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Simpler super

Taking the stress out of retirement

Brendan Coates, Joey Moloney, and Esther Suckling

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Overview

Australia makes superannuation too complex for retirees.

Most people find retirement planning stressful, despite typically having saved enough for a comfortable retirement. Few retirees draw down on their retirement savings as intended, and many are net savers. This is turning Australia's multi-trillion dollar compulsory superannuation system into a massive inheritance scheme.

For most Australians, retirement represents a big life change. Instead of being paid a wage, retirees must draw an income from their savings, together with the Age Pension. They must do this while managing the uncertainty of how long they will live and how their investments might perform, as well as navigating the complex interactions of their savings with the means-tested Age Pension. And they have to try get value for money from their super fund.

This puzzle is too hard for retirees to solve alone. Many other countries automatically offer retirees an income that lasts the rest of their lives, but Australian retirees get little guidance about how to use their super. While we're working, key decisions about our super are typically made for us – such as how much to contribute and how those savings are invested. But once we retire, the super system casts us adrift.

The little guidance retirees do receive is unhelpful, steering them into account-based pensions, which require them to manage their spending to avoid the risk of outliving their savings. Half of those using an account-based pension draw their super at the legislated minimum rates. This leaves 65 per cent of super balances unspent by average life expectancy. And despite the higher stakes, account-based pensions are less well-regulated than the products offered to working-age Australians.

Three key reforms are needed to simplify super in retirement.

First, retirees should be encouraged to use a portion of their super to buy an annuity from the government, which would pay an income that lasts retirees' the rest of their lives. Retirees should be guided, by both the government and their super fund, to use 80 per cent of their super balance exceeding $250,000 to purchase an annuity. This reform could boost retirees' incomes by up to 25 per cent, while also ensuring that the bulk of retirees' incomes, irrespective of their super balances, would be guaranteed to last the rest of their lives. Retirees remaining super would be drawn via an account-based pension, giving them flexible access to capital.

Second, Australians need better guidance to plan their retirements. The government should establish a free service that 'sums-the-parts' of the retirement income system for retirees (and people approaching retirement). This service should aim to advise at least one-third of new retirees, and would cost about $360 million over its first four years and $50 million a year thereafter, which should be funded by a levy on super fund balances.

Third, the government should create a list of the top 10 super funds, selected by an independent expert panel, and then steer retirees towards those funds. The performance test and comprehensive assessments of fund performance by APRA (the Australian Prudential Regulation Authority) should be extended to account-based pensions. These reforms could boost the incomes of future retirees who continue to opt for an account-based pension by up to $70,000 over their retirement.

This report charts the path to a simpler super system that lets retirees stress less, spend more, and truly enjoy their retirement years.

Recommendations

1. Encourage retirees to take-up a government annuity

The federal government should encourage retirees to annuitise a portion of their super. Retirees should be guided, by both the government and their super fund, to use 80 per cent of their super balance exceeding $250,000 to purchase an annuity.

Retirees should be guided into a simple lifetime annuity, which would provide a guaranteed level of income for the rest of their lives, and which should be offered by the federal government.

The government should also offer a range of annuities, including an investment-linked annuity.

2. Establish a government guidance service

The government should establish a free retirement guidance service. This service should provide general and personal advice that helps people plan and ultimately spend their retirement incomes with confidence. The service should also assist eligible retirees to apply for the Age Pension.

3. Performance test account-based pensions

The government should extend the *Your Future, Your Super* performance test to account-based pensions.

4. Publish assessments of all account-based pensions

The government should ask APRA to develop and publish performance assessments of account-based pensions in its Comprehensive Product Performance Package (formerly known as ‘Heatmaps’).

5. Guide Australians towards the best super funds

The government should create a list of the top 10 super funds, selected by an independent expert panel.

Funds should be selected on their capacity to deliver strong risk-adjusted returns in the long term, sound governance, and their capacity to provide the best guidance and advice.

People should be steered to these funds as they approach retirement, and new workers should be assigned to these funds upon entering the workforce (although people would retain the right to choose another fund).

6. Publish assessments of private annuity products and develop a product comparison tool

The government should ask APRA to develop and publish performance assessments of private annuity products in its Comprehensive Product Performance Package (formerly known as ’Heatmaps’), and the government should create an independent product comparison tool to help people compare products.

7. Empower funds to offer more personal advice, but only after the market design for retirement super has been improved

The government should follow-through on plans to expand the scope of super funds to provide personal advice to their members – but only after account-based pensions are performance tested, and all retirement products are included in APRA’s performance assessments.

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1 Super is too complicated for retirees

Australia makes superannuation too complex for retirees.

Most people find retirement planning stressful, despite having enough savings for a comfortable retirement. Few retirees draw down on their retirement savings as intended, and many are *net savers*. This is turning Australia's multi-trillion dollar compulsory superannuation system into a massive inheritance scheme.

For most Australians, retirement is a big and complicated life change. Instead of earning a wage, retirees must draw an income from their savings, managing the uncertainty of how long they will live and how their investments may perform, and navigating the complex interactions with the means-tested Age Pension.

This puzzle is too hard for retirees to solve alone. While we are working, key decisions about our super are made for us – such as how much to contribute each year to super and how those savings are invested.

But once we are retired, the super system casts us adrift. Retirees in Australia are offered almost no guidance on how to use their savings to fund their retirement.

Governments have been slow to comprehend the scale of this problem. Bold reform is needed.

1.1 More retirees are depending on their super to fund their retirement

About 200,000 Australians retire each year.[1] For the first time, many Australians are entering retirement with significant super balances. In 2019-20, Australians were retiring with an average super balance of more than $200,000, and couples about $300,000 (Figure 1.1 on the following page).

1. ABS (2024a, Graph 3).

In 2022-23, 34 per cent of Australians who had retired in the past five years reported super as their main source of income, compared to 28 per cent who said it was the Age Pension. Less than a decade ago, in 2014-15, 28 per cent of those who had retired in the five years prior reported super as their main source of income, and 38 per cent said it was the Age Pension.[2]

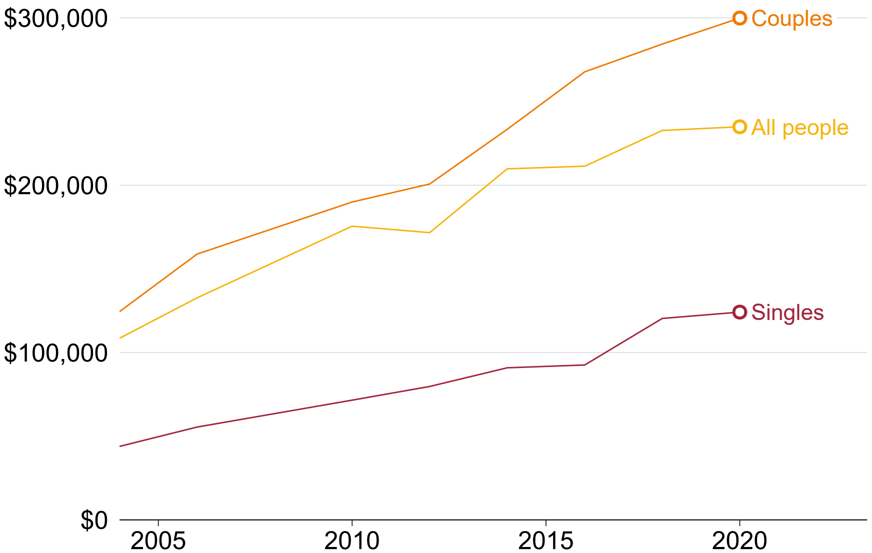
Today's pre-retirees anticipate super will play an even larger role in their retirement. In 2022-23, 60 per cent of people who planned to retire in the next five years said they expected super to be their main source of income.[3]

1.1.1 Retirees' reliance on super will only grow as the super system matures

The ageing of the population means retiree ranks will swell in the coming decades. The number of Australians aged 65 and older is projected to surpass 10 million by 2050.[4] By 2062-63, nearly one-in-five Australians will be a retiree drawing down their super, compared to less than one in 10 today.[5]

2. ABS (ibid, Table 6). 'Super' includes 'superannuation, an annuity, or private pension'. 'Age Pension' used as shorthand for 'government pension or allowance', which can include other transfer payments.
3. ABS (ibid, Table 10).
4. ABS (2023, Table B9).
5. Australian Government (2023a, p. 166).

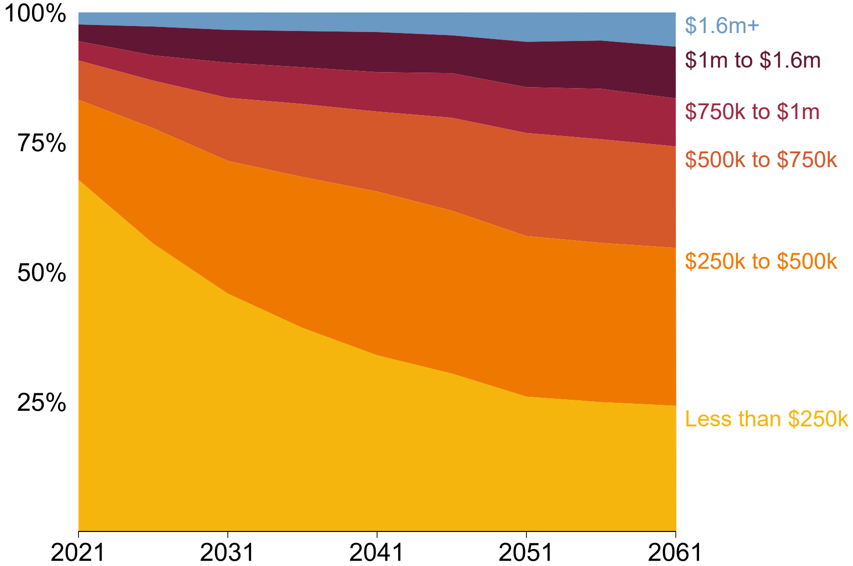
Figure 1.1: Australians' super balances at retirement age have grown substantially
Real average super balance for households and people aged 55-65, 2019-20 dollars



Notes: Household age measured as the age of the household reference person. Multi-family and group households filtered out. Includes individuals with no super, which leads to lower averages than those calculated using ATO or APRA data.

Sources: Grattan analysis of ABS (2006), ABS (2008), ABS (2012), ABS (2014), ABS (2016), ABS (2018), ABS (2020), ABS (2022a), and ABS (2024b).

Figure 1.2: Super balances will continue to grow
Projected distribution of balances at retirement



Notes: Values are in 2020-21 dollars and deflated by average weekly earnings.

Source: Australian Government (2021, Chart 7.4.4).

The number of retirees with substantial super balances will continue to grow as Australia's population ages and the super system matures (Figure 1.2 on the previous page).

About two-thirds of Australians who retired in 2020-21 had a super balance of less than $250,000. By the early 2040s, most Australians will retire with at least $250,000 in their super (in today's dollars), and by the 2060s many Australians will be retiring with nearly $500,000 in their super. By that time, retirement-phase assets will total $2.3 trillion in today's dollars, or 65 per cent of GDP.[6]

At the same time, the share of retirees on the Age Pension is projected to fall from 71 per cent in 2023 to 57 per cent by 2063. The share on the full pension will fall from 44 per cent to 21 per cent.[7]

These changes mean that retirees' living standards will increasingly depend on how they use their super in retirement.

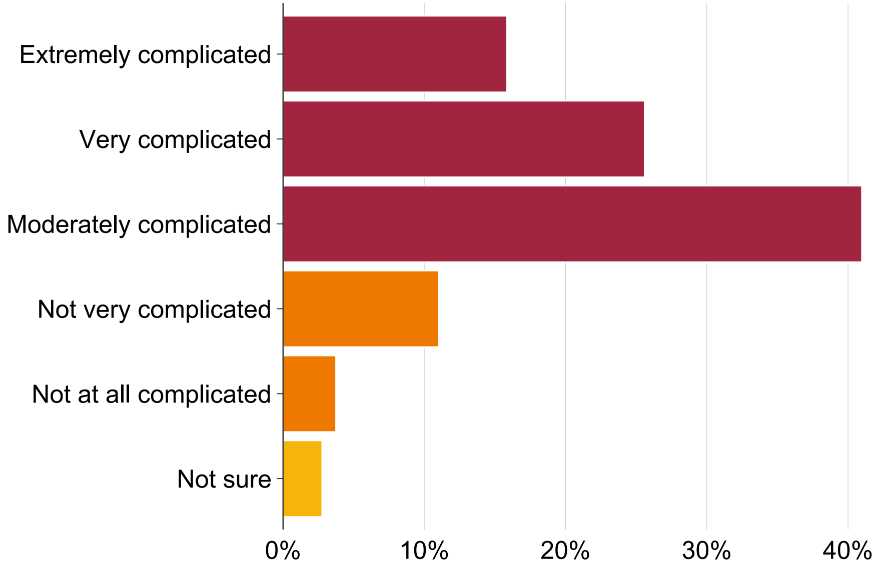
1.2 But most Australians find retirement planning stressful

Four-in-five pre-retirees find retirement planning complicated, with 40 per cent finding it 'very' or 'extremely' complicated (Figure 1.3). Well over half of Australians older than 50 report being worried about their retirement incomes.[8] In a recent survey by CHOICE, 61 per cent of respondents said they didn't believe their retirement would be financially stress-free.[9]

These survey results come despite the fact that, objectively, retirees typically have the financial resources to enjoy a comfortable retirement.

For instance, past Grattan Institute work has shown that retirees feel more comfortable financially than younger Australians who

Figure 1.3: Retirement planning is a challenge for most
Response rates regarding retirement planning, 2020



Note: Retirees were asked 'how complicated has it been to plan for your retirement?' and pre-retirees were asked 'how complicated do you think it will be to plan for your retirement?'.

Sources: CHOICE (2020).

6. Australian Government (2023a, Chart 7.19).
7. Australian Government (ibid, Chart 7.20).
8. NSA (2020, Figure 1 and page 18).
9. CHOICE (2020).

are working.[10] The 2020 Retirement Income Review tells a similar story, concluding that most recent retirees have adequate retirement incomes. And surveys suggest retirees generally have higher levels of financial satisfaction and lower rates of financial stress than working-age Australians.[11]

Where it arises, retirees' stress appears to be driven by concerns about *risks* to their living standards in retirement, such as whether their savings will last, and the challenge of managing complicated financial affairs in retirement.[12] Self-managing these complicated risks is stressful, particularly for middle-income retirees managing the interaction between super and the means-tested Age Pension. Qualitative research concluded that this cohort tended to be 'anxious about their futures and struggled to cope with some of the fundamental uncertainties and risks they might face in the future'.[13]

1.2.1 Few retirees spend their savings

Many retirees sit on their retirement savings rather than spend them. This is despite surveys showing that bequests are a low priority.[14]

Our analysis of the ABS Survey of Income and Housing shows that the generation of wealthier Australians who hit retirement in the early 2000s had, on average, maintained or increased their non-housing wealth through their retirement (Figure 1.4 on the next page).

For instance, the super savings of the wealthiest fifth of 60-64 year-olds in 2003-04 had increased by 58 per cent in real terms (i.e. adjusted for inflation) by the time they were aged 76-80 in 2019-20, and their total financial wealth (i.e. excluding the equity in their home) rose by 12 per cent. The real super balances of middle-income retirees fell by 25 per cent over these 16 years, but their total financial wealth still rose by 10 per cent. Whereas lower-income retirees – who mostly had little super to start with – tended to withdraw most or all of their super. Overall, the average super of all 60-64 year-olds in 2003-04 grew by more than 37 per cent in real terms by 2019-20, and their average net financial wealth grew by 14 per cent.[15]

These findings are consistent with a range of other studies all showing that many retirees don't draw down on their retirement savings.[16] For example, 2015 federal government data show that less than half of all pensioners draw down on their assets, and more than 40 per cent are net savers.[17] Claims by the super industry that most retirees spend their super down by the time they die are misleading.[18]

There are many reasons why retirees typically don't spend their retirement savings. As the Retirement Income Review concluded:[19]

> Retirees are generally reluctant to draw down their savings in retirement due to complexity, little guidance, reluctance to consume funds that are called 'nest eggs', concerns about possible future health and aged care costs, and concerns about outliving savings.

10. Coates and Nolan (2020).
11. Callaghan et al (2020, p. 19).
12. NSA (2024), NSA (2023), and NSA (2020).
13. Austen et al (2022, pp. 748–749).
14. See Callaghan et al (2020, Box 5a-4) for a review of the survey literature.
15. Retirees' spending needs tend to fall by 15-to-20 per cent through retirement, but this does not explain why savings tend to grow in real terms. See Coates and Nolan (2020, pp. 39–40).
16. See Coates and Nolan (2020, Section 1.6) and Callaghan et al (2020, pp. 432–438).
17. Morrison (2015).
18. Research from the the Association of Superannuation Funds of Australia (ASFA) – a lobby group for super funds – found that '80 per cent of people aged 60 and over and 90 per cent of those aged 80 and over who died in the period 2014 to 2018 had no super in the period of up to four years prior to death': ASFA (2021). But many people who died in this period would not accumulated much in super to begin with (especially older generations of women). Further, retirees are incentivised to shift money out of super late in life to avoid paying tax on death benefits.
19. Callaghan et al (2020, p. 19).

