

A framework for retirement incomes



KPMG and Challenger have conducted a series of workshops with various Australian superannuation funds to understand the importance of education and providing retirement income solutions to their respective member bases.

The key findings

- Member retirement outcomes and retirement income are the top strategic priorities for funds.
- Each fund appears to have a different approach and philosophy to providing retirement solutions to members. Funds need a retirement framework, an ability to implement a solution and a fuller suite of retirement products in order to optimise retirement outcomes for members.
- Retaining members approaching or in retirement is a significant issue for many funds, especially for funds with members with high average ages and balances.
- Online advice will increasingly play a critical role in servicing the volume of members requiring retirement education and solutions.
- Each fund faces the key challenge of integrating its retirement solution into a number of systems and processes. Funds that have kept their administration functions in-house may be able to implement solutions faster.

Our conclusion is that retirement income solutions will play an increasingly pivotal role in the Australian market as average member ages increase. However, funds appear to be struggling with how to implement a retirement philosophy into their operations. With the release of the Financial System Inquiry (FSI) Report and the recommendation for fund trustees to provide a Comprehensive Income Product for Retirement (CIPR), there will be increased focus on designing and implementing industry-wide retirement products.

In this paper, we propose a retirement framework which will provide funds with a consistent, practical way of helping members optimise their retirement outcomes.

The key challenges

While performance is a core element of the value proposition in accumulation, the goal of the retired member is to generate a sustainable source of income that lasts for the rest of their life. The FSI has proposed that the primary objective of the superannuation system is 'to provide income in retirement to substitute or supplement the Age Pension' and seeks to 'reorient the community mindset around superannuation away from account balances and towards the provision of retirement incomes'.

Critically, the nature of the relationship with members changes in retirement. For the majority of members in the accumulation phase the fund acts as a wholesaler; the relationship is via the member's employer to a large extent due to the default mechanisms. The individual circumstances of members in accumulation have relatively little impact on the management of the fund. Desired outcomes can be achieved without details of members' circumstances.

In retirement, however, there needs to be more of a direct, 'retail' relationship with the member. This shift from a fund to employer (B2B) model in accumulation to a fund to member (B2C) one is necessary to ensure retirement income products are tailored for individual member outcomes. The circumstances of individual members and the choices that they make can have substantial implications for tax, Centrelink benefits, access to capital and the like.

Actively engaging members in the retirement phase requires a comprehensive retirement framework to deliver, among other important elements, a digital strategy and environment where members can share additional information (i.e. a spouse's information about his/her assets) so that a whole of retirement view can be assembled and evaluated.

There is no single solution because the needs of retirees vary considerably; not just between individuals, but also between the different phases of retirement as retirees age. Thus a structure based on the needs of retiree members and how they change over time would provide a compelling retirement solution for members. As the superannuation system matures, funds will increasingly see the outcome where a prudent fund member spends the later years of their retirement relying solely on the Age Pension as a sign of failure.

Industry Super Australia research shows that only five per cent of active members of Industry Super Fund accumulation funds at age 55 are members of income streams at 66¹. It is likely the FSI recommendations will take some time to be accepted and implemented. With approximately 100,000 members retiring each year within not-for-profit funds, action needs to happen before retirement to retain these members.

Outcomes/future state

A retirement vision will likely include the following characteristics	<ul style="list-style-type: none"> • A clear philosophy around the optimum role that a fund wishes to play in members' retirement outcomes. • An overall framework and related design and implementation components from which to deliver the retirement philosophy.
Regardless of a fund's retirement philosophy and ideology, it is reasonable to envisage a future state with the following elements	<ul style="list-style-type: none"> • Increased sophistication around the management of sequencing risk. • Removal of regulatory hurdles for deferred lifetime annuities and other longevity products. • Use of a range of products to meet different member needs in retirement, such as a CIPR. • Prevalence of sophisticated digital advice strategies. • Greater understanding of members' retirement needs and broader financial status.
Funds will need to consider their strategy against this background. At the very least we expect those strategies to include	<ul style="list-style-type: none"> • A more sophisticated default strategy and product set driven by that philosophy. • Earlier engagement in a member's superannuation lifecycle via digital strategies.

