APOLLO

Consultation: Retirement Phase of Superannuation

Introduction

Apollo and Athene welcome the opportunity to comment on Treasury's recent discussion paper on the "Retirement phase of superannuation". As an organization, one of our core missions is to empower retirees and we look forward to sharing some of our key learnings to date as well as our perspectives on the future.

Globally, the retirement challenge is increasingly shifting from one primarily focused on ensuring sufficient savings at the time of retirement to one of providing sufficient and stable income to support a dignified retirement. This task has been made more difficult by secular shifts in global markets that have resulted in increasing correlation and volatility across public asset classes exposing retirees to meaningful drawdowns at times when they can least afford it. Many of the tailwinds that have bolstered markets over the past decade, and beta strategies in particular, are no more. This requires a re-think of the fundamental approach to ensuring that retirees continue to be able to sufficiently save for and draw income in retirement[1].

The Australian superannuation system has served as a beacon of success in the savings phase of retirement since its inception 30 years ago. The combination of increasing compulsory savings rates, flexibility and choice, a push for economies of scale, and expansion beyond public assets has enabled the system to grow to the fourth largest pool of retirement assets globally[2]. This success in accumulation brings about an increasing responsibility to members during the drawdown phase of retirement as super balances become a more central source of income alongside government support and private savings.

Meeting this obligation means solving a complex challenge that requires a better understanding of members, increased engagement and advice, and a different lens on the measurement of success. While no global market has developed a complete solution, there are important examples of both success and failure which can usefully inform a go forward view of optimization. Australia has the unique opportunity to leverage these past learnings to be at the forefront of delivering great value and security to retirees. The framework and approach developed today will have broad repercussions on the retirement outcomes of Australians in the coming decades, so it is important to think both broadly and boldly.

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[1] Following the 2008 Global Financial Crisis the US Federal reserve embarked on a long era of monetary expansion, cutting interest rates to zero and implementing several rounds of quantitative easing. Coupled with US$4.7trn of COVID stimulus, the Federal Reserve's balance sheet grew to US$8.1trn in 2022. As the expanded monetary base worked its way through the system, aggregate demand surged with consumption geared toward durable goods which, when coupled with supply issues, resulted in skyrocketing inflation. To combat rising inflation, the Federal Reserve reversed policy and embarked on a rate-hiking cycle, ending Quantitative Easing, and beginning the unwind of its balance sheet. This about face has resulted in the dramatic revaluation of public asset prices.

[2] APRA Superannuation Statistics September 2023

Global Perspectives on the Retirement Puzzle

Providing for a dignified retirement is a universal challenge. This gives rise to shared themes that are contrasted by diverse global approaches to policy, regulation, social safety nets, and retirement systems. This variation provides fertile ground for studying what has and has not worked and using these learnings to guide new thinking around providing optimal retirement outcomes for Australians.

What Hasn't Worked?

- **No choice but to make a choice:** As retirement systems globally shifted from Defined Benefit to Defined Contribution, largely disengaged members were increasingly forced to make critical decisions without appropriate education and support. This reliance on active choice has resulted in sub-optimal decision making and outcomes for savers and retirees with many members opting for the most conversative option or, in some cases, the naïve diversification of allocating an even percentage across all investment options. Quite simply, for most members, financial planning is not a core competency. Nevertheless, defined contribution systems have placed substantial burden on them to make optimal financial decisions.
- **Retirement, hold the retirement income:** Lack of attractive retirement products and suitable disincentives to high lump sum take up rates at the point of retirement has resulted in members pulling their assets out of the system and losing the benefit of plan scale, paying higher retail fees, and exhibiting a higher likelihood to overspend or over save.
- **Lost in the product supermarket:** As product choice in plans increased, advice capabilities and capacity often failed to keep pace. This resulted in lack of understanding for members and a lack of scale for plans with both outcomes having real economic cost to retirees. Embedding innovative solutions within broader strategies, coupled with enhanced engagement and education, offer one path to helping better guide retirees to make optimal decisions with respect to their financial future.
- **Liquidity for the sake of liquidity:** Retirement is inherently a long duration investment challenge. Even newly retired individuals have on average a 20-year plus investment horizon. While liquidity is an important consideration, capturing an appropriate illiquidity premium is equally important. Retirees in many global markets are over-indexed to liquid public assets foregoing a critical source of durable alpha and diversification to support long term portfolio growth. To date, Australia has successfully leveraged institutional asset management capabilities to embed less-liquid assets within broader strategies offering retirees the best of both worlds. In addition, excess liquidity has the potential to exacerbate members' tendency to focus on short-term performance resulting in over-trading. This is particularly evident in volatile markets, where members often sell-low and buy-high, ultimately driving worse portfolio outcomes.

