Ms Rebecca McCullum,
Manager Retirement Income Framework
Retirement Income Policy Division
The Treasury
Langton Crescent
Parkes ACT 2600
By email Superannuation@Treasury.gov.au

Dear Ms McCullum,

DISCLOSURE AND RISK MEASURE CONSULTATION PAPERS

1. This submission responds to the invitation to comment on the Retirement Income Disclosure Consultation Paper December 2018 (the Disclosure Paper) and the Retirement Income Risk Measure Paper December 2018 (the Risk Paper). It includes comments on both Papers.

2. This submission contains: -

- **a.** background information;
- **b.** impediments;
- **c.** general comments;
- **d.** simplified product disclosure;
- **e.** income;
- **f.** variation in expected income;
- **g.** access to capital;
- **h.** death and reversionary benefits;

i. future considerations;

j. consumer testing and

k. conclusion.

Background – Mutual Pension® Pty Ltd (MPPL)

3. Mutual Pensions Pty Ltd (MPPL) is a private company established to develop, market and operate a longevity protection product for Australian Superannuation Funds.

4. MPPL's product, called a Mutual Pension®, is intended to overlay Account Based Pensions (ABPs) such that, in return for a commitment to limit drawings and forfeit part or all of the balance on death, called a "Deferred Protection Fee", the surviving participants receive an annual distribution of the forfeitures of participants who die. A Mutual Pension® overlay is a Group Self Annuitisation (GSA) scheme that differs from others in that it is not intended to be a separate investment option, it is intended to overlay an ABP.

5. In its original form, a Mutual Pension® had a wide range of options, but in the context of Comprehensive Income Products Retirement, (CIPR), it is simple with no options. It involves adopting minimum ABP drawings and forfeiture on death phased in from zero at commencement to 100% of the ABP balance at half of the rounded up life expectancy at the time of commencement. The forfeiture proportion changes daily. If a reversionary spouse is nominated, the forfeiture is reduced to 30% of the standard forfeiture if the spouse is alive at the death of the principal member. The spouse's reversionary benefit is then subject to minimum drawings and the full forfeiture regime.

6. MPPL envisages superannuation funds offering a CIPR that comprises 50% unrestricted ABP and 50% Mutual Pension® overlay as described in paragraph 5 above.

Impediments to Mutual Pension®

7. In this section, I briefly describe areas in which the Mutual Pension® CIPR meets the spirit of the government's policy, but may run afoul of the letter of the legislation. MPPL urges that the legislation consider and enable solution to the issues raised here.

8. Mutual Pensions® work better the greater the number of participants, so it is desirable for multiple superannuation funds to participate in one pool. In MPPL's view, there should be no impediment to pooling across multiple funds. In particular, there should be no income or goods and services tax involved.

9. The CIPR outlined in paragraph 6 above comfortably complies with the CIPR requirements except that: -

- **a.** the use of minimum ABP drawings can mean that in some years real drawings will decrease or increase and thus not be broadly constant;
- **b.** forfeitures are expressed in terms of account balances, not purchase prices, which means legacies after forfeitures will have to be tested against the purchase price based declining capital access schedule - complicating the description of the product and
- **c.** at the very advanced ages, distributions are expected to grow strongly in real terms.

10. Remedies for these exceptions are: -

- **a.** impose a CPI based minimum increase in drawings;
- **b.** submit that the legislation allow funds to base the declining capital access schedule on either purchase price or account balance and
- **c.** submit that inflation of payments in excess of CPI at later ages should be ignored as it occurs at a time when care and medical costs are high.

11. MPPL therefore submits that: -

- **a.** the legislation should allow funds to base the declining capital access schedule on either purchase price or account balance and
- **b.** the requirement for broadly constant real income should be loosely administered.

General comments

12. MPPL notes that neither paper refers specifically to GSAs and there is minimal reference to investment protected products. It acknowledges GSAs and investment protected products generally fit within the paper. These products are not yet available, primarily because of old legislative impediments. MPPL urges Treasury to keep these products in mind as the proposals are finalised and to include them in some of its examples.

