

9 February 2024

Ms Lynn Kelly
First Assistant Secretary
Retirement, Advice and Investment Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: Retirement@treasury.gov.au

Dear Ms Kelly,

Retirement phase of superannuation discussion paper

TAL Life Limited (TAL) welcomes the opportunity to respond to the Retirement phase of superannuation discussion paper.

Ensuring Australia's world class superannuation system delivers against its promise to provide members with a dignified retirement is an important national policy goal. In the decades since its inception superannuation has evolved to ensure it efficiently and safely manages the growth of superannuation account balances through an individual's working life. Now, as superannuation savings reach a level where they are sufficient to meet a significant share of member retirement needs, it is appropriate for policy maker attention to focus on the retirement phase, and how members can maximise the benefit of their working life of contributions.

TAL acknowledges some initial policy and regulatory changes to improve the retirement phase are already in place, as referenced in the discussion paper. We also acknowledge these changes have yet to yield all of the outcomes desired, especially in respect of the uptake of lifetime income products. TAL agrees with the central Treasury position that encouraging uptake of these style of products will require retirees to have better choice and access to retirement information, advice and products.

As a life insurer with deep experience working with superannuation funds, TAL has the capacity, capability and expertise to support the achievement of this goal, especially in relation to longevity, mortality and asset risk management. Through our partnership with one large financial services company, TAL has already designed and issued a longevity insurance product supporting an innovative retirement income product. We have also worked closely with several other superannuation funds to build our understanding of their perspectives and requirements, and to assist them to understand retirement income products and how they can meet member needs.

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In this submission we comment on the issues raised in the discussion paper that are relevant to the role life insurers can play as issuers of insurance products that manage the longevity, mortality and asset risks for superannuation funds and their members. We see this role as similar to how we manage other life insurance products: to create efficient and sustainable insurance risk pools supported by a combination of prudential capital and global reinsurance.

A core question raised in the discussion paper, and one that we comment on in our submission, is the prospect of the Australian Government playing an active role in the design of retirement income products. The paper suggests this could be through both a standardised product and by way of the Australian Government intervening in the market by directly bearing the longevity risk itself. While these are options, we feel there is an opportunity for Australia to harness the capacity and interest of life insurers and global reinsurers to insure longevity risk, much as is occurring in comparable overseas markets. We include in this submission a short review of selected overseas markets and how they are grappling with similar challenges to Australia.

Furthermore, based on our own engagement with several superannuation funds, the pricing of longevity protection is not considered a significant barrier to the development and launch of lifetime income products. More frequently, concerns are expressed that member demand for lifetime income products is not yet at a level to justify the cost and effort to bring a product to market. The solution to how to encourage more members to take up this type of product is about much more than the manufacturing of the product, but also how superannuation fund members access the product and have confidence in their acquiring decision. The Australian Government's proposed reform of financial advice regulation will allow superannuation funds to better support members transitioning to retirement including in respect of retirement income products and how they can balance different retirement objectives, which will encourage uptake and help address this issue.

Making it easier for superannuation members to select a lifetime income product is also important. That is why TAL is focusing on adding longevity risk protection to account based pension products that are currently preferred in the market. These new longevity risk protection products (which are commonly termed lifetime pensions) guarantee income for life while retaining flexibility for members in terms of investment choice and the pattern and level of income payments of an account-based pension.

Other important issues to consider when reforming retirement income policy settings and that we comment on in our submission are the appropriate mechanisms to support members to understand and fairly compare products, and to switch between them. How to prevent the creation of sub-scale "legacy" products is also a key consideration that should be developed into the regulatory framework from the outset. Finally, from a regulatory perspective, while not a barrier for managing longevity risk, TAL believes that there are aspects of the APRA prudential standard framework that could be modernised to support insurance companies to manage lifetime income products more effectively.

About TAL

TAL is one of Australia's leading life insurers. Together with our partners, we protect over 5 million Australians against the financial risks of death, disability, and illness. In the 2023 financial year we paid \$3.5 billion in claims to 45,301 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.

For further information

Should you have any questions regarding the information in this submission, or about TAL generally, we would be pleased to assist. Please contact in the first instance Mr James Connors, Head of Corporate and Government Affairs, on 0484 083 208, or by email at james.connors@tal.com.au.

Yours sincerely

A handwritten signature in black ink, appearing to be 'Jenny Oliver', written in a cursive style.

