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Retirement Income Disclosure Consultation Paper: Stage Two of the Retirement Income Framework 2018

Thank you for the opportunity to provide written feedback on the 'Retirement Income Disclosure Consultation Paper: Stage Two of the Retirement Income Framework 2018'.

For over 100 years, QSuper has been the default superannuation fund of the Queensland Government, helping current and former public-sector employees and their spouses create a financially secure future. QSuper is one of the country's largest and most respected superannuation funds, with more than $84 billion in Funds Under Management. On 1 July 2017, QSuper became a public offer fund, opening our doors for all Australians to join.

QSuper is supportive of the Government's intent to better align the retirement phase of superannuation with the overall objective of the superannuation system. QSuper agrees that trustees should develop a retirement income strategy for their members. QSuper also supports the development of standardised disclosures for such retirement products.

QSuper's comments on the consultation paper follow, with further comments on the proposed specific metrics, their presentation and calculations addressed in the Attachment.

<u>Simplified, standardised product disclosure</u>

QSuper is supportive of the proposed factors underlying the development of the standardised metrics, namely:

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

QSuper suggests that there should be clear separation between a member's consumption needs, product income and total income. This will ensure consistency in the interpretation of various features and expectations of the CIPR.

In addition, QSuper believes the current proposed disclosure document has some shortcomings which will need to be addressed.

Access to capital

The proposed Retirement Income Risk measure does not intend to measure the access to capital, or the market risk associated with the amount that may be available at any time. This introduces the risk of subjective classification and incomparability between products. It also ignores the fourth factor listed above for the development of the standardised metrics.

The need to include Age Pension

QSuper believes that when developing metrics to assess the effectiveness of achieving the defined objective, care should be taken to ensure that the framework is adequately flexible to offer income streams that are appropriate for all members. The Consultation Paper does not allow for the interaction with the Age Pension. As the Age Pension remains an important source of retirement income for many Australians, its interaction with the retirement product is critical when developing solutions to achieve the objective. Omitting this could potentially lead to solutions which would promote an increase in the standards of living throughout retirement as a result of an increasing real income stream, therefore delaying consumption and potentially increasing bequests, which is contrary to the defined objective.

We trust this feedback will be beneficial. QSuper would welcome an opportunity to discuss our submission in further detail with Treasury.

Yours faithfully

Ben Hillier
Head of Product and Services

Attachment 1: Retirement Income Disclosure Consultation Paper and Retirement Income Risk Measure

The Retirement Income disclosures need to clearly distinguish between:

- product income, as set out in the Consultation Paper;
- total income, which should allow for other sources of income such as the Age Pension; and
- member's consumption needs, which may be different to either of the above.

Without a clear distinction between these, the disclosures could potentially lead to unintended interpretations and behaviours.

Metrics & Calculations

The need for a broadly constant income in retirement

In line with our previous submissions, QSuper maintains the view that income from a CIPR does not need to be constant but could vary according to the phase of retirement (in line with consumption needs). QSuper believes trustees should have the flexibility to offer income streams that are appropriate for their membership.

QSuper agrees with the position in *p6* of the Retirement Income Covenant Position Paper: Stage One of the Retirement Income Framework 2018 that states *"It would be at the discretion of the trustee to decide whether the expected income should be broadly constant in real or nominal terms (or in between)".* Following the discussion about clearly distinguishing between product and total income levels, the trustee could provide a member with a varying product income, which combined with Age pension will provide in expectation, a broadly constant total income.

Age Pension

QSuper's average Income account starting balance is approximately $400,000. This means the majority of our retirees will be eligible for some level of Age Pension benefit. We believe that the level of income projected in retirement is incomplete without an appropriate reference to the presence or expectation of Age Pension entitlements. Furthermore, the proposed risk metric should allow for the interaction between income from superannuation and the Age Pension.

Without regard to the Age Pension, the suggested "best outcome" would most likely result in an increasing real income stream in retirement (even when the person is entitled to a part Age Pension). Such an omission allows for real increases in income available for consumption, whereas various research suggests a decreasing real expenditure pattern, which is not the aim of the retirement framework set out in the background of the paper. It may also lead to other unintended consequences such as an increase in bequests.

Figures 1 and 2 show the impact of the Age pension (indexed twice a year) on the choice of nominal versus real income levels from a product. Figure 1 shows that real income from the retirement product will result in increasing total real income levels with age, while the nominal income drawdown from the product is more likely to result in broadly constant total real income levels over retirement, as shown in Figure 2.

Figure 1.

