



Australian Government  
The Treasury

**TSY/AU**

# Retirement Income Disclosure Consultation Paper

Stage Two of the Retirement Income Framework

December 2018

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# Consultation Process

## Request for feedback and comments

Treasury welcomes comments and feedback on the proposed disclosure metrics, their presentation and calculation. While submissions may be lodged electronically or by post, electronic lodgement is preferred. For accessibility reasons, please submit responses sent via email in a Word or RTF format. An additional PDF version may also be submitted.

All information (including name and address details) contained in submissions **will be made available to the public on the Treasury website unless you indicate that you would like all or part of your submission to remain in confidence**. Automatically generated confidentiality statements in emails are not sufficient for this purpose. If you would like only part of your submission to remain confidential, please provide this information clearly marked as such in a separate attachment.

Closing date for submissions: 28 March 2019

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The principles outlined in this paper have not received Government approval and are not yet law. As a consequence, this paper is merely a guide as to how the principles might operate.

# Background

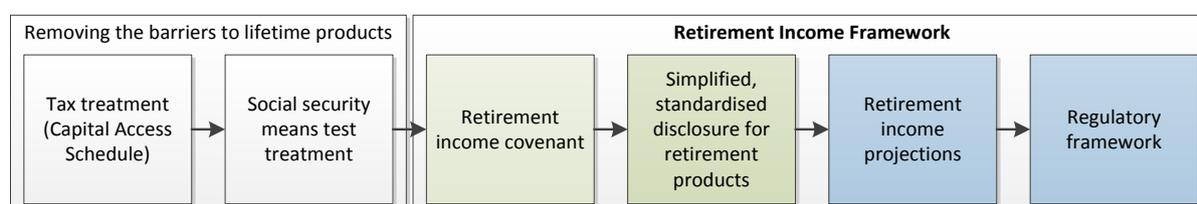
## The retirement income framework

The retirement phase of the superannuation system is currently under-developed and needs to be better aligned with the underlying objective of the system— to provide income in retirement as a substitute or supplement to the Age Pension. To support this objective, the Government is developing a retirement income framework to support consumers to maintain an appropriate standard of living and balance the competing objectives of high income, flexibility and risk management.

The Financial System Inquiry and the Productivity Commission’s Superannuation Draft Report found consumer-led competition in the superannuation market is weak due to a combination of the compulsory nature of superannuation contributions, disengaged members, complexity of the underlying decisions, and the lack of simple, relevant information to assist members.<sup>1,2</sup>

As part of the Government’s *More Choices for a Longer Life Package* in the 2018-19 Budget, the Government committed to introducing a retirement income covenant as the first stage of the Government’s proposed retirement income framework. The Retirement Income Covenant (the Covenant) position paper was released on 16 May 2018. That paper sought community views on a retirement income covenant for superannuation funds.

In addition to the Covenant, the Government also announced the next stage of the framework would be the development of simplified, standardised metrics in product disclosure to help consumers make decisions about the most appropriate retirement income product for them. Other elements of the framework, outlined below, will be developed progressively.



This paper seeks to identify the key information or metrics to ensure consumers are supported to make informed decisions about the income, risk and flexibility associated with different retirement income products. These metrics would form part of the simplified standardised disclosure for retirement products.

## Simplified, standardised product disclosure

Currently, when people approach retirement they are confronted with complex legal and financial information. In almost all cases, consumers are provided with lengthy Product Disclosure Statements which focus on discharging the product issuer’s legal responsibilities. Complex disclosure and a lack

<sup>1</sup> Commonwealth of Australia (2014), *Financial System Inquiry: Final Report*, Canberra.

<sup>2</sup> Productivity Commission (2018), *Superannuation: Assessing Efficiency and Competitiveness: Stage 3 Draft Report*.

of simple, clear information can lead to people relying on behavioural biases to make decisions and choosing a default retirement product, which may not suit their circumstances.<sup>3</sup>

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.