Simplified standard product disclosure

13. MPPL agrees that the factors shown on page 3 of the Disclosure Paper are relevant factors that should be disclosed. It notes, however, that disclosure will be considerably complicated if it is required to deal with products with reversionary spouse benefits. To the extent possible, disclosure should be concentrated on single beneficiaries.

14. MPPL notes that in many cases, funds will offer a CIPR that is a combination of an ABP and a longevity protected product. While this letter uses examples based on a stapled combination, disclosure could apply to the individual components. MPPL submits that the disclosure should relate to the combined CIPR. In doing so, MPPL notes that the Social Security treatment of the components will, almost certainly, differ.

Income

15. The proposed approach requires a graph of average income. The average income over the period, if graphed, will be a straight line. The likely meaning of the approach would be clarified if it required the expected income at each age to be graphed and reported.

16. Because of the fact that real income may vary as indicated in sub paragraph 9c above, MPPL favours tabulation of expected income at, say, quinquennial intervals as well as graphs produced.

17. In all GSA schemes, income will depend on the assumptions concerning mortality and net of fees investment earnings. For this reason the assumptions should be disclosed. Consideration should also be given to mandating the assumptions used in such disclosure (see paragraph 32 on page 6).

18. MPPL does not favour disclosure of lifetime average real income as such information overstates the value to members if it does not recognise that fewer members will actually receive the later life income.

19. It is not clear whether “presented numerically” means annually. MPPL suggests the information should not be less frequently, than quinquennially and that if accompanied by a chart, need not be more frequently than that.

20. MPPL considers specifying the period used in disclosing income is unnecessary. Consumers who wish to think in terms of weekly or fortnightly amounts can readily do the conversions. If the period is to be specified, MPPL supports expressing the income annually,

Variation in expected income

21. Page 6 of the Disclosure Paper notes the income security measure takes account of inflation, longevity and market risk. A three dimensional measure cannot realistically be reduced to a single number. Indeed, it is difficult to use a single number to rate the components of the proposed score. If scores are to be assigned, they should be assigned to each of these factors, not a weighted average implicit in a single score.

22. Use of a single risk score requires the adoption of weights for each risk which implies that all consumers weight the risks the same. As the Disclosure Paper says, consumers don't weight the risks the same - "for consumers these risks may be of different values."

23. For these reasons, MPPL submits that a single "income security " score is too arbitrary to be useful in helping consumers. It prefers comments be required on the elements described in the last paragraph of page 6 of the Disclosure Paper.

24. MPPL submits that investment variability and the probability of survival can be separated in the disclosure.

25. The issue of the extent of variation has two components – short and long term. If a GSA experiences poor investment returns, it can maintain the real income over a short period at the cost of possible diminishing real income later. This is hard to describe except in a simulation.

26. MPPL notes that inflation risk has two components: -

- **a.** a steady decline in purchasing power and
- **b.** an inflation shock.

27. Prices doubled in CPI terms from June 1990 to September 2018, and also in the six years from December 1972. This highlights the criticality of assumptions concerning the standard deviation of the inflation rate. It renders it difficult for consumers to consider the difference between capped and uncapped indexation.

28. MPPL notes that, in a GSA based on account based pensions, balances may asymptote to zero, but, absent fraud or destruction of records, provider insolvency is not an issue. In the case of annuities, the financial strength of the issuer is important and consideration should be given to publishing ratings from rating agencies.

29. The Risk Paper, on page 4, notes that individuals are more adverse to downside risk, and assign zero value to upside variations. If the concern is optimisation of expected real income, MPPL submits that the usual standard deviation risk measure should apply if any standard deviation is to be published.

30. To illustrate the disadvantage of the negative semi deviation, since the Papers has been released, Allianz has announced a product (admittedly not a lifetime income stream but nevertheless aimed at retirees) which contemplates capped and protected returns with an annual range of -10 to 13%. The fact that negative return floors are offered indicates a consumer appetite for that level of risk.

31. It is important that protected investment products are fairly treated.

32. MPPL observes that retirees are used to reading of risk described in terms of the frequency of negative returns. It could be useful to establish a definition of materially unsatisfactory (say fail to increase in real terms) and require disclosure of the number of years in which this is expected to occur.

