Retirement Income Review Secretariat
The Treasury
Langton Crescent
PARKES ACT 2600

31 January 2020

Dear Sir/Madam

Please find attached our submission to the Retirement Income Review.

About Optimum Pensions

Optimum Pensions Pty Ltd was established with a primary objective:

- *To positively change the attitudes of consumers and financial planners towards lifetime income stream products, so that retirees have at least 30% more income to improve their retirement lifestyles.*

A secondary objective is to help superannuation funds build their own products to achieve this, including an investment-linked product that we have designed called the Real Lifetime Pension – a practical application of the first objective.

Optimum Pensions are in discussion with over 40 of Australia's major superannuation funds. These funds know that, since 1 July 2017, they can manufacture their own investment-linked lifetime pension products by partnering with a specialist longevity insurer. Most are now waiting for the detail of the Retirement Income Covenant or alternative Legislation or Regulation to be finalized and the outcome of this Review.

We have chosen not to endeavor to address all section of the Review but keep the focus on the second pillar of the retirement income system (i.e. the Compulsory Superannuation pillar). We believe that the other issues need to be addressed however Compulsory Superannuation is where the most significant improvements can be made. Getting this right will help to resolve other imperfections in the retirement income system as well.

CONSULTATION QUESTIONS AND ANSWERS

Overview

Australia has one of the best retirement systems in the world when it comes to collecting and growing retirement savings. However, it needs to be pointed out that only one pillar is required to provide retirement incomes that are payable for people's lifetimes. The Age Pension pillar is required by way of legislation to make pension payments. Neither of the other two pillars have any such requirement.

The superannuation guarantee (SG) system is approaching maturity and millions of Australians are, or will be, relying on it to deliver robust, steady income that will keep pace with their living costs throughout their entire retirement. The Compulsory Superannuation and the Voluntary Savings pillars have developed as savings vehicles to date - without regard to the nature of any end retirement benefit, other than drawdown accounts known as Account Based Pensions.

The Financial System Inquiry made several observations about the current Retirement Income system:

- *At retirement, superannuation assets are not being efficiently converted into retirement incomes. This contributes to a significantly lower standard of living for some Australians in retirement and during their working life*
- *Economic growth will benefit if the growing number of retirees are able to sustain higher levels of consumption*
- *Tax concessions in the superannuation system are not well targeted at improving retirement incomes, which has a number of consequences*
- *Superannuation assets are not being efficiently converted into retirement including due to a lack of risk pooling and over-reliance on individual account-based pensions*

All of these observations are correct. In response, the Government proposed a Retirement Income Covenant for superannuation funds - with the aim of increasing the retirement incomes and hence the lifestyles (and consumption) of Australia's growing number of retirees.

The Productivity Commission has raised the following concerns about the proposed Retirement Income Covenant. However, these concerns were in fact solved when the relevant legislation was changed from 1 July 2017. The concerns mentioned in the Productivity Commission's summary report were:

- A concern that pooled lifetime income products may not suit the long-term needs of some members, may fail to take into account the diversity in household preferences and may not achieve the desired goal of increasing retirement consumption
- Concerns that superannuation funds without the capacity to create such products would be obliged to purchase them from a third party – where there are few choices currently on the market
- Concerns that the complexity of Australia's retirement income system combined with deficiencies in the credibility and affordability of financial advice leaves scope for member detriment from a requirement to offer pooled retirement products

In this submission we explain how the legislative changes that took effect on 1 July 2017 have effectively solved these concerns. By working with a specialist longevity insurer, even smaller superannuation funds can now create their own retirement products which take into account the full range of retiree objectives and preferences, including:

- Sufficient access to lump sums / flexibility
- High income that targets inflation increases
- Income that lasts for life (longevity protection)
- Investment choice – in line with their risk profile and which they can change if they wish – giving them some control over investment returns and thus their income
- A bequest motive (although this should not be the primary driver of any superannuation planning)

Superannuation funds commonly work with group life insurers to offer death, disability and income protection insurance cover to their members before retirement. In a similar way, they can partner with a specialist longevity insurer and provide pooled products that include longevity protection.

The legislation from 1 July 2017 removed previous impediments to this type innovation. It is important that the Retirement Income Review are aware of the positive impact these law changes have – and the efficiencies that the Compulsory Superannuation system can now achieve in delivering effective retirement income that has longevity protection built in.

Table 1: Products that superannuation funds can create by partnering with a specialist longevity insurer:

Superannuation product	Retiree objectives / preferences
Investment-linked pension	Longevity protection Confidence to spend their income without fear of running out of money Investment choice / allocation to growth assets Individual underwriting (based on their health status*) More favourable treatment under the Income Test Reversionary pension for spouse Death benefit in early years of retirement
Deferred investment-linked pension	Longevity protection at low cost Investment choice / allocation to growth assets Individual underwriting Reversionary pension for spouse

These products can complement an Account-Based Pension which provides access to lump sums and also allows investment choice.

* Note: "individual underwriting" means that each applicant for a lifetime product may complete a short questionnaire which seeks to establish their health status. Those in sub-standard health may receive an increased pension per annum – thus achieving equity between members and between members and the super fund manufacturer. International experience shows that this feature works very efficiently to ensure that every pensioner gets a fair deal.

In our response below we wish to:

- **Provide evidence that supports the FSI's conclusion: that using individual accounts i.e. Account Based Pensions (ABPs) for delivering retirement income is highly inefficient.** Centrelink data[1] shows that the median retiree spends much less than their assets can actually support. Ultimately this means around 30% of the money which enters the retirement phase becomes paid as a bequest, not as retirement income. This has an adverse impact on economic growth in Australia.

