**Response to**

**‘Retirement Income Covenant Position Paper’**

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**for**

**Australian Treasury**

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**Response to Discussion Paper ‘Development of the framework for Comprehensive Income Products for Retirement’**

Dear Sir/Madam

Thank you for the opportunity to provide feedback and comments on the Retirement Income Covenant Position Paper.

# Overall

We would like to commend the government on the position paper and the principles based approach taken by providing the Covenant and Supporting principles.

We support the two Covenant Principles.

The “Retirement income strategy” principle and the set of specific requirements for Trustees to consider provides a set of criteria against which CIPRs can be assessed to determine if if they are, or remain, in the public interest.

In particular, we support the “whether and how cognitive decline may affect outcomes” requirement as we believe this will become increasingly socially important as retirees age (that is, move into their passive and frail stages of retirement, say from age 80 onward). This is a critical acknowledgment that needs to be considered in the benefit design of CIPR’s (and any retirement strategy) to support the changing need of retirees as they age. As we move forward in time the proportion of the population aged over 80 more than doubles from now through to 2050. This is an issue we highlighted in our response to the CIPR Discussion paper in July 2017.

We also support the “Engagement” principle, as it clearly requires proactive input and products by trustees on behalf of their members, and the flexibility in permitting more than one CIPR and the capacity to tailor to individual needs.

In our response, we also provide several suggestions for consideration which we outline in the following sections.

# Paper

In June 2018 we presented a paper at the International Congress of Actuaries in Berlin, titled “Retirement - the new frontier of the over 80’s market”. We would be willing to provide a copy of the presentation and supporting paper, or discuss our findings, if this is of interest to you.

The paper focusses on holistically considering the suite of issues that need to be considered in designing retirement products for the over age 80’s segment of the population. In particular, to cater for this groups declining physical and mental capacity.

Our research suggests that in the over 80s segment the prevalence of individuals with either Mild Cognitive Impairment or dementia is substantial and may be 50% or more.

Separately, almost 40% of those aged over 65 need some form of assistance with everyday activities (almost half of the women and a third of the males). At age 85, more than 80% (eight out of ten people) need assistance compared to less than 30% (three out of ten people) aged 60-69. It is reasonable to conclude that the prevalence of individuals needing assistance with everyday activities exceeds 50% in the over 80’s segment of the population.

These facts have implications for the operation and mechanics of retirement products, including CIPRs, to properly cater for the changing nature and requirements of retirees as they age.

# Supporting principles

We support the high level “Definition of a CIPR for Retirement”, including the clarification that having a 100% allocation to an ABP is not an appropriate retirement strategy.

We also agree with the rest of the Supporting principles outlined.

We encourage the government to maintain a principles-based approach and avoid a highly detailed prescriptive approach within the regulations that follow, except where such prescription may serve to prevent abuse of retirees.

A highly prescriptive approach would stifle innovation, and also not properly cater to individual retiree requirements that vary from those of a perceived ‘average individual’.

## Features of a CIPR

We strongly support the point that actual outcomes will be impacted by future actual experience. In particular, this implies that future “guarantees” made at the inception of a group self-annuitised CIPR, should be avoided and may become unrealistic when future circumstances change. We strongly agree that CIPR products should aim to provide consistent income for the full lifetime of retirees. We also agree that CIPR products should not be required to be fully or even partially guaranteed, and that trustees should not be required to eliminate all inflation risk. These points will serve to maximise income to retirees within benefit designs, by minimising amounts held back through risk reserves. In this context the example on page 6 of the Position paper is encouraging.

However, we have some concerns about the proposed mechanics of the income corridor, and the specified +/- 2.5% variations of annual income payments to maintain ‘broadly constant’ income. This corridor seems to be based on a range around the initial expected outcomes for annual payments (either in nominal or inflated terms). We suggest that linking the corridor to initial expected cash flows is flawed. Rather we suggest that the management “trigger” for concern or review should be based on relative movements in expected incomes from year to year. To prevent unnecessary reactions to transient “noise” we suggest that a running average should be monitored. For example, the disparity between expectations and actual outcomes over a three-year forecast period should be monitored. It is important to respond to macro changes in economic environment yet retain the capacity to ride out or smooth micro and transient changes.

