Retirement Income Disclosure

SuperRatings' Submission

April 2019

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1. Executive Summary

SuperRatings would like to thank members of the Retirement Income Policy Division of Treasury for providing us with the opportunity to deliver this submission in response to the Retirement Income Disclosure Consultation Paper ("the Consultation Paper"), which was released in December 2018.

SuperRatings is a research and consulting firm, which has been assessing and rating superannuation funds and products for more than 15 years. Given SuperRatings' background in superannuation, we are well placed to provide input into the development of disclosure requirements for retirement income products.

In our June 2018 response to the Retirement Income Covenant Position Paper, we provided overall support for the proposed principles to underly a framework to support consumers to maintain an appropriate standard of living and balance the competing objectives of high income, flexibility and risk management. We stated in that paper (section 3.1), that 'We would encourage the Government to put in place a robust standard for disclosure of key product features, but to accept that a fair comparison in an individual case might only be possible within a formal, properly regulated advice environment.'

We strongly support the intention to introduce a standardised retirement income fact sheet. However, we would caution over simplification of the metrics disclosed. Selecting a retirement income product is a necessary, yet complex decision-making process. The factsheet should facilitate straightforward comparisons across different products but also serve to educate and encourage the consumer to think about different aspects of retirement and the various risks they face . As such, there is a need to present these different risks separately and not reduce them to a single factor.

Regarding the specifics of the standard metrics, we suggest:

- Income – rather than disclosing the best estimate (i.e. probability of 50%), disclose the expected income with a higher probability (e.g. 75%), or disclose expected incomes based on a range of probabilities;
- Variation in expected income – disclose a separate rating for each key risk faced by retirees. This would show consumers the trade-offs between different types of risks and allow consumers with different risk profiles to choose the product most suitable to their risk appetite.

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Once again, SuperRatings would like to thank Treasury for the opportunity to prepare a submission to the Consultation Paper and we would be happy to discuss any aspect of this submission further, as required.

Please feel free to contact any of the following SuperRatings team members should you have any questions or require further information:

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2. About SuperRatings

SuperRatings is a superannuation research and consulting company providing data analysis, information, bespoke services and product benchmarking to the superannuation industry, corporate sector and the general public. SuperRatings prides itself on providing impartial advice to funds and employers, therefore our ratings methodology includes all superannuation funds and we limit the ratings percentile bands of funds to ensure our assessment remains independent. We actively promote engagement, education and ownership of superannuation through the provision of:

- Research analysis;
- Ratings;
- Consultancy services;
- Product reviews;
- Benchmarking; and
- Opinion.

Since its inception, SuperRatings has comprehensively reviewed hundreds of Australia's largest superannuation funds and service providers. SuperRatings currently maintains detailed information in respect of 622 superannuation products, incorporating 113 MySuper products, 327 choice products and 182 pension products as well as 70,000 insurance product lines of premiums which are all housed within our in-house proprietary database, SMART.

We believe we offer the most extensive industry coverage accounting for over $1.38 trillion in funds under management and over 23 million member accounts. This allows us to understand the various costs, fees, products, services and performance of superannuation funds and benchmark these against the broader market.

3. Responses to consultation paper sections

3.1. Simplified, standardised product disclosure (page 2)

This background section of the paper contains some important guidance regarding the goals and objectives of the proposed disclosure requirements:

Choosing an appropriate retirement income product necessarily requires consideration of trade-offs between income, flexibility and risk management. However, it is rare for these trade-offs to be made explicit in product disclosure documents. In general, PDSs for retirement products rarely include information about levels of expected income or cash flow in dollar terms, the likelihood of money running out under certain withdrawal or drawdown strategies or the likelihood that income would be lower than expected.

A more effective disclosure framework would enable consumers to find and compare information about the income, risk and flexibility associated with different products. This should better equip consumers to choose a product that best suits their preferences.

Whilst we support the overall premise of these statements, it should be recognised that there are differences between:

a. Comparing different products offered by a single provider ('intra-fund' comparisons), and

b. Comparing similar products offered by different providers.

In our opinion, (b) is a much more challenging exercise, given the wide variety of mortality and morbidity rates that might be experienced by members of different funds. We think that it would be advantageous for Treasury to provide a clear statement of the objectives for these measures so that the full scope could be identified, and possibly limited or introduced in a staged manner.

3.2. Standardised metrics – Income (page 4)

The level of periodic income a retirement product is expected to provide each year is the central metric for disclosure. This is the one that all consumers should be able to relate to, and the one that consumers are likely to assign greatest weight in choosing a product. In fact, there is a risk that some consumers may not look far beyond this number.

A "best estimate" of the expected real income means that in modelling, half of the expected income is going to be higher and half lower. In other words, a probability of 50%. Given how central this metric is to the product disclosure and the risk that some consumers will purely rely on this metric, it would be worthwhile to consider setting the modelling threshold higher (for example, at a probability of 75%) or providing expected incomes at a range of probabilities (for example, at probabilities of 25%, 50% and 75%). Disclosing the range of income levels would emphasise to a consumer that the income is based on modelling and probabilities and is not guaranteed. It would also encourage the consumer to consider the range of income that they can live with in retirement, rather than focussing on a single income figure. Furthermore, for most products there will be some variation in the income generated from year to year.

