

6 July 2017

Manager  
Communications  
The Treasury  
Langton Crescent  
Parkes ACT 2600

By email: [medialiaison@treasury.gov.au](mailto:medialiaison@treasury.gov.au)

Dear Sir/Madam,

## **Re: Discussion Paper – Development of the framework for Comprehensive Income Products for Retirement**

AustralianSuper is pleased to take the opportunity to make a submission in response to the discussion paper on developing a framework for Comprehensive Income Products for Retirement (CIPRs).

Please note also that AustralianSuper generally supports the contentions regarding consumer protection contained in the submissions made by Industry Super Australia (ISA) and Australian Institute of Superannuation Trustees (AIST) in response to the abovenamed paper.

### **About AustralianSuper**

AustralianSuper is Australia's largest single superannuation fund and is run only to benefit its members. The fund has over 2.1 million members and manages over \$105 billion of members' assets.<sup>1</sup> Our sole focus is to provide the best possible retirement outcomes for our members.

### **AustralianSuper's interest in Comprehensive Income Products for Retirement (CIPRs)**

As Australia's largest superannuation fund, AustralianSuper is keenly interested in ensuring that the framework for the development of CIPRs remains open, flexible, non-prescriptive and member friendly.

<sup>1</sup> As at 31 December 2016

AustralianSuper bears the responsibility of stewarding more than 10% of Australia's current workforce investing in retirement, and we take seriously our responsibility to act in the best interests of our members in this process.

The parameters around which CIPRs are to be offered mean that we need to consider whether AustralianSuper offers a CIPR to its retiring membership at this stage. This does not mean that we cease to offer our members a range of retirement options, which we currently do and will continue to do in the future.

With the pending regulations on 'innovative retirement income stream products, AustralianSuper is concerned that the development of the framework for CIPRs is devolving to become a list of minimum requirements and product limitations that do not necessarily meet consumers' needs. This is a fundamental defect that should *not* be present in a mass-customised product framework. The aspects of proposed CIPRs that do not meet members' needs are demonstrated in the following aspects:

- The inappropriateness of requiring a CIPR to be offered to members who have low account balances and can never afford to fund their own retirement without significant reliance on the Government Aged Pension (GAP). (We note that the GAP is not included in CIPR calculations in the discussion paper).
- The inappropriateness of requiring a CIPR to be offered to members who come from identified socio economic cohorts who have a low life expectancy.
- The inappropriateness of requiring a CIPR to be offered to members who have a low life expectancy due to physical reasons.
- The inappropriateness of requiring a CIPR to be offered to members with preexisting annuitisation arrangements.
- A lack of flexibility – under proposed arrangements members can really only choose a CIPR once and not change their mind about their retirement arrangements, at a time of increasing longevity. This is in complete and nonsensical contrast to the mandating of choice of fund in accumulation phase.
- There is nothing in current CIPR product development or framework settings that suggests that CIPRs can appropriately deal with divorce in retirement.
- The age of imposing large exit costs for life-based products has long passed and AustralianSuper has no desire to support bringing back such products - it is against our members' best interests.
- Superannuation fund members have lumpy costs to cope with in retirement. These include paying off mortgages, funeral costs, aged care and renovation costs for those who wish to stay in their home. Compelling retirement income for those whose primary expenses are more efficiently dealt with by paying lump sums is condemning those members to retain debt through retirement against their own financial interests.
- The development of the CIPR framework presupposes the creation of high performing 'guaranteed' income products which do not exist at all currently, and are even less likely to exist in a long term low interest rate environment.

Bearing in mind these concerns, we have provided our comments on some of your specified questions which are restated in appendix A along with AustralianSuper's responses.

In Appendix B, AustralianSuper has considered the overseas experience of annuitized and pooled longevity products with a view that recent regulatory and legislative reforms in international pension markets may provide us with lessons that to help to design a better retirement income system in Australia.

The lessons from overseas markets suggest Australia should value maintaining *flexibility* in the superannuation system. In addition, international experience indicates that retirement products with guarantees are not well suited to providing value for retirees in low interest environments or generally serving members with low balances.

These insights underpin AustralianSuper's concerns that the current economic environment may not support the introduction of CIPRs as envisaged, and that a CIPR may not be the right option for the majority of AustralianSuper's low balance members.

If you have any questions of us or would like further information please do not hesitate to contact me on 03 8648 3847 or [lduprealba@australiansuper.com](mailto:lduprealba@australiansuper.com) in the first instance.

Yours sincerely



Louise du Pre-Alba  
Strategic Policy Advocate

## LIST OF DISCUSSION QUESTIONS

### A Defining a CIPR

#### 1. How can trustees design CIPRs to deliver the best outcomes for their members? What are the trade-offs of different design approaches and features?

Trustees generally need to focus on the demography of their membership, and their account balances at retirement, when fashioning a CIPR solution.

Trustees also need to understand the likely mortality of their membership at retirement as well and whether they are likely to be all or in part eligible for the Government Aged Pension (GAP) at retirement.