Jenny Oliver

Chief Executive - Group Life & Retirement

Section 1: Supporting members to navigate retirement income

Key points:

- Expanding access to retirement income advice provided by superannuation funds will enable millions of Australians to obtain the retirement advice they need.
- Further regulatory reforms funds may be needed to encourage superannuation funds to provide personalised information or product suggestions, and to prompt member action.
- An area where there is a strong case for change is the use of superannuation calculators and retirement estimates, which our testing reveals superannuation members value. The current regulatory settings limit access to these valuable tools.

General comments

TAL believes that helping superannuation members to navigate retirement, and removing any friction points and other barriers, will be critical in giving members greater financial confidence and ensuring that their superannuation savings are used efficiently to support their standard of living throughout their retirement.

In particular, through the Australian Government's *Delivering Better Financial Outcomes* reforms TAL welcomes the Government's decision to expand access to retirement income advice provided by superannuation funds. These changes will enable millions of Australians to obtain the retirement advice they need.

Beyond this, additional reforms that would lead to more members engaging with their retirement income options include allowing more sophisticated use of superannuation calculators and retirement estimates. As a developer and provider of calculators for our superannuation partners, TAL notes the conditions of relief and default assumptions prescribed in the new ASIC superannuation calculators and retirement estimates relief instrument that commenced 1 January 2023 places significant limitations on how calculators may be used particularly when comparing and estimating lifetime retirement income to help members better understand different retirement options and outcomes.

For example, the relief instrument does not apply to static retirement estimates provided to retirees in annual statements, meaning members holding products in the retirement phase can't receive an income estimate that can help them plan. TAL also notes the default setting for calculators assumes income will run out by a set age, e.g., 92 years of age, which causes income levels from lifetime income products that must, under the pension standards, be payable for life to compare unfavourably to account based pensions.

Resolving these tensions would provide superannuation funds with greater confidence to provide members with scalable education and guidance on retirement product and income outcomes in a fund. In testing TAL conducted with superannuation members via our superannuation fund partners, we have observed that presenting members with retirement income estimates that reflect their individual circumstances, and which compare outcomes across a range of products and product settings, increase the likelihood of members taking further action in retirement planning.

Section 2: Supporting funds to deliver better retirement income strategies

Key points:

- TAL believes establishing a competitive market for retirement income products will ultimately benefit consumers. Well-designed product disclosures, and the availability of comparison tools that enable members to compare retirement income offers, will help drive a competitive market.
- To encourage member understanding and uptake of innovative retirement income solutions, product disclosures and comparison tools should be outcome-based (displaying net income) rather than input-based. This will support member understanding of retirement income outcomes.
- TAL recognises consumers experience friction when switching between retirement income products, as compared to switching accumulation products. For lifetime income streams switching between products may be greatly restricted or not possible. However, we believe that with the appropriate regulatory infrastructure these barriers can be reduced.

Responses to further questions

What are the key characteristics or metrics for comparing retirement income products and services?

When deciding on a retirement income product (or products), there are number of characteristics which members need to consider. Many of the benefits offered by products are mutually exclusive and members need to understand the trade-offs between them.

Retirement income products may differ greatly in terms of the purpose of their design. For example, account-based pensions allow flexible income withdrawals until a balance is exhausted, while lifetime income products offer a less flexible income stream but provide income that continues for the member's lifetime. Given these differences we believe that any comparison of retirement income products must consider the outcomes throughout a member's full retirement and not just a point in time. This allows for like-for-like comparisons and member understanding of the trade-offs between different product designs.

The four key characteristics of retirement income products that members should compare are:

- **Income amount** – members should have an understanding of the net income level which they can expect to receive, which should also factor in any impact on the age pension through the means test treatment of the product.
- **Income longevity** – it is essential members understand whether their income will be guaranteed for their lifetime, or whether it might exhaust before they die. Where income is not guaranteed or is guaranteed but for a period that is less than lifetime (for example until a specified age or for a set time period), this should be clearly disclosed to the member.
- **Income variability** – members should understand the level of variability or uncertainty regarding the income they will receive. One product may have the income fully guaranteed, another may have the income linked to the investment performance of underlying assets. Some lifetime income products may have the income being dependent on mortality experience among members of a pool while others may have the mortality guaranteed by an insurer.
- **Flexibility** – members should understand what level of access they may have to ad hoc withdrawals which they may need in future to cover unexpected costs or changes in lifestyle. For example, most account-based pensions allow members to withdraw their

entire balance with no restriction, whereas lifetime income streams will at a minimum have withdrawals restricted by the Capital Access Schedule (CAS). Similarly, members should understand death benefits that may be payable to their beneficiaries.

