



Australian Government

Development of the framework for Comprehensive Income Products for Retirement

Discussion Paper

15 December 2016

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ISBN 978-1-925504-13-2

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CONSULTATION PROCESS

REQUEST FOR FEEDBACK AND COMMENTS

A public consultation process will run from 15 December 2016 to 28 April 2017.

Closing date for submissions: 28 April 2017

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Enquiries: Enquiries can be directed to Manager, Comprehensive Income Products for Retirement.

Providing a confidential response

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A request made under the *Freedom of Information Act 1982* for a submission marked 'confidential' to be made available will be determined in accordance with that Act.

Next steps following the public consultation process

Stakeholder feedback to the public consultation process will inform the Government's consideration of the framework for Comprehensive Income Products for Retirement. Once this public consultation process is concluded, further consultation may be necessary to clarify issues or questions which arise from the initial consultation period.

MINISTER'S FOREWORD



Australia has a world-class retirement savings system. The Turnbull Government is focused on ensuring we now develop a world-class retirement income system. This aim is consistent with the objective of the superannuation system – which is to provide income in retirement to substitute or supplement the Age Pension.

That is why, in response to the 2014 Financial System Inquiry (the Murray Inquiry), the Turnbull Government agreed to support the development of Comprehensive Income Products for Retirement (or CIPRs) and facilitate trustees pre-selecting these products for members to help guide members at retirement.

Although there has been significant focus on reform to the accumulation phase of superannuation over the past two decades, the Murray Inquiry concluded that the retirement phase of Australia's superannuation system was underdeveloped and could better meet both the risk management needs of many retirees and the objective of the superannuation system.

The 2015 Intergenerational Report outlined the size of the challenge of an ageing population for Australia. It showed that by 2055, the number of Australians aged 65 years and over is projected to more than double, while one in every 1,000 people will be 100 years or older.

Therefore, getting the policy settings of the retirement phase of the system right is critically important to ensure as a country we meet this challenge by delivering better retirement outcomes for retirees and ensuring the sustainability of the superannuation system for generations to come.

The potential gains to retirees, the economy and taxpayers from the introduction of CIPRs and a more efficient retirement phase are significant. For retirees, the Murray Inquiry noted that incomes from CIPRs could be 15 to 30 per cent higher than those from the current typical strategy of drawing the minimum amount from an account-based pension while providing security of income for life.

The Turnbull Government recognises that policy changes must significantly improve outcomes for retirees and increase the range of retirement income products available. However, this should not be at the expense of retirees' freedom to choose how to support themselves. We will seek to achieve these outcomes while managing the regulatory burden on the superannuation sector.

I appreciate that this policy area is complex and there will need to be careful consideration of many aspects of the framework. For this reason, an extended consultation period has been provided to enable stakeholders to reflect on the issues raised and provide considered views on the content of this paper.

I look forward to working with a broad range of stakeholders in the superannuation sector and the community as well as other interested parties as we develop a framework to deliver on the objective of superannuation for Australians and position our retirement income system for the future.

A handwritten signature in black ink, appearing to read 'Kelly O'Dwyer', with a stylized flourish at the end.

Kelly O'Dwyer MP
Minister for Revenue and Financial Services

EXECUTIVE SUMMARY

As Australia's population ages, Australians enjoy longer life expectancies, and the superannuation system matures, demands placed on the superannuation system to deliver income throughout retirement will increase. The retirement phase of superannuation is currently underdeveloped and could better meet both the income and risk management needs of many individuals and the objective of the superannuation system.

A well-developed, efficient retirement phase will lift the standard of living of individuals in retirement, and in doing so better achieve the proposed objective of the superannuation system, which is to provide income in retirement to substitute or supplement the Age Pension.

This paper explores a potential framework for the development and offering of Comprehensive Income Products for Retirement, or CIPRs. This framework envisages a greater role for trustees in guiding their members at retirement in a mature superannuation system.

Feedback to assist the development of the CIPRs framework is sought on the following:

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

WHAT IS A COMPREHENSIVE INCOME PRODUCT FOR RETIREMENT (CIPR)?

It is envisaged that a CIPR would be a mass-customised, composite retirement income product (for example, combining a pooled product with a product that provides flexibility), which trustees could choose to offer to their members at retirement.

The offering of a CIPR would provide an 'anchor' to help guide individuals in their retirement income decision-making. Importantly, an individual would have the freedom to choose whether to take up the CIPR or take their retirement income benefits in another way.

Under the CIPRs framework although different product providers (for example, life insurance companies) could administer the underlying component products, trustees would offer a single income stream to their members.

If a trustee designs a product that: meets the proposed minimum product requirements; is in the best interests of the majority of their members; and offers the product in line with the offering requirements, it is proposed that the trustee will receive a safe harbour. The safe harbour would protect the trustee from a claim on the basis that the CIPR was not in the best interest of an individual member. This is intended to provide legal certainty for trustees in undertaking the CIPR offering.

THE RATIONALE FOR THE CIPRS FRAMEWORK

The CIPRs framework is intended to:

- enable individuals to *increase their standard of living in retirement through increased availability and take-up of products* that more efficiently manage longevity risk, and in doing so *increase the efficiency of the superannuation system* and better align the system with its objective; and
- enable trustees to provide individuals with an *easier transition into retirement* through the offering of a standardised retirement income product.

The status quo – the income versus risk trade-off

Maximising income while managing other risks during retirement (such as inflation and longevity risk) is complex. Individuals need a portfolio of products to manage these multiple objectives. Yet, currently, the overwhelming majority of pension assets are in account-based pensions, which provide flexibility to access a lump sum but have limited protection against longevity risk. It appears to be the case that behavioural biases and/or the fear of running out of money leads the majority of individuals to draw down their account-based pension at or near the government-prescribed minimum drawdown rates, which means they face a lower standard of living than if their pension assets were in a product that more efficiently manages longevity risk.

A higher standard of living in retirement and increased product choice

The CIPRs framework would aim to facilitate the development and take-up of products that better manage longevity risk through risk pooling. These products would generally allow individuals to draw a higher income (than the minimum drawdown rates), balanced with flexibility, without increasing their risk of outliving their retirement savings. Higher incomes would enable individuals to increase their consumption, if they choose to do so, and thereby increase their standard of living. Providing individuals with a product that makes more use of their superannuation savings during their retirement would improve the efficiency of the superannuation system as a whole. Individuals would be able to achieve higher retirement incomes by trading off some of the flexibility offered by account-based pensions.

A better framework for decision-making, easing the transition into retirement

Currently individuals face a high decision burden at the point of retirement and receive limited guidance unless they are part of the minority who seek financial advice. The CIPRs framework envisages a greater role for trustees to assist their members to transition into retirement. In particular, facilitating trustees to offer a CIPR to members upon retirement would provide a better anchor or reference point to help frame the retirement income decision.

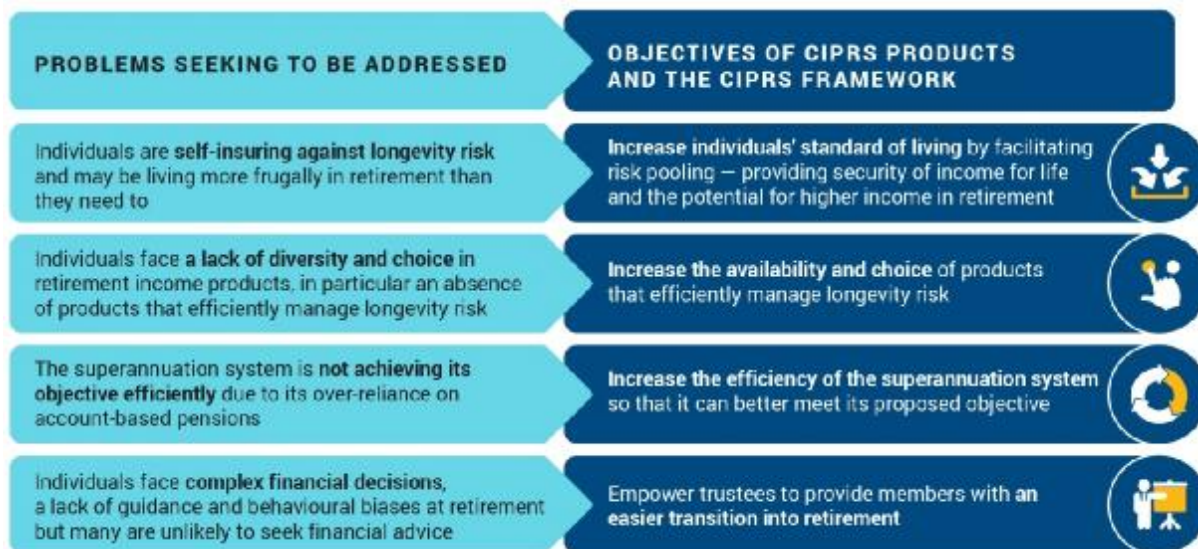
Feedback is sought on how to provide an improved decision-making pathway for individuals to assist them transition into the retirement phase. Key elements of the CIPRs framework in this regard include:

- facilitating trustees to offer a CIPR to their members;
 - Individuals could choose to accept the CIPR offering, or use it as a reference point against which to compare alternative products, including through the use of personal financial advice.

- early engagement with members by trustees to build awareness of a CIPR and its benefits; and
- providing an easy path to commence a CIPR.

Diagram 1, below, summarises the problems that individuals face in retirement and how the CIPRs framework is seeking to address them.

Diagram 1: Problems and objectives of the proposed framework for CIPRs



PROPOSED STRUCTURE AND MINIMUM PRODUCT REQUIREMENTS OF A CIPR

Ensuring all CIPRs meet minimum product requirements is a key way to achieve good outcomes for consumers and to increase comparability between products.

The paper seeks feedback on possible minimum product requirements of this composite product (see Diagram 2), such as requiring a CIPR to:

1. deliver a minimum level of income that would generally exceed an equivalent amount invested in an account-based pension drawn down at minimum rates, with recognition of the benefit of a guaranteed level of income where relevant;
2. deliver a stream of broadly constant real income for life, in expectation (in particular, to manage longevity risk); and
3. include a component to provide flexibility to access a lump sum (for example, via an account-based pension) and/or leave a bequest.

Diagram 2: Possible minimum product requirements of a CIPR



Through this consultation period, an actuarial working group is proposed to be convened to devise possible methodology that could be used in determining the minimum product requirements.

Within the framework itself, a third party, such as an actuary, could be required to certify that a CIPR meets the minimum product requirements before it could be offered to members. Alternatives to third party certification include trustee self-assessment or regulator authorisation.

PROPOSED REGULATION OF CIPRS AND TRUSTEES

The paper also seeks views on how to regulate both trustees and CIPRs, in addition to regulation of the proposed minimum product requirements outlined above.

Trustees could choose to design a single mass-customised CIPR that would be in the best interests of, and offered to, the majority of their members. However, trustees would not be required to design and/or offer a product that is in the best interests of any particular member. In designing the product, trustees would need to consider whether it is in the best interests of members to outsource the administration of underlying component product(s) where the trustee does not have the necessary skill set or scale to administer the underlying component product(s).

As is currently the case, trustees and other product providers such as life insurers could also create new retirement income products that are tailored to particular member segments or individuals, rather than to the majority of the membership. These products could be offered via personal financial advice (including through robo advice) where the adviser is required to consider the individual's circumstances and needs. Individuals could also purchase these products via direct channels. If these products are certified to meet the proposed minimum product requirements of a CIPR, it may be appropriate to allow a label to be attached indicating that the product 'meets the minimum product requirements of a CIPR'.

OTHER CIPRS FRAMEWORK ISSUES

In addition to seeking feedback on the minimum product requirements and appropriate regulatory framework for CIPRs the paper seeks views on the key questions for the CIPRs policy framework including:

- How can trustees design CIPRs to deliver the best outcomes for their members?
- Which trustees should offer CIPRs and which trustees should not offer CIPRs?
- After an appropriate transition period, should there be an express obligation on certain trustees to offer a CIPR?
- Should trustees offer a CIPR only to certain members? If so, to which members should a CIPR be offered?
- How can the framework facilitate comparisons of CIPRs?
- What is the best name for a CIPR?

See page 45 for a comprehensive list of the discussion questions.

WHAT THE CIPRS FRAMEWORK IS NOT ABOUT

It is important to debunk some myths about the CIPRs framework, as outlined in Diagram 3 below.

Diagram 3: CIPR myths dispelled

The CIPRs framework is not intended to:

- encourage annuities over other products;
- compel retirees to take up a certain retirement income product; or
- replace the need for financial advice.

PROCESS AND NEXT STEPS

The Government has announced a number of separate but interrelated measures to improve choice for individuals at retirement and the efficiency of Australia's superannuation system.

First, the Government is seeking to increase the range of retirement income stream products available. The Government's superannuation reform package, which provided for the development of an alternative set of income stream rules that will apply from 1 July 2017, was passed by the Parliament on 23 November 2016. The Department of Social Services will also consult on the Age Pension means test treatment of new retirement income products that are expected to be developed. These changes are important precursors to the introduction of CIPRs.

Further, the Government will *facilitate* trustees offering a CIPR for members at retirement, as part of its response to the Financial System Inquiry (the Murray Inquiry). This envisages a greater role for trustees to assist their members' transition into retirement but there would be no obligation on trustees to offer a CIPR. This is the central focus of this paper.

