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Subject: Consultation on Superannuation forecasts

Dear Ms Chew

Mercer congratulates ASIC on issuing Consultation Paper 351: *Superannuation forecasts: Update to relief and guidance* and appreciates the opportunity to make a submission. As will be obvious from our comments, Mercer supports many of the proposed changes. Nevertheless, there are areas where further improvements or changes should be made and these are discussed below.

In this submission, we will outline below some general comments and reactions regarding principles and approaches that should be used before we respond to many of your questions in the Attachment.

This is a really important topic for members of Australian superannuation funds and we believe that a more holistic and consistent approach to superannuation forecasts can provide real benefits to many Australians and help them make better informed financial decisions.

<u>A holistic approach is needed</u>

Superannuation forecasts, whether they be from a superannuation calculator or a retirement estimate, represent a critical component of the bigger picture which is needed to help members and households understand their financial position approaching and during retirement. That is, the forecasts do not operate in isolation. Rather, they form part of the broader context which also includes general information from superannuation funds and the provision of financial advice, as noted in para 10 of CP 351. Hence, it is important there is consistency and integration between these various forms of assistance. They all form part of retirement planning. Superannuation forecasts should complement these other forms of communication and advice.

Mercer strongly supports requiring consistency between calculators and estimates (as discussed in para 41 of CP 351) and aligning the scope and conditions of relief for superannuation calculators and retirement estimates, as outlined in para 20(b) of CP 351.

In this respect, Mercer strongly supports the proposal that retirement estimates on annual statements should use the same data, assumptions and methodology as those used in a superannuation calculator.

This will make much more sense to individuals who, after receiving their annual statement, then proceed to a superannuation calculator on their fund's website.

Economic and other assumptions

Superannuation forecasts provide estimates of retirement income and benefits for many years and decades into the future. Given the uncertainty of future economic conditions and investment markets, as well as life expectancies, it must be recognised that estimates will not be accurate, as discussed in para 9 of CP 351. They will be wrong! This is not to say they are of no use; far from it. However, given these inevitable uncertainties, the following should apply:

- All superannuation forecasts should be required to use the same deflator which should be regularly reviewed by ASIC, including advice from the Australian Government Actuary. Mercer accepts that wage inflation prior to retirement and price inflation thereafter is a reasonable compromise to obtain present values, whilst also recognising that actual expenditure (expressed in real terms) tends to reduce during the retirement years.
- Future investment returns are more problematic as these will depend on the underlying assets. Nevertheless, standard principles should be established for the assumed future investment returns as well as the assumptions used regarding future fees. Providers should not be able to select their assumptions without some limitations or guidance.
- Superannuation forecasts must also allow for the future costs that are likely to be incurred by the member. The indexed figure of the last 12 months may be a reasonable starting point but would not be correct for members who have not been in the product for 12 months. An adjustment may also be needed for any asset-based fees if an individual there has had a significant roll-in or roll-out during the last 12 months. Therefore it would be preferable to use the current PDS or forecast administration fees. This is forward looking and can also allow for known changes.
- Retirement estimates should be rounded to three significant figures (for example $22,300 pa) so there is no suggestion of precision or unwarranted accuracy.
- At least two, and preferably three, estimates should be shown to highlight this uncertainty. For example, projections in the Netherlands show three estimates representing the best estimate as well as a value either side of the best estimate. Trustees should be encouraged to develop approaches to highlight this variability.

Although fund stapling will reduce the number of individuals with multiple accounts, many individuals will continue to have more than one superannuation account for a variety of reasons. It is therefore important that superannuation forecasts from different funds are based on similar assumptions and are therefore comparable. The use of assumptions by trustees or providers to inflate or understate these estimates would be inappropriate.

Mercer agrees that the default retirement age should be age 67 which is the future eligibility age for the Age Pension. However, superannuation calculators must enable individuals to adjust this age to any age from age 60 (the future preservation age).

Mercer suggests that a default retirement period of 25 years (from age 67 to age 92) is too short as it represents about the average life expectancy allowing for future mortality improvements. It must be recognised that many retirees will have a life expectancy longer than the average. Further, life expectancy is strongly related to an individual's socio-economic class so that the average figure is not appropriate for many higher income earners who will be relying on their superannuation benefits to a greater extent than lower income earners. Therefore Mercer recommends that the default retirement period should be 30 years from age 67.

Of course, there will also be some circumstances where the standard period is inappropriate for a particular cohort of members based on the available statistical evidence. Hence some flexibility should also be available.

