Retirement Income Review

Submission by AIA Australia

Response to: Retirement Income Review Panel

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AIA AUSTRALIA LIMITED

HEALTHIER, LONGER, BETTER LIVES

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Introduction

AIA Australia (which includes CMLA, known as "CommInsure Life") is one of the country's leading life insurance companies, protecting the lives of more than 3.5 million Australians. Through CMLA and the CommInsure brand, we provide savings and investment solutions including annuities and investment bond products to meet the retirement needs of Australians, including those seeking to maintain a comfortable income throughout their retirement.

AIA Australia is a purpose-driven company and a founding member of the Shared Value Project, and we ensure our business decisions create shared value; that is, we seek to solve societal issues and make a difference in people's lives, in a way that is profitable.

As the Australian population ages, increasing pressure will be placed on the Government-funded Age Pension and Aged Care systems. AIA's shared-value purpose means that we can provide solutions to this societal issue, with a focus on the increasing importance of providing Australians with longer, healthier and sustainable lifestyles in retirement.

To increase engagement and confidence in the retirement system and reduce the burden on the Government and future generations, we suggest that the retirement income system should focus on providing Australians with a level of replacement income that allows for a comfortable lifestyle in retirement. The private sector, including the life insurance industry, has a role to play in better engagement and education of retirees, and the provision of retirement solutions that allow for the transfer of longevity risk from the public sector, through risk pooling mechanisms.

This was a view shared by the Financial System Inquiry (FSI) in 2013. The FSI noted in its interim report that "*Australia has an opportunity to introduce new products that could help retirees achieve their desired levels of income, provide them with flexibility and help them better manage risks. Currently, barriers are stifling innovation and adding costs to providers developing new products*." The FSI recommended promoting the use of guaranteed income products in order to address longevity risk, enable higher consumption during retirement and reduce the use of the Age Pension.

In response to the FSI, the Government agreed to support the development of more efficient retirement income products. This journey has commenced with changes to social security assessment criteria and the announcement of the Retirement Income Framework. We are keen to see this work progress with input from industry experts and other key stakeholders, including AIA and CommInsure Life.

In 2019, the Melbourne Mercer Global Pension Index 2019 rated the Australian system a very credible B+, and noted that the overall index value could be increased if (among other things), the Government introduced a requirement that part of the retirement benefit must be taken as an income stream.[1]

There are currently few nudges in place to help people as they graduate from saving to figuring out how to convert their savings into a reliable income stream in retirement ("decumulation"). We support the development and implementation of a retirement income system designed to enable consumers to maintain a comfortable standard of living, which is likely to require the use of behavioural nudges.

For example, people underestimate how long they will live – this is known as "survival pessimism" – thereby underestimating the longevity risk they face.[2] Consumer aversion to loss of capital arising from premature

[1] Melbourne Mercer Global Pension Index 2019.

[2] *Preventing Ageing Unequally*, OECD 2017.

death reduces the perceived attractiveness of longevity risk management solutions. This behavioural bias can be countered by nudges that include education, enhanced disclosure (for example, projected income in retirement) and appropriate regulatory mechanisms to guide behaviour.

	50% chance of living beyond…	25% chance of living beyond…	10% chance of living beyond…
Male, healthy at age 65	85	90.2	94.2
Female, healthy at age 65	87.8	92.6	96.4
Couple, both healthy at age 65	90.6	94.4	97.6
Male, healthy at age 65	85	90.2	94.2

Source: CMLA based on Australian Life Tables 2010-2012 including expected mortality improvements

In 2017, CommInsure Life produced a white paper with Professor Dave Babbel PhD, Professor Emeritus, The Wharton School, University of Pennsylvania. Titled *Retire Smarter – New Strategies Towards a Comfortable Retirement*, the paper identified five major challenges to achieving comfortable living in retirement:

1. Uncertain life expectancy
2. Uncertain inflation
3. Taking too conservative an approach to investment of retirement savings
4. Wanting to leave an inheritance for heirs
5. Finding the right balance of liquidity and diversification

Under the current system, at retirement the majority of Australians withdraw a portion of their savings as a lump sum to pay any remaining debt they may have and to make some one-off purchases (such as a holiday or home renovations). They then typically transfer their superannuation savings into an account-based pension which pays them an annual amount of their choosing (within limits). However, account-based pensions are not guaranteed to last for a set period of time; their duration will depend on how much is withdrawn each year and underlying investment performance.

Lifetime annuities provide an ability to minimise longevity risk and adverse market movements. Money invested in a lifetime annuity is pooled with other investors to deal with these risks. It is essentially a form of insurance where these risks are spread across a large group so that the average return from investing is used to pay an income for the average life of the people in the group.