33. MPPL submits that the disclosure of simulations should build on the charts of the Risk Paper. It suggests: -

a. the bars be removed;

there should be lines showing the 95th, 75th, 50th, 25th and 5th percentiles;

b. the thickness of the 50th percentile line be greater than that of the two adjacent percentile which be, in turn, greater than the extreme percentiles and

c. tables of quinquennial incomes should also show the percentiles.

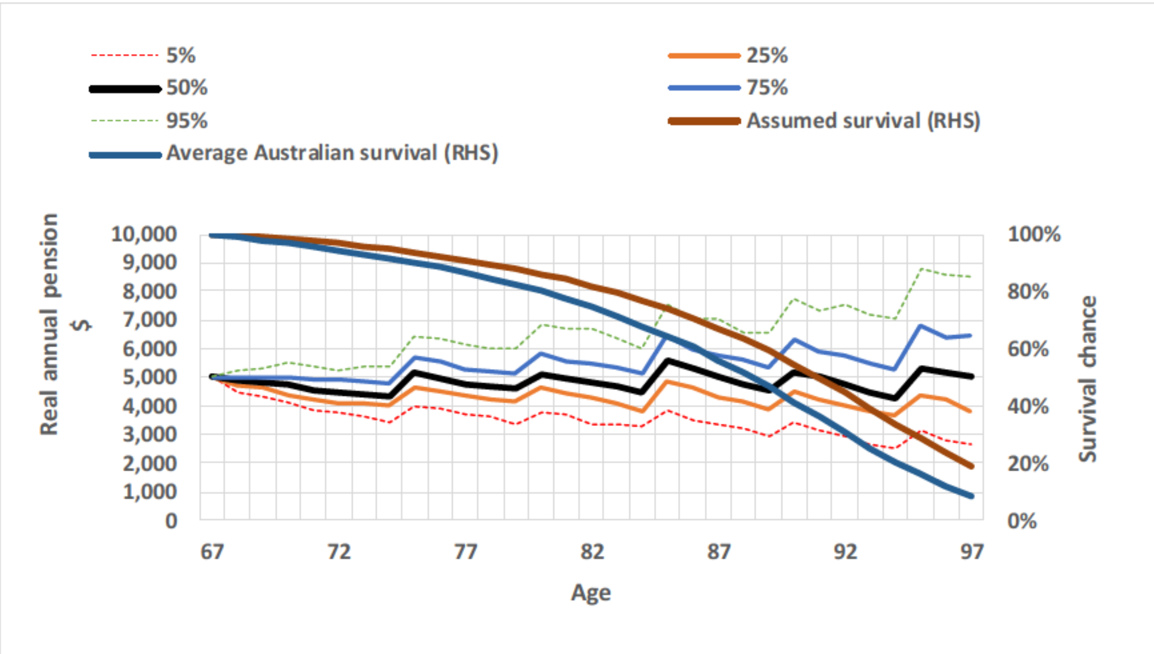
34. There may be a need to reflect the fact that the 50th percentile will not match the mean.

35. The pensions projected for any GSA will depend on the assumed mortality and this should be disclosed by a narrative and a survivorship probability. It is also useful to disclose population survivorship in the same way. MPPL submits that age specific survivorship probabilities based on the latest Australian Life Tables should be disclosed in chart and quinquennial table form.

36. For any product where the outturn depends on mortality, MPPL submits that the survivorship probabilities based on the assumed mortality should be similarly disclosed. Where this is not the case, similar disclosure of survivorship probabilities derived from the costing mortality assumptions may, MPPL submits, be disclosed.

37. The following text, table and chart shows the application of the MPPL submitted disclosure to its CIPR offered a couple comprising a male aged 67 and female aged 64.

The inflation adjusted income (real income) from investment of $100,000 in this product has been computer modelled many times to reflect the effect of random fluctuations in survival rates of your spouse and other participants, inflation and investment earnings. The chart and table below show the real income in each year that was attained in at least in 5, 25, 50, 75 and 95 percent of the calculations." They also show the chance of your survival based on the assumptions underlying these calculations and the chance of survival of an average Australian of your age and gender.



