Simpler super

Taking the stress out of retirement

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Simpler super: taking the stress out of retirement

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Super is too complicated for retirees

- Australians find retirement planning stressful and many do not spend their super
- Super in retirement asks retirees to solve an impossible problem: no one knows how long they will live
- The system provides too little guidance – bolder reform is needed

Retirees should be encouraged to annuitise some of their super

- What the system guides people to do matters because they anchor to it. Super guides people towards account-based pensions drawn at the minimum, which leave retirees to manage too much risk
- Retirees should be encouraged to annuitise some of their super – 80% above $250k – to reduce stress and boost spending

The government should offer annuities

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- Priced fairly, and managed by an independent agency, a government annuity would encourage take-up since retirees would be more confident that they're getting a fair deal.

The government should give retirees better guidance

- Government should establish `RetireSmart' – a free guidance service

The government should ensure super funds deliver for retirees

- Performance test account-based pensions & develop product assessments
- Establish a top-10 list of the best-performing funds, and steer both retirees (& new workers) into those funds

Many Australians are retiring with substantial super balances for the first time, which will grow further

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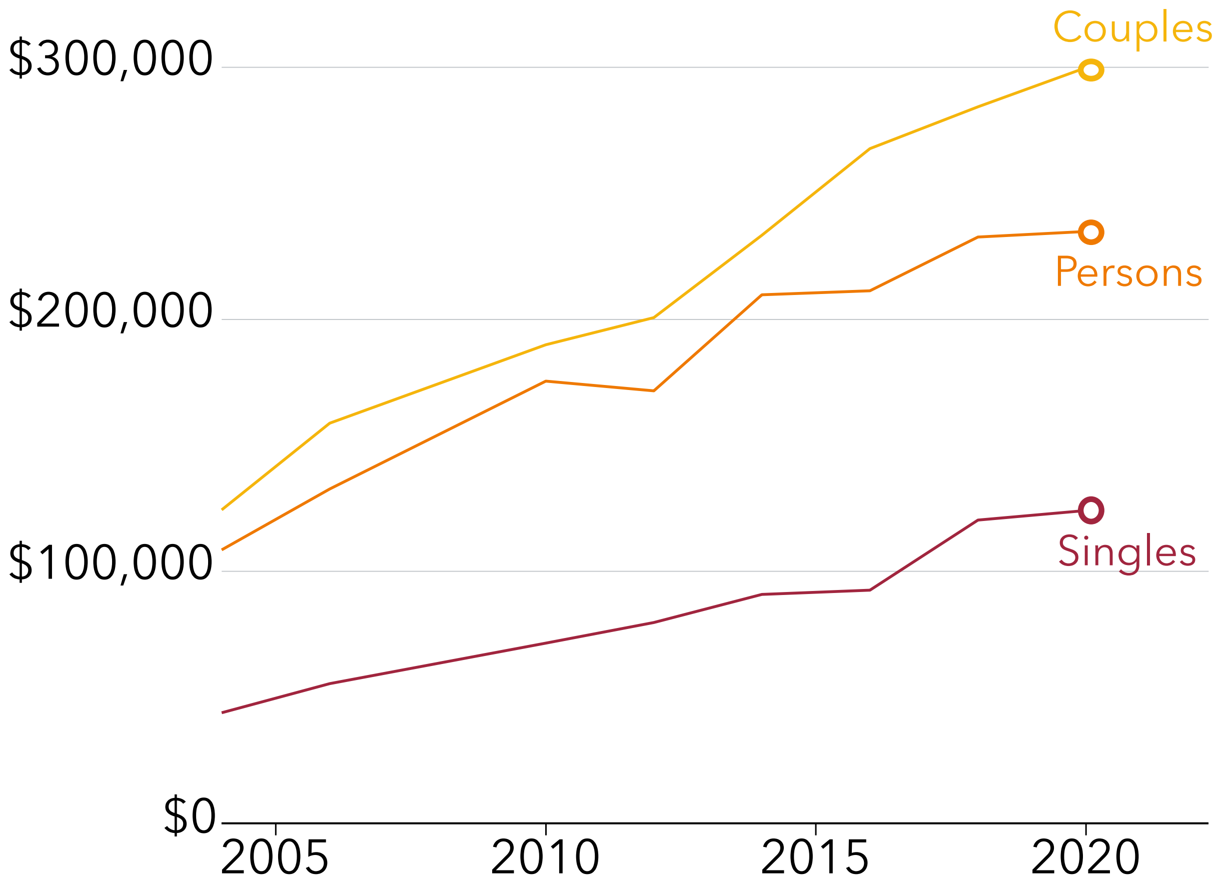
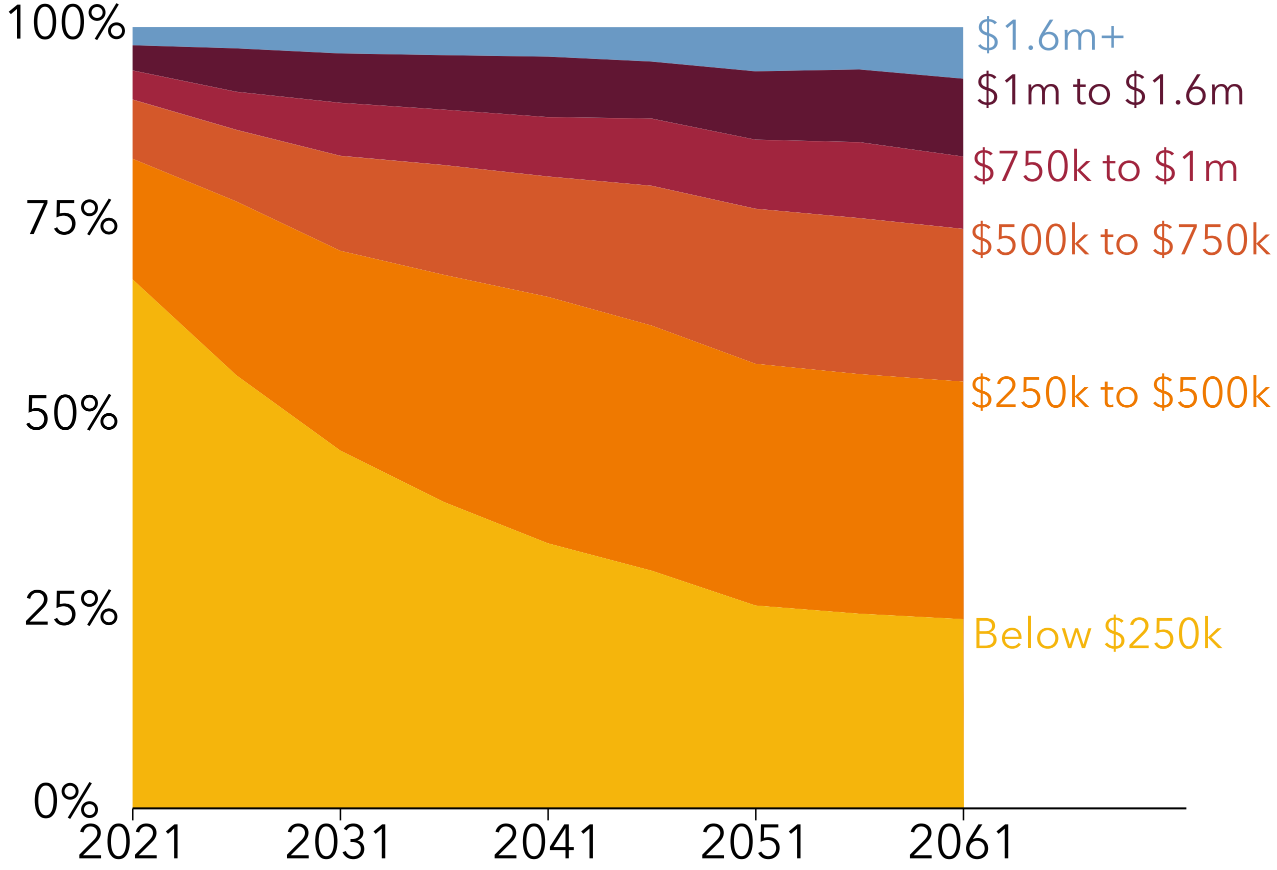
Real average super balance for households and persons aged 55-to-65, $2019-20



Notes: Household age measured via the household reference person. Multi-family and group households filtered out. Includes those with no super. Source: Grattan analysis of the ABS Survey of Income and Housing Basic CURFs 2003-04 to 2019-20, and ABS Consumer Price Index.

Projected distribution of balances at retirement, wage-deflated



Notes: Values are in 2020-21 dollars and deflated by average weekly earnings. Source: 2021 Intergeneration Report (Chart 7.4.4).

Yet most pre-retirees find planning for retirement complicated and stressful

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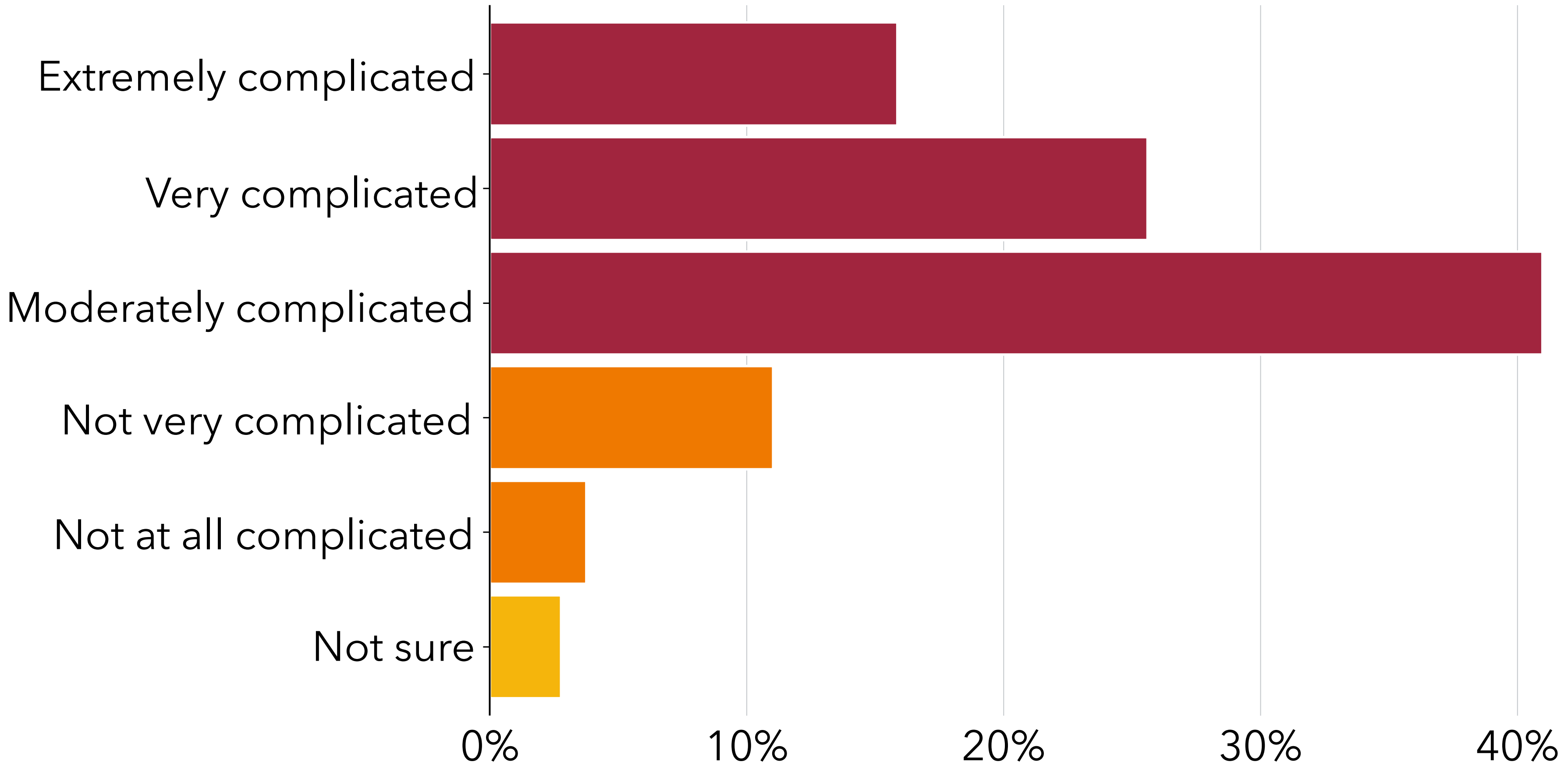
Share of responses to the question "How complicated have you found planning for retirement?"



