustees to collect more granular data on their membership in retirement, so they can use richer data sources to build their capability and capacity in the retirement phase. There might also be scope for the industry to get access to ATO and Services Australia data in the future.

The current proposal achieves this by requiring trustees to develop and implement a retirement income strategy that is tailored to the fund's members, rather than mandating a one-size-fits all approach. The strategy must be reviewed and re-evaluated over time to ensure it remains fit for purpose.

The requirement for a strategy is consistent with other SIS Act covenants and will fit neatly with the existing prudential framework, allowing APRA to supplement the covenant with more specific requirements, as best practice emerges.

It is also appropriate that the new requirements proposed for the retirement phase be delivered via a trustee covenant with the consequence that compliance with the covenant is a civil penalty provision. This approach ensures that the retirement income strategy is given an appropriate level of importance within the SIS Act framework.

(b) Encourage the development of new and innovative RI products

It is critically important that the RIC spurs the development of new and innovative retirement products so that members have more choice in a competitive market. There are currently very few products available to retirees that provide stable and sustainable retirement income. The Retirement Income Review (**RIR**) concluded that most retirees are worried about running out of savings before they die. As a result, they save more than they need to, and enjoy a lower standard of living in retirement.

The current proposal has strong potential to stimulate a deeper market in retirement income products because balancing the key objectives of the retirement income strategy lends itself to the pooling of mortality risk. It will be important that this concept becomes mainstream.

We also expect that trustees will, over time, collect more granular and new data from their members which in turn will allow a continuum of product innovation. The RIC should support and provide additional impetus to this process and provide an avenue for greater oversight of this activity by APRA.

(c) Address key risks

The second key objective is principally focused on risk management and will no doubt be expanded upon by APRA, whether in the form of new prudential standards or industry guidance. This is important because retirees face even more risks in retirement than they do in the accumulation phase, principally because they are drawing on their capital. They are therefore exposed not just to market risk, but also sequencing and longevity risks. The separation of these risks in point 5 of the Appendix to the position paper, where trustees must consider them, is important. Market and longevity risks are different, and trustees will need a separate plan for dealing with each.

The system acknowledges risks in the accumulation phase, such as premature death or incapacity, and that insurance products should be used to address or mitigate those risks. Similarly, the RIC will be the start of a new focus on risk management in the retirement phase. The benefit to a retiree from managing longevity risk is equivalent to a substantial (up to 30%) increase in wealth according to leading academic research.[1]

We expect the objective of managing risks to the sustainability and stability of a member's retirement income will encourage the development of products that mitigate market, sequencing, and longevity risks.

Another key risk to the level of retirement income a member might be able to enjoy over their retirement is inflation or loss of purchasing power. The risk that inflation could erode the present-day value of an income stream would not, in our view, be unambiguously addressed by the sustainability and stability objective. To ensure that this key objective covers all the known risks that could impact on retirees, we suggest that the actual risks are spelled out in the relevant provision in a straightforward, non-exhaustive list, or alternatively that they are spelled out in a note to the provision and then specifically referenced in the explanatory materials.

(d) **Flexible approach to advice and guidance**

A flexible approach to providing advice and guidance will allow trustees to tailor their communications to fit within existing advice business models and to suit the needs and characteristics of their membership. Trustees currently have different business models and advice delivery capabilities. At least initially, trustees will need to offer advice and guidance to members in the retirement phase in the same way that they do for members in accumulation. Members' characteristics and their advice needs also differ across funds. Some funds are predominantly made up of highly engaged members who are very likely to want comprehensive personal advice from their fund or a related advice service provider. Other funds will be dominated by disengaged members who are unlikely to take up comprehensive personal advice, but who might also be less likely to need complex products in retirement or advice to explain such products.

A (legislated) prescriptive, one-size-fits-all requirement to provide guidance in a certain form might not be appropriate for all members and risks setting a low bar that trustees will not seek to exceed. It is also likely to become outdated as the industry develops and would require frequent review and amendment. In addition, other existing regimes provide scope for trustees to communicate with their members about their product offerings without enlivening the financial advice laws. Information included in the disclosure document for a product can be made available on a trustee's website, in other printed materials and discussed orally with members, without this being deemed to be personal financial advice. Further, the legislation introducing the Design and Distribution Obligations exempts trustees from the personal advice laws where the trustee asks a member a series of questions for the sole purpose of establishing that the member is within the target market for the product. These other avenues of communication are discussed in more detail in paragraph 4.c below.