Age	*5th percentile*	*25th percentile*	*50th percentile*	*75th percentile*	*95th percentile*	*Average Australian* **survival**	*Assumed survival*
67	*5,000*	*5,000*	*5,000*	*5,000*	*5,000*	*100.00%*	*100.00%*
72	*3,789*	*4,100*	*4,458*	*4,941*	*5,245*	*94.39%*	*96.61%*
77	*3,734*	*4,334*	*4,767*	*5,269*	*6,155*	*86.54%*	*90.93%*
82	*3,386*	*4,265*	*4,811*	*5,494*	*6,672*	*74.52%*	*81.93%*
87	*3,364*	*4,266*	*5,025*	*5,786*	*7,056*	*56.06%*	*67.25%*
92	*2,964*	*4,014*	*4,733*	*5,787*	*7,500*	*30.65%*	*44.43%*
97	*2,686*	*3,839*	*5,002*	*6,420*	*8,531*	*8.74%*	*19.13%*

38. In order for all disclosures to be fully comparable, and to prevent “gaming” of simulations, MPPL submits that the Australian Securities and Investments Commission (ASIC) mandates: -

a. the mean and standard deviation of returns of investment portfolios for commonly used growth : defensive asset combinations;

b. the mean and standard deviation of CPI;

c. the number of trials in simulations;

d. random numbers to be used for –

- **i.** earnings,
- **ii.** population mortality,
- **iii.** spouse mortality,
- **iv.** investment returns and
- **v.** inflation and

e. the number of other participants to be assumed in GSAs.

39. There will also need to consider mandating factors for the simulation of returns in products that invoke protection strategies to address sequencing risk.

40. In MPPL’s opinion, the publication of a risk number such as that proposed on page 5 of the Risk Paper invests that number with an aura of authority but fails to provide a scale which consumers can meaningfully apply. An option to the upper left of another on the chart on page 10 of the Risk Paper is clearly better if one ignores MPPL’s reservations about the use of the negative semi deviation. In other cases, however, the consumer’s “indifference frontier” will be influenced by the scale on the two axes.

41. MPPL submits that the graphical use of percentiles as suggested in the Risk Paper is the best way to disclose income variability.

Access to capital

42. Mutual Pensions® and, probably, other GSA arrangements are based on ABP balances, not purchase prices. In the arrangement described in paragraph 6 above, the balance available for withdrawal will depend on investment earnings and drawdowns. GSAs will be able to estimate the balances available for withdrawal, based on central estimate assumptions, but it will be necessary to state that the balance is an estimate.

43. Where a CIPR is a combination of an ABP and a longevity protected product, MPPL submits that providers could be permitted to separate the permissible withdrawal into components. An example of this is shown after paragraph 48 below.

44. MPPL notes that the paper includes a table for ages 67, 70 and then increasing by five. MPPL suggests the increment should be universally five years to avoid confusion.

45. MPPL submits that disclosure in the form of a chart and quinquennial table is appropriate.

46. MPPL submits that access to capital and death and reversionary benefit disclosure can be combined. This is done in the example after paragraph 48 below.

Death and reversionary benefits

47. MPPL's recommended CIPR Is not amenable to simple description in the form described in the Disclosure Paper, so the ability to amend or delete depending on the particular product mentioned in the Disclosure Paper is welcome. It would be simpler for members to understand the MPPL default death and reversionary benefits if it were possible to describe them in terms of forfeiture and account balances.