1.3 Managing super in retirement involves making big, complex decisions

While they are working, super is simple for Australians – contributions are made and invested on workers' behalf, and their balance builds. But once they are retired, Australians' super balances must be managed while trading off between three very different objectives:

1. Maximising the income they receive over their retirement.
2. Insuring that income against various risks. Most importantly, this includes the risk of outliving one's savings (longevity risk). It also includes the risk that their investments perform worse than expected (investment risk), and the risk that living expenses rise faster than expected (inflation risk).
3. Maintaining some flexible access to their capital, to pay for unexpected or 'lumpy' items such as a new car, house maintenance, or health and aged care expenses.

In practice, retirees must choose between these objectives. For example, maximising the income you draw from your super can mean leaving less as a backstop against longevity and investment risk. Alternatively, using some super to buy an annuity that protects against these risks means giving up some flexible access to capital.

It's no wonder Nobel laureate William Sharpe described drawing down retirement savings over an unknown time horizon as the 'nastiest, hardest problem in finance'.[20]

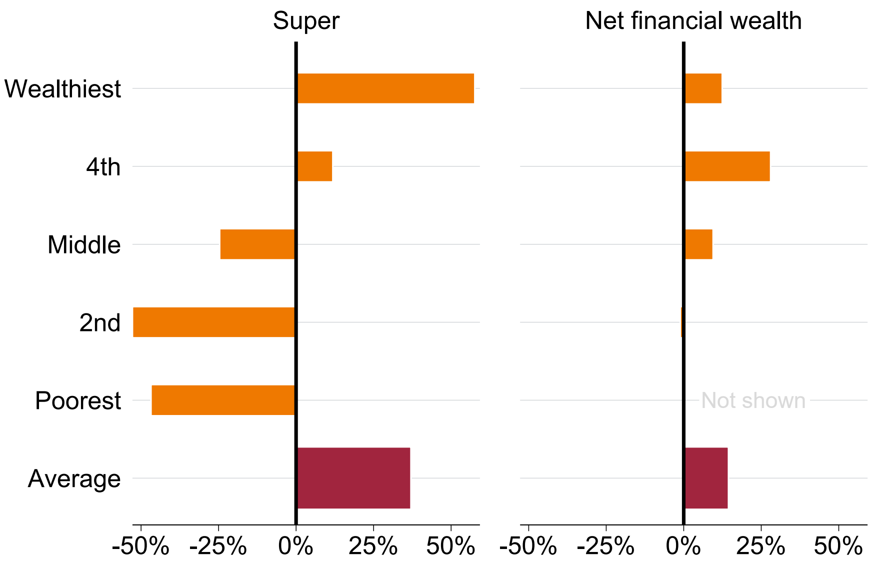
1.4 Australia's means-tested Age Pension further complicates retirement

Australia is unique in having a means-tested Age Pension that involves relatively generous payments and a taper rate that extends at least

20. Ritholtz (2017).

Figure 1.4: Wealthier retirees are net savers, and most retirees don't spend their financial wealth

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



Notes: Analysis takes cross-sectional samples in 2003-04 and 2019-20, matching by the change in age over this period. Net financial wealth is net wealth less the value of the primary residence, loans outstanding on the primary residence, and the value of home contents and 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. Analysis subject to survivor bias, because poorer retirees would have had higher mortality (although this is partially accounted for via the use of quintiles).

Source: Grattan analysis of ABS (2006), ABS (2022a), and ABS (2024b).

a part pension to most retirees.[21] Currently, 58 per cent of over-65s receive the Age Pension, rising to 69 per cent among over-70s.[22]

Australia's Age Pension is subject to not one but two means tests – an assets test and an income test – with the test that gives the lower rate of pension applied.[23] Therefore, how much a retiree saves and spends affects their future Age Pension entitlements in ways that are hard for retirees to predict.

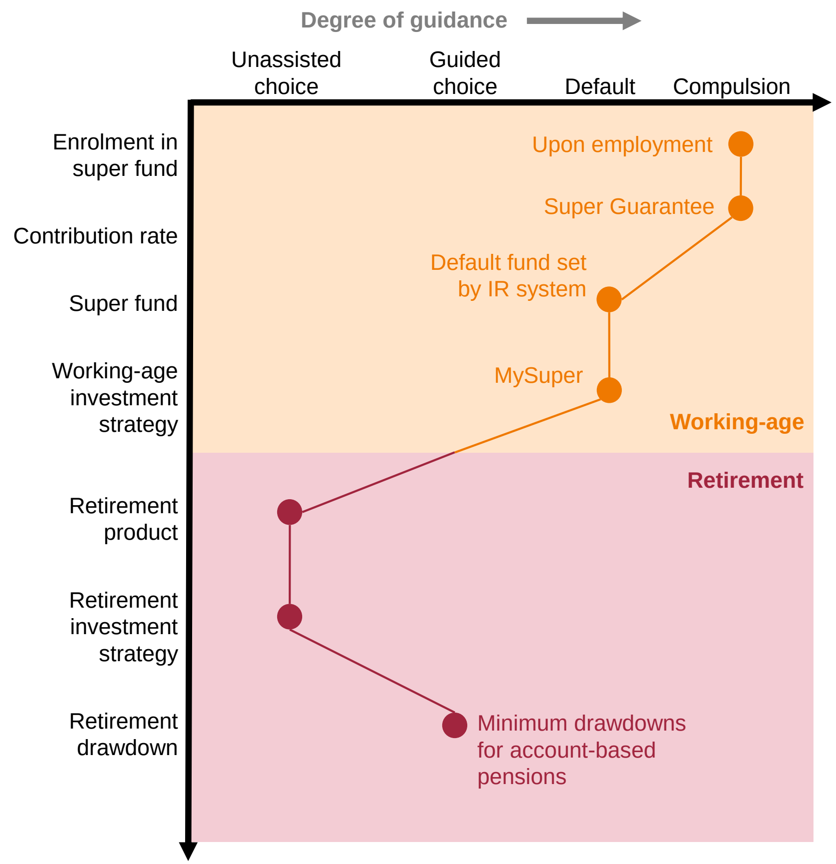
1.5 Yet our super system offers little guidance to retirees

Most Australians go their entire working lives without making any big decisions about their super. They are automatically enrolled in a super fund when they start work, and their employer is compelled to contribute 11.5 per cent of their wages to that fund (increasing to 12 per cent from 1 July 2025). Australians typically don't choose their fund or investment strategy, but rather are allocated to these via system defaults.

But once Australians retire, the system casts them adrift. Retirees are offered almost no guidance on how to use their savings to fund their retirement (Figure 1.5). In contrast, retirees in many wealthy countries are automatically given, or otherwise strongly encouraged to choose, a guaranteed income for life once they retire.[24]

21. OECD (2023a, pp. 134–136).
22. The Age Pension is available from age 67: AIHW (2023a).
23. In practice, most people are subject to the income test, with the assets test applying to those with more significant wealth: Callaghan et al (2020, pp. 51, 465). The bulk of the value of owner-occupied housing is excluded from the assets test, and such housing is completely excluded from the income test.
24. See Appendix B on page 54. A minority of Australian retirees are enrolled in defined-benefit super schemes, which were historically offered by federal and state governments and some large corporate employers. These schemes offer retirees a guaranteed superannuation pension, typically linked to their years of service and final salary, but have largely been phased out due to their cost. Mees (2020).

Figure 1.5: Retirees get much less guidance than workers about super
Decision-making in Australia's super system



Source: Grattan adapation of CEPAR (2020, Figure 1).

This matters because most people follow the guidance they get (Chapter 2 on page 15). And the super system steers people into treating their superannuation as a 'nest egg' to be protected rather than drawn upon.

1.6 Australia's compulsory superannuation system is becoming a massive inheritance scheme

Stressed retirees sitting on super rather than spending it means the system is on track to generate bigger and bigger bequests. Without the confidence to spend, much of what Australians have been forced to save will be passed onto the next generation, turning compulsory super into a massive inheritance scheme. The 2020 Retirement Income Review projected that by 2059, $1 in every $3 that's paid out of the super system will be a death benefit, compared to $1 in $5 today.[25]

Inheritances tend to transmit wealth to people who are already well-off. Big inheritances boost the jackpot from the birth lottery. Among those who received an inheritance over the past decade, the wealthiest 20 per cent received on average three times as much as the bottom 20 per cent.[26] One study estimates that 10 per cent of all bequests will account for as much as half the value of bequests from today's retirees.[27]

1.7 Bolder reform is needed to help retirees make the most of their super

The Retirement Income Covenant (the 'RIC'), adopted in 2022, places a legal obligation on funds to develop a 'Retirement Income Strategy', declaring the products and services they will provide to help their members achieve their retirement objectives across income, risk management, and access to capital.

The government has also announced plans to adopt reforms to financial advice rules stemming from the 2023 Quality of Advice review (the 'Levy review'), to free-up funds to provide more personal guidance.[28] These include legislating a new class of advisor that can be employed by super funds and provide personal advice on a narrower set of topics than existing advisers, and broadening the scope of what advice can be 'collectively charged' to all members.[29]

And in response to a Treasury consultation in 2024, the government has announced plans to boost the information and tools available to help Australians plan for retirement, alter the regulation of income stream products to allow for more flexible product features, develop voluntary best-practice principles for income stream products, and introduce a new reporting framework covering outcomes for retirees.[30]

But these initiatives are not sufficient. They might improve fund offerings for some, but they fall short of the more systemic changes needed to improve retirement outcomes for all.

The RIC bestows no concrete expectations on funds, and lacks any real penalty for funds that don't take it seriously. Unsurprisingly, implementation of the RIC by super funds has been patchy.[31]

Freeing up funds to give more financial advice *might* help a few retirees who are lucky enough to be in a fund that does it well. But relying on more financial advice alone to help retirees navigate such a complex system will prove less effective, and more expensive, than simplifying

25. Death benefits include money left to spouses, but inheritances to children will probably grow at a similar pace: Callaghan et al (2020, p. 435).
26. Wood et al (2019). In particular, super is likely to be more unequally distributed than other assets, such as owner-occupied housing, since super tax breaks favor wealthier Australians. Daley et al (2018, Figure A.2).
27. Productivity Commission (2021, Figure 3.2).
28. Levy (2022, Section 1.5.2 and Chapter 7).
29. Australian Government (2023b).
30. Australian Government (2024).
31. APRA and ASIC (2023), and APRA and ASIC (2024).

the choices retirees face in the first place. Further, loosening the regulation of financial advice is dangerous without better consumer protections in place. The most recent announcements are small steps in the right direction, but do not match the magnitude of the problems. Overall, current policy direction is asking too much of private financial advice to overcome the systemic flaws in the super system (Box 1).

Bolder reform is needed to simplify super in retirement and offer clearer guidance to retirees. Successive governments have largely compelled more than $4 trillion in super savings, and the system has a legislated objective to:

> ...preserve savings to deliver income for a dignified retirement, alongside government support, in an equitable and sustainable way.

But the purpose of any system is ultimately what it does, not what policymakers might want it to do. The government should do more to ensure the super system delivers on its promise of a more comfortable retirement for all Australians.

1.8 A guide to this report

This report shows what the government needs to do to ensure the super system is simpler for retirees, so they have the confidence to spend their savings and make the most of their retirement years.

Chapter 2 recommends that retirees be encouraged to turn some of their super savings into an annuity, which offers an income guaranteed to last for their rest of their lives.

Chapter 3 recommends that the government offer that annuity.

Chapter 4 recommends that the government establish a free government-run financial advice service to help retirees plan and manage their retirement finances.

Box 1: Financial advice can't do it alone

There is some evidence that the few retirees who engage financial advisers are more confident and less stressed.[a] But extending these benefits to all retirees is asking too much of private financial advice for three key reasons.

First, there are currently only about 16,000 financial advisers in Australia, down from a peak of 28,000 in 2018. And the Quality of Advice review estimated the cost of advice at between $2,000 and $4,000.[b] One survey found that nearly three-quarters of people who do not use advice cite cost or value-for-money concerns.[c]

Second, a lack of trust and concerns over advice quality, are also big problems. Almost half of respondents to another survey thought financial advisers were more interested in helping themselves than their clients.[d]

And third, financial advisers appear reluctant to help retirees to manage longevity, investment, and other risks in retirement in any case. In the UK, research found that only 13 per cent of retirees who sought private professional advice bought an annuity, compared to 54 per cent of those who received independent, state-funded advice, and 42 per cent of those who received no advice at all.[e] Financial advisers typically forego ongoing fees for managing retirees' capital if their clients choose annuities – a problem known as 'annuicide'.[f]

a. See Callaghan et al (2020, p. 451). The few Australians who get professional financial advice tend to be wealthy. See CHOICE (2020), AMP (2023), and NSA (2023).
b. Grattan analysis of ASIC (2024) and Levy (2022, p. 44).
c. ASIC (2019).
d. Conexus Institute (2022) and ASIC (2019).
e. Asher (2020, p. 10).
f. Leiber (2010) and Callaghan et al (2020, p. 439).

And **Chapter 5** recommends that government better regulate super funds in retirement, including via performance testing account-based pensions and establishing a top 10 list of the best super funds.

1.9 What this report is not about

This report is not about the adequacy of retirement incomes. Previous Grattan Institute work has shown that most retirees are on track for a comfortable retirement, especially if they draw on their retirement savings as intended.[32]

This report does not consider structural reforms to the Age Pension to simplify the retirement income system. Past Grattan Institute work has considered changes to Age Pension and superannuation access ages.[33] Nor does it consider whether the current means test treatment of income stream products is optimal. Future Grattan work may consider reforms to the Age Pension means test.

This report does not consider health and aged care funding and policy design. While the design of these systems affects retirees' spending and savings decisions, these issues are beyond the scope of this report.

This report is not about the taxation of superannuation savings. Investment earnings are tax-free once Australians retire and begin drawing an income from their super.[34] This is a more generous tax treatment than for any other savings vehicle. Previous Grattan Institute reports have shown that reforming super tax breaks would strengthen the federal budget and make the system fairer.[35]

32. Daley et al (2018), and Coates and Nolan (2020).
33. Daley et al (2018), and Coates and Nolan (2020).
34. Provided retirees comply with minimum drawdown rates and have a balance below the Transfer Balance Cap.
35. Coates and Moloney (2023).

2 Retirees should be encouraged to annuitise some of their super

The little guidance retirees currently receive is unhelpful. It steers them only into account-based pensions, which require them to manage their spending to avoid the risk of outliving their savings. Half of retirees also draw their savings at legislated minimum drawdown rates, which leave 65 per cent of retirees' super balances unspent by average life expectancy.

In contrast, retirees in many comparable countries are automatically given, or otherwise strongly encouraged to choose, a guaranteed income for life once they retire. Australia is an outlier in failing to guide retirees towards lifetime income.

Rather than steering retirees into account-based pensions drawn at the minimum, retirees should be guided – by both the government and their super fund – to use 80 per cent of their super balance exceeding $250,000 to purchase an annuity. Retirees' remaining super would be drawn via an account-based pension, giving them flexible access to capital.

This reform could boost retirees' incomes by up to 25 per cent, while also ensuring that the bulk of retirees' incomes – irrespective of their super balances – would be guaranteed to last for the rest of their lives. Having most of their income guaranteed for life would mean less stress and more spending for retirees.

2.1 System guidance matters

The super system makes most big decisions for working Australians. But once people retire, the system casts them adrift, offering no meaningful guidance on the best way for them to use their super (Section 1.5 on page 11).

This matters because what the super system puts in front of people is what most people tend to follow. Retirees tend to take the options put in front of them, or fall back on what they already are familiar with, to reduce the mental effort of decision making. For example, when given a choice, people in defined-benefit plans tend to choose guaranteed income, whereas people in defined-contribution plans tend to choose a lump-sum payment.[36]

Within defined-contribution plans, pre-sets can have a big impact on whether people opt for an annuity. In particular, evidence shows that pre-selecting some baseline level of annuitisation is likely to have a material impact. One experimental study found that at least a quarter of respondents tend to stick with the default allocation (Figure 2.1 on the next page).

Further, when retirement choices are framed in terms of the income retirees will receive, many opt for annuities, which offer a guaranteed income for life. But when retirement choices are framed in terms of investments, retirees are far more reluctant to convert their super balances into an annuity because of the risk that they may die early, before getting their 'money's worth'.[37]

36. Benartzi (2010, p. 13). See also Benartzi et al (2011) and Cannon and Tonks (2008).
37. Brown et al (2008) investigated the role of framing in retirement choices. When presented with the choice between a lifetime annuity or an interest-yielding savings account of the same actuarial value, 70 per cent of respondents chose the annuity when both options were presented in terms of the income they offered through retirement, compared to just 21 per cent of respondents when presented with the same choice in an investment frame.

