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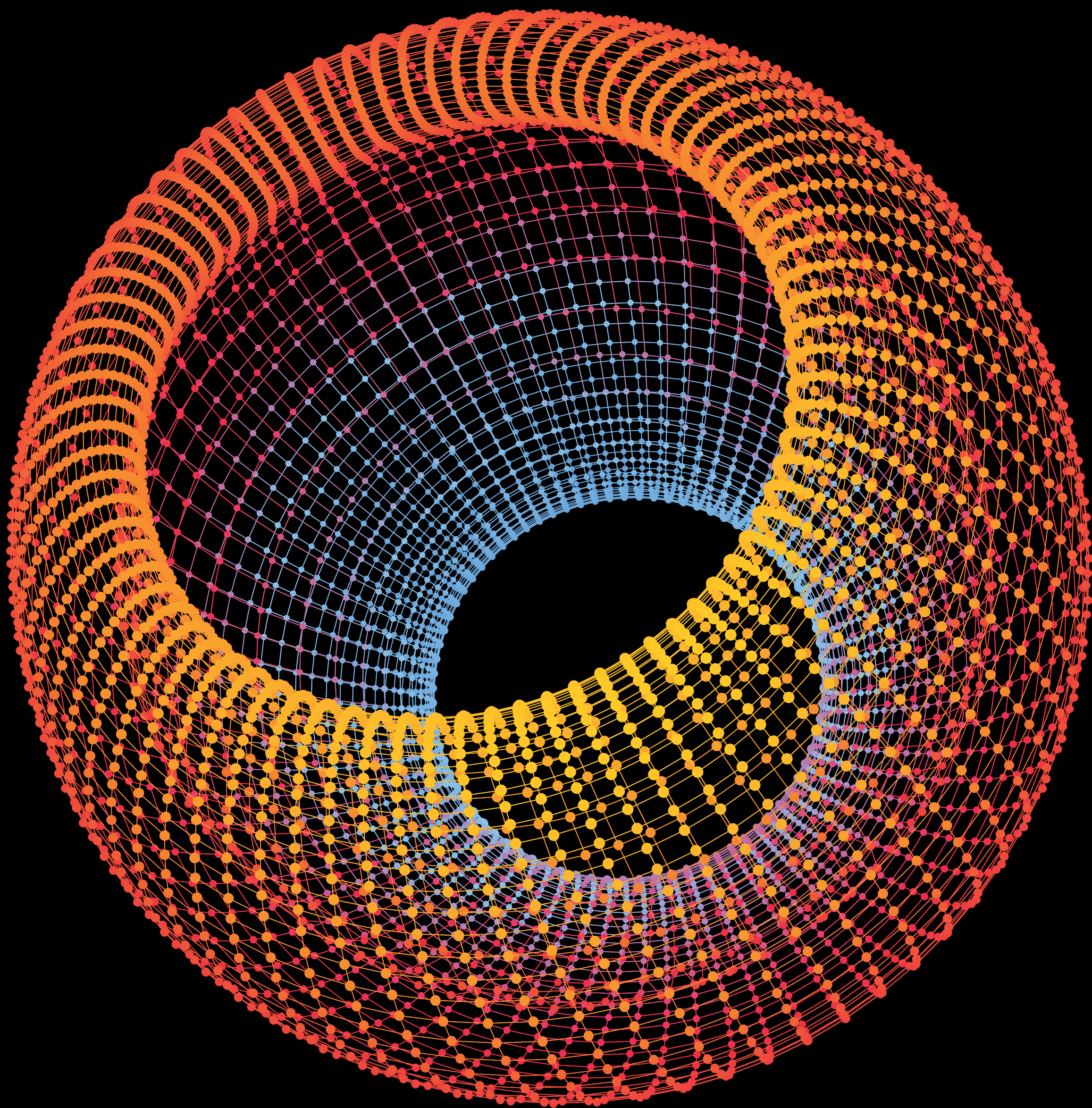


Retirement Solutions Assessment Framework

February 2023

Contents

1. Introduction

This report introduces our Retirement Solutions Assessment Framework (the "Framework") to assist superannuation funds that are seeking to explore available retirement solutions or to outsource a component of their retirement solutions in order to satisfy the fund's obligation under the Retirement Income Covenant (the "Covenant"). The Framework comprises a structured set of value-weighted detailed considerations by which to compare and assess solution providers and their solutions. This can be used in a process similar to how funds seek to fulfill their group insurance obligations under APRA Prudential Standard SPS 250.

We acknowledge that, as at the date of the preparation of this Framework, funds are in different stages of the decision-making process of adding retirement solutions to their product suite. While some funds have designed the new retirement solutions they plan to introduce and are at the stage of selecting a provider for the solution(s), other funds are still working through identifying the services and nature of products that the fund will offer. This Framework has been designed for funds to use in the selection of the nature of solutions as well as the selection of the provider of the retirement solution.

Section 3 describes the purpose of the Framework including the decision-making process while Section 5 describes each key criterion and our rationale for the detailed considerations. Section 6 of the report provides guidance to funds on how to apply the Framework including selecting the detailed considerations and how to set the value-weighting and scoring metrics.

Appendix 1 provides a brief list of the considerations under each key criterion. Should you be interested in the full detailed list (that may be used as part of a tender process), please contact us to find out more.

1.1. Acknowledgements

We would like to acknowledge TAL and other life insurers for their contribution in validating our modelling and assessment criteria for the insurance concepts referred to in this report.

2. Executive summary

2.1. Background and purpose

The Retirement Income Covenant (the "Covenant") came into effect on 1 July 2022, requiring superannuation funds to formulate a retirement income strategy (the "RIS"). The purpose of the RIS is to address how the fund will assist retirees in balancing key retirement objectives. The practical execution in line with the Covenant is beginning, with a number of new retirement income products and providers becoming available in the market, as well as a commitment from many funds to uplift their product suite and guidance offerings, including the use of digital tools.

For funds, the potential introduction of a new retirement solution is not a trivial undertaking, as it involves numerous steps and decision points including the exploration of different retirement solutions and the potential need to outsource various capabilities to specialist providers.

Funds are expected to execute their RIS and to develop new retirement solutions, giving consideration of prudential standards—in the absence of any detailed guidelines—including, but not limited to:

- *Prudential Standard SPS 515 Strategic Planning and Member Outcomes*
- *RG 274 Product Design and Distribution Obligations*
- *Prudential Standard SPS 231 Outsourcing*
- *Prudential Standard SPS250 Insurance in Superannuation* (specifically for any insurance transfer features designed into the products)

The Retirement Solutions Assessment Framework (the "Framework") offers a library of detailed criteria (see Appendix 1) that can be used to assist trustees with assessing solutions (and their providers). Funds can utilise this Framework in conjunction with their own RIS to select and weight the relevant detailed criteria and ultimately determine the solution that is best for their members.

The Framework can be used to support the funds through the following:

- Exploration of the universe of available retirement solutions in the market.
- Selection of components of retirement solutions the fund may seek to outsource.
- Selection of providers that offer the retirement solution (and required capabilities) the fund seeks to offer.

The Framework is structured with the library of detailed considerations categorised into the following four key criteria:

1. Product features
2. Services and technology
3. Price and associated terms
4. Provider strength and stability

A description of each of these key assessment criteria is provided in Section 2.2.

2.2. Product features

This criterion assesses the suitability of the solution benefit design and product features to meet the needs of the fund and its members. Some examples that a fund may consider include:

- **Product simplicity:** Various iterations of retirement products have been issued and subsequently closed to new business despite containing desirable features over the last 15 years. It was often found that these features were too difficult to understand, which hindered take-up.
- **Maximise expected retirement income:** There has been historical evidence that retirees tend to drawdown at legislated minimum rates and leave unintended bequests (2020 Retirement Income Review)[1]. To address one of the key objectives from the Covenant, superannuation funds will need to acknowledge how a solution can be used to maximise expected income throughout retirement and how this may differ for different cohorts of members.
- **Market protection:** For a retiree, the magnitude, order and timing of unfavourable market returns may lead to a lower retirement outcome and impact the sustainablity and stability of retirement income. Solutions may have in-built market protection mechanisms to mitigate this risk.
- **Longevity protection:** Longevity risk for a retiree is outliving their retirement savings. Existing solutions offered by providers have varying levels and nature of guarantees of protection against longevity risk.
- **Inflation protection:** Inflation poses a threat to retirees resulting in their money losing purchasing power.
- **Other protection considerations:** Cognitive decline, health events and beneficiary disengagement are a few additional risks that retirees may need some form of protection against.
- **Flexible access to expected funds:** Spending throughout retirement does not necessarily follow a constant real income and can fluctuate significantly with unforseen expenses. Some solutions offer flexible access to funds that may be a greater priority than achieving maximum expected income for life.

2.3. Services and technology

This criterion assesses both services and technology for members and for the fund and includes digital tools and guidance to retirees, member experience and seamless cost-effective integration of retirement solutions. Some specific considerations include:

- **Integration support:** Integration and alignment with the fund's existing solutions as well as ongoing support can provide a more seamless experience for the fund and ultimately the members.
- **Digital advice and tools:** New digital solutions will address the gap in the level of financial advice support for most retirees. However the ongoing Quality of Advice Review may have future implications on some of the regulatory framework and any digital advice and tools will need to continue to meet the latest prudential standards.
- **Services for funds:** Operational aspects of a superannuation fund including administration, investment management, member engagement may be outsourced to specialist providers. Integration and implementation support is a key factor here.

