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Please treat submission as: Not confidential

Synopsis (key Points)

Secure Annuity believes that only when there are suitable retirement products (annuities: traditional, pooled or innovative) can we address the needs of retirees. The current success in accumulation phase has stymied the development of such products. Experience tells us that super-funds are best considered as users/buyers of such products. The problem is that we do not have adequate providers of these retirement products due to a lack of capital and skillset to innovate and develop.

Re: Submission to the "Superannuation in Retirement" review (Dec 2023)

Please find this submission on behalf of SecureAnnuity Pty Ltd – a developer of innovative lifetime annuity solutions. The submission has been written by Dr George Nassios FIAA – the company's Managing Director.

Dr Nassios is a qualified Actuary who has worked in the areas of life insurance (covering lifetime annuity design, pricing and management), superannuation, investments, and wealth advisory. His career spans some 35 years and he is noted for the development of a number innovative investment products, and the establishment of product capabilities within a number of banking/wealth management organisations that he has worked for or been associated with.

The submission will not cover all areas of the treasury consultation paper but will focus, in particular, around the function of Super-*Annuation* and the need to develop new "annuity" products. On this basis it is premised that other aspects of the briefing paper by Treasury, such as advice to members, tools to present this advice will be redefined on the assumption that there are solutions (via products) that can meet the needs of superannuation retirees.

The reason for this focus is that we (SecureAnnuity) believe that there are innovative solutions to the provision of lifetime annuities, but that the funding and drive for such product development is virtually non-existent. Some of these impediments are due to the success of the Accumulation phase of superannuation, and hence the predominant bias on skills that achieve these very strong outcomes during a members accumulation phase

The lack of:

1. Development funding,
2. Relevant product development skillsets needed for a successful annuitisation phase of superannuation and
3. capital required to run a broad based Lifetime Annuity product suite,

are all barriers to allow the superannuation system to fulfil its true objective – being the provision of an acceptable income stream in retirement.

Response to Treasury Paper:

As we see it there are three main themes in the Treasury Discussion paper – these being:

1. Supporting members to navigate retirement income
2. Supporting funds to deliver better retirement income strategies
3. Making lifetime income products more accessible

While we recognise the driver for the format sequencing of the discussion paper, we would like to submit a response that starts with addressing the questions posed in the paper in the following sequence:

1. Supporting funds to deliver better retirement income strategies (item 2 in paper)
2. Making lifetime income products more accessible (item 3 in paper)
3. Supporting members to navigate retirement income (item 1 in paper)

Responses to ITEM “Supporting funds to deliver better retirement income strategies”

The one statement that stands out in the discussion paper under this section is the following:

Trustees moving from investment manager to retirement service provider

While the paper discusses the requirement(s) of the Retirement Covenant and the progress made (or not made) to date, it is our view that many APRA regulated funds are dominated by their activity as investment managers. While some have established Retirement Product divisions they are still secondary to the Investment management process relating to accumulation. There needs to be a critical change in this respect where the Funds are not just judged against their accumulation investment returns but against their ability to translate these successes into a regular income. This to us is a required mindset change.

For instance, a fund that has annuity products available for its client base should be able to present its investment success in the following manner:

- Our (fund) return of 10% for the year translates in the following manner for “you – the member”, being able to purchase an annuity income (using a traditional lifetime annuity) that is 5% better than last year (the reason for the lower increase in annuity income compared with the fund’s return of 10% is because the superfund only has access to a simple product that is dependent on the interest rate levels of the time – which in this example we have assumed the market had a drop in long term yields to those of the prior year)
- A fund that had an innovative annuity product would be able to note that their 10% performance resulted in a potential annuity income increase of 10% (because it had a lower interest rate exposure, having issued an equity linked style product)

Of course a framework would be needed so that these outcomes were comparing like with like, but until performance can translate to annuity income outcomes there is no driver for the investment manager to consider the annuity cycle of their business. Only quoting investment returns and not impact on retirement income potential means that the Trustee will not realign its view from investment manager to “retirement service provider”.

This is a must if the superannuation system is to succeed in providing an income in retirement.

The Table below lists the associated questions of this section in the Treasury consultation paper. Most of these questions we consider will be addressed by those entities with greater expertise than ours.

