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ASFA Submission to ASIC on Consultation Paper 101 – Superannuation forecasts

The Association of Superannuation Funds of Australia Ltd (ASFA) is pleased to provide its submission to ASIC regarding the consultation paper on Superannuation Forecasts.

ASFA is the peak superannuation industry association representing all sectors of the Australian superannuation industry. An important part of our mission is to advance retirement outcomes for members of funds through research and advocacy.

SUMMARY OF RECOMMENDATIONS

In this submission ASFA recommends the following.

- The superannuation forecasts be called "**Retirement Income Estimates**"
- There is a role for both paper based and calculator superannuation forecasts. The two should work hand-in-hand. Whilst the requirements for each will not be identical we believe that they should be considered together as part of this project.
- Paper-based "retirement income estimates" should ultimately be made mandatory as part of the superannuation fund's annual statement to a member. ASFA suggest a two-phase approach as follows (the dates assume that legislation and final detailed rules are available by 31 December 2009):
  - ability for funds to provide a "retirement income estimate" as part of their annual statement on a voluntary basis from 1 July 2010; and
  - requirement for funds to provide a "retirement income estimate" as part of their annual statement from 1 July 2011.
- Exceptions – for the following funds and account types there should not be a requirement to provide a "retirement income estimate":
  - small balances;
  - inactive accounts;
  - eligible rollover funds;
  - self-managed superannuation funds;

- pensions in payment; and
- consumers aged 65 or older.

Special treatment should be considered for:

- defined benefit funds or member accounts;
- consumers within 1-2 years of customary retirement age; and
- closed products or legacy products.

- Online calculators should remain voluntary and should not be mandatory.
- Legislation should be changed to allow both paper-based and calculator projections to be provided without having to meet the requirements of the personal advice regime. ASIC should grant relief for paper-based projections on an interim basis with a view to changing legislation as soon as this is practicable.
- A statutory exclusion of provider liability should be introduced in regard to mandatory retirement income estimates.
- The Government should fund an education campaign to alert consumers that they can expect a retirement income estimate in their annual statement, to tell them what it does and, importantly, what it does not do i.e. it is not a promise of a benefit.
- There should be communication to consumers of where to go for more assistance eg. FIDO website, providers' websites, other financial literacy information, etc.
- Where projections are mandatory, assumptions should be mandated by the Government Actuary (or similar authority) so that there is no ability for a provider to choose their own assumptions (beyond the ability to insert actual details from the consumer or the product).
- Where projections are voluntary, the mandatory assumptions should be the default position, but the assumptions can be varied within certain rules.
- Where projections are mandatory, assumptions should be relatively stable from year to year to avoid large swings in a consumer's estimated retirement income. The Government Actuary should review assumptions annually, but with the aim that the assumptions are suitable over the long term and are changed only as required.
- Fees and costs - the guiding principle should be a simple illustration of the adequacy of a person's super. There is not complete consensus amongst ASFA members on this point, however there is growing support for using standard fees and costs. That is, a standard rate (or rates) of return (refer below) net of all fees and costs. The simplicity for the consumer and the provider are seen as the main attractions of this approach.
- Rates of return:
    - providers must be directed in regard to the rate of return they use and there must be no room for a provider to "pick" a rate of return;
    - the rate of return should take some account of the investment profile (asset allocation) of the consumer; and
    - the rate(s) of return should be mandated by the Government Actuary and should be long term rates of return which, whilst being reviewed annually, are not designed to be changed on a regular basis.
- Inflation - all future dollar figures should be converted to today's dollars using a wage-based deflator, not a CPI-based deflator. The inflation/deflator assumption should be set by the Government Actuary.

- Taxation - projections should assume that the current taxation conditions and legislative situation remains unchanged. There are some personal tax considerations of the consumer that cannot be allowed for in a projection, and this fact should be made clear in disclaimers.
- Salary and contribution levels:
  - should be taken as at the end of the fund's annual review period i.e. whatever data are on the system at that date should be used.
  - salary increases should be assumed at a standard salary inflation rate (the wages deflator) set by the Government Actuary.
  - contributions should be assumed to continue at the same rate as was received during the annual review period i.e. the last year's contributions will continue, inflated with salary inflation for future years.

