TAL

6 August 2021

Director
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: superannuation@treasury.gov.au

Dear Sir/Madam,

Submission to the Retirement income covenant position paper, 19 July 2021

TAL Life Limited welcomes the opportunity to provide a submission to the Retirement income covenant Position Paper (the Position Paper).

TAL supports the introduction of a retirement income covenant (the Covenant) into the *Superannuation Industry (Supervision) Act 1993* (Cth). By codifying the requirements and obligations for superannuation trustees to improve retirement outcomes for individuals, the Covenant will help facilitate greater consumption of superannuation balances to maximise retirement income and increase the availability of support for Australians to manage specific risks that may affect their ability to achieve their retirement goals. The Covenant will be a significant step towards completing the vision for superannuation to support improved standards of living for all retired Australians.

About TAL

TAL is one of Australia's leading life insurers. Together with our partners, we protect 4.5 million Australians against the risks of death, disability, and illness. In 2020-21 we paid more than $2.7 billion in claims to 37,000 customers and their families. We provide life insurance cover in several different ways – through our partnerships with superannuation funds, via financial advisers, and directly to consumers through digital and other platforms.

TAL is a part of the Japan based Dai-ichi Life Group. 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. Dai-ichi Life Group is also one of the world's leading providers of retirement income products.

Summary of our submission

We have examined the Position Paper from our perspective as a group life insurer, supporting and protecting Australians against the life and living risks that they face from their first job and through to their retirement. Australians face different risks approaching and during the retirement phase when compared to the accumulation phase, particularly with respect to longevity risk and the increased risk of cognitive decline. We are working closely with our superannuation partners to expand the options available for retirees to manage these risks and support members to make better decisions about drawing down their super as retirement income.

We are pleased to see the policy direction outlined in the Position Paper continues to embrace a flexible, principles-based approach. This is important as it will enable trustees to use their knowledge of their member base to develop retirement income strategies that are best suited to their membership. In particular, we welcome the core obligation for trustees to formulate, review regularly and give effect to a retirement income strategy for their members that balances the three key retirement income objectives outlined in the Position Paper.

For further information

Should you have any questions regarding the information in this submission, or about TAL generally, we would be pleased to assist. [redacted]

Yours sincerely

Andrew Howard
Chief Commercial Officer – Group Life & Investments
TAL Life Limited

1. Achieving sustainable scale

While retirement income strategies will vary across funds according to the membership base, most strategies will likely lead to the development of solutions that reliably and sustainably deliver income to members throughout their retirement. A critical success factor for reliability and sustainability in retirement income solutions is scale.

Economies of scale in the accumulation phase of superannuation are associated with lower administration costs, improved investment performance and higher levels of competition[1]. These benefits can be expected to be as applicable to the retirement phase of super as they are to the accumulation phase. But scale also brings additional benefits for some types of retirement income solutions, that trustees may seek to offer.

Solutions that include pooling of longevity risk typically benefit from both scale (to smooth statistical volatility in mortality experience) and insurance expertise (to ensure appropriate management and distribution of mortality credits). In this regard, the success of the insurance within superannuation framework may be instructive as to approaches to reach appropriate scale, indicating as it does how scale efficiencies directly benefit members.

Whilst achieving scale may be easier if retirement age superannuation members were defaulted into retirement income products (similar to the MySuper regime), we recognise that there is little appetite to introduce such an approach at present. However, should a trustee determine that the interests of its members (or a cohort of its members) based on their characteristics could be best served by being guided into a retirement income product, then it should be permitted to do so, while preserving the right of members to opt out or choose alternative products or strategies.

In making this suggestion, TAL notes overseas experience supports auto-enrolment as an effective guidance mechanism. In the United Kingdom, the introduction of auto-enrolment 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[2].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[3].

Ongoing review of social security means testing incentives

To support the take-up of retirement income products designed to manage longevity risk, reforms to the *Social Security Act 1991* (Cth) were made by the *Social Services and Other Legislation Amendment (Supporting Retirement Incomes) Act 2019* (Cth), to provide concessional means test treatment for innovative income stream solutions.

In our view, these reforms were important in providing some financial incentives to eligible Australian retirees to “privately” self-insure against longevity risk rather than relying solely on the Age Pension. However, we note that the Age Pension assets and income means testing provisions were legislated in the context of a policy intention to encourage the uptake of pooled lifetime income stream products. The Act did not affect account-based income streams, the most common retirement income product.

