SUBMISSION

The Treasury

Retirement Income Disclosure

Consultation Paper

5 April 2019

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Lodged via e-mail to superannuation@treasury.gov.au

5 April 2019

Dear Ms McCallum,

Review of Retirement Income Disclosure

The Association of Superannuation Funds of Australia (ASFA) is pleased to provide this submission in response to the Treasury's consultation on proposed disclosure metrics, their presentation and calculation.

ASFA is a non-profit, non-political national organisation whose mission is to continuously improve the superannuation system, so all Australians can enjoy a comfortable and dignified retirement. We focus on the issues that affect the entire Australian superannuation system and its $2.7 trillion in retirement savings. Our membership is across all parts of the industry, including corporate, public sector, industry and retail superannuation funds, and associated service providers, representing over 90 per cent of the 15.6 million Australians with superannuation.

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Should you have any queries or comments in relation to the content of our submission, please contact me on [redacted] or by email to [redacted].

Yours sincerely

Ross Clare

Director of Research

General comments

ASFA is very supportive of more options being available to retirees in terms of various forms of retirement income streams being in the market. ASFA has long argued for the removal of any impediments to innovation in regard to the offering of retirement income products and for regulatory settings which support the offering of such products.

Many of those impediments (detailed at https://www.superannuation.asn.au/ArticleDocuments/359/1310-deferred-annuities.pdf.aspx?Embed=Y) have now been removed or soon will be. These changes include:

- Amendment of SIS regulations to encompass a broader range of products
- Changes to the means test treatment of longevity products
- Changes to the taxation of deferred annuities and other innovative longevity products

Selecting an appropriate retirement income product is not a simple task for consumers. In many instances tailored advice will be of more assistance than disclosure material, even if the disclosure material is in a simplified and standard form.

That said, simple and meaningful disclosure in regard to retirement income products would be an important contribution to a supportive framework for such products.

In particular, ASFA recommends that lessons learned from past disclosure initiatives be kept in mind when developing simplified, standardised product disclosure for retirement income products.

ASFA welcomes the consultation on the proposals relating to disclosure on retirement income. If inappropriate arrangements were put in place there would be a risk of consumers being misled and/or superannuation funds facing an excessive compliance burden and additional costs for little or no benefit to und members.

Factors which should be taken into consideration when determining the nature, composition and amount of an appropriate retirement income stream for a member include the member's

- age
- gender
- life expectancy
- health
- existence and nature of family relationships
- risk tolerance
- goals and objectives - what does a 'successful retirement' look like for them
- total amount of superannuation
- non superannuation assets and income, including potential inheritances
- eligibility for the Age Pension both initially and in the future
- current and likely future expenses and liabilities, including potential need for residential aged care and any outstanding mortgage amounts.

Disclosure material alone may not be conducive to such factors being properly considered by an individual when they are considering alternative retirement income arrangements. For many retirees and intending retirees there is a role for advice as well.

There also are a range of activities that could improve income in retirement, other than through disclosure documents, including:

- providing projections of income on member statements, to start effecting the shift in thinking from ‘accumulation of a lump sum’ to ‘entitlement to an income stream’
- improving financial literacy and educating Australians about superannuation, including the benefits of compounding returns and other benefits with respect to investing for retirement. This could extend to inclusion in school curriculums, with reinforcement in senior school as young Australians enter the workforce for the first time and receive contributions to superannuation
- improving the provision of information and advice to members, especially in the form of projections, guidance and information as to their level of superannuation as compared against default or selected benchmarks, as an engagement strategy
- providing more guidance and advice at the time of, and after, retirement, including how to manage the various investment risks and how to invest, and drawdown, appropriately through retirement.

It has proven to be possible and desirable to ‘mass customise’ a MySuper product in the accumulation phase as the desired outcome is simply to maximise the members’ accumulated account balance, through managing the risk adjusted returns credited to accounts and the fees/premiums deducted from accounts.

This is in complete contrast, however, with the retirement phase, where the objectives, financial circumstances and needs of individuals, in terms of their retirement income, are quite distinct and varied. The operation of the means test for the Age Pension also impacts on the relative attractiveness of different retirement income products. This has implications for disclosure of the characteristics of retirement income products.

The consultation paper claims that currently when people approach retirement they are confronted with complex legal and financial information and that in almost all cases consumers are provided with lengthy Product Disclosure Statements. However, this is largely a function of current legal requirements. As well, pension products are not included in the Shorter Form PDS regime, which in the case of accumulation products provides for eight page Product Disclosure Statements in a specified format for superannuation products.

As the paper notes, choosing an appropriate retirement income product necessarily requires consideration of trade-offs between income, flexibility and risk management and it is rare for these trade-offs to be made explicit in product disclosure documents. There are a number of reasons for this, including that it may not be possible to develop suitable, meaningful metrics on a standardised basis for such a task. In particular, in retirement the level of Age Pension received is crucial for retirement planning. Going forward many retirees will receive at least a part Age Pension at some point during their retirement. The level of the Age Pension generally will vary with changes in the financial position of the retiree. This can limit the amount of upside an individual receives when investment returns are relatively good but equally there is an income offset in many cases when investment returns are not so good.

As well, most retirees have a spouse. The spouse may be in receipt of a defined benefit or foreign pension or may even be employed and this needs to be taken into account in considering what retirement income product is most suitable for the retiree.