2.1.1 The system guides retirees towards account-based pensions drawn at the minimum required rates

It's unsurprising, then, that more than four-in-five Australian retirees with super end up in an account-based pension, because that is effectively what the system pre-selects for them (Figure 2.2 on the following page). Account-based pensions, which keep balances invested and offer retirees income via withdrawals from their account, as well as the flexibility of access to lump sums of money, have become the de facto default option.[38] And most financial advisers recommend account-based pensions to their clients.[39] As one recent assessment put it:[40]

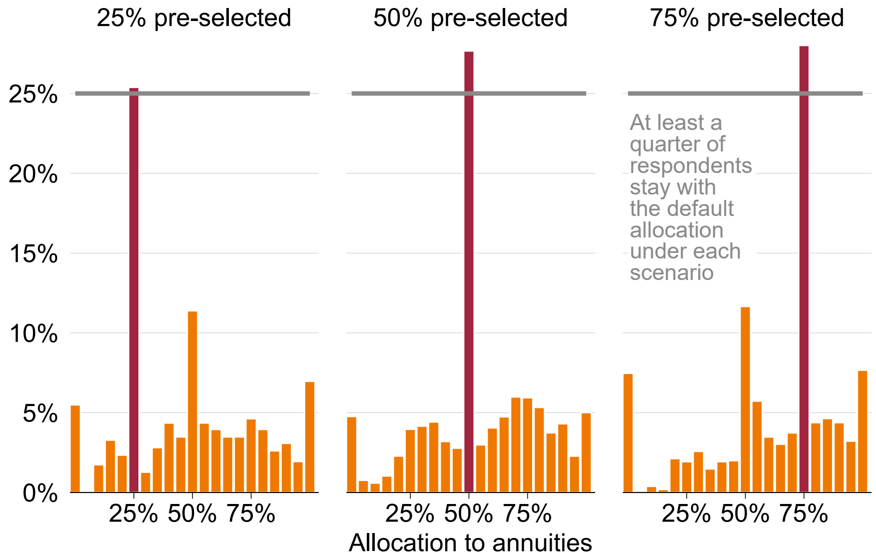
> Taking an account-based pension is the course of least action: it requires, at the very least, the conversion of an accumulation account to a decumulation account within the same superannuation fund, and is therefore likely to be associated with the stickiness of a default.

Account-based pensions leave retirees to manage a lot of risk

While offering flexibility in accessing their savings and continued investment returns in retirement, account-based pensions provide no protection against longevity or investment risks, leaving retirees to manage these themselves. In short, everybody has to become an actuary.

It is, of course, impossible to know how long you might live. Current life expectancy for a 65-year-old woman in Australia is about 88 years, but that person has about a 20 per cent chance of dying before 81 and a 20 per cent chance of making it to 94.[41]

Figure 2.1: Simple prompts can substantially affect retirees' choices
Proportion of respondents choosing annuity allocation option, with different pre-selected allocations

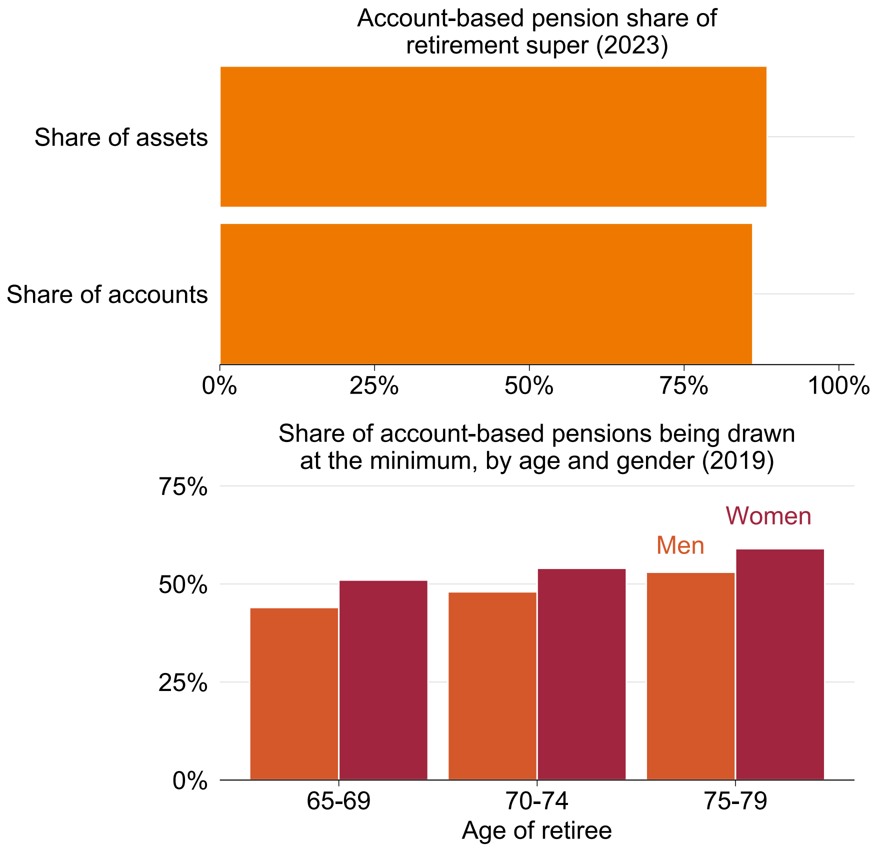


Notes: This study referred to pre-selected options as defaults. The allocation to annuities was pre-selected for participants who were able to change the allocation as they desired.

Source: Bateman et al (2016).

38. All super funds offer their members an account-based pension, although some funds have minimum balance requirements. See Bell and Warren (2024a).
39. Murray et al (2014, p. 119).
40. Bateman and Eberhardt (2024, p. 120).
41. Grattan analysis of AGA (2019).

Figure 2.2: The retirement phase of super is dominated by account-based pensions, and most people opt for the minimum drawdown rates

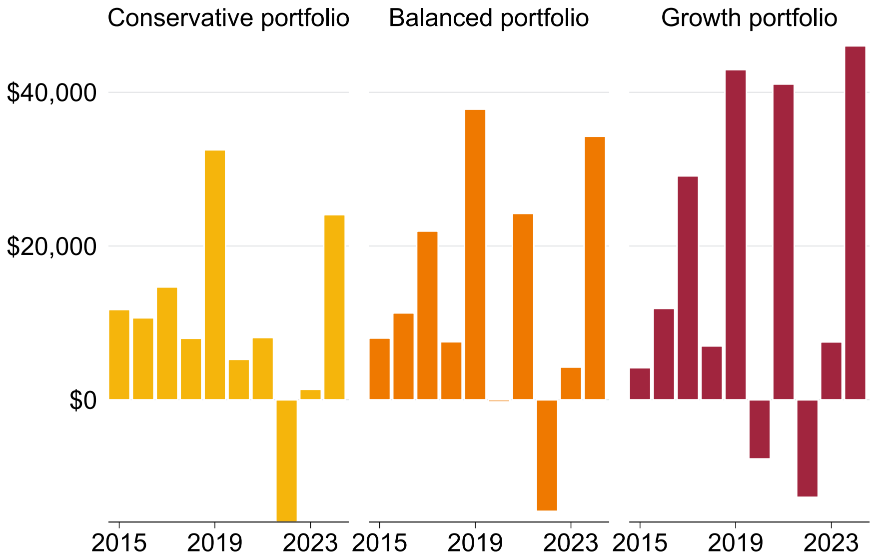


Note: ABP share excludes SMSFs, which would lift the ABP share further.

Sources: Top: Grattan analysis of APRA (2024a). Bottom: Rice Warner data from 2019 as presented in Callaghan et al (2020, Chart 3B-16).

Figure 2.3: Investment returns can be quite volatile year-to-year

Annual returns by portfolio, for a person who retired aged 65 in 2014 with $250,000



Notes: Uses S&P Blended Indexes for returns. Conservative is 30 per cent S&P/ASX 200 and 70 per cent S&P/ASX Australian Fixed Interest Index, balanced is 50 per cent and 50 per cent, and growth is 70 per cent and 30 per cent. Account drawn at legislated minimum. All other assumptions follow the Grattan Retirement Income Projector (see Coates and Nolan (2020)).

Source: Grattan analysis of S&P (2024) and Coates and Nolan (2020).

Account-based pensions also leave retirees heavily exposed to asset markets, which leads to swings in their total balances and the annual investment income they receive (Figure 2.3 on the previous page). Retirees being so exposed to asset market swings puts pressure on governments to help them self-insure against the risk of outliving their savings, which in turn leads to poor ad-hoc policy making. For example, during the COVID-19 pandemic when minimum drawdown rates were halved following sharp falls in equities markets.[42]

This demand on retirees to make guesses about life expectancy and investment returns is a major reason they feel stressed about their retirement, and ultimately why they self-insure by leaving much of their super unspent (Section 1.2 on page 8).

Retirees don't actually make much use of the flexibility account-based pensions offer

Few make use of the flexibility that account-based pensions offer to draw lump sums from their super, despite it being the key advantage of account-based pensions.

In 2022-23, only 11 per cent of retirees who had contributed to a super scheme during their working life had made a lump sum withdrawal in the last four years. More than half of the same cohort reported having never taken a lump sum withdrawal.[43] Analysis from the Productivity Commission in 2015 concluded that less than 30 per cent of super benefits are taken as lump sums, and they are mostly just those withdrawing very low balances (less than $10,000).[44]

Minimum drawdown rules encourage retirees to conserve their super

Retirees with account-based pensions are subject to minimum drawdown rules.[45] They must withdraw a mandated share of their remaining super balance each year in order to qualify for tax-free super earnings in retirement.[46]

About half of retirees draw on their super at the minimum required drawdown rates (Figure 2.2 on the previous page). A more recent survey by Super Consumers Australian found that more than 60 per cent were drawing at the minimum, with nearly one-in-five saying they do this because they (mistakenly) believe it is what the government has recommended.[47] Many more probably anchor to them simply due to the absence of better guidance.

Minimum drawdown rates encourage retirees to underspend their retirement savings. Grattan Institute modelling shows that working Australians who draw down their super at the legislated minimums when they retire will leave the equivalent of 65 per cent of their original super balance unspent by age 92.[48] Australians retiring today, who can expect to live until about age 89, will leave an even larger share of their super balance unspent if they follow the minimum drawdown rates.

Raising minimum drawdown rates might encourage retirees to spend more by forcing them to draw down their super faster. But raising

42. These changes tend to linger longer than the precipitating event too. This halving lasted four financial years from 2019-20 to 2022-23. The minimum drawdown rates were also halved for three years following the GFC (2008-09 to 2010-11), and stayed reduced by 25 per cent for 2011-12 and 2012-13. See ATO (2024).
43. ABS (2024a, Table 8.1).
44. Productivity Commission (2015, p. 2).
45. Minimum drawdown rates start at 4 per cent a year for people younger than 65, rising to 14 per cent for people in their 90s.
46. Superannuation fund earnings (such as interest and dividend income from investments) are taxed at 15 per cent while people are working age, but become tax free once people start drawing on their super in retirement.
47. See SCA (2024a, pp. 8–9) and SCA (2023). Further, this survey covered 2022-23 when the minimums were halved, which logically should have reduced the share anchoring to them.
48. Grattan Retirement Income Projector using a worker entering the workforce aged 30 in 2016 and retiring aged 67. We estimate 35 per cent will be left in inflation-deflated terms. See Coates and Nolan (2020).

minimum drawdown rates alone will not simplify super for retirees, because they would still be be required to manage their spending to try to make sure they don't outlive their savings.

2.2 Annuities offer higher, more stable incomes, while also insuring retirees against the risk of outliving their savings

Annuities can offer retirees regular payments for life, regardless of how long a person lives.[49] For example, a simple lifetime annuity pools retirees' savings and use those assets to fund a guaranteed income of a certain level for life to all members of the pool. The provider therefore insures retirees against longevity and investment risk, in exchange for retirees giving up access to the underlying capital.[50] In contrast, investment-linked annuities (ILAs) and group self-annuities (GSAs) offer an income that is guaranteed to last retirees' entire lives, but the level of income offered each year can vary with investment returns and/or mortality.

Research suggests having an income that is guaranteed to last until death can reduce stress and boost retirees' spending.

US research shows that retirees with a high percentage of annuitised income are significantly happier in retirement than their non-annuitised peers,[51] as does other international research.[52] One US study found that among retirees with comparable wealth and health, those with annuitised incomes report the highest levels of happiness, and this effect was higher for those who receive a higher share of their income via an annuity.[53]

US research also shows that retirees who draw a defined-benefit pension (which is guaranteed income for life) spend much more than similar retirees drawing from a defined-contribution account.[54]

In addition to offering more stable, guaranteed incomes, using an annuity can also boost retiree income. Compared to an account-based pension being drawn at the minimum, using their super balance to take out a lifetime annuity could boost retirees' private (i.e. not the Age Pension) incomes by about 15 per cent by life expectancy (Figure 2.4 on the following page).[55]

2.2.1 Yet annuities are rare in Australia

Despite these benefits, there are only four active providers of lifetime annuities in Australia, down from more than a dozen 20 years ago.[56] And just 6 per cent of Australian retirees today opt to take an income stream via an annuity.[57] There is no shortage of proposed explanations for this 'annuity puzzle'.

49. There are different types of annuities and lifetime-income products. This report focuses on ones that offer regular payments for life – i.e. longevity protection. Technically, annuities can only be offered by life insurance companies and there are other lifetime-income products that do not meet this definition, but we use the term broadly for simplicity.
50. In practice, the unused assets of people who die early are used to pay income to people who live longer than average life expectancy, often referred to as 'mortality credits'. See Moneysmart (2024).
51. Panis (2003), Bender and Jivan (2005), and Nyce and Quade (2012).
52. Villiers-Strijdom and Krige (2023).
53. Anderson (2012).
54. The authors found that retirees who receive a guaranteed income for life spend about twice as much each year as similar retirees drawing an income from a retirement savings account: Blanchett and Finke (2021).
55. AGA (2014) previously estimated that a simple life annuity could boost retirees' incomes by 19 per cent, compared to an account-based pension drawn at the minimum legislated rate. This used conversion rates of 5.7 per cent (male) and 5.3 per cent (female) for an immediate inflation-indexed life annuity bought aged 65, which are marginally more favorable than our approach. See Appendix A on page 51.
56. Bateman and Eberhardt (2024). Although there are a range of other providers offering more complicated products with less insurance, such as investment-linked annuities. See Bell and Warren (2024b) for a list of current offerings.
57. Callaghan et al (2020, p. 459).

Lack of awareness – and the super system's failure to combat this in any way – is undoubtedly a key factor (Box 2 on the next page).

2.2.2 Many other countries offer incomes that are guaranteed to last for life

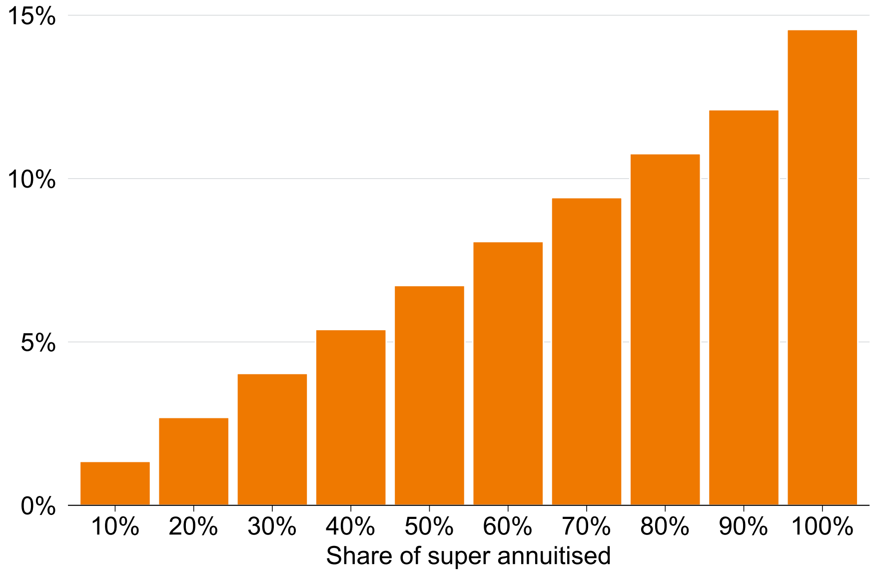
Australia is an international outlier by not emphasising guaranteed lifetime income (whether via annuities or other offerings). Most OECD countries' 'second-tier' schemes – those that are linked to what people earn while working – focus on delivering guaranteed lifetime income in the retirement phase. And many governments provide this function directly.[58]

Governments most commonly provide lifetime income to retirees via defined-benefit or 'points' systems – 22 OECD governments run such schemes. In these schemes, people make contributions to the government during their working life, and in return they are promised a regular income that is guaranteed to last the rest of their lives.[59]

Some OECD countries are shifting towards defined-contribution systems of individual savings accounts, like Australia's, to contain the budgetary (and intergenerational) costs of retirement income systems.[60]

However, those countries that have shifted to defined-contribution systems typically either have it as a supplement to a broader earnings-linked guaranteed-income system, have compulsory or heavily

Figure 2.4: Annuitising super can boost retirement incomes
Projected boost to total private retirement income by share of balance allocated to a lifetime annuity, compared to an account-based pension drawn at the minimum



Note: See Appendix A.1 on page 51 for details.

Source: Grattan analysis.

58. See Appendix B on page 54 for details on cross-country comparisons.
59. These schemes often have progressive formulas to calculate entitlements, which means they combine elements of 'first-tier' and 'second-tier' schemes.
60. In practice, public, earnings-linked defined-benefit schemes have often been underfunded, with workers' contributions being insufficient to fund the retirement benefits promised.

encouraged annuitisation, or operate 'notional' defined-contribution schemes.[61]

Nine OECD countries have mandatory or 'quasi-mandatory' private defined-contribution schemes, but seven of those countries either make annuities compulsory or strongly encourage retirees to choose the annuity option.[62]

These systems serve to limit the share of retirement income that is not guaranteed for life, while typically not requiring retirees to decide how to invest and draw down their retirement savings.

2.3 Retirees should be encouraged to use some of their super to buy an annuity

Retirees should be encouraged to use some of their super to buy an annuity. Offering retirees pre-set guidance to purchase an annuity would better anchor retirees' decisions.

Greater adoption of annuities could boost retirees' incomes by up to 25 per cent, while also ensuring that the bulk of retirees' incomes, irrespective of their super balance, would be guaranteed to last the rest of their life.