The findings of a 2017 study by the Behavioural Economics Team of the Australian Government (BETA), 'Supporting retirees in retirement income planning',<sup>4</sup> confirmed that presenting information in a relatively simple manner improves understanding and reduces cognitive load. Consumers are able to engage with a simplified presentation of the key considerations of different products, such as expected income throughout retirement, flexibility, investment strategy, pricing and associated risks.

Drawing on the findings of the BETA study, this paper proposes a new disclosure document – a retirement income fact sheet. Using standardised metrics the fact sheet would highlight the following factors:

- the amount of periodic income the product would be expected to provide;
- the likelihood that income may fall short of that expectation in a given period;
- the degree of protection the product provides against the risk of running out of money; and
- the level of access to the underlying capital or for lump sum withdrawals.

The fact sheet would be designed to be used as one source of information. They would not replace or remove the need for funds to provide PDSs and would be required for all retirement products.

It is proposed that the metrics and how they are displayed would be designed, as much as possible, to be product-neutral and to allow consumers to place their own value on the metrics in making their product selection. The fact sheet would avoid lengthy portions of text, use a combination of text and graphics, and use plain English.

Treasury is seeking views about whether the metrics proposed in this paper are appropriate and would achieve the aim of better informing consumers about their likely future income and potential risks.

Following consultation, Treasury will test a range of metrics and layouts with consumers to ensure they are meaningful and helpful to consumers when making decisions about retirement income products.

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<sup>3</sup> Hiscox, M., Hobman, E., Daffey, M. & Reeson, A (2017) *Behavioural Economics Team of Australian Government: Supporting retirees in retirement income planning*. Canberra: Australian Government.

<sup>4</sup> Ibid.

## Standardised metrics

It is proposed that the retirement income disclosure fact sheet will include information on the characteristics of retirement income products that are relevant to consumers when making a decision. It should provide enough information to understand the core trade-offs between different retirement income products. An outline of the proposed characteristics for inclusion in the fact sheet is below.

### Income

Given the core purpose of superannuation is to provide income in retirement, a central consideration for consumers is the level of periodic income a product is expected to provide each year. The level of income provided is connected to the product design and features that ameliorate the risk of income variation.

Product providers would need to report the best estimate of the expected real income level that their product can provide for a purchase price of \$100,000. Income is the disbursement to a member, inclusive of both investment earnings and distributions of capital. Income would be displayed net of any fees and charges and reported in real terms (adjusted to expected inflation of 2.5 per cent).

This would enable consumers to compare the level of income across retirement products on an equivalent basis.

Several options have been considered for describing the expected income from a product, including:

- as a single number, showing:
  - expected income in the first year;
  - average expected income over the life of the product; or
  - average expected income over a defined period of time.
- as a chart or graph, showing:
  - expected income each year over the life of the product; or
  - expected income each year over a defined period of time.

Reporting average income over a fixed period (proposed at this stage as 30 years) ensures product providers have incentives to design products that provide higher incomes over a longer period of time. For products with flexibility in drawdown, such as account based pensions (ABPs), providers would need to specify the drawdown rate for the product.

#### Proposed approach: Expected retirement income

**For all retirement income products, expected retirement income should be presented numerically and with an income graph using average 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.**

#### Presentation format: Income

A range of options could be considered for presenting income. Describing expected retirement income as the 'take home pay' from the product may make the concepts more user friendly for consumers. This language makes it clear that the income is net of any fees. However, alternative options such as 'expected retirement income' or 'expected income from the product' may be clearer to consumers.

Consideration is still being given to how best to present income. While consumers may be unconcerned about a difference in income of \$10 a week or \$20 a fortnight, a difference

of \$520 per annum may be considered substantial. The benefit of presenting fortnightly income is that it is more likely to encourage consumers to think about superannuation as a replacement for regular wage or salary income. The most useful approach may be to present both, to emphasise superannuation as a regular wage, while still highlighting the difference in annual income, which may be underemphasised when income is displayed as a fortnightly amount.

Some alternative numerical presentations for different products are shown below.