Our responses to these questions will be selective and driven by the underlying recommended change in mindset ie Superannuation funds need to change from being investment Manager to providers of Retirement services and solutions (of which accumulation is one phase of this).

Consultation questions

- Please provide comments on the need to support competition and product comparison across the services and products funds provide in retirement, or the need for greater consumer protection.

Response: These are predominantly generic questions related to the provision of advice. For income style products required by retirees there would need to be a strengthening of the knowledge around such products – in particular how mortality and investment sequencing may impact a retiree’s outcome.

There is a lack of understanding in the current advice industry of mortality and interest rates which are the two most basic drivers of lifetime annuity pricing. Similarly, the weakness of some current income solutions is not as well understood and again the advice industry will need to be skilled up. [here I am responding as an Actuary who has worked as a financial adviser for some 10 years.]

- What role should industry or other groups in the community play to support consumer protections and competitive products and services in retirement? What actions are being undertaken already?

Response: the biggest risk seen here is that we don't have sufficient capital or providers to create a competitive environment for the provision of retirement products. This weakness driven because of the lack capital for development and deployment of new (and also more traditional) annuity solutions, and that the larger players (superannuation funds) prefer to be Users rather than Developers – which creates a risk to any provider in that it is at the whim of a large player with large membership (a bit like the farmer and the supermarket)

- Of the approaches identified, what should be prioritised and what risks should be considered as policy is developed? What other approaches, if any, should Government consider?

Response: Given our more specific response to the above item, our recommendation is that the government needs to facilitate access to capital – could be via tax breaks, innovation funding, anti-competitive behaviour requirements etc. The Retirement Covenant has failed in spurring on the required innovation and product development because good intent still requires capital and membership commitment.

In terms of answering the question from a retiree perspective – again risk of access, risk of shortfall over the life of the retiree in terms of income and term of income are key considerations.

Further questions:

- What are the key characteristics or metrics for comparing retirement income products and services?

Response: I note that SecureAnnuity is a product innovator and as part of its product suite it intends to document the characteristics of its products – their risks and return benefits. The key reason for development of the product is that currently no product has a solution that balances risk with level of income appropriately. For instance, a term certain annuity will be cheaper than a lifetime annuity but the lifetime annuity will be there till death, the term certain annuity will overshoot or undershoot (which is much more problematic if a retiree has no access to alternative income of funds – note the government pensions currently can act as a backstop in certain situations but government policy becomes risk)

Income sustainability given a person's accumulation level is the deciding factor here.

- What approaches could make product disclosure useful for members? How might barriers such as complexity, or individuality of products, be overcome?

Response: this is the age-old question of how do we communicate a complex solution to a broad set of understandings.

First and foremost, these products, by the nature in catering for mortality, will be complex. If the product does not feature longevity (mortality) then it should be deemed to be inferior (ie a traffic light system would show a longevity product green, a long dated term certain annuity yellow and a short term-certain annuity red)

The use of traffic lights for other identified risks can also be useful (eg investment return impact on income level or variability of income level).

The one area that I will personally comment on is the failure of the current format of the disclosure documents – 90% of material in these PD's has nothing to do with the product or its characteristics and that is an outright failure.

What barriers are there for product switching in retirement and are there opportunities to make product switching easier?

Response: obviously this will depend on the type of retirement product and the provider. If the superannuation fund has sourced the product from a third party, then there will be very limited ability to switch. Also, ex market linked annuities, there would need to be a break cost calculation that takes into account the interest rate environment at the time of switching. Along similar lines a longevity product would need to consider the retirees health status and whether there is selection or anti-selection occurring (again very difficult concepts).

The one product that does not have the above risks/impediments is the allocated annuity structure – as it just transfers its outstanding accumulation amount plus the rules.

SecureAnnuity developed product would hope to have some transferability/switching mechanisms.

Our Response to the above set of questions has been premised on our focus to create a mindset that the provision of Superannuation services is about a Retirement Income not limited to just an Investment Management.