This paper seeks views on a number of possible elements of a framework for CIPRs. Note that definitions for the bolded words can be found in the Glossary. Submissions close on 28 April 2017. Stakeholder feedback is pivotal to the effective design of this framework and this paper is one element of an ongoing dialogue with stakeholders.

In due course, consultation will also be undertaken on exposure draft legislation and regulations to give effect to the CIPRs framework.

It is envisaged that the CIPRs framework would not commence until trustees and other product providers have had sufficient lead-time to develop appropriate products. Given a commencement date for alternative income stream product rules of 1 July 2017, and the Government is currently reviewing the social security means testing of retirement income streams, the CIPRs framework is not expected to commence any earlier than mid-2018.

The Government could, at a later date, and following an appropriate transition period, consider whether certain trustees should be obliged to offer CIPRs to any of their members. Given this, it will be important for the current proposed CIPRs framework to be sufficiently robust to accommodate a potential change in trustee obligations down the track.

THE PROBLEMS AND OBJECTIVES

THE PROBLEMS TO BE ADDRESSED

Australia has among the longest life expectancies in the world, and life expectancy is expected to continue to increase in the future. The number of Australians aged 65 and over is projected to more than double by 2054-55, with one in 1,000 people projected to be aged over 100. In 1975, this was one in 10,000.¹ The retirement income system needs to be robust to withstand demographic changes.

Currently, the superannuation system is focused on accumulating assets and there is limited availability and take-up of products that can assist individuals efficiently manage the risks they face in retirement, particularly longevity risk. The proposed changes explored in this paper are designed to improve the extent to which the superannuation system, as it continues to mature, meets its proposed objective: to provide *income* in retirement to substitute or supplement the Age Pension.

Complex financial decisions

At retirement, individuals are faced with having to manage multiple complex financial objectives and risks. Individuals also have limited (if any) ability to learn from past experience in setting up their financial affairs for retirement, or to later rebuild their capital to recover from poor decisions, poor market conditions, unexpected inflation, or a longer than expected lifespan.

Individuals who have been in a default accumulation product their entire life are often provided with little or no guidance from their fund as they approach retirement, unless they seek out financial advice. However, only around 20 to 40 per cent of Australians seek financial advice.²

Managing multiple financial objectives and risks from a fixed level of assets is a complex problem, even for retirement specialists and sophisticated investors. It is unsurprising that many individuals find the task overwhelming.

Behavioural biases

When confronted with complex and/or overwhelming problems, individuals tend to rely on behavioural biases or instincts.

These behavioural biases often work against the selection of an appropriate retirement income product. The Murray Inquiry recommended that defaults aligned with the objective of superannuation should be used to help overcome behavioural biases. There is significant international evidence that how retirement solutions are framed and presented has a substantial effect on purchase decisions.³

1 The Commonwealth of Australia, *Intergenerational Report Australia in 2055*, The Commonwealth of Australia, Canberra, 2015, p. 1.

2 Australian Securities and Investments Commission (ASIC), *Report 224, Access to financial advice in Australia*, ASIC, Sydney, 2010, p. 14.

3 See for example, Bateman, H, Eckert, C, Iskhakov, F, Louviere, J, Satchell, S and Thorp, S, *Default and 1/n heuristics in annuity choice*, School of Risk and Actuarial Studies Working Paper 2014/1, New South Wales, 2013; Brown, J, Kling, J, Mullainathan, S and Wrobel, M, *Why don't people insure late life consumption: a framing explanation of the under-annuitization puzzle*, National Bureau of Economic Research Working Paper 13748, Cambridge Massachusetts, 2008; and Brown, J, Kling, J, Mullainathan, S and Wrobel, M, *Framing lifetime income*, National Bureau of Economic Research Working Paper 19063, Cambridge Massachusetts, 2013.

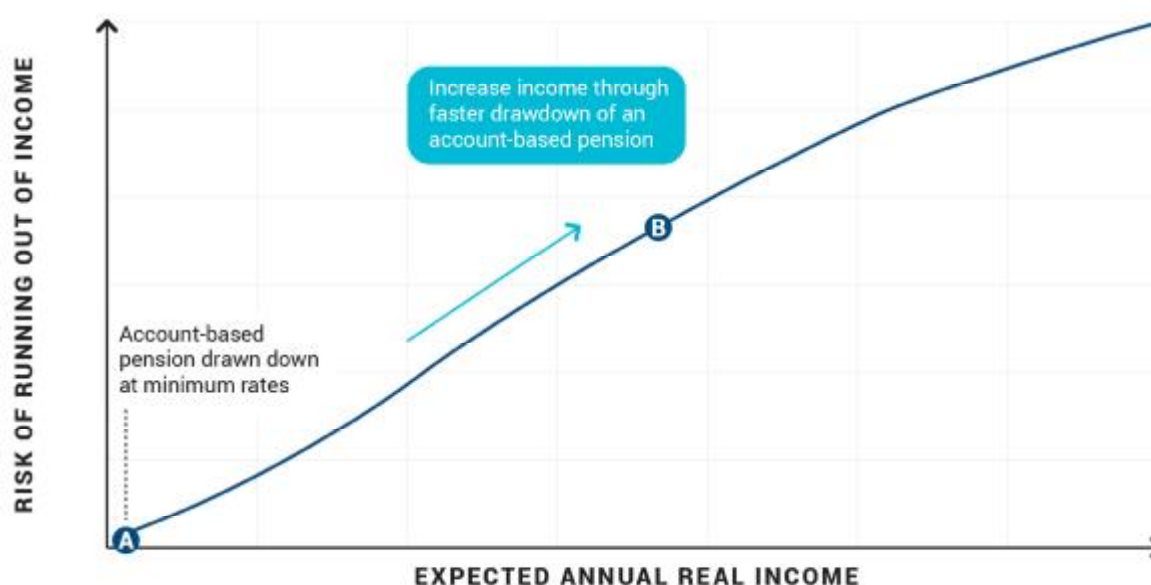
Individuals with an account-based pension can choose the level of drawdown (at or above legislated minimum rates). However, drawing income above the minimum rates causes individuals to face an increased risk of outliving their superannuation savings.⁴ This is a trade-off most individuals are unwilling to make: a majority of individuals draw down account-based pensions at or close to the minimum rates.⁵

Drawing down an account-based pension at minimum rates reduces the risk of outliving one's superannuation wealth, but it also reduces the standard of living that individuals can enjoy in retirement. In addition, it implies that a substantial percentage of superannuation assets is expected to be bequeathed rather than used as income during retirement.

By managing their superannuation assets in this way, individuals are self-insuring against longevity risk, which is an expensive way of managing this risk (measured in terms of forgone income). It means that individuals in retirement are drawing a lower rate of income so assets will last for the longest possible lifespan (potentially 40 years). Alternatively, products that pool longevity risk could potentially provide higher levels of income (all else equal), because they are priced to draw down assets over the life expectancy of the pool (typically closer to 20 years).

The chart below (Chart 1) shows that, in an account-based pension, if an individual chooses to draw down their superannuation at a faster rate, they can increase their income (moving from point 'A' to point 'B'), but the risk of outliving their savings also increases.

Chart 1: The trade-off between income and longevity risk



4 Evidence presented in the Murray Inquiry was that the major worry among retirees and pre-retirees is exhausting their assets in retirement. See Investment Trends, *December 2013 Retirement Income Report*, Investment Trends, Sydney, 2013, cited in The Commonwealth of Australia, *Financial System Inquiry Final Report*, The Commonwealth of Australia, Canberra, 2014, p. 120.

5 Treasury analysis.

Lack of diversity and choice in retirement income products

There is also a lack of choice for individuals who are looking for an alternative retirement income option in Australia that better meets their needs.

Australia has an under-developed retirement income stream market, with at least 94 per cent of pension assets in account-based pensions.⁶ Despite significant heterogeneity among retirees, almost all Australian retirees choose a standard account-based pension as their retirement income product.

POLICY OBJECTIVES

The development of a framework for Comprehensive Income Products for Retirement, or CIPRs, is based on several objectives.

A core purpose of the framework is to seek to expand individuals' choice of retirement income products and their standard of living enjoyed in retirement. Currently, individuals do not seem to be effectively balancing the competing objectives in retirement of delivering high income, risk management and flexibility. Even with new products (which will be facilitated by the new set of income stream rules from 1 July 2017), most individuals would generally not have the expertise to design a more balanced product mix on their own.

As such, the framework envisages a greater role for trustees to assist their members by offering them a mass-customised retirement income product – a CIPR. CIPRs would need to be appropriate for a majority of fund members. They would not commence without the express consent of the member. Upon retirement, individuals would be free to accept the offered product, modify the product to reflect their individual needs, or take their superannuation benefits in any other way.

This framework is designed to be appropriate in a mature superannuation system.

1. Increasing individuals' standard of living in retirement by facilitating more risk pooling – leading to security of income for life and potentially higher retirement incomes

An overarching goal of introducing a CIPRs framework is to increase the standard of living of individuals in retirement. If an individual chooses to commence a CIPR upon retirement, by pooling longevity risk (through inclusion of a pooled product in a CIPR) they can enjoy greater security of income for life and potentially higher retirement incomes (depending on the longevity risk product).⁷

Pooling longevity risk is essential to providing individuals with better outcomes in retirement by allowing individuals access to higher levels of income, balanced with flexibility, without increasing the risk of outliving their wealth.

Pooling takes advantage of fact that individual longevity risk is shared with others in the pool. This allows the pool to plan for individuals' average lifespans rather than their longest possible lifespans.

6 This is based on data presented to the Financial System Inquiry. See Plan for Life 2014, Data provided to Financial System Inquiry, 23 June 2014, cited in The Commonwealth of Australia, *Financial System Inquiry Final Report*, the Commonwealth of Australia, Canberra, 2014, p. 120.

7 Higher retirement incomes, in expectation, compared with the individual taking up an account-based pension with the same superannuation balance and same investment strategy, and drawing it down at the minimum drawdown rates.

If an individual wishes to self-manage their own longevity risk, they must save for their longest possible lifespan rather than an average life expectancy, to minimise the risk of outliving their superannuation savings. This is because no one knows their mortality and there is a significant possibility they could live longer than average life expectancy. Around 60 per cent of both males and females are expected to survive beyond the reported life expectancy.⁸ Saving for the longest possible lifespan constrains an individual's living standards during the accumulation phase and/or during retirement. In addition, on average, self-managing longevity risk results in a sizeable portion of one's superannuation balance being unused upon death.⁹

Longevity risk pooling is not a new feature of Australia's superannuation system (or foreign pension systems). For example, in defined benefit schemes longevity risk is managed by pools. Despite evidence of behavioural biases which work against the take-up of pooled products,¹⁰ many defined benefit members appear satisfied with their retirement income outcomes (including security of income for life) achieved through the use of pooling.

There is, however, a trade-off in achieving a higher level of income in a CIPR through pooling risk. Compared with account-based pensions, there is likely to be reduced flexibility, particularly in the form of lower bequests from superannuation assets. By creating a framework for CIPRs, individuals would be provided with a greater choice of retirement income products, allowing them to consider whether, for example, they would like to trade-off some degree of flexibility in order to commence a product that would provide higher and more certain income throughout their retirement.

It must be acknowledged that some longevity risk management products with high capital costs (to back a guaranteed level of income) will not necessarily offer higher incomes than the status quo based on current pricing. Nonetheless, some individuals with these products would enjoy a higher standard of living in retirement, knowing that the amount of income they receive would not be subject to fluctuations in investment returns.

Notwithstanding the current lack of diversity in the retirement income product market, there is evidence that individuals may be attracted to a portfolio of retirement income products. A range of surveys and studies typically show that individuals want to maximise their retirement income while managing longevity, inflation and investment risk and ensure they have sufficient access to their capital for lump sum withdrawals or unexpected expenses.¹¹ Individuals are rarely willing to fully trade off one retirement objective for another. This is consistent with our broader understanding of expenditure in retirement – retirees tend to have a diverse range of income and expense needs.¹² This means that a collection of products that manage these needs and objectives is likely to be appropriate.

8 Australian Government the Treasury, *Australian Life Tables 2010-12*, Canberra, 2014, p 12.

9 For example, the Australian Government Actuary has estimated that, if an account-based pension is drawn down at the minimum rate, for a 65 year old male around 31 per cent of the initial balance (in net present value terms) will be left over on death on average. Australian Government Actuary, *Towards more efficient retirement income products – Paper prepared for the Financial System Inquiry*, Canberra, 2014, p.12.

10 For example, the commonly-expressed 'hit by a bus' concern. This concern is frequently identified by market surveys and anecdotal evidence as a main barrier to purchasing an annuity. See Gazzale, R and Walker L, *Behavioral Biases in Annuity Choice: An Experiment*, Williamstown Massachusetts, 2009, p 2.

11 See for example, National Seniors Australia and Challenger, *Retirees' needs and their (in)tolerance for risk*, National Seniors Australia, Brisbane, 2013.

12 See for example, Australian Institute of Superannuation Trustees and Australian Centre for Financial Studies, *Expenditure Patterns in Retirement*, Melbourne, 2016, p. 22.

2. Increasing the availability and choice of products that efficiently manage longevity risk

The Government is removing tax impediments to the creation of more innovative longevity risk management products. This will assist product providers to offer products such as deferred annuities, group self-annuitisation products, and composite products such as CIPRs. Pooling longevity risk protects individuals from one of the major risks in retirement, and one of the major worries among pre-retirees and retirees – outliving their wealth in retirement.¹³

However, there are a range of behavioural biases, such as a bias to the status quo, which work against the take-up of longevity products. The proposed CIPRs framework includes the use of a soft-default as an anchor to help overcome the effect of these behavioural biases to better achieve the objective of the superannuation system. This would help to achieve a viable market for these products and increase consumer product choice.