The consultation paper notes that a first step for a standard product disclosure framework may only apply to account-based pensions initially; we would argue that starting with this focus may lead funds to concentrate on their account-based pension offering, potentially directing resources away from the development of lifetime income streams that support members to manage risks to the sustainability and stability of income. This would hinder efforts to improve the supply of longevity risk protection to retirees.

A high-level standardised disclosure framework that sits across different retirement income products and that considers the risks to be addressed in the retirement income strategy, including the four key characteristics listed above, would create consistent metrics enabling comparison of diverse solutions while not stifling innovation.

What barriers are there for product switching in retirement and are there opportunities to make product switching easier?

For members with account-based pension products, there are few barriers to switching providers. The biggest friction for members is the need to update Services Australia with new income stream details.

As more lifetime income products are developed, and to encourage greater member demand for these products, we see an opportunity for lifetime income product portability arrangements to be incorporated into the regulatory framework. Such arrangements would allow members who have already committed their savings to a lifetime income stream to be able to move to an alternative lifetime income stream provider, without converting the income stream to a capital value that is limited by the CAS. Options for lifetime income stream portability would become more important if funds were to transition or assist disengaged members into a retirement income stream, and the assisted member later seeks to take greater control over their retirement strategy. Portability would also support superannuation funds (with insurer support) to move members to better performing products.

Key considerations for any lifetime income product portability scheme include:

- Ensuring that there are appropriate safeguards to manage anti-selection such as limiting switching to income streams with like-for-like capital access entitlements.

For example, members should not be able to switch from a lifetime income stream with no benefit payable on death to one with a substantial benefit available on death. If this were possible, we would expect anti-selective behaviour from members which would undermine the benefits of longevity risk pooling.

- Industry standards for the calculation of a fair value transfer amount. Similar standards exist in jurisdictions in the context of the transfer of entitlements between defined benefit schemes.

For example, if the transfer amount was understated this would likely reduce a member's ongoing income and unfairly penalise them for switching providers.

- Age pension eligibility impacts – restricting portability to products with similar means-testing treatment.

For example, where a member has committed assets to a CAS-compliant product, they will benefit from more favourable means-testing treatment on those assets, which may lead to a higher age pension entitlement. The means-testing treatment is intended to

incentivise commitment to an income stream providing lifetime income with limited capital access. It would be inappropriate for members to benefit from the higher age pension for some years and subsequently switch to a product without the same restrictions.

Section 3: Making lifetime income products more accessible

Key points:

- The Australian financial services industry is well positioned to provide the full range of financial products and services retirees require. Product issuers, including life insurers and superannuation funds, are established in the market with superannuation funds already responding to new obligations under the Retirement Income Covenant. Proposed reforms to advice regulation will make it easier for members to access better help and advice on these products.
- Specific to the suggestion of a need for government-led market intervention in the provision of longevity retirement income insurance, based on our understanding of the local market conditions, TAL's view is that the private sector is ready and capable to meet superannuation fund needs, and there is no need at present for market intervention. Ideally, policy settings could facilitate Australian life insurers playing a leading role in retirement income products, as can be seen in comparable overseas markets.
- The APRA prudential standards create challenges for life insurers to offer guaranteed life insurance products. TAL is engaging with APRA to discuss reforms which would encourage the supply of these products and support superannuation funds and members to access them at more favourable prices.
- TAL is actively working with superannuation funds to explore new retirement income product concepts that help them to support members in retirement and meet their Retirement Income Covenant obligations. This includes adding longevity risk management to account-based pensions that are currently the most popular retirement income product with retirees.
- TAL does not support the development of a standardised retirement income product, but product design principles do have a role. There is also a role for Government to work with superannuation funds, life insurers and other stakeholders to establish a regulatory framework that supports superannuation funds to safely transition members to appropriate retirement income products, while retaining member choice and control.

Responses to consultation questions

Please provide any comment on the barriers in the supply and demand for lifetime income products.

Until recently, members who have wanted to acquire a lifetime income product had limited options, and most of those options were only accessible through seeking personal financial product advice. This is now changing as superannuation funds look for new ways to support their members in retirement and comply with the Retirement Income Covenant.