  Whilst it would be desirable to allow for time out of the workforce, this is unduly complicated in a mandatory projection.

  Voluntary projections such as calculators may provide more sophisticated assumptions eg
  - promotional pay rises
  - different contribution rates
  - time out of the workforce.
- Retirement date and life expectancy:
  - mandatory projections should have a retirement date of 65.
  - mortality improvements need to be taken into account.
  - all <u>benefits should be expressed as an income figure</u> (not a lump sum). The income figure is derived by dividing the lump sum by a factor determined by the Government Actuary.
  - receipt of the Age Pension should be taken into account or at the very least explicitly referred to.

  Voluntary projections such as calculators may provide more sophisticated assumptions eg
  - a choice of retirement date
  - flexibility in life expectancy
- The costs of insurance should be excluded from the projection and clear warnings are needed that this is the case.
- Presentation in periodic statements:
  - There should be no requirement for the retirement income estimate to be presented in, say, an orange envelope (as happened overseas) or on specially coloured paper. Such requirements would add enormously to administration costs, which would be borne by fund members.
  - The format of presentation in periodic statements should be mandated by ASIC as a schedule to regulations, and that all providers should be required to reproduce that schedule exactly. Costs to administrators will be prohibitive if every superannuation fund has a different format.
  - The schedule needs to be simple eg. a two page (one page front and back) document
  - Key assumptions should be disclosed, however consumers do not need to see detailed calculation methods – this more detailed information can be provided elsewhere.
- There should be no standard format for voluntary projections (including calculators), but there should a requirement that certain information be included, together with some controls over presentation and wording, and a requirement that certain disclaimers be made.

- Warnings need to make clear that:
  - the retirement income estimate is indeed an estimate and not a promise;
  - the returns assumed may have no relation to the returns the consumer is earning in their own fund; and
  - the returns assumed are long term, and that those retiring soon may have a different result. In fact further thought is required as to the validity of a projection for someone very close to retirement.
- Consumers should be directed to where they can obtain further information.
- Investment strategies - the mandatory projection in annual statements should not include other investment strategies or other contribution strategies but only the consumer's current strategy.
- ASFA recommends that all benefits should be expressed as an income figure (not a lump sum).
  - The income figure should be derived by dividing the lump sum by a factor determined by the Government Actuary. This factor takes account of improvements to life expectancy. The result should be an income figure that has a 90% chance of lasting for a person's life expectancy. Using a "normal" life expectancy will only deliver a 50% chance of this.
  - An indicative income from the Age Pension be included in the projection. Currently 75% of retirees receive at least a partial Age Pension, so a statement which excludes this source of income will not be meaningful for most consumers.

Yours faithfully,

Melinda Howes

Director of Policy & Industry Practice

INTRODUCTION

Our aim in this submission, after discussion with ASIC, is to focus on a number of big-picture themes and areas. ASFA appreciates that there will be further consultation from ASIC on the detail of the measures, and accordingly in this submission we take a broad approach. However, we do highlight those detailed areas that have proved contentious in discussions amongst the superannuation industry.

*The terminology to be used – "**Retirement Income Estimate**"*

In this spirit of education, we would suggest that these projections not be called "superannuation forecasts". We believe that the word "forecast" contains, or can be interpreted as containing, an implied promise of future benefits.

Similarly the term "end-benefit projection" implies that the consumer is only being shown one figure – the figure at the "end" or at retirement. A more useful projection would also show progress along the way eg. in the form of a graph.

ASFA would prefer that another term be used. A common term in the superannuation industry is "benefit projection", however this is not very illustrative.

Given the desired focus is on incomes in retirement and not lump sums, ASFA recommends that the term "retirement income estimate" be used. We will use "retirement income estimate" for the remainder of this submission.

The remainder of this submission follows the format of the Consultation Paper, and we use the same numbering and heading system as used in that paper.

A. BACKGROUND

A1.1 Proposed objectives

We applaud ASIC for the aim of this project, which is to help consumers achieve financial security in retirement by improving the clarity and effectiveness of information provided to them about their superannuation.

This aim of an adequate retirement outcome for all Australians is a key strategic focus for ASFA, and we are delighted to be able to participate in this consultation process.