Purpose of the system and role of the pillars

3. In what areas of the retirement income system is there a need to improve understanding of its operation?

The three pillars of Australia's retirement income system – that is, the Age Pension, compulsory superannuation and voluntary savings – provide a strong foundation for providing Australians with financial security in retirement.

However, the interaction between the three pillars along with elements that dictate a person's access to the pillars (for example, assets test thresholds) add complexity to the system which impacts on the average person's understanding of its operation. This leads to uncertainty and confusion for Australians which contributes to a lack of engagement in superannuation and retirement planning, and ultimately a need for advice.

Ongoing changes to superannuation rules magnify this. A period of stability in the superannuation rules would build confidence in Australia's retirement income system, which would allow for better education on the respective role of each component of the system.

Articulating the role of each pillar would increase its understanding. This should involve legislating to define the objective of the superannuation system, as has been previously contemplated by the Government and Treasury. As an example, the legislated objective of superannuation could be:

> *"To provide income in retirement (or earlier where someone is unable to work to retirement) to provide a comfortable standard of living as a substitute for, or supplement to, the Age Pension."*

An agreed objective would have the dual benefit of assisting Australians to understand the purpose of their superannuation, as well as operating as a benchmark for decision makers to assess the utility of any further reforms to the system.

It is important for Australians to understand that their superannuation savings are designed to be spent during their retirement, which should encourage retirees to deploy their capital on themselves (without worrying about leaving bequests for a future generation).

Another area that would benefit from better understanding is the purpose of the tax concessions associated with the retirement income system. These exist so that ultimately an individual's superannuation savings can be used to fund their own retirement, where possible. This will, in turn, reduce the social security burden on the Government.

It is important for people to understand that the retirement income system is not an estate planning vehicle and the concessions associated with the system, together with the Age Pension itself, are not to be thought of as being totally offset by income taxes paid over one's lifetime; this seems to be a common misconception.

4. What are the respective roles of the Government, the private sector, and individuals in enabling older Australians to achieve adequate retirement incomes?

The ageing population in Australia is likely to lead to increased reliance on the Age Pension as a source of longevity protection. In order to take pressure away from the Age Pension as the primary longevity product, the private sector – particularly the life insurance industry – has an important role to play in providing retirement income products that will reduce the burden on the public sector. The Government can then focus on using the Age Pension to support those who need it most.

In order to achieve this, part of the Government's role is to set a policy framework that incentivises the private sector to provide appropriate retirement income solutions. Industry can then focus on product design, consumer education and distribution mechanisms from a position of clarity.

Not only do policy settings need to be clear and capable of implementation by the private sector, but the Government must ensure the retirement income system incentivises people to take out longevity protection products.

The Government's Retirement Income Framework has achieved this in part by bringing in new means test rules and the Capital Access Schedule in July 2019, to provide certainty about the social security and tax treatment of pooled lifetime income products. However, we suggest that further incentives should be considered to support the development and take-up of lifetime income products.

Another important role of the private sector is in the provision of life insurance in superannuation. This is designed to compensate members or their beneficiaries for savings that they are unable to accumulate due to periods in which they cannot work due to disablement, or an early death. Without this safety net, there is a risk that those who have time out of the workforce due to illness or injury, either temporarily or permanently, will not have accumulated sufficient savings to ensure a comfortable life, and will be more reliant on the social security system, including the Age Pension.

APRA also has a role to play, in setting capital standards at a level that provides a prudent level of security at a reasonable cost in order to support the provision of attractive retirement solutions. We recommend that further research is undertaken to assess the costs and benefits of different levels of capital support, with a view to maximising the social benefit of providing secure and cost-effective retirement solutions to the greatest number of Australians.

6. What are the trade-offs between the pillars and how should the appropriate balance between the role of each pillar in the system be determined?

It is our view that everyone deserves a base level of retirement income, as a safety net. The Age Pension can provide this, and should always be available to provide a sufficient minimum level of income to those who need it most.

Compulsory superannuation and voluntary savings contribute to reducing reliance on the Age Pension and therefore both should be incentivised through tax concessions, proportionally.

As mentioned earlier, the role of compulsory superannuation should be determined by legislating to define the objective of the superannuation system. The retirement phase of superannuation can then be better aligned with its underlying objective:

> *"To provide income in retirement (or earlier where someone is unable to work to retirement) to provide a comfortable standard of living as a substitute for, or supplement to, the Age Pension."*

Principles for assessing the system

8. Are the principles proposed by the Panel (adequacy, equity, sustainability, and cohesion) appropriate benchmarks for assessing the outcomes the retirement income system is delivering for Australians now and in the future? Are there other principles that should be included?