The Australian market has many life insurers, including TAL, who have the capacity and willingness to accept longevity risk exposure. In recent years the number of life insurers issuing or supporting lifetime income products has increased from two to five. Importantly, Australian life insurers and superannuation funds are well regulated from both a prudential and conduct standpoint, ensuring consumer welfare comes first. In respect of prudential regulation, Australia's standards are among the world's strongest, requiring insurers to maintain significant

levels of capital. This leaves them well placed to withstand financial instability and stress. The Australian life insurance system is also integrated into the deep global capital pools that support the long-term commitments involved in lifetime income products.

In our discussions with superannuation funds, they often consider the most significant barrier to the development and launch of lifetime income products to be the upfront cost to bring a product to market weighted against the uncertain level of take-up among members who may only choose these products by choice or under advice. The supply or price of longevity protection is not considered a significant barrier.

Superannuation funds naturally wish to ensure that the lifetime income products they offer represent good value for their members. When we work with funds on the design of products that include longevity protection, it is important to demonstrate that the cost of that protection is reasonable and leads to enhanced member outcomes. This can include transparently sharing detail regarding how we arrive at suitable mortality assumptions. We can also compare the expected income levels achieved to other products or strategies.

Turning to demand, historically demand for lifetime income products has been low. Traditionally lifetime income products could only be acquired through an adviser. This reduced demand for these types of products due to the wealthier demographic of members with assets outside of superannuation who seek financial advice tending to prioritise capital flexibility over lifetime income. With proposed advice regulatory reform, members with differing levels of retirement savings and priorities will have greater access to retirement advice. This will increase understanding of and likely demand for lifetime income products, but alone may not generate the required scale for superannuation funds to invest upfront to bring these products to market. We discuss some possible solutions to generating scale later in this submission.

We consider demand is likely to grow as more Australians retire each year, and with larger superannuation balances compared to previous generations of retirees. These new retirees are more likely to see their superannuation savings as the primary means of supporting their lifestyle and availability of income over the period of retirement and are natural customers for lifetime income products. Recent research has found that the second most important product feature that non-retirees look for when choosing a retirement income product is that the income lasts for life¹.

What product options (or strategies within current retirement products) could better manage risks to retirement income?

We believe that enhancing account-based pension products through incorporating features and benefits that better manage retirement income risks (including longevity risk) could significantly increase the supply and demand for such longevity risk solutions. For example, by embedding longevity protection supported by insurance within the account-based pension product design.

Account-based pensions remain the most popular retirement income product with Australian retirees. While member behavioural patterns and take-up rates may change as more retirement income options become available, the account-based pension is likely to remain the most popular product.

Coupled with tools, calculators and advice from their superannuation fund, the ability for members to easily add longevity risk protection to their existing account-based pension should encourage member take up. This is especially the case in comparison to the more active action needed for members to choose traditional standalone lifetime income products, which might

¹ TAL and Investment Trends October 2023 Retirement Income Report survey of 10,604 Australians.

involve obtaining comprehensive financial advice and transferring part of their super balance to purchase a lifetime income with a third-party provider.

The ability for life insurers to provide longevity risk protection to superannuation funds that can be incorporated by superannuation funds within account-based pensions may help reduce the set up and maintenance cost compared to a stand-alone product. It should also lower the barrier to action by members. This integration model between life insurers and superannuation funds is already well established within the superannuation system via insurance inside super.

What action are funds taking to better manage longevity risk, and what role do funds see guaranteed income products (e.g. annuities, pooled products) playing in the future?

TAL is working with superannuation funds to explore new retirement income product concepts that help them to support members in retirement and meet their Retirement Income Covenant obligations.

Products with longevity risk protection provide greater certainty for superannuation fund members that their income will last for the period of their retirement. From an insurance perspective, the products are also a natural complement to provision of insured cover for death, total and permanent disability, and income protection during a member's working life when offered through group life insurance arrangements with superannuation funds.

In 2022, we partnered with a large financial services company to launch a guaranteed lifetime income product with embedded longevity protection. The longevity protection is provided through an annual survivor bonus based on age, with rates guaranteed for life. This can be considered a form of "unbundled" annuity, providing members income for life while the member retains flexibility in terms of the investment choice and the pattern and level of income payments.