What Has Worked?

- **DB-ification of DC:** Embedded solutions that intelligently manage risk and return can provide meaningfully enhanced retirement outcomes. Participants are asked to make fewer decisions and are guided or defaulted into products and services that help them achieve the best retirement. This concept of a "soft default"[3] coupled with product innovations like target date funds / lifecycle funds and features like auto-escalation have driven higher adoption rates and improved scale. Essentially, these innovations address one of the most pronounced risks members face as they save for and spend money in retirement, irrational behaviors undermining long-term outcomes. In a survey of retirement providers, 89% agreed that "to be effective, retirement income solutions must be a part of the default investment."[4]
- **Reach for stars, but with a safety net:** The incorporation of downside protected, or capital guaranteed, investment options that also provide upside participation can be an effective way to mitigate sequencing risk while still driving long-term returns. In the U.S. this has been supported by regulatory and system changes[5] that have increased plans' ability to embed innovative products, like indexed annuities[6], into default options.
- **Bigger may be better:** Economies of scale have driven lower fees and brought institutional-grade asset management capabilities to what is effectively the retail market. In Australia for example, the trend to partially in-source asset management coupled with enhanced pricing power has enabled larger funds to charge members approximately 50% lower fees on average than smaller funds[7].
- **Taking retirement product "to go":** As product innovation accelerated an increasing focus on portability (or in the absence of portability liquidity) has been important in ensuring that members retain flexibility and reducing the risk of legacy products. This has been a key innovation in the annuity space in the U.S. market which has greatly increased members ability to access guaranteed accumulation and retirement income seamlessly within their 401k defined contribution plan and then, if desired, rollover that income solution to an individual retirement account.
- **Riding the digital wave:** Given the volume of members moving into retirement in the coming decades, the ability to provide effective, low-cost advice at scale is critical. A high-tech, high-touch personalized approach coupled with the ability to speak to a financial professional via phone, video, chat, or in person as desired allows participants

[3] Soft defaults allow members to opt out at their discretion.
[4] RLF 2021 Retirement Income and Advice Survey
[5] Regulatory changes include the SECURE Act in the U.S., which grants "safe harbor" to employers seeking to offer in-plan annuities.
[6] Indexed Annuities provide policyholders with a level of upside participation in the underlying index (e.g., S%P 500) with full downside protection via a 0% return floor; these products have gained increasing traction globally and have naturally evolved to offer tailored downside levels and more bespoke underlying index choices (e.g., volatility controlled, multi-asset, etc.)
[7] APRA Statistics

to choose the method of engagement that best suits their needs. This focus on "meeting participants where they are" is becoming an increasingly prevalent theme in markets like the U.S.

Case Study: Robo-advice / Managed Account to Drive Better Outcomes

- Financial services firm launched managed account program that provided personalized investment strategies tailored to employees' financial goals and risk profiles.
- The program featured dynamic portfolio management enabled by digital advice and educational resources to support better financial decision.
- Feedback highlighted that participants highly valued the personalized approach and improved outcomes. Key challenges included engaging members, adapting to regulatory change, and ensuring data security with technology integration.