61. 'Notional' schemes involve workers accumulating notional balances that exist only to inform an annuity level at retirement, which is typically provided directly by the government.
62. Count excludes Australia. 'Quasi-mandatory' means collective agreements with at least 85 per cent coverage. In private schemes with high levels of annuitisation, the annuities offered by the private sector are typically either heavily price-regulated (e.g. Iceland and Switzerland), or operate with fully member-owned funds, no fund choice, and fund-level negotiations with life insurers (e.g. Denmark, the Netherlands, and Sweden).

Box 2: The annuity puzzle: Why don't retirees choose annuities on their own?

It has long been argued that lifetime annuities, which offer a guaranteed income for life by pooling risk across retirees, could leave many retirees better off.[a] But few retirees take up annuities on their own accord, in Australia or elsewhere. Experts describe the lack of interest in annuities, despite their clear benefits to retirees, as the 'annuity puzzle'.[b]

There is no shortage of explanations for this puzzle. A recent review identified 38 potential contributing factors. A lack of awareness and understanding are commonly cited reasons.[c] The super system design does nothing to combat this, and financial advisers are typically reticent to recommend them (Box 1 on page 13).

Research also suggests that for those interested in annuities, they find the process of choosing between specific products too difficult, and worry they may get stuck with a poor deal.[d] Annuities are also less attractive when interest rates are low, as they have been globally over most of the past 15 years. And retirees may overestimate the risk that the private annuity provider may fail, or underestimate their own life expectancy (which leads to an annuity appearing overpriced).[e]

Instead, widespread adoption of annuities and other lifetime income options only occurs where annuities are compulsory, or strongly encouraged (see footnote 61).

a. Yaari (1965). See also Barr (2001, Part 3).
b. Benartzi et al (2011).
c. Bell and Warren (2024b). See also O'Meara et al (2015) and Bateman et al (2024).
d. Altschwager and Evans (2020a).
e. Beshears et al (2014), and Productivity Commission (2018, p. 227).

2.3.1 The 'right' amount of super to allocate to an annuity varies across retirees

Encouraging retirees to use *all* of their super to buy an annuity is unlikely to be in their best interests. Partial annuitisation of super is likely to be best for most retirees.[63] Therefore, the amount of super Australians should be encouraged to allocate to an annuity should vary across balances, and retirees should remain free to make their own informed decisions if they choose.

The 'right' amount for an annuity varies because of the role of the Age Pension. People with modest super balances are likely to have modest overall assets, and therefore are likely to receive a full pension. This means the vast majority of their retirement income is already guaranteed, and annuitising their super would mean giving up a small-amount of flexible capital for little gain.

But more broadly, all retirees can benefit from some flexibility of accessible capital. Lump sums can be necessary or desirable early in retirement – to extinguish mortgages, to renovate a home, or to make one-off expensive purchases such as a caravan, for example – or later in retirement for unexpected health or aged care costs.[64] Further, keeping a sizable chunk of super in an account-based pension means retirees' savings and income can benefit from continued access to the equity risk premium during retirement.[65]

But the fact that retirees' needs and preferences differ does not undermine the need for better system-level guidance. People are different, but not *that* different. It is clear that more lifetime income for more retirees would solve a range of the problems that current system guidance produces.

Relying on personal financial advice to deliver better retirement incomes than solely account-based pensions drawn at the minimum is unnecessary and unrealistic. Good-quality advice would steer most retirees towards annuitising some of their super anyway, just at more cost than better system guidance. In any case, it is simply too big of an ask for funds to deliver good-quality personal advice at such a scale (Section 1.7 on page 12). No comparable country relies principally on personal financial advice as the mechanism to help channel retirees into income streams. Instead, most comparable countries have systems that steer retirees towards guaranteed lifetime income by design (see Section 2.2.2 on page 20).

2.3.2 Retirees should be encouraged to allocate 80 per cent of their balance above $250,000 to an annuity

The government should embed 'pre-set' guidance, via a range of communications with super fund members, for retirees to use 80 per cent of their super balance exceeding $250,000 to buy an annuity.[66] For example, someone with a super balance of $750,000 would have a pre-set of $400,000 – that is, 80 per cent of $500,000 ($750,000 less $250,000).[67]

63. See Iskhakov et al (2015) and Butt et al (2022) for detailed analysis of how optimal annuity allocations can vary in the Australian context.
64. Although many retirees underestimate how much of health and aged care costs are covered by government. See Callaghan et al (2020, pp. 440–443).
65. Although 'investment-linked annuities' can combined this benefit with longevity protection – see Section 2.4 on page 24.
66. Ideally, a pre-set suggestion would generate consistent outcomes vis-a-vis Age Pension entitlements (i.e the pre-set would produce the same total guaranteed income – Age Pension plus annuity – for households of the same means). But this approach is difficult to implement as it requires full visibility of all household assets and income. Further, while this pre-set sees the suggested share of super to be annuitised rising as super balances rise, in practice it would see a 'u-shaped' proportion of *total financial wealth* suggested to be annuitised. This is because wealthier households with larger super balances tend to have disproportionately more non-super financial assets. See Daley et al (2018, Figure A.2).
67. As at publication, the Age Pension assets-test free area for a home-owning couple is just under $500,000. Therefore, abstracting from non-super assessable

This pre-set should have a minimum suggested purchase to ensure people are not encouraged into annuitising negligible amounts. For example, 80 per cent of assets above $250,000 could be counted, but only 'activated' once a minimum annuity purchase of, say, $40,000 were reached (i.e. an effective balance of $300,000).[68]

The pre-set should also have a maximum suggested purchase, given the benefits of guaranteed income falls for those with greater wealth wealth.

The government should embed this pre-set guidance throughout the retirement income system, in all relevant communications with retirees and at all critical decision points.

A critical moment is when a pre-retiree initiates the process of rolling their super over into retirement phase to begin drawing an income from their super. The government should mandate that the materials and communications associated with this transition must prominently display the pre-set guidance to annuitise a share of the super balance.

Mandating the inclusion of information on the benefits of annuities and the suggested allocation in all other super fund communications would boost awareness pre-retirement. And including the pre-set in all retirement income calculators and projections would further crystallise the benefits of annuitisation to retirees.

The guidance and advice pre-retirees receive, whether from funds or government, should emphasise the benefits of annuitising some super, and should encourage it.

assets, the pre-set guidance would see suggested annuity allocations kick-in as Age Pension entitlements taper off. Our approach leads to a general equalising of projected guaranteed retirement incomes across balances (Figure 2.5 on page 26).

68. These thresholds should be indexed to inflation, to match the indexation of the Age Pension means-test free areas.

Ultimately, exactly where and how a suggested pre-set allocation to an annuity is embedded into the super system will need to be informed by behavioral testing of what works best.

Lastly, it is important to remember that this would be a suggestion, not a default opt-out or a mandatory purchase. Retirees should always be able to make their own decisions where their circumstances or preferences vary, including by choosing to annuitise a larger share of their super balance.

2.3.3 Following this pre-set suggestion would offer retirees higher incomes for the rest of their entire lives

Allocating 80 per cent of super above $250,000 to a simple lifetime annuity would boost retirement incomes, and substantially boost *guaranteed* retirement incomes, for many middle-class retirees, compared to just drawing an account-based pension at the legislated minimum (Figure 2.5 on page 26). Importantly, this pre-set suggestion would help 'offset' the impact of the Age Pension means test on retirees' guaranteed incomes as super balances increase.

Single retirees with $500,000 in super at retirement would see their average retirement income rise by 10 per cent, from $50,000 to $55,000 a year, compared to an account-based pension drawn at the legislated minimum. Whereas those with $750,000 in super at retirement would see their income rise by 24 per cent, from an average of $46,000 to $57,000 a year.

Couple retirees with a combined $750,000 in super at retirement would see a boost to their average retirement income of 13 per cent, from $75,000 to more than $85,000 a year. Whereas a couple with $1 million in super at retirement would see their retirement income rise by 26 per cent, from $70,000 to more than $88,000 a year.

Annuitisation can boost Age Pension entitlements

The key benefit of annuitisation is boosting *guaranteed* retirement incomes. But as outlined above, it also boosts expected retirement incomes overall, compared to an account-based pension at the minimum alone.

This is not just because annuitisation can produce higher private incomes than an account-based pension drawn at the minimum. It is also because using assets more efficiently like this boosts Age Pension entitlements, particularly with the treatment of annuities in the Age Pension means test.

The income test counts only 60 per cent of annuity income, and the asset test counts 60 per cent of the purchase price of an annuity (decreasing to 30 per cent for retirees aged 84 and over). Whereas 100 per cent of the balance of an account-based pension is counted in the assets test (although the deeming rates applied to inform the income test are quite low, maxing out at 2.25 per cent).[69]

Whether these parameters are optimal is beyond the scope of this report.[70] However, Grattan has previously argued that the assets test taper rate – retirees lose $3 per fortnight for each $1,000 of assets above the free area – produces very high effective marginal tax rates on long-term retirement savings, and therefore should be relaxed to $2.25 per $1,000.[71] Reducing the share of an asset counted is tantamount to reducing the taper rate.

69. See Services Australia (2024a) and Services Australia (2024b).
70. Although it is clear some 'concessional' treatment is warranted given the implicit asset value of an annuity falls over time, the deeming rates applied to account-based pensions are very low, and income drawn from account-based pensions is not counted in the income test.
71. See Coates and Nolan (2020, Section 5.4).

2.4 Retirees should be guided towards a simple lifetime annuity, but could eventually benefit from a range of annuities

Retirees should initially be guided into a simple lifetime annuity, where the provider takes on all longevity and investment risk, guaranteeing retirees a particular level of income for life. The impact on retirement incomes in Figure 2.5 shows the results for a simple lifetime annuity.[72]

However, retirees could benefit over time from a range of annuity options, which could offer an even larger boost to retiree incomes while still guaranteeing an income for life, albeit at the cost of accepting greater uncertainty regarding the level of retirement income offered each year.[73] These could include:

- Investment-linked annuities (ILAs). These offer an income guaranteed for life (i.e. they offer protection against longevity risk), but the level of income offered each year still varies with the investment returns. ILAs typically involve the provider bearing longevity risk but the retiree bearing investment risk, in the expectation of higher returns than a simple lifetime annuity, while also exercising continued control over investment strategy.[74]
- Group self-annuities (GSAs) involve the pool of retirees collectively bearing longevity and investment risk, rather than the provider. This means while an income is guaranteed to be paid for retirees' lives, the level of that income can vary with investment returns and the mortality of the group. In return for collectively bearing these

72. It is a fixed nominal annuity that sees the retiree left bearing inflation risk, but this makes sense given the Age Pension typically grows and spending typically falls in real terms over retirement. See Section 3.3.2 on page 31.
73. See AGA (2014) and Bell and Warren (2024b) for analysis of how alternative products could play out in the Australian context.
74. An ILA can lead to a higher Age Pension entitlement, because the means-test takes into account just the value of the initial capital contributed and not any potential increase in the value of the capital due to favorable investment returns. See Bell and Warren (2024b).

risks, retirees can expect to receive a higher income on average than a simple lifetime annuity (noting there remains the risk that actual income ends up being lower).[75]

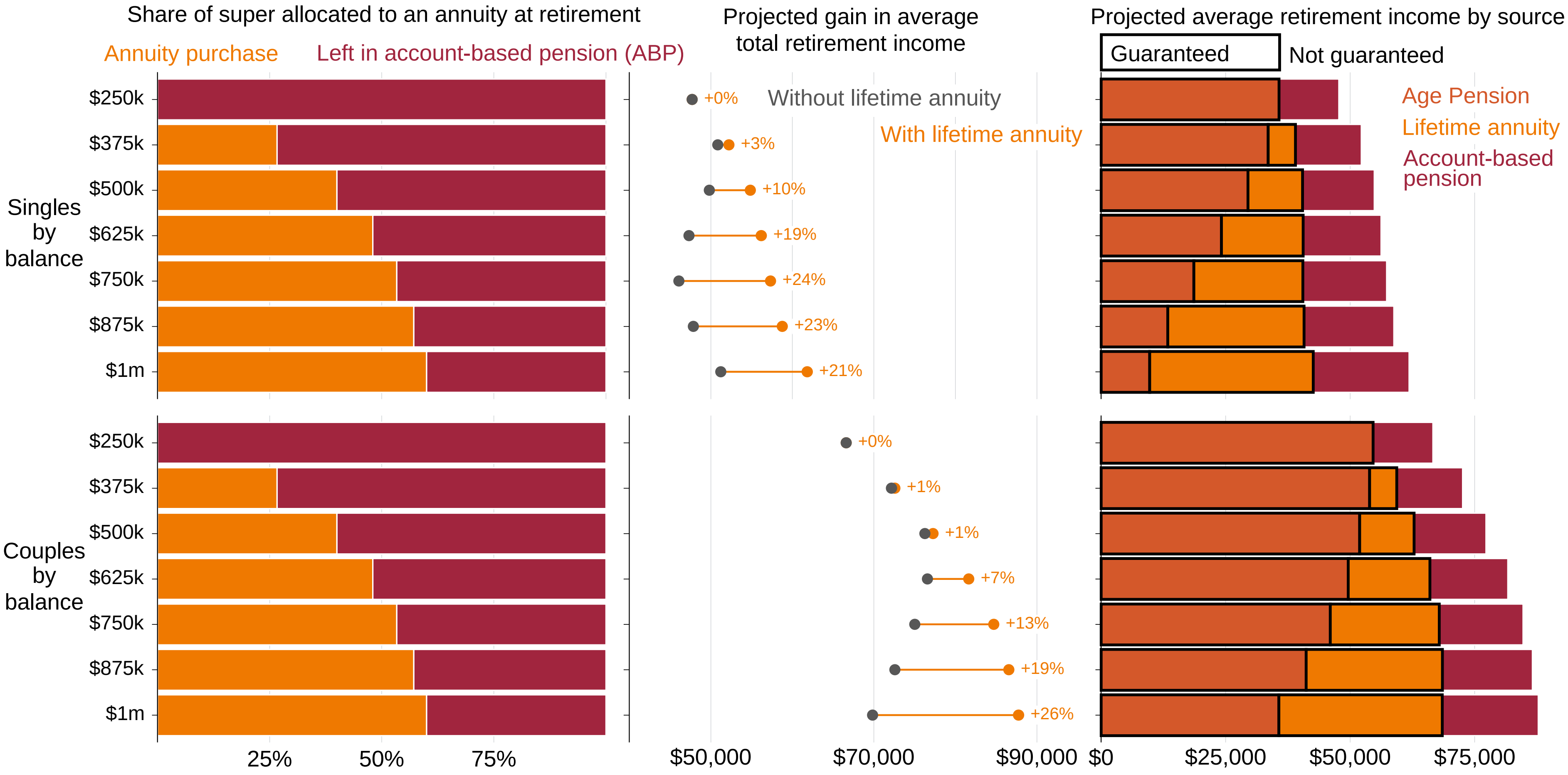
But there is no free lunch. The trade-off is how high an expected income can be verses how insured or guaranteed it is. Regular retirees may find the nature of variability in ILAs or GSAs difficult to understand or predict, and may find the combination of a separate account-based pension and lifetime annuity simpler to understand (and embrace) than combining the two in a variable annuity.

Therefore, we recommend a suggested pre-set, embedded in the system to better anchor retiree decision making, as described above, to encourage retirees into a simple lifetime annuity. But other options should be tested with consumers, and if deemed appropriate, be included in the pre-set guidance offered to retirees.

75. In 2014, the Australian Government Actuary published detailed modeling of a GSA, showing that compared to an account-based pension drawn at the legislated minimum, a GSA could lift expected retirement income by up to 40 per cent, whereas a simple lifetime annuity could guarantee a 19 per cent uplift: AGA (2014).

Figure 2.5: Annuitising some super would boost total retirement incomes, and substantially boost *guaranteed* retirement incomes

Allocating 80 per cent of super above $250,000 to a lifetime annuity: share of super annuitised, the expected impact on retirement incomes (compared to an account-based pension drawn at the minimum), and projected average retirement incomes by source, by retirement balance and household type



Notes: See Appendix A.1 on page 51 for details. The pre-set annuity allocation is run over combined couple accounts to provide indicative estimates.

Source: Grattan analysis.

3 The government should offer annuities

Most Australians would benefit from using some of their super to purchase an annuity at retirement. But relying on super funds to deliver annuities at scale is unlikely to work. Super funds have resisted previous attempts by government to get them to do so.

Further, people struggle to understand annuities, which can make it difficult for retirees to scrutinise products for their value and make rational decisions. And annuities are typically 'one-shot games' – a retiree typically cannot switch to a better deal if they see one. Designing a wholesale market that overcomes these issues would be challenging. Government-provided annuities are the best option.

The federal government should offer retirees a suite of annuities called 'Lifetime Super'. This should include a simple lifetime annuity as the baseline offering, as well as alternatives such as investment-linked annuities. These annuities should be priced at fair and sustainable rates and managed by an independent agency.

A government option would boost take-up, leverage economies of scale, and could be designed to better integrate with the Age Pension.[76]

3.1 Establishing an efficient market for private annuities at scale would be difficult

Current policy is tepidly pushing super funds to offer more annuities and other lifetime-income products to their members via the Retirement Income Covenant (Section 1.7 on page 12). But this approach is unlikely to work well at scale. Past attempts to encourage Australian retirees to use annuities have made little progress because they relied on super funds modest appetite to offer those products to their members (Box 3 on the following page). Additionally, to the extent funds do develop and offer products, a poor market design risks a proliferation of sub-scale, poor-value products.

