CALI Council of Australian Life Insurers

Mr Adam Hawkins
Retirement, Advice and Investments Division
Treasury
Langton Cres
Parkes ACT 2600

By email: retirement@treasury.gov.au

16 February 2023

Dear Mr Hawkins,

Retirement phase of superannuation

The Council of Australian Life Insurers (CALI) is the trusted voice of life insurance in Australia. We support Australians to make informed choices about their future and help them live in a healthy, confident, and secure way on their best and worst days. This includes advocating for national policy settings that expand their access to the life insurance protection that suits them when they need it most over their lifetime.

Our mission is to ensure Australians view life insurance and the industry as accessible, understandable, and trusted. We do this by supporting our members to deliver the protection and certainty Australians need through their working lives and in retirement.

Life insurance provides a safety net for Australians when they are unable to participate fully in an active working life due to illness, injury or death. Life insurance and superannuation work hand in hand to protect accumulated superannuation savings and provide financial security during retirement. The majority of lives insured are insured through superannuation. It is a natural progression for this partnership to extend to providing secure incomes in retirement.

CALI welcomes the opportunity to respond to the discussion paper on the retirement phase of superannuation. Australia's world class superannuation system now manages over $3.5 trillion in Australians' retirement savings and, with around five million Australians at or near retirement, it is timely for the Government to consider how the superannuation system delivers outcomes for Australians in retirement. In particular, Australians should have access to the right financial products to support them as they manage their financial security in retirement.

CALI believes significant government intervention is not required to increase supply in the market but there are some regulatory reforms which would build on the Retirement Income Covenant (RIC) and make it easier for Australians to affordably access longevity risk protection, which will be discussed in our submission.

The role of life insurers in providing retirement solutions

Life insurers can play an important role by providing longevity risk protection products to manage longevity risk and other risks in retirement. Globally, the role of life insurers in providing longevity risk protection products is well established and insurance providers have substantial expertise in efficiently pricing and managing longevity risk.

In recent years the number of life insurers issuing or supporting lifetime income products has increased from two to five. Life insurers in Australia are already working in partnership with superannuation trustees to provide longevity protection to superannuation members, and this has been increasing since the introduction of the RIC:

For example:

- Challenger has developed partnerships with TelstraSuper and the Commonwealth Superannuation Corporation, which are both in response to the RIC; and
- TAL has developed a partnership with AMP Superannuation funds to launch a retirement solution which combines the features of an account-based pension and an annuity.

Other superannuation funds are actively exploring retirement income options with life insurers. Several trustees have undertaken procurement processes recently to develop longevity solutions for members. These have been very competitive with good interest from life insurers, including global providers. In these processes, superannuation funds' decisions about whether to move forward have been affected by concerns about whether products will achieve the necessary scale and regulatory uncertainty rather than concerns about the effectiveness or cost of longevity risk protection.

In addition, there is interest in the Australian market from insurers that have established products in other countries. For example, global reinsurer SCOR, in a recent investor presentation day, highlighted its concerted effort to build on its expertise providing longevity products in the UK and explore and expand to new longevity markets, with a particular interest in Australia.

While uptake of longevity risk protection products is low, they have significant advantages for members. Longevity risk protection products provided by life insurers can give consumers a guaranteed lifetime income stream in retirement, which manages their exposure to the all the key risks of retirement. Life insurers are prudentially regulated, and products are required to meet minimum capital requirements, providing system stability and consumer confidence that the provider will be able to meet their obligations in the future.

Key recommendations

As discussed above, there is a well-established global market for longevity risk protection and Australia's life insurers have the expertise, capacity and capital to meet growing demand in the market.

We maintain that substantial Government intervention is unnecessary to increase market supply. We do not support the proposal to establish an industry standardised product. We do not believe Government intervention is required to provide longevity protection directly to superannuation trustees or provide a reinsurance pool for longevity risk.

However, certain regulatory reforms could enhance the RIC, facilitating more affordable access to longevity risk protection for Australians including:

- Enabling superfunds and life insurers to provide simple financial advice to members through the Delivering Better Financial Outcomes package;
- Enhancing the availability of information, guidance and advice to consumers from Government and industry at all stages of their life about retirement options and products;
- Enabling superannuation funds to nudge members towards retirement products that may better suit their circumstances;
- Ensuring member touch points are assisting members navigate the whole retirement income system e.g. super trustees could assist members to understand their eligibility for the Age Pension and assist them to comply;
- Providing simple and effective disclosure and comparison tools through Government channels to support choice and competition in the market;
- Putting in place standards for superannuation funds to apply in designing retirement income products and offerings; and
- Reviewing the capital rules for annuities with a view to changing capital requirements to encourage more competition and providing economically attractive product terms to retirees.