2.4. Price and associated terms

In the current member-centric regulatory focus, "the value for money" needs to be articulated to satisfy the member's best financial interest test for all decisions points. It is important to note that having the lowest price will not guarantee success, however being the most expensive can often make it difficult. This criterion assesses the cost and associated terms between the fund and the provider. These include any cost and terms that are included explicitly within the retirement income and those that are separate.

2.5. Provider strength and stability

While there are benefits to outsourcing components of a retirement solution, there is an inherent risk that the provider may fail to fufil their obligations. It is therefore essential to assess the level of confidence that the member reasonable expectations from the provider will continue to be met even in uncertain times. This includes appropriate due dilligence, relevant experience, meeting the existing prudential standards and ensuring risk management processes and frameworks are adequate.

2.6. Applying the Framework

Funds can amend the detailed considerations to tailor the Framework depending on their specific needs. The detailed considerations are then weighted under each key criterion and scored. Each of these key criteria are also weighted with consideration of the RIS of the fund. Figure 1 below provides a summary of the Framework, which is explained in greater detail in section 5.

Figure 1: Retirement Solutions Assessment Framework

Retirement Solutions Assessment Framework

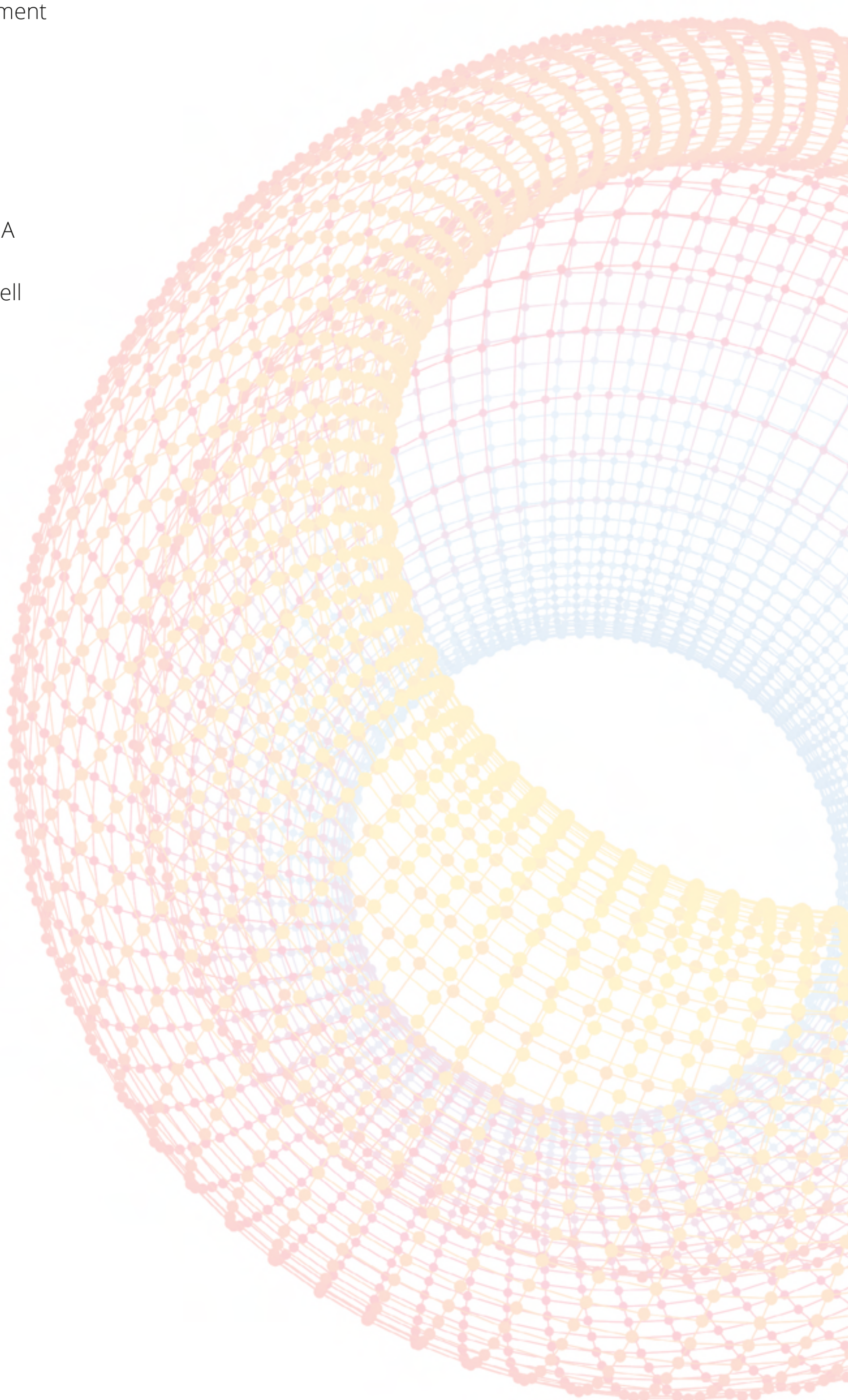
Retirement Income Strategy

Key Assessment Criteria (KAC)	Weighting (KACW)	Detailed Considerations (DC)	Weighting (DCW)	Scoring (DCS)
Product Features Assess the flexibility around benefit designs.	Each key criterion will be given a weighting such that the total sums to 100%. The weighting will based on the retirement solution(s) the fund is considering to outsource and reflective of the RIS.	Some examples include: • Simplicity of solution to communicate and distribute to members. • Maximise expected retirement income. • Nature and level of protection on the key risks (for example longevity, market and inflation). • Flexible access to expected funds.	Each detailed consideration will be given a weighting such that the total sums to 100% for each key criteria. The weighting will based on the retirement solution(s) the fund is considering to outsource and reflective of the RIS.	Each detailed consideration is scored out of 10. The scoring applies a level of judgement and agreement between the respective decision makers and subject matter experts of each fund.
Services and Technology Assess the services and technology offerings to ensure seamless integration of retirement solutions and/or member experience.		Some examples include: • Services and tools to assist members in making retirement decisions. • Services to integrate or supplement retirement solutions (for example investment, administration).		
Price and Associated Terms Assess the associated costs and terms between a fund and provider.		Some examples include: • Associated costs and terms between the fund and the provider (including any ongoing cost such as licensing agreements).		
Provider Strength and Stability Assess the level of confidence that the solution will be continued to be provided even in uncertain times.		Some examples include: • Financial strength (S&P ratings). • Licensing and prudential supervisions environment. • Relationship with funds and cultural fit.		

2.7. Conclusion

The growth in member balances and the number of members retiring every year, as well as the introduction of the Retirement Income Covenant, are driving an increased demand for retirement solutions and for providers of these solutions. Some trustees are considering outsourcing components of their solutions and partnering with specialist providers to develop a more comprehensive retirement solution.

Adding a new retirement solution to a super fund's product suite involves a number of steps and decision-making points. A robust framework that supports funds in the exploration and selection of the potential retirement solutions in market, as well as providers, will assist trustees to deliver better retirement outcomes to members.



3. Background

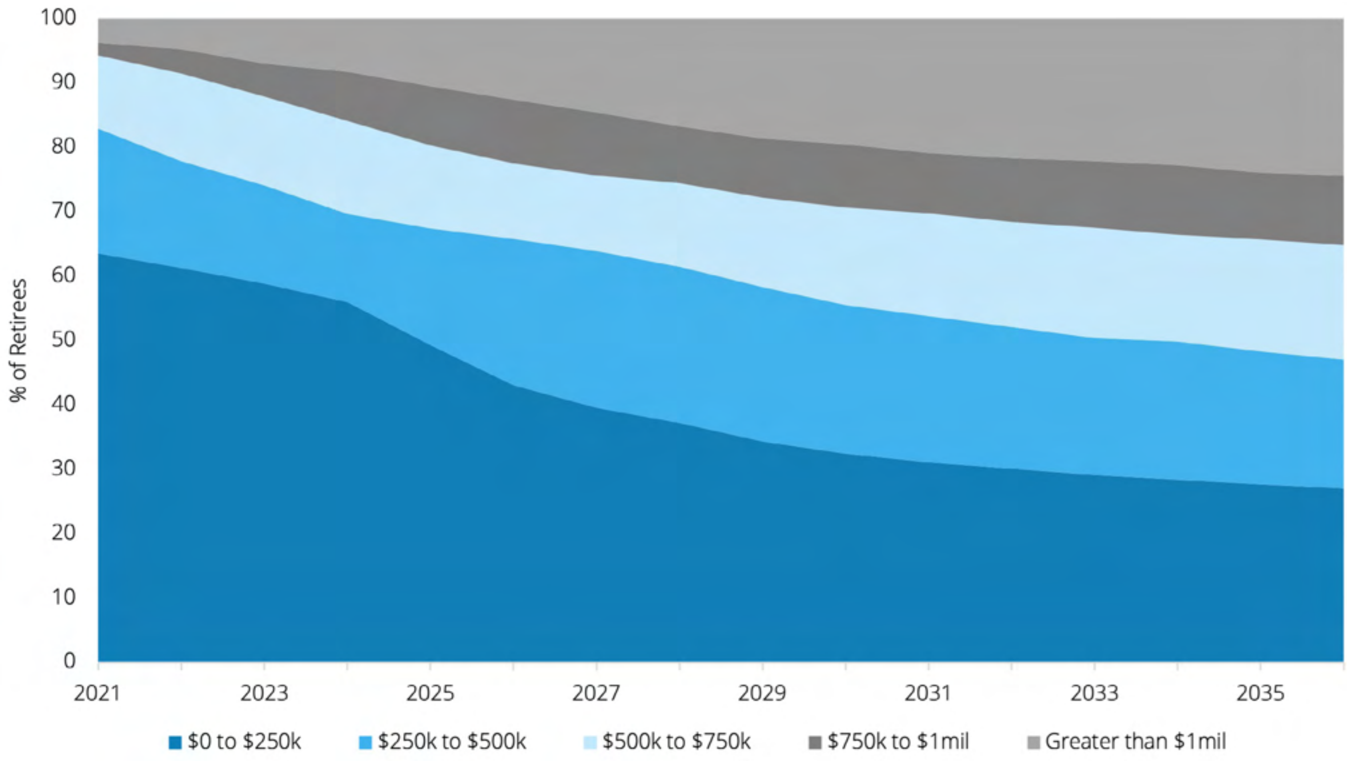
3.1. Retirement market

Since the implementation of the Superannuation Guarantee in 1992, there has been, rightly, a strong focus on accumulation of savings for retirement within superannuation funds. As the superannuation industry continues to evolve, average balances of members at retirement continue to grow. This, combined with an ageing population and the sheer number of superannuants entering retirement, is causing significant growth in the size of assets held within the retirement phase across the industry.