- **Highlight that the law changes from 1 July 2017 allow all superannuation funds to manufacture solutions to meet a wide variety of different retiree needs.** By combining product types together, super funds can help members to balance trade-offs between flexibility, high income, sustainability and bequest motives.

- **Explain that superannuation funds can partner with a specialist longevity insurer to do this in a highly cost-effective and safe way.** The superannuation fund can provide the administration and member service for longevity products and build the investment options (including products that benefit from exposure to growth assets) whist outsourcing the longevity risk to a longevity insurer - just like with group life and TPD insurance. Importantly, modelling by the Australian Government Actuary[2] shows that products which allow exposure to growth assets are often vital to ensure retirement income can keep pace with inflation for the two to four decades retirees now live after they retire.

- **Support the argument that every member deserves to receive top-quality advice when they enter retirement.**

[1] Asher, A., Meyricke, R., Thorp, S., & Wu, S. (2017). Age pensioner decumulation: Responses to incentives, uncertainty and family need. Australian Journal of Management, 42(4), 583–607.

[2] https://treasury.gov.au/sites/default/files/2019-03/Retirement-Income-Risk-Measure-FINAL-Consultation-1.pdf

The retirement income system

1. **Are there aspects of the design of retirement income systems in other countries that are relevant to Australia?**

   - Of note, in the USA, the Teachers Insurance and Annuity Association of America College Retirement Equities Fund (TIAA-CREF) is one of the largest, if not the largest, pension schemes in the world. Since 1952 TIAA-CREF has successfully offered investment-linked lifetime annuities that are voluntarily chosen by academics to deliver their personal retirement incomes. CREF invests primarily in equities and has over eight different investment choices. Given increasing lifespans, the number of years a person spends in retirement corresponds to a long investment horizon and having some exposure to growth assets is important to providing income that can keep pace with inflation.
   - In Chile advisers must undertake 120 hours of study and pass a specialist exam before being permitted to give advice to retirees[3].
   - Chile taxes lump sums lightly but sufficiently to encourage retirees to effect real lifetime pensions and annuities – and 80% of retires do so.
   - In Sweden, Denmark, Switzerland and Chile, where roughly 80% of retirees voluntarily effect real lifetime pensions (we use the word "real" to signify that incomes keep pace with inflation, which doesn't occur with an Account Based Pension – although its income may continue for life), the regulation of the product manufacturers is quite sophisticated. Australia will need to develop and acquire that regulatory framework.

[3] Rocha, Roberto, Dimitri Vittas, and Heinz P. Rudolph. 2011. "Annuities and Other Retirement Products: Designing the Payout Phase." International Bank for Reconstruction and Development, World Bank, Washington, DC. Page 103 Chile extensively regulates marketing activity in the annuity market. Pension advisers have to pass a certification test administered by the supervisory agency as well as a basic "fit and proper" test. Most applicants take a 120-hour course on annuities.

Purpose of the system and role of the pillars

2. Is the objective of the Australian retirement income system well understood within the community? What evidence is there to support this?

- At the highest level, yes, Australians understand that the objective is to ensure people can retire in their late 60s and still hope to have an adequate standard of living for life.
- However, there is little understanding of how the system actually achieves this. There is minimal understanding of the specific objectives of each pillar in achieving the overall objective.
- With the Age Pension, on the one hand, there is a belief that the Age Pension is an entitlement and that retirement decisions should be moulded around that entitlement, yet on the other hand, younger Australians have a belief that the Age Pension could cease or become unavailable in its current form when they get to retirement. As a result, very few Australians have any clarity about what income they can rely on in retirement.

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

- Projections of member's benefits until retirement and estimation of the annual income that accumulation might purchase is crucial. These projections should include account balances from all sources and the potential Age Pension. Such projections (the results of which will change over the years) are merely a guide. There is no guide at present, except that you'll receive a relatively large balance at retirement – which is misleading information.
- Every Australian deserves an answer to the question "What income can I rely on receiving in retirement?". Policymakers, financial planners, compliance staff, regulators and product manufacturers should refer to the paper "*Good Practice Principles for Retirement Phase modelling*" presented at the Actuaries Institute Financial Services Forum[4] in 2016 and sets out the techniques required to answer this question for Australians.
- There is a need to raise awareness that using averages in retirement projection models masks the risk that individual retirees face and hides the outcomes that many retirees experience in practice. In probability theory, the "law of large numbers" shows that the average of the results obtained from a large number of trials is close to the expected value. However, this theorem should not be applied to individual households which only have one

[4] https://www.actuaries.asn.au/Library/Events/FSF/2016/HenningtonLangtonRetirement.pdf

or two people in them. Studies show that the decisions made by people in retirement are heavily influenced by concerns around the personal risk they face about living too long and/or experiencing poor returns. The chart below Question 7 demonstrates the wide range for how long lifespans actually are. Over 50% of retirees live past the average and large numbers of them will live to age 90, 95 and even 100+.

- There is a need for policymakers, financial planners and those who design and distribute retirement products to understand the inefficiency of having individual accounts for retirement, and the consequences this has. It means each household must either take a "coin-toss" chance on their retirement or maintain a reserve to 'self-insure' their retirement risks. Studies show that most retirees avoid spending their assets in retirement and ultimately this reserve becomes a bequest when they die. It means that 30% of the money entering the retirement phase is not actually used as retirement income.
- There is a need to understand that growth assets are an essential part of funding long-term income that keeps pace with inflation over the two or three decades of retirement, and that the 'investment-linked pension' product class can facilitate this.
- There is a need to raise awareness of the lifetime income products that superannuation funds can now (but don't yet) safely manufacture since 1 July 2017, and how these products can be combined to meet the various preferences and objectives of different households whilst also providing longevity insurance and exposure to growth assets.

