14 June 2018

The Treasury

Manager, CIPRs

Retirement Income Policy Division

Langton Crescent

PARKES ACT 2600

By email: superannuation@treasury.gov.au

**SUBJECT: Consultation Submission - Retirement Income Covenant Position Paper**

Dear Manager, CIPRs,

Thank you for the opportunity to participate in the consultation of the Government’s Retirement Income Covenant Position Paper (‘Position Paper’).

JANA has a strong interest in this topic given it impacts our superannuation fund clients. JANA is an established investment advisory firm with over 30 years’ experience and over $400bn in funds under advice. JANA currently advises around 90 institutional clients, including corporate, industry and public-sector superannuation funds as well as charities, insurers, foundations and endowment funds. The retirement benefits of around one in three Australians are impacted by JANA’s investment advice.

**About JANA**

JANA was established in 1987 as a privately owned advisory firm to provide institutional investment advice. JANA was a fully-owned subsidiary of National Australia Bank (NAB) Limited from 2000 to September 2017. JANA is now majority owned by JANA management. We have offices in Sydney and Melbourne with over 70 investment professionals.

Investment consulting is our core business.

For over 30 years, we have focused on delivering strong returns and investment outcomes for our clients. By way of example, the default investment options of seven of the ten top performing institutional superannuation funds (over the past 10 years to December 2017) are advised by JANA.

The views expressed in this paper are the views of JANA and not made on behalf of JANA’s clients.

**JANA Position on the Government’s Retirement Income Covenant Position Paper**

JANA supports the Government’s position on Retirement which proposes that trustees of superannuation funds be required to develop a Retirement Income Framework. As part of this framework, JANA believes the requirement for trustees to formulate, review regularly and give effect to a retirement income strategy to assist members to meet their retirement income objectives is in the best interest of members. In our role as investment adviser to our superannuation fund clients, we have been working with our clients on their investment strategy for many years, and JANA is accordingly supportive of this policy initiative.

JANA believes the Government’s objective of expanding individuals’ choice of retirement income products to improve their standard of living in retirement is a positive move for members of superannuation funds, particularly in the context of Australia’s ageing population, which is driven in part by improvements in life expectancy.

JANA is also supportive of the measures to encourage superannuation funds to engage with their members about retirement from a young age (and on an ongoing basis), as well as changing the conversation with members from being focused on maximising superannuation account balances **at** retirement, to one of sufficiency of income streams **in** retirement.

JANA believes the introduction of a Retirement Income Framework will be one of the largest reforms to affect superannuation funds in recent times. It will require a substantial increase in workload for virtually all superannuation funds across all areas of product design, investments, member communication and advice. The impact on the investment services industry (that is, the product manufacturers that will develop and offer new products) should also not be underestimated.

***Challenges relating to the Provision of Comprehensive Income Products for Retirement***

It is in this context that JANA’s greatest concern in relation to the provision of CIPRs is that superannuation funds will need to undertake significant work and bear the associated costs, with difficulty in forecasting the number of members that may take up this type of product.

The potential for only a small take-up by members is a significant risk. Products such as annuities have historically been unpopular in the Australian market. The Australian Journal of Actuarial Practice (2015), Volume 3[[1]](#footnote-1), outlined a comprehensive list of reasons why consumers do not purchase annuities to the extent expected. This was based on research conducted by the US Society of Actuaries, with the findings falling into three main categories: rational decisions arising from personal preferences and circumstances (e.g. loss of liquidity, loss of bequest); rational decisions arising from environmental limitations (e.g. perception of expensive pricing, poor financial market environment at time of purchase); and decisions arising from behavioural biases (e.g. control, financial illiteracy).

The Australian Journal of Actuarial Practice (2015), Volume 3[[2]](#footnote-2), also outlined specific reasons why annuities have not been as successful in the Australian market, including the availability of the Age Pension, the perception that an annuity’s value is low, issues around marketing and distribution, and a trend in society towards greater individualisation. We recognise that recent regulation changes (particularly the extension of the tax exemption on earnings in the retirement phase to innovative products such as deferred lifetime annuities and group self-annuitisation products, as well as the proposed new Age Pension means testing rules for pooled lifetime income streams) will remove some of the inherent disadvantages of investing in annuities, but not all.

In addition, if we draw on the experience from the UK market, the major pension reform introduced in April 2015 resulted in a move away from compulsory annuitisation and provided retirees with more freedom and flexibility to choose how and when they access their retirement savings. In their Freedom and choice in pensions paper (2014)[[3]](#footnote-3), the UK Government acknowledged that, as the nature of retirement changes, annuities are no longer the right product for everyone. A reason for this is that people are living longer and their needs are becoming more varied. It was also acknowledged that the annuities market in the UK was not working in the best interests of all consumers, particularly in the areas of competitiveness and innovation. The reforms focused on introducing choice for consumers along with free and impartial guidance.

There is general industry consensus that there is a high level of uncertainty for fund members at the point of retirement in terms of income stream requirements, particularly as these tend to change throughout the different phases of retirement. As a consequence, areas that may deter superannuation fund members from opting-in to a CIPR product include concerns around handing over control of a material proportion of their superannuation balance to fund a future relatively fixed income stream, particularly when their income requirements are unknown and unpredictable. Other concerns that members may have include the counterparty risk of the institution offering a pooled lifetime income product (either immediate or deferred), as well as the increased cost of products (and consequential lower income streams) that provide a guaranteed or broadly constant income. Depending on the take up of annuities, this has the potential to create a scenario where an institution or market segment is structurally “too big” or “too important” to the provision of CIPRs to fail.