We accept this may introduce complexity through the need to manage smoothing. This may then drive the need to manage some form of reserves to manage the upsides supporting downsides. We believe the key to sustainable outcomes is to provide income visibility to retirees over a reasonable investment horizon, such as the next rolling annual three to five year periods, and hence any smoothing reserves should be framed from this perspective. We believe that holding capital to support guarantees for longer periods than this is inefficient from a social point of view and will constrain, rather than maximise, overall income payments to retirees.

Finally, while it may be the case that the current environment supports an estimate of annual inflation running at about 2.5% we warn against assuming this will remain the case in the future. Historic experience shows this is an unlikely scenario. Consequently, appropriate flexibility and relativity should be built into CIPR requirements and assessment criteria.

## Certification

We strongly support the need for appropriate certification of CIPRs. Both at their inceptions and on an ongoing basis as economic and experience circumstances change over time.

Certifications should be carried out by professionals who:

* Are independent and unbiased,
* Understand the importance of protecting the public interests to ensure retiree’s interests are protected,
* Understand the nuances of equity and fairness when managing benefits for a long-term group,
* Can exercise professional judgement, in the best interests of retirees, in a structured, consistent and transparent manner, and
* Have the support of an established profession so they can withstand pressures from specific interest groups or individuals.

We suggest the actuarial profession, through appropriately sanctioned and experienced actuaries, is best placed to provide appropriate, reliable and trustworthy certifications. We acknowledge that as we are qualified actuaries we may be accused of having a vested interest. However, our desire is not to “feather our own nest”, but to achieve an optimal outcome for retirees in the public interest.

# Flexibility

In our research paper, we also discuss the nature of retirement products which simply target “Mr & Mrs Average” and note that the vast majority of retirees will have circumstances that put them outside this standard stereotype of being healthy, and capable of dealing with retirement issues as they move from the active phase of retirement into the passive and frail phases. Accordingly, we agree with the flexibility provided to benefit designs, particularly if associated with tailored, individual retirement strategies.

In terms of offering a flagship CIPR, we agree with the requirement that CIPR’s should be designed to be in the best interests of the cohort, compared with other products. We believe that a product comparison process is essential to ensure that relevant and current ‘best practice’ product designs are maintained. We also note that this comparison process should be applied on an ongoing basis and not just at the inception of a CIPR product.

With respect to grouping, and the requirement to have the member option to include reversionary benefits, we would suggest that this should not be limited to traditional husband and wife reversion but should encompass a broader diversity of family units and other groups in today’s society (for example, given the ageing population it could be possible for reversion to extend as far as a retiree continuing to fund the care of elderly surviving parents).

We fully support the “future considerations” and would be keen to offer our input in to the development of these initiatives, in particular with lifetime engagement, and the treatment of legacy products.

# Wealth outside super system

We also believe the government should consider the current generation of elderly retirees that are in, or approaching, the passive and frail phases of retirement. These retirees have largely been passed by in the maturing superannuation system and many have had small (if any) superannuation benefits but may have more significant assets outside the superannuation system. At present, there is no equivalent CIPR product such as a “group self annuitised deferred annuity” available outside of the superannuation framework. The consequence of this is that older Australians with assets outside the super system may be denied options and choices on how they may manage longevity risk for their entire lives.

Accordingly, we would suggest that consideration be given to the elderly retirees to have the option to “purchase” a CIPR with non-superannuation money to be able to secure immediate, lifetime income support. We would suggest that this could be a capped amount, and possibly excluding any previous superannuation benefit amounts that have been taken as superannuation lump sums. However, we believe it is critical not to disadvantage the elderly that have by-passed the superannuation system, yet have the same needs for longevity protection as the future retiring generations.

# Next steps

We would welcome the opportunity to discuss our views with you. Please let us know if this would be of interest to you.

Yours sincerely,

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