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

- Government: It is the government's role to design the retirement system, including things like the Retirement Income Covenant, taking into account expert opinions, academic research and behavioural biases. The responsibility also includes having regard to the needs of the individuals and the country as a whole, and the ability to sustain the system. The SG system is an excellent example of the government achieving this to solve Australia's saving problem. Australians accept paying 9.5% superannuation irrespective of their diverse preferences, incomes and assets during their working lives. Australia is now depending on the Government to move forward and complete this work – to ensure the retirement phase of Compulsory Superannuation delivers on what it promised to do – provide a lifetime income in real terms.

- Private sector: To support and implement this system efficiently in members' Best Interests, provide valuable practical feedback to Government and to help to educate and support individuals as they engage with the system
- Individuals: To support this, engage with the system and to value it. While individuals can seem to be spooked by the many changes (good and bad) they all need more education about superannuation and retirement, so they can save themselves from a poor income in retirement, by saving harder and making informed decisions themselves.

5. The Panel has been asked to identify the role of each of the pillars in the retirement income system. In considering this question, what should each pillar seek to deliver and for whom?

- Australians needs clarity on whether the Age Pension is a safety net (i.e. welfare) or is a key part of each Australian's retirement plan that they should adapt their other resources around. This may encourage further self-help by contributing at higher levels.
- Every Australian deserves a clear answer to the question "What (total) income can I rely on in retirement?" as well as "How much will this change if I save more or less into superannuation?" Obviously, the answers to these questions need to take into account any Age Pension the household will receive. The Age Pension gets assessed at household level and takes into account all financial resources of both members of a couple. As such the Age Pension income can be highly irregular and time varying due to the means tests and market volatility.
- If access to the Age Pension is to become more restricted or phased out over time as the SG system matures and can take its place for the median retiree then this should be designed and clearly communicated. Without this clarity the question of whether to increase the SG contribution from 9.5% to 12% is somewhat meaningless. Clear policy is required to set out the target portion of retirement income funded by the Age Pension versus Compulsory Superannuation for each different age cohort. Obviously younger Australians will have more of their working life covered by SG than older Australians whose working lives commenced before 1992. Any policy must take into account that this impacts the median superannuation balance for each age group.
- The increasing reliance on Compulsory Superannuation for delivering retirement income escalates the importance that superannuation funds deliver real lifetime income products not just tax-incentivised savings where one third of what gets saved is paid as bequest benefits to non-members such as children, not as retirement income to surviving members.

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?

- From the Australian Government's (or taxpayers') viewpoint, for each dollar of retirement income available to each retiree, the Age Pension costs more than the SG system, so it would be desirable for the SG system to grow over time in order to replace the Age Pension as much as possible. However, the Age and similar Pensions will still be needed for those, for example, who were unable to work. This trade off requires members to receive their retirement benefits in income form. It will be even more important for retirees to receive real lifetime incomes.

The changing Australian landscape

7. Demographic, labour market, and home ownership trends affect the operation of the retirement income system now and into the future. What are the main impacts of these trends? To what extent is the system responsive to these trends? Are there additional trends which the Review should consider when assessing how the system is performing and will perform in the future?

- The superannuation system needs to be more cognisant of the wide dispersion around how long individuals actually live. Many financial planners assume that retirees will live until their life expectancy plus a few years. However, a large percentage of retirees live well past this age. Chart 1 on the following page (using ABS data) shows exactly how many females in Australia died at each age over 65 in the calendar year 2016. This highlights how inappropriate it is to assume everyone dies at their life expectancy or soon after.
- Individuals generally have no idea whether they (and/or their spouse) will be one of the ones who live into their late 90s or one of the ones who die in their 70s for example.
- Establishing a retirement income by only using an individual account (ABP) that assumes average returns and average life expectancy will very rarely deliver the most effective retirement income. In fact, using an ABP only reliably provides the best outcome for people who ***know*** they are going to die before their life expectancy. Everyone else can design a more appropriate retirement income plan by allocating some money to a pooled retirement product.

Chart 1: Actual age of death of female retirees who died during 2016[5]