61% of respondents to a recent CHOICE survey said say they **don't believe** their retirement will be **financially stress-free.**

Source: CHOICE (2020) Retirement planning survey; SCA (2020) Submission to the Retirement Income Review

Poorer retirees have taken out some of their super, but almost all retirees sit on their financial wealth

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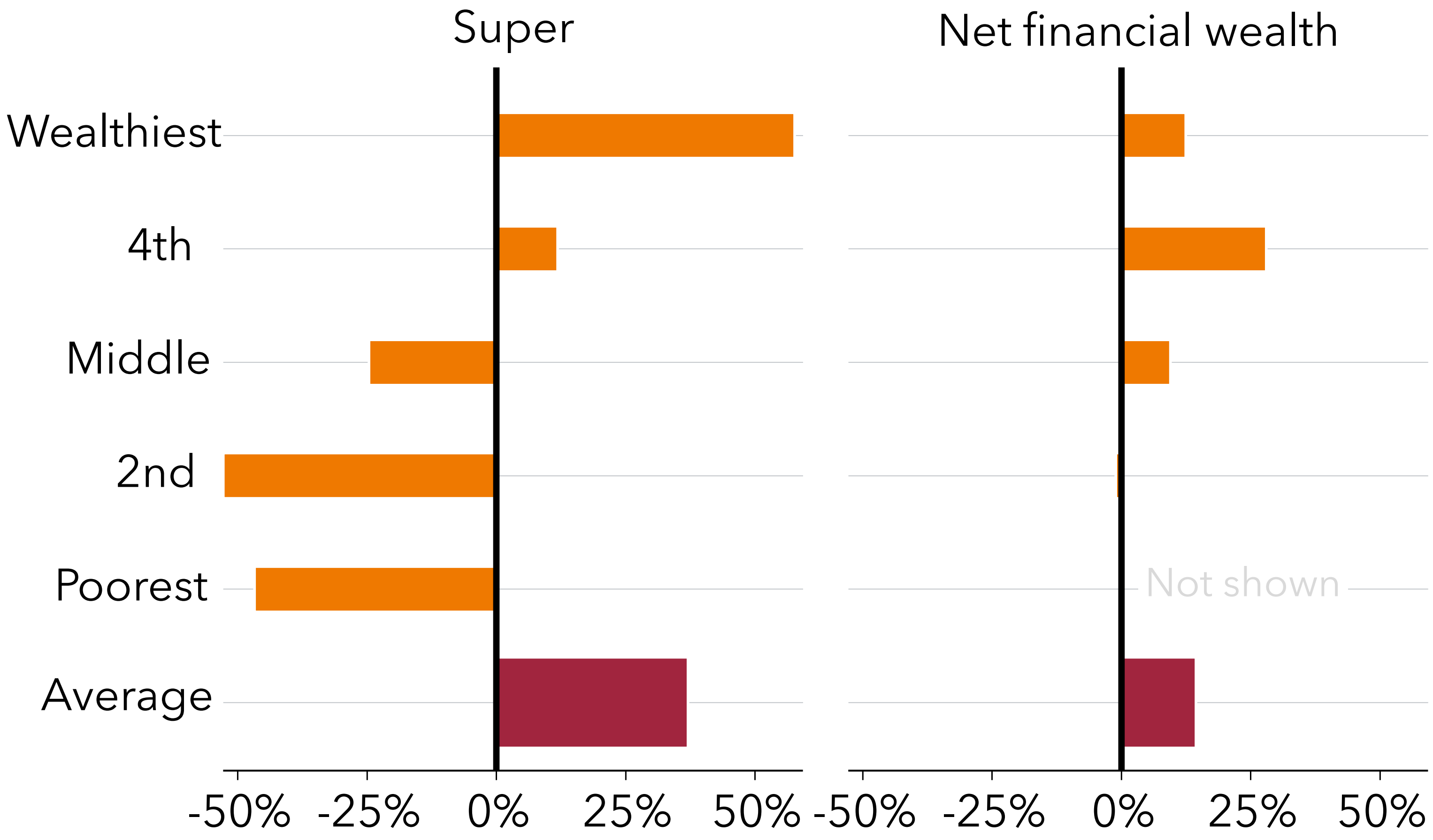
Real change to 2019-20 for those aged 60-64 in 2003-04 by wealth quintile, equivalised, $2019-20



There are several reasons why retirees don't spend down their retirement savings

- Precautionary saving due to longevity, investment and inflation risks
- Policy settings frame retirees' choices

Retirement system design can influence these factors

- Uncertainty over future health and aged care costs
- Falling spending needs (especially later in life)
- Bequest motives

Notes: Quasi-longitudinal analysis matching cohort across survey data from 2003-04 and 2019-20. Net financial wealth is net wealth less the value of the primary residence, loans outstanding on the primary residence, and the value of contents vehicles. Mortgage measurement changes between surveys from loans for the primary residence to all loans secured against the primary residence. Wealth quintiles are calculated using net financial wealth. Net financial wealth for the poorest not shown due to noise around zero producing a anomalously large result. Source: Grattan analysis of the ABS 2003-04 and 2019-20 Survey of Income and Housing Basic CURFs, and the ABS Consumer Price Index.

Managing super in retirement involves big complex decisions

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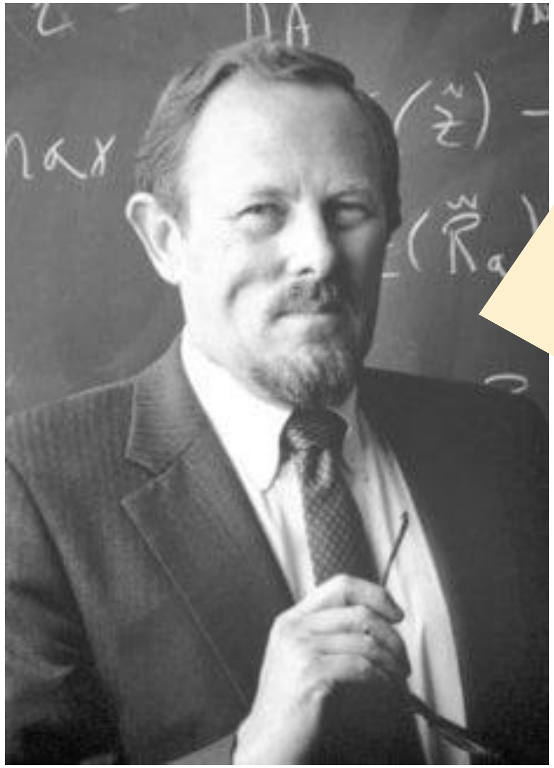
Retirement savings must be managed to balance competing objectives

- Working-aged super is simple:
  - Contributions made and invested on workers' behalf to build a balance
- Retirement super is more complicated, with trade-offs between:
  - Maximising income
  - Managing risks: investment, inflation & longevity
  - Flexibility in accessing capital

The means-tested Age Pension further complicates things

- Most retirees get at least a part pension
- The Age Pension subject to two means tests: an income test and an assets test
- Saving and spending impacts eligibility for the pension in ways that are hard to predict



"Comprehending the range of possible future scenarios from any retirement income strategy is very difficult indeed, and choosing one or more such strategies, along with the associated inputs, seems an almost impossible task."

William Sharpe (Nobel Laureate), *Retirement Income Analysis* (Chapter 21)

Compared to working-age, the retirement phase of super casts people adrift

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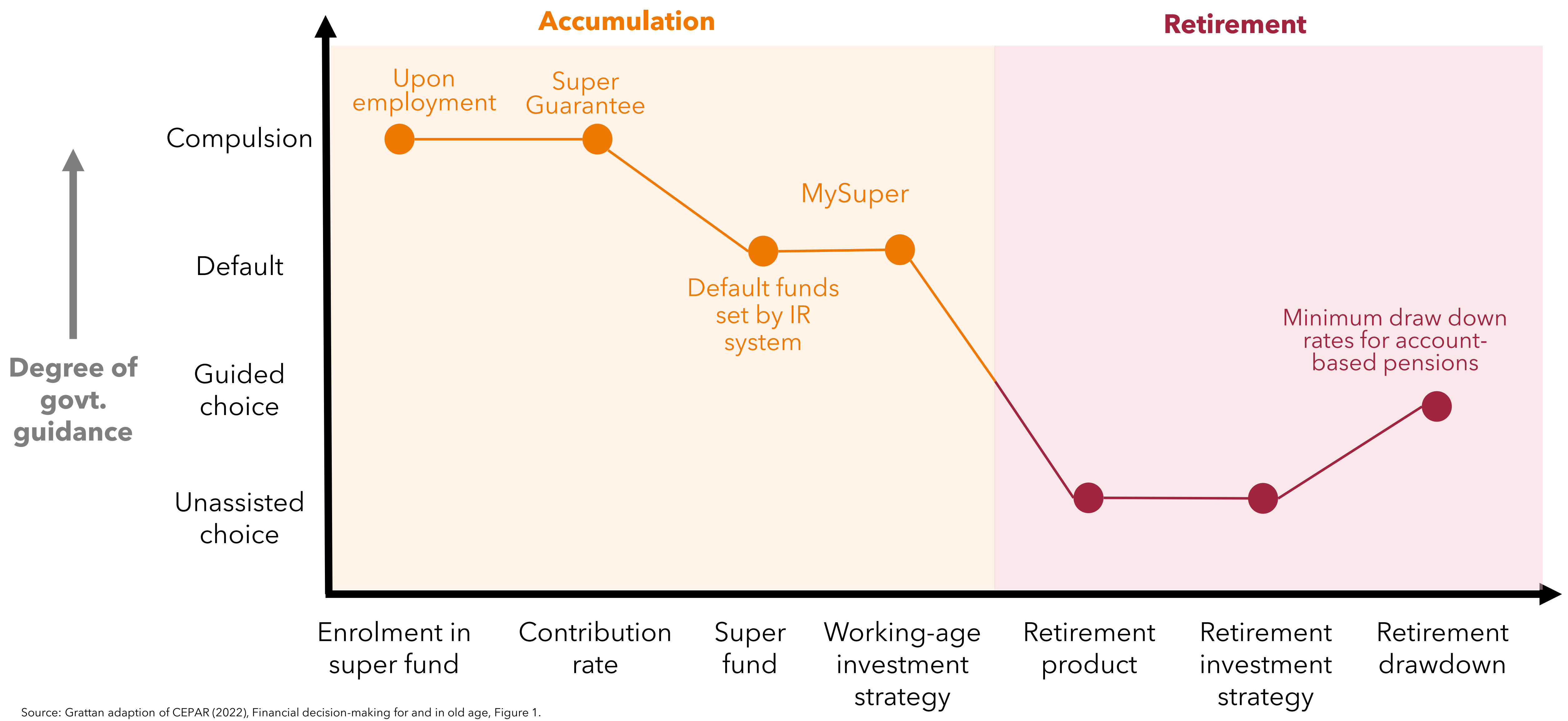

Source: Grattan adaption of CEPAR (2022), Financial decision-making for and in old age, Figure 1.