Key Guiding Principle: Adequacy is the Purpose

In discussing those issues contained in the Consultation Paper we have used the guiding principle that the purpose of the superannuation forecast is *to educate consumers about the adequacy of their superannuation*.

The purpose is <u>not</u> to provide a comparison between the investment performance and fees of different superannuation funds. Fund comparisons are better achieved with different tools such as investment performance tables and fee disclosure in PDS documents.

In any case a consumer could not use a superannuation forecast to compare the fees and performance of two funds unless they have exactly the same account balance, contributions and investments in two different superannuation funds. This is extremely unlikely.

A1.2 Benefits to consumers and providers

Benefit to consumers

ASFA believes that a personalised superannuation "retirement income estimate" delivered as part of a fund's annual statement will be read with interest by most consumers. The annual statement is often the only material sent from a superannuation fund that most consumers read. This is the best place to provide an educational message on adequacy of retirement income.

ASFA believes that such information *will be of significant benefit to consumers*, who may not feel confident or empowered enough to seek out such information on their own (such as by using a web calculator). It also allows the retirement income estimate to be personalised to the consumer.

The provision of such information on a regular (annual) basis will allow the consumer to start to understand what affects their superannuation– how it changes with market movements and with their contribution levels. A consumer who understands this is much more likely to take ownership of their superannuation and make key decisions. Making those decisions early in life (rather than relying on defaults) could have an enormous impact on the adequacy of a consumer's retirement income in future years.

Benefit to providers

The main benefit to providers of sanctioned arrangements for retirement income estimates is very simple: *providers of superannuation want certainty* on what information they can give that will not be treated as advice. Many superannuation fund trustees who are ASFA's members have told us that they want to provide more information and education to fund members. At present they are reluctant to do so for fear of crossing the line into "implied advice". Any clarity that can be given in this regard would be welcomed by superannuation providers.

Other benefits to providers include the potential for more cash-flows from members adding contributions or consolidating other benefits, and better retention of fund members who are more engaged with their superannuation and use more of the features of the fund.

A1.3 Form – paper, calculator or both?

ASFA believes that the delivery mechanism is probably the most important aspect – to get the best information to members we need to place it where they will see it. The one place that most consumers look is at their annual statement. This would imply that paper-based "retirement income estimates" are vital.

However it is likely that the paper-based "retirement income estimate" will be very simple and will not allow consumers to see the effects of varying factors such as their rate of contributions.

As such we believe that there is a place for a more sophisticated calculator where an interested consumer can (perhaps online) explore the effect of making some key decisions about their super.

ASFA believes that *there is a role for both forms of superannuation forecast*. The two should work hand-in-hand. Whilst the requirements for each will not be identical we believe that they should be considered together as part of this project.

A1.4 Should they be mandatory?

ASFA believes that *paper-based "retirement income estimates" should ultimately be made mandatory* as part of the superannuation fund's annual statement to a member.

However we recognise the significant implementation hurdles the industry will face in order to implement such a requirement. A significant lead time will be required from the date of the passage of legislation and final detailed rules to the date of implementation of compulsory projections.

Staged implementation:

As such ASFA suggest a two-phase approach as follows (dates assume that legislation and final detailed rules are available by 31 December 2009):

- ability for funds to provide a "retirement income estimate" as part of their annual statement on a voluntary basis from 1 July 2010; and
- requirement for funds to provide a "retirement income estimate" as part of their annual statement from 1 July 2011.

Exceptions – for the following funds and account types there should not be a requirement to provide a "retirement income estimate":

- small balances;
- inactive accounts;
- eligible rollover funds;
- self-managed superannuation funds;
- pensions in payment; and
- consumers who are already aged 65 or older.

Special rules – ASFA believes that in the following case whilst a retirement income estimate should be provided, special treatment should be considered:

- Defined benefit funds or member accounts – projection may have to look a little different or be simpler eg. generally cannot show an accumulating account balance on a graph, but would be able to show a benefit at age 65 expressed as an income. If the scheme is a pension scheme perhaps the promised pension could be shown. Further consideration of defined benefit funds is required and we suggest that ASIC consult with industry on the detail of this issue.
- Consumers within 1-2 years of retirement. For these people there is a high chance that the retirement income estimated will not be the actual retirement income achieved. Whilst it is still important to provide such people with an estimate, special warnings should be added, or perhaps a simpler result should be shown. Further consideration of this issue is required.
- Closed products or legacy products – the costs could be high for older style closed products on legacy computer systems. Further consideration of this issue is required.