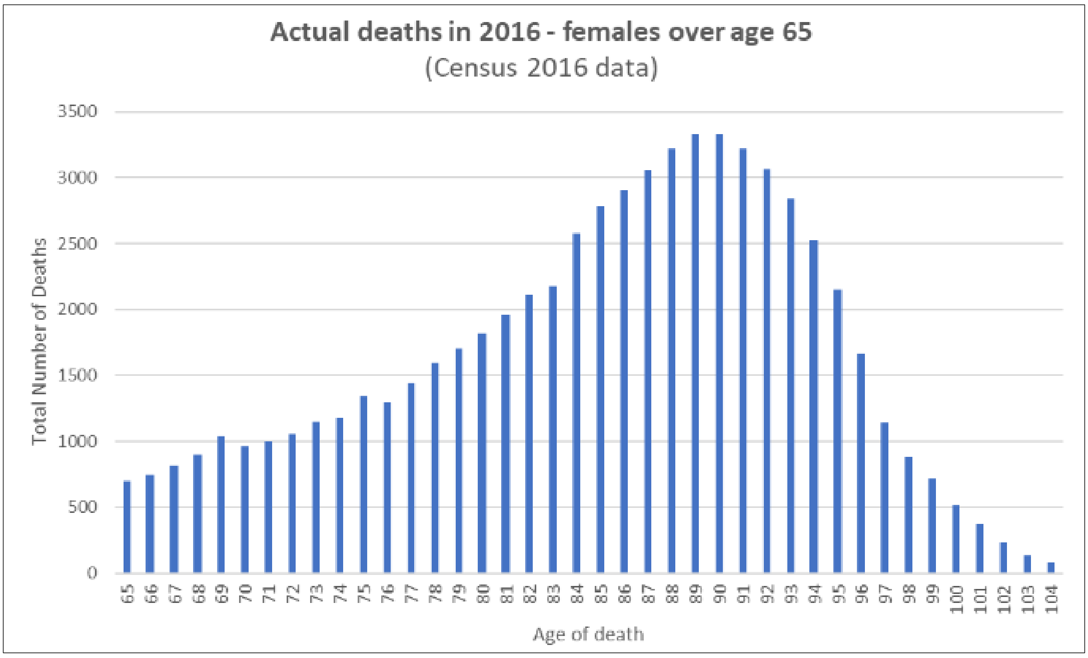
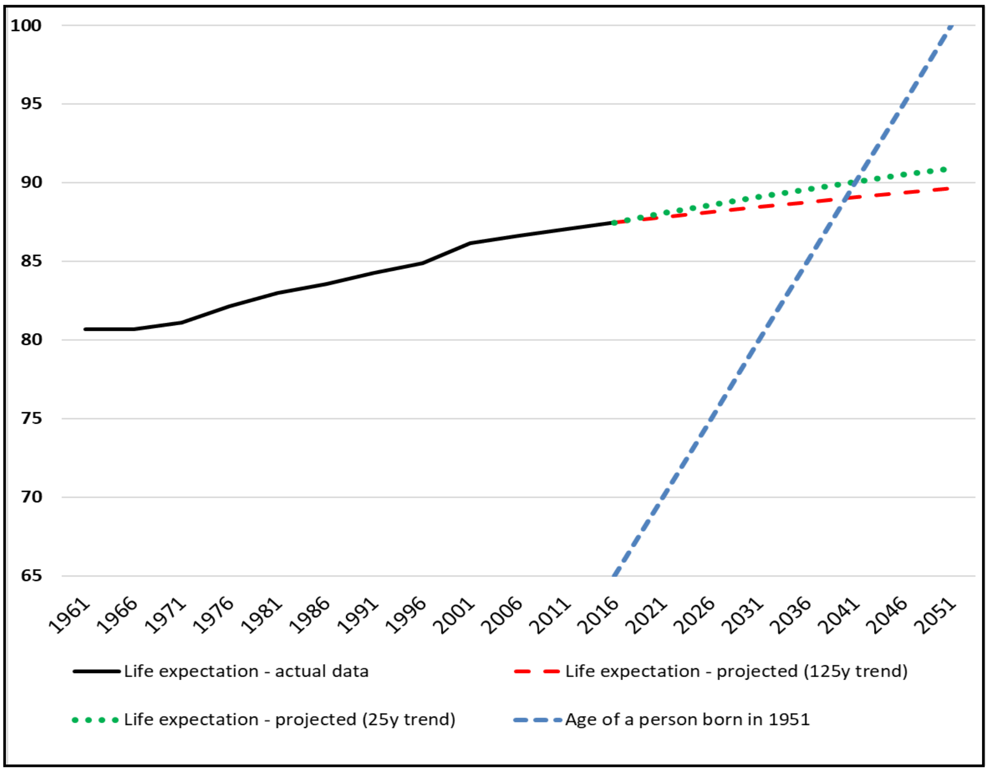


Chart 2: Actual and projected average lifespan - female age 65



[5] Source: https://www.abs.gov.au/AUSSTATS/abs@.nsf/DetailsPage/3302.02016?OpenDocument

- Chart 2 (refer previous page) demonstrates how average lifespans of retirees have increased by 40% since the 1960s. It also shows how these increases are expected to continue in the future – based on the estimated improvement factors from the Australian Government Actuary (using over 130 years of Australian mortality data). The line increasing diagonally from 2020 shows the increasing age of a 65 year old who enters retirement today. It clearly shows how, by the time today's retirees reach their life expectancy, average lifespans will be longer than they are now. It is important to note that this chart only shows the average. As per Chart 1, individual lifespans will show a wide dispersion.
- The issue of the increasing lifespans and the dispersion around the Mean puts a major responsibility on the retirement phase of superannuation to offer effective and efficient products to provide longevity protection and give retirees confidence to consume.
- Worryingly, it is non-homeowners who need lifetime income from their superannuation the most. This is because the actual cost of renting exceeds the amount that social security allows for – with the difference needing to come from the person's private resources across their entire life.
- The number of people who will be retiring over the next few decades is expected to change the ratio of taxpayers to retirees from the current 4:1 to 2.5:1[6]. This further increases the importance that tax concessions are fully focussed on delivering retirement income, not bequests, and to further encourage or require super funds to provide real lifetime pensions rather than ABPs in isolation.
- Behavioural science has shown that individuals sometimes have known biases in their thinking, and this can result in sub-optimal decision making. The SG system was designed to compensate for this type bias and has successfully addressed Australia's saving problem. Notably:
    - Many people don't naturally make appropriate saving (or dis-saving) decisions. Prior to the SG system's introduction in 1992 less than around half of the workforce had any superannuation (32% in 1974 and 51.3% in 1988[7]). Those who were members were typically public servants and those employees who worked for companies that provided superannuation as part of the employment package.
    - A secondary effect from this kind of behavioural bias is that superannuation industry innovation is <u>not</u> driven by consumer demand. It comes instead from Government - whose role is to

[6] United Nations research quoted by the Productivity Commission
[7] www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BN/0910/ChronSuperannuation

intervene when markets aren't operating efficiently themselves[8]. Other examples of this are the automotive industry. Consumers were not the ones who initially demanded air bags, anti-skid breaking or side impact bars. Likewise, without Government intervention, the superannuation sector would have no SG system, no account-based pensions, no MySuper and no SuperStream.