48. MPPL submits that it should be possible to use the following description.

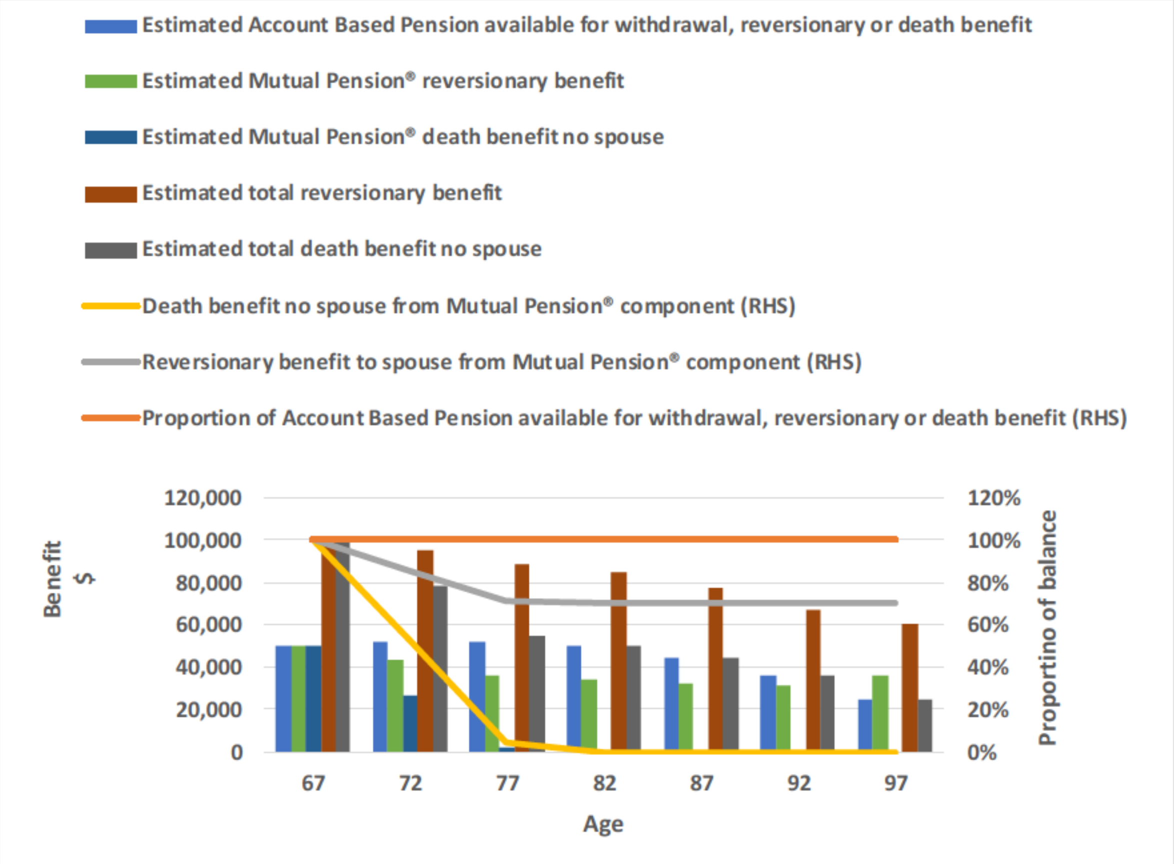
On your death, the entire balance of the ABP component of your CIPR is transferred to your partner, if alive, or payable as a death benefit.

If your nominated partner is alive at your death, a proportion of the Mutual Pension® component of your CIPR starting at 100% and reducing to 70% after 3,883 days (roundly 10.5 years) is transferred to a spouse pension account. Your partner may draw any chosen level of pension from the ABP component and may convert part or all of it to a lump sum. Your partner must draw the age specific minimum proportion from the Mutual Pension® component and cannot convert any of it to a lump sum..

On your death without a nominated partner or if your nominated partner is no longer alive, a proportion of the Mutual Pension® component of your CIPR starting at 100% and reducing to nothing after 3,883 days (roundly 10.5 years) is payable as a death benefit.

If you predecease your nominated partner, then on your partner's death, the entire balance of the ABP component of your CIPR that was transferred to your partner on your death is payable as a death benefit. In addition, a proportion of the current balance of your of the Mutual Pension® component that was transferred to your partner on your death starting at 100% and reducing to nothing after 3,883 days (roundly 10.5 years) from commencement is payable as a death benefit.

The following chart and table set out, for each $100,000 committed to the CIPR, your funds available for withdrawal and death and reversionary benefits.