We support the principles of adequacy, equity, sustainability and cohesion as appropriate benchmarks for the retirement income system.

We suggest the addition of the principle of **simplicity** as a further benchmark for assessing the outcomes that the system is delivering for Australians.

We believe that a current barrier to a more effective retirement income system is how difficult it is for the average person to understand their needs, the protections available to them and the incentives to take these up.

The Panel should consider behavioural biases that individuals have, that favour short term consumption at the expense of longer term savings and income. These behavioural biases can be countered by nudges in the form of education, enhanced disclosure (for example, projected income in retirement) and appropriate regulatory mechanisms to guide behaviour.

The rules should be easy to understand for income support recipients, trustees of super funds, financial advisers and income stream providers. A simplified system will support people to make good decisions.

The Government announced as part of its Retirement Income Framework that trustees must commence offering Comprehensive Income Products for Retirement (CIPRs) to members. We support this policy, but suggest that further consultation on the design and implementation of CIPRs is undertaken, to ensure simplicity for all parties.

We also suggest that CIPRs are renamed “MyRetirement”, to reflect the fact that they constitute the decumulation phase of the system, with MySuper constituting the accumulation phase. A retiree can then better understand the valuable role they can play in managing their retirement outcomes.

The Age Pension income and assets test thresholds add undue complexity to the interaction of the three pillars. Simplification of the income and assets tests should be considered.

Simplicity will result in greater understanding by individuals, reduced costs for providers, and will facilitate easier comparison of solutions from different providers, leading to greater competition and better outcomes for retirees, and less need for reliance on financial advice in all cases.

Adequacy

10. What should the Panel consider when assessing the adequacy of the retirement income system?

Adequacy of the retirement system should be measured against a target income replacement rate in retirement.

The ASFA Retirement Standard benchmarks the annual budget needed by Australians to fund either a comfortable or modest standard of living in the post-work years. It is updated quarterly to reflect inflation, and provides detailed budgets of what singles and couples would need to spend to support their chosen lifestyle.

We are of the view that a comfortable standard of living metric should be the minimum measure against which adequacy is measured. It provides a simple measure of a comfortable standard of living in retirement and is widely quoted and accepted in the industry. A single industry-supported measure would also provide greater confidence and understanding in the retirement system, which could be quoted in all income projections on statements to members.

Age	Modest Lifestyle		Comfortable Lifestyle	
	Single	**Couple**	**Single**	**Couple**
Around 65	$27,913	$40,194	**Around 65**	$27,913
Around 85	$26,450	$37,767	**Around 85**	$26,450

Source: ASFA Retirement Standard – September Quarter 2019, national

The Age Pension provides a base level of income, and the difference between the base pension and the comfortable lifestyle metric is the adequacy gap that needs to be addressed with compulsory superannuation, voluntary savings and retirement income products.

In order to improve adequacy and achieve the ASFA comfortable lifestyle, it is our view that the proposed increase in the Superannuation Guarantee contribution rate to 12% should be adopted. This would allow the Government to address sustainability and build confidence in the retirement system.

Equity

13. What should the Panel consider when assessing the equity of the retirement income system?

Determining the equity of the system should consider whether the concessions afforded by the system are in line with the benefits provided.

The possibility that the concessions allow the system to lead to sub-optimal and inequitable outcomes should be minimised, preferably by simplifying the rules.

As an example, additional savings can lead to a reduction in total retirement income (being income from Age Pension as well as additional assets), given the impact of the income and assets test thresholds on Age Pension entitlements. This has the potential to lead to inequitable outcomes and influence savings and investment decisions.

We suggest these tests would benefit from simplification, and as recommended in the Melbourne Mercer Global Pension Index 2019, the Government should consider "*moderating the asset test on the means-tested age pension to increase the net replacement rate for average income earners*". An option is to combine the income and assets test into one test, as suggested in the Actuaries Institute Green Paper "*Options for an Improved and Integrated System of Retirement*" (2019).

The Panel should also consider that there are many types of people in Australia and individuals are different. Any measure of equity should consider cohorts of individuals and assess whether the lifetime tax incentives are proportionately distributed across the current and future generations.

16. To what extent does the retirement income system compensate for, or exacerbate, inequities experienced during working life?

Inequities in the superannuation and retirement income system can occur where a person has taken breaks throughout their working life, and has not had the opportunity to build sufficient savings for their retirement. This can impact particularly on women who leave the workforce to raise children, or on those with a disability or mental health condition that affects their ability to work on a fulltime and permanent basis.

Similarly, low-income earners may not be able build up sufficient savings in their superannuation to achieve a comfortable lifestyle in retirement.