Now is the time to act: our compulsory super system is turning into an inheritance scheme

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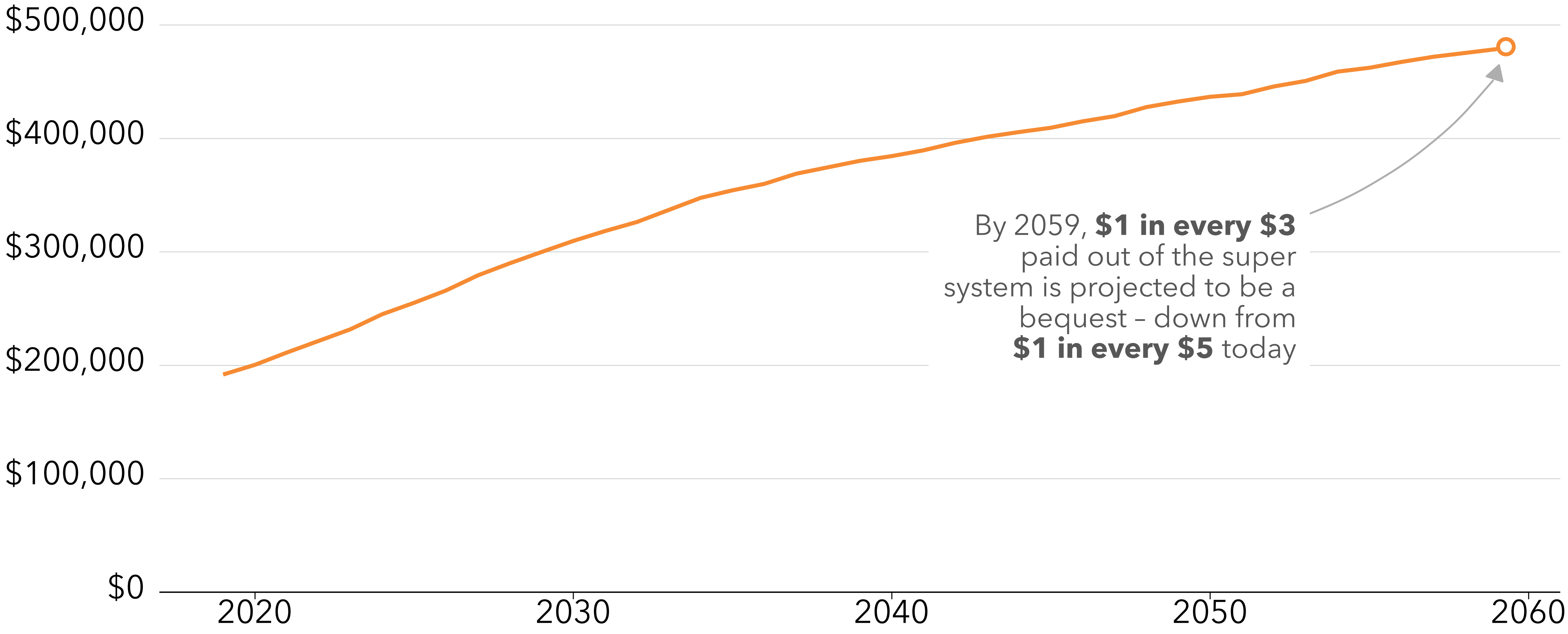
Projected average superannuation balance at death if observed drawdown rates continue (wage deflated)



Source: Retirement Income Review (2020, Chart 5A-13).

Bolder reform is needed

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Recent reforms are not enough

- **The Retirement Income Covenant** lacks concrete expectations and penalties super funds that are not taking it seriously
- **Financial advice reform** *might* help some retirees lucky enough to be in a fund that does it well, but private financial advice can't do it alone
- **Recent announcements** are steps in the right direction, but don't match the magnitude of the problems

Bolder reform is needed to ensure super delivers on it's promise (and legislated objective)

Simpler super: taking the stress out of retirement

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System design substantially affects retirees' choices

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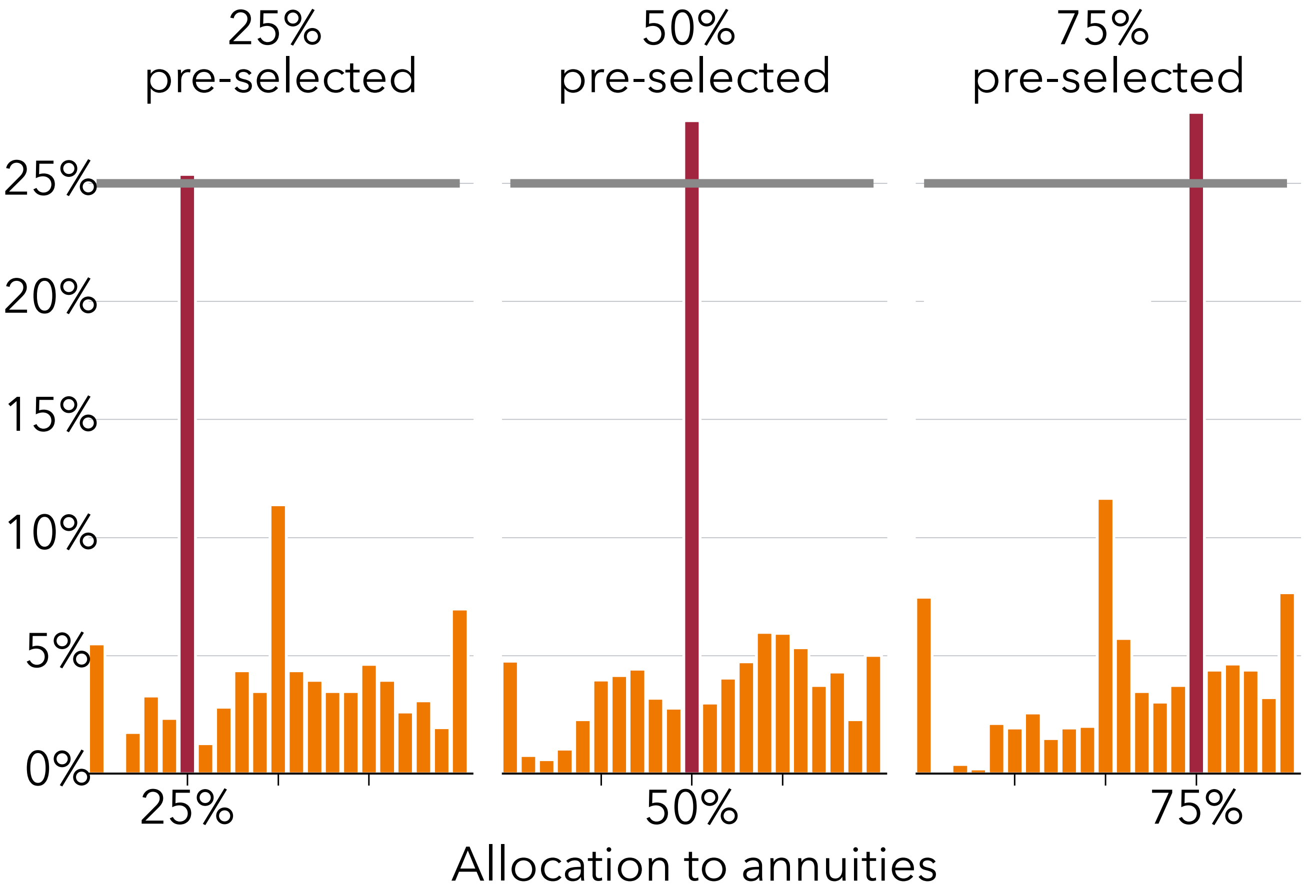
Per cent of respondents choosing allocation option, with different pre-selected allocations



People tend to take the options in front of them, or fall back on what they already know.

- Strong anchoring around pre-selected annuity allocations
- When given a choice, people in DB plans tend to choose a guaranteed income, whereas people in DC plans choose lump sums
- Income framing leads to annuity uptake, whereas investment framing doesn't

Note: This study referred to pre-selected options as defaults. The allocation to annuities was pre-selected for participants who were able to change the allocation as they desired. Source: Bateman et al (2016), Default and 1/N Heuristics in Annuity Choice

Sources: Benartzi (2010) Behaviourial finance and the post-retirement crisis, Benartzi (2011) Annuitisation puzzles, Brown (2008) Why don't people insure late-life consumption? A framing explanation of the under-annuitisation puzzle.