An offering of a CIPR by a trustee would in no way limit or reduce individual freedom and choice in how to support oneself in retirement. Individuals would still need to decide whether or not a product is right for them and make an active decision to commence the income stream.

Those more likely to benefit from greater choice in retirement income products are:

- individuals who desire higher levels of retirement income;
- individuals who are asset rich but income poor; and
- individuals who desire a higher level of protection against a range of risks in retirement.

Those who may not benefit from greater choice are:

- those whose income needs are already met;
- those with a terminal illness or very short life-expectancy; and
- those who value bequests from superannuation above other objectives in retirement.

Trustees offering CIPRs are expected to greatly assist the first group, and are not expected to affect adversely the second group of individuals who would remain free to take their superannuation benefits however they choose.

3. Empowering trustees to provide individuals with an easier transition to retirement

The retirement income decision is complex and can be overwhelming for retirees. The proposed framework for CIPRs envisages trustees having a role to play in helping members navigate this complexity.

¹³ See for example, Investment Trends, *December 2013 Retirement Income Report*, Investment Trends, Sydney 2013 and National Seniors Australia and Challenger, *Retirees' needs and their (in)tolerance for risk*, National Seniors Australia, Brisbane, 2013, p. 10, cited in The Commonwealth of Australia, *Financial System Inquiry Final Report*, The Commonwealth of Australia, Canberra, 2014, p. 120.

The Government will provide a legislative framework to facilitate trustees to design, manage (if they so choose) and offer to their members retirement income products that are of an appropriately high standard. This framework aims to provide trustees with more certainty of their fiduciary duty so they can be confident to assist their members in the retirement income decision through offering a CIPR.

Facilitating trustees to offer CIPRs as a mass-customised retirement income product aims to simplify the retirement financial decision for members, by providing a guided choice or an anchor for individuals' decision-making. There is significant evidence of the effectiveness of defaults in guiding people through complex financial decisions and overcoming behavioural biases. This would help:

- disengaged members, by presenting them with a product that provides a balance of multiple objectives in retirement, presented in standardised terms, and that is relatively easy to start; and
- more engaged members, by providing an anchor or reference point against which to compare other products and/or be able to 'rebalance' the product to better suit their individual retirement objectives.

4. Increasing the efficiency of the superannuation system so that it can better meet its objective

The proposed objective of the superannuation system is to provide income in retirement to substitute or supplement the Age Pension.

Facilitating more secure and potentially higher levels of income in retirement will more efficiently achieve the objective of superannuation. It will also help manage the economic and fiscal implications of Australia's ageing population by enabling individuals to sustain higher levels of consumption in retirement.

The proposed CIPRs framework would also assist in meeting the objective of superannuation by shifting the focus from accumulated assets at retirement to income in retirement. As discussed previously, how the retirement problem is framed has a pronounced effect on individuals' choices and outcomes. This distinction between assets and income is also critical when thinking about risk management in retirement.

A. DEFINING A CIPR

MASS-CUSTOMISATION: DESIGNING A CIPR TO BE SUITABLE FOR THE MAJORITY OF MEMBERS

It is envisaged that a CIPR would be a composite product (for example, combining underlying components of a pooled product with a product that provides flexibility) that is designed to be in the best interests of the majority of the members of a fund – that is, a mass-customised product. A CIPR would be offered to members at retirement. This would provide an anchor to help guide individuals in their retirement income decision-making. An individual would have the freedom to choose whether to take up the CIPR, or take their retirement income benefits in another way. Some people might characterise this offering of a mass-customised product as a ‘soft-default’.

In designing a mass-customised CIPR, it is considered that the trustee would need to take into consideration a number of factors including:

- the income needs of its members in retirement; and
- the trade-offs between income, risks and flexibility, including which elements are more important for the majority of its membership.

Trustees would be expected to use information they have available about their membership when designing CIPRs. This may include average retirement age, gender, average account balance, occupation, life expectancy of individuals in that occupation, and average income during working life. To the extent that trustees have additional information about their membership, such as average household income and assets (inside and outside of superannuation), health status and risk preferences, it would be expected that trustees would also take this into account when designing mass-customised CIPRs.

Designing a CIPR that is in the best interests of the majority of members will not just depend on member characteristics but also the fund characteristics, including the fund’s scale, and the trustee’s capability and skill set. Trustees may need to consider whether to outsource or insource capabilities to administer the underlying product components, as these factors will affect the cost of the CIPR, and the costs borne by members.

Of course, outside of the mass-customised CIPRs framework, trustees would continue to be able to provide individually tailored retirement solutions under the financial advice framework. Through personal financial advice, detailed information about the individual member can be obtained to ensure the recommended retirement income product is in the individual members’ best interests, see Part D for a further discussion of this.

Discussion Question

1. How can trustees design CIPRs to deliver the best outcomes for their members? What are the trade-offs of different design approaches and features?
2. Are there any lessons from defined benefit schemes that can be applied to the CIPRs framework?

MINIMUM PRODUCT REQUIREMENTS FOR CIPRS ARE IMPORTANT

The Government recognises that, by facilitating trustees to provide an easier transition into retirement for their members and allowing trustees to offer mass-customised CIPRs, there is a responsibility to ensure products are of a high standard.

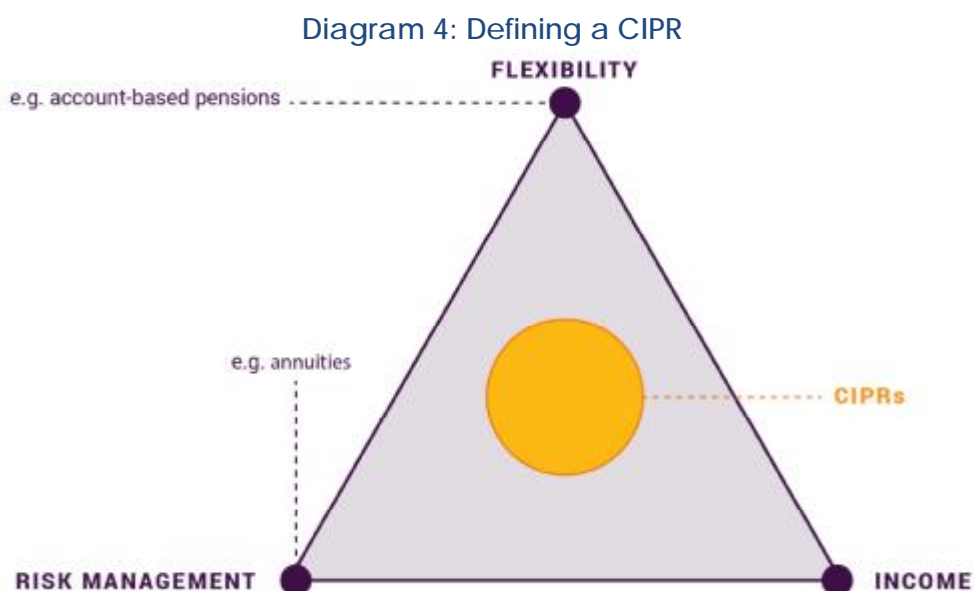
The need for minimum standards for mass-customised/default products has also been noted by the Super System Review and the Murray Inquiry. The Murray Inquiry noted, 'As pre-selected CIPRs are expected to influence retirees' decisions, it is important they provide good outcomes for large numbers of members.'¹⁴

It is proposed that CIPRs be required to meet minimum prescribed, principles-based requirements. Trustees offering these products would be obliged to ensure that CIPRs meet the requirements. This necessarily involves some degree of standardisation, which would help to simplify the framework for individuals, enable comparisons between CIPRs, and ensure that the 'CIPR' label represents an assurance of certain minimum or common features.

PRINCIPLES-BASED MINIMUM PRODUCT REQUIREMENTS

Consistent with the Murray Inquiry's recommendation, it is proposed there be a limited number of principles-based requirements for a CIPR. For example, it could be that the product must:

- a) deliver a *minimum level of income* that would generally exceed an equivalent amount invested fully in an account-based pension that is drawn down at minimum rates, with recognition of the benefit of a guaranteed level of income where relevant;
- b) provide, in expectation, a *stream of broadly constant real income for life* (to manage risks such as longevity); and
- c) include a component to *provide flexibility* to access a lump sum and/or leave a bequest.



14 The Commonwealth of Australia, *Financial System Inquiry Final Report*, The Commonwealth of Australia, Canberra, 2014 p. 127.

These features would be required to be delivered by a CIPR when considered as a whole – that is, each feature could be satisfied by one or a combination of the underlying component products of the CIPR.

Discussion question

3. Do you agree with the proposed three minimum product requirements of a CIPR? What are the alternatives?

More detail on the proposed three principles-based minimum product requirements is below.

(a) Higher standard of living: a minimum level of income

The core objective of introducing a framework for CIPRs is to increase the standard of living of individuals in retirement. The Murray Inquiry concluded that incomes from CIPRs could be up to 15 to 30 per cent higher than those from the current popular strategy of drawing the minimum amount from account-based pensions.¹⁵

To enable CIPRs to deliver better outcomes than the status quo, a minimum income efficiency could be prescribed. Income efficiency indicates how much income an individual is likely to obtain from a CIPR throughout their retirement based on their superannuation account balance. This could be a relative or absolute concept.

Possible ways to define the required income efficiency include:

- i. setting a minimum amount of income above a 100 per cent account-based pension drawn down at minimum rates; or
- ii. putting a cap on the total amount of ‘leakage’ from retirement incomes (for example, administration costs, capital costs and bequests).

Expected investment returns would not generally affect the minimum income level as the CIPR would be assessed against a given investment strategy.

It is proposed that expert advice would be sought in determining the income efficiency methodology to be used in the framework (as well as the methodology for assessing the other two proposed minimum product requirements of a CIPR), through convening an actuarial working group in 2017.

Under both options, the expected income from a CIPR would need to be higher (potentially by a certain amount) than would be received from investing 100 per cent of an individual’s superannuation account balance in an account-based pension drawn down at minimum rates (largely the status quo). In doing so, this would meet the objective of delivering higher retirement incomes and increasing individuals’ standard of living in retirement.

Setting an income efficiency ‘floor’ may help to avoid individuals paying for unnecessary ‘bells and whistles’ they do not need or use, at the expense of income in retirement. An income efficiency indicator would also aid comparability between CIPRs which have different underlying component products (based on income efficiencies). The need for comparability is discussed further in Part D.

¹⁵ The Commonwealth of Australia, *Financial System Inquiry Final Report*, The Commonwealth of Australia, Canberra, 2014, p. 123.

Whichever methodology is used, it would need to account for the benefits of products that provide a guaranteed level of retirement income (guaranteed products). In particular, the methodology would need to recognise that guaranteed products have better risk management (for example, investment risk management) - consistent with one of the objectives of the CIPRs framework - but this may be traded off against higher income (another objective).

Discussion Questions

4. How important is achieving a minimum additional level of increased income to the introduction of the CIPRs framework?
5. How should income efficiency be defined?
6. What minimum level of increased income should be required; that is, what should be the minimum level of income efficiency? How should guaranteed products be accounted for?

(b) A stream of expected broadly constant, real income for life

It is proposed that a CIPR should seek to provide a broadly constant stream of income to individuals throughout their retirement. This reflects the view that individuals generally have a preference to maintain a constant standard of living over time.¹⁶

A requirement of income for life would also enable individuals to manage the risk of outliving their savings in retirement. This could be achieved by a longevity risk management product, such as immediate or deferred life annuities or group self-annuitisation products as an underlying component product of a CIPR. Longevity risk management products capitalise on the benefits of pooling arrangements to manage longevity risk efficiently. This is essential to help avoid precautionary savings to manage longevity risk and to support higher income in retirement.

A requirement that a CIPR should provide an expectation of broadly constant income would not preclude individuals who have taken up these products from withdrawing less income or more income in any given year (within the bounds of the retirement income stream rules and the features of the underlying component products). Clearly, individuals would not be required to consume all of the income they receive from their CIPR.

Income indexation

If a CIPR is required to deliver a stream of expected broadly constant income, there is a question as to the level of indexation.¹⁷ Requiring CIPRs to deliver broadly constant *real* income would enable retirement incomes to keep pace with changes in the cost of living (that is, manage inflation risk).

An alternative would be to require CIPRs to deliver broadly constant *nominal* income. The benefit of this approach is that CIPRs would provide higher income immediately when the income stream commences, when individuals are typically more active in retirement. This may be consistent with spending patterns during the different phases of retirement. For example, one study found that

16 Australian Institute of Superannuation Trustees and Australian Centre for Financial Studies, *Expenditure Patterns in Retirement*, Melbourne, 2016, p. 22.

17 An outcome of the Income Streams Review is that indexation will not be a pre-requisite to qualify for the tax exemption on earnings on assets supporting a pension, meaning that it is possible therefore that not every product that meets the proposed new income stream rules will necessarily meet the minimum CIPR requirements.

individuals' expenditure decreased by around 2 per cent annually during retirement;¹⁸ however, it is unclear what has driven this result.