- Studies of Centrelink data between 1999 and 2007[9] show that the median retiree seems reluctant to see their savings balance reduce as they get older in retirement and passes away with assessible wealth (mainly financial) equal to 90% of the assets recorded at first observation. This isn't what the superannuation system was meant to achieve.
- This implies that pensioners try to only spend the investment income on those assets and means their consumption is less than their assets can actually support. A more efficient approach would be to turn their entire balance into lifetime income. Uncertainty about each individual's lifespan means none of them can achieve this effectively by using individual accounts. Only products that pool longevity risk can take advantage of the 'law of large numbers' and allow retirement income to be designed based on average life expectancy.
- Overseas studies show that retirees on lifetime incomes (e.g. annuities) have higher levels of satisfaction in retirement, even taking wealth effects into account. See Chart 5 (refer to Question 19).

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?
9. How does the system balance each of the principles and the trade-offs between principles (e.g. sustainability and adequacy) under current settings? What is the evidence to support whether the current balance is appropriate?
    - Generally, the principals proposed by the Panel represent a sensible approach. While these principles are deemed suitable, they do need to have a greater emphasis on retirement incomes, recognizing that the second and

[8] https://www.pmc.gov.au/sites/default/files/publications/Australian_Government_Guide_to_Regulation.pdf
[9] Asher, A., Meyricke, R., Thorp, S., & Wu, S. (2017). Age pensioner decumulation: Responses to incentives, uncertainty and family need. Australian Journal of Management, 42(4), 583–607. https://doi.org/10.1177/0312896216682577.

third pillars need to provide incomes and not just be retirement savings vehicles that provide lump sum benefits – such as the Account Based Pension which provides drawdowns.

- Retirees will also look for simplicity and flexibility. We believe that these should be added to how the system is assessed.

Adequacy

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

- Assessments of adequacy must be time varying – i.e. assessed at each future age given the number of external factors that can change a person's income *after* the point they have retired. For example, the Age Pension means tests or the impact of outliving one's assets. Adequacy assessments must also involve stress testing – to give confidence in relation to potential market risk, inflation risk and longevity risk
- The paper 'Good Practice Principles for Retirement Phase modelling'[10] presented at the Actuaries Institute Financial Services Forum in 2016 explains this in detail - through the eyes of consumers and the decisions and risks that they face in retirement.

11. What measures should the Panel use to assess whether the retirement income system allows Australians to achieve an adequate retirement income? Should the system be measured against whether it delivers a minimum income level in retirement; reflects a proportion of pre-retirement income (and if so, what period of pre-retirement income); or matches a certain level of expenses?

- Absolute measures can be used to ensure that the retirement income system delivers a floor income to all retirees. E.g. The ASFA modest retirement income standard.
- Relative measures can be used to help retirees to achieve a consistent living standard both before and after they retire. E.g. a 70% replacement rate compared to salary prior to retirement.
- All measures must allow for inflation in retirement and be stress tested to take into account how long the income lasts for all retirees such as in Chart 1 (refer to Question 7).

[10] https://www.actuaries.asn.au/Library/Events/FSF/2016/HenningtonLangtonRetirement.pdf

12. What evidence is available to assess whether retirees have an adequate level of income?

- Until an adequate level of income is defined, it is not possible to assess whether or not retirees have an adequate level of income.