In the context of the proposed Retirement Incomes Covenant, it may be appropriate to monitor whether the 2019 changes to the assets and income means testing limits for innovative income stream solutions are sufficiently attractive to encourage take-up of income stream solutions that

[1] Productivity Commission, *Economies of scale in superannuation*, Technical Supplement 8.
[2] 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
[3] Clark, JW and Young, JA 2018, *Automatic enrolment: The power of the default*, Vanguard, viewed 20 January 2020, https://institutional.vanguard.com/iam/pdf/CIRAE.pdf

facilitate greater consumption of superannuation savings as income in retirement. If sufficient take-up of income stream solutions is not observed, we recommend that the Age Pension assets and income tests be reviewed and further incentives be formulated.

Alternatively, changes to the deeming rates applied to products such as account based pensions could be considered to ensure that members are encouraged and incentivised to take up retirement income solutions to manage longevity risks (as well as an expected higher income over their lifetime based on the Retirement Income Review)It is important to consider whether the Income Test treatment delivers the desired incentives following such changes.

Reducing barriers to integrating innovative income streams
Recently TAL has been working jointly with our superannuation fund partners on retirement solutions that balance flexibility, certainty and longevity. This leads us to recognise the value of integrated and easy to understand products which support members as they move through retirement and their expenditure needs change.

Based on this experience, we recommend the Australian Government provide regulatory support for the creation of new account-based pension models which allow for integration of longevity protection as a core feature of the product design. Currently, innovative income streams are treated as a separate product category to account-based pensions and we see significant benefits to more integrated product designs, including:

- permitting a disclosure regime whereby members can receive combined statement information and correspondence for multiple income streams with the same fund
- embedding longevity protection (e.g., through a sub-fund or investment option model) within an existing and familiar product structure is likely to improve member take-up
- reducing administrative barriers to the creation of holistic retirement solutions by allowing trustees to extend or evolve their existing account-based pension product
- facilitating existing pension members to more easily purchase longevity protection without commuting their existing pension, rolling back to super and recommencing.

We note the above approach is consistent with the integrated product recommendation suggested by the Actuaries Institute in its recent retirement income paper[4].

2. Managing retiree risk - effectiveness of retirement income strategies

The Position Paper makes it clear that trustees should be empowered to use their knowledge of their membership base to develop retirement strategies for their members. However, we agree with the proposal for guidance to be provided by APRA alongside the introduction of the Covenant. This will help trustees understand the steps they need to take to meet the requirements of the Covenant and their trustee duties and how to approach trade-offs between competing retirement income objectives.

The Position Paper helpfully refers to the need for trustees to “consider” risks to the stability and sustainability of their members’ retirement income, specifically longevity and investment risk, but leaves to the trustee’s discretion as to how these risks are managed. Given the centrality of these risks to a retirement income strategy, we suggest that there needs to be clear guidance for trustees on how best to manage these risks, including how trustees can demonstrate they have appropriately balanced the various objectives of a retirement income strategy for different member cohorts.

The accompanying regulatory guidance should therefore be designed to remove any remaining barriers to trustees innovating, evolving, or expanding their available retirement income

[4] Actuaries Institute submission to Treasury, *Innovative Retirement Income Stream (IRIS) Legislative Considerations*, 19 July 2021

strategies and solutions beyond the existing account-based pension. This should not be prescriptive guidance but should empower trustees to innovate quickly with confidence and reduce the likelihood that new solutions are ineffective in achieving the policy aims or member outcomes desired by enacting the Covenant.

Non-financial risks: cognitive decline

TAL notes that the previous Retirement Income Covenant position paper issued in May 2018 referred to the potential importance of trustees considering *"whether and how cognitive decline may affect outcomes"* when formulating a retirement income strategy. However, the current version of the Position Paper now focuses solely on financial risks. We believe that trustees should be encouraged to consider, when formulating a retirement income strategy as envisaged by the Covenant, how both financial and non-financial risks (such as cognitive impairment) may impact retiree quality of life and retirement outcomes.

As has been well documented elsewhere, there is increasing prevalence of dementia in older Australians. Dementia is now the leading cause of death for Australian women and second most common cause of death across all Australians. 10% of individuals over the age of 65, and 30% of individuals over the age of 85, suffer from dementia[5].

Given the rising prevalence of dementia and cognitive impairment, and the lengthy time horizon of retirement, we suggest the Covenant specifically take into account the possibility of cognitive impairment as members age. While its onset and effects vary, cognitive decline is a normal physiological effect of ageing. This implies that trustees should consider this in their retirement income strategy and approach to guidance, as well as supporting members to take early steps to account for the financial impacts should the risk eventuate. We therefore believe the Covenant and supporting regulatory guidance could be enhanced by trustees:

- providing guidance as early as possible in retirement whilst members have a higher likelihood of still having sufficient capacity to make financial decisions
- keeping retirement strategies, products and communications as straightforward as possible and ensuring disclosure refers to the risks of cognitive decline
- supporting members to consider their late age lifestyle needs when selecting their desired retirement income strategy or product
- encouraging members to review their estate planning needs, including making an advance care plan or advance care directive and nominating an attorney or legal representative who is both financially literate and trustworthy
- being cognisant of the risks of elder abuse and institute control for this risk, for example by enhancing disclosure and member communications to provide information pertaining to organisations which may be able to provide support in the instance of elder abuse, information on powers 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.