Studies in overseas markets have drawn mixed conclusions as to whether consumers would prefer real or nominal income streams.¹⁹

Nonetheless, by not managing inflation risk, non-indexed products may give rise to greater precautionary savings by individuals. If this occurred it would result in a significant decline in living standards for individuals who live around 30 to 40 years in retirement.

A third option would be not to specify whether a CIPR needs to deliver either constant real income or nominal income. This would allow trustees the discretion to develop the CIPR based on known preferences of the majority of their members. However, this would significantly diminish individuals' ability to compare CIPRs, as they would need to compare both the initial level of income and the profile of income through time. There are significant simplification benefits if all CIPRs aim for broadly similar indexation through time, which is consistent with the objective of providing consumers an easier transition into retirement.

Discussion questions

7. Which indexation option best achieves the goal of increasing standards of living in retirement?
8. Are there comparability benefits from specifying which indexation option would be required of a CIPR?

(c) A flexibility component

Another significant objective for individuals in retirement is ensuring they have flexibility. Flexibility *within superannuation* could take several forms:

- access to funds for lumpy or unexpected purchases, such as for a holiday, a new vehicle, or to cover health/aged care costs that go beyond what is provided by Government. This could be provided, for example, through an account-based pension component, or withdrawal of a lump sum prior to commencing an income stream;
- the ability to commute a CIPR or underlying component product(s) after commencement of an income stream; and/or
- the payment of a lump sum or an income stream to a beneficiary upon death.

If flexibility is a requirement of a CIPR, trustees would need to design products with flexibility that is most appropriate for the majority of their membership. Flexibility can be added or built into a CIPR in many ways. Some examples include:

18 Hurd, M and Rohwedder, S, *Economic Preparation for Retirement*, 2012. cited in Wise D, *Investigations in the Economics of Aging*, University of Chicago Press, Chicago, 2012, Pp. 77-118.

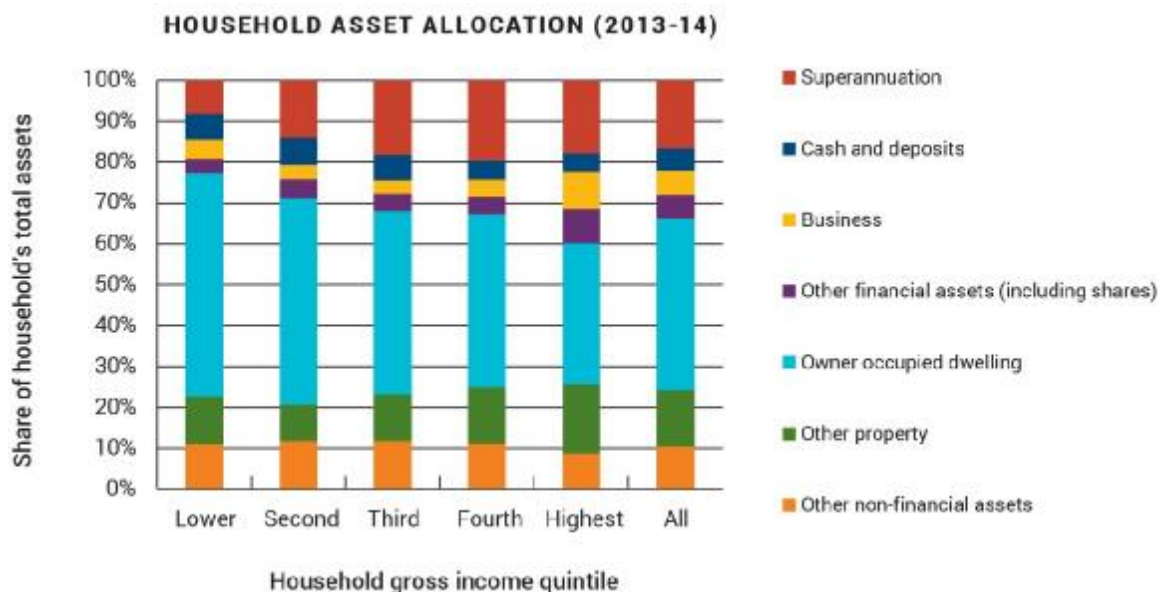
19 One study has concluded that households in the United States prefer annuities that offer inflation protection over nominal annuities. See Beshears, J, Choi, J, Laibson, D, Madrain, B and Zeldes P, *What Makes Annuitization More Appealing?*, *Journal of Public Economics*, vol. 116, 2014, pp. 2–16. However, another study has concluded that U.S consumers generally undervalued inflation protection. See Shu, S, UCLA, Zeithammer, R, UCLA, and Payne, J, Duke University, *Consumer Preferences for Annuities: Beyond Net Present Value*, *Journal of Marketing Research*, vol. 53, No. 2, 2016, p. 241.

- an account-based pension drawn down at minimum rates (*funds for lumpy or unexpected purchases*), paired with a group self-annuitisation product.
- an account-based pension with fast drawdown, paired with a deferred group self-annuitisation product or deferred life annuity (*ability to commute or pay a bequest*)
- a bequest or period certain guarantee (that is, if the individual dies during the guarantee period a beneficiary would receive the remainder of the income payments) attached to a pooled product (*ability to pay a bequest*).

In considering this issue, the need for flexibility within superannuation should not be overstated. While flexibility is important in retirement, individuals will always have a need for a regular stream of income in retirement, and there is a role for superannuation to provide this more efficiently to increase individuals' standard of living in retirement.

In addition, it is worth noting that flexibility can also be provided through assets *outside of superannuation*. Australian Bureau of Statistics (ABS) survey data shows Australian households' financial assets are split broadly evenly across superannuation, property (excluding owner occupied dwellings) and other financial assets, which can be both liquid and illiquid. This holds true for all household gross income quintiles (see Chart 2).

Chart 2: Assets outside versus inside superannuation²⁰



Furthermore, during their working lives, most individuals receive a regular income stream from their employer and need to explicitly save for lumpy or unexpected costs. This savings behaviour is likely to continue in retirement. As previously mentioned, individuals would not need to consume all of the income they receive from a CIPR, and could save some of it for lumpy purchases.

Similarly, those receiving defined benefit income streams have limited or no flexibility built into the product but instead obtain the benefits of having a constant, guaranteed level of income for life.

²⁰ Australian Bureau of Statistics (ABS), *Survey 6553 - Survey of Income and Housing*, ABS, Canberra 2015. The category 'other financial assets' includes the following assets: shares, public unit trusts, private trusts, debentures and bonds, silent partnerships, other financial investments and loans to persons not in the same household.

Therefore the need for flexibility in retirement should not be overemphasised, particularly if it comes at the expense of having a lower standard of living in retirement.

Discussion questions

9. What elements/types of flexibility are most valued by individuals in retirement, and does flexibility need to be provided for through a CIPR?
10. To what extent should savings outside superannuation be used to meet unexpected costs in retirement?

HOW WOULD A CIPR WORK IN PRACTICE?

Under the CIPRs framework, a trustee would:

- 1) design the CIPR, to be suitable for the majority of members in the fund (that is, mass-customised);
- 2) administer the CIPR (and its underlying component products); and
- 3) offer the CIPR to its members.

When designing the CIPR, the trustee could choose to:

- offer and administer one or more of the underlying component products (for example, an account-based pension or a group self annuitisation product); and/or
- partner with a third party to offer the underlying component products (for example, an account-based pension or group-self annuitisation product offered by another trustee, or an annuity offered by a registered life insurance company).

As part of trustees' obligations to design mass-customised CIPRs, trustees would need to consider whether it is in the best interests of their members to partner with a third party to design, administer and/or deliver all or some of the underlying component products where trustees may not have the necessary capability or scale.

For example, where a trustee does not have the necessary skills, experience or scale to manage a pooled product, the trustee should consider whether it could acquire these skills in-house, or whether it would be better to contract with another partner to provide these skills or products.

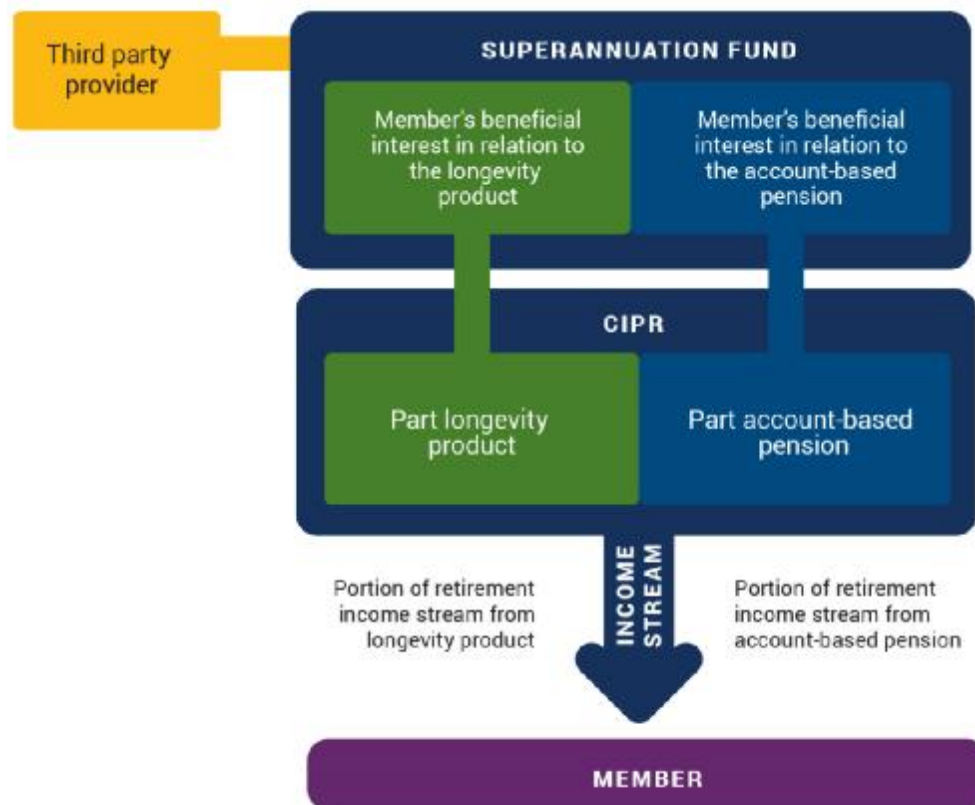
Consistent with their fiduciary duties, although trustees would be able to partner with third parties to offer a CIPR, the trustee would remain responsible for the CIPR. This would mean the member would have recourse to the trustee instead of a third party - similar to the arrangements when trustees offer group insurance to their members.

Providing individuals with recourse to the trustee instead of third parties would enable the income stream from a CIPR to be seen to be from a single source or 'product'. Having a single product would help to simplify the retirement income decision – as income options could be considered holistically, allowing individuals to assess the outcomes of the CIPR (income, risk, and flexibility, Diagram 4 above) rather than the inputs to the CIPR (see Diagram 5 overleaf).

The underlying component products of the CIPR would still need to meet the standards contained in the *Superannuation Industry (Supervision) Regulations 1994* (SIS Regulations), known as the 'annuity

and pension rules'. From 1 July 2017, the Government will extend the tax exemption on earnings in the retirement phase (for products outlined in the annuity and pension rules) to products with variable income streams, such as group self-annuitisation products, and to deferred life annuities. This extension of the rules will be an important pre-cursor to the development of CIPRs as these products may be appropriate underlying component products of CIPRs.

Diagram 5: Behind the scenes of an example CIPR



Given the CIPR would be viewed as a single, holistic product from the perspective of a consumer, it may be appropriate for CIPRs to be classified as a single financial product under the *Corporations Act 2001*, building on the regulatory framework for consumer protection (through financial advice and disclosure requirements).

Although individuals would receive a single income stream from a CIPR, an individual would have beneficial interests in the underlying component products (and associated rights), as outlined in Diagram 5 above.

Discussion questions

11. Is the proposed structure of a CIPR appropriate?
12. Are there any risks or issues with trustees partnering with third parties to enable them to offer certain underlying component products of a CIPR?

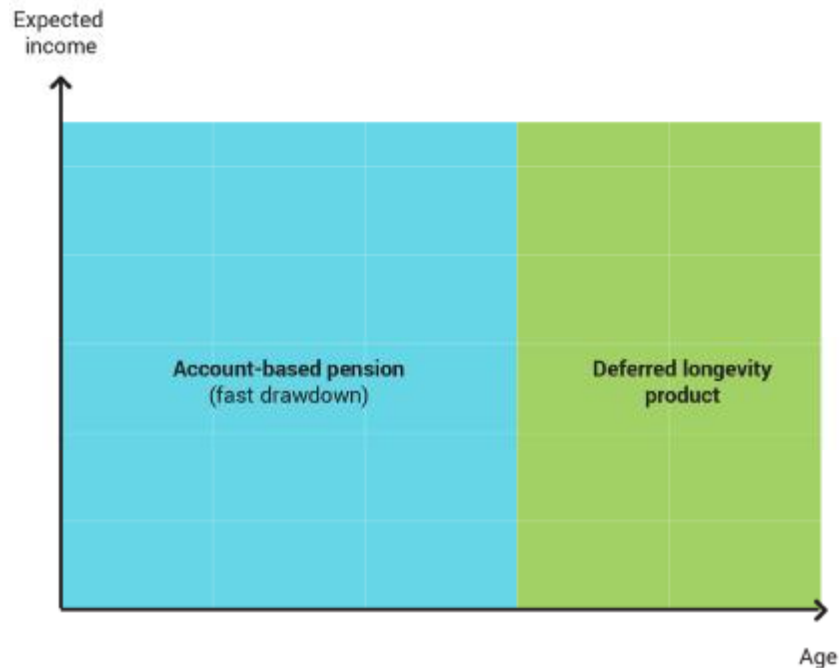
Examples of possible CIPRs

Below are three illustrative examples of possible CIPRs: 'the cut', 'the stack', and 'the wrap'.