##### (i) *Account balance*

There are generally two competing types of retirement solutions on offer in the financial services sector providing benefits at opposite ends of the spectrum from each other. The first is the Account Based Pension (popular in Australia), which has minimum drawdown levels but flexibility to drawdown at a higher rate with the risk of depleting the account too early. Death benefits are effectively the account balance at the date of death.

The second is the lifetime annuity (not popular in Australia) which guaranteed income for life but not flexibility – and potentially no death benefit if death occurs early (as it will for the half of members who die within their life expectancy).

A CIPR may have a blend of the two above products, incorporating the unpopular lifetime annuity, which because of the nature of the guarantee, will come with a cost. The key question is what cost members are willing or able to pay for this.

AustralianSuper is of the view that the members' willingness/ability to pay will vary in accordance with their account balance, and the size of the component of their account balance that they are willing to use to purchase an annuity.

##### (ii) *Mortality of membership base*

Trustees need to keep in mind the occupational profile of their membership when designing a CIPR.

Members with a heavier mortality profile tend to be members from blue collar occupations with low account balances where, potentially, the cost of 'insurance' for a longevity solution should be lower (as life expectancy will be lower than for the average population, and lower again than white collar workers).

AustralianSuper is of the view that there should be no cross subsidies in a CIPR – if one CIPR is offered for all members, these lower account balance/higher mortality cohorts will be overcharged compared to members who live longer. AustralianSuper does not want to offer a CIPR (one or more) that overcharges some of our members to the benefit of other members.

(iii) *Government Aged Pension (GAP)*

AustralianSuper members have average account balances at retirement that are still less than \$130,000, the majority of whom we expect will still largely be dependent on the GAP in retirement.

The proportion of the population getting the GAP is not set to substantially change – CIPR design *must* therefore consider the GAP.

AustralianSuper as a fiduciary accepts that the interplay between superannuation income and GAP must be taken into account when designing retirement solutions for our members. The reliance on GAP will necessarily influence how AustralianSuper segments and develops retirement products for our members.

As a fiduciary we are concerned about the mass customised offering of a CIPR to members in this cohort when taking up a CIPR might actually reduce their GAP.

**2. Are there any lessons from defined benefit schemes that can be applied to the CIPRs framework?**

Like CIPRs, defined benefit schemes involve a long term promise of either income or capital or both, arising from the investment of contributions.

Defined benefit schemes have failed to provide promised outcomes to members where employers have not been able to meet their contribution obligations.

Whilst defined benefit schemes have been traditionally subject to actuarial certification and a level of prudential regulation, the sponsoring employers of such schemes have never been, and are not prudentially regulated, so there is no overview of the promise made, only how the fund manages that promise.

The promises inherent in any CIPR made by third parties need to be subjected to prudential regulation over and above actuarial certification.

**3. Do you agree with the proposed three minimum requirements of a CIPR? What are the alternatives?**

AustralianSuper suggests that the three minimum requirements of CIPRs be guiding principles only, and with some caveats.

We applaud the objective to deliver a minimum level of income that would generally exceed an equivalent amount invested in an account based pension drawn down at minimum rates. We note that such a product does not exist in the Australian market at this point in time and that the long term low interest rate environment does not assist in achieving this objective. This objective should be refined to that the minimum level of income achieved is *net of fees and tax*.

AustralianSuper is supportive of measures to protect members against longevity risk, however, we are less supportive where some members who do not live as long subsidise the retirement income of members who have a greater life expectancy, and who invariably have a greater account balance at retirement.

**4. How important is achieving a minimum additional level of increased income to the introduction of the CIPRs framework?**

If CIPRs are expected to deliver income for life, higher than that delivered by an Account based Pension using minimum drawdowns, there should be a margin above the minimum level requirement<sup>1</sup>. Providing additional income is very important as this should be the motivating factor that enables members to trade off access to capital. However, the inherent promise means that a

---

<sup>1</sup> It should be noted that there are quality ABPs in the market currently that have earnings rates that exceed the minimum drawdown requirements in early retirement, which means that the capital of the ABP is not unduly depleted, reducing the need for a CIPR solution.

guarantee is required, which of itself serves to reduce income as reserves are required to back the guarantee.

**5. How should income efficiency be defined?**

Using a set of “best estimate” assumptions on mortality, real earning rates etc., a CIPR should offer a higher expected level of income in retirement than an account based pension (ABP) drawing at the minimum level. The CIPR should exceed the ABP by a certain percentage.

**6. What minimum level of increased income should be required; that is, what should be the minimum level of income efficiency? How should guaranteed products be accounted for?**

AustralianSuper defers to the Actuarial Working Group on CIPRs to develop this, but notes that it proposed to achieve a level of income efficiency that is not present in any retirement product in the Australian market at this point in time.

**7. Which indexation option best achieves the goal of increasing standards of living in retirement?**

CIPRs should have the same indexation rate that applies to the Government Age Pension (GAP) presently, which is effectively AWOTE (Average weekly ordinary time earnings), otherwise known as ‘wage inflation.’ This measure is higher than CPI but enables the CIPR to keep up with spending power of the workforce.