3.1.1 Retirees struggle to scrutinise and compare annuities

Research shows that people struggle to understand annuities. One recent survey found that fewer than half of people aged 50-75 were aware of them.[77] Another survey of Australians aged 50 and older found that less than a quarter reported a deep understanding of such products. Even for those aware and interested, it can be difficult to scrutinise products for their value and make rational decisions.[78]

Annuities are typically 'one-shot games', meaning a retiree typically cannot switch to a better deal if they see one. Further, the products in the market are becoming more complex, with the actual underlying fees and costs difficult to decipher.[79]

Unsurprisingly, simply relying on demand-driven competition in annuity markets has proven ineffective overseas (Box 4 on page 29). As noted by the OECD after a 2008 survey of annuity markets:

> In theory, consumers shop around to find the lowest price for their demographic combination and product needs. In practice, this does not appear to happen particularly well, at least in some markets, and this breakdown is evident in the pricing distribution.[80]

76. The Australian government offering annuities has also been proposed by other experienced policy experts. For example, see Podger and Breunig (2024).

77. Bateman et al (2024).
78. Altschwager and Evans (2019, pp. 6, 18–19).
79. See Bell and Warren (2024b) for a stocktake of current offerings, which include increasingly complicated investment-linked annuities.
80. Rusconi (2008, p. 24).

3.1.2 Designing an efficient wholesale market would be challenging

Government interventions to promote competition and improve super fund offerings to working-age Australians have produced enormous benefits. In particular, the performance test, introduced in 2021, has led to lower fees, efficiency-enhancing consolidation, and fewer and better-value investment options (Section 5.2.1 on page 45).

But a similar regime is unlikely to work for annuities. The power of the performance test rests on the consequences of failure – writing to members to encourage them to switch in the instance of a first fail, and the closure of the product to new members after a second fail. In practice, product failures have typically led to the fund opting to find a merger partner for the fund as a whole.[81] These consequences cannot be applied to annuities.

First, retirees cannot be encouraged to switch because they are typically locked in after purchase.

Second, limiting or banning annuity products from taking on new members risks creating a new class of expensive legacy products. Merging annuities is orders of magnitude more complicated (and therefore unattractive to potential merger partners) than merging simple investment accounts.

A tender model that selects the best-value annuity providers for retirees to be steered towards *might* work, but is not simple to design. To be effective in encouraging providers to offer competitively-priced options, a tender needs to be able to enact meaningful shifts in customer flows. But such shifts – or even just the prospect of such shifts – could undermine efforts to manage an annuity prudentially over the long term and could create legacy products.

81. Coates and Moloney (2022).

Box 3: Trying CIPRs (comprehensive income products for retirement) again is unlikely to succeed

In 2014, the Murray Financial Services Inquiry concluded that the super system was inefficient at converting balances into incomes due to lack of risk-pooling. It called for trustees to pre-select a CIPR option for their members, as a de facto default.[a]

In the face of super industry opposition,[b] the government opted against requiring super funds to offer and pre-select a CIPR for their members. Instead, regulations were adopted to facilitate development of a range of lifetime products that did not meet existing annuity and pensions standards, such as deferred lifetime annuities and investment-linked annuities.

One lesson from CIPRs is the pitfalls of relying on reluctant super funds to develop and offer products that manage longevity and investment risk. But there is also a genuine challenge in regulating CIPRs to ensure they offer good value to super fund members. Many Australians struggle to compare complex products such as CIPRs.

And one primary benefit of CIPRs – simplifying retirement by offering retirees a single income stream by combining products with different features – can also be achieved by allowing retirees to bundle their Age Pension, Lifetime Super, and account-based pension payments into a single, regular, retirement income, as we propose (Section 3.3.3 on page 31).

a. Murray et al (2014). CIPRs were envisaged to include regular and stable income, longevity risk management, and flexibility to access capital.
b. For example, see ASFA (2017), FSC (2017), and ISA (2017).

Further, a tender model will need to contend with the fact that there is currently only one active provider of lifetime annuities in Australia.[82] This means a tender that aims to enact competitive pressure will be relying on prospective market entrants.

And lastly, given the potential benefits of more complicated annuities to at least some retirees (Section 2.4 on page 24), a tender would need to select a suite of products rather than a single product. This greatly complicates the tender, which now has to make judgments across many more dimensions. For example, rather than simply assessing who offers the best-value lifetime annuity, it would have to assess the investment strategies underpinning investment-linked annuities.

3.2 Government-provided annuities are the best option

3.2.1 Government-provided annuities are the best way to boost take up

One reason few Australians buy annuities (Box 2 on page 21) is that they find it hard to trust that a private provider will offer them a good deal on a product they find hard to understand, or that a private provider will be around to keep its promises well into the future.[83] More Australians would opt for annuities if they had the option to buy a government-provided annuity.

The Home Equity Access Scheme shows how complicated financial products can become much more popular when offered directly by government (Box 5 on the following page).

Further, government-offered annuities would ensure retirees across all super funds have equal access to a safe means of annuitising some of their super.

82. Bateman and Eberhardt (2024).
83. Beshears et al (2014).

Box 4: The UK as a cautionary tale

Until 2015, the UK compelled retirees with defined-contribution balances to buy an annuity from the private market provider of their choice. Inertia reigned, and retirees typically stuck with their existing provider.

Reviews in 2014 and 2015 found that about 80 per cent of retirees who stuck with their existing provider could have got a better deal if they'd shopped around, that poorer retirees with lower balances were likely to be paying higher rates, and that firms quite openly admitted that selling to existing customers was more profitable than selling in the open market.[a]

The reviews concluded that the annuities market was 'not working well for consumers'.[b] The OECD came to a similar conclusion, noting that consumers typically did not get the best product available to them.[c]

The poor value of annuities offered to retirees, together with low interest rates, contributed to the UK government's decision to end compulsory annuitisation in 2015.[d]

a. FCA (2014, pp. 10–19, 23–24), and FCA (2015, pp. 7–8).
b. FCA (2014, p. 5), and FCA (2015, p. 29).
c. OECD (2016, Chapters 5 and 6).
d. Osborne (2014).

Super funds heavily resisted previous government attempts to require them to offer pre-selected product mixes that included annuities (Box 3 on page 28), and a recent review found that few funds offer such products.[84] The upshot is that many people who would benefit from products that offer a guaranteed income for life risk being left in a fund that refuses to offer one.

3.2.2 Government annuities can leverage economies of scale

Government-run annuities would minimise the administrative costs of product development and maintenance, compared to the approach of pressuring all super funds to offer annuities.

A government option means super funds can be released from the regulatory pressure to provide annuities. This can help ensure products are developed in the private sector only where they have a strong commercial case.

It would also prevent funds launching sub-scale products that impede cost-saving mergers. Stalled merger activity means a more expensive system overall.[85]

3.3 How government annuities – 'Lifetime Super' – should work

The federal government should establish an agency that sells annuities called 'Lifetime Super'.

Lifetime Super should offer a range of lifetime-income products sold at fair and sustainable prices by an independent government-owned entity. These products should include options to draw more income earlier in retirement, consistent with retirees spending patterns as they

84. APRA and ASIC (2023).
85. The Productivity Commission estimated that if the 50 highest-cost funds merged with the 10 lowest-cost funds, the annual savings would be about $1.8 billion. See Productivity Commission (2018, p. 355).

Box 5: The Home Equity Access Scheme is growing in popularity

The Home Equity Access Scheme allows retirees to draw home equity up to a maximum of 150 per cent of the Age Pension. Payments are made by Centrelink, are not taxable, and don't count towards the Age Pension income test. The outstanding debt accrues with interest, which the government recovers when the property securing the loan is sold, or from the borrower's estate.

Recent reforms have improved the scheme. Until 2022, it was called the Pension Loans Scheme, which erroneously suggested it was open only to pensioners, and the use of the word 'loans' may have discouraged debt-averse retirees. The interest rate was also lowered at that time, from 4.5 per cent to 3.95 per cent. And in January 2023, the Australian Securities and Investments Commission (ASIC) confirmed that financial planners could advise on the Home Equity Access Scheme without the need to hold a credit licence. This is likely to have prompted further interest in the scheme.[a]

The scheme is growing rapidly. Since 2020, the number of people using it has more than tripled, to 14,500 as of September 2024. The total value of the money drawn under the scheme by participants has increased from $138 million in June 2022 to $384 million in June 2024.[b]

a. Dastoor (2023). The low interest rate compared to rising commercial rates at this point would have also played a role.
b. Data received from the Department of Social Services upon request.

age. Retirees should be able to purchase Lifetime Super products with their super once they hit preservation age, which is now age 60.[86]

3.3.1 Lifetime Super should offer a simple lifetime annuity, as well as other annuity options

There are a range of annuity products with different risk-sharing arrangements with different degrees of guarantees on the income retirees can receive (Section 2.4 on page 24).

The government should first offer retirees a simple lifetime annuity, where the provider takes on all longevity and investment risk, guaranteeing retirees a particular level of income for life.

Lifetime Super should offer more complicated products as well, such as investment-linked annuities (ILAs), that insure retirees against longevity risk but not investment risk. An ILA can offer a higher expected average income, in exchange for it being variable.

An ILA would also mean the government balance sheet takes on less risk, vis-a-vis a simple lifetime annuity, since the government is not guaranteeing a particular level of income for life.

86. Previous proposals have involved a more integrated model whereby non-full pensioners can purchase the 'balance' of the Age Pension. See Dunsford and Wickham (2008). While integration is a desirable feature, it locks the model into Age Pension parameters such as the Age Pension age and wage indexation. Retirees should be able to annuitise their super from preservation age, and wage-indexation would make the product much more expensive only to produce more income later in life when retirees are less likely to spend it.

3.3.2 Lifetime Super products should offer retirees the option to draw more income early in retirement

Evidence in Australia and overseas shows that retirees' spending tends to fall in real terms as they age and become less mobile (Figure 3.1 on the next page).[87]

This implies annuity income for most typical retirees should ideally be front-loaded. This is not just to better match their expected spending, but also because they can expect their Age Pension to rise in real terms. Therefore, the ideal front-loading may even see annuity income fall in nominal terms over time. This approach would ensure the retiree got more income when they want to spend it, and less when they don't and can expect a larger Age Pension anyway.[88]

Front-loaded income from an annuity is the ideal way to integrate a retirees private lifetime income with the Age Pension. But it is more complicated, both to provide and for retirees to understand, than simple inflation-indexation, or simpler yet, a fixed nominal annuity. A falling nominal annuity may also dilute the sense of longevity protection a retiree might garner from buying an annuity.

The government should explore the feasibility of front-loading income, particularly for those expecting to spend a material share of their retirement on a part pension.

3.3.3 Retirees should be able to bundle their Age Pension, Lifetime Super, and account-based pension payments

Most people go through working-life with one predictable, recurring deposit of pay into their bank account. As much as possible, Australia's

87. See Coates and Nolan (2020, Section 3.2.4), Nanayakkara (2024), and Crawford et al (2022).
88. Some private products already offer a higher income earlier in retirement, to better match the observed spending pattern of retirees. For example, see Generation life (2024).

retirement income system should aim to replicate this. It's more familiar, simpler, and makes budgeting easier.

Therefore, retirees drawing an Age Pension should be able to have their Lifetime Super payments routed via Services Australia, to be deposited in one fortnightly payment. This would mean the retiree would get all their regular, guaranteed income in one stream.

And the feasibility of incorporating income from an account-based pension into the process should also be explored.

An independent government advice service could offer retirees a consolidated statement of their retirement income from all sources – the Age Pension, Lifetime Super, and any income streams paid by their super fund – via the MyGov online portal (Chapter 4).

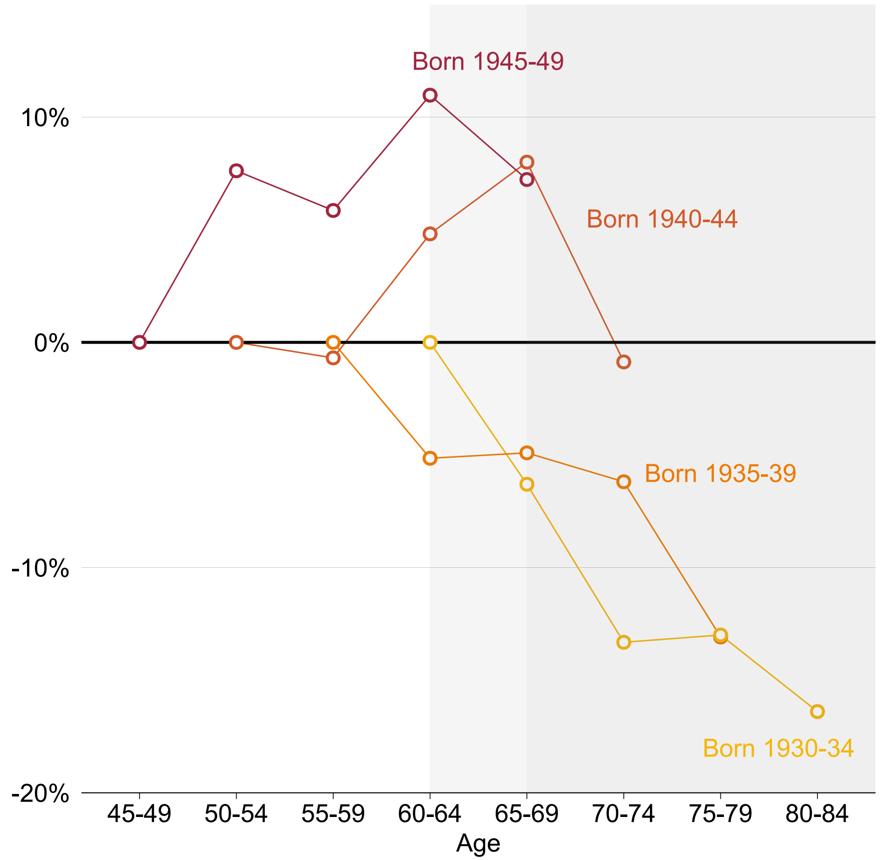
3.3.4 Lifetime Super should be managed and priced independently

Lifetime Super should be managed by an independent Commonwealth-owned entity run at arms' length from the elected government.

Policy makers have significant experience running public non-financial corporations free from political interference, including Australia Post and the Clean Energy Finance Corporation. Indeed, one of the most consequential economic policy levers – monetary policy – has strong independence from government.

Lifetime Super would benefit from similar independence. Independent board appointments, and a set of robust duties for directors, would help buttress its independence.[89] Management of the underlying assets could be delegated to the Future Fund.

Figure 3.1: Retirees spend less as they age
Real change in equivalised household spending by age cohort relative to 1993



Note: Spending from iterations of the ABS Household Expenditure Survey. Each line represents a single cohort across time as they age. While the age cohorts are five years apart, there was a gap of six years between the past three HES surveys.

Sources: Daley et al (2018, Figure 3.5).

89. See Wood et al (2022b) for more detail on Grattan Institute's recommendations for a transparent, merit-based selection process for all public appointments.

Regular independent auditing would ensure the prices were being set such that the scheme was operating prudently and sustainably.

3.3.5 People should be able buy Lifetime Super products in installments before retirement

People should be able to buy Lifetime Super products in installments in advance of payments starting. This has three key benefits.

First, spacing purchases out over time enables people to smooth out their exposure to prevailing asset prices and interests rates. This matters particularly for simple lifetime annuities because falls in share prices or interest rates pre-retirement can materially reduce the amount of income one can get from an annuity.[90] This 'sequencing risk' matters much less with investment-linked annuities, which is another argument for Lifetime Super to offer them (Section 3.3.1 on page 31).

Second, paying in installments would reduce the 'sticker shock' that would accompany a substantial, once-off purchase. Loss aversion reduces annuity take-up.[91] And people tend to feel better about making several smaller purchases than one large purchase, even if the amounts add up to the same.[92]

And third, paying in installments opens up the option of a deferred lifetime annuity for a retiree who may want guaranteed income later in their retirement.

Singapore's government-offered annuities have an installments mechanism: residents can start pre-purchasing their income stream up to 10 years before retirement age.[93]

90. This is because the payment an annuity provider can promise is typically tied to the expected return on the committed capital the provider can expect to get.
91. Altschwager and Evans (2021).
92. Mukherjee et al (2017).
93. See Singapore Central Provident Fund Board (2024a).

3.3.6 Lifetime Super products should offer a 'money back' guarantee

Fear of not getting one's 'money's worth' can prevent annuity take-up. A person who dies early in their retirement would get less value over their retirement from an annuity than someone who lives longer.

A 'money back' guarantee can offer some protection against this. For example, a simple nominal guarantee could see a retiree who commits $100,000 to a lifetime annuity, but only lives long enough to receive $60,000 worth of nominal income, entitled to a death benefit of $40,000.[94] However, death benefits such as this naturally reduce the mortality credits accruing to remaining members of the pool, which means a larger capital contribution is needed for a given level of promised income.

Annuities can also offer a 'cooling off' period, in which the remaining capital can be retrieved by the purchaser in the event of a change of heart, often accompanied by a penalty or exit fee. However, this introduces a behavioural risk – the provider has to make assumptions about how many purchasers are likely to exit and when.