For 'The cut' CIPR, the deferred longevity product component could represent as little as 15 to 20 per cent of an individual's total superannuation balance and still provide a higher and more stable

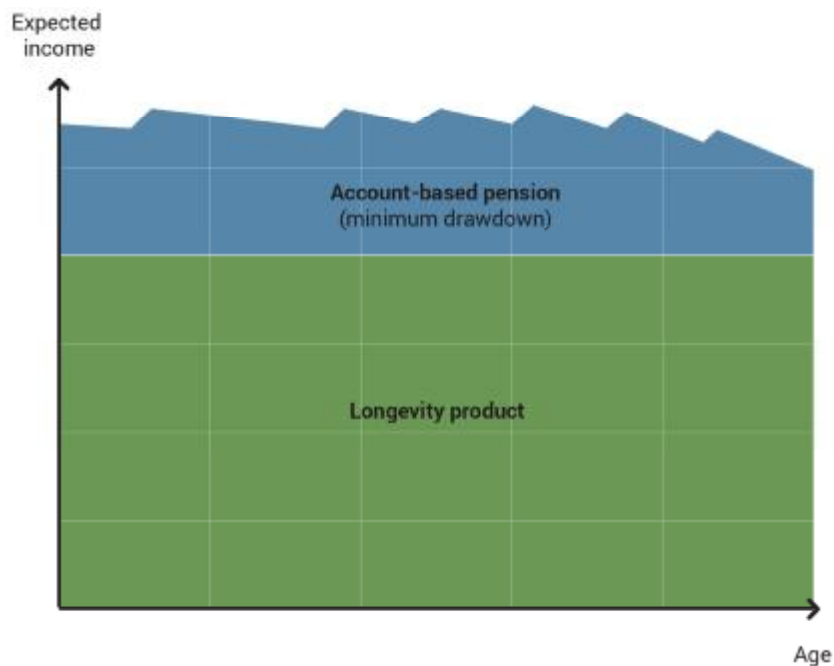
income than an account-pension drawn down at minimum rates. The large account-based pension component provides a high degree of 'flexibility', thereby efficiently managing the concern about dying early and forfeiting an individual's superannuation savings.

Chart 3: The cut



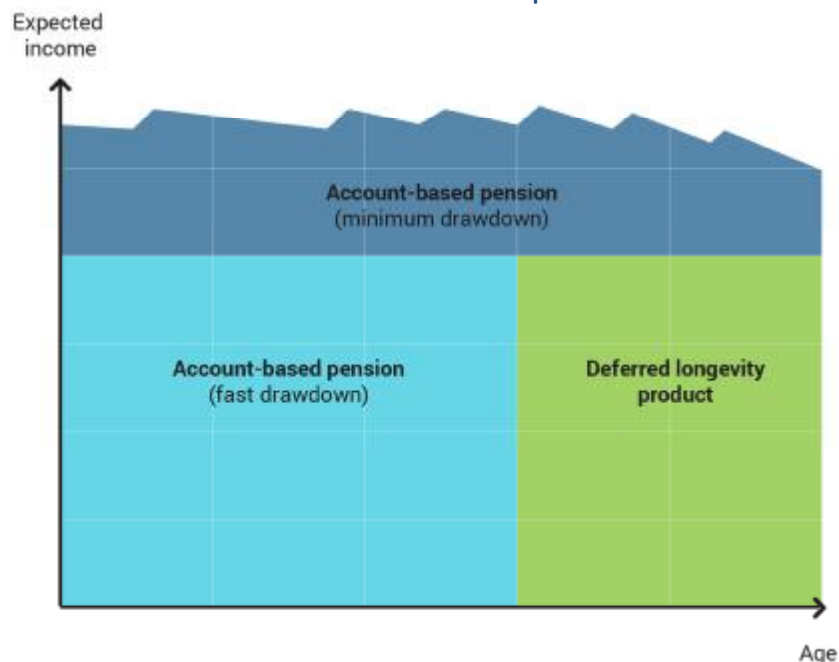
'The stack' CIPR would provide an individual with the flexibility to access 'lumpy' income throughout retirement from an account-based pension component drawn down at minimum rates. Compared to 'The cut', a larger proportion of the individual's total superannuation balance would go towards a longevity product component.

Chart 4: The stack



'The wrap' CIPR represents a combination of 'The cut' and 'The stack' CIPRs and in doing so, delivers a balance of their benefits. 'The wrap' provides longevity risk management (through the deferred longevity product), higher income than an account-based pension drawn down at minimum rates, and provides a degree of flexibility to access 'lumpy' income throughout retirement.

Chart 5: The wrap



The number of mass-customised CIPRs per fund

Facilitating trustees to offer a CIPR to members as the mass-customised retirement income product raises the question of whether trustees should be able to offer one or multiple CIPRs per fund.

A single CIPR approach would be broadly consistent with the MySuper framework, where trustees are generally allowed to offer only one MySuper product in the accumulation phase.²¹ The rationale for this rule was to limit costs and obtain the benefits of scale. These considerations equally apply to the CIPRs framework.

Limiting the number of mass-customised CIPRs per fund to one would allow the trustee to develop a generic product suitable for the majority of members. It would provide an anchor for members' decision-making, would avoid the risk that the CIPR would be presented as a product tailored to the individual's needs, and would avoid any appearance to individuals that it is personal financial advice.

A single CIPR per fund is likely also to reduce confusion and complexity for members, and would facilitate comparisons between funds' CIPRs.

Limiting the trustee to offering one mass-customised CIPR would not prevent trustees developing and offering tailored or bespoke retirement income products (which they can do currently). In addition, as part of this framework, products that are not mass-customised but are certified to meet the minimum product standards required of CIPRs may be able to use a label that shows that the product is of CIPR-quality. These bespoke products could be taken up through personal financial advice (where a financial adviser is required to take into account an individual's personal financial

²¹ There are exceptions for MySuper products for large employers and material goodwill: see Section 29T of the *Superannuation Industry (Supervision) Act 1993*.

circumstances and objectives) or direct channels (as is the case for other financial products). This idea is further explored in Part E.

An alternative approach may be to allow trustees to develop multiple mass-customised CIPRs that can be offered to members based on known characteristics of a particular member segment (that is, 'segment-customised CIPRs'). This approach may enable more tailored retirement income products to be offered to different member segments, which may be beneficial for funds with significantly different member cohorts. However, it is not clear on what basis the segment-customised CIPRs would be tailored and matched to specific member segments. It is likely to be difficult for trustees to identify a 'better' CIPR for a particular cohort of members without significant additional personalised information, such as assets and liabilities outside of superannuation, risk preferences and the member's spouse's financial circumstances. To date, the superannuation industry has not articulated on what basis CIPRs would be differentiated between different member segments.

Discussion questions

13. Should trustees be able to offer one or multiple CIPRs as the mass-customised retirement income product offering to members? Why/Why not?
14. If funds were able to offer multiple CIPRs as the mass-customised retirement income product, on what basis would CIPRs differ?

B. THE REGULATORY SETTINGS FOR TRUSTEES

EXISTING TRUSTEE REGULATION

Trustees have obligations imposed on them by both the general trust law and the obligations in the *Superannuation Industry (Supervision) Act 1993* (SIS Act). Trustees must also comply with the trust deed, including the deemed covenants which the SIS Act imposes into the trust deed. These each place a fiduciary duty on trustees to act in the best interests of members, meaning trustees are held to the highest standard of care. This best interest duty requires trustees to balance the interests of *all* members, rather than act in the interests of a *particular* member.

In addition, trustees are required to obtain a license from the Australian Prudential Regulation Authority (APRA) and have to comply with licensing requirements. Financial services law also imposes conduct, disclosure and advice requirements on trustees.

CURRENT IMPEDIMENTS TO OFFERING CIPRS

Currently, trustees consider there to be impediments in the regulatory settings preventing them from being able to offer CIPRs to their members.

One key barrier being removed by the Government (in a process parallel with this paper) is the tax impediments to the creation of more innovative longevity risk management products.

Another likely key impediment is that the fiduciary duty placed on trustees to operate in the best interests of members causes legal uncertainty and reluctance on the part of trustees to offer new innovative retirement income products, in particular longevity risk management products.

Trustees may be reluctant to offer longevity risk management products due to the risk of legal action being taken by members or their beneficiaries as these products trade-off flexibility for a higher standard of living for the member (security of income for life and potentially higher income).

It is also understood that some trustees may be reluctant to offer mass-customised products to a single member in the absence of a government mandate.

The CIPRs regulatory framework will need to balance protecting the interests of members, and ensuring that impediments to the offering of CIPRs are removed so that trustees are willing and able to offer these products. One way to do this would be to provide a safe harbour for trustees to offer CIPRs. This is discussed in the section below.

The proposed framework seeks to address these barriers through both trustee regulation and product regulation. It is important to note that such regulation would build on existing superannuation and financial services regulation, as discussed below. Notably, this regulation would only be applicable to trustees if they choose to offer a CIPR to their members. However, in designing a suitable facilitative framework, consideration should be given as to whether the settings would be transferable to a potential future framework that may require trustees (or a subset of trustees) to offer a CIPR to their members.

Discussion question

15. What are the key impediments currently preventing trustees from offering a mass-customised CIPR to their members?

DEVELOPING A SAFE HARBOUR FOR TRUSTEES TO OFFER CIPRS

In order to facilitate trustees designing, administering and offering a CIPR to members if they so choose, it is proposed that the regulatory framework include a safe harbour for trustees. This would seek to remove legal uncertainty as an impediment to the offering of a CIPR.

A safe harbour would provide a defence for trustees against a legal claim that they had not met their fiduciary obligations. Alternatively, the law could deem a trustee to have met their fiduciary obligations when offering a CIPR, provided that the trustee could show it had met the legislative requirements.

The safe harbour would only seek to overcome impediments trustees face in relation to their obligations under trust law and accompanying superannuation legislation. The safe harbour would not seek to provide a defence or a carve-out, for instance, from financial advice law (the interactions with the financial advice framework are discussed in Part D of this paper).

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

- design a mass-customised CIPR, to be suitable for the majority of members (outlined in Part A of this paper);
- design the CIPR to meet the minimum product requirements of a CIPR (outlined in Part A of this paper); and
- follow any other process or disclosure requirements associated with the CIPR offering (outlined in Part D of this paper).

It may be inappropriate for this safe harbour to extend to the offering of a CIPR to certain members, such as where the trustee is aware the member has a terminal illness (outlined in Part D of this paper).

Discussion question

16. Would a safe harbour for their best interest obligations remove a key impediment to trustees designing and offering CIPRs?

Which trustees could use the framework to offer a CIPR?

The Murray Inquiry recommended that APRA-regulated funds be *required* to offer a CIPR to their members.²² This would mean all registrable superannuation entities (RSEs),²³ which currently hold around \$1.3 trillion in total assets, of the total approximate \$2 trillion superannuation assets in Australia.²⁴ This approach would allow a market to develop for CIPRs without limiting members' freedom and choice.

22 The Commonwealth of Australia, *Financial System Inquiry Final Report*, The Commonwealth of Australia, Canberra, 2014, p. 127.

23 Australia's superannuation industry comprises: a) registrable superannuation entities (RSEs), which are superannuation funds regulated by the Australian Prudential Regulation Authority (APRA) and exempt public sector superannuation schemes regulated by the State and Territory governments in agreement with the Commonwealth; b) self-managed superannuation funds (SMSFs), which are regulated by the Australian Taxation Office (ATO); and c) life companies governed under the *Life Insurance Act 1995* and other formal agreements.

24 Australian Prudential Regulation Authority (APRA), *Quarterly Superannuation Performance*, September 2016, APRA, Sydney, 2016.

However, in its response to the Murray Inquiry, the Government agreed to *facilitate* trustees to offer CIPRs.

It is an open question as to whether RSEs, or a sub-set of this trustee population, would be most appropriate to offer a CIPR to their members.

For example, it may be more appropriate for trustees of superannuation funds that offer MySuper products in the accumulation phase to offer CIPRs to all or some of their members. These trustees would be expected to have sufficient scale to make the offering of a CIPR viable (given they have access to the default accumulation market), especially for CIPRs with a pooled product component.

It may not be appropriate for some trustees to offer a CIPR to their members. This may include trustees of legacy funds, life office statutory funds, certain defined benefit schemes, eligible rollover funds, Approved Deposit Funds, small APRA funds, and funds that are being 'wound up'. It may not be appropriate in these situations for these trustees to offer CIPRs as these funds either lack the scale, already provide longevity risk management, or lack a permanent membership population and therefore there is little rationale for them to offer a CIPR.

It also is unlikely to be appropriate for trustees of self-managed superannuation funds (SMSFs) to offer a CIPR given trustees of an SMSF are also the members of the fund. However, SMSF members could choose to purchase a CIPR from a product provider if they desired.

In a facilitative framework model (the current proposed model), the safe harbour could be made available to all trustees, with discretion left to trustees to determine whether it would be appropriate for them to offer a CIPR. Alternatively, a certain population of trustees – those deemed unlikely to be appropriate to offer CIPRs, as discussed above – could be prevented from accessing the safe harbour if they offer CIPRs to their members.