**8. Are there comparability benefits from specifying which indexation option would be required of a CIPR?**

There are trade-offs in determining the desirability of comparability benefits. Some may argue that comparability stifles innovation, for example, a trustee might conclude that a member’s real income in retirement should increase at a later stage if they form the view that income needs to rise to cover the costs of Aged Care in the later stage of retirement. This could lead to the solution being “rated” poorly, yet be the most suitable for the particular member.

AustralianSuper is of the view that CIPRs will be sufficiently complex for consumers, and that any measure to promote comparability, including in relation to indexation options, will only serve to promote confidence in the

offering of CIPRs to members. It would be preferable if the quest for comparability does not result in solutions being designed to comply with reporting standards; and they should be wide enough to avert a 'race to the bottom.'

Indexation options for CIPRs should be made comparable by use of graphical representations of worked examples for each option which projects the effect of the differing indexation rates on retirement index over a projected retirement period.

**9. What elements/types of flexibility are most valued by individuals in retirement, and does flexibility need to be provided for through a CIPR?**

*(i) Lump sums*

The type of flexibility most valued by individuals in retirement the ability to draw down a lump sum to deal with unforeseen events.

Superannuation fund members have lumpy costs to cope with in retirement. These include paying off mortgages, funeral costs, aged care and renovation costs for those who wish to stay in their home. Compelling retirement income for those whose primary expenses are more efficiently dealt with by paying lump sums is condemning those members to retain debt through retirement against their own financial interests.

Whilst superannuation fund members may wish to retain lump sum flexibility for bequests, they are increasingly reliant on those same lump sums for the abovenamed expenses which are normally incurred during the course of retirement.

*(ii) Switching products*

Flexibility to switch between CIPRs should be available to consumers during retirement phase as well as accumulation phase, as it will promote competition and serve to keep costs down for retirees.

The CIPR framework is seen as a 'soft default' option for retirees – conceptually any 'default' implies that there are other options available if choice is exercised. CIPRs *must* have portability in order to reasonably be considered to be a 'soft default', as portability would confirm that choice is available and can actually be exercised.

**10. To what extent should savings outside superannuation be used to meet unexpected costs in retirement?**



AustralianSuper does not assume that savings outside of superannuation can and should be used to meet unexpected costs in retirement, as not all retirees have such savings.

A 'flexible' CIPR should reasonably be able to meet some unexpected costs in retirement by ensuring a modest level of lump sum flexibility.

A 'flexible' CIPR should reasonably be able to accommodate windfall gains made by retirees such as inheritances, so that a CIPR can be topped up using such monies.

If both scenarios outlined above were achieved in CIPR development, then savings outside of superannuation need not be relied on to meet unexpected costs in retirement.

#### **11. Is the proposed structure of a CIPR appropriate?**

AustralianSuper supports using a prudential standard as a prompt to trustees to consider the CIPR framework when forming a view on how it will deliver a "soft" default in retirement for cohorts of members, but even this needs to be considered in the context of members needs first and foremost – sometimes they will achieve adequacy in retirement with the assistance of a CIPR, sometimes it will be with the GAP.

AustralianSuper is *not* of the view that the Future of Financial Advice (FOFA) reforms need to be revisited as a consequence of seeking to prescribe a framework for offering CIPRs. It is not the advice rules that are of concern, but the nature of a targeted offer of a CIPR to a range of members without knowing their circumstances that is of general concern – this would be the case regardless of the advice rules in place.

#### **12. Are there any risks or issues with trustees partnering with third parties to enable them to offer certain underlying component products of a CIPR?**

Trustees partnering with a third parties bear numerous risks, including legal, financial and reputational, when enabling them to offer certain underlying component products of CIPRs.

- (i) ***Provision of a guarantee***  
The provision of a guarantee over the long term is a key issue in this regard – a true guarantee relies upon the management of reserves held either by a third party or in a separate statutory account.
- (ii) ***Unexpected product price increases***  
The provision of a cost effective product over the entire retirement of a member is a key issue for AustralianSuper. The long term pricing challenges of some versions of CIPRs are not immediately ascertainable and overseas experience would lead to a conclusion that there is no long term guarantee of only modest price increases. Annuity products can contain provision for hefty price increases during the term of the contract. Retirees facing living on a fixed income for an indeterminate period are not in a position to absorb hefty fee increases as they directly and adversely impact retirement income.

(We note in this context that any assertion relating to generating a retirement income in excess of the minimum drawdown rate for account based pensions needs to be made *net* of fees charged to individuals in receipt of CIPR).

- (iii) ***Solvency of third party provider***  
Solvency of a third party provider is a key issue for trustees not only at the time of entering into agreement but ongoing over the long term. CIPRs contracts should include provisions that reflect this risk and enable trustees to proactively deal with these issues for the benefit of members, rather than be captured by these arrangements.
- (iv) ***Flexibility in changing CIPR providers***  
Trustees of superannuation funds providing CIPRs should be afforded maximum flexibility within the CIPR framework to change CIPR providers, (or providers of portions of a CIPR), in order to act in the best interests of members.