#### Product A

Fortnightly income \$150	Annual income \$3,900	Income \$150pf \$3,900pa	Fortnightly Take-home Pay \$150	Annual Take-home Pay \$3,900	Take-home pay \$150pf \$3,900pa
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#### Product B

Fortnightly income \$191	Annual income \$4,966	Income \$191pf \$4,966pa	Fortnightly Take-home Pay \$191	Annual Take-home Pay \$4,966	Take-home pay \$191pf \$4,966pa
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## Variation in expected income

There is a trade-off between income and risk. Reporting average retirement income alone could be misleading for consumers, as all retirement products are subject to risks that could mean that income would vary over time. Reporting a standardised measure of risk would allow consumers to balance their risk appetite against their desire to maximise income.

The common risk measure the superannuation industry focuses on is market volatility.<sup>5</sup> A product with low volatility is measured as low risk, however, these products are likely to yield low returns over the long term. Consumers that select a low risk investment option, such as cash, are likely to face lower long term returns and have a higher probability of running out of money. High life expectancy means retirement products need to provide adequate returns over the long term. Therefore in isolation, investment volatility is not the best measure of risk for retirement products.

The challenge for a metric that attempts to calculate income variation is to capture volatility as well as underlying risks associated with longevity and inflation risk. Since consumers are known to be more sensitive to downside risk than upside risk (they are loss averse), the risk metric focuses on the likelihood of negative variation from the expected income.

A measure of longevity could provide an estimation of the number of years it would take to exhaust funds or the probability of maintaining a positive account balance. However, this does not provide consumers with information regarding how their income could vary over time or the size of that positive balance. It also does not recognise protective factors against market volatility, which provide consumers with a level of confidence around their spending power.

Income variation could be measured as the number of times the income falls below the expected income or as the amount by which an annual payment has been reduced. However, frequency alone does not take into account the size of the negative variations.

A measure of the dispersion of decreased payments allows for the size and frequency of negative variations to be taken into account, as well as the possibility of fund exhaustion (running out of money). This metric would take account of investment strategies, mortality variations, product rules and any protection features a product might have.

<sup>5</sup> Ringrose, K. (2018) 'The Real Risk', Superfunds Magazine, February.

This proposed measure considers a range of risks and therefore is likely to provide a more holistic and relevant indication of the risks for the consumer. The risk calculation measures downside risk. The metric captures risks to income that are the result of market fluctuation, longevity risk, and expected inflation risk are included in the calculation. The calculation uses the expected first year income as a starting point for variation as it creates a clearer distinction between products, assisting consumers to see the differences between products.

This risk metric outlined applies to product income only for standardised product disclosure. However, the metric could be adapted to calculate risks to total income (including Age Pension and other investments) should a consumer seek personal advice. Technical details for calculating this risk are provided in the Australian Government Actuary (AGA) paper: “*Retirement Income Risk Measure*” available on the Treasury consultation website.

**For example:**

- A regulated life insurance company that remains solvent providing a Consumer Price Index (CPI) indexed life annuity should result in no payments that are below the expected real payment. So this would produce the lowest possible risk score.
- A product that has no longevity protection would have higher negative variances from the expected income. This type of product would have a higher risk score.

### Proposed approach: Calculating income variation

**For all retirement income products, income variation should focus on negative or downside variation measured against expected first year real income. The model measures downside income variations and the size of variations.**

**Products with risk mitigation strategies, protection factors, or conservative investment strategies, create fewer downside variations and therefore have lower risk scores.**

### Presentation format: Income variation

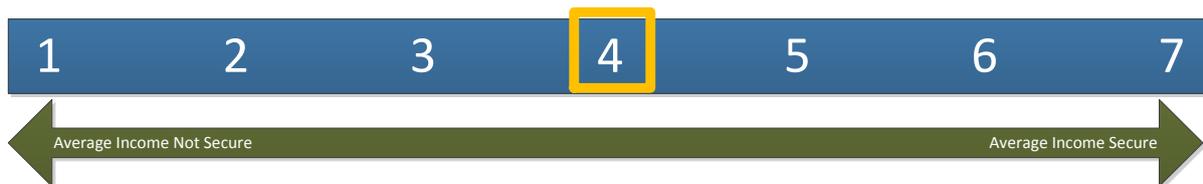
Publishing a risk measure such as a negative semi-deviation is likely to appear arbitrary and not readily understood by consumers. For this reason the risk measure would be placed on a scale of one to seven to make it simpler for the consumer and easier to compare products.