If, after a sufficient transition period, the Government was to decide to require trustees to offer a CIPR to their members, the trustee population able to make use of the safe harbour may be an appropriate starting point to determine upon which trustees such an obligation should rest.

Discussion questions

17. Which trustees should consider offering a mass-customised CIPR to their members? Should the safe harbour be made available to all trustees or a certain population of trustees?
18. After an appropriate transition period, should the Government consider whether there should be an express obligation on trustees to offer a CIPR? If so, what length of transition period would be appropriate?

C. ENSURING THAT PRODUCTS MEET THE MINIMUM PRODUCT REQUIREMENTS

As discussed in Part A of this paper, it is important that CIPRs meet minimum product requirements. There are a range of options for assessing whether a CIPR meets the minimum product requirements and can therefore be offered by a trustee to members.

Trustees would also need to satisfy a product regulation process in order to receive the safe harbour protection against a member making a claim that the CIPR was not suitable for that particular member. Three options for this process have been considered and are outlined below in Diagram 6.

Diagram 6: Spectrum of regulatory oversight options



Option A: Regulator authorisation

This approach would require a regulator to assess whether a CIPR meets the minimum product requirements before the product can enter the market. The law could provide the regulator with guiding or mandatory criteria for the assessment process.

This approach would be generally consistent with the MySuper framework. Currently, APRA authorises trustees to offer MySuper products using the criteria in section 29T of the SIS Act. This requires the product to satisfy the minimum requirements of a MySuper product (for example, fee structure) and for APRA to be satisfied that the trustee is likely to comply with their obligations.

Under the CIPRs framework, the regulator could be APRA or the Australian Securities and Investments Commission (ASIC). Although APRA has the responsibility for authorising trustees to offer MySuper products, ASIC has historically had a greater role in consumer protection.

Option B: Third party certification

An alternative approach would be to get a CIPR certified by a third party – for example, by an actuary. This certification process would centre on the minimum product requirements of a CIPR, with the certification process clearly set out in subordinate legislation and/or regulatory guidance.

If third parties were required to certify CIPRs, it would be important to ensure these individuals were held to high conduct standards. Currently, actuaries must adhere to professional standards imposed by the Actuaries Institute.

Option C: Self-assessment

At the other end of the regulatory oversight spectrum, product providers could self-assess whether their product meets the legal requirements of a CIPR. Although this option may impose the least amount of regulatory burden, trustees would still face costs if they were to seek legal or actuarial advice as to whether they could satisfy themselves that a product has met the minimum standards.

The risk with this option is that CIPRs could enter the market without meeting the minimum product requirements, leaving the regulators to take action after the product has entered the market. Taking legal action at this stage would be problematic for members who had commenced the income stream. Non-compliant products entering the market could also undermine member confidence in CIPRs.

Ongoing regulation of CIPRs

If Options A or B were adopted, ongoing regulation of CIPRs would help ensure that products continue to meet the minimum product requirements (including product features and standards). Although the regulator would have responsibility for surveillance of CIPRs in the market, individual CIPRs could also be reassessed periodically (such as every three years) or whenever there is a material change to the product offering, to confirm compliance with the minimum product requirements.

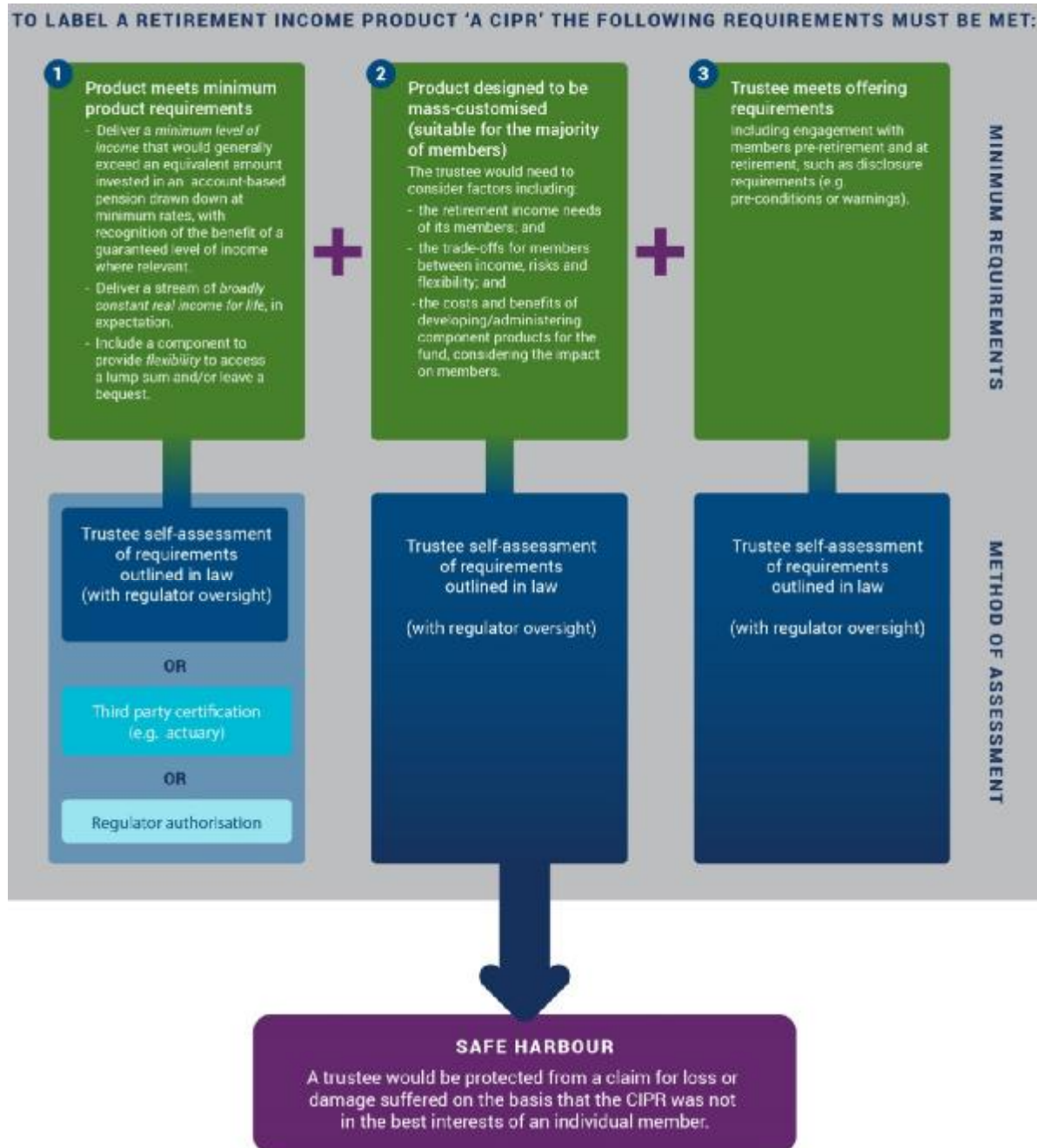
Under this option, if a CIPR no longer met the legal requirements then it would no longer be legal to offer the product to new members, and no safe harbour provision would be available. This risks creating legacy products.

Discussion questions

19. What process should be used to ensure that a CIPR meets the minimum product requirements?
20. Would it be appropriate for actuaries to provide third party certification? If so, what, if any, additional regulation of actuaries would be required?
21. Should there be ongoing re-authorisation/re-certification requirements for CIPRs? If so, how and how often should this be done?
22. What should the consequences be if a CIPR no longer met the minimum product requirements? Is it possible to avoid creating legacy products?

The below diagram summarises the regulatory framework for trustees offering CIPRs, as outlined in Parts B and C of this paper, and how the minimum product requirements and certification/assessment process would interact with a safe harbour.

Diagram 7: Overview of proposed regulatory framework



D. FACILITATING TRUSTEES TO OFFER A CIPR

THE OFFERING OF A CIPR AS THE MASS-CUSTOMISED RETIREMENT INCOME PRODUCT

It is proposed that trustees be able to offer to their members at retirement a mass-customised CIPR as the retirement income product that is suitable for the majority of members of the fund. This would present individuals with an anchor or starting point for the retirement income product decision. Having made the decision to retire and upon being presented with a CIPR as an option, members would need to make an active decision to commence the CIPR, or they may choose to take their retirement benefits another way (including, where available, by taking the CIPR offered by the trustee and adjusting the composition of the underlying products to meet their individual circumstances).

This choice architecture is predicated on the fact that, generally, individuals are likely to be better off in retirement when allocating a percentage of their superannuation balance to a longevity risk management product than if they do not. Secondly, while there are differences between individuals at retirement, in one sense all retirees are homogenous in the important respect that they do not know when they are going to die and must manage their longevity risk. This is the case whether an individual has a short or long life expectancy (except for those with a terminal illness).

Providing members with a guided choice upon retirement also seeks to address the problem that individuals face complex financial decisions, a lack of guidance, and behavioural biases at retirement. Behavioural research and experience overseas indicates that a 'default' has a very good chance of being selected by individuals, given the prevalence of status quo bias.²⁵

Under the CIPRs framework, the trustee would design the CIPR so that the member receives a broadly constant income stream for life. This contrasts with the status quo of drawing down account-based pensions where members can elect to draw down income based on the government prescribed minimum drawdown rates or can choose an alternative (higher) draw down rate. Therefore, a CIPR could reduce the decision-burden for individuals, and would provide a greater role for trustees to guide their members.

Importantly, by presenting a CIPR as the mass-customised retirement income product, the choice of products available to individuals would not be limited. Instead, the mass-customised product would provide an anchor for their decision-making when choosing how to take their retirement income benefits.

Upon being presented with a CIPR, individuals may choose to:

- a) commence the CIPR as offered, by taking positive action;
- b) select an alternative CIPR offered in another fund that is better suited to their individual needs;
- c) select an alternative retirement income product such as an account-based pension or a lifetime annuity;

²⁵ See for example, Bateman, H, Eckert, C, Iskhakov, F, Louviere, J, Satchell, S and Thorp, S, *Default and 1/n heuristics in annuity choice*, School of Risk and Actuarial Studies Working Paper 2014/1, New South Wales, 2013, p. 14.

- d) take no action, meaning their retirement savings remain in the accumulation phase and are taxed at 15 per cent; or
- e) remove their retirement savings from the superannuation system and place them in a non-superannuation financial product such as a term deposit.

Diagram 8: Providing an anchor for the retirement income decision



Discussion question

23. How can the framework facilitate trustees providing an easier transition into retirement for individuals, and what else can be done to meet this objective?

To which members should the mass-customised CIPR be offered?

It may be appropriate for trustees to offer CIPRs to all superannuation fund members, with certain exceptions (for example, those with a low superannuation balance or a terminal illness). Alternatively, it may be more appropriate to offer CIPRs only to MySuper members (with similar exceptions for certain members). More detail on possible exceptions is below.

One rationale for possibly limiting the CIPR offering to MySuper members would be that members in choice accumulation products may be more engaged and informed about retirement income products, and may not need a soft-default product to assist their decision-making.

However, offering a CIPR to all members would be consistent with the premise that CIPRs would be designed to be appropriate for the majority of fund members (see Part A of this paper) and that retirement decisions can be more complex than those in the accumulation phase.

Additionally, if CIPRs are offered to a wider population of members, this may lead to higher take-up of CIPRs. In doing so, this would increase scale (which is important particularly for pooled products) and would allow the proposed objective of the superannuation system (to provide income in retirement) to be met more efficiently.

Possible circumstances where a mass-customised CIPR may not be appropriate

A fund's CIPR may not be in the best interests of every member. An important check for individual suitability is the requirement for individuals to take positive action to commence a CIPR (or any retirement income product), with such action including needing to provide bank account details. Nevertheless, there may be circumstances where trustees should not offer their mass-customised CIPR to a particular individual. This may be the case, in particular, if the fund is aware of circumstances that make the CIPR highly unlikely to be suitable for that person, such as because they have a very low superannuation balance or a terminal illness. It may be inappropriate for a trustee to receive the safe harbour provision in these contexts.

Members with a very low balance superannuation account

A CIPR may be less appropriate for members with very low superannuation balances. A very low superannuation balance could potentially be an indicator of an individual's low value of total household assets and income. If this is the case, they are likely to be eligible for the full Age Pension. These individuals may be better off taking their superannuation balance as a lump sum (for example, to pay down debt or make upgrades to their accommodation)²⁶ and relying on the Age Pension to provide their longevity risk management. This is consistent with the Productivity Commission's finding that lump sum use is most prevalent among those with superannuation balances of less than \$10,000, who tend to take between half and all of their superannuation savings as a lump sum.²⁷

On the other hand, some individuals may value a small increase on top of their Age Pension payments and it may be in their interests to commence a CIPR. For these individuals, it is unlikely to be in their best interests to keep their superannuation in an account-based pension drawn down at minimum rates and hence bequeath a significant portion to their beneficiaries.

However, with more than 45 per cent of Australians having more than one accumulation account, a trustee may not know whether an individual's balance is indicative of their total superannuation balance or their household balance. If an individual has more than one account, receiving CIPR offerings from multiple trustees may provide an opportunity to consider and compare a number of CIPRs and/or help them decide with which superannuation fund to consolidate their assets.

Therefore, it may be appropriate to prescribe a pre-condition, where trustees would be required to advise members, first, to consolidate multiple account balances prior to commencing a CIPR and, second, that a CIPR may not be appropriate for individuals with balances below a certain amount. A number of possible pre-conditions are discussed further in this section of the paper.