The system guides people towards account-based pensions drawn at the minimum

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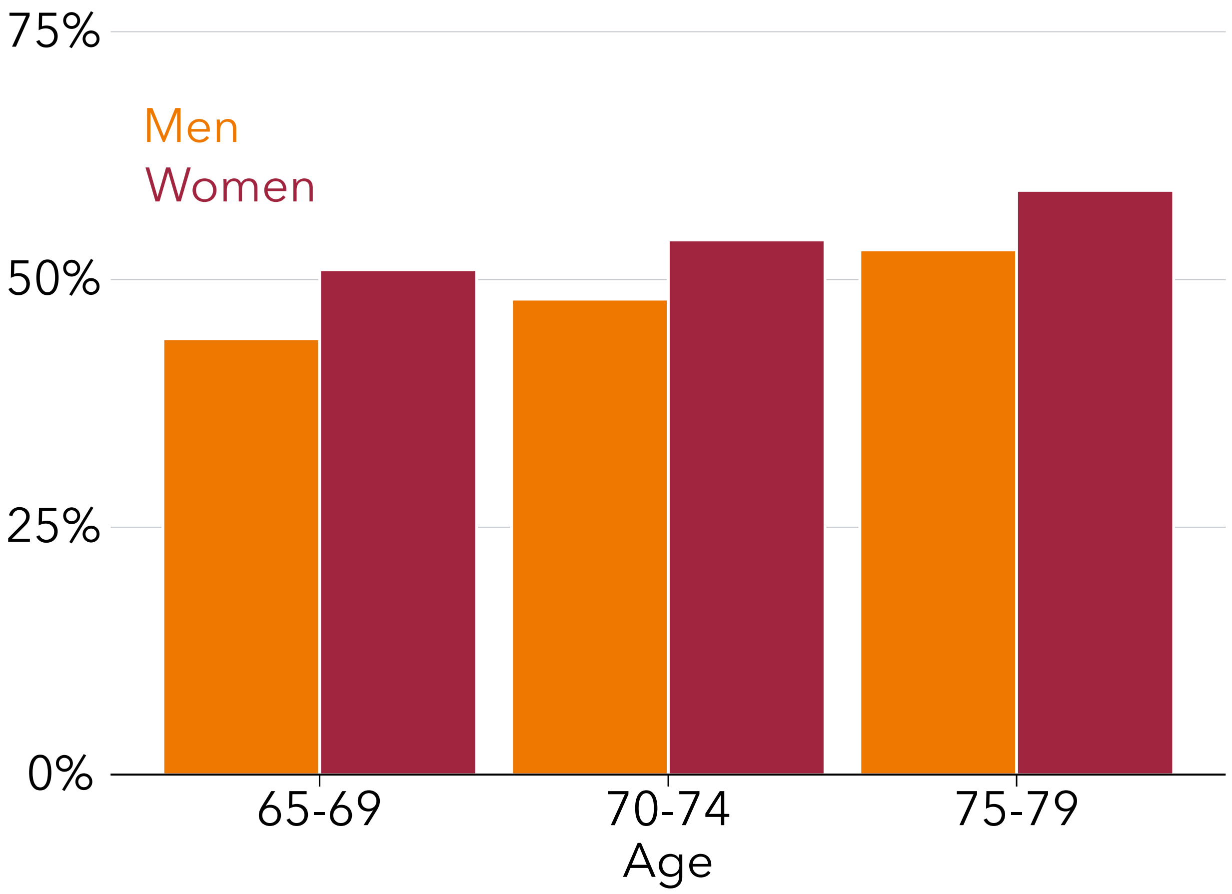
Proportion of people with an ABP drawing at the minimum drawdown rate, by age and gender



Note: Minimum drawdown rates for account-based pensions rise from: 4% annually of the account balance for those aged below 65 years; to 5% for those aged 65-74 years; to 6% for those aged 75-79 years; to 7% for those aged 80–84 years through to 14% for those aged 95 and older. Source: Retirement Income Review (2020, Chart 3B-16).

All super funds offer account-based pensions, and most financial advisers recommend them

- Offer retirees flexibility to access their savings via an income stream + lump sum withdrawals
- Retirees must meet minimum drawdown rates (4% for below 65s → 14% for 95+ years) to qualify for tax-free earnings in retirement

*"Taking an account-based pension is the **course of least action**: it requires, at the very least, the conversion of an accumulation account to a decumulation account within the same superannuation fund and is therefore likely to be associated with the **stickiness of a default.**"*

Bateman and Eberhardt (2024)

Steering retirees only towards account-based pensions leaves a lot to be desired

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Leaves retirees to manage too much risk

- Retirees have to plan spending despite not knowing how long they will live
- Retirees left to navigate volatile investment income (leads to ad-hoc policy making – e.g. minimum drawdown rates)

Retirees don't use flexibility that much

- Flexibility the key benefit of an ABP, but is underutilised
- Half of retirees with super have never made an ad-hoc lump sum withdrawal. PC concludes lump sums are mostly very small balances being emptied.

Minimum drawdowns encourage preservation

- Many mistakenly believe the minimum drawdown rates are a government recommendation
- Leaves ~65%+ of a nominal super balance at retirement as a bequest by average life expectancy

Most other countries design their systems around guaranteed lifetime incomes

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Classification of second-tier contributory schemes, OECD countries

Government

Lifetime income, defined benefit or points
Austria, Belgium, Canada, Colombia, Costa Rica, Czechia, Estonia, Finland, France, Germany, Greece, Hungary, Japan, Korea, Lithuania, Portugal, Slovak Repub., Slovenia, Spain, Switzerland, Turkiye, US

Lifetime income, notional defined-contribution
Demark, Italy, Latvia, Norway, Poland, Sweden

Private sector

Lifetime income, defined benefit or points
Luxembourg

Defined-contribution, compulsory lifetime income
Iceland, Israel, Netherlands

Defined-contribution, pushed / popular lifetime income
Chile, Denmark*, Norway*, Sweden*

Defined-contribution, little lifetime income emphasis
Australia, Mexico, UK

Notes: Second-tier classifications table from OECD (2023, Table 3.1). This means schemes that do not fit into the OECD framework (e.g. NZ's opt-out DC system, various quasi-mandatory occupational schemes) are not included. *Demark, Norway and Sweden appear in both columns of the top row as the OECD classifies them as having both public and private arms to their second-tier. Around two-thirds of Chileans annuitise their DC balance as it is heavily promoted and encouraged, tax benefits make annuities a common option in Denmark's private DC system, annuitisation appears relatively unpopular in Mexico potentially due to the scheme being immature and balances being low, Norway and Sweden's private DC systems have something close to compulsory annuitisation but there is a lot of flexibility of the exact product/type of income stream. The UK removed compulsory annuitisation in 2015. Sources: Grattan analysis of OECD (2023) Pensions at a Glance; Mercer (2024) Pensions Index, and various foreign government websites.

Annuitising super can boost retirement incomes

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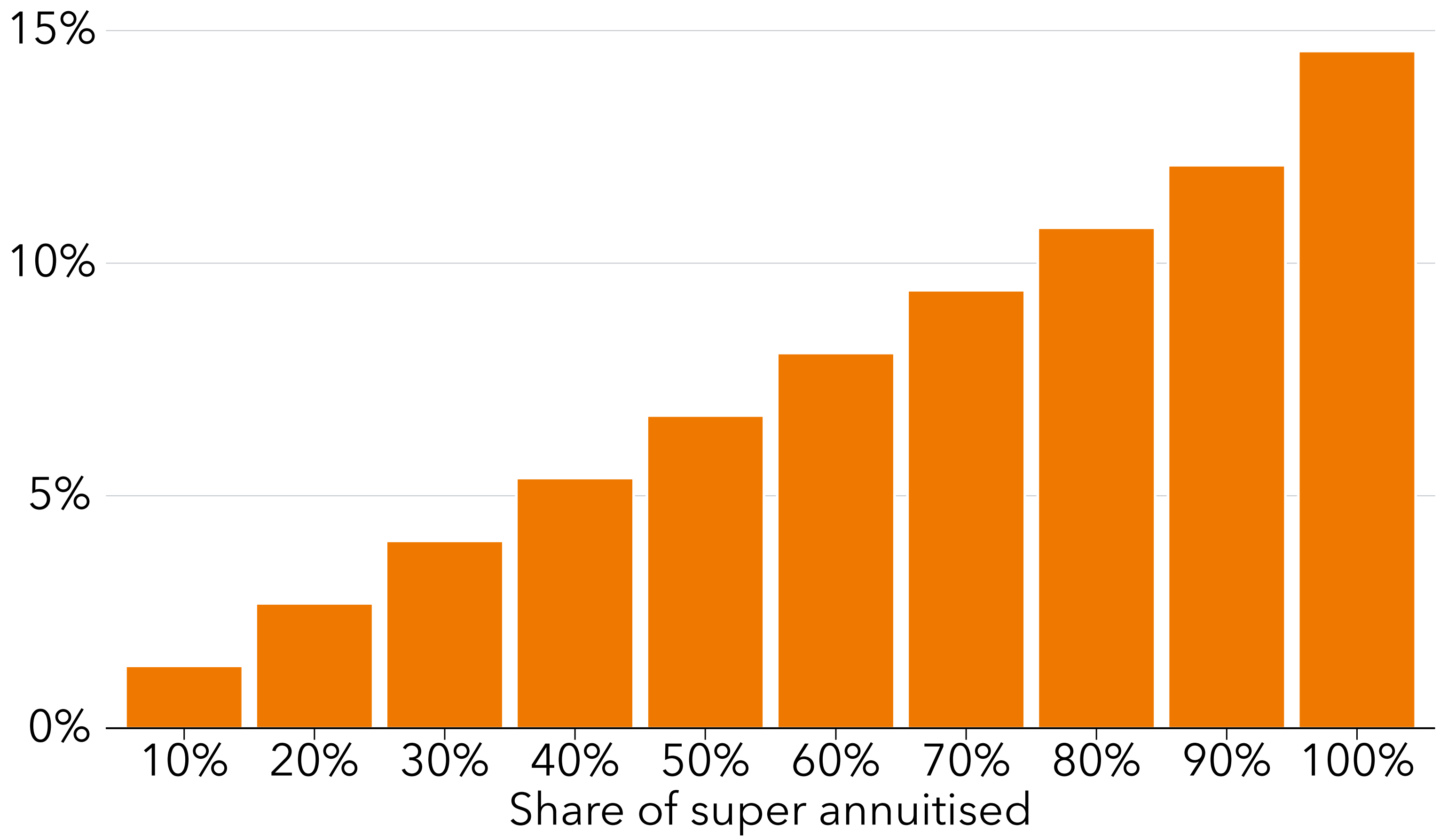
Projected boost to total private retirement income by share of balance annuitised, compared to an ABP at the minimums



"We find that retirees who hold a higher percentage of their wealth in guaranteed income spend more than those whose wealth consists primarily of non-annuitized assets... In other words, ***retirees will spend twice as much each year*** *in retirement if they shift investment assets into guaranteed income wealth."*

Blanchett and Finke (2024)

RETIREMENT INCOME INSTITUTE
Alliance for Lifetime Income

RESEARCH PAPER
JUNE 2024
Retirement Income Institute Original Research-#028-2024

GUARANTEED INCOME: A LICENSE TO SPEND

DAVID BLANCHETT AND MICHAEL FINKE

ABSTRACT

We explore how the composition of retirement wealth is related to retirement spending and find that retirees who hold a higher percentage in annuitized income spend more than retirees with an equal amount of non-annuitized wealth. This result is consistent with traditional economic theory that predicts risk-averse retirees who do not know how long they will live should spend less than retirees who hold an equal amount of annuitized wealth, and with behavioral framing preferences that may make retirees more comfortable spending from income than assets. Marginal estimates indicate that investment assets generate about half of the amount of additional spending as wealth held in guaranteed income, which means that retirees could spend substantially more each year in retirement if they shift investment assets into guaranteed income wealth.

