Australian Prudential Regulation Authority
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1 October 2019

To whom it may concern,

RE: CONSULTATION – *SPG 516 BUSINESS PERFORMANCE REVIEW*

We refer to the above consultation seeking further responses to the proposed revisions to SPG 516.

Optimum Pensions ("Optimum") made a previous submission dated 29 May 2019. This letter provides our further feedback.

We would be delighted to discuss our comments further.

Yours sincerely

[redacted]

Peter Rowe
General Manager

Further feedback

IT'S ALL ABOUT RETIREMENT INCOME

The Draft Prudential Practice Guide - SPG 516 has been prepared to provide guidance to RSE licensees to undertake an annual business performance review to assess their performance in achieving their strategic objectives and to determine what action it might take to improve performance.

Retirement income for members is the primary objective and primary outcome of superannuation. Accordingly, we think APRA's guidance should be much more specific about the outcomes to meet this objective.

Six million Australians have already reached their preservation age and are already eligible to start drawing an income from their superannuation funds. Half of these Australians (the healthier, wealthier and luckier cohorts) will live beyond average life expectancy. A predictable number of them will live to age 90, 95, 100, 105 etc.

- APRA's 2019-2023 corporate plan identifies the lack of retirement products available in the market to manage longevity risk as being a key issue for superannuation funds.

- The Government has stated clearly that "the retirement phase of the superannuation system is currently under-developed and needs to be better aligned with the underlying objective of the system – to provide income in retirement as a substitute or supplement to the Age Pension"

- To ensure that superannuation fund trustees are carrying out their roles to meet members' best interests, they will need to implement the Retirement Income Covenant proposals including:

    - Retirement income strategy
    - Retirement income fact sheets, disclosure and income risk metric
    - Retirement income projections
    - Offer longevity products

APRA's guidance, including SPG 516, should be much more specific to help RSE Licensees design, implement and measure the outcomes from their retirement product offerings. This is critical to helping the transition of $1.5 trillion, of the sector that will be entering the retirement phase, from focussing on "having a high balance" to framing the entire member outcome in terms of retirement income. It will also assist Trustees with preparing a Target Market Determination for each retirement product by 6 April 2021, as outlined in the Design and Distribution Obligations and Product Intervention Powers Bill.

Whether or not it is the Australian Government or APRA that wants better outcomes for members, trustees are still required to act in "Members' Best Interests"" by providing products that offset or eliminate the greatest retirement risk of Longevity.

The Government wants funds to build products to pool longevity risk…

Pooled retirement income products deliver up to 30% more retirement income[1] to members because:

- At the system level, all money (other than fees) in the pool gets used for retirement incomes (not death benefits to non-members);
- At the individual level, pooled products remove the need for each person to hold a safety buffer (e.g. by drawing income at the minimum level) due to the fact that their individual lifespan is uncertain.
- That safety buffer ultimately ends up paid as a death benefit to non-members rather than retirement income to members.

Drawing income from ABPs at minimum levels will not avoid real reductions in income after a member reaches their life expectancy, even allowing for the increased Age Pension to offset the reduction in income.

The Government is acutely aware that account-based products on their own do not deliver the best retirement outcome to longer-living cohorts. **Account-based pensions only provide the best outcome to those cohorts of members who die before their life expectancies.** Since 1 July 2017, investment linked lifetime income streams can be offered as an alternative retirement product that can supplement the Account Based Pensions.

While investment strategies can assist in providing greater pensions, without longevity protection, they are not a powerful enough tool to deliver the best member outcomes (in terms of retirement income). Adding longevity insurance to an account-based pension can enhance the outcome via a retirement income for <u>any</u> investment strategy.

In addition, the DSS provides means test incentives for retirement income products that last for life – further improving member outcomes for many members.

Optimum Pensions have carried out sophisticated stochastic modelling (in conjunction with actuarial firm 10E24 Pty Ltd) showing that these rules increase income and thus the member's lifestyle. "Means tested" retirees can safely enjoy up to 50% or more if they allocate some of their superannuation to an investment-linked lifetime income product.

[1] Financial System Inquiry final report page 92

Superannuation funds that do not respond to these policies promptly cannot say they are delivering the soundest, value-for-money outcomes for the 50% of their members who are the longer living cohort. This means that they are not delivering on members' best interests.