[1] For example, see Mitchell, Olivia S., James M. Poterba, Mark J. Warshawsky, and Jeffrey R. Brown. 1999. "New Evidence on the Money's Worth of Individual Annuities." American *Economic Review 89(5)* 1299-1318; and Milevsky, Moshe A., and Huaxiong Huang. 2018. "The Utility Value of Longevity Risk Pooling: Analytic Insights." *North American Actuarial Journal* 22(4) 574-590.

By not requiring a specific form of guidance as part of the RIC, the current proposal gives trustees the flexibility to provide information to their members that fits with their existing business models, and which is tailored to the needs of their members. This approach also does not pre-empt the Treasury review into the quality and accessibility of financial advice, which might provide further insights into how advice and guidance should be provided to members in the retirement phase.

(e) **Giving members the confidence to spend**

The combination of the first and second key objectives seems targeted at giving members the confidence to spend their sustainable and stable income. This can also be reinforced over time by how trustees describe the purpose of the strategy and how the products that give effect to it are explained. A key driver will be the sustainability objective. A drawdown from an ABP involves the partial consumption of retirement savings in circumstances where sustainability is not an inherent design feature of the product. Retirees who are aware of this, will tend to preserve savings if possible. A product that aims to produce sustainable income, on the other hand, can be described by the fund as 'for spending.'

If we assume, broadly in line with the analysis in the RIR, that each retiree in large APRA funds will, in future, draw down an extra 1.5% of their super balance each year, then this extra income would equate to $7.3bn in aggregate - or, to put it another way, the average retiree in an APRA fund would be able to spend an extra $4,300 a year, or a bit more than $80 each week. This extra expenditure in the economy should have a 'multiplier' effect of about 1.2 over the first two years. These additional drawdowns would result in almost $9bn of additional annual spending throughout the economy. This would be a significant boost to the economy, equal to about 0.5% of Australian GDP. A recent opinion piece explaining this analysis in more detail is reproduced in Appendix B.

Reproduced in Appendix C is a June 2021 report commissioned by Allianz Retire+, Challenger, Fidelity International and Mercer, summarising the results of a survey conducted by research firm Lonergan. Lonergan conducted a telephone survey of over 2,500 Australians over the age of 65 about how they would spend an additional $80 a week.

The results show that with greater options to have some retirement income that lasts for life, retirees would spend that extra income in their local economy.

Lastly, we wanted to make two points about the first key objective – maximising retirement income – which, if appropriately addressed, should encourage the development of products that will enable members to better smooth their consumption over the course of their retirement.

Assessing whether this objective is met by the strategy involves two issues:

(i) First, using a sensible timeframe for making the assessment. The preferred approach would be to use a forward-looking estimate of life expectancy of the typical retiree taking up the products offered under the strategy, or potentially longer – to protect the 50% of members who will live longer. This estimate should consider expected mortality improvements (as published by the Australian Government Actuary), rather than any shorter period such as the backward-looking estimates from period life tables.

(ii) Secondly, when making projections about future (uncertain) investment returns, proper account needs to be taken of the distribution of outcomes over time under any probability-based investment approach. In our view, APRA will need to apply a stochastic approach to assumptions trustees make about future investment returns, otherwise the industry-wide confidence interval of 50% will prevail. If this occurs, it will mean that half of the time retirees will not achieve the income projected.

4. APRA and ASIC's roles in facilitating the successful implementation of the covenant

The principles-based nature of the proposed covenant will necessitate a greater role for both APRA and ASIC in facilitating its successful implementation than if a more prescriptive approach had been taken.

For the covenant to be a success, it will be important for APRA to have a clear mandate to drive a best practice improvement program, to bring the whole industry up to the standard exhibited by the leading funds. This could be facilitated by an appropriate emphasis in any statement of expectations issued by the Treasurer to APRA. This is timely because the most recent statement of expectations was issued in 2018.[2]

(a) Retirement Income Strategy Prudential Standard

As is the case with the insurance and investment covenants, APRA should develop a prudential standard to direct the industry as to the form and substance of the Retirement Income Strategy. For example, APRA might set prudential requirements that the strategy:

- details how the trustee has constructed one or more cohorts in retirement;
- explains how the trustee has balanced the key objectives, while also managing the key risks in retirement;
- reflects the results of balancing the objectives in determining the trustee's retirement product offering;
- specifies an appropriate selection process for, and due diligence of, third party product providers (if they are to be used) and explains how the trustee will monitor the relationship with those providers on an ongoing basis;
- sets out investment and drawdown strategies for each product offering; and
- provides a mechanism for monitoring, reviewing, and revising the strategy over time.