Equity

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

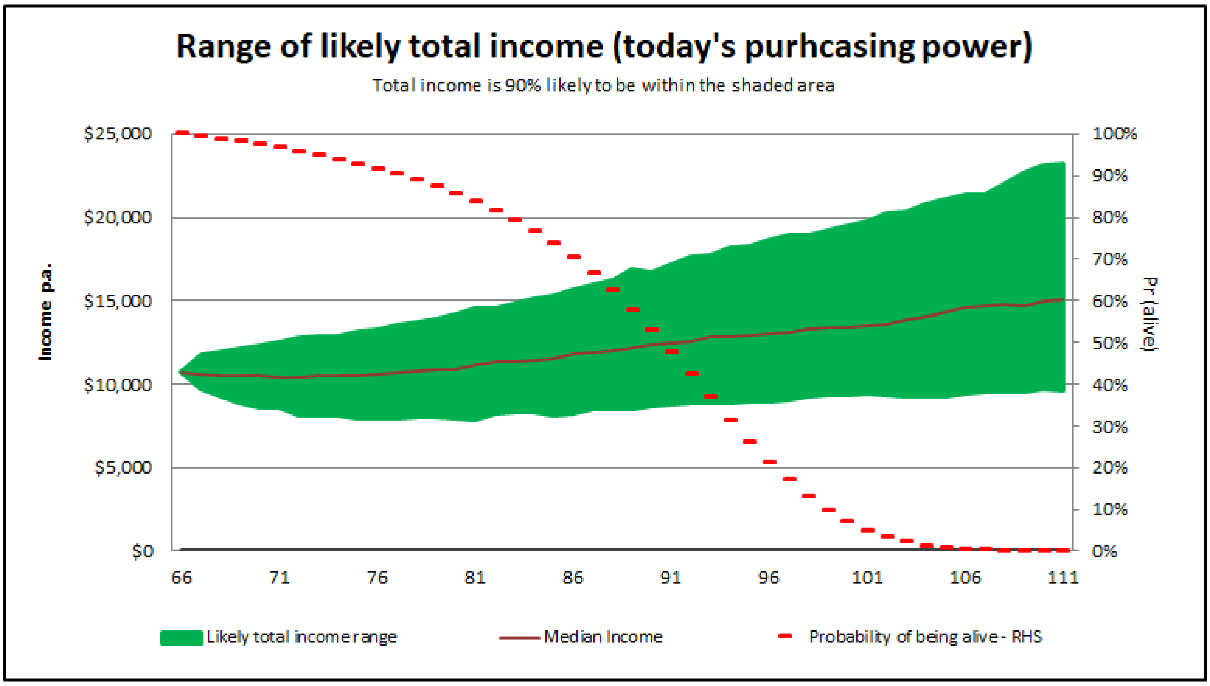
- Individual underwriting of pooled retirement products can act to ensure those with shorter life expectancy do not subsidise those with longer life expectancy. E.g. blue collar workers subsidising white collar workers, or smokers subsiding non-smokers.
- Individual underwriting is similar to the type of underwriting and personal profiling carried out when a person applies for life insurance. In the case of pooled retirement products, it means that people with shorter life expectancy receive a higher annual income than those who are likely to live for longer. This works to ensure each retiree gets a fair deal.
- The retirement income product designed by Optimum Pensions and presented to over 40 superannuation funds facilitates individual underwriting.
- Also, tax concessions should be specifically focussed on delivering retirement income, not just retirement savings. The consequence of an inefficient retirement phase within concessional superannuation system is that taxpayers must also pick up the burden of funding higher Age Pensions for those whose incomes are insufficient or have run out.

14. What factors and information should the Panel consider when examining whether the retirement income system is delivering fair outcomes in retirement? What evidence is available to assess whether the current settings of the retirement income system support fair outcomes in retirement for individuals with different characteristics and/or in different circumstances (e.g. women, renters, etc.)?

- As referred to earlier, Centrelink data shows the that median pensioner is spending less than their assets can support, resulting in enormous levels of retirement wealth ultimately paid as a bequest on death, not as retirement income. The FSI highlighted that this could be improved through some allocation to pooled retirement income products that insure personal longevity risk.

- The following charts (Charts 3 and 4) show the projected range of income that could be expected by using a pooled retirement product (an investment-linked pension) compared to a typical account-based pension offered by superannuation funds today. In both cases we assume the asset allocation is 'balanced' (with 70% allocation to growth assets).
- In each chart we assume a 66-year old female in good health with $200,000 in a balanced superannuation option. The green shading shows the results, in today's purchasing power) of 1,000 stochastic projections of investment returns and inflation (CPI) over the next 45 years. There is an estimated 90% chance that her income will be somewhere within the green shaded area each year of her life (i.e. there is a 5% chance it will fall below the green shaded area and a 5% chance it will exceed the green shaded area).
- The investment and CPI simulations were provided by consulting actuaries 10E24 Pty Ltd. An allowance of 0.5% for admin and 0.6% for investment management fees has been made.

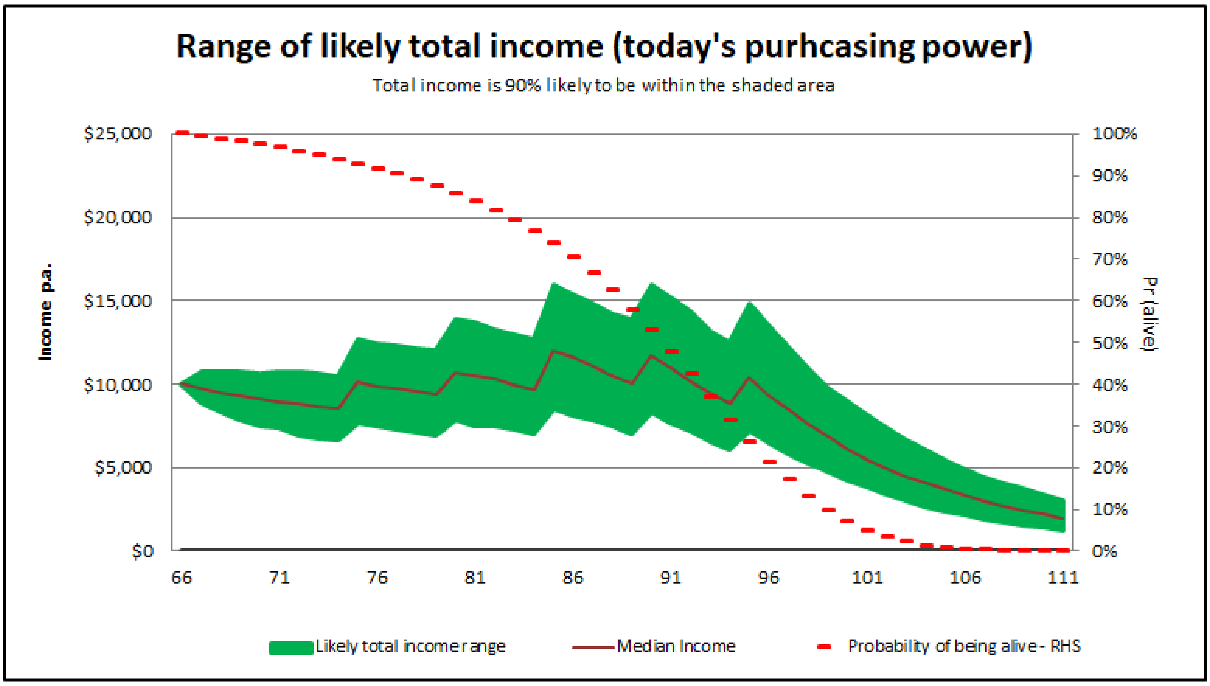
Chart 3: Projected income from a pooled longevity product (investment-linked)