***Implementation issues***

From an investment perspective, JANA views the valuations of assets that are used to fund an annuity structure, such as fixed interest assets, to be unattractive investments at the current time given low market interest rates and the risk that these will rise at some point in the future, which would impact the value of existing bonds on issue. From a valuation perspective, JANA views the proposed timing of the consideration of annuities to be likely to be suboptimal. The potential adverse impact on a member’s income for life by committing to a life-long income stream at a point when real market interest rates are at near zero levels could be devastating.

***Key areas for consideration***

In the context of these concerns, we outline below four key areas for consideration by the Treasury.

***A minimum income floor:***  Rather than a requirement for a broadly constant income stream for life, JANA proposes that a minimum income floor for CIPR products be considered as an alternative requirement. This would remove a degree of product complexity without sacrificing a minimum level of income for members.

By providing a minimum level of income, there would be a degree of certainty for members which could be combined with the Centrelink Age Pension, while simultaneously providing the prospect for considerably higher income in retirement through active management of market risk. In our view, market risk should not be eliminated through the use of annuities and annuity-like products, but should rather be actively managed to provide additional return.

***The ability for members to blend Account Based Pensions and CIPRs:*** There has been discussion at the industry level that members tend to underspend in retirement, due to the uncertainty of their income requirements and longevity. In response, members tend to build up a ‘reserve’ to guard against future income requirements, for example, uncertainty around health costs and aged care requirements or other family needs. This is arguably an entirely rational response by retirees given that retirees often do not have the benefit of future income derived from employment or capital contributions to “top up” their account balance. The constant income requirement for CIPR products may encourage members to spend even less, given their tendency to be conservative in retirement, particularly if the ability to access capital in the future is partially constrained.

One option for consideration by Treasury could be to allow members to have two retirement accounts, a CIPR combined with an account-based pension account. The ability for a member to hold an account-based pension account with a proportion of funds allocated to the account based pension (over and above the potential inclusion of an account-based pension in a CIPR product structure), would provide members with greater flexibility for unknown upcoming costs and help to address the historical behavioural resistance to pooled lifetime income products. In reality, this would not be materially different from the proposed CIPR structure, but it would provide clarity to members as to what proportion of their assets would be accessible as a lump sum, and which should be used for long term income purposes.

We understand that a combination of a CIPR and an account-based pension account would not be ruled out by the proposed CIPR framework, but we believe it would be beneficial to make this aspect clearer in terms of the retirement product solutions a superannuation fund may offer to members.

***Greater clarity around the timing in retirement of the uptake of CIPRs:*** Given the uncertainty members have upon reaching retirement age and given a member’s retirement may span a number of decades, JANA believes many members will wish to defer making a decision about committing to a lifetime income stream until after they have been retired for a number of years. It is not clear to us from the Government’s Retirement Income Covenant Position Paper whether the CIPR can only be taken out at the point of reaching retirement age. JANA accordingly seeks further clarity from the Treasury on this issue.

***Evolution of Retirement income strategy by the market:*** Given the above considerations, JANA’s view is that the market should work through the Retirement Income Strategy issues in a measured way. Instead of prescribing an approach for all superannuation funds, JANA considers that an “if not, why not?” approach to the introduction of CIPR products may be an appropriate balance for superannuation funds, when considering the demand from members for CIPR products versus the cost and time commitment involved in offering a CIPR product. For example, JANA highlighted earlier in this paper that we view the valuation of assets that are used to fund an annuity structure, such as fixed interest assets, to be unattractive investments at the current time. If this was to be the case at the point of offering a CIPR, a fund may not wish to offer a CIPR based on the implicit cost of offering an annuity type product when compared to other products.

In addition, JANA believes there are significant barriers to entry for new entrants to the pooled lifetime income product market, with consequential concerns about competitive offerings being available to superannuation funds. JANA believes the market will need time to evolve into a competitive marketplace. However, superannuation funds will need to start reviewing these products today in order to have a CIPR available for members on 1 July 2020.

A further consideration as the market evolves is the issue of superannuation fund consolidation, and the potential legacy issues that having a CIPR could create for funds that have already offered pooled lifetime income products to their members prior to merging with another fund. We have seen the unintended complexities of consolidation of various fund schemes (of which CIPRs would be a type) and their attendant long-term costs to the industry.

JANA is grateful for the opportunity to contribute to the discussion around the Retirement Income Covenant Position Paper and welcomes the opportunity for further discussion of this submission with the Treasury.

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# References

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1. Taleitha O’Meara, Aakansha Sharma, Aaron Bruhn, ‘Australia’s piece of the puzzle – why don’t Australians buy annuities?’, *Australian Journal of Actuarial Practice*, Volume 3, 2015, pp 49-55 [↑](#footnote-ref-1)
2. As above. [↑](#footnote-ref-2)
3. HM Treasury, *Freedom and choice in pensions*, United Kingdom, March 2014 [↑](#footnote-ref-3)