The proposed presentation for the fact sheet is a scale of one to seven referencing ‘income security’. A high number on the scale would indicate expected income is stable and reliable, higher risk products would equate to a low level of security, so a lower number on the scale.

Different products would have different income shapes depending on the product design. It is proposed that the fact sheet also include a graph which shows simulated real income between the 5<sup>th</sup> and 95<sup>th</sup> percentile over the life of the product. This should provide consumers with an indication of payments outcomes over the life of the product.

The income security measure takes account of inflation, longevity and market risk. For consumers these risks may be of different values. For example, a consumer who is concerned about whether their income varies due to market forces may want to know whether the product protects them from this particular risk.

A section would also be included on the elements of the product that contribute to the ratings such as, information on inflation, longevity and market risks, counterparty risk and guarantees. This should give consumers some indication of why products get certain risk rankings and allow easier product comparison. The elements listed, their weight and ratings will be developed through consultation with industry and the AGA.

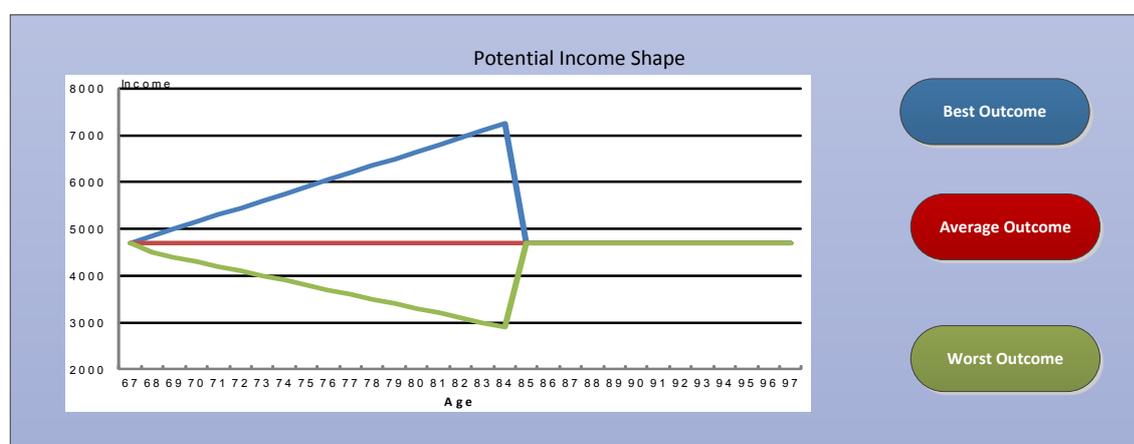


Elements that contribute to this product’s rating  
 This product is rated X because it :

- seeks to provide a consistent take home pay
- seeks to provide income for life so you will not run out of money
- is designed to reduce the impact of downturns on investment returns
- guarantees payments if the fund becomes insolvent
- keeps pace with expected inflation

[Wording for this section is not fixed. The final wording will draw on evidence from academic research and consumer testing on how to best describe these concepts.]

Product Rating  
**4**



## Access to underlying capital

Individuals with sufficient funds may wish to set aside some of their superannuation or have other assets available for planned expenses.

Accessibility of funds is also important when selecting a product, particularly when circumstances change, resulting in people needing large sums of money to adapt or deal with that change. This may include lump sums for home improvements, or accessing funds for large purchases. Having the flexibility to access emergency funds can help consumers cope with large unexpected expenses.

Accessibility of capital in retirement varies depending on the type of product. Products such as ABPs offer very high accessibility to funds and bequests upon death, whereas a product with an annuity component would provide less accessibility, but a more stable income. Accordingly there is a trade-off between that accessibility and volatility of income.