**13. Should trustees be able to offer one or multiple CIPRs as the masscustomised retirement income product offering to members? Why/Why not?**

Trustees of superannuation funds should be able to offer multiple CIPRs if they wish to do so, and to take on the responsibility of offering one CIPR to one type of membership, and another to a different membership cohort.

The 'CIPR' badge should not be afforded to numerous choice investment options within retirement as it would lose its meaning in terms of providing a mass customised product for a specified membership demographic.

**14. If funds were able to offer multiple CIPRs as the mass-customised retirement income product, on what basis would CIPRs differ?**

CIPRs should only differ if there is a difference in the product on offer in terms of its appropriateness for a specified membership cohort of a superannuation fund.

For example, a CIPR for small to medium account balance holders may include a deferred annuity that provides additional income over the age of 80. A CIPR for an account balance holder in excess of \$500,000 arising from white collar employment may include an annuity.

A safe harbour should be provided to a trustee when they offer each of these CIPRs to members, based on specific assumptions. In order to avail themselves of the safe harbour, trustees would need to engage with a prescribed process which captures the assumptions made in offering a CIPR to a specific cohort, as a mass-customised CIPR meeting minimum requirements for the offer.

There should be prescribed requirements for the offer process, which recognise both the absence of advice and the process of a member opting in to a CIPR product.

**B. The regulatory settings for trustees**

**15. What are the key impediments currently preventing trustees from offering a mass-customised CIPR to their members?**

**(i) *Legal liability in relation to the offer of a CIPR***

Legal liability is a key concern for trustees of superannuation funds considering offering a CIPR for some or all of their retiring members. A mass customised offer to members whom a trustee might have limited knowledge about may give rise to some concerns. The nature of the offer might be construed by some to be a recommendation of the CIPR as a financial

product, and would need to contain the general advice warnings as a minimum. The appropriateness of the offer to a cohort that the trustee has limited knowledge about always be in question, hence the need for some sort of safe harbor in circumstances where a trustee is 'compelled' to make this offer to membership whilst in possession of some personal information on those members.

(ii) ***Lack of control over third party arrangements***

The lack of control over third party arrangements over the long term would be a key concern for trustees. The solvency, pricing and guarantee concerns arising from a long term contract with a CIPR third party are issues which directly affect the reputation of the trustee, but which they have less control over during the long term.

(iii) ***Loss of capital***

The most fundamental impediment currently preventing trustees from offering a mass-customised CIPR to their members is the preferences of members themselves. Members are not enthusiastic about giving up the rights to the capital they have accrued in superannuation over their lifetime and this is reflected in the limited take-up of relevant products in the market presently.

(iv) ***Affordability of longevity products***

The number of members who can afford a longevity product serves as an impediment preventing CIPR offerings.

(v) ***Lack of flexibility and portability***

The lack of flexibility and ability to change retirement investments in CIPRs is a key impediment to trustees offering CIPR products, as it makes them unattractive to members, and also imposes a level of risk on trustees who offer such products.

**16. Would a safe harbour for their best interest obligations remove a key impediment to trustees designing and offering CIPRs?**

A safe harbour would assist trustees considering offering a CIPR, and would remove a key impediment to trustees designing and offering CIPRs.

There is merit in considering whether a safe harbour could or should apply in relation to features of the actual CIPR product rather than the trustees' actual *offer* of the CIPR to retiring members. Arguably this would become necessary if the offer of CIPRs becomes mandatory in the future.

Some argue that no safe harbour is required for these products in the market place presently – but that is because these products are sold under full personal advice arrangements, and not as a mass customised offer that has limited flexibility and portability.

**17. Which trustees should consider offering a mass-customised CIPR to their members? Should the safe harbour be made available to all trustees or a certain population of trustees?**

Referring to our answer above, the safe harbour should be offered to all superannuation trustees offering a CIPR, with the safe harbour applying to offer scenarios consistent with the offer of a mass customised product – it should not otherwise include exempting trustees from observing their best interests obligations when personal advice is provided.

**18. After an appropriate transition period, should the Government consider whether there should be an express obligation on trustees to offer a CIPR? If so, what length of transition period would be appropriate?**

AustralianSuper cautions against requiring an express obligation on trustees to offer a CIPR in the near term. This should only become an express obligation after a review of voluntary CIPRs has been conducted to ascertain whether they are meeting retirement objectives of members and are generally operating in members' best interests. A review should be conducted around five years after voluntary CIPRs are able to be offered.

**C Ensuring that products meet the minimum product requirements**

**19. What process should be used to ensure that a CIPR meets the minimum product requirements?**

AustralianSuper suggests that APRA authorisation of the CIPR is more important than actuarial authorisation. This is because the scale and financial health of the superannuation fund offering the CIPR is at least as important as the CIPR product.

APRA is in a better position to assess the CIPR in terms of the credit risk and market risk issues involved in using a third party to form a CIPR, as it is expected that APRA will prudentially regulate the third party provider as well.