To embed longevity risk protection within this product design, TAL issues a group longevity insurance contract to the superannuation fund to facilitate the transfer of longevity risk to TAL. The superannuation fund retains management of member assets, enabling the member to benefit from the superannuation fund's investment expertise and scale throughout their retirement. It is also attractive to funds that are incentivised to grow and maintain scale, in terms of assets under management, to reduce costs to members. Meanwhile, the role for TAL as an insurer is focused on our core capability of pooling mortality and morbidity risk.

Furthermore, we take a co-design approach to working with trustees of superannuation funds in developing solutions which meet the needs of their members. We are also willing to support superannuation funds with associated services including administration, actuarial longevity management, income shaping, assisting with supporting advisers, training and development of member-facing tools and calculators.

Do the barriers to managing longevity risk in the Australian market necessitate Government action? What Government action could assist funds in offering appropriate longevity protection to members?

We note the discussion paper contemplates the Government directly participating in the longevity protection market. TAL questions whether this is necessary as, in our observation, Australian life insurers and reinsurers have the capacity, capability and experience to insure longevity risk. This form of life insurance business is a complement to other life insurance products and a diversifying factor for other forms of life insurance risks. Life insurers manage longevity risk in a similar way to other insurance products: by creating efficient and sustainable risk pools supported by a combination of prudential capital and global reinsurance. We believe that insurers can take advantage of the natural diversification between the longevity risk of supporting lifetime income products and the mortality and morbidity risks of other life insurance business, and in

doing so reduce the cost to superannuation funds and members for both forms of risk management.

Furthermore, life insurers are already an integral and integrated part of Australia's superannuation system, working closely with funds and their members to provide death and disability insurance in superannuation. This leaves insurers well placed to add longevity risk management to existing arrangements. Life insurers also have a strong track record as insurance in superannuation providers of providing value-adding services, of improving customer value over time, and of helping funds and their members to manage mortality and morbidity risk. These existing capabilities, for which this is no equivalent within a Government-run reinsurance pool, can be naturally and easily extended to longevity risk management.

TAL has reviewed comparable overseas markets and notes the challenges facing retirees, industry participants and policy makers are similar. Common to each is that life insurers play a central role in the provision of lifetime income products, even where the accumulation phase is through a public scheme or highly regulated. Australia should seek to take a similar approach. See Appendix One for further detail on the similarities and differences in retirement income policy in the United Kingdom, United States, and the Netherlands.

Additionally, Government market intervention through the provision of longevity risk protection may hinder the development of a private market for longevity risk protection and reduce competition which has traditionally led to the best value outcomes for consumers. The Government is increasingly exposed to longevity risk through population aging, and it may be beneficial to limit that exposure via a meaningfully sized and efficient private market for longevity products. This type of intervention may also lead to a significant burden on future taxpayers; in the scenario where life expectancies for older Australians increase much more rapidly than expected, taxpayers would be paying more both for age pensioners and for claims under the longevity scheme.

There are other government actions which TAL believes would support the growth of a broad and competitive market in products offering a lifetime income with investment guarantees, such as traditional guaranteed annuities.

The following are possible changes to prudential standards which would benefit both consumers, who would be able to access annuities at a more favourable price, and life insurers, who would be able to manage longevity risk more effectively.

- Greater allowance for illiquidity premium in the valuation discount rate. When writing a competitively-priced annuity under current standards, the discount rate used to value the liabilities is less than the discount rate implied by the premium. This causes immediate reporting losses that the insurer must recognise when the annuity is issued. Combined with the prudential capital required for asset risk and longevity risk, this causes annuity business to be highly capital-intensive.
- Addressing the pro-cyclical volatility in profit and capital requirements caused by mark-to-market impacts arising from changes in credit spreads or other asset prices. These occur even if duration risk is well-matched, and insurers hold assets to maturity to meet highly certain and illiquid liability cashflows. Again this could be achieved through allowing the illiquidity premium to change in response to market conditions – such that asset movements are matched by liability movements.
- Relaxation of the longevity stress margin, and allowing insurers to take greater advantage of diversification between longevity, mortality and morbidity risks, would reduce the capital cost of providing longevity insurance. Regarding the stress margin, these could be determined by

the Appointed Actuary rather than being prescribed, as is the practice for other insurance risks. This practice encourages the insurer to measure and manage these risks more accurately.

TAL intends to suggest changes to APRA which address the above points.