The size of the effect suggests that the explanation for under-spending non-annuitized savings is likely both a behavioral and a rational response to longevity risk. A survey conducted to test behavioral preferences toward income finds that 59.4% of respondents would feel more comfortable spending on nonessential activities if given $10,000 of additional income rather than $140,000 of wealth.

INTRODUCTION

In 2022, 11% of private industry employees in the United States participated in an employer pension and 49% participated in a defined contribution retirement savings plan (Zook, 2023). Workers participating in 401(k)s arrive at retirement with a nest egg of stocks and bonds. Prior studies find little evidence that retirees spend investments down over time in a manner that resembles life cycle theory. If retirees spend less when they contribute to an investment account rather than a pension, this can have a significant impact on retiree welfare and on aggregate spending among older consumers.

Deciding how much to spend each year in retirement from investments is complicated when both the length of retirement and returns on assets are not known. Unknown longevity presents a tradeoff in which a retiree can either spend generously and risk outliving savings, or spend conservatively and live a less enjoyable retirement. A retiree who prefers not to accept the risk of outliving savings will spend less.

An alternative to spending from investments is to transfer the risk of an unknown lifespan to an institution, such as a pension, the federal government, or an insurance company. A rational, risk-averse retiree who does not transfer longevity risk will spend less each year than if they had purchased a fairly-priced income annuity. Economic theory predicts that a retiree with a similar annuitized wealth will spend more than a retiree with an equal amount of non-annuitized savings. The lifestyle that retirees give up by failing to annuitize is referred to by economists as the "annuity puzzle."

There may also be behavioral costs from failing to annuitize. Retirees who are behaviorally resistant to spending down savings may better achieve their lifestyle goals by increasing the share of their wealth allocated to annuitized income. This could take the form of delaying claiming Social Security retirement benefits, choosing a job with an employer pension, or purchasing an income annuity from an insurer. An annuity can not only

Protectedincome.org | 1

Notes: Retires at 67, live to 92. Conversion rates are for a fixed-nominal annuity: 7.08% conversion rate calculated with 4% interest, using the 8th decile IRSAD mortality table to account for adverse selection, with improvement factors applied to 2028 as the base year, and charges admin fees of 0.1% p.a. All other assumptions as per Grattan Retirement Income Projector (see Coates and Nolan, 2020, Balancing Act). Source: Grattan analysis.

Annuitising some super can boost retirees' incomes, while still leaving access to capital

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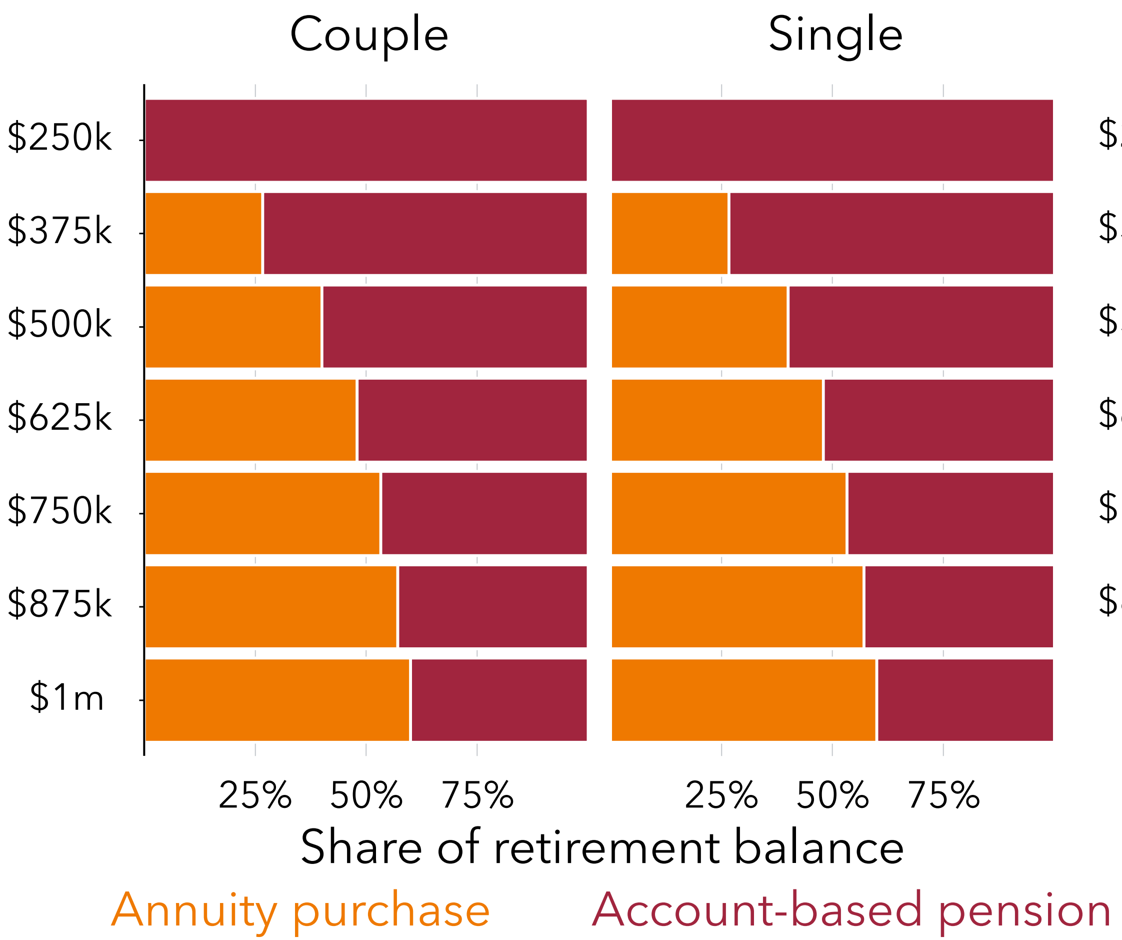
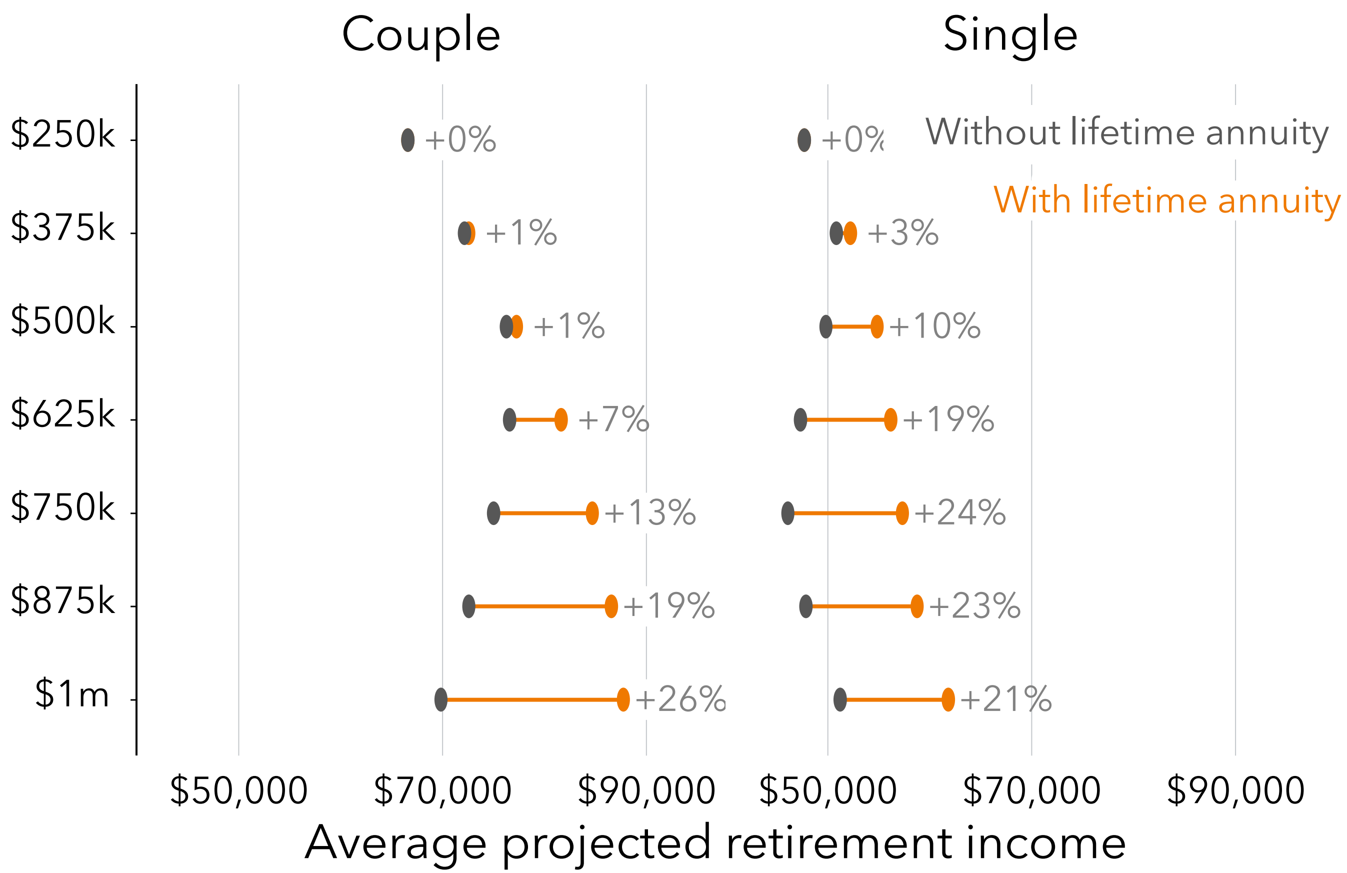
Share of super annuitised if 80% of balances between $250k and $1m is annuitised, by retirement balance



Projected gain in avg total retirement income, if some super is annuitised, by retirement balance, $2024



Source: Grattan analysis.

Notes: Retires at 67, live to 89. Remaining super is an ABP drawn at the minimum. Conversion rates are for a fixed-nominal annuity: 7.08% at 4% interest. Includes 0.1% administration/Govt levy; uses the 8th decile of the female IRSAD sub-group mortality rates to account for potential adverse. AGA improvement factors applied to adjust mortality from 2016 to expected 2028 terms (our base year). All other assumptions as per Grattan Retirement Income Projector (see Coates and Nolan, 2020, Balancing Act). All retirees have a small amount of assessable assets that scales with super.
Source: Grattan analysis.