**20. Would it be appropriate for actuaries to provide third party certification? If so, what, if any, additional regulation of actuaries would be required?**

AustralianSuper is of the view that actuarial certification is relevant only where the design of the CIPR requires actuarial skills to be used. Some CIPRs would require more actuarial input than others in design and ongoing supervision. For the reasons outlined in the answer to question 19, APRA authorisation is preferred.

**21. Should there be ongoing re-authorisation/re-certification requirements for CIPRs? If so, how and how often should this be done?**

See 19 and 20.

**22. What should the consequences be if a CIPR no longer met the minimum product requirements? Is it possible to avoid creating legacy products?**

If a superannuation trustee is unable to continue offering a CIPR then as a feature of its original APRA authorisation it should be required to have a CIPR offered by another fund preselected as a product to transition existing and/or future members as required.

**D Facilitating trustees to offer a CIPR**

**23. How can the framework facilitate trustees providing an easier transition into retirement for individuals, and what else can be done to meet this objective?**

The framework should force trustees to examine how they effectively offer a soft default to cohorts of members. Trustees may choose *not* to offer anything or offer a few solutions using a combination of products.

**24. To which members would it be most appropriate for trustees to offer a CIPR? All members or only MySuper members?**

As a CIPR is intended to be a mass customised product it can be offered to both MySuper members and choice members, as long as the parameters of the offer are clear to both.

**25. In what circumstances should trustees not offer a CIPR to certain members?**

*(i) Members with low account balances*

Trustees should not offer CIPRs to members with low account balances as it is likely not in their best interest. An unsolicited offer bears with it the imprimatur

of the fund concerned, and may be construed by members as being appropriate for them when a CIPR may not. If such members wish to enquire about purchasing a CIPR, they would still be able to consider it themselves and obtain advice in that regard.

*(ii) Disability and/or socio-economic factors affecting mortality*

AustralianSuper is also concerned about the appropriateness of a mandatory offer of a CIPR to known members of cohorts with reduced life expectancy for socio economic reasons, or by reason of disability. We conclude using only the demographics of our own fund however, that CIPRs would likely not be offered to the majority of members in these cohorts if CIPRs were not offered to those with account balances of less than for example \$200,000.

*(iii) Disability payments under court action*

In addition, CIPRs should not be offered to those receiving disability awards under a court action, as mass customised offerings might not be in their best interests as they will have different needs in retirement in terms of care etc. Retirement income products for such individuals can appropriately be considered as choice investment options rather than as a CIPR offering. Personal financial advice is often key in this scenario.

**26. Should the safe harbour only apply to the offering of a CIPR to certain members?**

If a safe harbour is to apply in respect of CIPRs, it should apply to the entire offer made to all relevant members as a mass customised product offering, rather than restricting the application of the safe harbour to certain members only. The safe harbour should apply to the initial offer of a CIPR only and not follow up advice interactions with the customer.

The safe harbour should *not* apply to a personal advice situation facilitating CIPR uptake. Once a member/prospective member has engaged with the fund and their personal financial circumstances have been determined (in all or in part) by the trustee of the CIPR, then a safe harbour that applies due to lack of knowledge of personal financial circumstances should not apply.

***Disclosure***

**27. What information about CIPRs should be conveyed to members by trustees during the pre-retirement phase and how often should this occur? Should this information, its form and frequency, be prescribed?**

Disclosure of key features of a CIPR should be readily available on a trustee's website for those members considering retirement options.

**28. When should the pre-retirement engagement between a trustee and a member commence and how frequently should it occur? Should this timing be prescribed?**

AustralianSuper does not require prescription in relation to how often it needs to communicate to members about CIPRs. Our retirement communications occur as early as possible to ensure that members are thinking about retirement years ahead of their actual retirement.

If a time is required, then we suggest communications commence at age 45, and occur annually and when life events occur where the trustee is made aware of such events.

**29. What is the best way to communicate the offer of a CIPR to members? Will warnings/pre-conditions when offering a CIPR be effective? If so, which warning/pre-conditions are necessary? If not, what is the alternative?**

Disclosure of key issues prior to commencing a CIPR need to be made, but it is acknowledged that not all consumers respond to disclosure, hence the need for a safe harbour around the initial offer of a CIPR. Such disclosures would include coverage of the following issues:

- Whether the member needs to consolidate superannuation accounts before commencing/considering a CIPR
- Whether the member has any debts that need to be extinguished prior to commencement of a CIPR
- Whether the member has a terminal illness or has a reduced life expectancy.
- Whether the member has considered how commencement of a CIPR would interact with any Centrelink benefits they might receive.
- Whether the member has invested in, or become subject to, any other annuitisation arrangement which would reduce the need to commence a CIPR to ascertain retirement income.

**30. What is the most appropriate type of disclosure document to provide further information about a CIPR to consumers and intermediaries such as financial advisers?**



A shorter PDS needs to be developed and consumer tests specifically for CIPRs. It should be subject to a mandatory and comparable fee disclosure regime as currently applies for MySuper product PDSs.