1 ISA Positioning Paper, Retirement Income Policy, November 2013

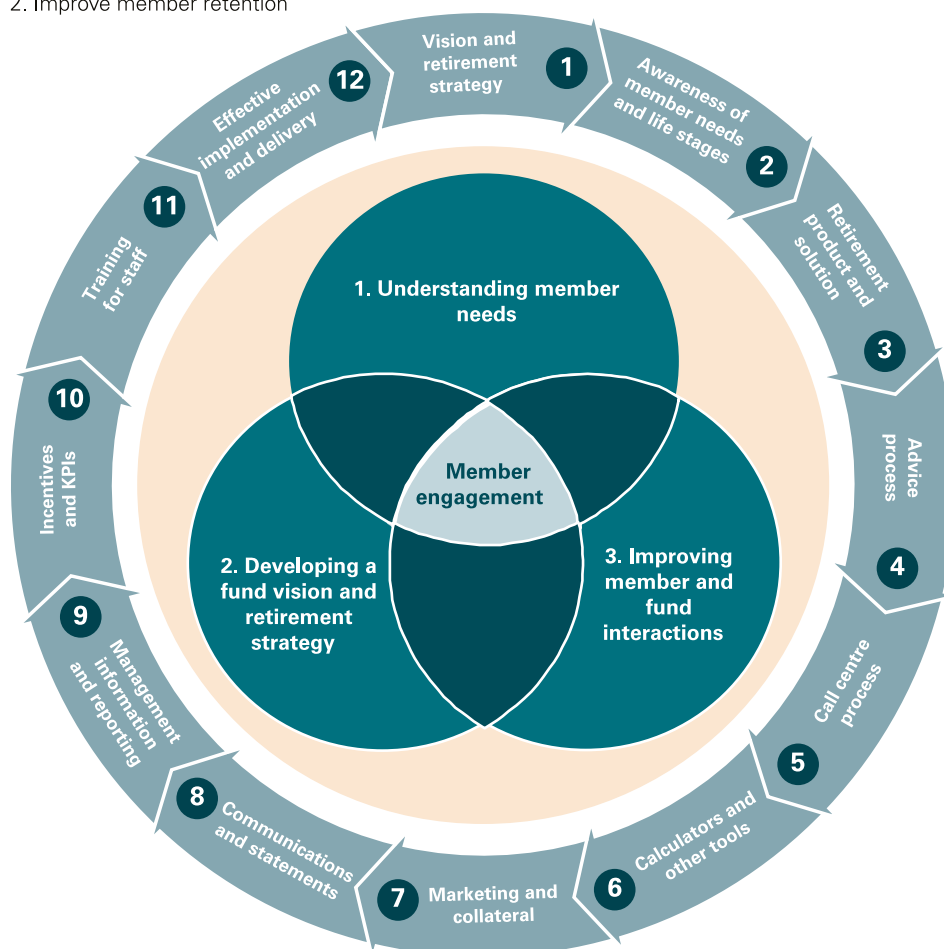
A way forward: One framework, multiple solutions

We propose the following framework that brings together the current issues and future state requirements. It consists of three core tenets supported by 12 design principles.

A framework for member engagement

Performance outcomes:

1. Improve member engagement
2. Improve member retention

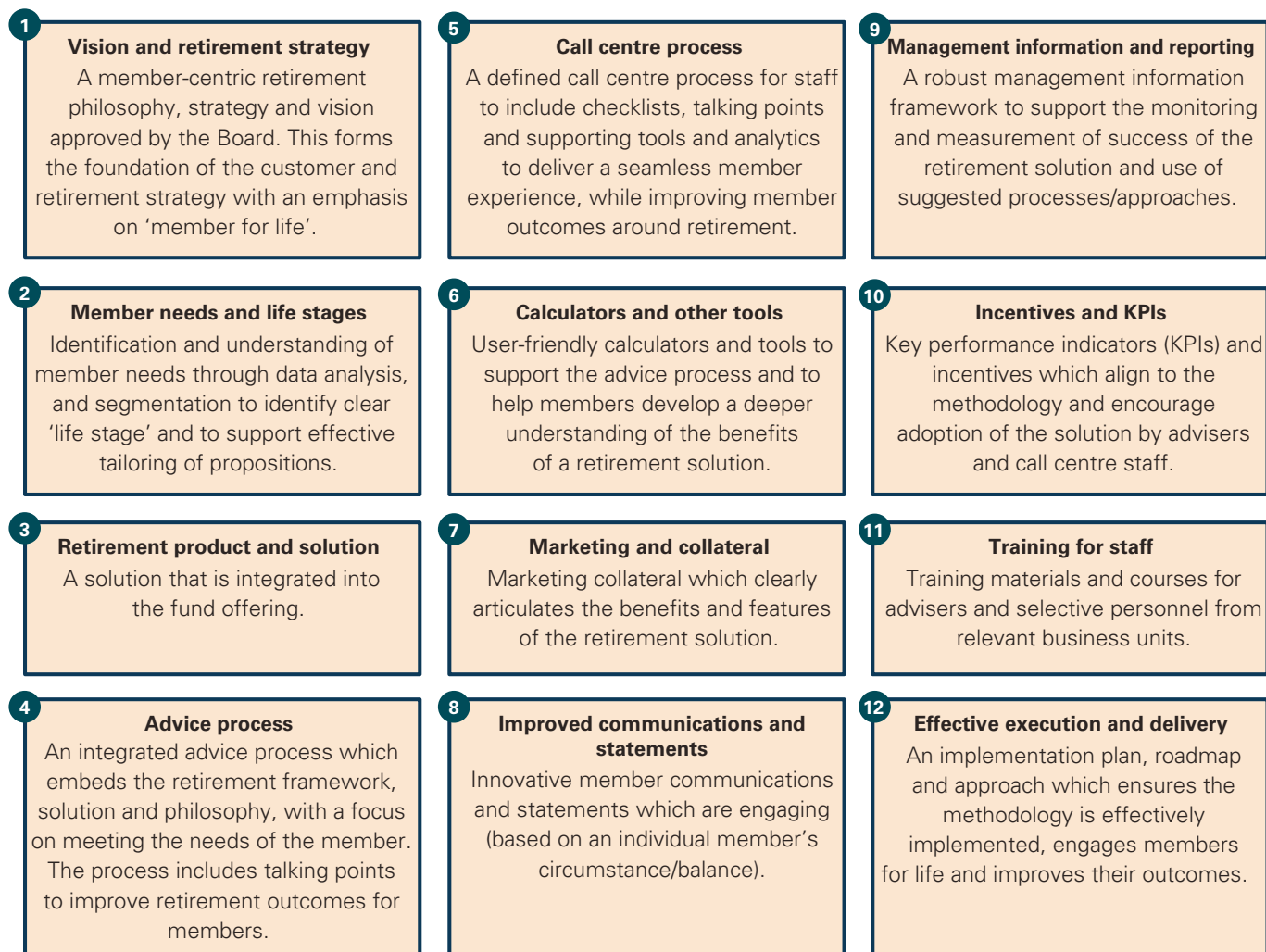


The three tenets are the overarching foundations on which a fund's retirement philosophy is built. They are:

- 1 Understanding member needs.** Member needs are the backbone of defining a successful fund strategy and to optimising member interactions with a fund.
- 2 Developing a fund vision and retirement strategy.** A clear strategy and retirement philosophy will drive effective member interaction approaches and overall methodology.
- 3 Improving member and fund interactions.** A foundation to building life-long member relationships is the development of meaningful interaction points between a fund and its members.

Funds should focus on providing members with retirement education, tools, advice and products in a structured way throughout their entire relationship. We have also developed 12 design components to assist funds implement their retirement solution in a cohesive, integrated fashion that enables their retirement philosophy.

Supporting operational components



Each design component, while important in its own right, requires fund customisation and integration with the other components into an overall implementation roadmap. We believe that each fund will have differing requirements and characteristics which require unique tailoring. The implementation of these components will result in bespoke interaction points with members.

To reach the volume of members and to interact with them optimally requires a focussed digital strategy. Online advice and gathering information regarding members' assets and circumstances will play an increasingly significant role in the future.

Summary

We have identified the key issues that fund providers need to solve to successfully implement retirement income solutions for their members. To provide retirement education and products to members, the following areas are important.

- Fund focus has traditionally been on helping its members save for retirement. The increasing average age of the member base and number of new retirees each year in Australia will place greater emphasis on providing retirement income solutions that will provide members with optimal outcomes in retirement.
- While funds have a greater focus on the decumulation phase, there still exists a degree of immaturity to understanding, adopting and implementing a retirement philosophy. An overall framework to retirement is a critical building block to successfully service the retirement market and retain members.
- The FSI recommendations support the view that fund trustees should provide a CIPR. If adopted, this recommendation will accelerate the further innovation and development of the retirement income market.
- Early adoption of the business model to facilitate providing retirement income products. The business model for the accumulation phase of a member's life is predominantly a wholesale, business-to-business one where the key interaction with the members has been via an employer. In the retirement phase, the business model will change to a retail, business to customer arrangement.
- Digital strategies including the provision of online advice to educate and understand member needs are fundamental to increasing member take-up of retirement income solutions.
- The adoption of an overall framework and design components to implement a comprehensive retirement income solution for members. The solution should consider all member related elements including their broader family and household relationships.

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