In our view, APRA should develop and finalise its prudential requirements for the strategy six months in advance of the commencement date for the RIC, to assist the industry to comply on time.

(b) APRA prudential standard SPS 515, and guidance SPG 516

Trustees' performance in delivering outcomes in the best financial interests of their retired member cohorts will need to be regularly assessed and supported by sound

[2] https://www.apra.gov.au/statement-of-expectations-2018

strategic and business planning, as required under Prudential Standard 515. In addition, trustees will need to undertake the annual legislated outcomes assessment for any retirement product that is offered to members as part of the trustee's retirement income strategy.

APRA's member outcomes prudential framework includes some guidance on how trustees should set strategic objectives and assess the outcomes being delivered to members in the retirement phase. However, more detail might be required, particularly as the retirement phase of the system matures and develops over time.

As industry best practice emerges, APRA might provide further guidance on cohort construction in the retirement phase and encourage or require new sources of member demographic data to be collected by trustees to inform this. APRA might also specify new metrics for benchmarking retirement products for the purpose of the legislated outcomes assessment, and for assessing the fund's performance under the prudential framework. Appropriate metrics could include:

- the stability of retirement income via a standard deviation or other volatility measure;
- the sustainability of the member pool;
- the efficacy of the risk management under the second objective;
- how effectively the strategy deals with sequencing risk; and
- the extent to which the strategy matches assets with expected drawdowns.

Any changes that APRA deems necessary to its member outcomes prudential framework would be less urgent and could reasonably be developed and finalised a few months in advance of the one-year anniversary of the RIC taking effect.

(c) Finding ways through barriers to providing advice and guidance to members

There are a range of ways in which a trustee can provide information to members on its retirement product offering without enlivening the financial advice laws, noting that these methods of communication do not involve the trustee contacting members.

(i) Disclosure document exemption

The law already makes it abundantly clear that giving a product disclosure document (**PDS**) for a retirement income product to a member is not giving financial product advice.[3] Product disclosure documents for retirement income products are not required to follow the prescriptive standard 8-page format that applies to superannuation products in the accumulation phase. This creates an opportunity for a PDS to be prepared that contains information about different types of retirement products and for whom they might be suitable.

[3] Section 766B(1A) of the *Corporations Act*.

Logically, from a policy perspective, the exemption that means that giving a PDS is not financial product advice should apply equally where information in the disclosure document for a retirement product is reproduced on the trustee's website, in print, or discussed with a member over the phone (where the member contacts the trustee). To the extent there was any doubt about this, it would be helpful for this position to be confirmed (potentially by ASIC guidance if it were thought necessary).

For example, the trustee's disclosure document might include a case study of a member, Sally, who is about to retire at the age of 67. Sally could be described as partnered, having worked most of her career in white collar (low occupational risk) roles, with a balance between $350,000 and $500,000, and owning her own home. The material could then provide information on the fund's product offering – an ABP and a deferred annuity commencing at age 82 - and suggest that a member broadly like Sally could expect approximately $X per week and flexible access to most of their savings, if they invest 10% of their superannuation balance in the deferred annuity and the rest in the fund's ABP. The provision of this 'representative member' information through various mechanisms should not constitute personal financial advice.

The trustee would need to warn members that if their personal circumstances departed in any significant way from Sally's, they should try to find a different representative member cameo that was more like them. The material might list factors that a member could consider using to compare their circumstances against Sally's. They could also seek advice or independently assess whether Sally's investment is appropriate for them.

The exemption for PDSs also applies for other regulated documents, such as periodic statements. There are currently no tailored requirements for the content of periodic statements for superannuation funds but there is provision for regulations to be made to prescribe additional content. It might be appropriate for regulations to be made to require additional information to be included, perhaps when members reach specified ages, designed to start a process of engagement with the member in relation to clarifying their retirement income needs and options. For example, summary information about retirement income products offered within the fund, and potentially income projections, could be required to be included in periodic statements.