  - The pooled product is based on the Real Lifetime Pension design by Optimum Pensions. The pension factor used assumes that the investor comes from a representative sample of people who have both blue and white collar background. It assumes a 15 year guarantee period, meaning that on early death, a minimum of 15 years' income is payable.

- In addition to the administration and investment management fees, an assumption of 0.5% of assets p.a. for longevity insurance is also made.
- The red dashed line shows her probability of being alive at each age based on ALT2015-17 with 25 year improvement factors.

Chart 4: Projected income from an account-based pension



- For the account-based pension projection above, she is assumed to elect to receive the standard minimum income level. The minimum is an age-based percentage of her evolving account balance at each age. The percentage starts at 4% for those under age 65 years, then increases in increments at ages 65, 75, 80, 85 and 90 until it hits 14% at age 95. This explains why the green shading steps up at those ages.
- The median income falls in real terms between age 66 and 75 then steps up each time the minimum percentage increases. From age 95, when she still has a 26% chance of being alive, it starts to fall dramatically.
- On death, any balance remaining in her ABP is paid as an unintended death benefit to her dependants or, if no dependants, to her estate.

15. Is there evidence the system encourages and supports older Australians who wish to remain in the workforce past retirement age?

- For those who choose to retire later, lifetime income stream products pay a higher annual rate of income. For example, indicative rates of income from an investment-linked pension paid to a single male in good health with $200,000 in super are:

Table 2: Annual income from a pooled product by age of purchase

Retirement Age	Indicative income from a lifetime income stream product designed to target inflation increases over time	Uplift for delaying retirement
60	$10,150 p.a.	-
65	$11,450 p.a.	13%
70	$13,250 p.a.	31%

16. To what extent does the retirement income system compensate for, or exacerbate, inequities experienced during working life?
17. What are the implications of a maturing SG system for those who are not covered by compulsory superannuation?

We have chosen not to respond to these questions.

Sustainability

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

- As discussed in Question 7, the Panel must consider the wide dispersion for how long actual retirees live and the products they require to achieve confident outcomes in light of this uncertainty. See Chart 1 (refer to Question 7).
- It also must consider the impact of market uncertainty and future inflation. Please refer to Charts 3 and 4 (refer to Question 14) (the stochastic projected income charts). In both examples, the investment option chosen is a typical superannuation balanced fund (70% allocation to growth assets).
- Given retirement typically lasts for two to three or more decades, having some allocation to growth assets is needed to ensure that income can keep

pace with inflation. For a detailed explanation of overall risk faced in retirement and the potentially counterintuitive fact that growth assets can result in a 'safer' overall retirement income, we refer to the Government Actuary's paper which accompanied Treasury's Retirement Income Disclosure consultation[11].

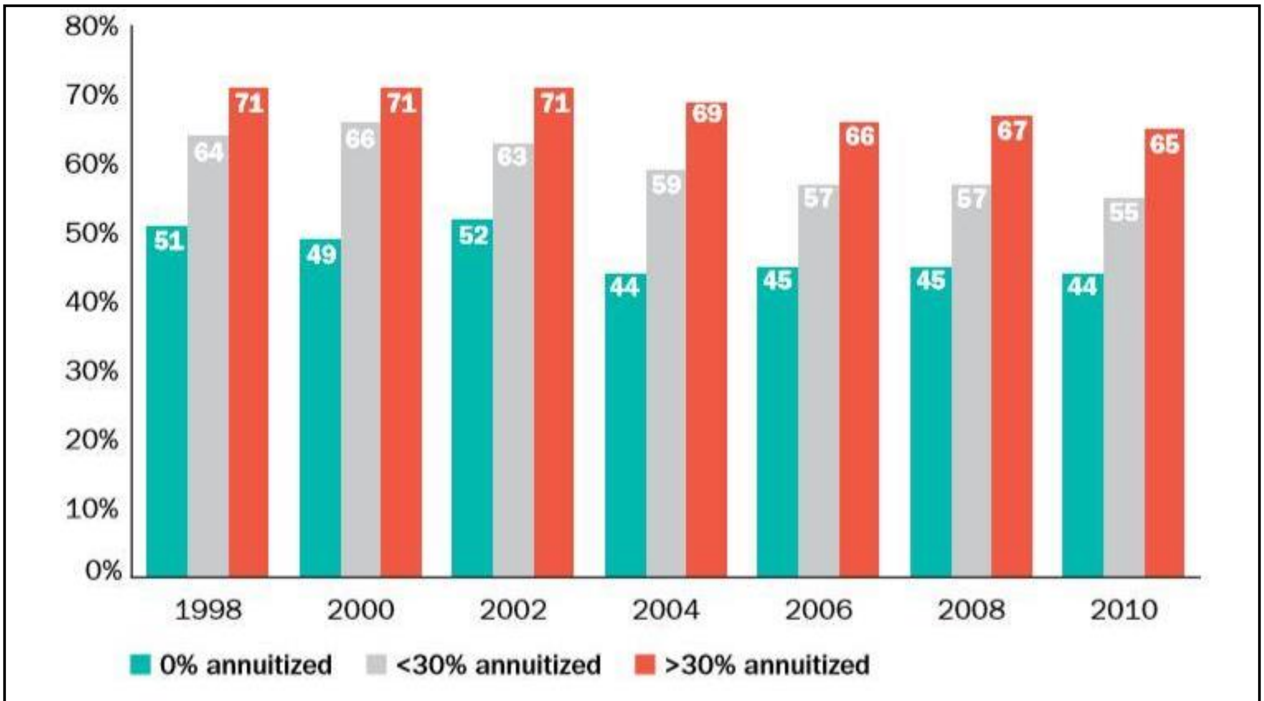
19. What factors should be considered in assessing how the current settings of the retirement income system (e.g. tax concessions, superannuation contribution caps, and Age Pension means testing) affect its fiscal sustainability? Which elements of the system have the greatest impact on its long-term sustainability?