<u>The data to be used</u>

Inevitably superannuation forecasts are based on underlying data relating to the superannuation fund as well as the individual member. Superannuation funds must be required to use product-related data related to their circumstances and not general industry data. In respect of data relating to individual member data or assumptions, a standard approach should be adopted initially. However, this must be able to be changed when additional data, information or assumptions are provided by the individual through an interactive calculator. Of course, the subsequent forecast must note that the forecast is now based on input provided by the member with appropriate caveats.

Mercer strongly supports the proposal in paras 29(b) and B7 of CP 351 to allow interactive retirement estimates. As suggested in para 56, we believe these interactive estimates can improve understanding and provide real benefits to members.

<u>Which members should receive retirement estimates?</u>

Section B of CP351 proposes to limit the members who may be given a retirement estimate. These restrictions include:

- The member must be aged under 67 (para B5)
- The member must not be in the retirement phase (para B5(a))
- The member does not have a defined benefit interest in the fund (para B5(d))

Mercer disagrees with each of these exclusions for the following reasons:

- As life expectancy continues to rise and many older individuals remain in good health, we are witnessing an increase in the labour force participation at older ages. That is, some individuals remain the workforce after age 67. There is no reason why these active members should not receive retirement estimates, even if the assumed retirement age is their current age.
- The most common retirement product in Australia is the account-based pension which represents a current account balance from which future drawdowns are made. In many ways, these retired members are in a very similar position to individuals approaching retirement. Hence superannuation funds should be able to provide these members with an updated retirement

estimate, which may help them move away from a 'set-and-forget' mindset. An adjusted retirement period would be required for estimates for older members as their life expectancy would be longer than for those under age 67. Mercer would be pleased to work with ASIC to develop an appropriate adjustment.
- Many defined benefit members in Australia will receive a lump sum retirement benefit and not a pension. These members will be in exactly the same position at retirement as those who receive a lump sum benefit from a defined contribution (DC) plan. Hence superannuation forecasts will be as valuable for these members as for DC members. Hence they should not be excluded.

Format of presentation

It is common practice to present the superannuation forecast as a number, say a future income of $X per month or $Y per year. Yet it must be recognised that many people understand pictures better than text. It is therefore recommended that the three estimates (see our suggestion above) should be presented graphically as well as in text format.

It is also recommended that the retirement estimates should show both the projected lump sum at the assumed retirement age as well as the projected level of real retirement income. These two forecasts provide valuable information to prospective retirees as the fund does not know whether the individual plans to pay off a debt with the lump sum or to rely on regular income payments.

A remaining question is whether the superannuation forecast should be of a deterministic or stochastic format.

There are many advantages in stochastic projections as they highlight the variety of possible outcomes. However, they require a more sophisticated set of assumptions and are harder for most members to understand.

Therefore Mercer supports the use of deterministic projections but each forecast should show three results; namely, the best estimate as well as a more optimistic and a more pessimistic outcome.

Inclusion of the Age Pension

The means-tested Age Pension is an important source of income for most Australian retirees. Hence, Mercer believes that it should be included in retirement estimates. That is, without its inclusion, the estimates are not realistic for many individuals. Hence Mercer opposes the proposal to remove the option of including the Age Pension in a standard retirement estimate.

Of course, we also recognise that the level of future Age Pension payments depend on a range of factors (as recognised in para 96 of CP 351), many of which the superannuation fund is in no position to know or estimate.

Therefore Mercer recommends that the first estimate of future retirement income provided to fund members should exclude the Age Pension. However, a second retirement income estimate, including the Age Pension, should also be available on the retirement estimate provided to members. This is consistent with the current Class Order.

The attached documentation should make clear the assumptions used relating to future Age Pension payments. Such estimates should not be restricted to situations when members can input their own assumptions as proposed on page 24 and para C11 in CP 351. The Age Pension is an important source of retirement income for most retired Australians and its exclusion from the retirement estimates received by members would considerably diminish the value and relevance of these estimates.

Of course, Mercer supports the proposal that interactive retirement estimates should have the provision to allow individuals to adjust the relevant inputs relating to the means tests (for example: the presence of other assets, their partner's financial position, etc.) so that the retirement estimates are even more relevant and realistic. Similarly, funds should be permitted to gather member information from interactive retirement estimates and calculators to personalise future superannuation forecasts on annual statements. However, this allowance does not go far enough as a minority of members are likely to engage with an interactive calculator.

<u>Calculation of future retirement income</u>

Para 80 of CP 351 proposes that ASIC will continue to specify how trustees must make assumptions about future annual income streams. Para C10 then notes that trustees are to work out the annual income stream on the basis that the member would have constant income in real terms for 25 years from age 67.