ASFA believes that *online calculators should remain voluntary* and should not be mandatory.

A1.5 How has current relief on calculators worked?

The current relief has worked to an extent but there are still some issues as follows:

- the relief does not cover paper-based projections, however as discussed above the annual statement has the "highest visibility" to consumers
- providers are receiving conflicting legal advice about the extent of the relief, and as such there is much uncertainty and some funds have shied away from providing projections
- providers desire guidance on assumptions – there is an appetite for uniform assumptions. In fact the ASIC FIDO calculator assumptions have become a de facto "standard" for quite a few other calculators.

As discussed above, providers want certainty on what information they can give that will not be treated as advice. Many superannuation fund trustees who are ASFA's members have told us that they want to provide more information and education to fund members. At present they are reluctant to do so for fear of crossing the line into "implied advice". Any clarity that can be given in this regard would be welcomed by superannuation providers.

A1.6 Relief for paper-based projections?

As discussed above, relief or its equivalent is also required for paper-based projections.

However relief may not go far enough. The problems outlined above (conflicting interpretation of relief, uncertainty) would apply if the current model of giving relief were extended to paper-based projections.

ASFA believes that a better model is to change legislation to allow both paper-based and calculator projections to be provided without having to meet the requirements of the personal advice regime. Projections would have to adhere to a strict set of rules in order for the personal advice regime to not apply.

The main problem with this approach is timing. A change to legislation may not be consistent with implementing this project in a timely fashion.

Staged implementation:

As such, ASIC could grant relief for paper-based projections on an interim basis with a view to changing legislation as soon as this is practicable.

A1.7 Risk for providers

Whilst there will always be some risk for providers of any retirement income estimate in terms of potential liability to consumers, this risk is greatly reduced to the extent that:

- the estimates are mandatory; and
- the calculation methods and presentation are standardised.

Strong, prominently placed consumer warnings should be mandatory, and the wording should be standardised. Even with this, not all consumers will read the warnings.

Whilst warnings will reduce the potential risk for providers, ASFA recommends the introduction of a statutory exclusion of provider liability in regard to mandatory retirement income estimates - this would further reduce if not eliminate any potential liability.

As this is a new concept for many consumers it will take a few years for them to understand how the retirement income estimates work and how they can expect their figures to change from year to year.

For this reason ASFA suggests that the Government funds an education campaign to alert consumers that they can expect a retirement income estimate in their annual statement, to tell them what it does and, importantly, what it does not do i.e. it is not a promise of a benefit.

Current market environment

Volatile investment environments create special problems for projections.

For example, if projections were being sent to consumers now based on their 30 July 2008 balance, there is a risk for the provider and the consumer that any projection at a standard rate of return will overestimate the retirement income for a consumer retiring in the next 1-2 years.

Warnings and education will need to make it clear that the returns assumed are long term, and those retiring soon may have a different result. In fact further thought is required as to the validity of a projection for someone very close to retirement.

A1.8 Other resources for consumers

Ideally the retirement income estimate should be simple enough that consumers could understand it without the need for financial advice.

However ASFA suggests that the following other resources be made available and publicised to consumers:

- Government-funded educational campaign in the early years to alert consumers to the estimate and tell them what it does.
- Wide communication of where to go for more assistance eg. FIDO website, providers' websites, other financial literacy information, etc.

ASFA does not believe that general financial literacy training would be sufficient in this regard. The education would need to be quite targeted initially at the purpose and uses of the retirement income estimates. The campaign could then be extended (in future years) to the consequences of making decisions about superannuation and ways in which a consumer can influence their retirement outcome.

A1.9 Other barriers to consumer engagement?

The main barrier to consumer engagement is apathy. This is not something that can be changed quickly, however we believe that the combination of regular provision of retirement income estimates and the related government educational campaigns will go a great way towards gradually breaking down this barrier.

We cannot think of any other measures at this stage that would be more effective for the current working generations.