Age	*Proportion of Account Based Pension available for withdrawal, reversionary or death benefit*	*Reversionary benefit to spouse from Mutual Pension® component*	*Death benefit no spouse from Mutual Pension® component*	*Estimated Account Based Pension available for withdrawal, reversionary or death benefit $*	*Estimated Mutual Pension® reversionary benefit $*	*Estimated Mutual Pension® death benefit no spouse $*	*Estimated total reversionary benefit $*	*Estimated total death benefit no spouse $*
67	*100.0%*	*100.0%*	*100.0%*	*50,000*	*50,000*	*50,000*	*100,000*	*100,000*
72	*100.0%*	*85.7%*	*52.4%*	*51,732*	*43,319*	*26,473*	*95,051*	*78,205*

Age	*Proportion of Account Based Pension available for withdrawal, reversionary or death benefit*	*Reversionary benefit to spouse from Mutual Pension® component*	*Death benefit no spouse from Mutual Pension® component*	*Estimated Account Based Pension available for withdrawal, reversionary or death benefit $*	*Estimated Mutual Pension® reversionary benefit $*	*Estimated Mutual Pension® death benefit no spouse $*	*Estimated total reversionary benefit $*	*Estimated total death benefit no spouse $*
77	*100.0%*	*71.4%*	*4.8%*	*52,393*	*36,093*	*2,406*	*88,486*	*54,799*
82	*100.0%*	*70.0%*	*0.0%*	*50,326*	*34,269*	*0*	*84,595*	*50,326*
87	*100.0%*	*70.0%*	*0.0%*	*44,819*	*32,141*	*0*	*76,960*	*44,819*
92	*100.0%*	*70.0%*	*0.0%*	*35,725*	*31,255*	*0*	*66,980*	*35,725*
97	*100.0%*	*70.0%*	*0.0%*	*24,746*	*35,942*	*0*	*60,688*	*24,746*

Future considerations

49. MPPL notes that the suggestions for lifetime engagement would likely involve the use of artificial intelligence. To do otherwise would, it submits, stray into the area of personal advice. It cautions, however, that algorithmic assignment of attitudes to the various risks inherent in retirement is fraught.

50. MPPL considers that, in the context of a default CIPR that the fund trustees believe best suits most members on a "take it or leave it" basis, over customisation should be avoided.

51. MPPL agrees that the standard measures should not constitute financial advice.

52. MPPL can see no purpose in post purchase engagement where the consumer has no further choices, for example, a life time annuity. The Mutual Pension® CIPR product allows changes in the drawings of the ABP portion and in the investment options chosen. This counsels post purchase engagement in these elements probably through annual statements.

53. MPPL will provide reports for funds to send to members on the experience of the longevity protection to ensure complete clarity and disclosure. It expects other GSAs would do likewise.

54. MPPL does not think reporting of negative semi deviations is appropriate for the reasons given in paragraph 32 above.

55. MPPL will provide to funds the necessary reporting on the progress on the forfeiture aspects of Mutual Pension® which will, no doubt, flow to the regulator.

56. While there may be use in reporting historical information, MPPL sees little advantage in reporting expected results unless the basis of calculation the expected results is rigorously externally defined. The reason for this view is set out in paragraph 38 above.

57. MPPL has a bespoke product which could be made available to funds and would be amenable to "Intra fund" comparisons using a website calculator. Because of the virtually infinite range of options for members in areas around the pace of drawing permitted commutation and reversionary proportions in such arrangements, a one page comparison is impracticable. This is true also when a fund offers annuities with different forfeiture schedules and CIPRs where the ABP : longevity protected ratio is variable.

58. For reasons given in paragraph 32 on page 6, MPPL does not consider income variation should be subject to any different measurement than the returns in the accumulation phase.

Consumer testing

59. MPPL submits that it is important that the consumer testing encompasses GSAs as well as traditional annuities and is flexible against the introduction of other classes of product. It needs to allow for fair treatment of "protected" investments.

Conclusion

60. Thank you for the opportunity to make this submission. I would be pleased to discuss it should you wish.

Yours sincerely

Dennis E Barton FIAA

Director