In terms of comparability between products offered by different providers, it would be essential that there be very clear specification of assumptions and methodologies, including where appropriate prescription of uniform assumptions.

Responses to specific proposals

1. EXPECTED RETIREMENT INCOME

The paper proposes that for all retirement income products, expected retirement income should be presented numerically and with an income graph using average real annual income from a $100,000 investment, over the period from retirement (currently age 67) to age 97. Income presented should be net of fees and taxes.

ASFA has a number of comments to make in regard to this proposal.

In retirement the amount of income received by most retirees will depend on the amount of Age Pension received. Assuming that the only source of income for an individual is private income from a retirement income product is potentially misleading.

As well, only a relatively few individuals will live from age 67 to age 97. The most recent life tables from the Government Actuary indicate that only around 8 per cent of males aged 67 will live to age 97 and around 14 per cent of females. Many individuals at age 97 will also be living in an institutional setting with low amounts of discretionary spending.

If such a metric is to be presented, any estimates of average real income should use growth in wages as the deflator rather than growth in the Consumer Price Index.

Any such measure should also make it clear that "income" for this purpose includes return of the initial capital to the purchaser of the product and that with some products payments cease on death with no payment to the estate of the individual.

Another challenge with this metric is that it assumes that all longevity products will deliver income to age 97 or have the potential to do so. However, the contractual provisions of some products such as term annuities or life expectancy annuities mean that income payments will cease before age 97 given that such an outcome is an integral part of the design of the products concerned.

In regard to the suggested way of presenting income, use of the term "Take-home-Pay" arguably would be misleading when a product involves return of capital. Another issue is that when an individual is in receipt of a full or part Age Pension the amount they draw down from an account based pension will depend on the amount of Age Pension they are receiving, amongst other things. The amount will not be constant over time, even if allowance is made for the changing value of money over time.

2. VARIATION IN EXPECTED INCOME

The consultation paper proposes that for all retirement income products, income variation should focus on negative or downside variation measured against expected first year real income and that the metric should measure downside income variations and the size of variations. The paper argues that products with risk mitigation strategies, protection factors, or conservative investment strategies, create fewer downside variations and therefore have lower risk scores.

Development of a meaningful metric of such a kind would involve considerable technical challenges as it seeks to combine measures of different kinds of risks and volatility into one combined measure. Past performance also may provide only a very general guide to future performance and there also will be uncertainty in regard to the future rate of inflation or wages growth.

In reality, the weighting given to the importance of each sort of risk will vary from individual to individual and arguably is better suited to assessment on an individual basis.

There also is the matter of the non-inclusion of the probability of upward variations in income. The potential for returns exceeding the investment return goal for the product will be important for many retirees and can be an important attribute of a retirement income product.

As well, and as noted earlier, the Age Pension will play an important role in mitigating the risks of variation in expected private income.

The metric proposed also would have very high informational demands as the measure would need to take into account the dispersion of decreased payments and allow for the size and frequency of negative variations to be taken into account, as well as the possibility of fund exhaustion (running out of money). This metric also is expected to take account of investment strategies, mortality variations, product rules and any protection features a product might have. However, certainty of achieving a given retirement income needs to be balanced against the level of retirement income and return of capital likely to be delivered by a product for a given purchase price. Typically a price has to be paid for certainty of retirement income, with higher retirement income payments on average associated with products where there is greater volatility in investment income.

As well, as noted above past performance is only a general guide to future performance and some of the factors mentioned are hard to put into numerical terms let alone quantify in a meaningful way. Putting in place the current standard risk measure for accumulation products was challenging enough and that measure still has its critics. It might be optimistic to assume that it would be possible to get agreement on the elements listed, their weight and the rating of each through "consultation with industry and the AGA" (page 6 of the Consultation Paper).

The Retirement Income Risk Measure proposed by the Australian Government Actuary in essence relies on a very peculiar utility function for an individual. It in essence assumes that individuals are very risk averse in terms of downward variations in income and that they are not interested in potential upwards variations from expected average investment returns. The utility function places emphasis on both low volatility and payments continuing with certainty to age 97 and beyond. Many individuals will put a greater emphasis on outcomes in the immediate years following age 67 relative to the years around age 97 which are relevant to only a relatively small proportion of the population.

While the consultation paper states that giving a product a numeric rating will not be regarded as providing financial advice, it is possible that at least some fund members would regard the failure of a product with a high numeric rating to deliver the retirement income that was projected as grounds for pursuing legal action against the product provider. Blame might also be apportioned by consumers to the regulator who endorsed or supported the issuing of such numeric ratings.

3. ACCESS TO UNDERLYING CAPITAL

ASFA supports the provision of information on the amount of access to underlying capital of a retirement income product.

One of the challenges though is that with account based pensions the amount available in the future will depend on both future investment returns and the amount of drawdown in each year of retirement. The interplay with the Age Pension also will impact on the required drawdown.

It might be better to disclose access to capital in a written description rather than through what might be a potentially misleading chart or table.

4. DEATH BENEFITS AND REVERSIONARY BENEFITS

Care would need to be taken in regard to the language used for disclosure on this aspect of a retirement income product.

“Remaining commutable value” might not be a term understood by many consumers.

For an account based pension, it might be difficult to calculate the future value of an ongoing payment to a spouse.

As well, many individuals will be interested in what happens on their death when they do not have a spouse. While as noted early most retirees have a spouse, some do not and the percentage without a spouse tends to increase over time through death or divorce.

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