A product dashboard disclosure for CIPRs should form part of this shorter PDS to facilitate comparison with other CIPRs as a minimum. There should be a capacity to compare CIPRs with choice investment options as well. By the time a member is considering other retirement options, they are fully engaged members and should be provided full access to comparative information in relation to choice investment options. To do less is to impede their ability to have choice.

Such disclosure is *not* developed with financial advisers in mind. Financial advisers have a duty to prioritise their clients' interests over their own – they may need to apprise themselves of more information from trustees in relation to the CIPR in order to comply with this duty. Their information needs should not be considered to be the same as consumers needs because of their greater fiduciary responsibility.

Having said that, consumers considering CIPRs and other retirement products (as choice investment options within a superannuation fund) should not have reduced access to disclosure if they do not wish to use a financial adviser – this is anti-competitive and reduces the prospects of real comparison.

Significant features of CIPRs should be disclosed and coverage should include the following key items of specific importance to purchasers of CIPRs:

- Portability of CIPRs
- Ongoing fees and costs and capacity to increase fees
- Taxation
- Social security treatment
- What happens on death
- How a CIPR is valued against the \$1.6million balance transfer cap

### ***Competition***

#### **31. What is the best way to assist individuals to assess the pros and cons of a CIPR?**

As a feature of the mass customised CIPR offer, prospective purchasers should be subject to a Q and A on the issues outlined in the answer to Question 29.

Prospective purchasers should only be able to purchase a mass customised CIPR if they have account balances greater than a specified amount determined by the trustee having regard to the type of CIPR they offer.

A shorter PDS with a product dashboard which attaches to and forms part of the shorter PDS needs to be provided. Additional information on the CIPR should be incorporated by reference and be contained on the website of the trustee of the superannuation fund offering the CIPR.

Prospective purchasers should be provided with a reference to a comparator that deals with CIPRs and means to compare CIPRs with retirement products that are choice investment options within superannuation.

### **32. What is the best way to foster competition in the CIPR market and the broader retirement income product market?**

The lack of flexibility and portability of CIPRs in their currently envisaged form means that competition in the retirement market will not work effectively. High exit fees exacerbate this issue.

More flexibility and portability will serve to keep prices down, reduce sharp practice in the industry and ultimately make product offerings more competitive and appealing to consumers. Ironically, if such products were made to be more appealing to consumers then there would be less need to mandate CIPR offerings.

Refer answers to question 31 in relation to effective disclosures to foster comparison and therefore competition. The comparator referred to should be on the ASIC Moneysmart website and be able to demonstrate the effect of fees on \$100,000 balance where a purchase figure is required, and demonstrate the effect of fees on ongoing retirement income. The comparator should project fees based upon the highest fee that can be charged for a CIPR, rather than the middle of any range.

Any disclosures and representations made about ongoing retirement income need to include figures that are *net* of fees – if they are gross figures they do not give prospective purchasers a clear indication of their expected retirement income.

If a superannuation fund member wishes to compare the CIPR offer with other retirement products that are choice investment options offered by the same trustee, then the comparator provided in relation to the CIPR should be provided in relation to the retirement product that is a choice investment option as well.

**33. Should CIPRs be able to be provided via direct channels and financial advice?**

Yes this is appropriate. CIPRs should be provided via direct channels and available for personal advice by financial advisers as well.

In each case the use of comparators should be mandatory. The use of comparators should apply when comparing between CIPRs, when comparing between CIPRs and retirement choice investment options, and when comparing between retirement choice investment options.

***Fees and pricing of CIPRs***

**34. Is there a need for regulation of fees and pricing of CIPRs? What are the options?**

Yes. AustralianSuper is concerned that the mandatory offer of CIPRs for its members may not always satisfy the best interests of members. One of the key concerns in this regard is the ability of third party CIPR providers to increase fees during the period of retirement when the retiree has no bargaining power to leave the product without serious financial loss. A large increase in fees during the period of retirement would leave CIPR retirees with a tangible reduction in retirement income as a result of fee increases.

AustralianSuper suggests that a projection of fees over the life of the product is required, otherwise providers could apply higher fees at the 'back end' of the product, to make a CIPR look cheaper at commencement.

The lack of flexibility and portability of CIPRs in their current form means that competition in the retirement market will not work effectively – refer to the answers question 32.

**E Products outside the mass-customised CIPR framework**

**35. Should a retirement income product that meets the minimum product requirements of a CIPR be labelled as such?**

No. It would appear that the CIPR framework intends to foster development of mass customised CIPR products that a trustee concludes are appropriate for a broad demographic in their superannuation fund. To allow a choice investment option to be labelled as a CIPR without the same considerations would serve to confuse consumers and imply that advice is less likely to be required, when it may be necessary for advice to be provided.

Further, the safe harbour should only apply to CIPRs offered as mass customised products and not 'choice' versions of the same product.