There is also a lack of availability of risk-free (i.e. Government-issued) inflation-linked assets with sufficient duration to match annuity liabilities. This in turn means there is limited capacity in the swap market at longer durations. Government can support annuity issuance through issuing more Treasury bonds with these characteristics.

Legacy product replacement

Across the financial services sector, product issuers are frequently faced with a tail of older generation, sub-scale legacy products. This is a function of changing laws (such as tax and superannuation laws), customer and market expectations on product design preferences and reflects the longevity of these products. These legacy products often lack the features of newer products, or do not reflect current laws or market/consumer demands and can be expensive for issuers to maintain as customer numbers in the product decline and supporting systems become out-dated or superseded. Avoiding the occurrence of this issue in retirement income products is desirable, and a mechanism to facilitate product replacement or rationalisation should be included in the regulatory architecture from the outset.

One of the issues with many regimes to transition customers from older to newer products is the requirement for court or regulatory approval or customer/member consent. This is expensive, time consuming and uncertain, and a significant deterrent to firms to undertake.

To address this issue, we recommend the Government look to the Successor Fund Transfer (SFT) process as a model and consider extending it to the superannuation product level. The SFT process recognises that superannuation trustees have an obligation to act in the best financial interests of members as a whole, while also ensuring that members being transferred are granted equivalent rights in the new product. The process should also address any tax and social security impacts.

The benefits of this approach compared to a court or regulator approved process or member consent is that they are lower cost and more certain while retaining strong internal rigor and prioritising member financial interests.

Reinsurance

TAL notes the suggestion in the discussion paper for the Australian Government to directly intervene in the pricing of longevity risk insurance through a Government run reinsurance scheme. As noted above, TAL believes Australian life insurers working with existing global reinsurers is sufficient to supply fairly priced products as well as value added services for superannuation funds and their members.

Nevertheless, we do see a potential limited role for Government as a stop-loss reinsurer that could be drawn upon in the case of a low probability but high impact event that undermines insurer mortality assumptions. This could function through the Australian Reinsurance Pool Corporation in a similar way as occurs for cyclones and terrorism events. Access to such a stop-loss scheme should be limited to APRA regulated life insurers, the capital reserves of which would decrease the likelihood of the pool being utilised and therefore limit the liability of the Government and of taxpayers.

Would an industry-standardised product(s) assist funds to develop and offer lifetime income products to their members?

TAL does not support an industry standardised product. The main concern with a standardised product is that it is unable to meet the varied needs and circumstances of retired people – for example, varied levels of wealth and differing family and lifestyle circumstances. Specifically, TAL recognises that receiving a lifetime income is not the only consideration during the period of retirement for all members, or even possible in the case of smaller balance accounts.

Instead, retirement income products should be more tailored to the needs of different cohorts, i.e., for lower or higher balanced members the product settings could be different to achieve suitable outcomes. This reflects the existing obligation in the Retirement Income Covenant for superannuation funds to identify member needs and circumstance and to develop products suited to them.

TAL believes that a better approach is to encourage the establishment of a principle set of standards rather than a prescribed standard product.

1. What features should a standardised product include?

With a principle set of standards to follow, superannuation funds could have greater certainty in product design parameters. This will support funds to invest in product development and administration system enhancement while encouraging funds to innovate for their specific membership and member cohorts.

If Government were to proceed with developing a principle set of standards for retirement income products, we believe that the following should be considered to help improve retirement outcomes for Australians:

- A level of longevity protection included in products for certain member cohorts. Including an insurance guarantee provided by an APRA-regulated insurer gives confidence in the promise of lifetime income, even for the longest living members.
- Consideration of protections for older members who may experience cognitive decline and need protection from either elder abuse or their own poor decision making.
- Strong prudential standards and supervision to protect against counterparty risk.
- Consideration of exposure to capital market and inflation risks and whether protection is necessary.

The principle set of standards should be flexible enough that funds can tailor the settings offered to members of different cohorts, i.e., for lower or higher balanced members the product settings could need to be different to achieve suitable outcomes.

2. Should there be a path to more easily transition members to a standardised product?

There is merit in considering a regulatory framework that permits superannuation funds to transition members from accumulation products to a retirement income product where doing so is likely to be in the member's best financial interests or likely to deliver a better outcome than the member staying within their accumulation product. For some member cohorts a component of lifetime income could be suitable; however, frequently there are many cohort members who have not acted or made an active choice.