3. Engaging and guiding members in retirement

Creating a legal environment where trustees can confidently provide retirement guidance to their members in the lead-up to retirement is of utmost importance to the success of the Covenant. Given the importance placed on the role of guidance in the Position Paper, it is vital that regulatory support is provided to the expansion of the intra-fund advice regime alongside the commencement of the Retirement Income Covenant, and not await the completion of the Quality of Advice Review.

[5] Dementia Australia, Dementia statistics | Dementia Australia, accessed 5 August 2021

TAL notes that the Position Paper positions retirement guidance as being a continuum, ranging from factual information through to personal financial advice. Parts of this continuum are currently subject to policy uncertainty plus challenge in the context of recent case law. Given the nuanced line between factual information and advice (general and personal) and legal risk arising from the possibility of crossing the line between what constitutes 'personal', as opposed to 'general' financial product advice, trustees are likely to approach the provision of guidance with considerable trepidation.

As suggested by Australian National University Associate Professor Geoff Warren, TAL agrees that trustee should be allowed to help retirees who are disengaged or struggle with making a choice. Professor Warren suggests giving members a choice to ask their fund to select a retirement solution on their behalf as a recommendation or an assignment, and creating a means of addressing highly disengaged members who do not make a choice, rather than leaving them in accumulation phase[6].

A further obstacle to the provision of guidance is the limited information that trustees have access to. Generally, trustees will have access to broad member information only, such as age, sex and account balance. Trustees do not usually have access to other information that may otherwise have a major influence on retirement goals and strategy, such as retiree health status, partnered status, home ownership status, non-superannuation assets and income, and spending patterns, to name a few.

Reliably collecting these types of information at the individual level can be difficult and expensive. These issues could be eased if trustees were able to access, with member consent, government collected data such as Australian Taxation Office and Department of Human Services data. TAL notes that the roll out of the Consumer Data Right (CDR) could, over time and with member consent, help trustees to address the current data discrepancy. The CDR could assist trustees to gain streamlined access to relevant information from a wide variety of sources, adding both richness and fidelity to trustee guidance, and ultimately enabling the mass-customisation of retirement solutions for the needs of different member cohorts.

Safe-harbour protections

Trustees may be more confident towards providing guidance if they were granted the surety of a legal safe harbour. A safe harbour would ensure that, as long as trustees are able to demonstrate they meet certain requirements, they will not be held liable for negative individual outcomes when providing general membership or cohort level guidance.

This safe harbour could build upon the incoming Design and Distribution Obligations (DDO) that require trustees to make a Target Market Determination (TMD) by giving confidence to trustees' ability to not only *market* a product to the desired target member cohort (as per the TMD) but also *actively guide* members within that target cohort to a retirement income selection decision. Factors that trustees could be required to demonstrate in order to access the protection of safe harbour could include:

- At a minimum, utilising member age, gender and account balance in order to develop the fund's strategy or strategies.
- At a minimum, utilising member age, gender and account when stratifying members into cohorts.
- Demonstrating reasonable assumptions relating to age pension eligibility, based on the cohort level information.
- Putting in place reasonable mechanisms to manage investment and longevity risk.

[6] Warren G, Bell D, *Ensuring all retirees find a suitable retirement solution*,

A safe harbour should also extend to permitting funds to be able to provide guidance in a medium-neutral way, according to the needs and wants of the funds' members. For example, this might include providing guidance advice in person, by telephone, digitally and via AI or algorithm-based mechanisms.

Improving the effectiveness of intra-fund advice

The regulatory constraints limiting the ability of superannuation funds to provide retirement guidance and planning should be reformed alongside the introduction of the Covenant.

As it currently stands, intra-fund advice and use of superannuation fund resources is highly limited in scope, confined to advice concerning a member's superannuation account only. In our view, some basic extensions should be made to the existing intra-fund advice regime to enable funds to guide and support members on their retirement income strategy by being able to explicitly consider:

- assets and income outside of super to the extent it impacts age pension eligibility
- the retirement income needs of an entire household, notably a spouse.

This approach would have dual benefits of helping funds better guide members to make effective decisions around their retirement plan, while also supporting the uptake of retirement income streams.

Consideration should also be given to whether the costs of providing guidance under the Covenant should be borne by members collectively (as per simple intra-fund advice models) or individually (as per more complex intra-fund advice and financial product adviser models). In the case of the latter, advice or guidance relating to the retirement income strategy of a household should be permitted to be funded from a single member account.