Figure 1 Case Study: Key Outcomes

What Might Optimal Look Like?

The diverse circumstances of members as they enter retirement means that a one-size-fits all solution will struggle to provide optimal outcomes to all members. Products should seek to target key objectives (e.g., certainty of income, downside protection, growth, etc.) and can then be leveraged in a building-block approach to best support individual cohorts. This cohort-based approach, as highlighted in the Retirement Income Covenant, allows funds to support members in mass and enables product development efforts to be focused on the most at-risk members to enhance the societal impact. Recognizing that super funds will always inherently possess imperfect information on members, development of digital engagement tools that allow members to self-cohort can enhance the overall effectiveness of solutions.

Below is an illustrative framework that highlights how objectives and key risk factors are likely to vary by cohort and where new product technologies may be additive in improving retirement outcomes.

	Cohort 1: Lower Balance	Cohort 2: Middle Balance	Cohort 3: High Balance
Age Pension Benefit	**Full**	**Partial**	**None**
Primary Source of Retirement Income	**Age Pension**	**Age Pension + Super**	**Super + Discretionary Savings**
Expected Volatility in Replacement Ratio	**Low**	**High**	**Low**
Key Considerations	Increased liquidity need to fund early retirement expenses	Highly exposed to sequencing and longevity risk	Higher risk budget and longer investment horizon
Product Objectives	Capital Preservation, Inflation Protection, Liquidity	Longevity Protection, Inflation Protection, Certainty of Income	Downside Protected Growth
Potential Offering	Conservative portfolio with laddered guaranteed income (e.g., 3, 5, 7-year)	Downside protected accumulation annuity with ability to elect lifetime income at future date	Buffered annuity offering tailored level of downside + higher allocation to alternatives/growth

Figure 2 Illustrative Retirement Framework by Cohort

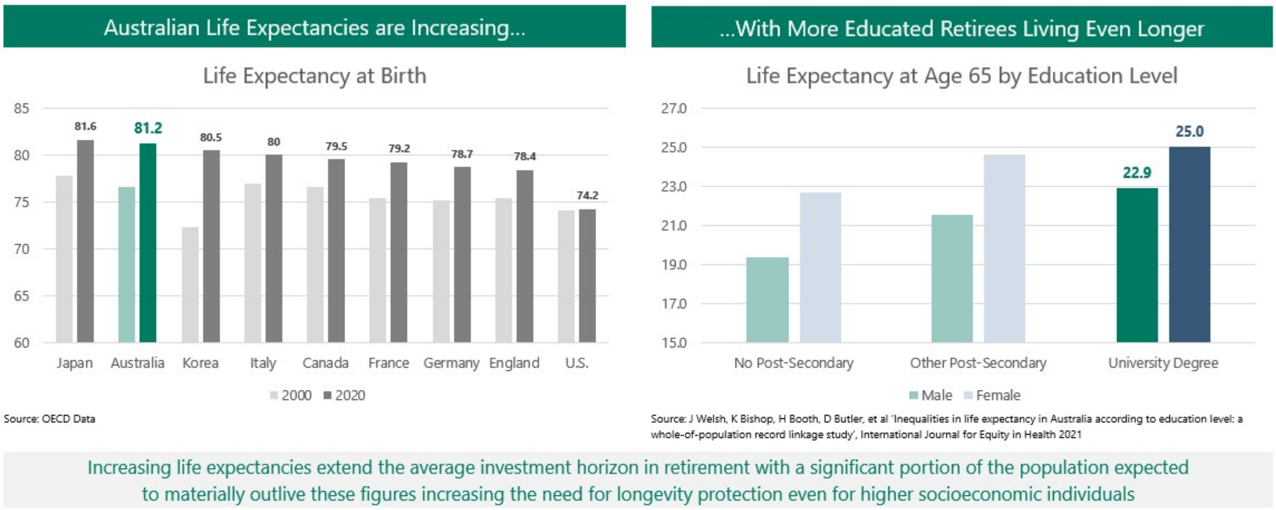

Figure 3 Increasing Life Expectancies Heighten the Need for Longevity Protection

How Can the System Enhance the Probability of Success?

