3 February 2020

Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600
Via email: retirementincomereview@treasury.gov.au

Dear Sir/Madam,

TAL Life Limited (TAL) submission to the Retirement Income Review Consultation Paper dated November 2019 (Consultation Paper).

TAL welcomes the opportunity to participate in this consultation in relation to the Retirement Income Review.

We support the work being undertaken by the Government on retirement income and have previously commented on our support for the introduction of a retirement income covenant in the Superannuation Industry (Supervision) Act 1993 (SIS Act) and for enacting legislation enshrining a purpose for the superannuation system to provide income to members in retirement. We believe that passing this legislation would allow government, superannuation funds and other industry participants to better support and educate members on this core purpose of superannuation.

About TAL

TAL is one of Australia's leading life insurers. Together with our partners, we support almost four million Australians and their families. During 2018 we paid out almost $1.62 billion in claims. Providing financial support to our customers when they need us most is a responsibility we take very seriously.

TAL is a part of the Dai-ichi Life Group in Japan. Starting with the Dai-ichi Life Insurance Company, which was established in 1902 as Japan's first mutual insurance company, today the Dai-ichi Life Group is one of the world's largest life insurance groups.

We have therefore examined the Consultation Paper from our perspective as a life insurer, responding to those questions relevant to the longevity risks faced by Australians in funding their retirement through superannuation. In doing so, we have not distinguished between the compulsory superannuation system (Pillar 2) and voluntary superannuation contributions (part of Pillar 3).

TAL Submission

We welcome the opportunity to participate in this consultation in relation to the Retirement Income Review and throughout our submission identify the following considerations for the Panel:

- considering together the collective purpose of the retirement income and the disability income systems and codifying this in legislation;
- the important role of market-linked income in supporting the adequacy of the retirement income system;
- promoting equity within the retirement income system by harnessing the benefits of pooling whilst ensuring fairness in product design;
- the impact that cognitive decline and social isolation can have on the mental health of retirees and the ability of retirees to make financial and lifestyle decisions;
- achieving a sustainable, competitive and cost-effective market for longevity products through financial and behavioural incentives;
- the need for regulatory and legislative certainty to provide product providers, superannuation trustees and advisers with the confidence to develop and recommend new solutions to meet the changing needs of retirees; and
- recognising the role of financial advice in helping to facilitate cohesion between the three pillars of Australia's retirement income system.

Purpose of the system and the role of the pillars
Consultation Question 2. Is the objective of the Australian retirement income system well understood within the community? What evidence is there to support this?

It is our view that the objective of the Retirement Income System is not well understood in the community nor agreed at a policy level. While superannuation is only one pillar of retirement income, the lack of agreement on its objective was evident in the wide range of responses to the 2016 consultation on the *Objective of Superannuation* and subsequent *Senate Standing Committee on Economics report on the Superannuation (Objective) Bill 2016*.

We welcome the policy debate about objectives being broader than just of one pillar of the system. However, we believe the concept of retirement is inextricably linked to disability and therefore it is more meaningful that any objectives encompass both the retirement income and the disability income systems and to consider both systems as an integrated whole.

Retirement income systems and disability income systems, around the world, have always been linked. In fact, old age income support initially evolved from disability pension schemes – the earliest income schemes were military disability schemes[1] . The world's first social security income support system commenced as disability support (1884 in Germany) and evolved to include old age pension (1889) at a time when most people eligible for age pensions were likely to have been disabled in any case. In fact, the primary reason why the concept of retirement exists in the first place is due to old age disability[2].

[1] Wickham, D "It's time to abolish retirement" (Institute of Actuaries of Australia, 2007)
[2] Wickham, D "It's time to abolish retirement" (Institute of Actuaries of Australia, 2007)

The benefit of considering the objectives for the retirement income and disability income systems together is to ensure there are integrated and coherent policy settings for the large proportion of those who "retire early" due to illness or injury.

According to the ABS Retirement and Retirement Intentions Survey[3], around half of all retirees do not chose to retire voluntarily. There are number of reasons for this including the need to care for others, but the largest single reason for retirement, outside of voluntary retirement, is disability (around 28.2% men, 23% women retire for this reason).

This is even more pronounced for the more than 1 million Australians who have retired before age 60. Around 40% of those who have retired before the age of 60 did so due to disability, illness or sickness. For that large proportion of the population who retire early due to disability - insurance (including disability income insurance, Total and Permanent Disability insurance, workers compensation), superannuation savings and the Disability Support Pension - all play a vital role in the provision of income before the Age Pension commences.

The current policy settings for all these different income sources are not integrated and are often inconsistent. We recommend considering the objectives of retirement income and disability income systems collectively to ensure coherence in the system and optimise outcomes for all retirees (not just those lucky enough to reach age 67 without a disability).

Adequacy

Consultation question 10. What should the Panel consider when assessing the adequacy of the retirement income system?

In our view, adequacy should involve a consideration of both the amount of income and longevity risk and how best to balance any trade-offs to the member.