Members with a terminal medical condition

A CIPR is very unlikely to be appropriate for individuals with a terminal medical condition, as this means they have a reduced life expectancy. The most suitable option for these individuals may be to take their superannuation balance as a lump sum or through an account-based pension.

If a trustee is aware of a member's terminal medical condition, a prohibition could be imposed on the offering of a CIPR to such a member. If this approach were to be taken, the standard of awareness required of the trustee would need to be clearly set out.

26 The Commonwealth of Australia, *Financial System Inquiry Final Report*, The Commonwealth of Australia, Canberra, 2014, p 124.

27 Productivity Commission, *Superannuation Policy for Post-Retirement*, Productivity Commission Research Paper, Canberra, 2015.

Discussion question

24. To which members would it be most appropriate for trustees to offer a CIPR? All members or only MySuper members?
25. In what circumstances should trustees not offer a CIPR to certain members?
26. Should the safe harbour only apply to the offering of a CIPR to certain members?

DISCLOSURE

Transparency, through effective disclosure, can assist consumers and other intermediaries, such as financial advisers, to understand and evaluate financial products. Appropriate disclosure arrangements can also enable efficient and competitive product markets.

Disclosure can take many forms, including member statements, offer documents and product disclosure statements (PDSs).

Disclosure pre-retirement

One of the objectives of introducing a CIPRs framework is to provide members with an easier transition into retirement. Given the importance and complexity of the retirement income decision, there is likely to be benefit in trustees engaging with their members well in advance of retirement regarding how the CIPR would assist to meet retirement objectives and how it would help to manage risks in retirement.²⁸ Pre-retirement engagement would also help address the various behavioural biases members face when considering what to do with their superannuation balance near, at, or during retirement.

The content, timing and format of pre-retirement disclosure could vary. Pre-retirement disclosure could cover matters such as:

- a) the member's projected retirement income if the trustee's CIPR was taken up at the member's preservation age;
- b) an explanation of the range of risks individuals face in retirement (longevity risk, sequencing risk, inflation risk, investment risk, etc);
- c) an explanation of the fund's CIPR and how it seeks to manage these risks;
- d) detail on where further information may be available; and
- e) information outlining that the CIPR is the trustee's mass-customised retirement income product and, should the member wish to obtain a retirement income product tailored to their individual circumstances, they should consider obtaining personal financial advice.

Pre-retirement disclosure could also involve comparisons between the fund's CIPR offering and other retirement income products.

The more standardised the pre-retirement disclosure is across funds, the more easily members would be able to compare products. However, standardised disclosure may risk simplifying the

²⁸ The Financial System Inquiry proposed that CIPRs should be communicated to members during their working lives. See The Commonwealth of Australia, *Financial System Inquiry Final Report*, The Commonwealth of Australia, Canberra, 2014, p 117.

decision or risks members must grapple with. More prescriptive standardised disclosure may also encourage funds to focus only on improving metrics related to certain product features (with less effort on others that are not part of the standardised disclosure). In addition, prescriptive standardised disclosure documents may be more costly to produce; a cost which would ultimately be borne by consumers. It is also important that any standardised disclosure requirements be balanced against the need to allow for product innovation.

In relation to timing, retirement income projections using the trustee's mass-customised CIPR could be provided on every member statement from a certain age onwards (for example, 35 years of age).

Discussion questions

27. What information about CIPRs should be conveyed to members by trustees during the pre-retirement phase and how often should this occur? Should this information, its form and frequency, be prescribed?
28. When should the pre-retirement engagement between a trustee and a member commence and how frequently should it occur? Should this timing be prescribed?

Disclosure at retirement or preservation age

Under current disclosure requirements in the *Corporations Act 2001*, product providers are generally required to issue a PDS when issuing a financial product. A PDS could be required to be issued by trustees when offering a CIPR or an alternative disclosure method could be considered. If PDSs were to be required, there is an open question as to whether a PDS would be required for the CIPR as well as each of the underlying component products of the CIPR.

It may be appropriate to prescribe certain disclosure requirements on trustees when a member reaches preservation age, or when a member contacts the fund about their retirement (which may be prior to or after the member's preservation age).

Key information that could be prescribed may include a description of the CIPR under certain metrics or key features (linked to the minimum product standards), a high level statement of the objectives and risks faced at retirement, and a number of pre-conditions or warnings.

Pre-conditions could be prescribed which convey that:

- a) superannuation accounts should be consolidated before commencing an income stream;
- b) after the cooling-off period, the CIPR is not able to be easily commuted (or that it may be partially commutable, depending on design characteristics);
- c) individuals should consider their needs to access funds for lumpy purchases and their assets outside of superannuation;
- d) the CIPR is unlikely to be appropriate for those with a terminal medical condition, which means they have a reduced life expectancy;
- e) the CIPR may not be appropriate for very low balance account members (if their consolidated balance is still very low); and
- f) should the member wish to obtain a retirement income product tailored to their individual circumstances, they should consider obtaining personal financial advice.

In addition to a PDS, these pre-conditions could be required to be communicated through other channels, such as a Statement of Advice when personal financial advice is provided, or through the fund's call centre when general financial information or general advice is provided.

Disclosure by the member to the fund will also be necessary upon retirement. In order for a CIPR to commence, trustees would need to ascertain from the member certain information, such as the date when they wish their retirement income to commence, and their bank account details. This action required by members can also be seen to act as a 'safe-guard' to stop individuals inadvertently commencing a CIPR that may not be appropriate for them.

Discussion questions

29. What is the best way to communicate the offer of a CIPR to members? Will warnings/pre-conditions when offering a CIPR be effective? If so, which warnings/pre-conditions are necessary? If not, what is the alternative?
30. What is the most appropriate type of disclosure document to provide further information about a CIPR to consumers and intermediaries such as financial advisers?

COMPETITION

Assessing the value of a CIPR and fostering competition

The CIPRs framework will seek to achieve two, partially competing policy objectives. One significant objective is to ensure individuals take up CIPRs (where appropriate), to improve their retirement outcomes. To help achieve this objective, the CIPRs framework will include a soft-default mechanism to ease the decision-making burden for individuals. However, another objective is to ensure system efficiency, and achieving this requires adequate competition between trustees who offer CIPRs. Competition should increase choice, place downward pressure on prices, and help optimise retirement income outcomes for consumers.

To facilitate greater consumer engagement, thereby assisting to create consumer-driven competition within the retirement income product market, consumers should be able to make meaningful comparisons between different CIPRs and other retirement income products such as account-based pensions. Ideally, products would be compared by their outputs (for example, income, risk, and flexibility) rather than their inputs (for example, the nature of their underlying component products) to reduce complexity and enhance comparability for consumers.

There are several tools which could facilitate comparability, including disclosure documents (such as member statements and offer documents), online comparison tools (Government or private) and/or product dashboards.

Discussion questions

31. What is the best way to assist individuals to assess the pros and cons of a CIPR?
32. What is the best way to foster competition in the CIPR market and broader retirement income product market?

Taking up CIPRs through direct channels and financial advice channels

As with MySuper products, it is proposed that mass-customised CIPRs would be able to be purchased by consumers through direct channels. This would involve consumers acquiring the product through an execution-only, no-advice arrangement.

Additionally, financial advisers operating under an Australian Financial Services Licence may wish to advise on CIPRs. Ensuring Australians have access to quality financial advice is important given the complexity of retirement income products and the onus on individuals making active financial decisions to ensure their financial security in retirement. Financial advice may also be an important option for individuals who have bespoke retirement needs, where another retirement income product may be better suited to them than the mass-customised CIPR offered by their trustee (which is designed to be suitable for the majority of members).

The Future of Financial Advice laws would apply to financial advice provided on CIPRs, such as the Best Interests Duty. To meet the Best Interests Duty, advisers providing personal advice would need to outline, in the Statement of Advice, why they recommend a particular retirement income product. This would require the adviser to make reasonable inquiries to determine the individual's personal circumstances relevant to the advice.²⁹ It is anticipated this fact-find would include information about household status, assets, debt, health, and risk preferences.

In addition, it would be anticipated that a financial adviser providing personal advice on retirement income products would be required to disclose in the Statement of Advice why their recommended product would better meet the individual's needs over the mass-customised CIPR offered by the individual's trustee(s).³⁰

Financial advice can also be provided through robo advice or digital advice. This type of advice can either be personal or general advice. Trustees and product providers would likely use robo advice to supplement traditional financial advice models to advise on CIPRs.³¹

Trustees may also be authorised to offer financial advice, including intra-fund advice, where trustees can provide once-off scaled (limited in scope) personal advice relating to the member's account within the superannuation fund and for that cost to be collectively charged across the membership. The CIPRs framework could continue to permit superannuation funds to offer this service, including once-off advice concerning their CIPR, while noting the existing intra-fund advice provisions do not enable a member's circumstances outside of the superannuation fund to be taken into consideration for the purposes of providing advice.

Discussion question

33. Should CIPRs be able to be provided via direct channels and financial advice?

²⁹ Section 961B of the *Corporations Act 2001*.

³⁰ Akin to Section 947D of the *Corporations Act 2001* concerning switching advice involving MySuper Products.

³¹ The Australian Securities and Investment Commission (ASIC) has recently released regulatory guidance on robo-advice. See ASIC, *Regulatory Guide 255, Providing digital financial product advice to retail clients*, ASIC, Sydney, 2016.

FEES AND PRICING OF CIPRS

Increasing the fees charged on a CIPR, post-commencement

Currently, fees for annuities and defined benefit pensions are essentially 'locked in' at the time of purchase due to the guaranteed level of income these products provide. However, for an account-based pension component or a group self-annuitisation component of a CIPR, there is a risk that increases in administration fees would decrease income in retirement. Individuals would not easily be able to change CIPRs in response to an increase in fees.

One option may be to restrict administrative fees from increasing over the life of a CIPR, although there is a risk that if administrative costs increased substantially accumulation members may need to cross-subsidise members in the pension phase.

Another option may be to rely on the income efficiency concept. However, given that administration fees would have a small effect on efficiency as compared with bequests and capital costs, there would need to be a large increase in fees before income efficiency is affected.

An alternative option could be to allow trustees to increase fees so long as there is no differentiation between the fees paid by existing members and new members of the CIPR. This would ensure trustees continue to face competitive fee pressure. Trustees could lose the right to offer a CIPR to new members if they increased their fees only for existing members.

This paper also seeks alternative ideas on how to protect individuals from significant increases in fees that would erode retirement incomes.

Discussion question

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

E. PRODUCTS OUTSIDE THE MASS-CUSTOMISED CIPRS FRAMEWORK

Thus far, this paper has focused on the framework for mass-customised CIPRs that trustees could choose to offer to their members. However, this would not restrict trustees and product providers from developing products that meet the minimum product requirements of a CIPR and offering them to individuals via direct channels or financial advice.

If a product met the minimum product requirements of a CIPR but it was not offered as the mass-customised product, an option could be to enable trustees and product providers to label the product as 'meeting the minimum product requirements of a CIPR'. This could be determined either through a self-assessment, or by regulator authorisation or third-party certification, as discussed in Part C of this paper. However, under this approach, the safe harbour, also discussed in Part C, would not be available to the trustee or product provider.

Discussion question

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

F. OTHER MATTERS

LABELLING

Although the Murray Inquiry coined the term 'Comprehensive Income Products for Retirement' or 'CIPRs' to describe new innovative retirement income products and the regulatory framework, feedback to date is that this label is not particularly meaningful.

The label 'MyRetirement products' may be a more consumer-friendly label and 'MyRetirement framework' may be more meaningful for trustees. Stakeholder views are sought on the suitability of the 'MyRetirement' name.

Discussion question

36. Is 'MyRetirement' a more appropriate label for a CIPR in both the product and framework sense?

PORTABILITY OF UNDERLYING COMPONENT PRODUCTS OF CIPRS

Portability of CIPRs would increase the competitive pressure on trustees which could lead to better outcomes for individuals in retirement. However, portability could impose costs on funds which would have to provision for a certain number of members exiting the CIPR. These costs may be borne by members and affect income efficiency.

In practice, the extent to which CIPRs would be portable would depend on the product features of the underlying component products.

Portability of an account-based pension component of a CIPR is already provided for under existing law which allows members to commute their account-based pension and roll it into another fund. An account-based pension component of a CIPR would continue to be able to be rolled over into another product under the proposed CIPRs framework.

With regard to the longevity risk management component of a CIPR, portability would depend on the product. Under the proposed new retirement income stream product rules product providers will be able to provide products both with and without the option of being able to be rolled over (that is, both with and without a commutation value), but the commutation amount will be limited by the proposed capital access schedule.

However, rolling over only part of a CIPR, whilst theoretically possible, may appear to be at odds with the intent of providing individuals with a holistic product (a single income stream), as individuals would then receive income streams from multiple product providers. There would also be a question as to whether trustee obligations would cease in relation to the CIPR as a whole, and obligations would attach to the provider of the CIPR underlying component products.

Certain types of CIPRs may allow for entire product portability, such as where a CIPR includes a deferred life annuity or deferred group self-annuitisation product purchased in instalments, for example over a 10 year period. In these circumstances, the account-based pension component would be larger at commencement, making the CIPR more portable in the early years (noting that the individual may forfeit the small part of their balance they have spent on the deferred longevity product).