To drive success, a retirement system must be structured in way that incentivizes the creation of attractive, relevant products that address the key risks retirees face in a cost-effective manner to both members, funds, and the state. At the same time, the system must recognize the dependence of product success on engagement and advice and work to arm funds with the capabilities necessary to provide members with knowledge and support as they move along their retirement journey. Australia has made strong progress in enhancing the availability, affordability, and quality of advice. The policies recommended by the recent Quality of Advice Review are forward thinking and similar concepts could directly benefit other global markets.

Evolving Performance Metrics for Retirement:

- It is important that the metrics governing the system reflect the fundamental change in the investment task that occurs as members move from accumulation to decumulation.

In retirement, it is no longer sufficient to focus solely on total return. The obligation to members has now shifted to providing sufficient and stable income in retirement. This will necessitate taking a more liability-driven approach to investment alongside performance metrics that reflect this broader objective. The example below highlights how expanding performance metrics to incorporate downside measures can enable retirees to better assess and understand the implications of various products and strategies.

Evolving Performance Testing to Focus on Downside Measures

	Illustrative Retirement Portfolios		
	Public Equity / Public Bonds / Private Assets / Indexed Annuities		
Performance Metrics[1]	60/40/0/0	40/20/40/0	30/20/40/10
Total Return	7.90%	9.05%	8.82%
Volatility	10.43%	8.74%	7.75%
Semi-deviation	12.06%	10.84%	9.71%
Maximum Drawdown	22.75%	20.15%	17.08%
Sharpe Ratio	**0.71**	**1.00**	**1.11**

1. Measures represent the average of 10-year rolling windows over the period from September 2004 to March 2013
Public Equity represents a 50/50 blend of the MSCI World Stock Index and S&P 500. Public Bonds represents the ICE BofA US Investment Grade Corporate Bond Index. Private Assets is comprised of a 50/50 blend of Alternatives and Private Credit. Alternatives are comprised of a 50/50 blend of the Pitch Book Private Capital Index and the Preqin Private Capital Index. Private Debt represents an equal blend of the Pitch Book Private Debt Index, the Preqin Private Debt Index, and the Cliffwater Direct Lending Index. Index Annuity returns are modeled on a back tested basis with caps dynamically set based on a fixed spread to Treasury and a 0% return floor.

Figure 4 Illustrative Performance Testing Metrics in Retirement

In addition, as members' key risks and motivations can vary widely in retirement, products should be assessed on the basis of fulfillment versus more static, global measures. Retirees will need a straightforward framework which enables them to evaluate and compare products to understand both the value proposition and role within their own portfolio. The creation of new retirement specific performance metrics, like expected replacement ratio volatility, can help distill an otherwise complex set of considerations into one easy to understand measure.

Broadening the lens to ecosystem partners including insurers, there are several global precedents that can be helpful in shaping a view of an optimal framework.

Bridging the Transition from Accumulation to Decumulation with Deferred or 'Glide Path' Solutions:

- Aligned with the recent policy push to clarify the objective of superannuation as "preserve[ing] savings to deliver income for a dignified retirement", education and engagement around retirement income products should begin early in members' journey through the system. Success in driving better retirement outcomes can further be enhanced by the introduction of tax-efficient embedded deferred retirement products in accumulation that allow members to translate their education into action. These products would enable members to gradually fund a more secure retirement while avoiding concentrating critical decision making at the singular point of retirement. Deferred products can be structured in a flexible manner, providing downside protection up to a fully guaranteed return, with the ability to convert into a lifetime income stream upon reaching a defined preservation or retirement age.