Given the long-term nature of retirement and historic mortality improvements, we believe some exposure to market risk is a necessary consideration to fund an adequate level of retirement income. The time horizon between converting a market-linked superannuation accumulation balance to retirement phase and the continued need for income in retirement could be 20 years or more. To manage this longevity risk, longevity products available in the market today typically forgo potentially higher market-linked returns in favour of generally lower level guaranteed income that is ultimately tied to long-term bond yields.

Through our work with superannuation funds, we have identified that lifetime income stream products with some exposure to market-linked returns may provide overall higher levels of long-term income than fully guaranteed lifetime annuities, albeit at the cost of some uncertainty in annual payments caused by investment fluctuation risk. This may better help to address adequacy needs of members in retirement.

[3] ABS 6238.0 (2016-17)

However, we recognise there is a crucial difference in the member experience between the certainty of guaranteed income – effectively replacing an earned salary – to a partly market-linked income, which will move with the vagaries of the market.

Consistent with our submission in response to the Retirement Income Disclosure Consultation Paper, we recommend the Panel consider the work already undertaken as part of this consultation process when assessing the adequacy of the retirement income system. This includes consideration of steps to help pre-retirees navigate the magnitude of decisions they face on retirement and help them compare and select a suitable product through a standardised approach to disclosure of expected income and a legislative or prudential framework for trustees and product providers when developing innovative superannuation products that better address adequacy, income and protection needs of members.

Equity

Consultation question 13. What should the Panel consider when assessing the equity of the retirement income system?

In pooled longevity arrangements, members who live longer than average receive more total income (as a percentage of the amount they initially invested) from the income stream than members who live shorter than average. While this is intuitively reasonable, the equity and fairness of this arrangement may be questioned by retirees. For example, if cohorts of members who have a materially lower life expectancy enter a pooled arrangement on the same terms as cohorts of those members with a higher life expectancy, the product may be perceived to provide poor value to those members with a lower life expectancy.

Drawing on our experience partnering with superannuation funds to provide group insurance to their members, it is common for different groups of members to be offered insurance at different pricing to reflect the variation in insurance risks between groups. For example, blue-collar or manual workers are typically charged higher premiums than white-collar workers due to a greater exposure to mortality risk within the former group. This principle could also be applied to longevity products, whereby a higher level of income may be offered to groups which may have a lower life expectancy. We suggest this could be considered by the Panel when assessing the equity of the retirement income system for individuals or groups of individuals whose circumstances may mean that they typically have less favourable life expectancies.

United Kingdom and South African annuity providers commonly offer different rates of income based on an individual's health, lifestyle and postal code, ultimately pricing the longevity risks in line with an individual's level of risk under similar principles to life insurance underwriting.

This approach promotes fairness, by avoiding the situation where members with a shorter life expectancy unfairly cross-subsidise more affluent or healthier members, while encouraging greater usage of income stream products among groups who might otherwise see them as poor value.

Additional considerations relating to equity and the impact of cognitive decline

In 2016, dementia overtook cardiovascular disease as the leading cause of death for Australian women and is the second most common cause of death across all Australians[4]. 10% of individuals over the age of 65, and 30% of individuals over the age of 85, suffer from dementia.

Given the prevalence of dementia and cognitive decline within the community, and the long time horizon of retirement, we believe that products and superannuation fund member engagement approaches need to be designed as simply as possible. In addition, we suggest that retirement products should include appropriate safeguards to protect individuals from potential decline in their capacity to make financial decisions while maintaining their independence and dignity in retirement.

Although the diagnosis of dementia is determined by the treating medical professional or other clinical best practice scoring methodology, we advocate for the superannuation industry playing a role in supporting individuals to plan ahead. This could be achieved by providing information on cognitive decline in disclosure for retirement products along with encouragement for individuals to nominate, by way of executing power of attorney instrument, a legal representative who is both financially literate and trustworthy.

Furthermore, superannuation funds could enhance disclosure and other member communication to provide information pertaining to organisations which may be able to provide support in the instance of elder abuse, information on power of attorney, and information on guardianship boards/tribunals in the instance that an individual who is no longer able to make these decisions for themselves.

Although we acknowledge it is a separate issue, individuals experiencing cognitive decline are also at risk of elder abuse, these safeguards could also perform the dual function of providing some protection to individuals from this abuse.

Sustainability
Consultation question 18. What should the Panel consider when assessing the sustainability of the retirement income system?

The compulsory superannuation guarantee system helped many working Australians save for their retirement. The scale achieved in accumulation phase savings has supported the development and offer of accumulation products in the superannuation industry.

To help build a sustainable market for retirement income and longevity products, we suggest that the Panel consider how scale in member take-up of these products could be achieved. Achieving scale will assist to:

- reduce costs for providers which should benefit members in the form of higher income;

[4] Dementia Australia 2020, *Dementia statistics*, viewed 28 January 2020. https://www.dementia.org.au/statistics

- spread longevity risks among a larger pool of members; and
- encourage providers to innovate and offer value for money solutions.