(ii) **DDO target market questions**

Similarly, where a member contacts the trustee to direct it to invest the member's savings into an available retirement product, under the DDO regime the trustee can ask the member a series of questions to determine whether the member is within the target market for the product. Where the questions are asked solely for the purpose of determining whether the member is within the target market, the laws governing personal financial advice do not apply.

(iii) **Intra-fund advice**

The cost of personal advice to members can be met by the member individually or charged for collectively across the whole membership of the fund, depending on the trustee's business model. The latter is 'intra-fund advice,' the scope of which is defined by s 99F of the SIS Act. In RG 244, ASIC has provided guidance on the type of personal advice that can be given under a collectively charged model without breaching s 99F. This guidance does not make any specific reference to advice about retirement. We suggest that ASIC revise its RG 244 once the RIC is legislated to provide greater clarity to trustees on the scope of personal advice they can provide to members approaching retirement under a collectively charged model.

(iv) **Trustees contacting members**

There are barriers to trustees proactively contacting members to inform them of the fund's retirement product offering and to making recommendations to acquire a product. The recent High Court decision in *Westpac v ASIC* would suggest that were a trustee to contact a member in this regard the member would reasonably expect the trustee to have considered one or more of the member's objectives, financial situation and needs. This would therefore involve the provision of personal advice, which is problematic where the trustee is not licensed to provide such advice or doesn't intend the contact to involve personal advice and therefore doesn't comply with requirements, such as giving a statement of advice.

In addition, the new anti-hawking provisions in the *Corporations Act* would prohibit communication initiated by the trustee, as described in Appendix A.

The likely impact of the barriers described is that disengaged members who do not make any decision at the point of retirement might languish in the accumulation phase and suffer negative tax consequences as a result. However, we expect the number of completely disengaged members with very low superannuation balances at retirement to diminish sharply over time.

Appendix A – more detailed issues

This section points out matters of detail that do not relate to the proposed high-level policy settings of the RIC.

(a) New anti-hawking of financial products rules

The position paper suggests that trustees should consider what guidance will need to be given to members as part of implementing the fund's retirement income strategy. The question then arises: what form should this guidance take? In normal circumstances, trustees could think about giving this guidance by outbound email or paper mailouts in addition to the 'static' information a member could access by exploring the fund's website. Alternatively, trustees could seek higher levels of engagement through more interactive methods such as orally by direct phone calls or using online chatbots, as some funds now do.

Apart from static online or printed information, reforms to the anti-hawking regime under the *Financial Sector Reform (Hayne Royal Commission Response) Act 2020*, which are due to commence on 5 October 2021, will make it difficult for trustees to safely seek to provide guidance via any form of unsolicited real-time communication. This is because offering financial products using this method is generally prohibited.

'Unsolicited contact' is contact by telephone, face-to-face contact, or any other real-time interaction in a discussion or conversation to which the consumer did not consent: see new s992A(4) of the *Corporations Act*. A trustee could contact a client to seek consent to arrange a phone call, but care is needed because the consent requirements are prescriptive.

ASIC has power to grant exemptions to these rules. ASIC could exercise this power to allow unsolicited contact by a trustee to a member for the purpose of discussing moving from accumulation to retirement, checking their eligibility and informing them about retirement income products available within the fund. ASIC intervention in this way could be justified on the basis that the trustee would not be seeking to capture new business. The trustee already holds the member's savings on trust. Rather, the trustee would be contacting the member to discuss converting the member's existing accumulation product into a retirement income stream. At a minimum, this would result in the member avoiding the higher tax rate in the accumulation phase. In this sense, contact initiated by the trustee might even be necessary for the trustee to discharge its duty to act in members' best financial interests.

ASIC has exposed for consultation in CP346 an updated RG 38 on the new anti-hawking rules.[4] The updated draft RG acknowledges that if a super fund trustee needs to contact a member to comply with the law, this will not breach the anti-hawking prohibition.