Other barriers include:

- a lack of a sense of ownership of superannuation – a lack of engagement in the process;
- the perceived complexity of superannuation;
- general lack of understanding of financial matters; and
- a lack of trust that the rules will stay the same.

A1.10 Defined benefit schemes and niche products?

Defined benefit schemes

As discussed above, ASFA recommends that a retirement income estimate should be provided for defined benefit schemes, however special treatment should be considered as follows

- the projection may have to look a little different or be simpler eg. it cannot show an accumulating account balance on a graph, but would be able to show a benefit at age 65 expressed as an income.
- if the scheme is a pension scheme perhaps the promised pension could be shown.

Further consideration of defined benefit funds is required and we suggest that ASIC consult with industry on the detail of this issue.

Consumers within 1-2 years of retirement

Special treatment should be considered for consumers within 1-2 years of retirement as there is a high chance that the retirement income estimated will not be the actual retirement income achieved. Whilst it is still important to provide such people with an estimate, special warnings should be added, or perhaps a simpler result should be shown. Further consideration of this issue is required.

Closed or legacy products

Special treatment should also be considered for closed products or legacy products – the implementation costs could be high for older style closed products on legacy computer systems. Further consideration of this issue is required.

Small balances

It is not meaningful to project a very small account balance – say under $2,000. Also the costs of providing such a projection are large compared to the value of benefits.

For practical purposes, ASFA recommends that small balance accounts below $2,000 be exempted from having to be projected.

Inactive accounts and Eligible Rollover Funds

When accounts are inactive or are with Eligible Rollover Funds retirement income projections will not be very meaningful given that no contributions are being made. In these circumstances it would not generally be helpful for a member to be provided with a retirement income projection. In any event in the case of most ERF accounts it will not be possible for the fund concerned to contact the member.

Self managed superannuation funds (SMSFs)

As members of self managed funds are also the trustees and heavily involved with running the fund, there is no need for a member of a self-managed fund to provide themselves with a projection. ASFA recommends that Self Managed Superannuation Funds not be required to provide a retirement income estimate to members.

Pensions in payment

Some superannuation funds have a pension section within the fund, and others have pensions in separate products. Whatever the structure, ASFA recommends that those superannuation monies that are in the "pension phase" i.e. are backing pensions already in payment, be excluded from the requirement to provide a retirement income estimate.

This means that for a person who is transitioning to retirement, they will receive a projection on their "accumulation phase" money but not their "pension phase" money.

Consumers aged 65 or over

If standard projections are to age 65 there should be no requirement to provide a projection for a superannuation fund member who is already aged 65 or older.

A1.11 What can we learn from the overseas experience that is relevant in Australia?

ASFA agrees with the points raised in regard to this by the Institute of Actuaries in their submission on lessons from the UK system, paraphrased as follows:

- Technical Memorandum – provision of detailed technical advice will be required to enable the projections to be built by the industry.
- Consistency
    - point of sale disclosure (eg. PDS fees disclosure) and annual projections should both be presented in today's dollars; and
    - results should only be shown in today's dollars, not in future dollars (otherwise too confusing for consumers).
- Simplicity – the UK system showed three different projections at different rates of return. This caused consumer confusion and still did not adequately illustrate the downside risk.
- Salary and Price Inflation – future dollar figures should be converted to today's dollars using a wage-based deflator, not a CPI-based deflator.

B. CALCULATION METHODS

B1 - Making Assumptions

B1.1 Who should make the assumptions?

B1.2 Which assumptions should be set by which parties?

B1.3 Who should set standardised assumptions?

Mandatory projections

ASFA recommends that where projections are mandatory, assumptions be mandated as well so that there is no ability for a provider to choose their own assumptions (beyond the ability to insert actual details from the consumer or the product).

That is:

- The main external assumptions should be standardised and prescribed by the Australian Government Actuary or similar authority eg. inflation rate or deflator, rates of return.

- Assumptions relating to the consumer (age etc.) should be drawn from the fund's customer record system.
- Possibly some assumptions could relate to the superannuation fund itself eg. actual fees – however note the discussion below.

Voluntary projections

Where projections are voluntary (eg. calculators or voluntary projections from the provider eg. as part of educational seminars), the mandatory assumptions should be the default position, but the assumptions can be varied within certain rules.