Several options have been considered when providing information regarding lump sums, including disclosing information on partial withdrawals and full withdrawal (commutation). The impact of partial withdrawals on future income and lump sums is difficult to standardise for disclosure purposes. For this reason the preferred approach is to focus on commutable value or the maximum amount of the purchase price a consumer could cash out as a lump sum at any period during the life of the product.

There is an expectation that the fund would provide information to individual fund members if the consumer wanted to withdraw a partial amount. Consumers would benefit from being provided with information on how that specific withdrawal would impact their income and any potential future capital withdrawals.

### Proposed approach: Access to Capital

**For all retirement income products, consumers should be presented with information on the maximum amount they could withdraw at any time if they wanted to stop using the product. This amount would vary depending on what type of product they have purchased and the capital access schedule.**

### Presentation format: Access to capital

There are two potential options for how access to lump sums can be presented on a fact sheet, these are presented below. These could be included as illustrated, or in a combination with text. All of these options assume a consumer has not already withdrawn money and the median expected income has been achieved.

The options below assume an initial investment of \$100,000 in a product that has 80 per cent ABP and 20 per cent deferred life annuity, with minimum draw down rates and take into consideration the capital access schedule. Option A provides a chart representing how much of the original purchase price is available as a lump sum from age 67 to age 97.

#### Option A – Chart



This chart shows you how much you would get if you stopped using your product at any time in your retirement.

Depending on the product purchased you may be able to withdraw portions of your investment during the life of your product. You should consult with your provider to discuss your options should you wish to do this.

#### Option B- Table

Age	Amount of purchase price available for withdrawal	% of purchase price that you can withdraw.
67	\$100,000	100%
70	\$90,695	91%
75	\$69,897	70%
80	\$40,491	40%
85	\$0	0%
90	\$0	0%
95	\$0	0%

This table shows you how much you would get if you stopped using your product at any time in your retirement.

Depending on the product purchased you may be able to withdraw portions of your investment during the life of your product. You should consult with your provider to discuss your options should you wish to do this.

## Death benefits and reversionary benefits

Although superannuation is accumulated on an individual basis, the majority of people approach retirement as a member of a couple. In most cases, superannuation balances will differ between partners and the couple may want to be able to plan together how to make the most of those savings. For some consumers that are a member of a couple, providing income for a surviving partner may be important.

The preferred options for disclosing this information is to provide information on ongoing income payments to a partner (reversionary benefits), remaining underlying cash balance to be paid on death (commutable value), and any lump sum death benefits (life insurance components). For example, an ABP would outline the underlying cash balance remaining that can be paid to a spouse or partner. For annuities, the percentage of reversionary benefits available for a partner or spouse can be provided.

### Presentation format: Death and reversionary benefits

Three components on the fact sheet could be provided to consumers, including; 'ongoing income as a percentage of the average income', any 'remaining commutable value' and 'insurance payments'. These could be deleted or modified depending on what the product provides.

#### On death

Should your spouse or partner live longer than you, this product will pay them:

X% of the income above/no ongoing income

AND/OR

The remaining amount available for withdrawal in the table/graph above at the age of death

AND/OR

A lump sum death benefit of \$x,000

## Future considerations

This paper presents only one element of a full disclosure framework. There are other elements to ensure that consumers stay informed throughout their retirement. While these elements are not included in the fact sheet, they may nonetheless form part of the retirement income framework. The matters below are being considered at a later time as a part of the broader retirement framework.

### Lifetime engagement

Consideration is being given to requirements for funds to engage with members leading up to retirement to ensure consumers have a greater understanding of retirement income products and trade-offs between the metrics. Other factors are likely to affect a consumer's product selection, including the ability to access full or part of the age pension, other investments or superannuation funds, and home ownership.

These factors and the level of importance a customer places on income levels, stability and flexibility affects their willingness to accept risk and their desire to have a broadly constant income. These factors can only be taken into account if a fund is aware of them, which would require earlier engagement with fund members. This early engagement will enable funds to further tailor retirement products and develop more appropriate retirement strategies.