At first sight, this is a reasonable basis to use as it provides a constant income for a period that is slightly longer than the current life expectancies for 67-year-olds. However, its major flaw is that any future Age Pension payments would be ignored.

Most Australians will receive a part or full Age Pension during their retirement years. Furthermore, the recent Retirement Income Review concluded that the Age Pension is financially sustainable, and Australia is likely to have the lowest cost of public pensions of any OECD nation by 2050, when expressed as a percentage of GDP. In other words, the Age Pension is likely to remain an important source of retirement income for decades to come.

The calculation of a projected constant income for 25 or 30 years of retirement that considers the superannuation benefit only is both unrealistic and unhelpful. In fact, it may encourage behaviour and financial decisions from members which unnecessarily reduce their current living standards to the detriment of all members of their household, including their children.

Therefore, Mercer strongly recommends that the retirement estimates must show the potential impact of the Age Pension on future retirement income, whilst recognising that all these estimates are exactly that, and do not represent promises or precise forecasts.

<u>Compulsion or voluntary provision?</u>

Although it is outside the scope of the current consultation, Mercer believes that the provision of annual retirement estimates should be compulsory for all superannuation funds to provide to members over the age of 40, including those over age 67. Retirement estimates for those in the decumulation phase are even more relevant than those in the accumulation period. Excluding retirees with an account-based pension makes no sense.

The provision of pension projections is now a requirement in Europe under IORP II (Institutions for Occupational Retirement Provisions II), published by the European Insurance and Occupational Pensions Authority. There is no reason for Australia to lag behind such requirements.

Interestingly IORP II requires income to be shown for at least two scenarios to show the potential variance of pension income. This is consistent with our earlier recommendations.

The UK also requires all defined contribution schemes to provide members, on an annual basis, with an illustration of the possible pension that could be secured from their projected retirement benefit.

Who is Mercer?

Mercer is one of the world's leading firms for superannuation, investments, health and human resources consulting and products. Across the Pacific, leading organisations look to Mercer for global insights, thought leadership and product innovation to help transform and grow their businesses. Supported by our global team of 22,000, we help our clients challenge conventional thinking to create solutions that drive business results and make a difference in the lives of millions of people every day.

Mercer Australia provides customised administration, technology and total benefits outsourcing solutions to a large number of employer clients and superannuation funds (including industry funds, master trusts and employer sponsored superannuation funds). We have over $280 billion in funds under administration locally and provide services to over 2.2 million superannuation members and 15,000 private clients, including the Mercer Super Trust, which has around 230 participating employers, around 200,000 members and more than $29 billion in assets under management.

Naturally, we would be very pleased to discuss any of these matters with you and members of the ASIC team. Please do not hesitate to contact me on [redacted].

Yours sincerely,

[redacted]

Dr David Knox
Senior Partner

ATTACHMENT

Here are Mercer's answers to many of the questions outlined in Consultation Paper 351.

Proposed update to relief for superannuation forecasts

Continued relief for superannuation forecasts

B1Q1 *Should ASIC continue to offer relief to trustees and other providers for superannuation calculators? Why or why not?*

Answer Yes. The relief makes superannuation calculators accessible without having crossed the line into providing personal advice. Superannuation calculators provide real help to Australian super members who could/would not otherwise receive financial advice and plan for their retirement.

B1Q2 *Should ASIC continue to offer relief for trustees to provide retirement estimates to their members? Why or why not?*

Answer Yes. Retirement estimates are a useful reminder each year to members that super is for retirement and give an indication of how their retirement adequacy is building. Mercer provided retirement estimates to more than 400,000 members in 2021.

B1Q3 *Are there elements of the current relief for superannuation calculators or retirement estimates that discourage or prevent the provision of these tools by trustees?*

Answer Yes. The current relief doesn't allow for the same assumptions and methodology to be used in retirement estimates as is allowed in superannuation calculators. This is a constant pain point. For example, the Class Order relief for retirement estimates doesn't allow for the phased increases in SG; flexible investment returns across a range of options; or an integrated Age Pension estimate, whereas the Corporations (Generic Calculators) Instrument does.

The current relief is silent on how client data can be used in superannuation calculators. Funds have relevant data on members' ages, super balances, contributions, fees, investment choices, and potentially salaries. Further, in using superannuation calculators, members can provide further information about retirement plans, partner status and homeowner status. All this data can allow trustees to provide more personalised superannuation calculators, but the current regulations are silent on its use.