Providers can provide a voluntary projection at any time, for example they could be provided with half-yearly statements on the same basis as the annual statement projection.

B1.4 If all assumptions are standardised (eg. earnings rates and fees & costs) will this prevent people from using forecasts to compare funds? Does this matter – is this one of the things forecasts should be used for?

This is the area of most contention in the superannuation industry. The arguments can be grouped into two main approaches which can be broadly summarised as follows:

1. Retirement income estimates should <u>take into account relevant characteristics of the superannuation fund the consumer is in</u>. As such actual fees should be used and /or applicable long term returns if the investment characteristics of the fund differ markedly from standard investment returns.
2. Retirement income estimates should be used to <u>illustrate on a generic basis the adequacy</u> of a consumer's retirement outcome. As such standardised returns and fees should be used.

There are also those who are half in approach 1 and half in approach 2, with a view that returns and investment fees should be standard but administration fees should be the fund's actual fees.

ASFA's view is that the guiding principle should be a simple illustration of the adequacy of a person's super. However it is also important to make the projection relevant to the consumer. This is an area where further industry work will be required with the aim of reaching a consensus view.

Fees and costs

The Institute of Actuaries of Australia submission sums up the pros and cons of including or excluding actual fees at various levels (investment, administration etc.) - please refer to B1Q4 and B2Q1 of their submission. Again they do not come to a hard recommendation but lean towards approach 2 above.

There is not complete consensus amongst ASFA members on this point, however there is growing support for approach 2, that is, assuming standard fees and costs (i.e. a standard rate (or rates) of return net of all fees and costs). The simplicity for the consumer and the provider are seen as the main attractions of this approach.

Earnings rates

In terms of the use of actual investment returns we believe the situation is clearer. ASFA recommends that actual returns not be used. The Institute of Actuaries submission gives a good reason for this recommendation as outlined below:

> *"We do not recommend <allowing a fund to project at their actual historical rate of return> as past investment performance can be a poor predictor of future performance. For example we have just exited an extended period of extremely high returns which has stretched for most of the last 20 years. Any long-term projection into the future using this historical data is likely to overstate the future return. Also actual historical returns even when averaged over many years will fluctuate from year to year and it is desirable to have consistency of assumptions over time."*

The Institute of Actuaries go on to recommend a maximum 7% return net of tax and investment fees and costs. This could be reduced at trustee discretion.

ASFA's concern is that such an approach could overstate the return for a consumer with a conservative investment portfolio such as a cash account, and that some trustees might not act to reduce the maximum rate. This is even more of an issue after recent events which led to some members with significant amounts of superannuation switching to cash investment options. Projecting such investments at 7% for a long time period will greatly overstate a consumer's expected retirement benefit and give them a false picture of adequacy.

ASFA recommends that:

- providers must be directed in the rate of return they use and there must be no room for a provider to "pick" a rate of return;
- the rate of return should take some account of the investment profile (asset allocation) of the consumer; and
- the rate(s) of return should be mandated by the Government Actuary and should be long term rate(s) of return which, whilst being reviewed annually, are not designed to change on a regular basis.

This could be achieved for example by using a stepped basis (eg. 0 to 25% growth assets 6%, 25-70% growth assets 7%, 70+% growth assets 8%) or with a phase-in scale (eg. return = 5% + 3.5% x % growth assets).

Please note there are different approaches in the industry at present in terms of which assets are classified as "growth" or "defensive". ASFA is currently undertaking work on this in an attempt to achieve industry consensus. A common definition would have to be mandated for the above process.

B1.5 Which assumptions require updating and how often?

ASFA recommends that where projections are mandatory, assumptions be relatively stable from year to year so as to avoid large swings in a consumer's estimated retirement income.

The Government Actuary should review assumptions annually, but with the aim that the assumptions are suitable over the long term and are changed only as required.

B2 - Investment Earnings, Fees and Costs

We believe that ASFA's views on questions **B2.1 to B2.8** have been outlined at **B1.4** above.

B3 - Inflation

We believe that ASFA's views on questions **B3.1 to B3.4** have been outlined at **A1.11** above.

That is, all future dollar figures should be converted to today's dollars using a wage-based deflator, not a CPI-based deflator. The inflation/deflator assumption should be set by the Government Actuary.