Views are sought on whether portability of a CIPR is required to ensure competition between CIPRs as well as other retirement income products, and if so, how portability could be included in the design of CIPRs, in line with the new retirement income stream rules, to the benefit of members.

PERIOD CERTAIN GUARANTEES (A FORM OF DEATH BENEFIT)

A period certain guarantee provides a guaranteed minimum period of payment, including a continuing income stream or lump sum equivalent paid to beneficiaries if the retiree dies within the guarantee period. This would help to mitigate fears that if a member dies earlier than expected the member would lose a lot, if not all, of their capital. It would also help mitigate issues that may arise if a member was unfortunate enough to find out they have a terminal illness shortly after commencing a CIPR, such that the CIPR was no longer in their best interests.

These concerns mean that product providers may design CIPRs which have some sort of period certain guarantee, in line with the new income stream product rules. These rules will allow for a 100 per cent death benefit for a maximum of half of a member's life expectancy but will allow product providers to design products that meet members' preferences.

However, there will be some trade-off between period certain guarantees and income efficiency (discussed in the problems and objectives part of this paper), where income efficiency requirements may limit the length of a period certain guarantee that can be provided.

An alternative approach to period certain guarantees could be designing CIPRs which include deferred life annuities or deferred group self-annuitisation products that are purchased in instalments, for example over a 10 year period, from an account-based pension with the final instalment paid before the deferral period is reached. As well as assisting to manage sequencing risk, this approach would ensure that only small amounts of the longevity product are purchased per year (in the order of two per cent of the account balance), meaning that relatively large death benefits would be payable from the account-based pension in the early years of the CIPR.

It is proposed that it will be up to trustees and other product providers to determine what types of flexibility to offer to members, providing the product meets the minimum product requirements, particularly income efficiency.

A COOLING-OFF PERIOD

Another product feature which could provide flexibility and overcome concerns about commencing a CIPR given the permanency of the decision is a cooling-off period. Currently, financial products have a minimum 14 day cooling-off period, but there are products on the market with much longer cooling-off periods.

A longer cooling-off period (in the order of say, six months) could address circumstances where an individual commences a CIPR without considering their other financial needs, such as debt. It could also make the retirement income decision easier for individuals, as they could take up a CIPR, knowing that they could change their mind in the near future.

However, akin to period certain guarantee periods (discussed above), a long cooling-off period could impact income efficiency and impose costs on funds (and thereby on existing members) who would have to provision for a certain number of members exiting.

Finally, a product's maximum cooling off period would need to comply with the proposed capital access schedule under the new retirement income stream product rules in order to qualify for the tax exemption.

JOINT CIPRS

A further issue to be considered is whether the CIPRS framework should facilitate trustees creating a 'joint CIPR' for couples to take up if they choose to.

It is estimated that at least two thirds of people enter into retirement as a couple.³² Many couples also pool their income and assets together. Further, an individual's retirement income often depends on their status as a couple because their access to, and amount of, Age Pension depends on whether they have a partner and the assets and income of the couple as a whole.

A joint CIPR could simplify the retirement situation for individuals, as couples would only have one income stream in addition to their Age Pension entitlements. Joint CIPRs could offer couples single administration fees and lower transaction costs as they convert their accumulation accounts into single income stream products.

Furthermore, a joint CIPR would facilitate longevity risk management for surviving spouses (as a reversionary benefit would) with the added benefit of providing control of the product to the surviving spouse.

However, there is likely to be a number of implementation issues that would need to be considered in relation to joint CIPRs. For example, people in a couple may retire at different times. This may therefore require that a joint CIPR be purchased in stages, or that an account-based pension be taken by the first member of the couple and then be converted into a CIPR once both partners in a couple have retired.

The interaction of joint CIPRS with the tax system would also raise additional implementation issues. For example, consideration would need to be given to how a joint CIPR is valued for the purpose of the \$1.6 million transfer balance cap. A non-commutable joint CIPR could be problematic if one or both individuals were in excess of their transfer balance cap, or in the case of a divorce. The treatment of a joint CIPR in the event of death raises additional issues, particular in relation to the surviving spouse's transfer balance cap.

COLLECTIVE DEFINED CONTRIBUTION SCHEMES

Collective defined contribution schemes (CDCs) can be understood as a lifetime group self-annuitisation product, or conceptualised as somewhere between defined benefit schemes and defined contribution schemes. In a CDC, an individual member's benefit will depend on the member's contribution; however, the contributions of the members are pooled and invested together, and investment returns are often smoothed.

The lifetime nature of a CDC means that trustees can manage investments across the lifetime of all members, and not just until or during the retirement phase.

However, members would be making a decision about joining a CDC when they first join an accumulation product (for example, at the start of their working life), a long time before they are likely to focus intently on their retirement income. Depending on their design, CDCs may reduce flexibility for members, if they are non-commutable or very costly to commute.

³² Rice Warner, *Newsletter: Joint Superannuation Accounts*, Rice Warner, Sydney, viewed 20 June 2016, http://ricewarner.com/wp-content/uploads/2015/10/Joint-Superannuation-Accounts_April-2014.pdf.

While CDCs are essentially both an accumulation and retirement income product, CIPRs are only a retirement income stream product. Views are sought on how CDCs would fit into the proposed CIPRs framework outlined above.

AGED CARE EXPENSES

A significant concern for individuals is medical and aged care costs later in retirement. This may be a key driver for the holding of precautionary savings and the desire for flexible access to superannuation. In 2010-11, of those aged at least 65, 80 per cent used aged care services in the eight years before death, with 43 per cent using residential aged care services.³³

It is worth noting, however, that since the commencement of the recent aged care reforms, individuals who are required to pay an accommodation payment for their aged care facility now have the option of paying rental-type regular payments rather than a lump sum (refundable accommodation deposit). This rental-type payment structure is congruent with the proposed CIPRs framework as the payment of a regular and stable income stream from a CIPR would likely enable individuals to meet the ongoing costs of aged care.

However, should individuals prefer to pay an aged care refundable accommodation deposit, the CIPRs framework may be able to accommodate this through the development of new financial instruments such as aged care deposit insurance-type products (should a market for these products be created).

Discussion questions

37. Would portability foster competition between CIPRs as well as other retirement income products? If so, how could portability be built into the design of a CIPR, should portability be mandatory or discretionary for trustees, and what would be the implications of this?
38. Should it be mandatory or left to the discretion of trustees to decide whether to allow for period certain guarantees in the design of CIPRs? What would be the implications of this?
39. What should be the maximum and minimum cooling off periods?
40. Should the CIPRs framework accommodate (and if so, how):
 - a. joint CIPRs for couples?
 - b. collective defined contribution schemes?
 - c. aged care refundable accommodation deposits?

33 Australian Institute of Health and Welfare, *Use of aged care services before death*, Australian Institute of Health and Welfare, Canberra, 2015.

LIST OF DISCUSSION QUESTIONS

A. Defining a CIPR

1. How can trustees design CIPRs to deliver the best outcomes for their members? What are the trade-offs of different design approaches and features?
2. Are there any lessons from defined benefit schemes that can be applied to the CIPRs framework?
3. Do you agree with the proposed three minimum requirements of a CIPR? What are the alternatives?
4. How important is achieving a minimum additional level of increased income to the introduction of the CIPRs framework?
5. How should income efficiency be defined?
6. What minimum level of increased income should be required; that is, what should be the minimum level of income efficiency? How should guaranteed products be accounted for?
7. Which indexation option best achieves the goal of increasing standards of living in retirement?
8. Are there comparability benefits from specifying which indexation option would be required of a CIPR?
9. What elements/types of flexibility are most valued by individuals in retirement, and does flexibility need to be provided for through a CIPR?
10. To what extent should savings outside superannuation be used to meet unexpected costs in retirement?
11. Is the proposed structure of a CIPR appropriate?
12. Are there any risks or issues with trustees partnering with third parties to enable them to offer certain underlying component products of a CIPR?
13. Should trustees be able to offer one or multiple CIPRs as the mass-customised retirement income product offering to members? Why/Why not?
14. If funds were able to offer multiple CIPRs as the mass-customised retirement income product, on what basis would CIPRs differ?

B. The regulatory settings for trustees

15. What are the key impediments currently preventing trustees from offering a mass-customised CIPR to their members?
16. Would a safe harbour for their best interest obligations remove a key impediment to trustees designing and offering CIPRs?
17. Which trustees should consider offering a mass-customised CIPR to their members? Should the safe harbour be made available to all trustees or a certain population of trustees?
18. After an appropriate transition period, should the Government consider whether there should be an express obligation on trustees to offer a CIPR? If so, what length of transition period would be appropriate?

C. Ensuring that products meet the minimum product requirements

19. What process should be used to ensure that a CIPR meets the minimum product requirements?
20. Would it be appropriate for actuaries to provide third party certification? If so, what, if any, additional regulation of actuaries would be required?
21. Should there be ongoing re-authorisation/re-certification requirements for CIPRs? If so, how and how often should this be done?
22. What should the consequences be if a CIPR no longer met the minimum product requirements? Is it possible to avoid creating legacy products?

D. Facilitating trustees to offer a CIPR

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

Disclosure

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

Competition

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

Fees and pricing of CIPRs

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

E. Products outside the mass-customised CIPR framework

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

F. Other matters

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

ACRONYMS AND GLOSSARY

ACRONYMS

ABS	Australian Bureau of Statistics
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
CDC	Collective defined contribution scheme
CIPR	Comprehensive Income Products for Retirement
GSA	group self-annuitisation product
PDS	product disclosure statement
RSE	registrable superannuation entity

GLOSSARY

Anchor	A reference point to frame a decision.
Account-based pension	An individual investment account set up with superannuation benefits from which a retiree draws a regular income. Also known as an allocated pension.
Annuity	A regular guaranteed payment that is made to a person for life or for a fixed number of years by a life insurer.
Behavioural bias	Human decision-making which differs from the rational behaviour assumed in economic models.
Comprehensive Income Products for Retirement	A mass-customised, composite retirement income product that is designed to be in the interest of the majority of members of a fund and meets minimum prescribed standards.
Collective defined contribution schemes	A 'whole of life' product offered by a superannuation fund to a member in the accumulation phase. Contributions made for a given member are invested with the aim of providing that member with a targeted (but not guaranteed) income stream in retirement. Regular income is paid from a collective pool to surviving members. The income stream is subject to investment risk/performance and mortality assumptions. The product is not capital-backed (i.e. not guaranteed).
Default accumulation product	A superannuation product to which employers make compulsory superannuation contributions for employees who do not choose a fund of their own.
Deferred life annuity	A form of annuity where the commencement of payments is delayed for a set amount of time after purchase.
Fiduciary duty	An obligation borne by trustees to their members, to act in the best interest of members and with the highest standard of care.
Financial product	For the purposes of the <i>Corporations Act 2001</i> , a financial product is defined as a facility through which a person makes a financial investment, manages financial risk or makes non-cash payments.
Group self-annuitisation product	A retirement income product where members invest capital into a pool and regular income is paid from the pool to surviving members. The income stream is subject to investment risk/performance and the mortality experience of the pool. The product is not capital-backed (i.e. not guaranteed).
Guaranteed products	Retirement income products, such as some annuities, which carry a promise to pay a set level of income. These products are capital-backed (i.e. guaranteed) and offered by registered life insurers.
Guidance	Enabling an easy transition into retirement for members through providing of an 'anchor' or reference point to facilitate decision-making.
Income efficiency	The present value of income in retirement as a percentage of a product's purchase price.
Inflation risk	The risk that inflation will undermine the purchasing power of future income.
Investment risk	The risk that the return on an investment is lower than expected.

Longevity risk	The uncertainty about how long an individual will live. For an individual, it is the risk of outliving their savings.
Mass-customised	A standardised product that is designed to be in the best interest of the majority of fund members.
Minimum product requirements	The three proposed requirements to meet the definition of a CIPR are that the product must: <ul style="list-style-type: none"> (a) deliver a minimum level of income that would generally exceed an equivalent amount invested fully in an account-based pension that is drawn down at minimum rates, with recognition of the benefit of a guaranteed level of income where relevant; (b) provide, in expectation, a stream of broadly constant real income for life; and (c) include a component to provide flexibility to access a lump sum and/or leave a bequest.
MySuper	A cost-effective, simple default accumulation product, established as part of the Stronger Super reforms announced in 2011.
Offer/the offering	The process that a trustee would follow to encourage take up of a CIPR.
Period certain guarantee	A guarantee that if a consumer of a product dies during the guarantee period, their beneficiary would receive the remainder of the income payments for the guaranteed period.
Pooled product	A product in which participants contribute funds to a pool that is invested in financial assets and distributed according to an individual's share in the pool. Annuities, group self-annuitisation products and collective defined contribution schemes are all examples of pooled retirement income products.
Precautionary savings	Savings held in response to uncertainty about future expenses and income.
Retirement phase	The period after an individual has retired from the workforce and qualifies for, and may be in receipt of, superannuation benefits.
Robo advice	Financial advice delivered using algorithms and technology in place of, or supplementary to, financial advice delivered by a human.
Safe harbour	Protection from legal liability, in the form of a defence or deemed compliance with the law.
Sequencing risk	The risk of experiencing poor investment performance at an inopportune time; for example, just before retirement when the portfolio assets are likely to be largest.
Soft-default	Also known as a guided choice, a pre-selected product option offered to members which they can choose whether or not to take up. It requires members to make an active decision to commence the product.
Status quo bias	A preference for things to stay the same by doing nothing.

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