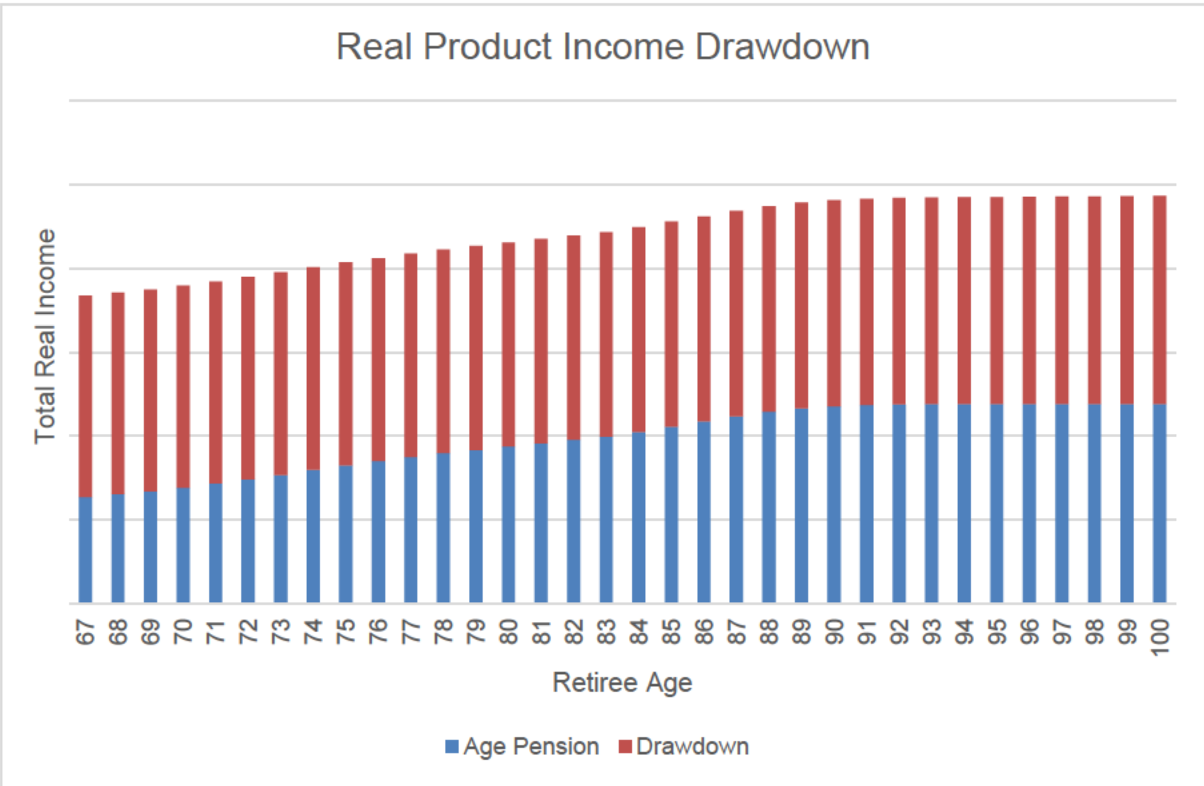
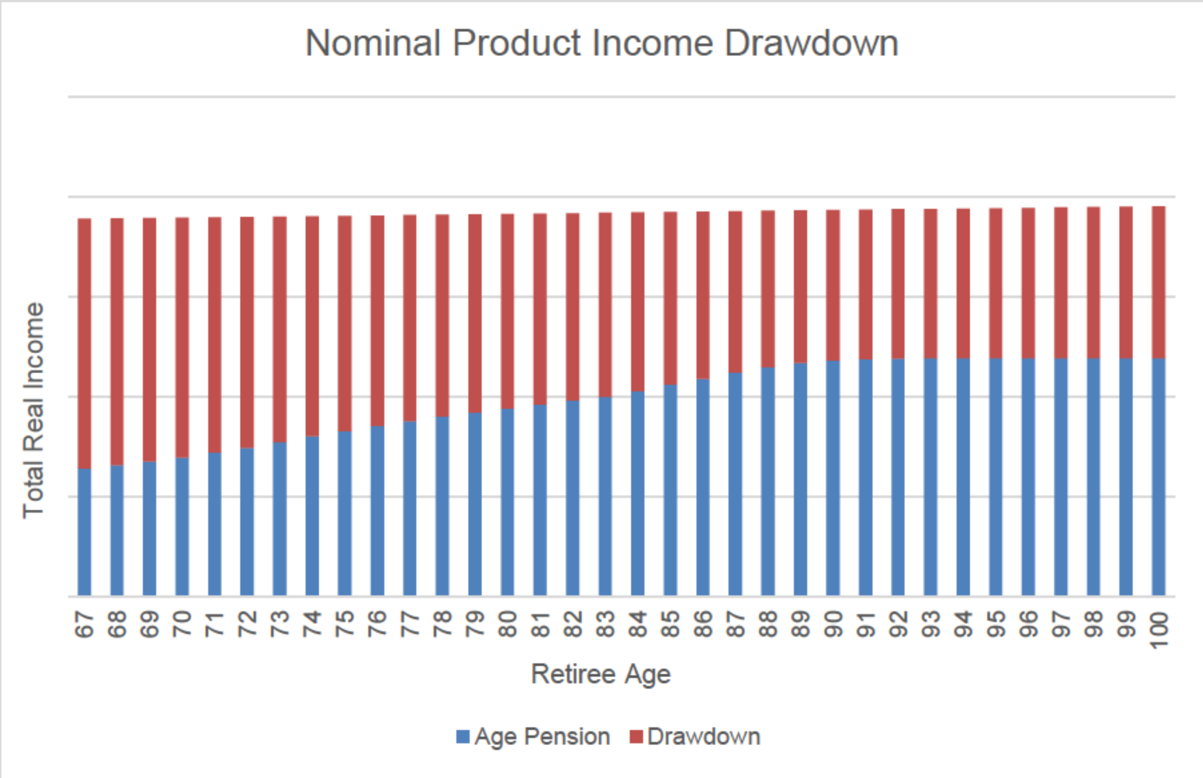