The development and availability of longevity products that appropriately meet the retirement income needs of members, will help give members confidence in the retirement income level they can afford to spend. This, in turn, can help reduce long-term reliance on the Age Pension in an environment where replacement ratios are expected to rise.

We support using behavioural insights in communicating offers to members transitioning into retirement. To assist to build scale and sustainability, we suggest the Panel consider the role of behavioural insights in communicating offers to members transitioning into retirement and potentially using the concept of an 'informed' or active decline model for retirement income products.

Milliman[5] analysed the difficulty that superannuation funds have in encouraging individuals to purchase a product where the value is not realised for many years. This research found that although initially most superannuation members do not care about their future selves, this is overcome if the provider is able to illustrate to the member their future self in a way that is meaningful to them. This leads to increased engagement and ultimately leads to more meaningful choices relating to their retirement.

Experience in both the UK and USA suggest that applying the lessons of behavioural finance in the design of retirement systems can help lead to better outcomes. In the UK, the introduction of the "auto-enrolment" scheme in 2012 required employers to enrol employees in a private plan on an opt-out basis. This change increased the participation in the non-compulsory private retirement savings system from 8 million in 2012 to 19 million in 2018[6]. In the USA, the government allowed employers to automatically enrol employees into 401(k) defined contribution plans without accepting financial liability, provided they met certain requirements; a study by Vanguard showed that participation rates with auto-enrolment were 93% compared to 47% where enrolment was voluntary[7].

In both above cases, the decision to be part of a savings plan was framed as a decision to leave rather than a decision to join. Whether as a result of a preference for the status quo, an aversion to losing something with perceived value, or simply apathy, this simple re-framing produced striking results. In the context of encouraging Australian retirees to make use of lifetime income products to manage longevity risks, framing such a product as the "default" option may help lead to higher take-up. To support superannuation funds trustees in this, the USA model, where employers are offered

[5] Gebler, J 2018, *How to help customers make choices today that will benefit them tomorrow*, Milliman

[6] Collinson, P 2019, *Watchdog hails success of auto-enrolment pensions*, The Guardian, viewed 20 January 2020, https://www.theguardian.com/money/2019/oct/24/watchdog-hails-success-of-auto-enrolment-pensions

[7] Clark, JW and Young, JA 2018, *Automatic enrollment: The power of the default*, Vanguard, viewed 20 January 2020, https://institutional.vanguard.com/iam/pdf/CIRAE.pdf

a safe harbour, is instructive. It could help trustees feel empowered to guide members towards a mass-market default retirement option; a framework analogous to MySuper in accumulation, which allows a default option without offering individual advice, should be considered.

Beyond the challenge of stretching retirement savings over an unknown number of years of retirement, older Australians also face the prospect of a deteriorating capacity to look after themselves and an increasing need for some form of Aged Care. Illnesses such as Alzheimer's disease may result in a need for Aged Care that the retiree had not planned for, leading to financial hardship. Australia's Aged Care system is difficult to navigate, and insurance products which could fund unexpected care costs do not currently exist. Potential changes to the Aged Care system, such as caps on costs and clear definitions of different forms of care, combined with standardised ways to assess the need for care, could facilitate the development of a market for insurance products to help manage this risk.

As a provider of long-term insurance contracts, we are cognizant of the challenges in administering products which have long term time horizons and are binding on both the customer and provider. To provide a level of confidence to superannuation funds and insurers when developing retirement income products, we support the development of a framework which would give providers the ability to make changes to products after issue, in the interests of providing better outcomes for retirees and ensuring the sustainability of offering.

Given the long term nature of retirement income products and the potential for members to lose out to modern products which may offer better returns and features, we recommend the Panel consider termination and exit provisions or a legacy product rationalisation framework for lifetime income products. These could, for example, operate in a way similar to the current successor fund transfer (SFT) rule provisions in the *Superannuation Industry (Supervision) Regulations 1994 (Cth)* to help ensure members are not disadvantaged.

Cohesion

Consultation question 25. What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?

The financial decisions that individuals are required to make when retiring are often more complex and have the potential to have significant financial consequences. Without access to quality financial advice, it can be difficult for retirees to navigate a range of complex decisions including unfamiliar risks, uncertain spending needs, and interaction with the Age Pension.

To assist members in making financial decisions on the draw-down of their superannuation savings when approaching retirement, we suggest the Panel consider a holistic review of the legislative framework for advice. In our opinion, this would include a review of the appropriate distinctions between intra-fund and personal advice with the purpose of providing clarity to assist superannuation fund trustees in providing more guidance to their members.

Clarification of the distinctions between intra-fund and personal advice would assist trustees in offering longevity products to their members and assist members in understanding whether a longevity product may be suitable for them. It would also assist trustees when providing guidance to their members in relation to a combined account based pension and deferred longevity product structure where the members may need guidance in working out the draw-down amounts to prevent the capital of their account based pension being exhausted prior to commencement of the deferred longevity product.