For those who are forced to leave the workforce either temporarily or permanently due to illness or injury, life insurance in superannuation acts as an important safety net, to replace lost income.

The Age Pension system should act as a safety net in retirement for those cohorts of people who have not built up sufficient superannuation savings; however this is not set at a level that can comfortably fund someone's retirement on its own. This means that the retirement income system will exacerbate inequities between those who can comfortably fund their retirement with their superannuation savings, and those who are solely reliant on the Age Pension.

We suggest that the Government consider policies to boost superannuation savings of people with broken work patterns and those on low incomes, and also commit to the target increase in the Superannuation Guarantee to 12%, to help all individuals achieve a better retirement outcome.

Sustainability

18. What should the Panel consider when assessing the sustainability of the retirement income system?

Australia's pre-paid superannuation tax model (whereby superannuation tax is collected on the way in and throughout, but not on the way out) is susceptible to intergenerational equity issues if tampered with in any significant way. Therefore it is important that the current system is continually improved so that each generation is as self-sufficient as possible. The Panel should consider the sustainability of the retirement income system over a period of the lifetime of the population, rather than over a three or five-year fiscal period.

Australia is the only system with no tax on retirement income. If an Australian accesses any of their superannuation as an income stream, the income earned on the capital supporting that income stream is concessionally taxed at 0%. Since 2017, a $1.6M transfer balance cap has applied as a limit on the total amount that can be transferred into the retirement phase. This has attempted to address the tax advantages flowing to retirees; however, the cap may be deemed to be overly complex from a customer understanding and an administrative perspective. We suggest the Panel consider a simpler model.

The current ability for a retiree to withdraw unlimited lump sums from their superannuation can have an impact on the sustainability of their retirement income. Introducing a requirement that part of a retirement benefit must be taken as an income stream (or greater incentives to take an income stream with longevity protection) should be considered, as was recommended by the Melbourne Mercer Global Pension Index 2019.

20. How can the overall level of public confidence be assessed? What evidence is available to demonstrate the level of confidence in the system?

During accumulation, the level of voluntary superannuation savings (particularly at ages well below preservation age) can act as a gauge of public confidence in the system.

Another indicator of confidence in the system is the level of take-up of annuities products. Australia has a comparatively low annuitisation rate (around 5%) relative to other countries around the world.

This is partly due to a lack of education, behavioural biases and a lack of suitable incentives. People are not aware of how to optimise their retirement savings across the investment products available (such as account-based pensions, deferred/immediate lifetime annuities and group self-annuitisation solutions).

Developing "MyRetirement" for a person's decumulation phase, to sit alongside MySuper in the accumulation phase, will provide a lifetime retirement income system that Australians can better understand, engage with and in which they can have confidence.

Cohesion

22. Does the retirement income system effectively incentivise saving decisions by individuals and households across their lifetimes?

Compulsory superannuation has forced the majority of Australians to save for their retirement, but this has not incentivised any active decision making about savings. The proportion of people that make additional, voluntary contributions to their superannuation balance is low.

Regardless, retirement balances are projected to increase significantly over time as salaries increase and the Superannuation Guarantee contribution rate rises.

In our view, the most impactful decisions for the retirement income system to incentivise are not savings decisions but spending decisions in the decumulation phase.

Many retirees are conservative in their drawdowns as they do not participate in any form of mortality pooling and do not want to spend their pensions too quickly and run out before they die.

Better education can provide greater certainty to Australians about their lifetime income, which would give them comfort to be able to draw down their superannuation. Equally, a MyRetirement system that offered and incentivised the purchase of simplified longevity protection products would lead to a more effective retirement income system.

25. What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?

We do not believe there is evidence that supports this, as the system is currently too complex for the average Australian to navigate without personalised financial advice.

The proportion of account based pensions and CommInsure Life annuity products that are sold without the assistance of a financial adviser is very low.

The complexity in retirement planning requires a thorough understanding of future income requirements and the integration between the Age Pension and superannuation systems, including means testing and tax treatment. Choosing an appropriate retirement income solution necessarily requires consideration of trade-offs between income, flexibility and risk management; a trade-off that can be difficult for individuals to assess. This complexity leads someone to seek financial advice to maximise their retirement outcomes.

We believe there will always be a role for advice in retirement planning, which should extend to more flexible methods such as robo-advice and general advice tools that can be made available to individuals.

However, a simpler system with better education could also allow an informed person to achieve their desired retirement income outcomes without seeking formal financial advice.

A MyRetirement solution offered by superannuation funds, with education in the lead-up to retirement and greater incentives to take out longevity protection products, could lead to better take-up of retirement solutions by members. We are keen to participate in Government and Treasury working groups to develop retirement product design and distribution principles to facilitate this system.

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