## Advice framework

Provision of the standard metrics would not constitute financial advice. Clarity regarding the interactions with advice will be addressed as part of the regulatory framework of the retirement income framework. At this stage, the preferred option is for the fact sheet to be exempted from the advice framework, similar to the current treatment of PDSs.

## Post purchase engagement

Not all risks can be captured in the standard metrics. Some risks will change during the lifetime of the product as a result of a consumer's life expectancy, withdrawal of lump sums, changes in investment strategy, changes to consumers in a pool, fee structures and fluctuations in the market. All of these factors can affect a consumer's potential cash flow. As the retirement income framework expects that funds maintain engagement with their consumers through the life of the product, there may be benefits in the provision of additional age appropriate information to consumers, for example outlining what changes have occurred and how it would affect the consumer's income.

## Reporting requirements

The regulatory framework is likely to include requirements for funds to report to regulators the annual and average expected income on each product, average purchase price or investment, average negative semi deviation and risk metrics. Funds would also be required to report the assumptions they use to calculate expected income and risk metrics. This information would be used and made available publicly to support the development of a comparison tool to enable consumers to compare products across the industry in one location.

## Intra-fund product comparisons

The provision of guidance and information by trustees to their members is also part of the Retirement Income Covenant. It is expected that funds would begin to provide comparison tools on their websites. This would allow existing and potential members to compare the products on offer within the fund. It may be beneficial to require funds to produce a one-page summary or comparison table, comparing the key metrics of all the products they offer.

## Income variation risk measure consultation

For illustrative purposes the income variation risk measure outlined in this paper utilises an investment product model that does not incorporate a full range of asset classes. If the proposed method of calculating risk is adopted, further consultation would occur on the model to be used and associated assumptions on various asset classes, their returns, correlations and volatility; including collaboration with the AGA, industry and investment model practitioners.

# Next steps

## Consumer testing

Following the consultation process on the proposed metrics, Treasury will undertake consumer testing. Testing the design and content of fact sheet is an essential step in ensuring the effectiveness of the fact sheet in assisting consumers to choose a retirement income product that aligns with their needs and preferences. The aim of this work will be to improve economic and financial decision-making by consumers in relation to their retirement income.

## Glossary and Acronyms

annuity	a regular guaranteed payment that is made to a person for life or for a fixed number of years by a life insurer
Account Based Pension (ABP)	an individual investment account set up with superannuation benefits from which a retiree draws a regular income. Also known as an allocated pension
AGA	Australian Government Actuary
BETA	Behavioural Economics Team of the Australian Government
cash flow	combined investment earnings and draw down of capital that a person receives net of fees
CIPR	a composite retirement income product that meets certification requirements
commutable value	the amount of cash a consumer could receive if they convert their pension into a lump sum
commutation	the process of converting part or all of a pension product into a lump sum
death benefits	lump sum payment made from a super fund to a beneficiary when you die
deferred life annuity	a form of annuity where the commencement of payments is delayed for a set amount of time after purchase
dispersion	in this context refers to the range of possible income outcomes
exhaustion	in this context refers to retirement income products running out of money
expected inflation	the expected percentage increase in the level of prices for a basket of selected goods and services over a given period
indexed life annuity	an annuity with payments that increase in line with an external index such as CPI
inflation risk	the risk that inflation will undermine the purchasing power of future income
longevity risk	the uncertainty about how long an individual will live. For an individual, it is the risk of outliving their savings
market volatility	measure of the dispersion of returns from the market
mortality variations	where the number of deaths each year is more or less than expected
negative semi deviation/negative variation	measure of the number and size of deviations below the mean payment
periodic income	income received on a regular basis
pool	in this instance a pool refers to a group of people that collectively invest in the same product to share returns and risk
Product Disclosure statement (PDS)	Information provided by the person making or selling the financial product for consumers to make a decision on the suitability of the product
purchase price	the total amount invested in a product
retirement phase	the period where investors start to withdraw from their savings and superannuation
reversionary benefit	income paid to a surviving spouse, partner or beneficiary upon death of the primary product owner