[4] https://asic.gov.au/regulatory-resources/find-a-document/consultation-papers/cp-346-the-hawking-prohibition-update-to-rg-38/

(b) Trustee discretion on life expectancy assumptions

Page 11 of the position paper says: 'It is at the trustee's discretion as to what assumptions they make regarding the life expectancy of their members, or cohorts of their members.' Presumably, this is to allow trustees to make informed assessments of the potential for lower or higher than average life expectancies in their fund. The need for this will arise because of occupational factors. A fund might be solely white collar (eg a public sector fund) or in a dangerous/heavy blue-collar industry (such as construction or mining). These are valid considerations but using assumptions to deviate from population-wide figures would have to be based on expert actuarial advice, using valid fund mortality data, ABS data and other sources of publicly available data.

We consider that it would be appropriate to require trustees to use, as their starting point, up-to-date mortality-improved life tables (available from the Australian Government Actuary) when undertaking this exercise.

(c) Getting retirement income projections and calculators right

ASIC's retirement income projections in super regime (RG229 and CO 11/1227) works off relatively conservative fixed assumptions built into the ASIC class order. Any fund wanting to make a projection must apply all the assumptions without alteration so that all funds compare 'apples with apples.' The advantage of this approach (originally sanctioned by the Australian Government Actuary) is that it models 25 years of annual income streams (from age 67-92), during which all capital is smoothly consumed at the annual rate of 5.66% of the start of retirement balance. This is much the same sort of approach as adopted in 2019 for all KiwiSaver funds and follows pension finance thinking in many jurisdictions, including the Working Party on Private Pensions within the OECD.

On the other hand, since 17 April 2020, the ASIC MoneySmart online retirement income and superannuation planners use fixed assumptions derived from Treasury's MARIA model. These are explained in the 2019 Treasury Research Institute paper 'Accumulation of superannuation across a lifetime'.[5] Importantly, the paper assumes a 6.5% annual investment return in the retirement phase, before fees and insurance costs. However, because MARIA also uses a 4% per annum wage deflator, the 6.5% pa is effectively only 2.5% pa.

The ASIC class order, on the other hand, assumes a net real investment return of 3% per annum (after fees and taxes, but not administration fees). There are other differences. The MoneySmart calculators now use drawdown assumptions based on the MARIA model, which just follows minimum drawdown rates, again a different approach from the ASIC class order which assumes a constant rate.

Another limitation of ASIC's approach is that projections may only be given to members who are under age 67.

In summary, the net effect of this is that consumers are going to get materially different information from their fund's periodic statements under the ASIC class order

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[5] https://research.treasury.gov.au/sites/research.treasury.gov.au/files/2019-11/Accumulation%20of%20superannuation%20across%20a%20lifetime.pdf

(if any is provided – it is not currently mandatory for this information to be provided), compared to what they will get from MoneySmart. The solution will involve changing the ASIC class order to align with MoneySmart.

Given that relatively few funds currently provide members with projections, this issue does not need to be addressed before the RIC is introduced. However, we would argue that in moving toward best practice, the regulatory settings should do more to encourage (and potentially, require) funds to support members by providing them with projections and calculators that are as accurate and meaningful as possible.

Appendix B – *The Australian Financial Review* op ed 4 May 2021

Retirees should splash on themselves, and save the economy

Super savings
How can cautious seniors be persuaded to dip into their nest eggs more often?

Jeremy Cooper

David Knox

One of the observations of the recent Retirement Income Review was that it would be good for retirees to save less and spend more in retirement.

The final report talked about a more efficient use of retirement savings and better outcomes for older Australians, but it really meant more spending, less saving, leading to a better standard of living in retirement. The review found that many retirees leave most of their super as an inheritance, rather than spending it.

Recently, the Association of Superannuation Funds of Australia issued a research report challenging this finding, but it was largely focused on much older retirees, many of whom never had any or much super to begin with.

Our focus is on younger retirees and the future, where super balances will be larger.

An important reason for this saving-oriented behaviour is retirees worry about running out of money and are uncertain about future aged care and health costs.

To guard against these unknowns, they underspend. This means that many retirees have a lower standard of living than they could afford.

If these worries could be reduced, retirees could improve their standard of living in retirement by spending more of their super.

To change this behaviour, retirees would need more confidence about both their future income and ongoing government support. This would not only benefit retirees but also be a boost to the economy.

The RIR found the minimum drawdown rules that apply to account-based pensions act as an anchor or guide for many retirees

Retirees are in the habit of underspending.
PHOTO: ROS HOLCOMBE

Trustees of super funds will need to be more actively engaged in providing retirement income solutions to their members.

as they spend their super. Mercer research showed that about half of all retirees drawing on their super do not exceed the required minimum amount.