B1Q4 *How are superannuation calculators and retirement estimates currently being provided by industry under ASIC's current relief?*

Answer Mercer provides retirement projection calculators for around 15 super funds in Australia, using one common calculation engine. They appear both on public websites and in secure login areas. In secure areas, these calculators are populated with a member's age, sex, salary and super balance. Our calculators supported more than 250,000 member sessions in 2021.

B1Q5 Are superannuation calculators or retirement estimates being provided without relying upon the current relief? If so, why are providers choosing not to rely on the relief?

Answer For some trustees who wish to provide retirement estimates, the limitations of the Class Order relief do not suit their needs. As an AFSL holder, we provide retirement estimates as Statements of Advice to members of these funds. We have included a sample of these in a separate confidential submission. If the relief is amended to allow the inclusion of an Age Pension estimate and an alternative scenario, then we will be able to meet our clients' needs under the relief and will no longer need to provide Statements of Advice.

B2Q1 *Do you agree that our relief for superannuation calculators and retirement estimates should be combined into a single legislative instrument? If not, why not?*

Answer Yes. Superannuation calculators and retirement estimates essentially do the same task, and it's important that fund members receive consistent projections across channels.

Presentation and disclosure of superannuation forecasts

B3Q1 Do you agree with our proposal for principles-based disclosure requirements? Why or why not? Should there be any conditions or other steps taken to address particular risks arising from a principles-based approach?

Answer Yes, we agree. A principles-based approach to disclosure allows for flexibility to serve different types of funds, members and channels. A fund can use their own 'tone of voice' and vocabulary in communicating retirement projections.

The risk is that the same metrics may be described using different terms, and this confounds comparability between providers. We suggest that ASIC define key terms to be standard across superannuation forecasts.

B3Q2 Should we prescribe how specific assumptions should be disclosed (e.g. insurance premiums)?

Answer We don't believe it is necessary for ASIC to prescribe how specific assumptions should be disclosed; it will be sufficient to require that certain key assumptions are disclosed. We understand the Actuaries Institute's Good Practice Principles for Retirement Modelling Information Note will suggest a preferred approach for disclosing the most important assumptions.

B3Q3 *Are there any specific changes we should make to our relief or guidance on presentation or disclosure that would encourage trustees to provide superannuation calculators or retirement estimates?*

Answer Yes, the following changes would encourage us to provide superannuation calculators and retirement estimates:

- Allow the inclusion of an Age Pension amount in a retirement estimate based on reasonable assumptions and member preferences
- Allow the inclusion of an alternative scenario or a range of outcomes in a retirement estimate
- Validate the use of member data to inform default assumptions in superannuation calculators

B4Q1 *Do our proposed changes to the relief and guidance give sufficient clarity about how a superannuation calculator or retirement estimate may be given without advertising or promoting a specific financial product? If not, why not?*

Answer Currently, there is a requirement that superannuation calculators must not be used to advertise or promote a specific financial product. We understand that the relief proposes to retain this requirement for superannuation calculators and introduce the same requirement for retirement estimates.

The draft Regulatory Guide provides practical guidance on how superannuation calculators or retirement estimates may be provided without advertising or promoting specific financial products. Importantly, the Guide recognises that in the case of retirement estimates, it may be necessary to refer to the member's current superannuation product or investment.

While we accept that the estimates should not promote a specific product, it is inevitable that they will assume a particular type of product, such as an account-based pension or a lifetime annuity. It will also be necessary for the estimates to assume certain product-related characteristics. Hence, while a specific product may not be promoted, it would be reasonable for the estimates to use those characteristics associated with the fund's retirement products. Furthermore, many members would assume that the estimate provided by the fund would be based on their product. Hence, in the eyes of the member there may not be much difference.

B4Q2 *Are there other ways to reduce the risk of a member assuming the forecast can be relied on to make a decision about a specific financial product?*

Answer We note that the Regulatory Guide outlines how assumptions relating to specific financial products can be used without advertising or promoting specific financial products.

This includes guidance on the disclosure requirements where the provider deems it necessary to refer to specific financial products. As previously noted, a principles-based approach to disclosure and standard key terms defined by ASIC may also allow members to better understand the superannuation forecasts as well as the rationale for the assumptions used.

The retirement estimate will inevitably be based on the current cost structure for the relevant retirement product(s). It may be appropriate to add a warning that whilst the estimate is based on the current fees, there is no guarantee that these fees will apply in the future.