Ultimately, the more Lifetime Super promised to return in the event of early death or a change of heart, the higher price it would need to charge in the first instance. Therefore, the nature and level of any guarantees would need to be informed by detailed modeling of the costs and benefits, and extensive consumer testing of a range of options.[95]

94. Singapore's CPF LIFE refunds a portion of the initial premium in the event of early death. See Singapore Central Provident Fund Board (2024b). In the Australian context, any nominal guarantee has to be consistent with the 'Capital Access Schedule' to access concessional means-test treatment. The schedule dictates that access to capital declines over time and reaches zero after life expectancy. See DSS (2024).
95. See OECD (2016) for a discussion of these trade-offs. Having general provisions for flexible access to the underlying capital is unnecessary given we propose that

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

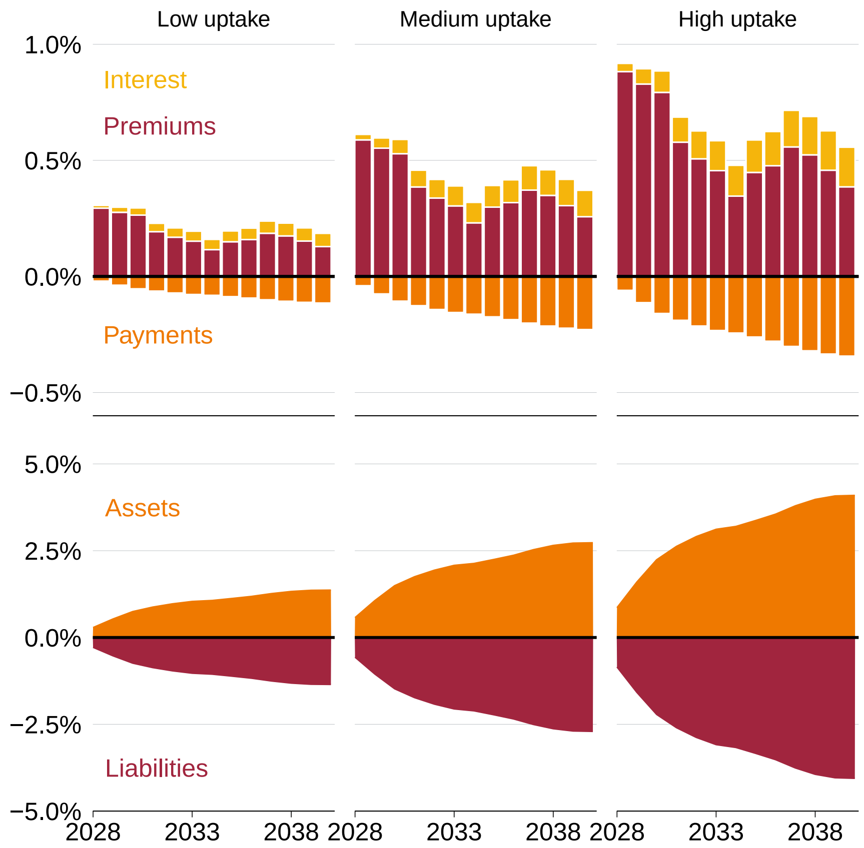
Lifetime Super would invest the capital from retirees choosing to purchase an annuity (premiums) and distribute payments back to those retirees from the pool of invested assets.

In our baseline scenario, we assume that 40 per cent of new retirees with super balances larger than $250,000, and 10 per cent of existing retirees currently drawing no Age Pension, would take up the option of a Lifetime Super lifetime annuity.[96] In this scenario, the assets underlying Lifetime Super would total about $157 billion, or just over 2.5 per cent of GDP, by 2040 (Figure 3.2). This compares to current federal government assets of 31 per cent of GDP ($827 billion) and liabilities of 51 per cent of GDP ($1.37 trillion).[97] Lifetime Super would also distribute payments of around 0.2 per cent of GDP to retirees by 2040.

If Lifetime Super proved more popular – with 60 per cent of new retirees with balances larger than $250,000, and 15 per cent of existing retirees currently drawing no Age Pension taking it up, the federal government balance sheet could expand by just over 4 per cent of GDP by 2040 (Figure 3.2).

Figure 3.2: Lifetime Super would have only a modest impact on the federal government balance sheet

Projected flows and stocks of Lifetime Super, by uptake scenario, proportion of GDP



Notes: Low uptake is 20 per cent of expected new retirees each year with a balance above $250,000 and 5 per cent of existing retirees with no Age Pension and a balance between $400,000 and $1.5 million purchasing over the first fives years of operation (2028). Medium uptake is 40 per cent and 10 per cent. And high uptake is 60 per cent and 15 per cent. See Appendix A.2 on page 51 for full details.

Source: Grattan analysis.

retirees be encouraged to annuitise only a portion of their super, leaving the rest in a flexible account-based pension (Chapter 2 on page 15). See Bell and Warren (2024b, p. 7).

96. While we advocate for Lifetime Super to offer an investment-linked annuity, this modeling uses only a basic lifetime annuity for simplicity.

97. Grattan analysis of Treasury (2024a) and ABS (2024c).

3.4.1 Lifetime Super should pay a levy to government for the benefit of using its balance sheet

Life insurers offering annuities are required to hold enough capital to withstand a significant negative shock to the balance of their assets and liabilities.[98]

However, it would make little sense to require Lifetime Super to meet the same capital requirements, given the agency would have the implicit backing of the federal government. Instead, Lifetime Super should pay an annual levy to the government to reflect the value of the implicit government guarantee it receives.[99] An annual levy would ensure that Lifetime Super complies with the government's competitive neutrality policy.[100] The annual value of the levy should be set independently by the Australian Government Actuary.

3.4.2 Lifetime Super would grow modestly over time

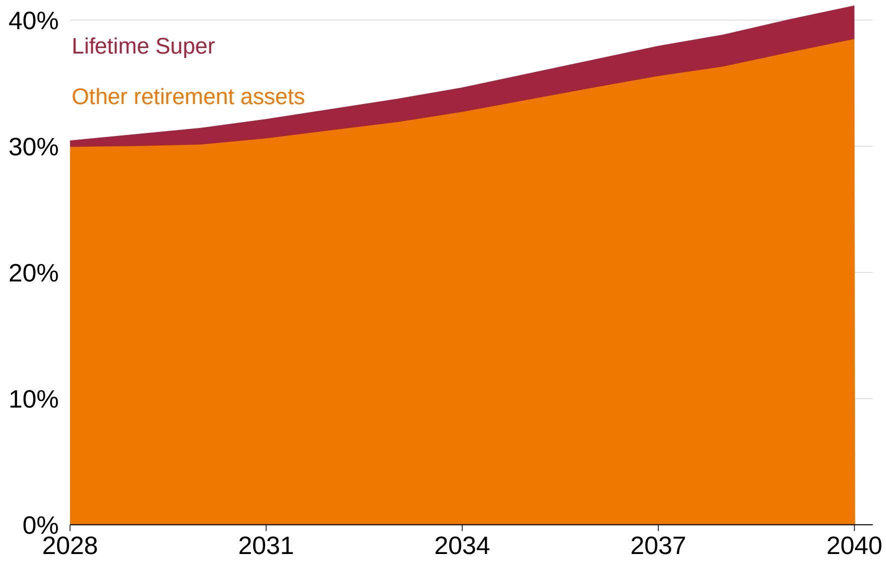
Under our baseline scenario, the vast majority of retirement assets would continue to be held in account-based pensions in APRA-regulated super funds and self-managed super funds (Figure 3.3).

Treasury projects that retirement assets under management could reach about 40 per cent of GDP by 2040.[101] Of this, we project that Lifetime Super would probably reach just over 2.5 per cent of GDP by the same year (Figure 3.3). This would leave at least 1-in-every-16 dollars of retirement super in the super system. This is mainly driven by the capital reserve in our proposed 'pre-set', which leaves the first $250,000 of everyone's super in an account-based pension,[102] resulting in many retirees not annuitising any super, and the typical retiree annuitising less than half of their super balance.[103]

Importantly, while Lifetime Super may only serve a minority of new retirees initially, this would grow in the future. In our high-uptake

Figure 3.3: Lifetime Super would account for a small share of retirement-phase assets in coming decades

Projected shares of the retirement phase of super under medium-uptake Lifetime Super scenario, proportion of GDP



Notes: See Figure 3.2 on the preceding page for Lifetime Super projections. Overall retirement-phase projections exclude defined benefits, regulatory capital, and life office statutory funds.

Source: Grattan analysis of Australian Government (2023a, Chart 7.19).

98. APRA (2013).
99. The government levies a charge on major banks of 0.015 per cent of total liabilities to cover the cost of the implicit government guarantee.
100. Competitive neutrality requires that government business activities should not enjoy net competitive advantages over their private sector competitors simply by virtue of public sector ownership: Treasury (1996).
101. Australian Government (2023a, Chart 7.19).
102. This value is indexed to inflation of 2.5 per cent p.a. in our modeling.
103. Less than half of retirees will have super balances greater than $500,000 by 2060. See: Figure 1.2 on page 7.

scenario, 60 per cent of expected new retirees with balances greater than $250,000 in 2028 is only about 27 per cent of all new retirees. But this will grow as the super system matures. By 2040, we project that this number will be about 46 per cent.

4 The government should give retirees better guidance

The federal government should establish a free guidance service that ‘sums-the-parts’ of the retirement income system for retirees.

As the architect of the retirement income system, the government bears an obligation to help retirees navigate it.

A government guidance service would be less likely to be conflicted than the advice offered by super funds, and therefore more likely to be trusted by many retirees. It would be much better placed than super funds to help couples plan their retirement income, and to service people with diverse linguistic or other needs. It could consolidate existing government services, integrate with the myGov online portal, and could also assist retirees to apply for the Age Pension.

A government guidance service should offer general information and tools, as well as more useful personal advice. We calculate it should cost about $360 million over its first four years, and $50 million a year thereafter.

4.1 Most people need help with retirement planning

Encouraging Australians to annuitise some of their super will simplify retirement planning for most (Chapter 2 on page 15). But Australia’s retirement income system will remain complex. The decisions people make with their super have interactions with the means-tested Age Pension in ways that are almost impossible for most to understand. And many people will want personally-useful guidance on figuring out the right amount of annuity for them, as well as how to invest and draw on their remaining super.

The UK government implemented a service, called Pension Wise, to help people navigate the complex decisions they face approaching retirement, that Australia can learn from (Box 6 on the following page).

4.2 Many people won’t trust guidance from their super fund

Super funds have a growing and important role in helping their members navigate retirement planning (Chapter 5 on page 44). But retirement guidance from a super fund runs the risk of being conflicted. Many people won’t trust it.[104]

Super Consumers Australia found that only 21 per cent of people would trust advice from their super fund and only 10 per cent seek guidance from them.[105] Other surveys found ‘general assistance provided by a superannuation fund’ ranked lower on trust than government sources and paid financial advisers.[106] And a survey from Colonial First State found that just one in three pre-retirees aged 50-64 are interested in hearing from their super fund about retirement in general.[107]

4.3 The government should set up a guidance service

An independent government-run guidance service – ‘RetireSmart – is needed. It should offer general advice and information, interactive tools, as well as personalised portals and personal advice.

104. Previous reviews have found decent levels of *general* trust in super funds. But the Productivity Commission argued that ‘trust is a fickle aspect of people’s subjective judgment’, noting there was an almost one-to-one relationship between trust and satisfaction with fund investment performance. See Productivity Commission (2018, p. 200) and Callaghan et al (2020, p. 398).
105. SCA (2023).
106. Conexus Institute (2022).
107. CFS (2024, p. 7).

Box 6: Australia should learn from the UK Pension Wise service

Pension Wise is a UK government-funded service that offers free, impartial guidance to over-50s on what to do with their accumulated defined-contribution balance.

It was set up in 2015, after the 'Pension Freedoms' reforms which abolished compulsory annuitisation. Pension Wise was established to ensure people were adequately assisted in the new system.[a]

The Money and Pensions Service (MaPS) oversees Pension Wise. MaPs is an independent government agency under the Department for Work and Pensions. In turn, MaPS has contracted out a large portion of the delivery of Pension Wise to a non-government organisation called Citizens Advice. Citizens Advice has a near 90-year history of delivering accessible financial and other advice to UK citizens.[b]

Pension Wise appointments can be in person or via phone. There is also an online 'self-service' option. The service provides guidance on the options for accessing the balances of defined-contribution pension schemes. These include purchasing an annuity, flexible drawdown, lump-sum withdrawals, or a mixture. However, Pension Wise does not recommend particular financial products.

Pension Wise has quickly become central to the UK retirement income system. In 2023, 30 per cent of people who had accessed their balance in the past four years had used Pension Wise.[c] It fills about 100,000 appointments a year, and cost about $A32 million to run in 2022-23.

Pension Wise is well regarded. In 2022-23, the phone service had a customer satisfaction rating of 93 per cent, and the self-service portal had an 82 per cent rating.[d]

Engagement with Pension Wise tends to prompt people to act. About half of phone customers and online users said that after their appointment, they changed how they accessed or intend to access their balance.[e]

a. GOV.UK (2020), and Work and Pensions Committee (2022, p. 31).
b. Money and Pensions Service (2023a) and Citizens Advice (2024).
c. FCA (2023, pp. 88, 89).
d. Money and Pensions Service (2023a).
e. Money and Pensions Service (2023b).

4.3.1 RetireSmart should offer interactive tools and general advice

RetireSmart should provide useful general information and advice, as well as interactive tools that people can use in their own time to help understand how the retirement income system works and what their options are. This could bring together the disparate government information sources currently available for retirees.

Lots of government websites contain helpful information on parts of the system. ASIC's MoneySmart provides an retirement income calculator that projects income from the Age Pension and superannuation. Services Australia goes the furthest, overseeing the Financial Information Service (FIS) that offers webinars and individual appointments with staff to help people make informed decisions about their finances.[108]

These mostly provide information on individual pieces of the retirement income system, but do not 'sum-the-parts'.

People should also be able to set up a RetireSmart account. This individualised portal could build a picture of the person's retirement, ideally drawing information from Services Australia and super funds, particularly during retirement. RetireSmart could also offer retirees a consolidated picture of their situation via the MyGov online portal. Most other OECD countries have 'dashboards' that bring the pieces (or 'pillars') of the retirement income system together.[109]

108. In 2014-15, the latest published, only 5,000 calls were fielded about retirement, and 14,000 pre-retirees attended seminars. There are no data on the outcomes of people who use the services: ANAO (2016), Services Australia (2024c), and Services Australia (2023).
109. See OECD (2024, Table 7.1).

4.3.2 RetireSmart should also offer personal advice

High-quality general advice and interactive tools are necessary, but not sufficient, to give Australians the help they need planning for retirement. RetireSmart should have staff that are empowered to take individuals' circumstances into account and help them understand their options in a personally-useful way.[110]

Offering personal advice is a much bigger endeavour than offering general advice. It introduces new risks, such as a retiree feeling as if the government has given them a bad steer, hurting their financial well-being. It is also more costly.

But the retirement income system will remain complex, meaning Australians will inevitably have questions that they need answered in a more personally-useful way than general advice can provide. This covers all elements of the retirement income system.

Accessing and understanding the Age Pension

Understanding how much Age Pension one can expect and how it might evolve over time is complicated. It means understanding not just the means-test parameters and indexation methods, but also how any part-rate entitlements will increase or decrease depending on the decisions people make with their savings.

Further, even just the process of applying for the Age Pension is a stumbling block for many older Australians. A study by Link Group found that 30 per cent of existing Age Pensioners delayed their application for the Age Pension by more than a year, citing 'low

110. RetireSmart could integrate with the emerging regulatory regime and be staffed by the proposed new class of advisor that is able to provide personal advice with a narrower scope (Section 1.7 on page 12). Personal advice from RetireSmart should be free in the first instance, but there may need to be a modest fee after a certain level of advice, to manage demand.

confidence' and 'system complexity' (Figure 4.1). This delay comes at a cost. A one-year delay costs a couple on the full rate $42,000 in foregone pension income.[111]

Half of existing Age Pensioners tackled the application process alone. Of that group, 60 per cent said they had wanted help, but did not know where to turn for it. And 79 per cent of future Age Pensioners say they want help applying.[112]

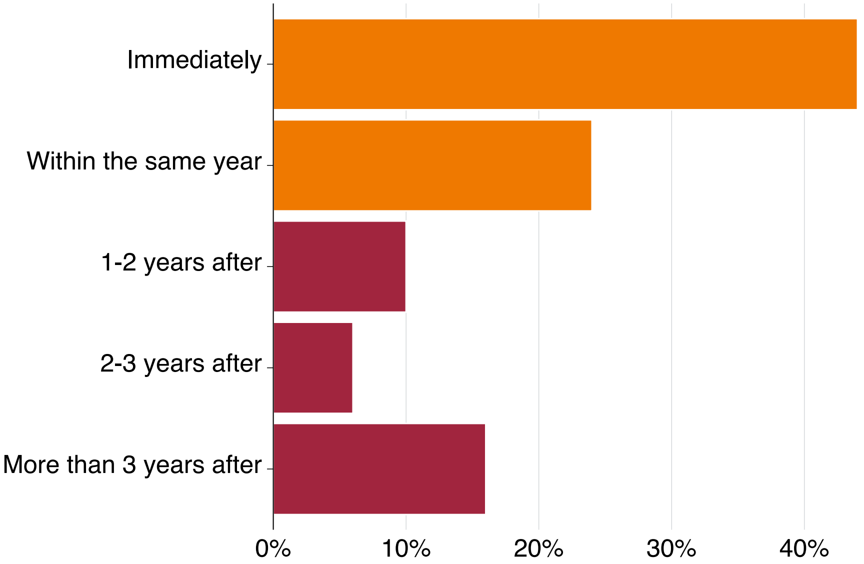
Using super

Even with annuitisation, most retirees will need some personalised help figuring out how to use their remaining super. There are at least three big decisions.