The *Australia's Future Tax System Review* (Henry Review)[2] of 2010 pointed out that a drawback of the current retirement income system was the "failure to provide products that would allow a retiree to manage longevity risk" while the Retirement Income Review in 2020 concluded that the objective for the system should be developed around the goal "*to deliver adequate standards of living in retirement in an equitable, sustainable and cohesive way*".

As noted in Deloitte's *Dynamics of the Australian Superannuation System*[3] Report in December 2021, the maturing of the superannuation system will greatly increase the importance of the retirement segment of the market. Figure 2 below shows that the proportion of members at retirement with an account balance over $750,000 (in today dollars) is projected to increase from approximately 5% today to nearly 35% by 2041. Similarly, the proportion of members expected to retire with less than $250,000 will reduce from 64% to 23% by 2041.

Figure 2: Proportion of members with varying account balances at retirement



3.2. The Retirement Income Covenant

The introduction of the Retirement Income Covenant (the "Covenant") was an acknowledgement of the importance of solving the retirement income problem. As of 1 July 2022, Trustees are required to formulate, regularly review, and give effect to a Retirement Income Strategy ("RIS") for beneficiaries who are retired or approaching retirement. The Covenant is principles-based in nature and allows superannuation funds the flexibility to design and tailor their RIS to meet the needs of different sub-classes (or cohorts) of their memberships, now and in the future. Figure 3 below outlines the three objectives that the Covenant is intended to help members achieve and balance in retirement.

Figure 3: Retirement Income Strategy—a balancing act

3.3. Retirement income solutions

Many funds will require a transformation from their traditional retirement income product offerings because current offers typically do not implement structures to effectively mitigate market and longevity risk for a number of member cohorts, and simply rely on an account-based pension being appropriate for all members as a single source of retirement income alongside the Age Pension. Given the nature of the three objectives, the offer of a wider range of retirement income solutions is expected to form an integral part of an effective RIS for a number of member cohorts. This is good for members, but there are complexities associated with retirement income solutions that potentially present challenges for trustees seeking to fulfil their obligations under the Covenant. In particular, the design and operation of retirement income products are sufficiently more complex than those of accumulation products to warrant a different approach.

3.3.1. Assistance and guidance

Increased balances, more choice and potential complexity of retirement income products, and the interaction between superannuation, the tax system and the Age Pension, suggest that members will require increased guidance to navigate their personal financial situation in retirement. There are some obstacles currently for members in making decisions about their personal situation including the perceived high cost of obtaining full comprehensive advice and concerns around the quality of advice affecting the industry since the Hayne Royal Commission. All these factors have prompted moves to reform the delivery of financial advice to make it more affordable and accessible, as signalled by the recent Quality of Advice Review[4].

The Explanatory Memorandum[5] to the Covenant suggests that, in addition to the provision of specific retirement income products, a RIS could include a range of assistance to members, such as:

- Developing specific drawdown patterns that provide higher income throughout retirement.
- Providing tools such as expenditure calculators to identify income and capital needs over time.
- Provision of information about key retirement topics such as eligibility for the Age Pension, the concept of drawing down capital as a form of income, or the different types of income streams available.
- Provision of guidance to beneficiaries during the accumulation phase about potential income in retirement through superannuation calculators or retirement estimates.

In addition to those mentioned in the Covenant, we believe retirees will also need guidance on the choice of products at retirement.

3.4. Early Covenant observations

As noted in APRA's published joint address with ASIC[6], since the implementation of the Covenant, it is clear that "trustees are at different phases of their implementation of the Covenant, and have different starting points, in terms of their existing focus and their stated plans to expand their product and guidance offerings to members in future. Some summaries provide more detail on trustees' current offerings and plans for expansion than others."

Some trustees have indicated that they are already in the process of introducing new retirement income solutions and guidance frameworks to address their Covenant obligations, while other trustees—with fewer members approaching or in retirement—are moving more slowly. Regardless, both ASIC and APRA want to see trustees focusing on taking a member-centric approach as they rise to the retirement income challenge and help deliver better outcomes for members in retirement over time.

Over the coming year, APRA jointly with ASIC will conduct a thematic review of the retirement strategies adopted by funds and examine the need to integrate the Covenant into the superannuation prudential framework. In addition, APRA intends to assess the implications of the Covenant on the life insurance industry and whether existing standards are adequate for managing the risks of retirement income solutions and set appropriate standards if required.

3.5. Existing prudential standards

APRA has been explicit in public announcements[7] that in the absence of a detailed prudential framework on how to implement the Covenant, trustees are expected to execute their Covenant obligations in the best financial interest of beneficiaries and with consideration of existing prudential standards, specifically *Prudential Standard SPS 515 Strategic Planning and Member Outcomes* and product design and distribution obligations (DDOs).

In addition to the above standards, we would expect funds offering retirement solutions with an outsourced component and/or insurance risk transfer features would need to comply with the following standards, depending on the nature of the arrangements and services provided:

- *Prudential Standard SPS 231 Outsourcing*; and/or
- *Prudential Standard SPS 250 Insurance in Superannuation*

Both these standards ensure a fund undertakes an appropriate level of due diligence in the selection process of an outsourced provider. Specifically, SPS 250 provides guidance for trustees for the selection of an insurer, for example as part of entering a group insurance arrangement. Despite the numerous parallels with group insurance, the retirement market does exhibit some unique differences that funds will need to consider when applying the principles of the standards in the retirement market:

- The retirement solutions market in Australia is currently immature and innovating to a greater extent than traditional group insurance. In recent years, we have seen an increased number of providers entering the market. Most are presenting different product offerings and there is no established or default solution. This diversity of solution offerings adds a layer of complexity for funds looking to compare solutions.
- There is a wider variety of potential retirement solutions providers relative to group insurance, which can only be offered by life insurance companies.
- Given the current heterogeneity of retirement solutions, changing providers on a frequent basis is less straightforward and likely to be more costly. In the future, a mature market for group longevity insurance may lead to greater homogeneity.
- Unlike group insurance, retirement solutions are expected to be offered to members as a choice, rather than a default offering. Solutions are therefore likely to require flexibility for customisation to specific member needs.

One of the key features associated with operating a group insurance tender is that APRA's SPS 250 sets out the RSE Licensee's *minimum obligations* that apply when selecting an insurer. In addition to SPS 250, APRA's Sustainability of Life Insurance in Superannuation letter8 states that tender assessment criteria should align with and reflect the key requirements of an RSE licensee's insurance strategy. We note that no such minimum obligations currently exist for selecting retirement solution providers. Whilst minimum requirements are not the intention of the Framework, we believe it is the Covenant itself that sets the obligations for superannuation trustees and the Framework can act as a starting point for superannuation funds to consider how their retirement solutions arrangements will ensure successful implementation of their RIS.

This Framework considers the principles in a similar manner to a group insurance tender and other existing prudential standards.

4. Purpose of the Framework

In meeting their Covenant obligations, superannuation funds may recognise the need to outsource components of their RIS implementation to other providers. The purpose of our Retirement Solutions Assessment Framework (the "Framework") is to assist trustees in assessing solution providers and their solutions. The Framework provides a library of questions that could be asked to providers, some of which will be relevant depending on the needs of the fund in terms of product benefit design, member experience, target operating model and the extent to which they want to manage components of the solution internally versus outsourcing to specialist providers (for example longevity risk pooling, investment management, administration services or member engagement services).

Introducing new retirement solution(s) is not straightforward and involves numerous steps and decision-making points. Figure 4 provides a brief overview of the decision-making process in designing and developing retirement solutions.

The Framework can be utilised to support funds through the following:

- Exploration of the universe of potential available retirement solutions in the market and selection of specific retirement solutions to assist in the discovery phase;
- Selection of components of retirement solution(s) the fund may seek to outsource during the design phase; and/or
- Selection of providers that offer the retirement solution(s) the fund seeks to offer in the design phase.

The Framework provides a structured set of detailed criteria to compare and assess retirement solutions from different providers (see Appendix 1). Funds are then expected to be able to utilise this Framework, in conjunction with their own RIS, to select and weight the relevant detailed criteria and, ultimately, determine the retirement solution(s) and/or solution(s) provider that is best for their members.

Figure 4: Steps in introducing new retirement solution(s)

1. Identify the gaps	2. Discovery	3. Define	4. Design	5. Development/ implementation
The fund identifies as a part of the RIS there are gaps in their current retirement offerings.	The fund undergoes an exploration of retirement solutions that will address these gaps.	The fund defines the new solutions that will be added to their product suite. This includes any decisions to outsource components of the solutions.	The fund designs the new solutions including the procurement of outsourced provider(s). Funds may seek input from providers in the design of solutions.	After the go-ahead of the designed solution, the fund will proceed to develop and implement the solutions.