Annuitising some super can substantially boost *guaranteed* retirement incomes

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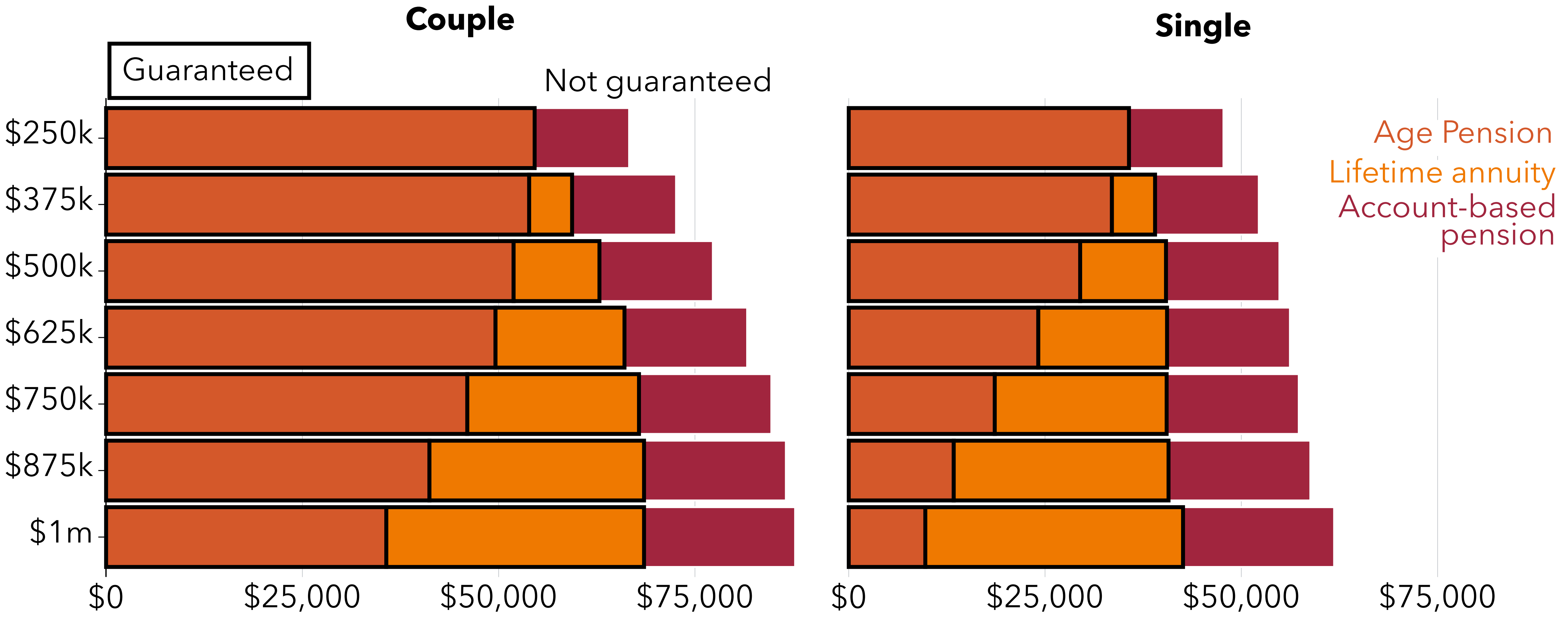
Projected average retirement incomes if some super is annuitised, by sources and retirement balance, $2024



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A Government option is the best way to provide more insured income

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Relying on private annuities is unlikely to be effective

- There are market failures in the annuities market:
  - Consumers struggle to scrutinise and compare lifetime income products – they won't shop around
  - Consumers can't easily switch to a better deal
  - Other countries tend not to rely on demand-driven competition, and those that have have seen poor-value outcomes (e.g. UK).
  - Funds don't want to do it; vetoed CIPRs
- A wholesale process *might* be possible, but won't be simple to design
  - Hard to prevent legacy products
  - Hard to optimise over suite of products
  - Very shallow market of private providers

A government annuity is the best option

- Would encourage take up – less risk of 'getting ripped off' if the govt is offering it + counterparty risk
- Home Equity Access Scheme shows complex financial products can be more popular when offered by Govt
- Economies of scale – prevents repeated fixed costs in private sector
- Government provision of lifetime income common overseas

‘Lifetime Super’ – Govt provided annuities

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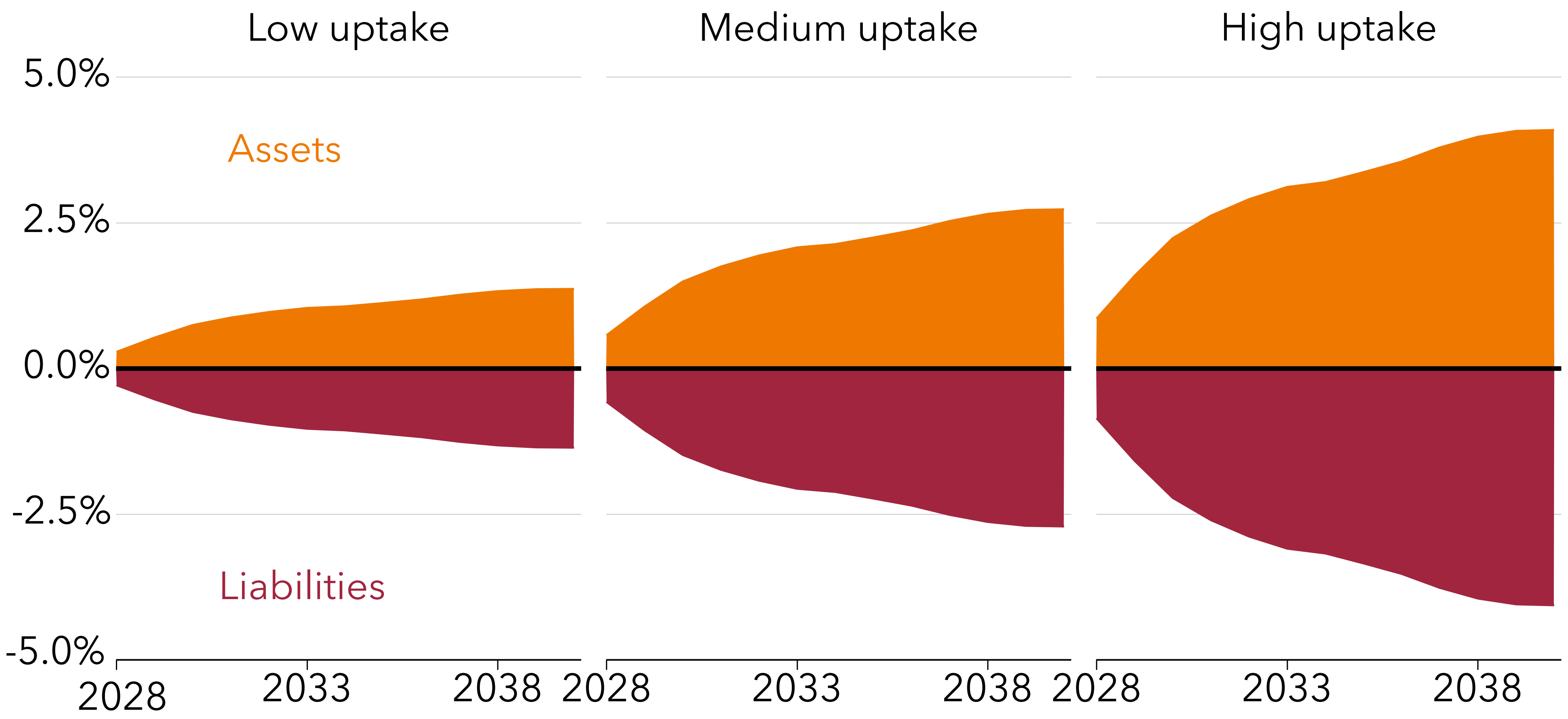
Access	• Available for purchase by anyone over preservation age
Product	• Guaranteed lifetime annuity as a pre-set option • But also offer options for investment-linked annuities etc.
Income path	• Option to draw more income early in retirement to match expected fall in retirees’ spending as they age + expected growth in wage-indexed Age Pension
Safety	• Aim for ‘money back’ guarantee to reduce anxiety • Staggered purchasing to reduce sticker shock
Pricing	• Priced fairly, with regular independent audits
Provider	• Administration at arms-length from government – independent government agency • Asset management overseen by Future Fund • Payments could be bundled with Age Pension and account-based pension for single income stream • Pay levy to account for implicit government guarantee (instead of holding regulatory capital)

Lifetime Super would modestly add to both sides of the Government balance sheet

Projected stocks of Lifetime Super, by uptake scenario, per cent of GDP



- The govt annuity would be **priced fairly**
- Total assets (and liabilities) are projected to be ~**2.5% of GDP by 2040**
- Compares to total projected retirement phase assets of **40% of GDP by 2040**

Notes: Low uptake is 20% of expected new retirees each year with a balance above $250k and 5% of existing retirees with no Age Pension and a balance between $400k and $1.5m purchasing in the first four years of operation. Medium uptake is 40% and 10%. And high uptake is 60% and 15%.Flows of retirees come from 2022-23 ABS Retirement and Retirement Intentions (RRI) survey. Super balances at retirement from 2021 IGR (Figure 7.4.4), interpolated linearly for intervening years. Retirees who take up option annuitised 80% of balances between $250k and $1m. Existing retirees drawn as a share of as retirees with sizable super and no Age Pension, estimated from the ABS SIH. All annuities fixed nominal. Interest rates held constant at 4%. Conversion rates vary by average expected age of retirement for future retirees (from RRI) - 6.42% for a 63-year-old to 11.92% for a 80-year-old.. Includes 0.1% administration/Govt levy; uses the 8th decile of the female IRSAD sub-group mortality rates to account for potential adverse. AGA improvement factors applied to adjust mortality from 2016 to expected 2028 terms (our base year). Nominal GDP is taken from the 2024-25 Budget assumptions, with 5% p.a. applied after 2035. Sources: Grattan analysis of ABS 2022-23 Retirement and Retirement Intentions survey (Table 14.1), ABS 2019-20 Survey of Income and Housing Basic Microdata, AGA Life Tables, Treasury (2021) Intergenerational Report, Treasury (2024) 2024-25 Budget Statement 1.

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A government guidance service – RetireSmart – is needed

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Most people need help with retirement planning

- Annuitisation simplifies things, but the system will remain complex – particularly with the means-tested Age Pension

Many won't trust guidance from their funds

- An impartial government option is needed to ensure no one is left behind

RetireSmart can better cater to couples

- Couples need to plan together, but funds oversee individual accounts

RetireSmart can consolidate current piecemeal help from government

- Various information and services provided across parts of government can be efficiently consolidated
- Better positioned to integrate system (e.g. help with Age Pension access)

Offer general information and advice, but also personal advice

- The system will remain complex – people need personalised answered to their question to get the help they need

The UK Pension Wise service shows the value of a government retirement advice service

Welcome to Pension Wise

Pension Wise is a service from MoneyHelper, backed by government. We offer free, impartial guidance to over 50s. We'll explain the options to take money from your defined contribution pension pots.

Not sure if you have a defined contribution pension? Find out your pension type

During your appointment, we'll explain:

- how each pension option works
- what tax you could pay
- how to look out for scams.

Appointments last **around 60 minutes**.

You can have an appointment if:

- you're **aged 50 or over** and have a **UK-based defined contribution pension pot** (this could be a personal or workplace pension), or
- you've inherited a pension pot or are able to take your pension early due to ill health.

It doesn't matter how small your pension pot is.

Pension Wise is an independent government agency, set up in 2015 following the 'Pension Freedom' reforms.