Timing and delivery of retirement estimates

B5Q1 *Do you agree with the proposed restrictions on who may be provided with a retirement estimate? Why or why not?*

Answer We do not agree that retirement estimates should only be given to members aged under 67 as well as those not in the retirement phase.

Many individuals are now working past age 67 for several reasons, including increasing longevity and the financial impact of COVID-19. There is no reason why members in the accumulation phase who are over age 67 should not be provided with a retirement estimate. The standard assumption for those over age 67 could be that they retire immediately. That is, no assumption about their retirement age is required.

Similarly, many members in the retirement phase will have a balance in an account-based pension. This balance could be used to provide a retirement estimate from this point on. It may be some years since the member retired and the impact of financial markets and capital withdrawals could have had a significant impact (upwards or downwards) on their projected income.

B5Q2 *How do trustees currently decide which members to give retirement estimates to? For example, are members selected on the basis of age, current balance, contributions history or other factors?*

Answer We generally provide retirement estimates to all members with the following exceptions:

- Members below and above certain ages
- Members with Defined Benefits
- Members with unusual employment status (no employer, more than 1 employer and unusual service)
- Members with large non-concessional personal contributions (post-tax) of more than $30K
- Members with no contributions in the last 12 months
- Members with an excess contributions tax amount
- Members with prior period adjustment (e.g. adjustment to account, premium or fee rebate)
- Members with projected balance less than a threshold

- Members with a current insurance claim or who made an Income Protection claim before the projection date
- Members with a very low current balance
- Members with transition-to-retirement accounts
- Members with an overseas postcode
- Members who made benefit category change in the last 12 months

B5Q3 *Are there other types of members that should be included or excluded from the scope of our relief for retirement estimates? Why or why not?*

Answer The key inclusion principle is:

- Any member for whom a retirement estimate would not be misleading should be in scope

B6Q1 *Are there practical limitations to trustees providing retirement estimates more frequently than in periodic statements?*

Answer If the requirement that a retirement estimate accompany a periodic statement is relaxed, then retirement estimates can effectively be provided on demand, provided good data is available.

B7Q1 *Do trustees already provide interactive forms of retirement estimates? If so, how are these provided to members?*

Answer Yes. At Mercer we provide interactive retirement estimates in our secure website. There is an estimate of a member's retirement benefit available on their dashboard, and another page allows them to modify the key inputs. Taken together, we consider this to be a superannuation calculator.

B7Q2 *Are these interactive estimates provided by relying on ASIC's current relief? How are the default assumptions set?*

Answer Yes. Apart from a member's age and account balance, the assumptions are all defaults, set in the same way as for a superannuation calculator.

New relief to last for a set period of time

B8Q1 *What is the appropriate period of time for the relief, given the need for trustees and other providers to have certainty about the regulatory settings to make use of the relief?*

Answer 5 years

Six-month transition period

B9Q1 *Do you agree that a transition period of six months is appropriate for providers to comply with the proposed relief (i.e. by 1 October 2022, assuming the new instrument is made on 1 April 2022)? If not, do you consider a longer or shorter period is required?*

Answer A period of 12 months' transition is recommended to allow for a range of product transitions and system changes.

B9Q2 *Are there any unintended consequences of the proposed relief that would affect implementation by industry?*

Answer Where existing relief has been insufficient to meet client and member needs, and other solutions have been developed, it may take some time and research to determine whether the new relief has any impact on the viability of those solutions. This is further outlined in our confidential submission.

B9Q3 *Will it be practical for trustees to provide retirement estimates under the proposed relief as part of, or alongside, periodic statements for 2021–22?*

Answer Yes

B10Q1 *What impact (if any) will our plans to update the default assumptions in our calculators have on trustees or other providers who choose to use the same assumptions?*

Answer As noted above, some assumptions (some as the deflator) should be standard across the industry. The assumptions used by the ASIC calculators should also be consistent with the requirements imposed on the industry.

Removal of the no-action position from RG 229

B11Q1 *Is the no-action position necessary for trustees to feel comfortable providing retirement estimates? If so, why?*

Answer RG 229.14 outlines ASIC's current no-action position where a trustee must not provide a member with a retirement estimate if doing so would be misleading or likely to mislead. This means that action will not be taken where the trustee adopts ASIC default assumptions and methodology.

ASIC is now seeking to remove its no-action position in the context of providing retirement estimates. We broadly agree with ASIC's rationale that the no-action position may no longer be necessary because:

- The proposed relief now provides trustees with greater flexibility as the disclosure requirements will be principles-based rather than prescriptive
- Providers of retirement estimates may still apply to ASIC for individual relief on a case-by-case basis where they do not feel comfortable in meeting the requirements.