6. Monitoring

5. Structure of the Framework

The Retirement Solutions Assessment Framework comprises four key assessment criteria:

1. **Product Features:** To assess the suitability of benefit designs to meet the RIC objectives. This section also incorporates considerations such as disclosed costs, net income level, sustainability of income, the nature of any guarantees and the trade-off between income and additional product features.
2. **Services and Technology:** To assess the services and technology offerings to ensure speed to market and seamless cost-effective integration of retirement solutions and/or member experience (with a consideration to the cost of in-house alternatives).
3. **Price and Associated Terms:** To assess the associated costs and terms between a fund and provider. These include costs and terms that are included explicitly within the retirement income and those that are separate.
4. **Provider Strength and Stability:** To assess the level of confidence that the member reasonable expectations from the provider will continue to be met even in uncertain times. This needs to be considered from an ongoing basis and in setting up and implementing a proposed solution. Assessment would include a consideration of provider tenure in the market, track record and financial circumstances.

In applying these, each of the above would be weighted to reflect the RIS of the fund.

Each key assessment criterion has a range of detailed considerations (see Appendix 1: Detailed Considerations) that providers can respond to. Funds can amend the detailed considerations to tailor the Framework depending on the level of clarity already reached on the fund's understanding of its desired retirement solution(s). The detailed considerations are then weighted under each key criterion and scored. Figure 5 provides a summary of the Framework, which is explained in greater detail in the following sections of this report.

Figure 5: Retirement Solutions Assessment Framework—summary

Retirement Solutions Assessment Framework				
	Retirement Income Strategy			
Key Assessment Criteria (KAC)	**Weighting (KACW)**	**Detailed Considerations (DC)**	**Weighting (DCW)**	**Scoring (DCS)**
Product Features Assess the flexibility around benefit designs.	Each key criterion will be given a weighting such that the total sums to 100%. The weighting will based on the retirement solution(s) the fund is considering to outsource and reflective of the RIS.	Some examples include: • Simplicity of solution to communicate and distribute to members. • Maximise expected retirement income. • Nature and level of protection on the key risks (for example longevity, market and inflation). • Flexible access to expected funds.	Each detailed consideration will be given a weighting such that the total sums to 100% for each key criteria. The weighting will based on the retirement solution(s) the fund is considering to outsource and reflective of the RIS.	Each detailed consideration is scored out of 10. The scoring applies a level of judgement and agreement between the respective decision makers and subject matter experts of each fund.
Services and Technology Assess the services and technology offerings to ensure seamless integration of retirement solutions and/or member experience.		Some examples include: • Services and tools to assist members in making retirement decisions. • Services to integrate or supplement retirement solutions (for example investment, administration).		
Price and Associated Terms Assess the associated costs and terms between a fund and provider.		Some examples include: • Associated costs and terms between the fund and the provider (including any ongoing cost such as licensing agreements).		
Provider Strength and Stability Assess the level of confidence that the solution will be continued to be provided even in uncertain times.		Some examples include: • Financial strength (S&P ratings). • Licensing and prudential supervisions environment. • Relationship with funds and cultural fit.		

6. Key assessment criteria

This section of the report provides detailed information about the key assessment criteria underpinning the Framework. The key assessment criteria are the core building blocks of the Framework that are not expected to change over time. Therefore they have been selected to be broad enough to withstand future developments relating to product innovation, technological advancements and emerging risks.

6.1.Product features

The underlying purpose of this key assessment criterion is to assess whether a retirement solution offers suitability of benefit design and product features that meet the needs of the fund and its members.

Depending on the design, features and risks the solutions addresses, comparison of provider solutions needs to be carried out carefully. Expected retirement income through a retirement period are sensitive to key assumptions such as investment returns, mortality rates, drawdown rates, required liquidity and the individual member risk profile. As such, if a fund is only considering protection against a single risk, for example longevity risk, then other assumptions (apart from mortality rates) will need to be normalised to make a like- for-like comparison.

6.1.1. Product simplicity

A prevailing issue of legacy retirement products of the past has been product complexity, not just for consumers, but even for distributors such as financial advisers. Various iterations of retirement products have been introduced, and subsequently closed to new business, over the past 15 years. These products, although containing many desirable features for retirees, were considered difficult to understand and, coupled with prior disadvantageous social security treatments and limited integration alongside existing retirement solutions, had limited take up—leading to their closure. To address this issue, we have added a consideration that relates to the simplicity of a retirement solution, and its ability to be easily understood by members and distributors.

6.1.2. Maximise expected retirement income

The degree to which a retirement solution maximises retirement income, both in terms of level and pattern, is an important consideration and therefore included in this key criterion.

The 2020 Retirement Income Review[9] states that "The evidence indicates that retirees tend to hold on to their assets and leave significant bequests, even though surveys suggest people do not prioritise leaving a bequest." The review also stated various factors that contribute to the low drawdown of assets in retirement, including:

- Complexity and little guidance on how to maximise retirement incomes.
- Adopting the minimum drawdown rates required for a superannuation pension account.
- Concerns about outliving savings, which can lead to underspending in retirement for fear of running out too soon.

In addition, the review provided examples of the many common misconceptions surrounding the retirement income system, including:

- "The minimum drawdown rate is what the Government recommends."
- "I need to preserve my assets in case I get sick or need aged care."

These factors signify the importance of retirement solutions in maximising expected retirement income for members so that they have their best possible retirement lifestyle.

These issues had been raised even prior to the Retirement Income Review. For example, the 2014 Murray Inquiry[10] noted that 15-30 per cent higher income could be obtained from a pooled longevity risk product than an account-based pension with a drawdown at the minimum amount and that "one of the primary reasons why income is significantly higher in products that pool longevity risk is that they reduce bequests from superannuation".

Superannuation funds will however need to acknowledge that an appropriate strategy for 'maximising expected retirement income' may vary for different cohorts. For example, less affluent members may perceive the Age Pension as being sufficient income to meet their retirement expenditure needs in the event of having exhausted their superannuation savings.

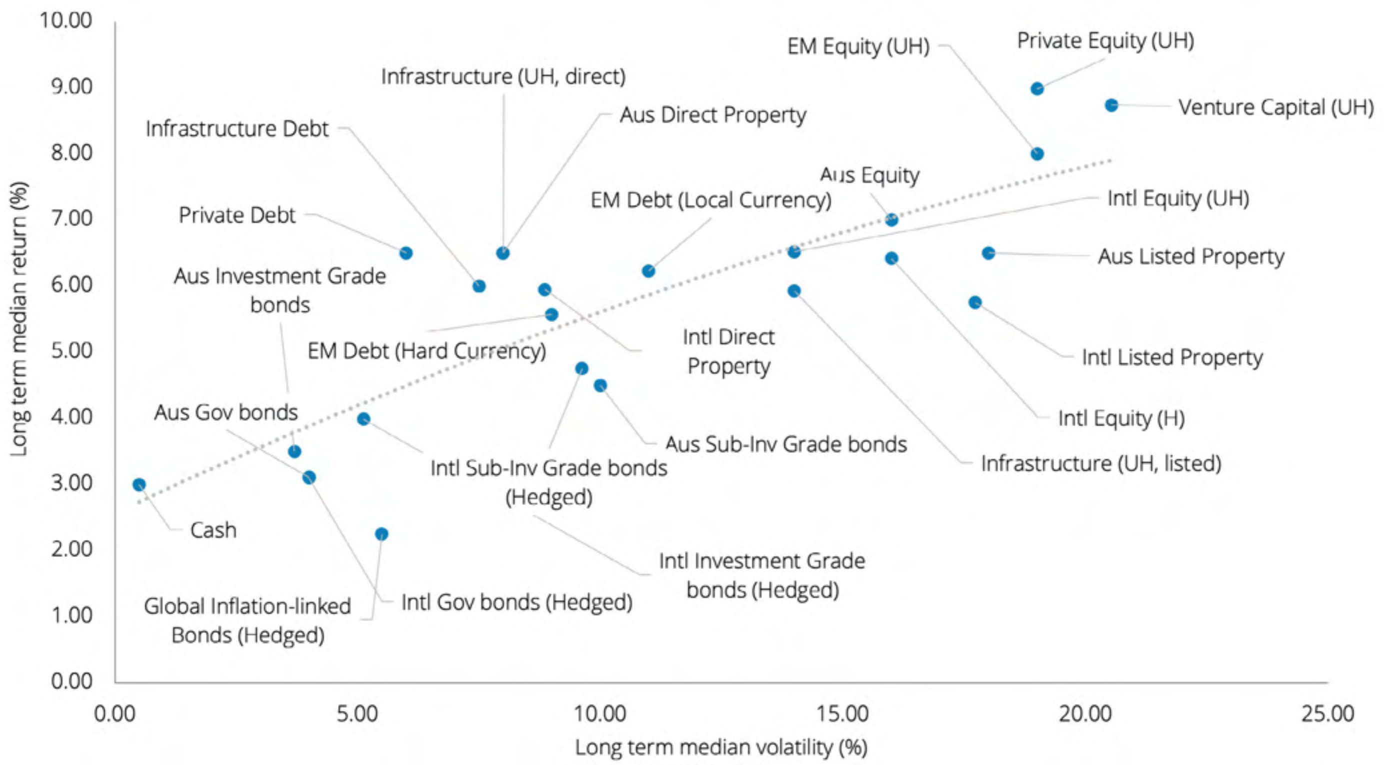
There is publicly available guidance for what constitutes an adequate level of income during retirement, for example from Super Consumers Australia[11] and ASFA[12]. These guidances are for indicative example retirees, and are not necessarily reflective of specific individual circumstances. However, both guidances indicate that income needs are higher than the maximum Age Pension, meaning that for many members the Age Pension alone will not be sufficient to cover their lifestyle spending needs. Solutions will need to consider that each individual and cohort of members is different.