B4 – Taxation

ASFA's views on questions **B4.1 and B4.2** are as follows:

- Yes, projections should assume that the current taxation conditions and legislative situation remain unchanged.
- There are some personal tax considerations of the consumer that cannot be allowed for in a projection. This fact should be made clear in disclaimers.

B5 – Salary and contribution levels

ASFA views on questions **B5.1 and B5.5** are as follows:

- Salary and contribution levels should be taken as at the end of the fund's annual review period i.e. whatever data are on the system at that date should be used.
- Salary increases should be assumed at a standard salary inflation rate (the wages deflator) set by the Government Actuary. Voluntary projections such as calculators may provide more sophisticated assumptions (promotional pay rises etc.) as an option.
- Contributions should be assumed to continue at the same rate as was received during the annual review period i.e. the last year's contributions will continue, inflated with salary inflation for future years.

  The reason for this approach is that many funds do not know the consumer's salary and as such a percentage of salary approach is not possible.

  Also this approach picks up any voluntary contributions a consumer is making, and assumes they will continue. If they stop making such contributions, they will see a drop in their estimated retirement income – this is a powerful educational message.
- We believe whilst it would be desirable to allow for time out of the workforce, this is unduly complicated in a mandatory projection. This could be provided as an option in a voluntary projection like a calculator.

Providers who want to provide other more complex contribution assumptions could do so in a voluntary projection – this could be given at the same time.

B6 – Retirement date and life expectancy

ASFA views on questions **B6.1 and B6.3** are as follows:

- A retirement date of 65 should be used as a standard in mandatory projections. Although benefits are available tax-free at age 60, consumers should not be encouraged to think of this as a standard retirement date. As well the Age Pension is not available until age 65 for future retirees, making it very difficult to provide retirement income estimates for those retiring prior to age 65.
- Calculators can offer a choice of retirement date. Warnings will need to be included that tax may be payable on retirement before age 60.
- Calculators can also offer flexibility in life expectancy, allowing a consumer to extend their expected life expectancy (but not reduce it) to see the impact if longevity on their retirement income.
- Mortality improvements need to be taken into account – ASFA supports the recommendations of the Institute of Actuaries of Australia in regard to mortality and life expectancy assumptions.
- Importantly, all <u>benefits should be expressed as an income figure</u> (not a lump sum). The income figure should be derived by dividing the lump sum by a factor determined by the Government Actuary. This factor should take account of improvements to life expectancy. The result should be an income figure that has a 90% chance of lasting for a person's life expectancy. Using a "normal" life expectancy will only deliver a 50% chance of this.
- Receipt of the Age Pension should also be taken into account or at the very least explicitly referred to.

B7 – Insurance

ASFA views on questions **B7.1 and B7.2** are as follows:

- As insurance costs change with age, they cannot be projected based on current year's costs plus inflation. To project actual insurance costs based on each consumer's insurance premium table would be very expensive and complex. As such ASFA recommends that the costs of insurance should be excluded from the projection. Clear warnings are needed that this is the case.

B8 – Further variables and assumptions

ASFA agrees with the comments of the Institute of Actuaries of Australia on further variables and assumptions.

C. PRESENTATION IN PERIODIC STATEMENTS

C1 – Standard format?

ASFA views on questions **C1.1 to C1.6** are as follows:

ASIC has asked that we consider implementation costs as part of our response. This is the area that will have the largest impact on such costs.

ASFA recommends that there be no requirement for the retirement income estimate to be presented in an orange envelope (as happened overseas) or on specially coloured paper. This would add enormously to administration costs, which would be borne by fund members. Placement of the estimate in the consumer's annual statement is enough to ensure its prominence.

ASFA recommends that the presentation in periodic statements be mandated by ASIC as a schedule to regulations or legislation, and that all providers must reproduce that schedule exactly.

The schedule needs to be simple. It could be a two page (one page front and back) document where the front page is the retirement income estimate (including graphs etc) and the back page has the assumptions and disclaimers.

Key assumptions should be disclosed, however consumers do not need to see detailed calculation methods – this more detailed information can be provided online with references as to where to find this information.

ASIC (with assistance from industry) would develop the format, and all text would be mandated.