We note that clarity regarding whether product providers are required to use standardised assumptions to model expected real income or whether they are free to use their own assumptions would be beneficial. Standardised assumptions would of course reduce the risk of providers using overly optimistic assumptions to improve their modelling results; however, they may not reflect the mortality or morbidity experience of a particular fund. Therefore, there needs to be clear rules outlining when a product provider may depart from standard assumptions and use their own assumptions (e.g. only when this results in lower expected retirement income being calculated).

In addition, it may not be appropriate to report a single, or a single range of, expected real income for a product, as the expected real income could vary materially between different occupation groups (e.g. white collar and blue collar) and perhaps genders. There needs to be further investigation in this area to determine whether there is a need to produce multiple retirement income factsheets for a retirement income product.

Another consideration in disclosing the expected real income is whether to incorporate an allowance for a potential Age Pension entitlement or not. Notwithstanding the fact that disclosure cannot address the needs of specific individuals, we feel that it would be useful to remind consumers of the potential value of an Age Pension in extending the potential term of an income from a retirement account or other product. This could be undertaken simply by showing two scenarios, one based on the product alone, and the other taking into account an Age Pension at the standard single rate.

On the presentation format, we agree that real income net of fees and taxes would be the most suitable to use. We believe that consumers would understand the term “expected retirement income”, thus it would not be necessary to use the term “take home pay”. The latter is more closely associated with after tax salary/wages from employment and does not readily relate to retirement income. The other concern is that the term “take home pay” does not reflect the fact the income is expected based on modelling and generally not guaranteed.

We also agree that the reported average income over a long period should be reported; however, we would suggest that rather than mandate reporting expected income over a specific period (proposed at this stage as 30 years) from retirement (current age 67), it would be simpler to just report to a specified age (for example, to age 105).

3.3. Standardised metrics – Variation in expected income (page 5)

Retirees are all different and have different risk profiles, some may be more averse to the risk of running out of money (longevity risk) and some might prefer to retain some investment risk so that they may enjoy an improved retirement lifestyle when the investment goes well. The trade-off when choosing a retirement income product is not just between income and risk, there are also trade-offs between different types of risks. We do not think that a single standardised risk measure based on stochastic modelling of negative semi-deviation in income is helpful to illustrate these trade-offs to consumers. In fact, it is entirely conceivable that products with very different characteristics would receive the same rating on a scale of one to seven based on modelling results. As such there is a danger that a single standardised risk measure could mask the differences in the products. It is also challenging to explain to a consumer how the single standardised risk measure captures the different risks a consumer faces in retirement.

Despite their different risk profiles, all consumers face essentially the same set of key risks in retirement. Therefore, we believe that each retirement income product should be given separate ratings for each key risk, with appropriate explanations of these risks. Consumers can compare these risk ratings of different products and weigh up their individual preferences for different risk factors when choosing a product. We believe multiple key risk ratings would be more meaningful and easier for consumers to understand and relate to, given the potential for a standardised metric to result in equal ratings for different products with diverse underlying risks.

Comparing retirement income products is not an easy thing to do, and we would caution against over-simplification of the comparison metrics. The disclosure documents should standardise disclosure and metrics to ensure straightforward comparisons across products. However, they are also a way to educate consumers and encourage them to think about different aspects of retirement and the various risks they face. To do so, it is necessary for the disclosure documents to present information on the different risks, so that consumers can compare and distinguish the different risk mitigation strategies of the products.

While we do not believe a single risk metric is sufficient for consumer disclosures, the methodology proposed by the Australian Government Actuary (AGA) paper, “Retirement Income Risk Measure” is valuable for the regulator in licensing retirement income products, especially for default products. The regulator could mandate that only products with ratings above a certain level be deemed eligible for default status. This would ensure that all default retirement income products encompass a minimum level of risk mitigation in securing retirement income.

In terms of the presentation format, we agree that a rating scale (rather than statistical measures of risk) should be used for ease of consumer understanding, and a graphical projection of the range of possible income levels would be useful to help consumers understand (a) the risk of variability in income due to market volatility, and (b) the risk of the consumer's money running out.

3.4. Access to underlying capital (page 7)

We agree that the disclosure document needs to provide information on accessibility to capital which is an important consideration for consumers when choosing a retirement income product. We believe that it is generally better to provide both graphical and tabular disclosure if possible. Many non-mathematical consumers don't easily relate to graphs, whilst some prefer the visual immediacy of the shape over a period of time.

3.5. Future considerations (page 9)

We agree that lifetime engagement will be an important factor in assisting fund members to transition to retirement in an orderly manner. However, it is difficult to be prescriptive about how this might be done. In practice, most funds already actively engage in pre-retirement 'coaching' as a matter of course, given the incentives for a fund to maintain and protect its customer base.

One of the best ways to foster pre-retirement engagement is to provide members with a projected income statement while they are still in the pre-retirement phase. There is already a regulatory framework in place for Retirement Projections, and it might be beneficial for this to be a mandatory requirement. We note that this framework includes standardised assumptions, set by the AGA.