- **Provides information on options** to over 50s. Does not recommend specific products.
- Pension Wise appointments offered via phone or in person. Offers more than **100,000 appointments annually**.
- Pension providers are **required to refer customers** to Pension Wise, including offering to book appointments on their behalf.
- A large portion of the delivery of Pension Wise is outsourced to non-government organisation, Citizens Advice.
- Cost **$32 million** in 2022-23

30 per cent of people who had accessed their pension pot in the past 4 years had used the Pension Wise service.

The phone service has a customer satisfaction rating of **93 per cent.**

Around **half of users** said they changed how they accessed or intend to access their balance following their appointment.

Many eligible retirees miss out on receiving the Age Pension: RetireSmart could also help retirees apply

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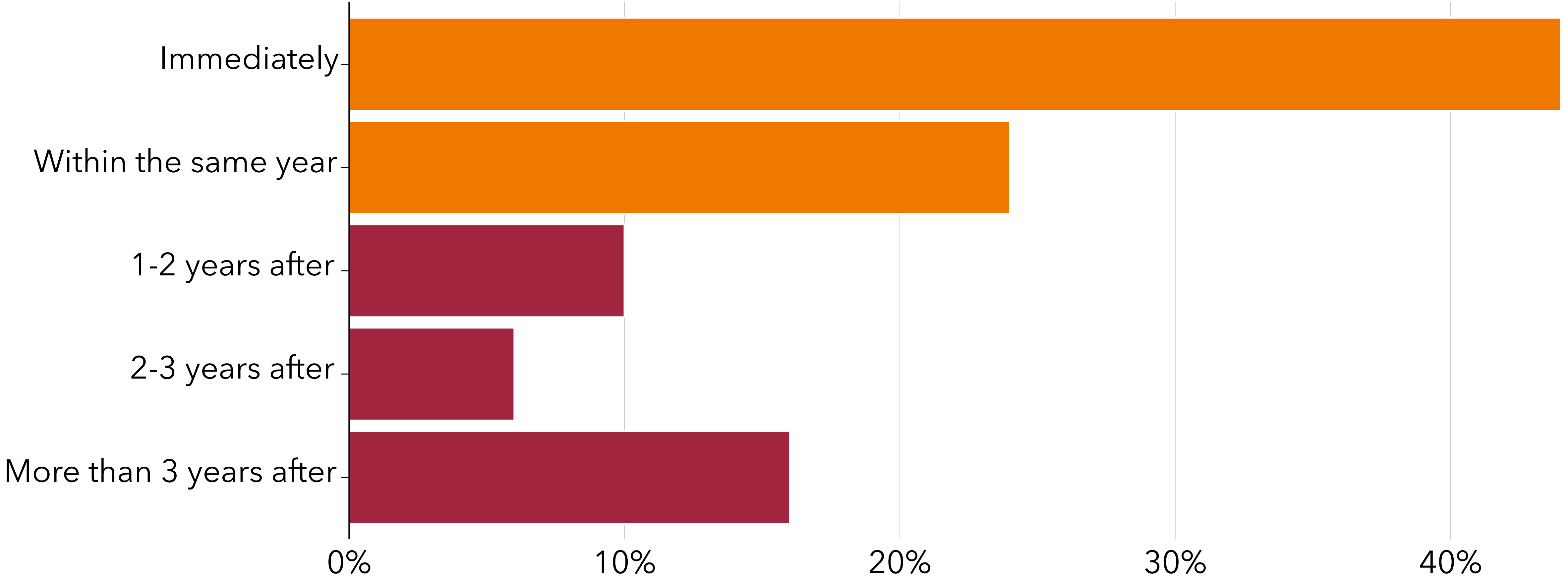
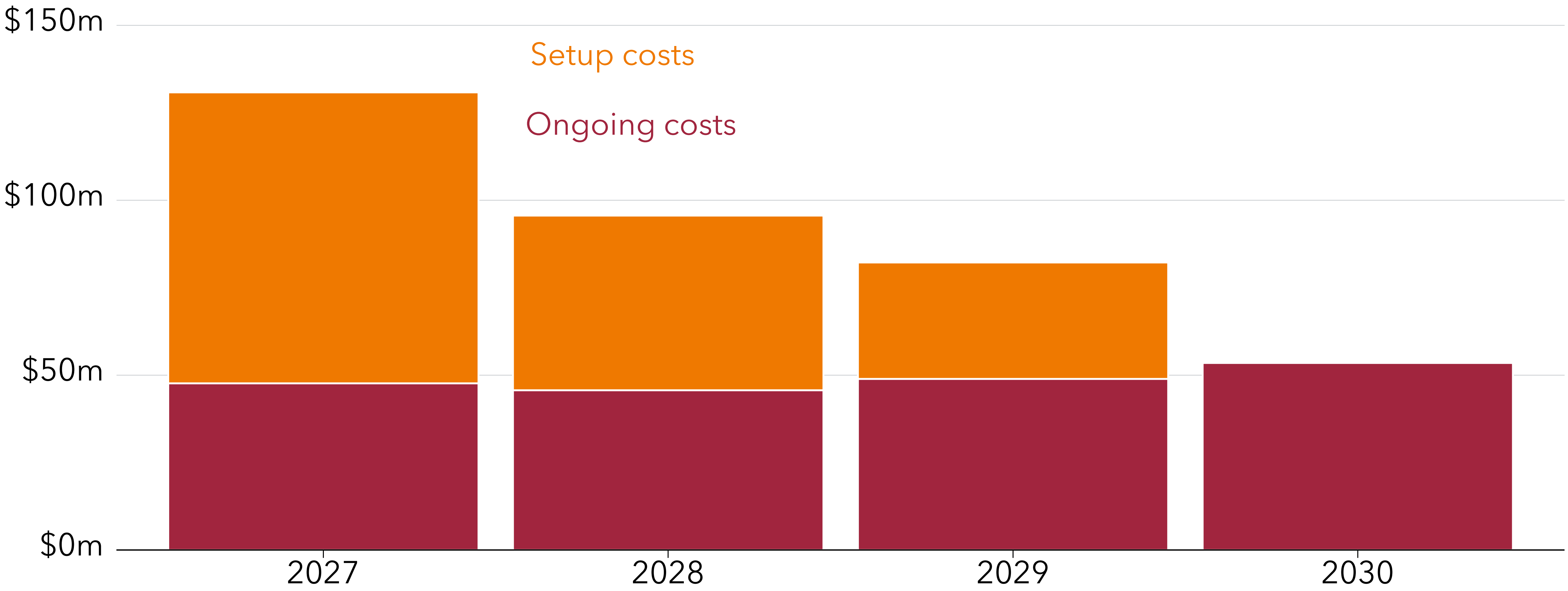
Response to: "How soon after you became eligible did you apply for the Age Pension?"



Source: Link Group (2022)

RetireSmart should cost around $360 million over the first four years, and around $50 million ongoing

Projected cost of RetireSmart, 2027 to 2030



Notes: Assumes 35% of new (from ABS Retirement and Retirement Intentions) and existing (from ABS population; 65+) retirees use the service. New retirees use two long-form appointments (1 hour) approaching retirement, existing retirees use one short-form appointment (15 mins) every five years. Assumes 70% of retirees are in a couple and share an appointment (estimated from ABS 2019-20 SIH microdata). Setup costs are $166m spread across the first three years, but front-loaded. Staff costs are based on 235 work days a year for a full-time worker working 7.6 hours per day, with half of hours spend in appointments, and being paid around $94,000 a year in the first year, increasing by 3.7 p.a. thereafter. This is around 70% of the current average salary of a fully-qualified financial planner (SEEK). Overheads are factored in as a doubling of the wage costs. Sources: Grattan analysis of the ABS 2023-23 Retirement and Retirement Intentions, ABS 2019-20 Survey of Income and Housing Basic microdata, Government News (2022) 'Service NSW - Popular, but expensive', SEEK (2024) Financial Planner Salary.

Simpler super: taking the stress out of retirement

GRATTAN Institute

Super is too complicated for retirees

- Australians find retirement planning stressful and many do not spend their super
- Super in retirement asks retirees to solve an impossible problem: no one knows how long they will live
- The system provides too little guidance – bolder reform is needed

Retirees should be encouraged to annuitise some of their super

- What the system guides people to do matters because they anchor to it. Super guides people towards account-based pensions drawn at the minimum, which leave retirees to manage too much risk
- Retirees should be encouraged to annuitise some of their super – 80% above $250k – to reduce stress and boost spending

The government should offer annuities

- Establishing an efficient private market for annuities at scale would be difficult – government provision is best
- Priced fairly, and managed by an independent agency, a government annuity would encourage take-up since retirees would be more confident that they're getting a fair deal.

The government should give retirees better guidance

- Government should establish `RetireSmart' – a free guidance service

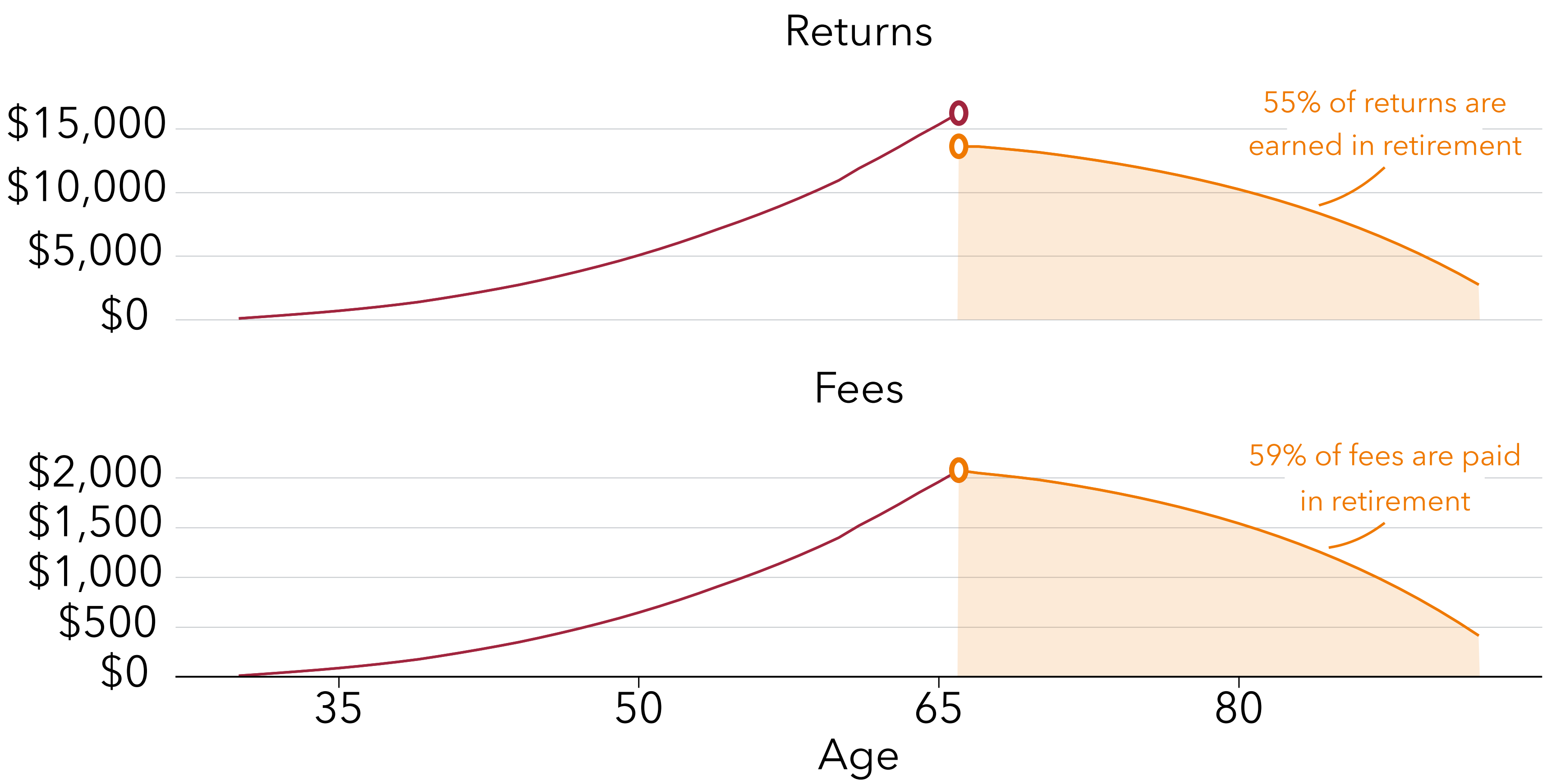
The government should ensure super funds deliver for retirees