First, lump-sum withdrawals, either to make large purchases or to pay down mortgage or other debt. People need help understanding how these can be accommodated and what the expected impact on overall long-term retirement income should be.

Second, an investment strategy, including the level of risk that retirees wish to be exposed to. Most people are unlikely to fully understand investment risk, let alone how much insurance they might have against it, whether through the Age Pension or Lifetime Super.[113]

Figure 4.1: One-third of retirees delayed their Age Pension application by more than a year
How soon after you became eligible did you apply for the Age Pension?



Source: LINK group (2022, p. 5).

111. Roughly 26 fortnightly payments at the full rate for a couple as at July 2024: Australian Super (2024, p. 15).
112. LINK group (2022, p. 6).
113. Although it is unnecessary for RetireSmart to provide advice on particular assets for retirees to invest in. Personalised guidance at the investment-option (e.g. balanced, conservative etc.) level would suffice.

And third, a drawdown strategy – the rate at which people withdraw income from their remaining super balance, after lump-sum withdrawals and lifetime income purchases.[114]

Understanding Lifetime Super

Many people will need help understanding government-offered annuities, even with the best system-level guidance in place (Chapter 3). Research suggests that clear, concise information can make people more likely to choose lifetime-income products.[115] To be a useful as possible, this guidance should be tailored to individual circumstances. RetireSmart should also be capable of helping retirees through the Lifetime Super purchase process.

Using the Home Equity Access Scheme

RetireSmart should also be able to provide guidance on the Home Equity Access Scheme for interested retirees, and initiate the process for retirees who choose to use it.

The Home Equity Access Scheme allows retirees to draw home equity up to a maximum of 150 per cent of the Age Pension. Payments are made by Centrelink, are not taxable, and don't count towards the Age Pension income test. The outstanding debt accrues with interest, which the government recovers when the property securing the loan is sold, or from the borrower's estate. The scheme has grown rapidly in popularity in recent years (Box 5 on page 30).[116]

114. See Bell and Warren (2024c) for a comprehensive analysis of drawdown strategy options. These can involve targeting an overall income level, or optimising income based on investment returns and expected remaining years of life.
115. Hiscox et al (2017, p. 6).
116. Grattan Institute has previously recommended improvements to the Home Equity Access Scheme. See Wood et al (2022a, Section 9.2.6).

Home equity increasingly represents an underutilised resource in Australia's retirement income system. Even using quite small portions of home equity can substantially improve retirees' incomes. For instance, a typical retiree who uses the scheme to withdraw $5,000 in home equity can boost their income by 10 percentage points.[117]

4.3.3 RetireSmart could better cater to couples

A government guidance service would be much better placed than super funds to help couples.

More than two-thirds of Australians aged 55-70 are part of a couple, and the rate increases with higher super balances.[118] This means the people who need guidance the most are even more likely to need it as a couple.

Super funds are inherently constrained in providing advice to couples. Superannuation is a system of individual accounts. But retirement planning is a set of household-level decisions, with savings and Age Pension entitlements pooled.

If a couple have accounts at different funds, neither of those funds is well placed to provide good household-level advice and guidance. A government option taking a broader view would be better positioned.

4.3.4 RetireSmart could provide accessible guidance

A government guidance service could, and should, cater to a wider range of Australians than super funds.

The 2021 Census showed that there are nearly 200,000 Australians older than 60 who do not speak English well, and another 70,000 who

117. Callaghan et al (2020, p. 183).
118. Grattan analysis of ABS (2022a).

do not speak it at all.[119] And a third of Australians older than 65 are deaf or partially deaf.[120]

It is cheaper and easier for governments to provide translation and interpretation services for people who need them, rather than obligating each fund to do so. RetireSmart could use and expand the existing Services Australia service, which offers free interpreters and translators in more than 100 languages, including Auslan.[121]

4.4 Setting RetireSmart up for success

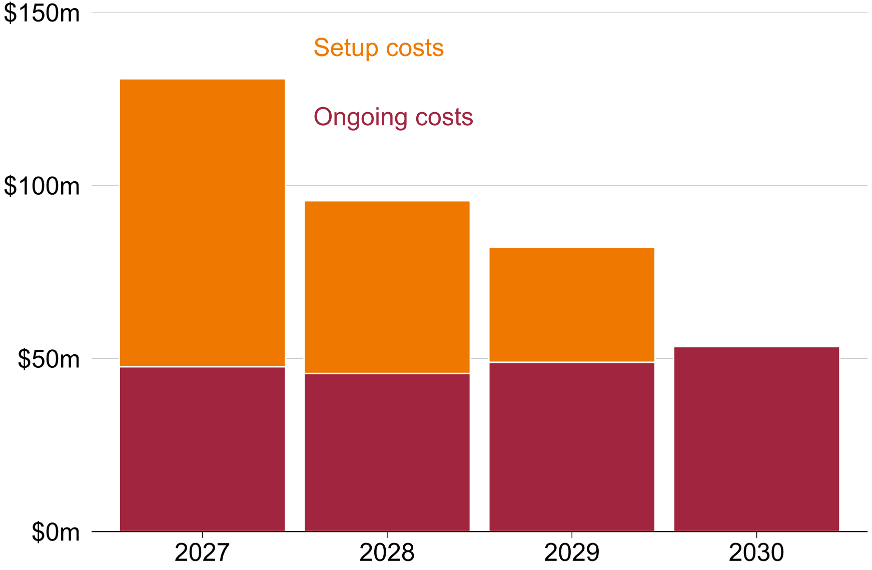
RetireSmart should be an independent body, free from ministerial control, and with legislated objectives and stable funding.

RetireSmart should also actively encourage pre-retirees to use the service. It should send tailored (as far as is practicable) communications to individuals at milestone ages. For example, from age 55 – and potentially via ATO tax returns – encouraging them to start thinking about their options and exploring the information on the RetireSmart website. This should also happen at preservation age, Age Pension access age, and other milestone episodes – for example, when they have applied for the Age Pension or asked their super fund to rollover their balance to retirement phase.

And last, RetireSmart should have a strong data and analytics capability, tracking who is using the service and how, as well as satisfaction with and outcomes from the service. This data could inform research into how to improve the service offered by RetireSmart, as well as the financial advice service offerings of super funds. However, any personal information provided by people to RetireSmart should be

119. Grattan analysis of ABS (2022b).
120. AIHW (2023b).
121. Services Australia (2024d). Translation refers to written word, and interpretation to spoken word.

Figure 4.2: RetireSmart should cost about $360 million over its first four years
Projected cost of RetireSmart, 2027 to 2030



Note: See Appendix A.3 on page 52 for details.

Source: Grattan analysis of ABS (2024a, Table 14), ABS (2022a), ABS (2024b), Philipson (2017), and SEEK (2024).

ring-fenced to the provision of advice, and not passed-on to be used in other parts of government for other purposes.

4.5 RetireSmart would be cheap relative to the benefits

If RetireSmart advised about one-third of new retirees, we calculate that it should cost about $360 million over its first four years (including setup costs) and about $50 million per year thereafter (Figure 4.2).

This is a small price to pay to provide people with accessible, tailored guidance through a complicated set of important decisions.

A simple way to keep the proposal budget neutral would be to fund it via a levy on super fund balances. For example, a levy of $1.30 for every $100,000 of super under management – applied to APRA-regulated super funds and self-managed super funds – could raise $50 million a year.[122]

Alternatively, budget neutrality could be accomplished via some modest trimming of superannuation tax breaks. For example, removing government co-contributions and pre-tax cap carry-forwards – which mostly flow to well-off households – would save more than $1 billion over four years without affecting the adequacy of retirement incomes.[123]

122. Grattan analysis of APRA (2024a).
123. See Coates and Moloney (2023, Chapter 2).

5 The government should ensure super funds deliver for retirees

This report recommends that the government offer and promote annuities and a government advice service to simplify retirement planning and empower retirees to spend their super.

However, super funds still have a big role to play in helping Australians in retirement. Even with widespread annuitisation, most retirees with super will continue to use an account-based pension. And many Australians will seek guidance from their super fund.[124]

But the regulation of retirement super is too light. More is needed. The performance test should be extended to account-based pensions, to weed out those that are poor-value. The government should ask the Australian Prudential Regulation Authority (APRA) to develop and maintain performance product assessments for account-based pensions and private lifetime-income products.

The government should create a shortlist of the top 10 super funds, selected by an independent expert panel, and then steer retirees towards those funds. Funds should be selected on their capacity to deliver strong risk-adjusted returns in the long term, sound governance, and their capacity to provide the best guidance and advice in retirement. This would encourage all super funds to lift their game – including the quality of the guidance and support they provide to retiring members – as funds would compete to make the top 10 and stay there.

Together, these reforms could boost the incomes of future retirees who opt for an account-based pension by up to $70,000 over their retirement.[125]

124. If Lifetime Super is implemented, the Retirement Income Covenant obligations can be simplified to just the investment and drawdown of account-based pensions, and funds should no longer be expected to provide lifetime-income products.
125. See Appendix A.4 on page 53.

5.1 Where to invest their super in retirement is one of the biggest financial decisions Australians ever make

The account-based pension retirees choose is one of the biggest financial decisions they will ever make. Australians can expect to earn more than half their investment returns, and pay more than half their fees, in the years after they retire (Figure 5.1 on the following page).

The typical retiree today can expect to be charged about $25,000 in account-based pension fees over their retirement, and wealthier retirees can expect to be charged more than $50,000.[126] In fact, households aged 65 and older spend more on average each year on super fees than they do on their energy bills.[127]

5.1.1 Despite the higher stakes, there is less regulation of retirement super than working-age super

Workers who do not choose a super fund are defaulted into a standardised MySuper product (Figure 1.5 on page 11).[128] Super funds' offerings to workers have been subject to performance testing since 2021 (Box 7 on page 46). Super products for workers are also subject to comprehensive, transparent, and robust assessments,

126. Wealthier retirees are those in the top net wealth quintile for wage-earning aged 55-64. Starting fees are $74 and 0.85 per cent, with the fixed value indexed to wages. Grattan analysis of ABS (2022a).
127. The average spending of households aged 65 and older on domestic fuel and power exceeds projected super fees, assuming super fees total at least 0.75 per cent of super account balances of that cohort. Grattan analysis of ABS (2017) and ABS (2018).
128. Only funds offering a MySuper product are eligible to receive default superannuation contributions from new employees, but workers can opt out of the MySuper option at any time.

compiled and published by APRA.[129] These reforms have lowered fees and improved the performance of super for working Australians.[130]

In contrast, there are no 'default' account-based pensions, and they are not subject to performance testing or public assessments by APRA.

5.2 Reforms are needed to improve the performance of account-based pensions

Successive governments over the past decade have improved the performance of super funds' offerings to workers, saving Australians up to $7 billion a year.[131]

But the market design for account-based pensions remains much weaker. Australians have historically paid more to have their super managed in retirement than during when working.[132]

5.2.1 Account-based pensions should be performance tested

The *Your Future, Your Super* performance test should be extended to the simple account-based pensions super funds offer to retirees.

The performance test has been a success in working-age super since its implementation in 2021 (Box 7 on the next page).

129. These assessments are presented in APRA's Comprehensive Product Performance Package (CPPP). They assess performance across three areas: investment pathways, fees and costs, and sustainability of member outcomes: APRA (2024b).
130. Coates and Moloney (2022).
131. 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 Productivity Commission (2018, Figure 3.11), APRA (2024c, Tables 4a, 5a, 6a), and APRA (2024a).
132. The Productivity Commission found that administration and investment fees were typically higher for retirement super than working-age super: Productivity Commission (2018, Figure 3.10 and 3.11).

Figure 5.1: Australians earn more than half their lifetime investment returns, and pay more than half their lifetime super fees, in retirement
Annual projected investment returns and super fees incurred for a worker aged 30 today, 2024 dollars

Notes: Assumes a worker who is 30 today and retires at 67. Assumptions as per Coates and Nolan (2020).

Source: Grattan analysis of Grattan Retirement Income Projector (see Coates and Nolan (ibid)), including a 1 per cent lower return in retirement as retirees shift towards less-risky investment strategies.

Box 7: The performance test has been a success for working-age super

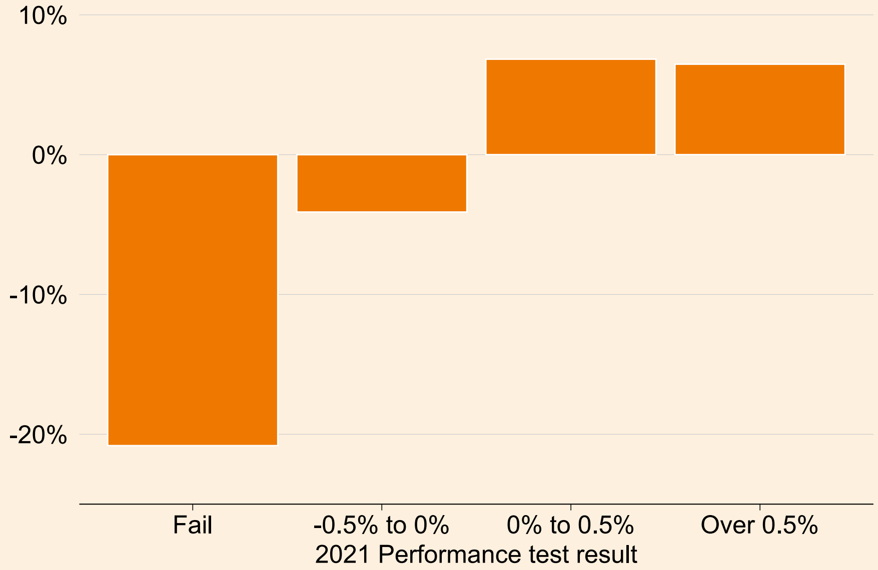
The performance test was implemented in 2021 following a recommendation from the 2018 Productivity Commission inquiry. It covers most working-age super – MySuper products and 'trustee-directed products'.[a]

Performance testing for working-age super has been a success. The performance test gave APRA the much-needed leverage to push under-performers out or require them to merge with better-performers.[b] Almost all of the MySuper products that failed the first test have merged into a better-performing fund, saving members millions. From October 2020 (just before the performance test was announced) to December 2023, the number of MySuper products fell from 88 to 60.[c]

Just a year later, members of the products that failed the first round of the test in 2021 were paying fees at least 20 per cent lower than before the test was announced (see right). This represents a fee saving to those members of more than $100 million – and probably many more millions of dollars over subsequent years. These members would have also benefited from better investment performance in successor funds.

A common complaint is that the test encourages 'benchmark hugging' and short-term decision making. Treasury reviewed the test in 2022, with amendments made, and then again in 2024.[d] But the test's framework remains the best available. The test should continue to be refined over time to minimise unintended consequences.

Percentage change in average MySuper fees from September 2020 to June 2022 for a representative $50,000 balance, by 2021 performance-test result



Notes: Fees are asset-weighted administration and investment fees, using assets as at September 2020. This period includes the transition to the new fee disclosure regime, RG97. Excludes the four products not tested in 2021, and products that passed but did not have a performance test metric reported in 2021. 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.

Source: Grattan analysis of APRA (2024d) and APRA (2021).

a. Trustee-directed products are a subset of working-age choice products that are multi-sector, and where the fund trustee exercises control over the design and implementation of the investment strategy.
b. Chester and Ruting (2024).
c. Coates and Moloney (2022, Table 1.1), and APRA (2024d).
d. Treasury (2022) and Treasury (2024b).

Super funds are required to notify their members if the tested product falls more than 0.5 percentage points under a combined 10-year net investment return benchmark and administration fee benchmark. Products that fail the test for two consecutive years are unable to accept new members.[133]

A key reason the performance test was not applied to retirement products was that some retirement products are more complex, involving some pooling of longevity risk, for example. But this is no reason to not extend the test to the simple account-based pensions that currently dominate retirement super (Section 2.1 on page 15).

The existing performance test framework could easily be applied to account-based pensions. About two-thirds of retiree savings are in the multi-sector portfolios for which the testing framework was designed.[134] The chair of APRA – the agency that administers the test – has said it would not be a big step to apply the test in the retirement phase.[135]

The existing time-frame, set of market indexes, investment fee assumptions, and the consequences of failure,[136] are all suitable for simple account-based pensions.[137]

However, an alternative approach would be needed for determining the level of administration fees, because retirees need more services.

133. APRA (2023a).
134. Excludes SMSFs. Grattan analysis of APRA (2024c, Table 1b).
135. Mather and Shapiro (2023).
136. In the unlikely event that all of a fund's account-based pensions failed the test twice and the fund could no longer offer a retirement-phase account, the trustee would presumably conclude it is in the members' best financial interests to merge into a better-performing fund.
137. The tax assumptions would need to change to reflect tax-free retirement earnings. Further, funds differ in how they account for the windfall of unrealised gains no longer being taxable once the member retires, which may lead to artificial differences in reported net investment returns. Ideally, there would be a legally-prescribed consistent method of reporting these gains and attributing them to members.

The administration fee benchmark should be the median charged for the account-based pensions of the 10 'best-in-show' funds, rather than the median of all account-based pensions. Retirees also have higher balances, so a higher representative balance than the $50,000 currently used for working-age products should be used.