Superannuation funds need more help to be confident offering different retirement products…

The response by superannuation funds to the legislation, System Inquiries and policies that allow and encourage pooling of retirement risk have been close to non-existent. Funds seem tentative to take the lead in this area.

We note that, like life insurance products (see SPG 515 para 36), there are challenges in developing benchmarks for retirement income products. This is due to the unique nature of such products. Like insurance, retirement products are designed to deliberately deliver higher benefits (ie pensions that are paid for life – however long that may be) to members in certain circumstances than to others - to help customers manage risk in line with their objectives and health. ***Retirement incomes, like life insurance, are not about winners and losers. They are about providing protection in the form of an income for a lifetime (however long) once a member retires.***

Because of this, the retirement products the Government is encouraging, and incentivising might appear to clash with some of the themes and principles in APRA's current materials and guidance. In particular, the purpose of a pooled retirement income product is to 'shape' which members get what outcome. Members take out these products knowing that some members (the long living ones needing longevity protection) will benefit at the expense of other members (the ones who die early and stop needing income). There is no 'free lunch'. Members select the product that suits their needs and risk preferences. However, all members need longevity protection as no member knows in advance when they will die. Age at death of parent may be no predictor.

With group life or any other form of insurance, those who make a claim benefit at the expense of those who pay premiums for years but never claim. With longevity protection, people want to remove the risk of running out of money. Those who live a long time receive more money because everyone who took out the product was willing to sacrifice other outcomes such as their death benefit if they die early (and no longer need income). ***Research in USA has shown that members are willing to pay a premium over "fair value" to insure their longevity and thus lifestyle.***

For superannuation funds to be able to responsibly insure the mortality or survivorship risk themselves, they will all need to 100% reinsure. By reinsuring, the pooled the experience of many super funds in Australia, so can far more quickly get to scale, and thus improve the reliability of the mortality rates.

This all has an impact on designing member cohorts…

RSE licensees should be required to estimate how many retirees (but not who) will live to each age - for example see the Chart 1 in Appendix 1 to this letter. This is a relatively simple actuarial exercise, but some funds may wish to look more deeply at the demographics of their specific membership given there are known factors that cause some groups of members to live longer than others. For example, wealth, education level, and occupation-types can be indicators of personal life expectancy. However, age at death is random.

In our opinion it is highly inappropriate for RSE Licensees to assume all members will live to life expectancy or even some margin above life expectancy. Funds who provide any sort of retirement offering should monitor the projected and actual deaths at each age for their retired members to see whether they had adequate income. Funds should provide tools to help members understand the likely variability of their age at death.

APRA's approach should also incorporate other policy work being done….

Treasury has worked with the Government's Behavioural Economics Team (BETA) to develop and test Fact Sheets that present the best metrics to help members choose between different retirement income products. An example is shown in Appendix 2. Under these proposals, all RSE Licensees will need to produce similar metrics to these for all retirement products.

APRA's SPG 516 should provide guidance to use similar metrics. This would include the metric proposed by the Australian Government Actuary to assess the income risk of any retirement product (including account-based pensions) in a consistent way.

At some stage all RSE Licensees are likely to need to produce these metrics for every retirement product. The disclosure proposals have already undergone considerable industry consultation.

And be consistent across products…

As per our previous submission, the metrics and benchmarks required to assess retirement product outcomes ideally need to "look through" different product designs and rules and assess the underlying efficiency of each product (allowing for all fees and risks).

For example, an RSE Licensee might model a hypothetical 1,000 members who take out a particular product and project the outcomes for every member using the life tables. Stochastic techniques like those proposed by the Government Actuary could help to achieve this.

We would be pleased to discuss this with APRA and share some of our own stochastic modelling.

It will take time for members to understand these products and for financial advisers to coach and counsel their clients about the risks they are exposed to and the solutions that are coming on board to solve them.

Financial advisers will need more education about new products too. Possibly they should be required to complete specific training before becoming qualified to provide retirement income advice. During this period, APRA and/or ASIC should provide clear, prescriptive methods that are in line with the work of other Government departments and give RSE Licensees the confidence that they are moving in the right direction.

In summary…

We feel that the current SPG 516 could go further to assist RSE Licensees in this regard as they “develop the retirement phase to be better aligned with the underlying objective of the system – providing income in retirement as a substitute or supplement to the Age Pension”.