Optimizing Insurance Capital and Reserving Frameworks:

- Insurers can be a key source of stability and downside protection for retirees. However, their ability to offer attractive retirement solutions is heavily influenced by the capital and reserving framework in which the insurers operate. In Europe, the introduction of Solvency II[8] resulted in the market for guaranteed retirement income shrinking by 30% to 40% from 2010 to 2020 with several European life insurers exiting completely. In contrast, the US market for guaranteed retirement solutions provided by insurers expanded by 48% over the same period[9]. In July 2023, Larry Lindsay, former Director of the U.S. National Economic Council and Governor of the U.S. Federal Reserve, wrote an Op-ed on this topic noting that the imposition of a Solvency II like regime in the U.S. "…would divert resources away from investment and lower returns to the pensioner or annuitant." As the retirement system in Australia evolves, it is worth considering the criteria necessary for financial services companies to offer attractive long-term guarantees to policyholders as part of broader portfolio solutions.

Accessing Global Longevity Risk Capacity:

- The size of the Australian retirement system creates both benefits and challenges. As an increasing number of members move into retirement it will be important that Australian retirees are able to access global pools of risk capacity and capital to enhance the value proposition local products can offer. The accumulation phase is a prime illustration of this, with pricing of Group Life cover benefiting from the diversification and support of global reinsurers. A similar benefit can be found in retirement, where in markets like the UK, insurers have provided £66 billion of longevity cover over the past four years[10]. With

[8] There are two key challenges with the Solvency II framework. First, it results in punitive capital charges for long-dated assets, even when these assets are a better match for the long-dated guarantees made to retirees. This results in insurers investing short, taking on additional reinvestment risk and exposing themselves to mark-to-market basis risk between assets and liabilities. Second, the fractured nature of Solvency II implementation introduced inconsistent and opaque capital standards (e.g., transitional measures and forbearance) that have made it difficult to compare capitalization across entities and geographies. This has resulted in difficulties attracting the patient, long term necessary to support longer dated guarantees to policyholders.

[9] Sources include the French Insurance Federation Annual Reports, the Netherlands Bank "Vision for the Future of the Dutch Insurance Sector," LIMRA, and JP Morgan Market Share Bible. Data for the Netherlands is based on change in GWP between 2013-2018. US data includes both fixed and fixed indexed annuity sales.

[10] Source Hymans Robertson "Risk Transfer Report 2023" represents total notional of longevity swaps written in the UK market over the period from 2019 to 2022.

Australian life expectancies continuing to extend, the risk of outliving one's savings in retirement will continue to be a central concern for members in decumulation.

Benefiting from Long-Dated Guarantees:

- As defined benefit plans have closed to new members, many corporations have looked to find long-term partners to provide their members with enhanced protection and certainty in receiving their promised pension payments. Global insurers have again played a critical role, matching the benefits provided by the plans and backing these guarantees with hard capital. Over the past four years, US$295 billion of pension risk transfer business has been written across the US and UK markets[11] and more global markets are becoming active. This highlights that, with the appropriate operating framework, insurers can be a significant source of value-additive long dated asset guarantees that complement the deep investment acumen that super funds have developed in the accumulation phase. Given the "silver tsunami" bearing down on Australia, it will also be imperative that global players can effectively support and empower domestic insurers with capital and expertise in order to provide sufficient capacity.

Conclusion

Solving retirement is bigger than any one entity and will require collaboration across industry, policymakers, and regulators with the common goal of enhancing outcomes for Australian retirees. The focus should be on ensuring that members have access to suitable, cost-effective products and the education, engagement, and support necessary to make informed decisions. There is much insight that can be gained from looking at both the successes and failures within other markets. Australia is well-poised to be on the leading edge in thinking through the complexities of decumulation. We are excited to be engaged in such a dynamic market and look forward to what the future holds.

[11] Source Hymans Robertson "Risk Transfer Report 2023" and LIMRA, represents total volume of pension buy-outs and buy-ins executed over the period from 2019 to 2022. GBP transactions converted to USD at 31/12/2022 spot FX rate.