The minimum rates are conservative and were never intended as a guide for an adequate standard of living in retirement.

Using the minimum rates for that purpose can have some surprising outcomes. For example, assuming a constant 5 per cent annual investment return, a 65-year-old retiree drawing at the minimum rates would still have 32 per cent of their initial retirement balance left at age 100.

Even if drawdowns were increased by two whole percentage points of their balance each year, the amount left at age 100 would still be 15.5 per cent of the level at retirement.

There is clearly scope for more spending, and less saving, in retirement, but how can this be achieved in the face of entrenched retiree behaviour?

The RIR expressed support for some changes the government proposes to achieve this very outcome – a new duty for super fund trustees to have a strategy for their retired members that, importantly, provides those members with options to create income that lasts for life.

The intention is that retirees would become more confident to spend their super in the knowledge that it will last as long as they will. The proposal is that a retirement income "covenant" creating this new duty will be added to the superannuation legislation, commencing on July 1, 2022.

To make the covenant work, super funds will need to provide guidance to members about how the fund's retirement income products will work for them.

Trustees of super funds will need to be more actively engaged in providing retirement income solutions to their members. In particular, helping members understand that they can, in many circumstances, draw down more than the minimum rate on the basis that they will not run out of money. Funds shifting their focus to a consumption frame in retirement, as opposed to a saving frame, will be key to the success of the covenant.

If retirees spend instead of saving, this is good for the economy.

According to the Australian Prudential Regulation Authority, at June 30, 2020, there was $485 billion in retirement-phase accounts held by members of large superannuation funds, with an average account balance of $289,000.

If we assume, broadly in line with the analysis in the RIR, that each retiree in these funds will, in future, draw down an extra 1.5 per cent of their super balance each year, then this extra income would equate to $7.3 billion in aggregate – or, to put it another way, the average retiree would be able to spend an extra $4300 a year.

This extra expenditure in the economy should have a multiplier effect of about 1.2 over the first two years. These additional drawdowns would result in almost $9 billion of additional annual spending throughout the economy. This would be a significant boost to the economy, equal to about 0.5 per cent of Australian GDP.

Increased spending by retirees would provide a boost to the economy, and this boost would not be from the budget, but from retirees spending more on themselves; a win-win for retirees and the economy.

Jeremy Cooper is chairman of retirement income at Challenger Limited.
David Knox is senior partner at Mercer.

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Appendix C – Lonergan survey report

Retirees should splash on themselves, and save the economy

One of the observations of the recent Retirement Income Review was that it would be good for retirees to save less and spend more in retirement.

The final report talked about a more efficient use of retirement savings and better outcomes for older Australians, but it really meant more spending, less saving, leading to a better standard of living in retirement.

The review found that many retirees leave most of their super as an inheritance, rather than spending it. Recently, ASFA issued a research report challenging this finding, but it was largely focused on much older retirees, many of whom never had any or much super to begin with. Our focus is on younger retirees and the future, where super balances will be larger.

An important reason for this saving-oriented behaviour is that retirees worry about running out of money and are uncertain about future aged care and health costs. To guard against these unknowns, they underspend. This means that many retirees enjoy a lower standard of living than they could aff

If these worries could be reduced, retirees could improve their standard of living in retirement by spending more of their super. To change this behaviour, retirees would need more confidence about both their future income and ongoing government support. This would not only benefit retirees but also be a boost to the economy.

The RIR found the current minimum drawdown rules that apply to account-based pensions act as an anchor or guide for many retirees as they spend their super. Mercer research showed that about half of all retirees drawing on their super do not exceed the required minimum amount.

The minimum rates are conservative and were never intended as a guide for an adequate standard of living in retirement. Using the minimum rates for that purpose can have some surprising outcomes. For example, assuming a constant 5% annual investment return, a 65-year-old retiree drawing at the minimum rates would still have 32% of their initial retirement balance left at age 100. Even if drawdowns were increased by two whole percentage points of their balance each year, the amount left at retirement. There is clearly scope for more spending, and less saving, in retirement, but how could this be achieved in the face of entrenched retiree behaviour?

The RIR expressed support for some changes the government proposes to achieve this very outcome – a new duty for super fund trustees to have a strategy for their retired members that, importantly, provides those members with options to create income that lasts for life. The intention is that retirees would become more confident to spend their super in the knowledge that it will last as long as they will. The proposal is that a retirement income 'covenant' creating this new duty will be added to the superannuation legislation, commencing on 1 July 2022.