**F Other matters**

**36. Is 'My Retirement' a more appropriate label for a CIPR in both the product and framework sense?**

AustralianSuper supports the use of the term 'MyRetirement' in relation to the framework only – not for use on products per se. This is especially so given the current parameters for CIPRs allow inflexible products that do not meet the needs of consumers who change their mind.

**37. Would portability foster competition between CIPRs as well as other retirement income products? If so, how could portability be built into the design of a CIPR, should portability be mandatory or discretionary for trustees, and what would be the implications of this?**

Yes, portability would foster competition between CIPRs as well as other retirement products. Portability should be mandatory. It is understood that this will necessarily affect both pricing and performance of the CIPR. To have CIPRs with both mandatory and discretionary portability would hamper effective comparison and we are not convinced that consumers would always be in a position to determine whether they have purchased a CIPR that was portable or not.

**38. Should it be mandatory or left to the discretion of trustee to decide whether to allow for period certain guarantees in the design of CIPRs? What would be the implications of this?**

International experience indicates that retirement products with guarantees are not well suited to providing value for retirees in low interest environments or generally serving members with low balances.

### **39. What should be the maximum and minimum cooling off periods?**

More consultation needs to be done on the cooling off period after a reconsideration of the flexibility and general portability of CIPRs.

### **40. Should the CIPRs framework accommodate (and if so, how):**

- a. Joint CIPRs for couples?**
- b. Collective defined contributions schemes**
- c. Aged care refundable accommodation deposits?**

AustralianSuper would support joint CIPRs for couples but these products would need to be considered as divisible property in family law settlements in the event of divorce or separation, rather than provided to one party or another in a property settlement.

AustralianSuper supports the CIPR framework accommodating collective defined contribution schemes and also aged care refundable accommodation deposits.

## **Appendix B - Lessons from International Markets - Pension Systems and longevity products**

### **Background**

Pension systems in developed markets are facing a myriad of pressures. A trio of demographic trends – low birth rates, an ageing population and increasing life expectancy – is placing pressure on governments' capacity to pay public pensions. Further, current economic themes such as a protracted period of historically low interest rates, are accentuating the structural weaknesses of public pension systems and private retirement guarantees.

In response, governments and pension funds around the world are grappling with questions about how to reform pension systems to reduce reliance on government pensions and to increase the size of private pension pools. Indeed, regulatory and legislative changes of pension systems have been introduced or are currently being negotiated in a number of developed markets.

This paper considers lessons that may be imported from overseas markets to design

a better retirement income system in Australia. Specifically, reviewing key experiences in the US, UK, Germany and the Netherlands we consider:

- i) Recent pension reforms and the role of guarantees in these markets; ii) How a low interest rate environment has impacted retirement guarantees and the solvency of counterparties; and
- iii) What international experience indicates about the appropriateness of guarantees for low-income workers.

### **Pension reforms and the role of guarantees**

Unlike Australia, many developed nations have not mandated compulsory participation in private pensions. In order to boost the number of people who will be retiring with some form of retirement savings, Germany, the US and the UK have recently introduced automatic enrolment into occupational pension plans.

Governments have also sought reforms to introduce greater flexibility regarding benefit disbursement arrangements. Specifically, the UK and Germany – two systems with a long-standing reliance on retirement guarantees – have reviewed or are in the process of reviewing the role of guarantees in the context of the current low interest rate environment.

The UK has a long history of mandatory annuitisation of private pensions, dating back to the *Financial Act* of 1921. Prior to recent reforms, the UK pension system was designed to discourage lump-sum withdrawals and mandated annuitisation by the age of 75. Prior to 2015, retirees with balances higher than £18 000 but lower than £310 000 pounds could access their money in a lump sum only if they paid a 55% tax charge on their balance.

In 2014, the UK government announced the most extensive changes to its pension system for a century, effectively ending the regime of mandatory annuitisation. The new structure allows retirees with any size balance, to choose the best option for them.

These changes were motivated by both a belief that retirees should have flexibility to make decisions at retirement depending on their personal circumstances and a concern that annuities no longer represented value in a low interest rate environment, in particular for retirees with a low balance. These factors and how they apply to the UK market are discussed in sections below.

The German pension system has also traditionally incentivised retirees to enter into products which guarantee some form of lifelong income. However, current reforms which focus on changes to the second pillar of the German system – occupational pensions - indicate that the government is seeking to introduce additional flexibility in the system by moving away from guarantees. Recent consultation paper released by

the German government suggests that reform will remodel the pillar into a defined contribution model without guarantees.<sup>2</sup>