Reasons for a standard format for annual statements

1. Cost of administration

We have been made aware by superannuation administrators that the implementation of mandatory projections will present a significant challenge.

Many administrators provide services to more than one superannuation fund. If each superannuation fund is allowed to tailor their own format, we do not believe that many administrators will be able to deliver the projections in the required time frame. If they are able to do so, the costs (which consumers will end up bearing) will be prohibitive.

However if all funds are using the same format, each administrator only needs to "build" the format once and then all funds can use it.

2. Ease of understanding for consumers

A standard format means that when someone changes funds, they will still receive the same format and know where to find the information.

Many consumers are in more than one superannuation fund, so will need to "add" their estimate from the different funds in order to get a full picture of their adequacy. This process is facilitated by a standard format.

3. Voluntary projections can get more creative

If a provider wishes to add more information or illustrate other things, they can do so using web calculators or provide other "more detailed" projections as part of educational campaigns.

Things to be included in the standard format

- Retirement benefits should be expressed as income in retirement rather than as a lump sum.
- An indicative income from Age Pension should also be included. Currently 75% of retirees receive at least a partial Age Pension, so a statement which excludes this source of income will not be meaningful for most consumers. Some standard assumptions would need to be made.

No standard format for other projections

ASFA recommends that for voluntary projections (including calculators) there be no standard format, but a requirement that certain information be included, there be some controls over presentation and wording, and a requirement that certain disclaimers be made.

C2 – Statements and warnings

ASFA agrees with the comments of the Institute of Actuaries of Australia on statements and warnings. ASFA recommends that warnings make it clear to consumers that what is involved is an estimate and not a promise.

Current market environment

Volatile investment environments create special problems for projections.

For example, if projections were being sent to consumers now based on their 30 July 2008 balance, there is a risk for the provider and the consumer that any projection at a standard rate of return will overestimate the retirement income for a consumer retiring in the next 1-2 years.

ASFA recommends that warnings and education make it clear that:

- the returns assumed may have no relation to the returns the consumer is earning in their own fund; and
- the returns assumed are long term, and that those retiring soon may have a different result. In fact, further thought is required as to the validity of a projection for someone very close to retirement.

C3 – Further information

ASFA recommends that consumers be directed to where they can obtain further information.

If projections are standardised, a detailed guide to the projection could be placed on the ASIC website (similar to the FIDO guide that currently exists).

Many providers will have online educational and help material where they can also direct members.

A space should be provided on the standard template to allow direction to other sources of material.

C4 and C5 – Changes to investment strategy and contributions

ASFA recommends that in the interests of simplicity and clarity, the mandatory projection in annual statements not include other investment strategies or other contribution strategies but only the consumer's current strategy.

This was one of the lessons from the UK experience – showing three different investment strategies proved confusing to consumers.

ASFA believes that voluntary projections (eg. calculators or more complex projections produced by providers as part of educational programs) are the most appropriate place to illustrate the effect of a change in investment strategy or a change to contribution levels.

There should be some controls in place so that consumers or providers cannot enter extreme assumptions in a voluntary projection. A valid range of assumptions may be required to be mandated, or warnings provided if a consumer enters assumptions outside the “sensible” range.

Additional pages can be included in the annual statement if desired to illustrate some of these changes to strategies.

Alternatively further information could be included to tell the consumer where they can get a more complex projection eg. the provider’s website, or the FIDO calculator.

C6 – Today’s dollars or future dollars

ASFA agrees with the Institute of Actuaries recommendation that there be a requirement that all future dollar figures should be converted to today’s dollars using a wage-based deflator, not a CPI-based deflator. The inflation assumption should be set by the Government Actuary.

C7 – Conversion to an annual income stream

ASFA recommends that all benefits should be expressed as an income figure (not a lump sum).

The income figure should be derived by dividing the lump sum by a factor determined by the Government Actuary. This factor takes account of improvements to life expectancy. The result should be an income figure that has a 90% chance of lasting for a person’s life expectancy. Using a “normal” life expectancy will only deliver a 50% chance of this.

ASFA recommends that an indicative income from the Age Pension be included in the projection. Currently 75% of retirees receive at least a partial Age Pension, so a statement which excludes this source of income will not be meaningful for most consumers. Some standard assumptions would need to be made.