Proposed approach to economic and financial assumptions

Our approach to economic and financial assumptions

C2Q1 *Do you support trustees and other providers having flexibility to set their own reasonable assumptions for investment earnings, fees and costs, including on the basis of the product a member is invested in? Why or why not?*

Answer We propose that default investment returns should be reasonable long-term (10+ years) assumptions for investment earnings in respect of each investment option used in the estimate or calculator, including the product(s) where the member is invested.

Trustees and providers should be able to set their own reasonable assumptions for investment fees and costs for their products.

C2Q2 *What are the risks to members and to industry of trustees setting their own reasonable assumptions for investment earnings, fees and costs relating to the product in which a member is invested in, or a product which the trustee offers? How can these risks be mitigated?*

Answer There is a risk that members compare superannuation calculators when they are selecting a provider, and that the reasons for any differences are not apparent.

One example is the significant difference in retirement income projections through the use of different deflators in the retirement phase. While we support a principles-based approach, we believe it would be beneficial to adopt a consistent methodology and consistent disclosure of key assumptions to members.

There is a risk that trustees may understate the fees and costs for the purposes of providing a higher projected retirement benefit. However, there is also a risk that a larger projection would reduce the incentive for members to contribute extra, which is not in the provider's best interest.

The current stated levels of fees and charges could be used as the basis for projections, on an ‘if not, why not’ basis to allow for future changes, which can be supported.

C2Q3 *Should trustees have greater flexibility to set other types of assumptions, either for a retirement estimate or superannuation calculator? Why or why not?*

Answer Yes, trustees should be able to set reasonable assumptions for contributions, retirement age, retirement income (including indexation), the period in retirement, lump sum drawdowns, home ownership, and partner status.

C4Q1 *Do you agree with our explanation of when default assumptions are likely to be reasonable? Why or why not?*

Answer We agree that the assumptions should be internally consistent. However each assumption should also be able to be justified on its own, as some assumptions will be less relevant for some members than other members. For example, future salary increases are not very relevant for a 60 year old.

C4Q2 *How frequently should providers be expected to revise the economic and financial assumptions they apply?*

Answer Economic assumptions should be set based on a ten-year outlook. If they allow for current market conditions, they should be reviewed at least annually. If they are set independently of the market cycle, then at least every three years.

Regardless, the economic assumptions should be reviewed consistently with the fund's PDS update cycle.

C5Q1 *Should trustees be expected to set the same assumptions across all superannuation calculators and retirement estimates they provide? In what circumstances should assumptions be able to differ?*

Answer There are valid reasons to assume different investment earnings for different investment portfolios. Similarly, it may be reasonable to assume different salary increase assumptions for different industries. For example, a State Government may have imposed a maximum salary increase rate for the next three years which would not apply in the private sector. Likewise insurance premiums differ between blue and white collar workers. But in the absence of product- and member-specific differences, trustees should be required to use the same assumption set across all superannuation calculators and retirement estimates.

Investment earnings, fees and costs

C6Q1 *What are the advantages and disadvantages of giving trustees and other providers flexibility to set their own reasonable default assumptions for investment earnings, fees and costs?*

Answer There are clear advantages in giving trustees and other providers the flexibility to set their own assumptions for investment earnings, fees as and costs as they can adopt reasonable assumptions based on their experience and actual products. The major disadvantage is that they may adopt unreasonable assumptions which would inflate the estimate. It is therefore recommended that ASIC provide clear guidelines for setting these assumptions and monitor the assumptions used.

C6Q3 *In working out a retirement estimate, would it be practical for trustee to set assumptions about investment earnings, fees and costs that may differ based on the products members are invested in? Why or why not? Are there alternative approaches?*

Answer The assumptions used should be based on the investment portfolio that each member is invested in and the cost structure that applies to them. For example, if a member is invested in multiple products, then it would be reasonable to use assumptions for the majority product if a weighted average approach was not achievable. If an employer pays the administration fee or the insurance premiums (as occurs in some industries), the retirement estimate should take this into account.

C6Q4 *What guidance should ASIC provide on how assumptions about investment earnings, fees and costs should be set? Would it be appropriate for trustees to set assumptions on the basis of existing investment return objectives for superannuation products they offer (e.g. the return objective disclosed in the Product Disclosure Statement (PDS) or set by the trustee board?)*

Answer Economic assumptions should be based on central estimates using at least 10-year geometric expectations. Using investment return objectives will not give a central estimate because objectives are usually set to have a greater than 50% chance of being achieved.