- As noted by the FSI, Australia's economic growth will benefit if the growing number of retirees sustain higher levels of consumption. The current system has retirees under-spending compared to what their savings can support.
- The ratio of taxpayers to retirees is expected to decrease from the current 4:1 to 2.5:1[12]. The burden of the Age Pension and aged care on taxpayers should be reduced by ensuring that Compulsory Superannuation is more effectively put toward retirement income - rather than the Government needing to provide income to retirees who DO have the means to support themselves.
- A change to the retirement income system that requires part of superannuation savings to be used as a lifetime income stream at retirement could result in many benefits, as follow: -
  - The Government will have put in place a long-term solution to help contain increasing Age Pension and aged care costs.
  - Taxpayers will benefit from this cost containment.
  - The superannuation and life insurance industries will benefit by retaining more members to confidently manufacture efficient products and help reduce unit costs.
  - Higher levels of retirement phase assets will allow higher and longer-term investments to be made to help the economy.
  - Individuals will benefit by having a sustainable lifetime income stream that provides a better standard of living than they would have otherwise. Higher spending by the growing number of retirees will benefit economic growth.

[11] https://treasury.gov.au/consultation/c2018-t347107
[12] United Nations research quoted by the Productivity Commission

- Research indicates that retirees are happier when their retirement income is regular, lasts for life and is more certain. The following chart is based on a University of Michigan study of over 20,000 retirees. It shows that those who annuitized part of their retirement savings have higher levels of retirement satisfaction than those who did not.

Chart 5: US retiree satisfaction rates by extent of annuitisation, full sample, 1998-2010



Source: Towers Watson

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

   - The Melbourne Business school has commenced a three-year project investigating key public perception issues within the Australian Retirement Ecosystem. The goal is that by understanding the viewpoints of all key members of the ecosystem (i.e. government agencies, financial planners, superannuation funds, the media, consumers) we are better able to identify the mechanisms that will assist retirees to adequately plan for their retirement and obtain financial security. A key aspect of this research is to deeply understand the viewpoint of consumers and how people make decisions about retirement. Please refer to the Melbourne Business School page for publications and research outputs: https://go.mbs.edu/orford/

Cohesion

21. What should the Panel consider in assessing whether the retirement income system is cohesive?

    - Please refer to the paper "Good Practice Principles for Retirement Phase modelling" presented at the Actuaries Institute Financial Services Forum[13] in 2016. This sets out clearly the challenges that Australian retirees face in trying to fund their consumption for life by combining the Age Pension, superannuation and non-superannuation assets.

22. Does the retirement income system effectively incentivise saving decisions by individuals and households across their lifetimes?
23. What evidence is available to show how interactions between the pillars of the retirement income system are influencing behaviour?
24. What is the evidence that the outcomes the retirement income system delivers and its interactions with other areas (such as aged care) are well understood?
25. What evidence is there that Australians are able to achieve their desired retirement income outcomes without seeking formal financial advice?
26. Is there sufficient integration between the Age Pension and the superannuation system?

CONCLUSIONS

GOVERNMENT ACTION TO DATE

Since the Financial System Inquiry was completed, the Government, Treasury and APRA have done a commendable job of enabling the superannuation industry to encourage their members to use lifetime income products.

[13] https://www.actuaries.asn.au/Library/Events/FSF/2016/HenningtonLangtonRetirement.pdf

This work has included:

- removing legislative impediments in July 2017,
- proposing a Retirement Income Covenant,
- providing social security incentives,
- carrying out behavioral research and designing a framework for presenting and disclosing retirement income products to members.

The action by the Government has provided an opportunity for superannuation funds to develop a new approach to developing or adopting retirement income solutions that will:

- Let all superannuation funds create their own pooled retirement products in a cost-effective and safe way by partnering with a specialist longevity insurer.
- Build longevity products that meet the varying long-term needs of members - including the 50% of Australians who live past life expectancy.
- Build solutions that combines these products in order to take into account the diversity in household circumstances and preferences.
- Build products that are equitable for all retirees irrespective of their health status – through use of individual underwriting similar to when a person applies for life insurance.
- Allow pooled longevity products that facilitate exposure to growth assets – given the long investment timeframe of modern retirement.

Historically, most superannuation funds rely on Government to legislate before implementing improvements. It is therefore imperative the Government continues what the SG superannuation system started so that Australia once again leads the world by confidently and effectively completing the retirement phase of our Compulsory superannuation system.

Yours sincerely

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