Figure 2.



Source: QSuper Calculations, February 2019 (For illustrative purposes only).

The analysis in the Consultation Paper suggests that the non-indexed lifetime annuity is the highest risk example of the products considered. However, when allowing for the Age Pension entitlements this product potentially best reflects a constant real income stream during retirement.

Risk measure

The proposed risk measure allows for a variation of negative semi-deviation where any excess over the benchmark income is expressed as 0% variation. Under a framework like this, the choice of benchmark income is then at risk as the provider can assess if showing a first-year lower amount is worth it to reduce the risk measure as compared to higher first year income with greater risk of missing in later years. This might also lead to disinterest of product providers using risk management mechanism which is likely to result in income variation in both directions. One way to avoid this flaw is by making use of a utility framework where both directions of income variations are considered while underperformance is penalised more than outperformance of the same level is rewarded.

Another flaw to the approach is that observed variations are not weighted to the probability of survival to various ages to retain sensitivity to longevity protection. This is likely to result in skewed recommendation of products with and without longevity protection.

Life expectancy

The Consultation Paper makes a simplifying assumption for life expectancy and can benefit from more sophisticated calculations, such as including the standard deviation around the member's life expectancy, as members are highly exposed to their own idiosyncratic mortality and longevity risks.

Presentation

Access to capital

The paper acknowledges on p3 of the Retirement Income Risk Measure that *"the scope of this paper does not intend to measure the access to capital, or the market risk associated with the amount that may be available at any time."* Unfortunately, it is inefficient to measure income risk in isolation when making a retirement plan. A successful risk measure should make adequate provision for the remaining balance which will be used for lump sum purposes, emergencies amongst others. An important component of the CIPR framework is flexibility which is achieved through access to one's funds when needed. Only showing income and relative risk levels does not properly inform members of the value of capital that may be payable in some situations.

Subjectivity in "best estimate of the expected real income level"

The paper states that the central consideration for consumers is the level of periodic income and *"Product providers would need to report the best estimate of the expected real income level that their product can provide for a purchase price of $100,000".* While it is beneficial to have a good starting point for all funds and products, the best estimate may lead to very subjective interpretations.

The best estimate for an income level will depend on various factors including the underlying investment options, payment periods and age of the consumer. For example, the choice of underlying assets forms the investment strategy which inform the 'best estimate' at the commencement of the product. This makes such a product attractive to members. However, this strategy may change over time as assets are traded, which may cause the actual income levels for the life of the product to be significantly different from the expected income levels projected at the onset. The subjectivity of this process due to self-classification presents a similar risk to the 'growth' and defensive' debate currently underlying Balanced fund classification in Accumulation products in the industry.

Unless the risk measures are externally validated or audited it will be difficult to ensure product providers are disclosing their assessment of their products on the 1 to 7 scale on a consistent basis.

Difficulty interpreting the risk scale

In addition to the subjectivity highlighted in the classification of the scale from 1 to 7, we are also concerned about the difficulty for members to consider the trade-off between a converted scale of 1 to 7 for risk of income versus access to capital and therefore underlying liquidity.

Dashboard

The risk measure ignores the Age Pension for the purposes of the dashboard. This could potentially have unintended consequences with members delaying consumption to later in life, possibly leading to unintended bequests.

Including the Age Pension impact on the dashboard will also give an indication of relative benefit of one product over another. Given that a discounted amount of the nominal purchase price and product payment from a pooled product will be assessed for means-testing, including this outcome on the dashboard will highlight the benefit, making these products more attractive.

To illustrate this, the table below shows the asset and income test assessment of $100,000 for a 67-year-old retiree in year 1.

Product type	Asset test on $100k	Income test on $100k
100% ABP	$100k (100%)	$1,975 (deemed)
100% GSA	$60k (60%)	$3,000 (60% x 5% for example)
50%/50% ABP GSA	$80k (blended)	$2,787 (blended)