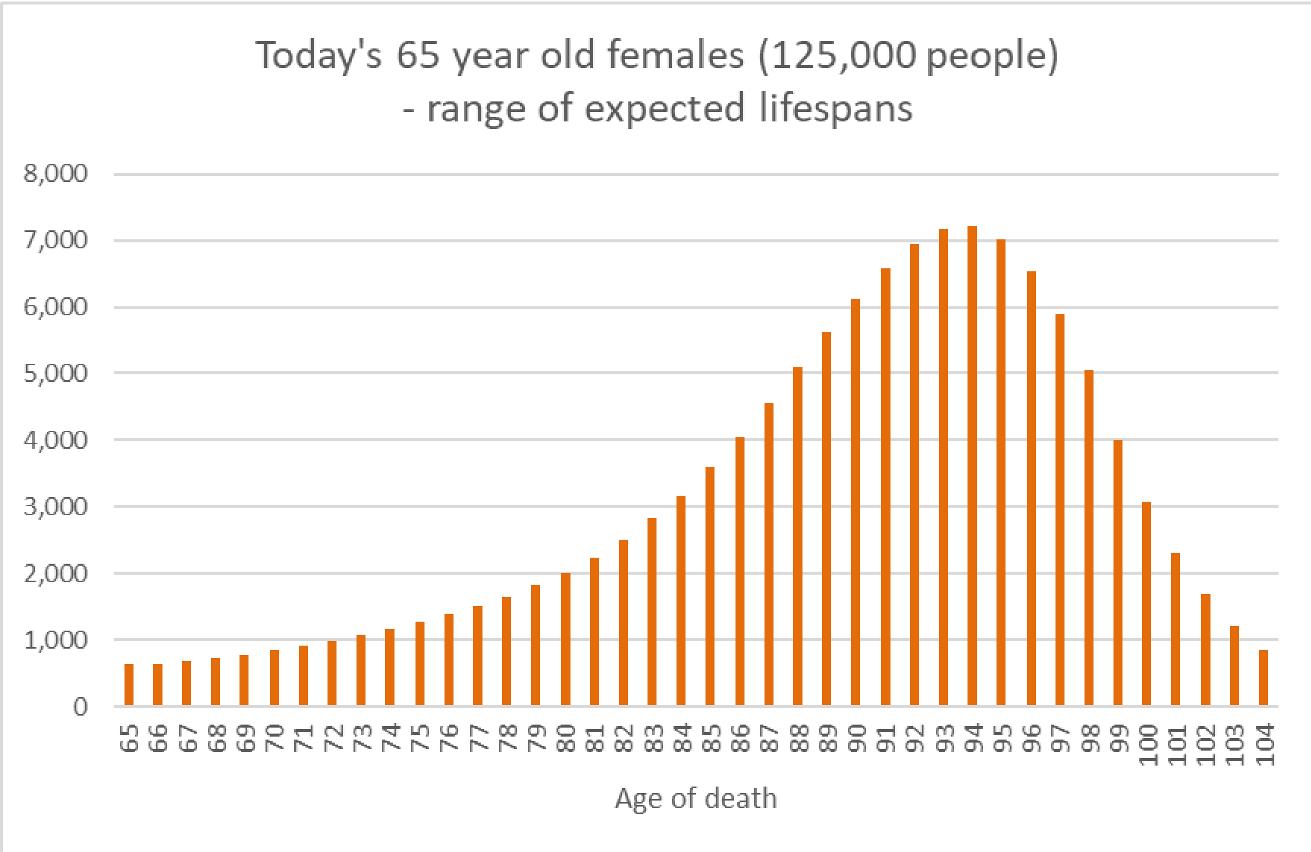
APRA should potentially even issue a third guide to deal with how to define, measure, assess and compare retirement income products and outcomes.

[redacted]

Peter Rowe
General Manager
Optimum Pensions

Appendix 1: The range for how long retirees are projected to live (females)

Chart 1: Australia currently has around 125,000 females aged 65. The chart below shows the number who are projected to die at each future age. Account-based pensions do not provide the best retirement income outcome for the cohorts who will live longer than average.