It is also worth noting that the PDS objectives may assume a level of inflation which is different from the deflator prescribed by ASIC. Hence, the use of PDS objectives may lead to inconsistencies.

Fees and costs should be based on the PDS for the relevant products, but a reasonable approximation should be acceptable (e.g. where fees are complex).

C7Q1 *Would requiring trustees to make reasonable assumptions about administration fees based on the administration fees paid by the member over the previous year be workable in practice?*

Answer This approach may be workable in practice, but excludes members who have not been in the product for 12 months.

It would be preferable to use the current PDS or forecast administration fees. This is forward looking and can allow for known changes.

C7Q2 *Could members be misled if trustees use member-specific assumptions for administration fees in working out a retirement estimate alongside generic assumptions for investment earnings and investment fees and costs? If so, how could the risk of misleading forecasts be minimised?*

Answer There is always potential for a member to misunderstand a retirement estimate, but the more tailored the assumptions can be, the better. Future investment earnings cannot be known, but administration fees (at least in the near future) can be known. The use of member-specific assumptions should be encouraged as they will provide more personalised results. Any associated risk could be minimised through a relevant comment in the table outlining the assumptions used.

C7Q3 *Should we allow or require trustees to set different default assumptions for administration fees in the accumulation and retirement phases when working out a retirement estimate? Why or why not?*

Answer For someone in accumulation phase, generic assumptions (aligned with current RI product fee structures) about the retirement phase should be used. For someone in retirement phase, the administration fees should reflect the product they are invested in.

Retirement age and drawdown period

C8Q1 *What are the advantages and disadvantages of prescribing a default retirement age and drawdown period for superannuation calculators and retirement estimates under our relief? Please include relevant evidence, where available, of: (a) the extent to which prescribed assumptions would reduce the risk of members being confused or misled if they use one or more superannuation calculator or retirement estimate; (b) the proportion of members that currently choose to input their own retirement age or drawdown period assumptions into superannuation calculators; and (c) any differences in likely future retirement ages or drawdown periods across different superannuation funds' memberships.*

Answer It makes sense to prescribe a default retirement age and drawdown period in the absence of any other information. However, there may be good reasons why a trustee may choose a different default retirement age, particularly in employer-sponsored funds and certain industries.

Retirement age is probably the easiest retirement concept for members to relate to and as long it is disclosed in close proximity to the estimate, members will not be confused by estimates based on different retirement ages.

However a single retirement age assumption precludes projections that take into account the circumstances of a retired couple.

The drawdown period should be prescribed, and we comment on that in our answer to C8Q4. It should be noted that a single drawdown period has problems associated with:

- A retired couple
- Uncertain longevity/health of the individual

C8Q2 *Are there some types of superannuation calculator for which these assumptions would be inappropriate or irrelevant?*

Answer The standard assumptions would be inappropriate where there is stipulated retirement age, which could include some elements of the public sector or a standard practice within some industries. It may also be inappropriate for Indigenous members.

The standard assumptions would be irrelevant for non-projection calculators.

C8Q3 *Is age 67 (the age pension eligibility age) a reasonable assumption for the retirement age? Why or why not?*

Answer Yes, this makes good sense as a default retirement age. However flexibility should be available with interactive calculators.

Where members retire earlier, they will normally have to meet their entire retirement income needs from super.

C8Q4 *Is 25 years a reasonable assumption for the duration of the retirement period? Why or why not?*

Answer With allowance for “25 year” mortality improvements, people under age 40 have a 50% chance of living beyond age 91 and a 20% chance of reaching age 97. In this context, we believe 30 years is a better assumption for the retirement period.

In addition, we recognise that many higher income earners, who have the higher super balances and will therefore rely on their super to a greater extent than lower income earners, also have a higher than average life expectancy.

Annual income stream and age pension benefits

C10Q1 *For retirement estimates, what additional assumptions would need to be made to work out the annual income stream in the way that we propose? Should ASIC prescribe a specific formula? Why or why not?*

Answer In addition to the retirement age and the drawdown period, these assumptions are needed:

- Investment earning rate during retirement
- Indexation of retirement income
- Age Pension
    - Statutory rates and thresholds
    - Indexation of means test thresholds
    - Partner status
    - Homeowner status
    - Other assets
- Present value deflation rate for retirement phase

The need for these additional assumptions means that a closed formula for calculating a level total retirement income is not feasible. It requires a programmatic solve.