Many retirees leave most of their super as an inheritance.

To make the covenant work, super funds will need to provide guidance to members about how the fund's retirement income products will work for them. Trustees of super funds will need to be more actively engaged in providing retirement income solutions to their members. In particular, helping members understand that they can, in many circumstances, draw down more than the minimum rate on the basis that they will not run out of money.

Funds shifting their focus to a consumption frame in retirement, as opposed to a saving frame, will be key to the success of the covenant.

If retirees spend instead of saving, this is good for the economy. According to APRA, at 30 June 2020, there was $485bn in retirement phase accounts held by members of large superannuation funds, with an average account balance of $289,000.

If we assume, broadly in line with the analysis in the RIR, that each retiree in these funds will, in future, draw down an extra 1.5% of their super balance each year, then this extra income would equate to $7.3bn in aggregate – or, to put it another way, the average retiree would be able to spend an extra $4,300 a year (or a bit more than $80 each week). This extra expenditure in the economy should have a 'multiplier' effect of about 1.2 over the first two years. These additional drawdowns would result in almost $9bn of additional annual spending throughout the economy. This would be a significant boost to the economy, equal to about 0.5% of Australian GDP.

Increased spending by retirees would provide a boost to the economy, and this boost would not be from the budget, but from retirees spending more on themselves; a win-win for retirees and the economy.

Jeremy Cooper

Chairman, Retirement Income
Challenger Limited

Dr David Knox

Senior Partner
Mercer

96%

Almost all retirees feel it is important to contribute to their local economy.

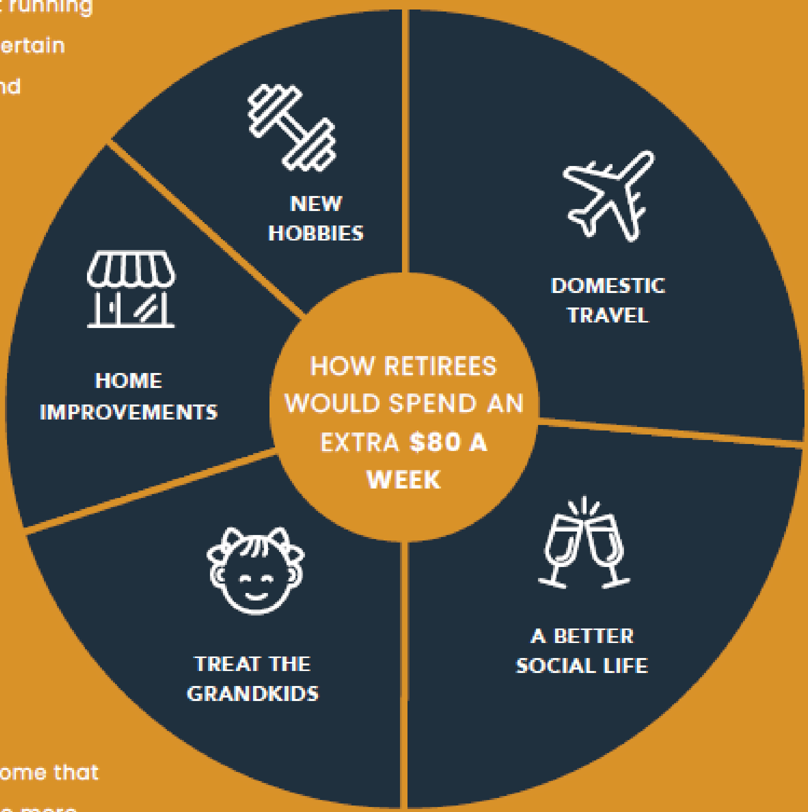
Many retirees worry about running out of money and are uncertain about future aged care and health costs.

To guard against these unknowns, they underspend. This means that many retirees have a lower standard of living than they could afford.

How can cautious retirees become more confident to spend their superannuation savings?

With options to create income that lasts for life, retirees will be more confident to spend their super.

There is a boost to the economy if retirees have the confidence to spend more of their superannuation savings.



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Trustees of super funds will need to be actively engaged in providing retirement income solutions to their members that give them the confidence to spend.

JUNE 2021