Funds should also consider the definition of "retirement income" from their RIS. Section 52AA (5) of the Covenant states "The trustee must determine the meaning of retirement income for the purposes of the strategy, which must include income, net of tax, received during the period of retirement…". It goes on to state that retirement income must include superannuation interests, Age Pension and other sources the trustee determines appropriate. Additionally, products that are classified as innovative retirement income streams in the *Superannuation Industry (Supervision) Regulations 1994* may allow members to receive favourable social security treatements and thus increase Age Pension eligibility. The detailed considerations therefore require a view of the income, net of tax, generated from the solution itself and how the solution supplements or interacts with the Age Pension.

6.1.3. Market protection

Market risk, also known as investment risk, in the context of retirement income, refers to the risk of movements in markets that can have a negative impact on the sustainability and stability of retirement income for a retiree. For a retiree, the order and timing of these unfavourable returns can further lead to lower retirement outcomes.The level of market risk retirees are exposed to depends on the underlying asset classes their retirement savings are invested in. Figure 6 shows the long-term median expected annual return versus expected market volatility from the Deloitte Expected Returns Survey 2022. It is important to highlight that volatility is only one dimension of risk and in particular that it ignores liquidity risk.

Figure 6: Long-term median expected annual return versus volatility (over the next 10 years)



Some retirement products expose members to market risk (which could mean higher expected returns over the long term, but with greater volatility or point-in-time exposure to poorer outcomes), relative to a fully guaranteed product which insulates members from this risk. Further, there are product designs which include market exposure but which have additional guarantees to protect members, to an extent, from downside market risk.

6.1.4. Longevity protection

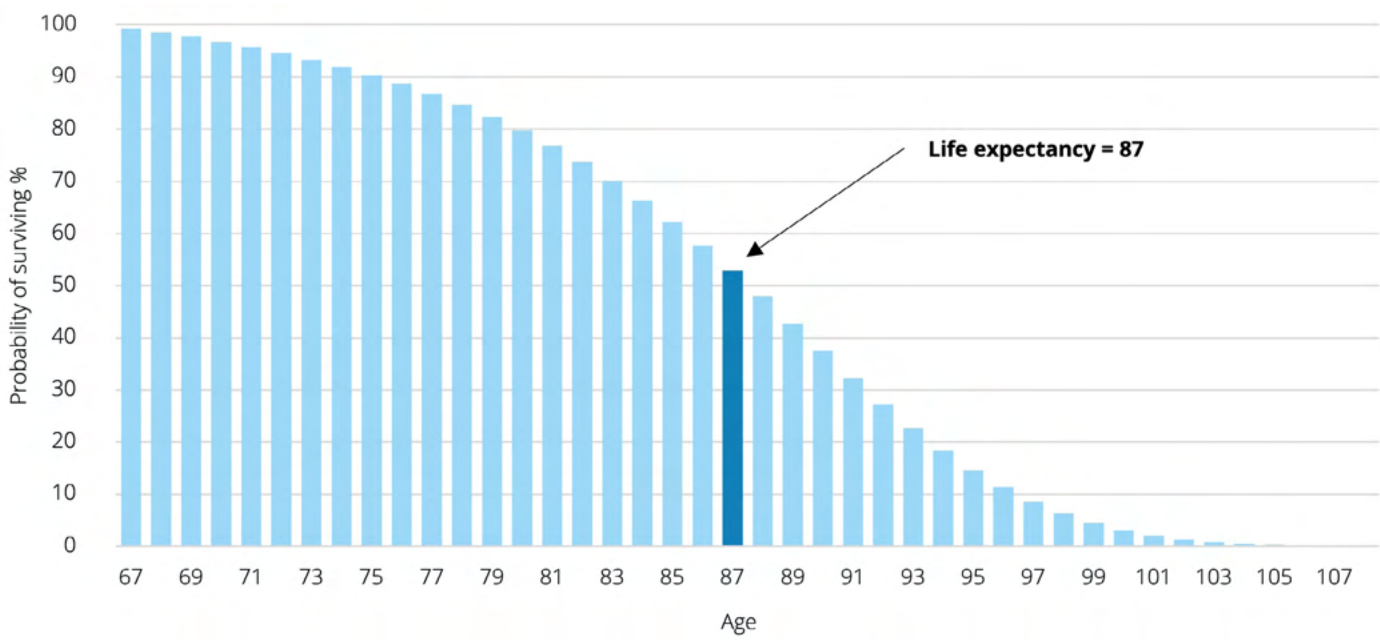
Longevity risk, in the context of a retiree, is the risk that the retiree outlives their savings. However, each individual's life span is unknown and there is greater uncertainity how long an individual will live relative to the average life expectancy. To add to this, according to the Australian Bureau of Statistics[13] on 8 November 2022, the average life expectancy at birth over the decade to 2020 increased by 1.6 years for males and 1.2 years for females.

Figure 7 illustrates the uncertainty in how long an individual will live using the Australian Life Tables (ALT 2015-2017) for a 67-year-old female. Although the average life expectancy is 87, there is still a 15% probability that an individual will survive to at least age 95.

A longer lifespan means a longer period during which income is required. Therefore, the inherent uncertainity in survival has significant implications for a member's choice of retirement solution. This is because the nature of longevity protection and the level of guarantee offered by a retirement solution may vary considerably. Some products offer guaranteed income, in dollars or investment units, for life (e.g. conventional lifetime and investment-linked annuities), which provides protection against longevity risks. Other products might offer non-guaranteed income through the redistribution of mortality credits[14] to the remaining survivors in a pool. Such arrangements (also known as Group Self Annuitisation or GSA solutions) seek to diversify the idiosyncratic risks, but are reliant on sufficient scale being achieved. However certain risks, such as an increase in overall expected life expectancy can not be diversified away and, as such, insurance protections are available to cover these risks.

The detailed considerations cover these nuances around the level and nature of longevity protection.

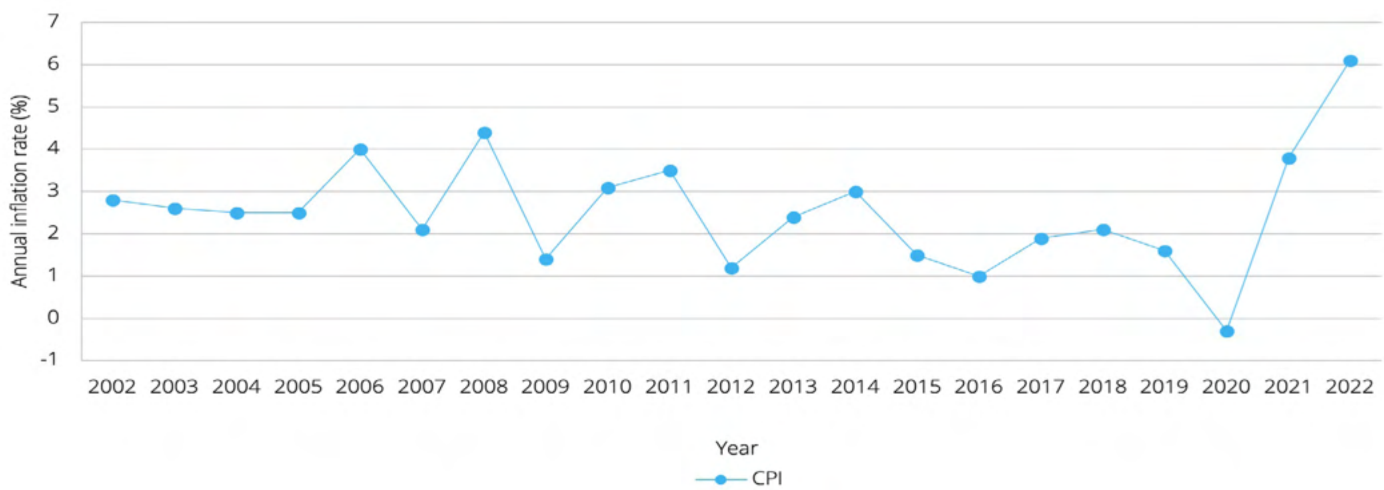
Figure 7: Probability of surviving to each age for a female aged 67



6.1.5. Inflation protection

Inflation is the tendency of the value of goods and services to increase over time and can pose a threat to retirees whose money loses purchasing power. Whilst there exist numerous metrics to capture inflation, there are three core measures that retirement income sources typically track or are compared to: the Consumer Price Index (CPI), Average Weekly Ordinary Time Earnings (AWOTE) and ASFA's Retirement Standards[15]. Figure 8 below shows historical annual inflation, by measure of Australian CPI movements for 20 years to June 2022.