Responses to ITEM “Making lifetime income products more accessible

This is the item where we see our expertise is best suited to address. In essence our preamble noted that we do not have an environment that is conducive to product development and hence access is only limited to standard products that have been in existence pre the establishment of the SG Superannuation system. This is a sad outcome given that mandatory superannuation has been in existence for over 30 plus years.

In general, we agree with the observations of this segment (ITEM) of the consultation paper, and all insurance-based principles should be explored – pooling, interfund pooling, accessing insurance risk-based solutions etc. Again, though we emphasize that focus needs to change with respect to the Superannuation funds ie “Trustees moving from investment manager to retirement service providers”

SecureAnnuity was founded to explore an innovative pooling solution that would mitigate many of the pooling features that weaken earlier developments using such a technique. It also focusses on what’s the appropriate asset-liability that can assist in the delivery of this type of structure. In the 9 years of dialogue with parties that are strong providers of investment management capabilities to the superannuation system we have found that as “end users” they have limited interest or capital in product development. Our experience tells us that the large superannuation funds (our investment managers) should be viewed as the purchasers of annuity (income) products and solutions and not the developers of such.

Instead, entities outside the industry need to fund and develop these solutions and then on-sell them to the current Superannuation funds.

The problem with this is that much of these development skills would have existed within the life insurance businesses but these life insurers have lost a considerable amount of capability – in that we have lost a number of viable life insurers over the last 30 years, and we have consequently lost capital that could be deployed in providing traditional lifetime annuity solutions.

This loss of capability and capital also means that we have lost considerable development capital (and a will to deploy because its in the business’ interest). We have also lost considerable actuarial skill in this area – many actuaries that I know would not have even been involved in the development or deployment of annuity solutions (I accidentally was involved because I had to upgrade the software for National Mutual’s annuity system and in that process realised we had a number of erroneous assumptions and this led me to consider how these could be mitigated or amended)

One may have assumed that the batten should have been transferred to the large industry and corporate superannuation funds – but they focussed on the investment component not on the risk component (mortality), and rightly so, as the mortality component would have required a greater capital base.

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Consultation questions

Please provide any comment on the barriers in the supply and demand for lifetime income products.

Response:

- *Main barrier has been the historical disinclination by large providers, (Industry and Corporate) superfunds, to develop new income products or to establish captive life companies that can provide such lifetime products (Q super being the only one that has established a captive life company and provided an innovative pooled solution)*
- *Besides the above disinclination, there is now limited capital to establish any broad-based capabilities (even if the focus is only on traditional products such as lifetime annuities) to actually cater for the demands of a super-system that may need a solution for up to \$1 trillion of demand.*
- *The life industry, the traditional developer of such products, has been reduced in number and also in capability – capital and knowledge.*
- *Demand for income-solutions will overwhelm capacity to supply, and the default option will still be Allocated Pensions because they involve no risk-management skills only investment management skills*

I am generally in favour of market dynamics solving such problems but the current situation is critical and needs assistance after which it is hoped the market dynamics can take over.

There is a total loss of capability and no stimulus to re invigorate the risk component (ie mortality risk – much more important for income products) by the super industry. Either we need tax breaks, tax penalties or priority funding for this industry to re-establish itself. The main failure has been the looseness of the retirement Covenant in that it has led to not much progress because there has not been any “penalty” for failure.

What actions are industry or other participants in the community taking to assist retirees to better manage the risks for retirement income?

Response: Products are needed and these are limited

I can quote on one hand these products – lifetime Annuities, term certain annuities (mortality risk not eliminated), pooled retirement annuities. Index linked Lifetime annuities (no certainty of outcome). All these have had limited deployment.

Education is always a help, as is financial planning advice – but with no products that solve the identified risk(s) then all we have is discussion and risk.

What policy approaches should be taken to support use of lifetime income products to address the risks to retirement income? What risks should be considered?

