29 May 2019

Ms Heidi Richards
General Manage, Policy Development
Australian Prudential Regulating Authority
GPO Box 9836
SYDNEY NSW 2001

superannuation.policy@apra.gov.au

Dear Ms Richards,

RE: CONSULTATION - PROPOSED REVISIONS TO PRUDENTIAL STANDARD SPS 515 STRATEGIC PLANNING AND MEMBER OUTCOMES

We refer to the above consultation on APRA's website which states that APRA welcomes feedback on its proposed revisions to SPS 515.

Optimum Pensions and Hannover Re have partnered to help all Australian superannuation funds implement a new retirement income stream product type, called the Real Lifetime Pension ("RLP"). The RLP and Deferred RLP allow super funds to give members the best of both worlds – investment choice regarding the assets that support their income and the benefit of longevity protection that ensures retirees cannot outlive their pension.

This letter provides our feedback and comments based on our combined 150+ years of experience working with retirement income products in Australia and overseas.

We would be delighted to discuss our comments further.

Yours sincerely

[redacted]

Peter Rowe
General Manager

Feedback regarding the proposed disclosure metrics and presentation

Optimum supports the proposed Business Performance Review (BRP) requirement for RSE licensees to be reflective and forward-looking in identifying improvements that can be made to drive the sustainable delivery of better outcomes for members.

Our key recommendation is that SPS 515 should explicitly require separate strategic objectives and assessments for cohorts of retired beneficiaries.

The products and services offered by an RSE licensee to its members in the retirement phase will have a bigger impact on members' retirement outcomes than the products and services offered in the accumulation phase. The methodologies used by the RSE licensee to develop and manage these products and services need to be fit for purpose and necessarily different from those used in the accumulation phase. **The Australian Government Actuary estimated that retirement product decisions can improve a member's retirement income outcome by up to 30%[1].**

Superannuation outcomes for retired members

In the accumulation phase the emphasis is on the member's balance. But 'balance at retirement' is not the member's 'superannuation outcome' per se unless they exit the fund!

The purpose of superannuation has been agreed almost unanimously as being "To provide income in retirement to substitute or supplement the Age Pension".

For this reason, RSE Licensees must undertake a separate and reflective process for how they define outcomes for those who have already entered the retirement phase and design benchmarks to assess the outcomes from different retirement phase products.

During the accumulation phase, the main material drivers of a member's balance are largely outside the control of the RSE licensee. These include the member's:

- Career pattern
- Rate of salary over time
- Length of time in this particular fund
- Voluntary contribution decisions
- Performance of the markets (equities, bonds, cash, property etc)
- Retirement age

In the retirement phase, the RSE licensee has a MUCH more material role to play. It is the RSE licensee's responsibility to select which retirement income product types to offer members and the RSE licensee is responsible for the efficient operation of these products.

[1] Financial System Inquiry Final Report page 26

RSE business plans - impact on outcomes for retired cohorts

APRA data shows that over $500 billion will transition from the accumulation phase to the retirement phase in the next decade. This is in addition to the $322 billion already held in APRA funds by members over the age of 65.

We recommend that Trustees should develop and implement separate strategic sections within their business plans that relate to the outcomes of their retired cohorts.

The role of a retirement income product is to spread the member's accumulated superannuation across their (and potentially their spouse's) remaining future lifespan. There are several different ways of doing this. The Government's Retirement Income Covenant position paper in May 2018 stated that a **100% allocation to an Account Based Pension would not meet the new requirements for a fund's flagship retirement income product[1].**

RSE licensees are in the process of developing new methodologies to assess, implement, measure and manage the right retirement income products - as the amount of superannuation held by the retired cohort heads toward $1 trillion.

An added complication is that the definition of what is 'better' or 'worse' is different for different members depending on their personal needs and objectives.

Annual outcomes assessment – for retired cohorts

The RSE licensee's choice of retirement income product(s) may have a material impact on the fund's projected funds under management (FUM), its projected demographic profile and its future income for a number of reasons:

- Having excellent products and support services to meet members' needs is critical in the retirement phase – given that superannuation is no longer compulsory when members retire
- Some retirement product types allow a member's superannuation to run out while they are still alive
- Some product types (in particular account-based products) aren't able to ensure that the entire balance is used for retirement income and therefore 'leak' FUM in the form of death benefits that could have been used to provide higher income while the member was still alive
- Some retirement products, by nature, are irrevocable once selected thus locking in the FUM

Because retirement products are very long-term contracts, assessing outcomes will require projections. For example, these projections should include a range of investment outcomes, not just setting a standard return for the next 30 years. Models already exist to enable this type of stress testing to be performed with relative ease. Determining whether the financial interests of beneficiaries are being met will require regular information to be gathered about what retired members needs and preferences are.

[2] Treasury: Retirement Income Covenant Position Paper Stage One of the Retirement Income Framework. Page 7.

Metrics for measuring member outcomes from retirement products

We recommend that RSE licensees should be required to establish several separate, distinct techniques for defining and assessing the effectiveness of their efforts to improve outcomes for retired cohorts.

We recognised that there are many ways to assess retirement income products. Listed below are some of the metrics that could be considered as appropriate to assess the success of strategic objectives which help retired cohorts:

- Metrics that assess actual member outcomes for all retired members:
  - o Income volatility observed
  - o the number of times in a specified period the changes in members' income are negative or incomes fall below an inflation linked benchmark
  - o The number of members who ran out of money in a specified period
- Metrics to assess the pricing / inherent charges of longevity products:
  - o The risk metric recently proposed by the Australian Government Actuary[1]
  - o Metrics used in other countries (e.g. the UK's compulsory critical yield calculations) or other internal rate of return type calculations
  - o Credit risk of external providers (such as longevity risk insurers)
  - o Demographic studies of how long the fund's retired members are living in practice and the distribution of how many members are likely to live to each age
- Metrics to monitor retired member behaviours, circumstances and preferences:
  - o Assess whether the member has a dependant spouse, desire to leave an inheritance, health status, and so on
  - o Take up of each product type and product option
  - o Surveys to assess retired members feelings of confidence, financial security etc
- Metrics to assess the experience of investment linked retirement products:
  - o Returns of underlying investment options
  - o Fees and charges
- Metrics to assess what level of engagement and education is provided for those nearing and entering retirement:
  - o Whether the Fund has any programs or provided advice to this cohort
  - o The level of take up of engagement programs (e.g. retirement seminars or planning appointments)

Fund Data on payments from retirement products

In order to improve the focus on retirement outcomes, APRA could require funds to provide data on payments from retirement products – for inclusion in APRA's Fund-level Superannuation Statistics report. Even simple data that shows lump sum payments and income paid from pension accounts in age bands would assist in considering how successful the fund is in achieving retirement income outcomes.

[3] https://treasury.gov.au/consultation/c2018-t347107

It would highlight how much was being paid out (i.e. is it just the minimum from an Account Based Pension or are people making lump sum withdrawals). This would assist in understanding how retirement savings are being used.

At present there is considerable focus on contribution by age, which is important, but how these contributions are being used at retirement is becoming more important with the ageing of the Funds' memberships.

We would be happy to discuss these suggestions further.