Empowering superannuation funds to transition appropriate member cohorts to products offering longevity protection that comply with a principal set of standards could produce dual, mutually reinforcing benefits:

- For the individual member, they could be transitioned to a retirement income product that will, on average, leave them better off than doing nothing by remaining in an accumulation product. These members would also benefit from tax-free investment earnings and additional income to support their standard of living in retirement from their super savings.
- At the system level, it will give confidence to funds that a product will reach scale, justifying designing and building the product, and continuing to invest in its ongoing management and further innovation.

Members should be permitted to opt-out of being transitioned and be given ample information and opportunity to do so. Based on industry experience with the *Protecting Your Super* changes (which saw higher than expected member response rates), communications informing superannuation members that a change will occur in the absence of action can boost member engagement. Where a member is transitioned to a lifetime income product, consideration could be given to the timeframe provided for members to re-engage and change this selection without impacting incomes of other members.

3. *Should superannuation funds be required to offer a standardised retirement product, similar to MySuper for accumulation? – How should a product vary for individual circumstances of the member?*

MySuper has been a very successful mechanism to ensure that all accumulation phase members who do not take an active role in managing their superannuation are placed into a product that is simple, cost-effective and in the best financial interests of members. However, because there is no mechanism to move, at retirement age, disengaged members from a MySuper accumulation product to a pension product, the MySuper benefits do not continue into retirement for members whose engagement with their superannuation remains low.

If the impacts of MySuper for members in the accumulation phase is a guide, then providing a legislated mechanism to support the transition of MySuper members, who do not make an active decision after reaching retirement age, to a retirement phase product may have several positive effects. It could:

- help create a generation of retirement products that are simple, cost-effective and balanced, and suitable for the majority of Australians
- through the trusted MySuper label, support consumer confidence in the transition to the retirement phase and understanding of their superannuation as a source of retirement income
- protect funds, by reducing exposure to legal risk if an unresponsive member is placed into a simple retirement product that meets legislated guardrails but is not necessarily optimised to an individual member's specific circumstances.

The MySuper conceptual framework does have some limitations. For example, it should not be a way to impose a “default” product - members should have the option to remain in the accumulation phase or select any other product of their choice. Similarly, funds should be free to build on the minimum standards by adding features that respond to the needs of different cohorts within their membership base.

Appendix one: review of selected overseas markets

Australia is not alone in its goal to improve retiree income outcomes, or in the issues that confront both retirees and retirement income industry participants. TAL has reviewed comparable defined contribution markets in the United Kingdom, the United States and the Netherlands, and noted a range of similarities and differences.

Similar to Australia, in the reviewed systems, the focus until recently has been on optimising accumulation. But now, with increasing numbers of people retiring with their retirement savings their main or sole source of income, the focus is broadening to address the challenge of converting savings into an adequate retirement income. Managing longevity risk is frequently at the forefront of these considerations.

United Kingdom

As a proportion of total pension fund assets, the United Kingdom (UK) defined contribution market is just 19%, but is rapidly growing¹. Over the last decade the UK has seen substantial change in the way these pensions are structured and managed. Until 2011, it was compulsory for pension holders to annuitize a portion of their savings, but reforms since this date have removed this obligation, and pension holders now have increased flexibility around how they use their savings. This has seen a sharp decrease in the rate of annuitisation, and an increase in more account holders relying on drawdown plans similar to Australian account-based pensions².

In the UK insurers play a different, somewhat larger role than in Australia, both in the accumulation phase and crucially at and around retirement. The role of life insurers in the UK pension market essentially blends together that of Australian life insurers and superannuation funds. Insurers:

- Offer and deliver a range of relevant pensions products to meet the needs of customers and scheme trustees. These are mainly drawdown-based products and annuities.
- Provide support to customers making retirement decisions both during accumulation and decumulation phases. Support can take the form of guidance, enhanced guidance or advice depending on need and customers' ability / willingness to pay.
- Fulfil the products sold during the decumulation phase (drawdown services, annuities in payment).

The market challenges in the UK are similar to those in Australia, with researchers identifying demand side issues that resemble those described in the Treasury discussion paper. This includes complexity, low financial literacy, underestimation of life expectancy and advice access issues. On the supply side, issues identified include a lack of product innovation (especially for products that combine drawdown with longevity risk protection), and the risks of developing products.