Response:

- *Providers of superannuation investments need to refocus their outcomes on what is the resultant income benefit of these endeavours eg someone who enters a fund at 25 years will need to take into account 42 years of savings and then 20 years of drawdowns to provide for their income needs in retirement.*
- *Regulatory policy needs to drive change in current behaviour of those that control the current majority of funds of which 1/3 of their membership will need a solution now, or sooner than later.*
- *Some environment changes via tax-breaks, innovation -funding, capital relief, to encourage development and capability to manage such products (including the recommendation in the consultation paper of "Facilitating funds in risk pooling within retirement products. For example, smaller funds could be allowed to pool mortality risk with each other, which is currently not possible as any movement of mortality credits are constrained by contribution rules"*
- *Mortality, sequencing, tax treatment etc are all risks to an annuity recipient. Deferred annuities also have the same issues.*

Further questions:

- What product options (or strategies within current retirement products) could better manage risks to retirement income?
Ans: Pooled annuity style products offer the greatest pathway to variable solutions that could cater for the needs of individual members and may lead to lower capital requirements – one of the greatest barriers to using traditional lifetime annuities as the preferred option.
- What is the role for a 'suggested' product in overcoming low take-up of lifetime income products?
Ans: the availability of the product will assist. It may also allow for competition and innovation of solution. However, a product without a refocus to retirement solutions will not result in any better outcome
- What action are funds taking to better manage longevity risk, and what role do funds see guaranteed income products (e.g. annuities, pooled products) playing in the future?
Ans: you will be the better judge of this via the submissions you will receive. My own experience has been to say that the superfunds have acted more as purchasers of retirement solutions/products, but that we have a limited product suite and an even more limited set of product providers and/or developers (pooled or traditional lifetime annuities) – again there is the lack of capital – a barrier for these solutions to be mainstay and for the current membership funds to utilise on a broad base.
- Do the barriers to managing longevity risk in the Australian market necessitate Government action? What Government action could assist funds in offering appropriate longevity protection to members?

Ans: Yes there will be a need for some support from government to allow development, establishment of entities that can provide the above mentioned products. Also, some regulatory changes – identified above and also identified in the consultation paper

- Would an industry-standardised product(s) assist funds to develop and offer lifetime income products to their members?
 - : *NO – but some standardised test against what they are offering as their default annuity option might (eg for a fund that has the traditional lifetime annuity option as their default option for retirees, then this is what their investment performance should be tested against – which means the test will also have to factor in interest rate risk)*
 - What features should a standardised product include?

Ans: We are against a standardised product, but not against a fund chosen default offering that their investment performance can be tested against
 - Should there be a path to more easily transition members to a standardised product?

Ans: NO, this will overwhelm the industry segment that will need to provide this product
 - Should superannuation funds be required to offer a standardised retirement product, similar to MySuper for accumulation?

Ans: see my answer above
 - How should a product vary for individual circumstances of the member?

Ans: this will be product dependent eg lifetime annuities are very much a poor solution to someone who has health issues that could reduce their lifespan
 - Would a standardised product be cheaper to develop and offer (e.g. compared to a general mandate to offer a longevity product)?

Ans: a traditional lifetime annuity would not be cheaper because of its demand on capital. A pooled life credit product might be cheaper, but will need changes, skill sets and the wrong choice of product might stymie product development.

There is no need for standardisation, there is a need for focusing the industry on product solutions and also testing their performance on the basis of how have they improve the potential for income in retirement.

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Summary re Submission:

On behalf of SecureAnnuity and Dr George Nassios please find the above as a submission to the consultation paper. Our observation and comments are ours and are made on the basis that the industry needs to evolve from one that solved the problem of adequate savings to one that now needs to help these savers deploy these funds into suitable income proving products.

Our key points are:

- A need for change in mindset as noted by the consultation paper e.g. "Trustees moving from investment manager to retirement service provider"
- A focus on product solutions that can result in appropriate income solutions.
- A test that enforces the Superannuation funds to view their performance with respect to the retirement ("annuation") phase as it is about the savings phase
- A need to develop new annuity products that can solve the needs of retirees noting that traditional products may be heavily dependent on capital availability and capability.

The lack of capital, lack of capability has been identified as a key risk to the development of such annuity products and this does need to be addressed at government and policy level

We thank you for your time and hope that some of the above will be factored into the outcomes of the consultation process so that a set of income solutions can be developed and deployed – time for this is running out and the demand side of the problem keeps increasing in need and volume.

Sincerely

treasury

Dr George Nassios FIAA

Managing Director

Secure Annuity Pty Ltd.

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