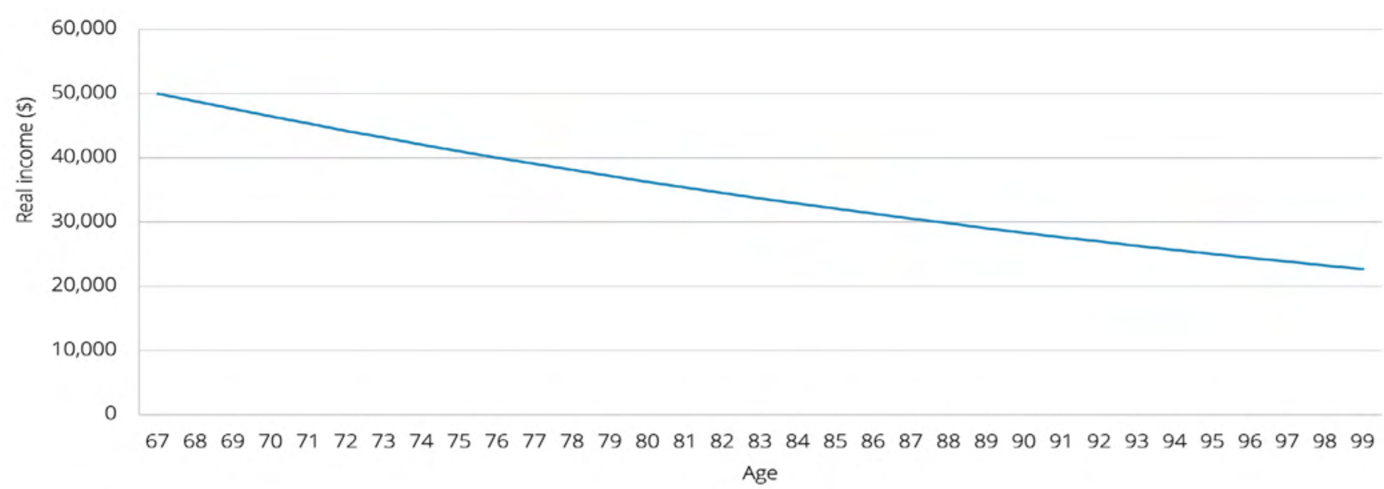
Figure 8: Australian CPI movements*



* CPI inflation figures are as at June while the AWOTE figures are as at May

Figure 9 below shows the impact of a 2.5% annual inflation rate on a starting retirement income of $50,000 per year.

Figure 9: The impact of 2.5% inflation rate on the real value of $50,000 per year



Both Figure 8 and Figure 9 illustrate the impact of inflation on retirement outcomes and therefore the potential benefit of having some level of inflation protection within a retirement solution. Three ways to potentially protect against inflation risk are:

- Have an income that goes up each year, or is expected to go up, by a given amount (e.g. 2.5%). This leaves the member with the basis risk that actual realised inflation is higher than the defined increase.
- Purchase an explicit inflation protection possibly through inflation-linked assets in order to achieve more certainity of the real income level.
- Have exposure to growth assets (such as equity returns) which would generally provide a positive real return in the long term.

6.1.6. Other protection considerations

The Explanatory Memorandum to the Covenant acknowledges that the risks listed in the legislation are not exhaustive of the types of risk that could be considered and managed, and so a retirement solution—and its associated communication—should also be assessed in terms of its ability to manage these risks. A few additional risks commonly identifed are:

a. Cognitive decline: Consideration should be given to the degree to which a retirement solution requires retiree action well past the purchase date. As cognition declines, it can be difficult for retirees to weigh up the various competing retirement objectives.

b. Health events: It should be understood how retirement solutions can be used to assist with the medical costs associated with unexpected health events. This also extends to how they may be used to enhance quality of life.

c. Beneficiary disengagement: A solution that requires retiree action, either at the point of purchase, or at some other point in the lifecycle, is less valuable if the retiree is not engaged at those critical moments.

6.1.7. Flexible access to expected funds

The third objective to be achieved and balanced in the Covenant is flexible access to expected funds over the period of retirement. Spending throughout retirement does not necessarily follow a constant real income and can fluctuate each year with any unforeseen expenses. Retiree expenditure generally declines over the retirement period and in the early years of retirement may include some ad hoc spending on activities such as a holiday. The "ASFA Retirement Standard—Detailed budget breakdowns (June 2022)" shows that the expenditure for over 85 year olds is around 7-8% annually less than the expenditure for retirees aged 65-84[16]. Notwithstanding this decline in overall expenditure, total health services expenditure increases with age and can also be highly volatile for any individual. For some retirees, flexibility in access to funds is a greater priority than achieving the highest possible expected income for life.

6.2. Services and technology

In superannuation, it is widely accepted that the drawdown, or decumulation, phase is significantly more complex than the savings, or accumulation, phase. This is due to the many uncertainties in retirement such as how much to drawdown each year and how long retirees will live. In addition, the accumulation phase is largely driven by defaults and compulsion, but these do not currently exist in drawdown other than the legislated minimum. Members are likely to require engagement, education, guidance, help and advice when it comes to making the many financial decisions throughout retirement. Considerations around couple status and financial circumstances beyond superannuation such as home ownership and Age Pension eligibilty are essential to making informed financial decisions concerning retirement.

There is no doubt that technology is rapidly transforming the entire way that the financial sector operates. As noted in *Deloitte's Dynamics of Superannuation Report* in 2021, over time we can expect to see the development of more sophisticated advisory services facilitated by technology. Superannuation funds can be expected to expand their engagement and services to retired members and those approaching retirement are likely to need assistance in assessing their different retirement options.

As at the time of writing, Treasury is currently conducting a Quality of Advice Review[17], which focuses on the Government's commitment to ensuring that Australians have access to high-quality, affordable, accessible, and sustainable financial advice. This review may drive some regulatory changes that will impact superannuation funds and the type of advice offered. While the review is expected to be finalised at the end of the year, the Framework is not expected to change and, as with any other market developments, responses to the detailed considerations and associated scoring may simply be altered as necessary.

6.2.1. Integration support

The integration support with the fund's current retirement solution is an essential factor in selecting the provider. Services that consider and provide support through the integration and ongoing support will provide funds, and ultimately members, the right experience. In addition, integration, and alignment of solutions with existing retirement offerings will assist with reducing complexity, especially to non-advised members.

6.2.2. Digital advice and customer tools

In addition to the Covenant Explanatory Memorandum's reference to digital tools, Michelle Levy's "Quality of Advice Review Consultation paper—Proposals for Reform"[18] dated August 2022 makes frequent references to digital advice, and the intention to make it easier for providers of financial advice to provide "good" advice. We observe that the level of advice support varies by wealth segment in the community and note that most retirees are currently not receiving financial advice.

It is our view that new digital solutions will assist in filling the gap. We have therefore framed some of the detailed considerations around the retirement solution provider's ability to offer these services to members. This is especially important in the context of helping members understand the interaction between different sources of retirement income, such as account-based pensions, lifetime annuities and the Age Pension.

6.2.3. Services for funds

Superannuation funds have complex operational models for both accumulation and retirement members that need to incorporate administration, investment management, member engagement (potentially involving member education and call centre support) and adviser education (for some funds). Funds may outsource some of these operational aspects in a partnership arrangement to external providers, so we have included in our detailed considerations the ability for providers to describe the surrounding services they can offer funds to assist with the integration of their retirement solution. Providers have also found that funds appreciate and value a collaborative approach to implementation and integration of retirement solutions, including a roadmap and strategy plan.

6.2.4. Cyber risk

The Australian superannuation industry holds $3.4 trillion of superannuation and retirement assets, and is facing an increase in cybercrime due to large account balances, low member interactions and the potential gaps in controls against cyber attacks.

In 2020, $6.4 million was lost to superannuation scams[19], and from 2020 to 2021, there was a 323% increase in superannuation scam reports[20]. Some of the most common cyber threats seen across superannuation and retirement are phishing emails, identity theft, cyber-enabled fraud, human error, and third-party/supplier risk. In response to the emerging cyber threats, APRA has increased regulatory requirements primarily to the digital platforms used.

The more frequent and sophisticated cyber-attacks means that superannuation funds need to take a holistic approach to uplift cyber resilience capabilities by implementing layered security controls across their people, technologies, process and ensure any outsourced providers have adequate cyber risk management that meet the APRA Prudential Standard CPS 234 Information Security and consider APRA Practice Guide CPG235 Managing Data Risk.

6.2.5. ESG investing

Environmental, Social and Governance (ESG) investing has become standard practice in recent times and is expected to continue gaining traction until the vast majority of all professionally managed assets have an ESG mandate[21]. Considerations for ESG investing include:

- ESG screening policies and processes.
- Level of stewardship providers have with regard to ESG investing.
- Transparency of ESG metrics and reporting.
- Disclosures and signatories that provider belongs to.

The fund should consider ESG practices of the provider and how these fit with the fund's policies and practices.

6.3. Price and associated terms

Deloitte's extensive experience in running and analysing both group insurance and superannuation related tenders is that while having the lowest price will not guarantee success, being the most expensive can often make success difficult. Hence, the articulation of "value for money" especially in an environment where trustees are required to satisfy the members' best financial interest test for all decisions is very important. Therefore, this justifies the inclusion of *Price and associated terms* as a key assessment criterion in our Framework.

APRA has previously produced commentary relating to the sustainability of group insurance pricing[22], stating their concerns about the pricing on which tenders are being won by insurers. APRA states that the pricing "whilst initially attractive to RSE licensees, may prove to be unsustainable, and therefore likely to lead to significant increases in premiums at the end of premium guarantee or contractual periods". This issue is equally, if not more prevalent for retirement solutions providers for the following reasons:

- Products with longevity protection are highly sensitive to mispricing risk, due to their long-term time horizon. What can appear to be low levels of mispricing initially can be exacerbated over the long term and threaten the sustainability of a solution provider.
- Retirement solutions typically would not likely undergo a regular tender process every three or so years (nor are required to do so under the current regulations). A tender process allows for funds to seek competitive prices and terms. Without this process, funds are at risk of being locked in with a provider offering unsustainable and uncompetitive pricing. This can hinder the member experience and may breach the best financial interest duty. Therefore, superannuation funds should seek very clear commercial terms and understand how the pricing will remain competitive.