More detailed comments against the sections in the discussion paper are included in Attachment A.

Thank you for the opportunity to contribute to this consultation. I look forward to continued engagement as the Government progresses this important reform. Please contact Michael Johnston at michael.johnston@cali.org.au.

Kind regards,

Christine Cupitt
Chief Executive Officer
Council of Australian Life Insurers

Attachment A: Detailed comments in response to the discussion paper

Supporting members to navigate retirement income

As acknowledged in the discussion paper planning for retirement is inherently complex and this, combined with a lack of assistance, guidance and advice, is a major obstacle to ensuring retirees are efficiently using their retirement savings. Australians need to have access to the right information, advice, strategies, and products to help them make the most of retirement through superannuation and understand how it integrates with the rest of the retirement income system.

We welcome the Government's commitment to reducing red tape for financial advisers and expanding advice via superannuation funds and other licensees, as part of its Delivering Better Financial Outcomes package. This will ensure many more Australians are able to access retirement advice.

To complement this measure, there are further steps the Government could take to ensure Australians are able to access reliable information. Factual information, guidance and education should be made available to Australians from a wide range of sources. This needs to be throughout their life and not only when they are near or in retirement. Members should begin thinking about their retirement savings and needs well ahead of the day they retire and ideally have a strategy in place to ensure they are confident they will not run out of money.

We agree there is a key role for Government in providing impartial and relevant information which consumers can access through MoneySmart, the ATO, Services Australia and other relevant Government agencies where Australians may be seeking information about retirement. This could include explaining superannuation's purpose when members start working and the options available beyond account-based pensions. The Government should also share educational materials about retirement income sources and encourage Australians to use available services like financial advice and information from financial services providers.

We also agree there is an important role that superannuation funds can play in 'nudging' members towards solutions that may better suit their circumstances. This will be critical to overcome the default behaviour that is exhibited where retirees hold an account-based pension product and draw down at the minimum amount they are allowed. As well as continuing to improve data, we believe the development of default solution can be supported by principles for superannuation trustees to use in the design of retirement solutions. This is discussed further below.

In providing information and further direction to consumers, it is important that a holistic approach is being taken to member's needs in retirement. This means focusing on Australian's broader retirement arrangements and not only their needs within superannuation. Many retirees will also have retirement savings outside superannuation and interaction with the Age Pension.

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Aged care is also an area that warrants further consideration in this consultation. In setting policy settings for managing income in retirement, consideration should be given to how they will assist members to meet their aged care needs and if required have funds available to pay lump sum deposits in the future. There is also the potential for insurance solutions to support members meet their aged care needs and assist in addressing aged care funding challenges in the future.

Supporting funds to deliver better retirement income strategies

The Retirement Income Covenant (RIC) has been an important first step in supporting superannuation members to make the most of their retirement. Life insurers are seeing superannuation trustees take meaningful steps to meet their RIC obligations. The long-term effectiveness of the RIC will depend on the availability of suitable retirement income products. Within this framework, members' needs will be best met by a competitive market that provides innovative retirement income products to meet the various needs of retired Australians.

Members will benefit from having the ability to compare products and switch between providers to find solutions that meet their needs. Additionally, ensuring the performance of these products through comparison and testing contributes to a competitive market, which ultimately improves product quality and pricing.

Given differences in the design and objective of retirement income products and the varying needs of members in retirement, it is more challenging to provide simple comparison and performance tools like those that exist in the accumulation phase of superannuation. The bundling of products, where Australians may use more than one retirement income product to meet different needs, also increases the complexity of comparison.

However, effective and relatively simple comparison tools that Australians can use will be a critical source of information for consumers and help drive choice and competition in the market. Developing educational tools to fund retirement outcomes comprehensively is essential which will help address risks, particularly those associated with longevity, requires multifaceted strategies. While tools like the MoneySmart calculator have been instrumental, they have historically fallen short in accurately calculating risks. There's a clear imperative for precision in risk assessment and building a comparison tool led by the Government to provide members with reliable guidance.

The Government's paper suggests a standardised framework could empower consumers by providing essential information about the products they are purchasing, allowing for comparison with other options, evaluating performance, and ensuring alignment with individual needs. This disclosure framework would cover a variety of facets including characteristics of retirement products, performance indicators, and ongoing assessments of how funds fulfill their covenant obligations. CALI is supportive of a high-level standardised retirement product disclosure framework that could be applied to different products. Over time, as the market develops, consideration could be given to whether more detailed frameworks are required for different types of products in the market.

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Making lifetime income products more accessible

For many retirees, lifetime income products can play an important role in their retirement income arrangements. They give members greater confidence to efficiently use their retirement savings. However, as noted in the discussion paper, the take-up of these products has been limited. While we acknowledge there are a number of factors that contribute to the small market for lifetime income products, there are not significant barriers on the supply side.