- Performance test account-based pensions & develop product assessments
- Establish a top-10 list of the best-performing funds, and steer both retirees (& new workers) into those funds

Australians accrue more than half of their lifetime super returns and fees in retirement

GRATTAN Institute

Annual projected investment returns and super fees incurred for worker aged 30 today, $2024



- Improved working-age super has saved up to **$7b** a year
- Yet, despite the higher stakes, the market design for ABPs **remains much weaker**

Notes: Includes a 1 per cent lower return in retirement as retirees shift towards less-risky investment strategies. In 2010, the Productivity Commission estimated the typical fee for working-age members was 1.25 per cent of assets. By 2023, we estimate it was down to about 0.9 per cent. This represents savings of nearly $7 billion for working-age members in 2023 alone. Grattan analysis of PC (2018) Figure 3.11; and APRA Quarterly Product Stats (Tables 4a, 5a, 6a) and Annual Super Bulletin. Source: Grattan analysis using the Grattan Retirement Income Projector - see Coates and Nolan (2020) Balancing Act.

The performance test is working for accumulation: it can do the same for retirement

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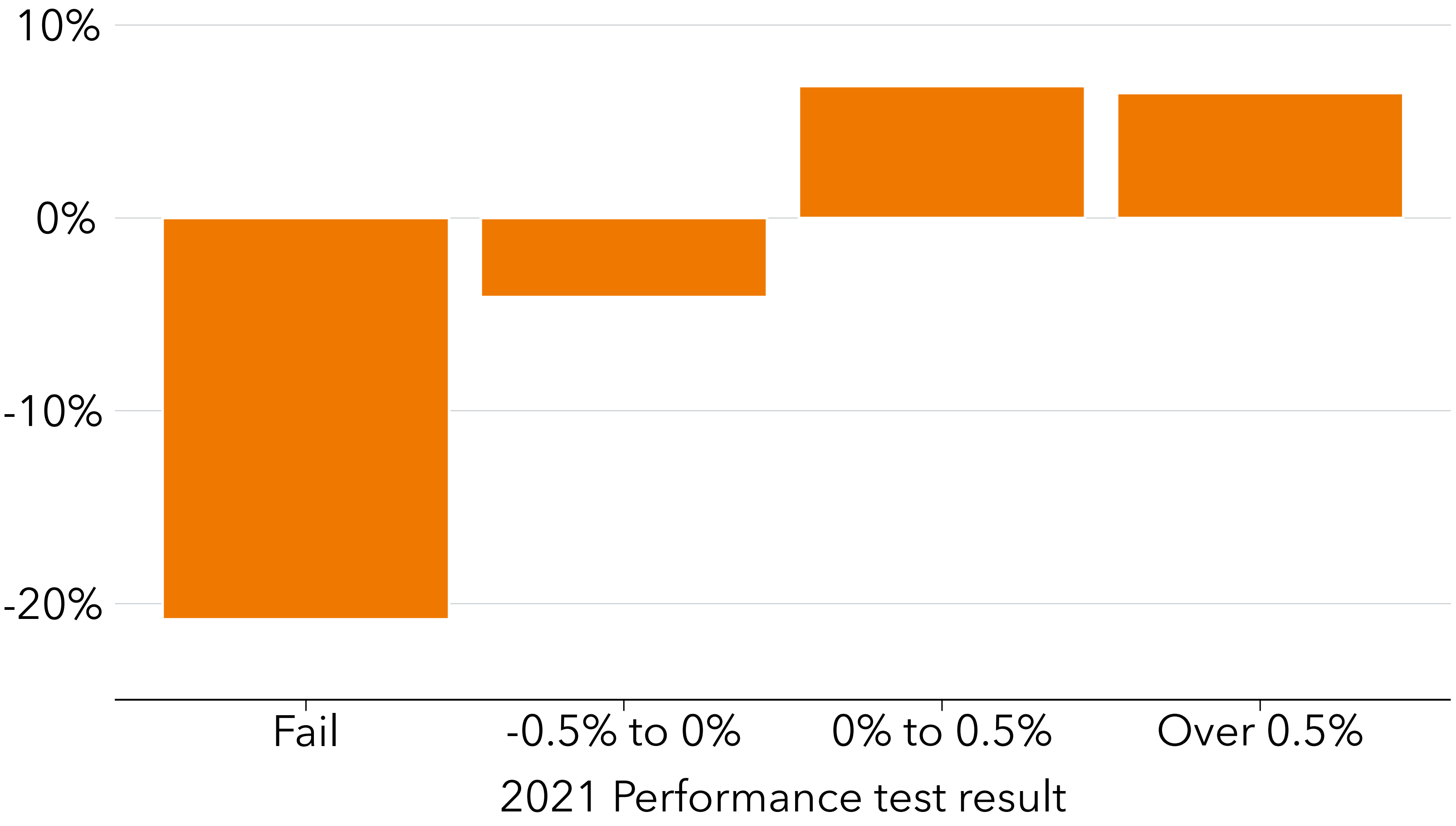
Percentage change in average asset-weighted fees from September 2020 to June 2022, by 2021 performance test result



Bright-line testing works

- Performance testing has saved members upwards of $100 million
- Works for any investment portfolio, including those underpinning ABPs

Tweaks needed for ABPs

- High-quality guidance is not costless – admin fee benchmark should account for it

Other interventions needed

- Extend Product Assessments (formerly `Heatmaps') to all retirement products
- Create comparison tools

Notes: Fees include administration and investment and are as charged on a $50,000 balance. Asset-weighted average uses assets as at September 2020. This period includes the transition to the new fee disclosure regime -- RG97. It is difficult to unpick the effect of this, but the averages across these broad groups are likely to be indicative of 'true' fee changes. Excludes the 4 products not tested in 2021 and products that passed but did not have a performance test metric reported in the 2021 Heatmap. Products that have merged since September 2020 are matched to the June 2022 fees now charged by the receiving product to reflect the fees paid by members. Mergers planned but not yet completed are not factored in. Sources: APRA Quarterly MySuper Data September 2020 to June 2022; APRA MySuper Heatmap 2021.

Implementing ‘Best-in-show’ will improve incentives across the board

An efficiency floor is not enough

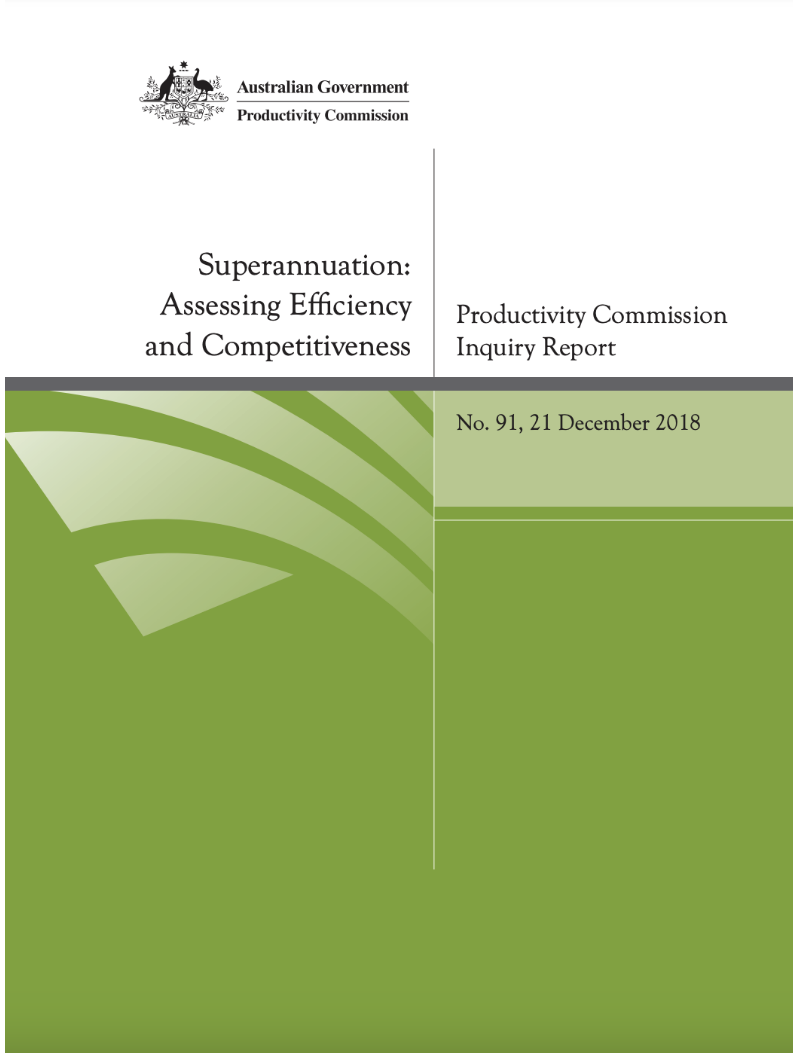
- Performance testing guarantees a floor for ABPs, but doesn’t create incentives for funds to continually improve

A wholesale tender can create a simple, safe choice architecture for retirees

- Retirees face too much choice – there are 64 public-offer funds offering 121 ABPs with at least 866 investment options

Extending `Best-in-show’ to retirement is easy

- Criteria mostly applicable to working-age and retirement
- Include ABP performance, and retirement guidance and services


Australian Government
Productivity Commission

Superannuation: Assessing Efficiency and Competitiveness

Productivity Commission Inquiry Report

No. 91, 21 December 2018

Source: Grattan analysis of APRA Quarterly Product statistics

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