In addition, there are historical examples of retirement products that have shut down due to poor take-up from members which resulted in material costs for the provider to close the product. For superannuation funds, there is a possibility that the costs associated with the closure of a product are borne by not only the members who are invested in the product but also other members of the fund, which subsequently impacts the equity principle and members' financial interest. Therefore, we have incorporated a question about the cost associated with the closure of a product.

There has been significant merger activity between funds (particularly profit to member funds) in recent years. In our *Dynamics of the Australian Superannuation System* Report 2021, we predict that we will see continued consolidation of funds, particularly over the next five to ten years, as the industry rationalises around improving member outcomes and the best financial interests of members. APRA continues to encourage smaller funds to explore mergers with larger players, applying varying levels of pressure. This ultimately justifies the inclusion of our question relating to contingency plans and portability of solutions in the event of a fund merger or acquisition, with a key focus on a continuation for members who have already purchased the solution.

It is also important for funds to factor in any opportunity cost associated with outsourcing services to providers. For instance, a fund may outsource investment management services to a retirement income provider, and this will translate to lost investment management revenue for the fund and impact the fund's headline assets under management number. The fund should consider whether the benefits associated with outsourcing outweighs these negatives.

6.4. Provider strength and stability (as a retirement solution provider)

With the introduction of the Covenant, several organisations have identified an opportunity to provide retirement solutions in the market. These solutions may be offered to retirees where the product issuer, from a retiree's perspective, is the fund (e.g., a group longevity insurance policy) or the solution provider. Either way, while there are benefits of outsourcing components of a retirement solution, there is a risk that the provider may fail to fulfil their obligations to the fund or the retirees, without significant and unexpected changes to the solution.

APRA's primary objective is to ensure "individual institutions meet their financial promises to beneficiaries…"[23]. The long-term nature of retirement income solutions is likely to require long standing partnerships with providers. Therefore, it is imperative for funds to ensure providers will be operating for the foreseeable future, especially when guarantees are offered to members. While funds may be able to change providers if necessary, this will incur costs which will ultimately be passed on to members if these cannot be absorbed by the provider.

Prudential Standard SPS 231 Outsourcing[24] states that a fund "must identify, assess, manage, mitigate and report on risks associated with outsourcing to meet its obligations to beneficiaries...". SPS 231 applies to outsourcing a material business activity that, if disrupted, will have a significant impact on the fund's business operations. Depending on the nature of the arrangement and services provided, SPS 231 may not apply in all circumstances, therefore this Framework sets out considerations to ensure a fund undertakes an appropriate level of due diligence when selecting a retirement solution provider.

The market for retirement solution offerings is still developing and every provider will be at different stages in their journey of offering retirement solutions. To ensure that the provider has the right level of expertise to be able to offer the retirement solution, it is important to assess the team and organisation that will be involved in developing the retirement solution.

Funds have a responsibility to ensure they are meeting their financial obligations to their members. To protect its members, the fund should assess the governance policies and risk management frameworks of the provider. This should include any reportable breaches, issues with compliance, management of operational risks under CPS230 and the provider's responses to such events. Retirement solution offerings carry different risks to a traditional life insurance product, an investment manager/ adviser or an administrator. APRA has stated in its corporate plan for 2022-2023, that "in support of APRA's work on superannuation retirement income strategies, APRA will also consider the implications for the life insurance industry, including setting appropriate standards for managing the risks of retirement income products within the life insurance market.[25]

6.4.1. Additional considerations

Funds should factor in the following when assessing provider strength and stability:

- Financial strength of the organisation including credit ratings, key profitability and capital adequacy metrics
- Licensing and prudential supervision applicable for the provider.
- Business and strategic plans.
- The team that the service provider has put together in relation to their retirement solutions, and their relevant experience.
- Experience in offering retirement solutions in the Australian market and value proposition moving forward.
- Governance, compliance and risk management frameworks.

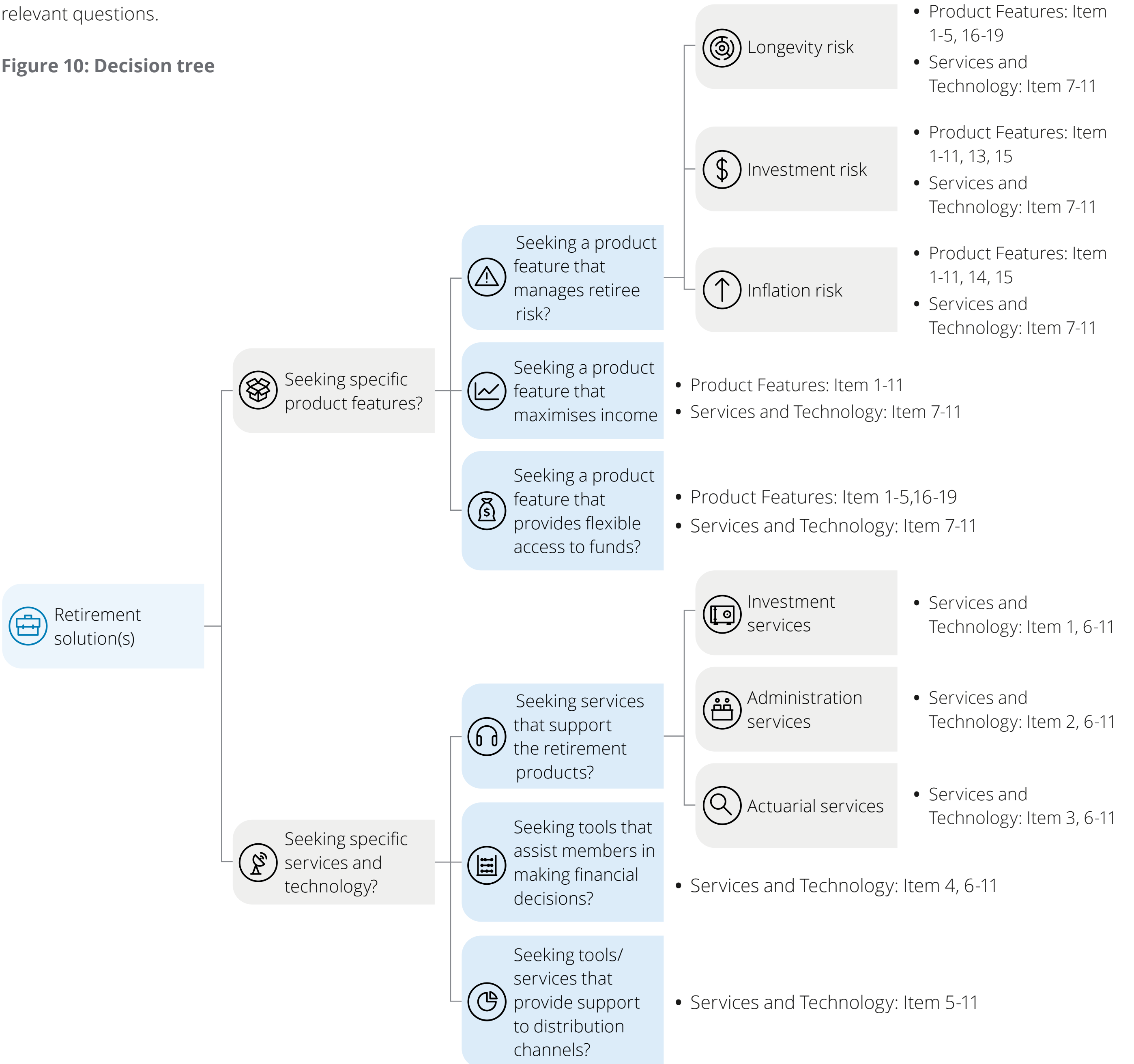
7. Applying the Framework

7.1 Selecting the detailed considerations

The selection of the detailed considerations will depend on the needs of the fund in terms of product structure and the extent to which they have both the capacity and the capability to manage some aspects in-house versus outsourcing.

Figure 10 below is a decision tree to assist funds in selecting the relevant questions.

Figure 10: Decision tree



A fund may consider outsourcing only a component of its retirement solution to a provider, for example managing the longevity risk. In this case, the fund may select to only ask for the detailed considerations Item 1-5,12 and 15 in Product Features and Item 7-11 in Services and Technology.

On the other hand, funds that are looking for more comprehensive retirement solutions, such as ones that offer broader risk management mechanisms and flexible access to capital, as well as tools to assist members in decision making should also consider asking for the detailed considerations Item 1-19 in Product Features and Item 7-11 in Services and Technology.

7.2 Quantitative assessment

To be able to make a determination as to the preferred provider, there will need to be a framework within which a quantitative assessment can be allocated to each detailed consideration, as well as an appropriate weighting to come up with an overall total score for each provider. We acknowledge that this is a complex process and have therefore provided guidance in this section to assist superannuation funds.

The overall process we recommend is as follows:

- **Key Assessment Criteria Weighting (KACW):** Funds assign an appropriate weighting to each Key Assessment Criteria (KAC) such that the total sums to 100%. This weighting is based on the retirement solution(s) the fund is planning to outsource and reflective of their RIS.
- **Detailed Consideration Weighting (DCW):** Under each KAC, the Detailed Considerations (DC) are assigned an appropriate weighting such that the total for the KAC sums to 100%. Again, the weighting is based on the retirement solution(s) the fund is planning to outsource and reflective of their RIS.
- **Detailed Consideration Score (DCS):** Each DC is scored out of ten.