Like Australia, the UK is exploring changes to advice regulation intended to aid the ability of product issuers to provide limited advice on their products directly to consumers.

United States

The United States is similar to Australia in that most current and future retiring workers are a part of defined contribution schemes, with participant retirement incomes based on a combination of social security and income generated from retirement savings³. Also, like Australia, millions of workers are poised to retire in coming years, driving an expected surge of interest in retirement

¹ Pension Policy Institute, *What can the UK learn about other countries' approaches to accessing DC savings?*, November 2023

² AJ Bell Investcentre; *Why the annuity market is out of favour*, 2021, <https://www.investcentre.co.uk/articles/why-annuity-market-out-favour> accessed 2024.

³ Pension Policy Institute, *What can the UK learn about other countries' approaches to accessing DC savings?*, November 2023

income products¹. In a further similarity, there is a tendency for US retirees to hold onto rather than spend their wealth in retirement².

To prompt consumer uptake of longevity insurance, the United States has introduced tax incentives to encourage the purchase of longevity insurances. Since 2014, qualifying products called Qualified Longevity Annuity Contracts (QLAC) have received favourable tax treatment. A QLAC is a deferred fixed annuity that meets a set of minimum standards set by the United States government. The cost of purchase is tax free and will also quarantine a portion of their retirement account balance from tax calculations, resulting in lower income tax liabilities³.

From a policy and regulatory standpoint, while most policy activity is focused on the accumulation phase of retirement, there has been some limited reform of decumulation settings. The United States Congress passed a bill in 2019 (the SECURE Act) containing provisions intended to reduce some of the barriers that have traditionally discouraged the use of lifetime income products and to encourage participants to consider lifetime income streams. The provisions include:

- New disclosure obligations on providers, including to express benefits as a lifetime income stream by default.
- New laws to reduce the liability of fiduciaries should their retirement income insurer fail to meet their obligations, as long as the fiduciary meets a suite of safe harbour obligations when selecting the insurer.
- The removal of complexities stifling product portability⁴.

Additionally, the US has tax rules to ensure that assets in pension funds are drawn down during later life. From age 73 retirees are required to take a Required Minimum Distribution (RMD) from their accounts each year, with the amount withdraw intended to extinguish the assets in their remaining expected life span.

The Netherlands

In contrast to Australia, the defined contribution system in the Netherlands covers a relatively small proportion of employed people - approximately 20%, compared to 80% of people in defined benefit schemes⁵. The retirement phase is also quite different, with account holders obliged to convert their pension funds into lifetime income stream, though either a fixed or variable annuity. Variable annuities retain investment risk, allowing for the possibility of higher incomes.

Traditionally fixed annuities have been the most popular choice for Dutch retirees, but recent reforms aimed at making variable annuities more attractive have been introduced. These include:

- Retirees are provided with retirement estimates to illustrate the expected outcomes from different investment strategies and assumed returns, as well as outcomes in 'optimistic' and 'pessimistic' scenarios.
- More investment risk also allows providers to apply, within regulatory limits, an assumption for outperformance.

¹ McKinsey, The Key to Growth in U.S. Life Insurance: Focus on the Customer, 2016,

<https://www.mckinsey.com/industries/financial-services/our-insights/the-key-to-growth-in-us-life-insurance>

² Pension Policy Institute, *What can the UK learn about other countries' approaches to accessing DC savings?*, November 2023

³ Forbes Advisor, *Qualified Longevity Annuity Contract: What Is A QLAC?*, July 2023.

⁴ Groom Law Group, Lifetime Income Provisions Under the SECURE Act, 2020 <https://www.groom.com/resources/lifetime-income-provisions-under-the-secure-act/>

⁵ This is changing - almost all employers, when setting up a new pension plan, opt for a defined contribution plan and from 2027 defined benefits schemes will be disallowed, Lexology, *Q&A: occupational pension schemes in Netherlands*, 2023.

<https://www.lexology.com/library/detail.aspx?q=bba90362-ae12-498a-90e2-89602f1e6b86>

- Product issuers are required to tailor their offers to those most appropriate for the differing cohorts within their membership and to alert account holders to choices that may not be optimal.

Retirees have portability at the point of retirement only, at which point they are free to select from their preferred annuity product and provider. Once entered into these products, they are not portable as the individual has entered a longevity insurance contract¹.

¹ Pension Policy Institute, *What can the UK learn about other countries' approaches to accessing DC savings?*, November 2023