C11Q1 *What are the advantages and disadvantages of allowing trustees to include age pension amounts in a retirement estimate only if it is an interactive retirement estimate that allow the member to make changes to the assumptions?*

Answer The advantage of excluding the Age Pension is that it is simpler to calculate and show, and requires fewer assumptions. The disadvantage is that members who see their retirement estimate based on super only will get an inadequate picture of their retirement. This may or may not be enough to pique their interest to engage with an interactive retirement estimate. The other disadvantage is that many members are used to seeing a retirement estimate that includes the Age Pension on their annual statement, and now they will see a degraded version.

Mercer recommends that the Age Pension be included in a retirement estimate as well as allowing it with an interactive retirement estimate. Omission of the Age Pension from the retirement estimates would represent a major shortcoming for most members.

(a) *What evidence is there for how numerical forecasts of age pension eligibility influence member behaviour? Does this vary depending on the magnitude or accuracy of the forecast?*

(b) *Would factual information alongside a static retirement estimate be more or less effective in raising member awareness of their potential age pension eligibility compared to a numerical forecast? Why or why not?*

Many individuals will not read information about Age Pension eligibility because it's very complicated. Therefore Mercer recommends the introduction of a second estimate allowing for the Age Pension based on a standard set of reasonable assumptions.

(c) *Why do trustees currently choose to include, or not to include, age pension amounts in retirement estimates? Do trustees choose to include age pension amounts only for specific subsets of their members?*

Trustees include Age Pension amounts in retirement estimates because it allows the retirement estimates to represent a holistic income, which can then be compared against industry benchmarks, such as the ASFA Retirement Standard. It is pointless comparing a retirement estimate that doesn't include Age Pension with such a benchmark.

(d) *Would trustees be less willing to provide retirement estimates to their members if they could not include age pension amounts in static estimates? If so, would trustees seek to provide interactive retirement estimates instead?*

C11Q2 *Should age pension amounts be required by default in interactive retirement estimates or in superannuation calculators? Why or why not?*

Answer Yes, the inclusion of age pension amounts should be required by default in interactive and static retirement estimates and superannuation calculators that provide projections. This is because the estimation error of excluding the Age Pension completely is much larger than the estimation error of not using an accurate assumption.

The Age Pension should be required as it provides a more holistic outcome. However, the member should also be able to turn off this allowance. The default assumptions used in a calculator should be consistent with the retirement estimates provided to the member. Hence, the publication of a second estimate, allowing for the Age Pension, would lead to a calculator with a default allowing for the Age Pension.

Retirement estimates: Factors personal to the member

C12Q1 *Are there other ways in which assumptions could be made about future superannuation contributions in working out retirement estimates (e.g. using a three-year rolling average)? To what extent would this better reflect how contribution levels may change over the long term for most members?*

Answer Legislated SG increases should be assumed

C13Q1 *Are there other ways in which future insurance premiums could be taken into account in working out retirement estimates?*

Answer The current annual insurance premium at the projection date is a reasonable starting point.

Inflation

C14Q1 *What are the advantages and disadvantages of ASIC setting standardised default inflation rates for both superannuation calculators and retirement estimates? Please include relevant evidence, where available, of:*

(a) the extent to which common assumptions would increase or reduce the risk of members being confused or misled;

(b) the proportion of members that currently choose to input their own inflation rate assumption into superannuation calculators; and

(c) any differences in forecasts of long-term price or wage inflation across different superannuation funds' memberships.

Answer The key advantage of ASIC setting standardised default inflation rates as deflators is that projections are directly comparable across funds, and any differences are limited to indexation assumptions and methodology. Future projected values can differ significantly with even 0.5% p.a. difference in the deflator.

It is our expectation that there will often be alignment between the deflator for the retirement phase and the indexation of total retirement income. In this way the projection can describe the projected retirement income as a single number.

The key disadvantage of setting standardised default inflation rates is that the standard rates may be inconsistent with modelling used to set default investment returns, and this modelling is often used to set CPI based investment objectives. Hence, the assumed investment earnings will need to allow for the default inflation rates.

Mercer supports the use of a standard default inflation rates for both retirement estimates and superannuation calculators.

C14Q2 *What are the most appropriate types of inflation rate to apply to the accumulation and retirement phases?*

Answer Mercer supports the use of wage inflation before retirement and price inflation after retirement.

C15Q1 *How should ASIC set values for the default inflation rates, and how frequently should these rates be reviewed?*

Answer ASIC should set these default inflation rates in consultation with the Australian Government Actuary. They should be reviewed every three years, or more frequently, if required.