5.2.2 Account-based pensions should be included in APRA's performance assessments

The Comprehensive Product Performance Package (formerly called 'Heatmaps'), produced and published by APRA, has provided comprehensive, transparent, and robust assessments of superannuation fund offerings to working-age Australians.[138] APRA should add account-based pensions to its assessments.

5.3 The government should create a list of the top 10 super funds

Performance testing and assessments of account-based pensions would weed out the poorest products. But more is needed to ensure funds deliver for retirees.

The government should therefore established a list of the top 10 super funds. This would implement the 2018 Productivity Commission recommendation to create a single 'best in show' shortlist of up to 10 super funds, selected by an independent expert panel, and also extend it to cover super funds' offerings to retirees.[139] Funds should be selected on their capacity to deliver strong risk-adjusted returns in the long term, sound governance, and their capacity to provide the best guidance and advice.

138. Performance assessments have been published for MySuper default products since 2021, and for choice products in the working-age phase since 2023. See APRA (2024b).
139. Productivity Commission (2018, Chapter 12). See Wood et al (2022b) for more detail on how to ensure independent appointees.

New workers should be assigned to these funds upon entering the workforce (although people would retain the right to choose another fund), and existing workers should be steered towards these super funds as they approach, and upon, their retirement.

'Best-in-show' would encourage all super funds to lift their game, because funds would compete to make the top 10 and stay there. Market discipline would come from experts who have the time, resources, and expertise to decide which funds to list, rather than individuals who don't.

It would also create a safe and simple choice environment for retirees, in contrast to the complex and perplexing one retirees currently face. There are 104 institutional funds offering 246 account-based pensions, of which 64 funds offering 121 account-based pensions are open to the public. These publicly-open products offer an eye-watering amount of choice, with at least 866 investment options (and thousands more available for 'platform products').[140] A top 10 list would offer retirees a short-cut to a good decision.[141]

5.3.1 Extending 'best-in-show' to the retirement phase is simple and makes sense

The Productivity Commission proposed 'best-in-show' to identify the funds that are most likely to deliver the best results for members, with a focus on the working-age phase. But a fund that is good for workers is generally one that is good for retirees too. The criteria the Productivity Commission proposed for selection onto the 'best-in-show' list are largely applicable to the retirement phase as well.[142]

For example, the performance criteria are designed to assess the likelihood of a MySuper product delivering strong, long-term, risk-adjusted returns. These criteria are equally applicable to an account-based pension.

Similarly, fund-level criteria such as administrative efficiency, fund governance practices and track record, innovation, capacity to identify and meet member needs, and the quality of advice are all as relevant, if not more so, to retirement as working-age.

Under our proposal, there should be criteria that covers funds' performance against the Retirement Income Covenant. Top-10 status should be granted only to funds that have a proven record of providing useful retirement advice and guidance to their members. That is, funds that are taking seriously their obligations under the Covenant.[143] Where possible, these assessments should put weight on the actual outcomes received by retirees.

Annuities and other more sophisticated income-stream products would not need to be included as criteria if Lifetime Super was fulfilling that role in the system (Chapter 2).

How to steer pre-retirees into 'best-in-show' funds

The primary benefit a 'best-in-show' fund would receive is some of the default flows of new workforce entrants. But people already in the system should also be steered towards 'best-in-show' funds for their retirements.

Funds that are not on the list should be obligated to communicate this to pre-retirees – at certain milestone ages and events, and in a prescribed form.[144]

140. Grattan analysis of APRA (2024c, Tables 1a and 1b). See Appendix A.5 on page 53 for details.
141. Souvlis et al (2016, p. 32), and CHOICE (2018, p. 6).
142. See Productivity Commission (2018, Box 12.4).
143. See Bell and Warren (2022, Table 2) and Bell et al (2023) for examples of the kind of capability leading funds should have.
144. For example, from age 55, at preservation age, and when a member starts making inquiries about the retirement phase.

When retirees seek to rollover their super into the retirement phase, such as by opening an account-based pension, retirees should again be advised whether their fund is on the list. If it is not, the retiree should be presented with the option of instead rolling over their super into one of the 'best-in-show' funds.

Existing government advisory services, such as the ASIC *MoneySmart* website, should feature 'best-in-show' retirement funds prominently. The ATO comparison tool should also be expanded to include account-based pensions, with the top 10 clearly highlighted.

When pre-retirees are open to switching, RetireSmart (see Chapter 3) should steer them exclusively towards 'best-in-show' funds.

5.3.2 Concerns about market concentration are overblown

Some have argued that producing a top 10 list to receive default flows could lead to undue concentration in the superannuation sector.[145] Yet the risks to super fund performance, and members' retirement incomes, from an increase in concentration are small, and the benefits could be large.

Market concentration among APRA-regulated funds is low. As at June 2023, there were 115 APRA-regulated funds, down from 252 in 2015.[146]

We estimate that the superannuation sector has a Herfindahl–Hirschman Index (HHI) – a commonly accepted measure of market concentration – of 501 for APRA-regulated funds, based on their share of assets under management. Only HHI scores exceeding 2,000 are generally considered to signal that a sector is becoming highly concentrated.[147]

Reducing the fragmentation of the super sector could produce further gains from economies of scale.

The Productivity Commission estimated in 2018 that cost savings of at least $1.8 billion a year could be realised if the 50 highest-cost funds merged with the 10 lowest-cost funds, saving Australians on average $22,000 over their retirement, mainly via lower investment management and administration costs.[148]

And it is likely that a substantial share of the $7 billion-a-year reduction in super fees, as a share of assets, in working-age super since 2010 is attributable to economies of scale in funds' management and administration following super fund mergers.

5.4 Consumer protections for private lifetime-income products should be boosted

Irrespective of whether the government offers annuities, at least some super funds and other providers will continue to offer lifetime-income products.

Government-offered annuities are the first-best protection for consumers against being sold poor-value products (Chapter 3). But even then, there are simple steps government should take to further protect people in the private product market.

For example, the government should ask APRA to develop and publish performance assessments of private lifetime-income products, and the government should create a user-friendly tool to help people compare

145. See Productivity Commission (2018, pp. 550–551) for a summary.
146. APRA (2024a).
147. Grattan analysis of APRA (2023b, Tables 9 and 11) and APRA (2024c, Table 1a). The HHI was estimated using data on funds' share of assets. See Productivity Commission (2018, Figure 7.3).
148. Productivity Commission (ibid, pp. 22–23).

products. And there should be regular audits of super funds that steer retirees away from Lifetime Super and into their own lifetime-income products, to test whether such recommendations were in members' best financial interests.

5.5 Plans to allow funds to provide more personal advice should be put on hold until the market design has been improved

In response to the 2023 Quality of Advice review, the government plans to make it easier for funds to provide tailored guidance to members (Section 1.7 on page 12).[149]

The complexity of the retirement income system means funds should be able to help their members on a more personal level. But if these moves are to work in the interests of retirees rather than funds, the government should first create a stronger market design. The Delivering Better Financial Outcomes package should therefore only proceed once account-based pensions are performance tested, and all retirement products are included in APRA's performance assessments.

149. Australian Government (2023b).

Appendix A: Data and methods

A.1 Retirement income projections – Figure 2.4 on page 20 and Figure 2.5 on page 26

The retirement income projections in this report all use the same model.

Our model takes either a single or couple homeowner and projects their retirement income under different assumptions of how much of their super they annuitise and the interest rate used to price the annuity. They start retirement at 67 and die aged 89.

We use the eighth decile of the IRSAD (Index of Relative Socio-economic Advantage and Disadvantage) sub-group mortality rates to account for potential adverse selection (particularly given the use of a capital reserve in nudging will mean the pool skews towards healthier retirees).[150] We use the female tables to be conservative. We also apply the improvement factors provided by the AGA to adjust mortality from 2016 to expected 2028 terms (our base year).[151]

Purchasers pay 0.1 per cent of the implicit balance per year to cover administration and the levy we propose to cover the implicit government guarantee. We price the lifetime annuity with an assumed nominal interest rate of 4 per cent. For a 67-year-old, the conversion rate for a fixed-nominal lifetime annuity is 7.081 per cent.

All Age Pension parameters start as at 1 July 2024, and are then indexed as per current policy: the higher of CPI or the Pensioner and Beneficiaries Living Cost Index (PBLCI), and then benchmarked to a share of Male Total Average Weekly Earnings (MTAWE): 41.75 per cent for a couple, with the single rate following as 66.33 per cent of the couple rate.

We project forward following analysis from Super Consumers Australia predicting it will take about 11 years from 2024 for the indexation to catch the benchmark, leading to effective indexation of 2.8 per cent (0.3 per cent real) until 2035, and then 3.7 per cent thereafter (1.2 per cent real – following standard Treasury assumptions).[152] We assume inflation is 2.5 per cent p.a. for the indexation of the means-test parameters. Age Pension entitlements factor in the concessional treatment for lifetime-income products.

All retirees have a small amount of non-super assessable assets (about 15 per cent of their retirement super balance). The value of these assets grows with inflation.

All our other assumptions are as per the Grattan Retirement Income Projector.[153]

A.2 Projected aggregates of Lifetime Super – Figure 3.2 on page 34

These estimates come from a cohort-based model that estimates uptake for new and existing retirees separately.

For new retirees, the model takes a share of the annual predicted new retirees who have balances greater than $250,000 from 2028 (assumed product launch) to 2040, buys them a fixed-nominal lifetime annuity, and simulates each cohort's payment flows and stocks out to 2040.

150. AGA (2021).
151. AGA (2019).
152. See SCA (2024b) and Treasury (2024a, pp. 70–71).
153. See Coates and Nolan (2020).

For existing retirees, it also takes a smaller share (given they already have established retirement plans and are not subject to nudges). Existing retirees enter the scheme evenly over the first five years of operation.

The flow of new retirees and their average age comes from the 2022-23 ABS Retirement and Retirement Intentions Survey.[154] We use a representative super balance at retirement which comes from the 2021 Intergenerational Report. We filter out the share expected to have balances below the inflation-indexed capital reserve (i.e. $250,000 in 2028), and take the weighted-average balance of those remaining by a linear interpolation of the weighted-average balance of the mid-point of the reported ranges. The raw data are wage-deflated, so we re-inflate by expected wage growth of 3.7 per cent p.a.[155]

We estimate the stock of existing retirees by using the 2019-20 Survey of Income and Housing.[156] We filter for those who are over preservation age, younger than 80, out of the labour force, not drawing an Age Pension (i.e. do not already draw guaranteed income) and with balances between $400,000 and $1.5 million. We then use the size of that population (342,000), their average age (68), and average super balance ($755,000). We increase population by 1 per cent p.a. from the year of the survey data (2019-20) to 2028. We increase super balances by 2.5 per cent (assuming they grow even after withdrawals, given the low minimum drawdown rates and relatively strong returns over the period since the survey was taken).

For new retirees, the representative retirees buy an annuity with 80 per cent of their balance above $250,000 up to a maximum purchase of $1 million (with these thresholds indexed to inflation of 2.5 per cent p.a.). Existing retirees use 50 per cent of their balance above the same threshold.

Annuities are priced using a 4 per cent interest rate, and conversion rates vary depending on each cohort's average age. Headline conversion rates range from 6.42 per cent for a 63-year-old to 11.92 per cent for a 70-year-old. We use the same processes as described in Appendix A.1 on the preceding page to calculate conversion rates.

We use a representative retiree for each cohort, using the average expected age across the cohort. Using the average age across the cohort abstracts from the non-linearity of conversion rates (they increase at an increasing rate with age). This means that if the actual age of retirement is uniformly distributed around the mean, the actual average conversion rate across a given cohort will be higher than the representative agent we use. But retirement ages are unlikely to be uniformly distributed, with earlier retirements more likely than later ones. This means any downwards bias in our estimates from this abstraction is likely to be negligible.

We then turn the nominal results into a share of GDP using nominal GDP growth of 5 per cent p.a after the Treasury medium-term projection finishes in 2036.[157]

A.3 Estimating the cost of RetireSmart over four years – Figure 4.2 on page 42

This analysis assumes set-up costs are $166 million spread across the four-year period, but front-loaded.[158]

154. ABS (2024a, Table 14.1).
155. Australian Government (2021, Figure 7.4.4).
156. ABS (2022a).
157. Treasury (2024a).
158. $120 million was the estimated cost to set up Services NSW in 2017. We then inflate by CPI to year 2028. See Philipson (2017).

We also assumes that one-third of new and existing retirees use the service for personal advice.[159] New retirees use two-and-a-half long-form appointments on average (1 hour each) in the lead up to retirement. Existing retirees use one short-form appointment (15 minutes) every five years. We assume 70 per cent of retirees are in a couple and share an appointment with their partner.[160]

Staff costs are calculated as follows. Staff work 7.6 hours per day for 235 days a year. They spend half this time in appointments. They are paid about $107,000 a year in the first year, increasing by 3.7 per cent p.a. thereafter. This is about 80 per cent of the current average salary of a fully-qualified financial planner.[161] Other functions, overheads and management costs are factored in as 150 per cent of the wage costs.

A.4 Estimating the benefits of performance testing account-based pensions and creating a top 10 list – Chapter 4 on page 37

These estimates take the current stock of account-based pensions, and assume their performance-test result would be the same as the providing funds' average fund-level result for their trustee-directed products in 2023.[162]

The benefits of performance testing involve every product with a performance test score below 0 per cent lifting their score to 0 per cent.

We use the average distance from zero of 0.58 per cent (to allow a buffer from -0.5 per cent) to simulate the benefits to total expected retirement income over time for a typical future retiree.

159. The expected 'flow' of new retirees is taken from ABS (2024a) and the stock of existing retirees is taken as those aged 65 years and older from ABS (2023).
160. Grattan analysis of ABS (2022a).
161. See SEEK (2024).
162. We used 2023 data because that was the first year trustee-directed products were tested, so provides the best available proxy for the first year of account-based pensions. Grattan analysis of APRA (2024c, Table 1a) and APRA (2023a).

To simulate the benefits over time for a typical future retiree of a Top 10 fund (to total expected retirement income), we use the average performance test score for the current top 10 public-offer funds with a MySuper license (as ranked by fund-wide average performance test score) of 0.89 per cent.

The benefits for a future retiree (retiring at age 67 in 30 years' time) are discounted by inflation of 2.5 per cent p.a. during retirement, and then by wage growth of 3.7 per cent p.a. to the present.

Unless otherwise stated, cameo modelling assumptions follow those used in the Grattan Retirement Income Projector.[163]

A.5 Estimating the number of investment options – Section 5.3 on page 47

This estimate adjusts for double-counting where the same option is offered in multiple products. It also excludes transition-to-retirement products. These 64 funds also manage another 87 transition-to-retirement products that allow someone past preservation age to simultaneously continue to work and make super contributions, while drawing a tax-free pension. There is nearly $13 billion, and there are about 58,000 accounts, in these products.[164]

There are at least another 8,934 options available on publicly-open platforms. 'Publicly-open' means it accepts new members from the general public. Other products are open to new members, but only via particular channels (e.g. select employers or industries).[165]

163. See Coates and Nolan (2020).
164. Grattan analysis of APRA (2024c, Tables 1a and 1b).
165. Grattan analysis of APRA (ibid, Tables 1a and 1b).

Appendix B: Classification of OECD countries' retirement income systems

Our classifications in Section 2.2.2 on page 20 are outlined in Table B.1. They look at the 'second-tier' schemes. These are the ones that are earnings-linked or contributory, designed to produce a retirement income that scales with working-life earnings. This is in contrast to 'first-tier' schemes that are more redistributive by nature, designed primarily to prevent poverty.

Our classifications build off the OECD classification framework, which includes mandatory or 'quasi-mandatory' (collective agreements with at least 85 per cent coverage) schemes.[166] This means schemes that do not fit into the OECD framework are not included. For example, New Zealand's opt-out defined-contribution system, and various occupational schemes with lower coverage. Denmark, Norway, and Sweden appear in both columns because the OECD classifies them as having both public and private arms to their second-tier.

For private defined-contribution systems with 'heavily promoted or popular lifetime income', drivers vary. About two-thirds of Chileans annuitise their defined-contribution balance (this option is heavily promoted and encouraged). Tax benefits make annuities a common option in Denmark's private defined-contribution system. Annuitisation appears relatively unpopular in Mexico, perhaps because the scheme is immature and the balances are low. Norway and Sweden's private defined-contribution systems have something close to compulsory annuitisation, but there is flexibility regarding the exact product/type of income stream. The UK removed compulsory annuitisation in 2015. This information was sourced from the same sources cited in Table B.1.

Table B.1: Classification of 'second-tier' contributory schemes in OECD countries

Government schemes	Private sector schemes
Lifetime income, defined-benefit or points: • Austria, Belgium, Canada, Colombia, Costa Rica, Czechia, Estonia, Finland, France, Germany, Greece, Hungary, Japan, Lithuania, Portugal, Slovak Republic, Slovenia, South Korea, Spain, Switzerland, Turkiye, US **Lifetime income, notional defined-contribution:** • Denmark, Italy, Latvia, Norway, Poland, Sweden	**Lifetime income, defined-benefit or points:** • Luxembourg **Defined-contribution with compulsory lifetime income:** • Iceland, Israel, Netherlands **Defined-contribution with heavily promoted or popular lifetime income:** • Chile, Denmark, Norway, Sweden **Defined-contribution with little lifetime income emphasis:** • Australia, Mexico, UK

Sources: Grattan analysis of OECD (2023a, Table 3.1), OECD (2023b), Mercer (2024), and Altschwager and Evans (2020b), and various foreign government websites.

166. OECD (2023a, Table 3.1 and p. 148).

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