The RIC introduced a principles-based framework for superannuation fund trustees to implement retirement income strategies for cohorts of members. This is a good first step towards a more robust retirement framework that incentivises the conversion of accumulation benefits into income streams, including a portion for longevity products. This will continue to support a deeper market as superannuation trustees embed the RIC and develop their approach to support members in retirement.

Life insurers are actively working with superannuation trustees to develop retirement income products and offerings to meet their RIC obligations. We expect this to continue and accelerate as superannuation trustees fully implement and embed the RIC and more Australians retire.

A wide range of existing and potential product issuers are established in the market and we believe the private sector has the skill and capacity to support Australian’s retirement needs. Life insurers see providing insurance for longevity risk as a complement to other life insurance products and a significant growth opportunity as more Australians retire, and with larger superannuation balances. In recent years the number of life insurers issuing or supporting lifetime income products has increased from two to five.

An efficient global market exists for pricing longevity risk. Australian insurers are connected to large global capital pools and global reinsurers, with significant experience with longevity risk products. This will support the development of an effective market in Australia.

To date, the key barrier to providers bringing products to the market has been the uncertainty about the level of demand when balanced against the cost of development and challenges of managing a product that does not achieve scale. Some members have well-developed products that they provide in other markets, including working with pension funds. They have not brought these to the Australian market yet because they need to see the demand exists to justify the cost and risks involved.

Given the strong private market that exists to manage longevity risk, we do not believe Government intervention is required to provide longevity protection directly to superannuation trustees or provide a reinsurance pool for longevity risk. This could hinder the development of a private market for longevity risk protection and product innovation. When combined with existing exposures to longevity risk through Government programs such as the Age Pension, aged care and Pharmaceutical Benefits Scheme, it could concentrate risk for the Government from

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the aging population. This would be a significant residual risk for the Government and Australian taxpayers, when the evidence does not show there is a market failure.

While they do not represent significant barriers, there are some regulatory changes that would assist life insurers to more easily bring products to market:

- Review of APRA prudential standards: Compared to global standards, Australia has a particularly conservative prudential capital treatment of long-term insurance liabilities, which results in relatively high regulatory capital levels, but more significantly, regulatory capital requirements that increase during times of market stress. This means the cost of providing annuities is higher in Australia than in some other markets. APRA should consider reviewing its regulatory capital settings to ensure they are not overly conservative, for example, considering allowing a more market sensitive illiquidity premium in liability valuations. CALI is discussing these issues with APRA.
- Review of social security treatment of all income stream products: Deferred lifetime income streams (those that delay the start of payments for a set amount of time, for example 5 or 10 years after purchase) are currently assessed under the same asset test rules as lifetime income streams that make payments immediately (i.e. from the date of purchase). Deferred lifetime annuities are fundamentally insurance products where consumers will need to have met the insured event (be alive at the time the deferral period ceases) to receive any benefits from the product. Applying the same asset test rules to both products creates a clear disadvantage and disincentive to consumers of deferred lifetime annuities.
- Legacy products: The life insurance industry currently experiences issues with outdated legacy products held by consumers. Moving consumers on to newer products typically requires court or regulatory approval which can be a costly and time-consuming process. Further consideration should be given to how regulations can be designed now to avoid this issue emerging in relation to retirement income products.

There are also opportunities for Government to take steps to support the development of the market. We do not support the proposal to establish an industry standardised product. It is difficult to create a standardised product that would meet the different needs of retirees. Such a product would necessarily be designed for an average retiree but in reality very few members would align to the average. However, as discussed above there is a role for default solutions or recommendations, tailored to particular cohorts of members, that individual members could choose to accept or opt out and choose different options.

Instead of a standardised product, we believe the Government should establish a framework that superannuation trustees could follow in designing products and support for their membership or different cohorts of members. This will allow trustees, working with life insurers, the flexibility to continue to innovate and tailor their solution to their members' needs.

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Factors that could be considered as part of this framework include:

- The level of longevity protection included in products. Including an insurance guarantee provided by 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 compromised decision making;
- Interactions with other aspects of the retirement system and government programs, including the Age Pension and aged care;
- Strong prudential standards and supervision to promote consumer trust and confidence and protect against counterparty risk;
- Consideration of exposure to capital market and inflation risks and how these risks can be managed.

Where members take no action in response to information and nudges, consideration could be given to permitting superannuation funds to transition members to a retirement income product that would be in the members' best interests. If superannuation funds are permitted to do this, the regulatory framework should ensure:

- Members are transitioned to arrangements and products that comply with appropriate standards;
- Members are given sufficient notice and opportunity to opt out; and
- Members are able to choose to change their arrangement with no impact on them or other members.

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