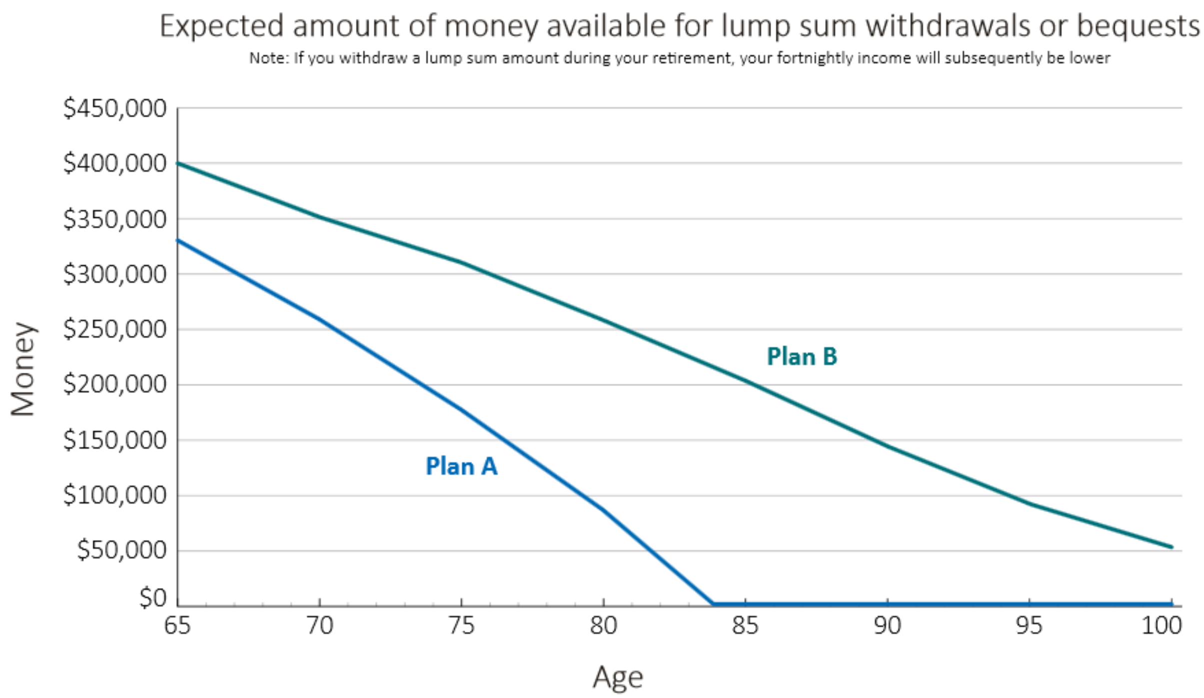
Uses the AGA 2010-12 mortality tables and applying the ‘25 year’ improvement factors.

Appendix 2: "Winning" fact sheet tested by the Behavioural Economics Team of the Australian Government

See pages 6 and 30 of this report: https://www.pmc.gov.au/sites/default/files/publications/supporting-retirees-in-retirement-income-planning_1.pdf

FIGURE 7: TEXT TABLE
(WITH INCOME MADE SALIENT WITH A BORDER)

	Plan A	Plan B
Amount of income	This plan provides a **medium-to-high** amount of income Expected average fortnightly income is: **$843**	This plan provides a **low** amount of income Expected average fortnightly income is: **$667**
Protection from running out of income	This plan provides you with **high** protection from running out of income	This plan provides you with **high** protection from running out of income
Amount of money available for lump sum withdrawals or bequests Note: if you withdraw a lump sum amount during your retirement, your fortnightly income will subsequently be lower	This plan provides a **low** amount of money for lump sum withdrawals or bequests Expected average amount of money available is: **$41,000**	This plan provides a **high** amount of money for lump sum withdrawals or bequests Expected average amount of reserve money available is: **$173,000**
Protection from fluctuations in income	This plan provides **low-to-medium** protection from income fluctuations due to changes in investment returns (positive or negative) In most years, income could rise or fall by: **4.5%**	This plan provides **low** protection from income fluctuations due to changes in investment returns (positive or negative) In most years, income could rise or fall by: **6.7%**


Expected amount of money available for lump sum withdrawals or bequests
Note: If you withdraw a lump sum amount during your retirement, your fortnightly income will subsequently be lower
Money
$450,000
$400,000
$350,000
$300,000
$250,000
$200,000
$150,000
$100,000
$50,000
$0
65
70
75
80
85
90
95
100
Age
Plan A
Plan B