Table 1 illustrates an example of how the scoring works. This is the weighted average score of each key criteria and the weighted average to come up with an overall score. The overall score is 7.7 out of 10.

Table 1: Product solution assessment criteria-example

Item	Weight	Score
Product Features	**60%**	**6.5**
Overview of solution	70%	5
Maximise expected retirement income	0%	0
Nature and level of longevity protection	30%	10
Services and Technology	**40%**	**9.6**
Investment management services	0%	0
Administration services	0%	0
Services to assist members in making retirement financial decision	20%	8
Integration Support	80%	10
Overall Score	**100%**	**7.7**

7.3 Assigning a weighting

The weighting is an essential component of the Framework as the overall score will then reflect the higher importance assigned to the considerations that the fund deems necessary to be addressed from the tender, relative to other considerations.

A typical approach for assigning a weighting to the key assessment criteria and the detailed criteria is as follows:

- Workshop to allocate each detailed consideration into one of three buckets (high, medium or low) depending on their importance.
- Apply an overall weighting to each bucket. For example; 60% to high, 30% to medium and 10% to low importance buckets.
- Adjustments to ensure the total weighting sums to 100%.

7.4 Scoring metrics

The scoring assigned to each detailed consideration will be a score out of 10 and will require a level of reasonable judgement and agreement between the respective decision-makers and subject matter experts of each fund.

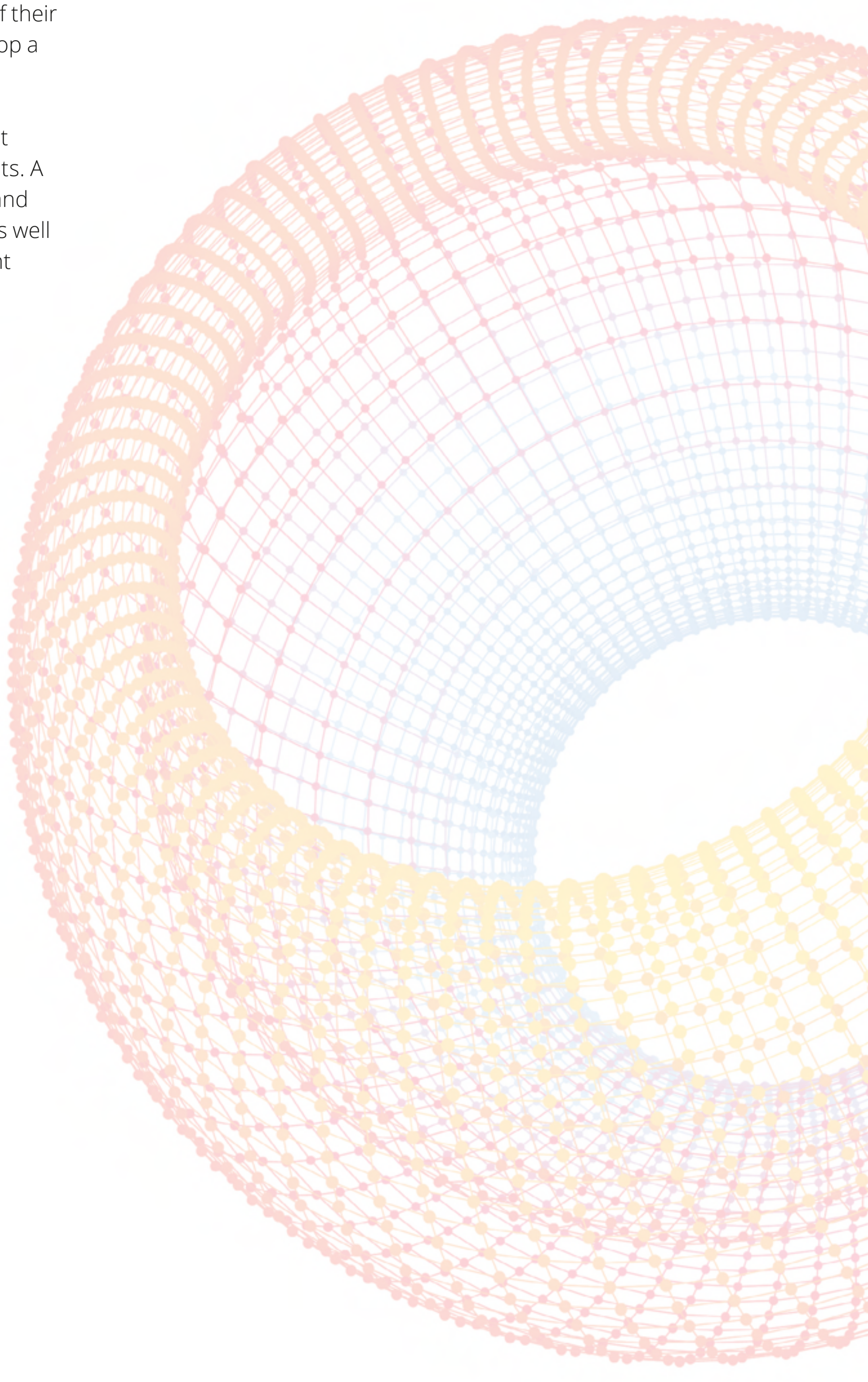
It is important to note there may be some responses that could lead to disqualification of the provider from the selection process. Superannuation funds will need to review these "gating criteria" prior to any scoring.

We suggest that each detailed consideration is scored by the same subject matter expert(s), given the subjective nature of scoring, which will help ensure a fair comparison across solutions and providers. A sound process for scoring each detailed consideration is for two subject matter experts to assess each detailed consideration independently and note their reasoning for each score. This initial work is then followed by a workshop whereby the scores and reasoning are compared. Any material difference in scores are discussed with the wider stakeholder group and other subject matter experts where a final score is allocated.

8. Conclusion

The growth both in member balances and in the number of members retiring every year, as well as the introduction of the Retirement Income Covenant, are driving an increased demand for retirement solutions and for providers of these solutions. Some trustees are considering outsourcing components of their solutions and partnering with specialist providers to develop a more comprehensive retirement solution.

Adding a new retirement solution to a super fund's product suite involves a number of steps and decision-making points. A robust framework that supports funds in the exploration and selection of the potential retirement solutions in market, as well as providers, will assist trustees to deliver better retirement outcomes to members.



Appendix 1 Detailed considerations

This appendix provides a library of detailed considerations for each of the four key assessment criteria introduced in the Framework. For a more comprehensive list of specific tender questions that may be put forward to solution providers, or in-depth explanations of each of the considerations, please contact us for more information.

1. Product features

Item
1. Overview of retirement solution offering
2. Impact on fund's AUM
3. Product development framework
4. Simplicity of solution for members
5. Codesign of retirement solutions tailored to specific member cohorts
Maximise expected retirement income
6. Projected total retirement income
7. Breakdown of retirement income
8. Sensitivity to key assumptions
9. Review of pricing to emerging experience
10. Maintaining competitiveness of solution
11. Compliment other sources of income
12. Change in price for different member characteristics
Managing expected risks
13. Longevity protection
14. Market protection
15. Inflation protection
16. Other risks
Flexible access to funds
17. Death benefits
18. Voluntary withdrawal benefits
19. Contribution to flexible spending patterns
20. Bequests motives

2. Services and technology

Item
Services/Technology
1. Investment management services
2. Administration management and member experience services
3. Actuarial and investment operation services
4. Assist members in making retirement financial decisions
5. Marketing and distribution of product/services
6. Data capture analysis
Integration support
7. Technology strategy and roadmap
8. Data privacy
9. Leveraging existing capabilities
10. Cyber security risks
11. Disclosure documents
12. Post implementation support

3. Price and associated terms

Item
1. Associated costs and terms between fund and provider
2. Fund's retention of member assets
3. Costs of switching providers or cancelling solution
4. Ongoing plan in event of low take-up of solution
5. Ongoing plan in event of merger or acquisition
6. Benefits of scale passed on to funds

4. Provider's strength and stability

Item
1. Company Name, ABN, licensing details
2. Ownership structure
3. Office locations and staff working on retirement solutions in Australia
4. Number of superannuation fund clients and total FUM
5. Business plan
6. Key people and relationship management experience
7. Standard & Poor ratings
8. Reportable breaches
9. Reinsurance arrangements
10. References
11. Right provider for the solution and fund
12. No conflict of interest
13. Industry regulatory development
14. Awards and recognition as brand in retirement solutions
15. Risk management and compliance framework
16. Key profitability and capital adequacy metrics
17. Risk appetite in managing key risks of solution

Endnotes

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3 https://www2.deloitte.com/au/en/pages/financial-services/articles/dynamics-australian-superannuation-system.html

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7 https://www.apra.gov.au/sites/default/files/2022-03/Letter%20to%20RSE%20licensees%20-%20Implementation%20of%20the%20retirement%20income%20covenant.pdf

8 https://www.apra.gov.au/sustainability-of-life-insurance-superannuation

9 https://treasury.gov.au/publication/p2020-100554

10 https://treasury.gov.au/publication/c2014-fsi-final-report

11 https://www.superconsumers.com.au/retirement targets

12 https://www.superannuation.asn.au/ArticleDocuments/269/2208-ASFA_Retirement_Standard_Budgets_June_2022_quarterV2.pdf.aspx?Embed=Y

13 https://www.abs.gov.au/statistics/people/population/life-tables/latest-release

14 In this context, mortality credits are defined as unrepaid principal contributed by members who have not survived.

15 https://www.superannuation.asn.au/resources/retirement-standard

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