### Low interest rate environment – Reduced benefits and solvency risks

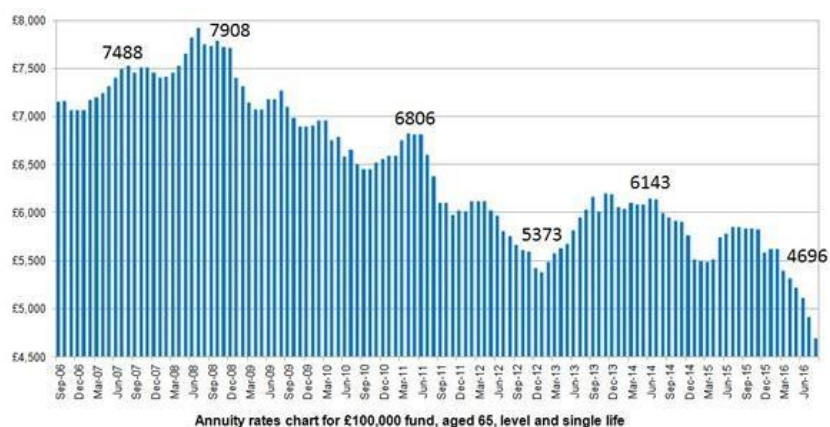
Following the GFC, interest rates reached historical lows in major developed markets. Economists anticipate that we may have entered a protracted period of low interest rates. Extended periods of low interest rates present risks for retirees who have purchased some form of nominal income guarantee and governments seeking to increase private pension savings:

- i) Retirement guarantees are linked to interest rates. A low interest rate environment can therefore reduce benefits.
- ii) Low interest rates, particularly under a mandatory annuitisation regime, may discourage citizens from saving for retirement
- iii) Low interest rates can create funding pressures for counterparties offering retirement guarantees, increasing solvency risk.

#### *Low payouts and reductions in benefits*

Low interest rates coupled with mandatory annuitisation in the UK has locked millions of retirees into increasingly low annuity payouts in the past 10 years. The chart below shows how annual annuity payout rates for a 65 year old male purchasing a £100 000 annuity have reduced from £7500 in 2007 to below £5000 in 2016.

*Figure 1 Annual annuity payout rates in the UK since 2006*



Source: MVOEM: <http://mvoem.com/wp-content/uploads/2016/09/annuity-rateschart-main-large.jpg>

<sup>2</sup> <https://www.ipe.com/pensions/pensions-in/germany/sector-fund-proposals-a-new-tune-for-germanpensions/10007276.fullarticle>

In 2016, UK annuity rates dropped 15%, to their lowest on record.<sup>3</sup> Poor payout rates in the last decade have reinforced the claim that annuities deliver poor value for retirees and added pressure to the UK government to legislate greater flexibility in the pension system.

Retirees in the Netherlands have also experienced reductions in retirement guarantees. As a result of funding pressures, the calculation of benefits in the Netherlands has changed in recent years with an aim to reduce the income guaranteed. The size of an income guarantee in the Netherlands typically depends on a reference wage and the number of years of service. The reference wage used to be calculated on the basis of a retiree's final wage however, that has progressively changed in the last decade so that a reference wage is now calculated as a career average wage, effectively lowering annual benefits in most cases.<sup>5</sup>

Retirees in a number of funds in the Netherlands have also experienced nominal cuts of pension payments as a result of funding pressures induced by persistent low interest rates. For example in 2013, 16% of Dutch pension funds cut pension rights.<sup>4</sup> These cuts were capped by the government at 7%. Other funds have forgone traditional indexation of benefits in an effort to reduce funding pressures.<sup>7</sup>

### *Discouraging Saving*

Low interest rate environments, particularly when paired with mandatory annuitisation, can have the second order effect of reducing the amount that members save throughout the accumulation phase. This is precisely the opposite behavior the majority of developed market governments are seeking with current reforms.

Following the announcement that annuitizing pension savings would no longer be mandatory in the UK, 28% of workers believed they were more likely to start saving for retirement or more likely to save more for retirement than they were before the reforms.<sup>5</sup>

### *Increased risks of counterparty solvency*

A protracted period of low interest rates presents unique challenges to pension and insurance funds offering long-term retirement guarantees. Specifically, counterparties guaranteeing retirement incomes experience challenges in having adequate

---

<sup>3</sup> <http://www.telegraph.co.uk/news/2016/09/14/worst-ever-year-for-annuities-as-rates-fall-by-15pc/> <sup>5</sup> L Bovenger, R Mehlkopf & T Nijman 'The promise of defined ambition plans: Lessons for the United States, <http://pensionresearchcouncil.wharton.upenn.edu/wp-content/uploads/2015/09/WP2014-15Bovenberg-Nijman-Mehlkopf.pdf>

<sup>4</sup> Ibid. <sup>7</sup>

Ibid.

<sup>5</sup> Pension and Lifetime Savings Association, [http://www.plsa.co.uk/PressCentre/Press\\_releases/040028-per-cent-of-workers-more-likely-to-save-into-a-pension-following-Budget.aspx](http://www.plsa.co.uk/PressCentre/Press_releases/040028-per-cent-of-workers-more-likely-to-save-into-a-pension-following-Budget.aspx) <sup>9</sup> European Central Bank, Financial Stability Review 2015.



longdated assets to match their long-term liabilities. This may create a long-term liability gap for funds or induce funds to undertake risky investment strategies.

As such, the persistence of low interest rates increases the risk that counterparties offering the guarantees will become insolvent. In the event of an insolvent counterparty, retirees either lose their retirement benefits or an industry or government insurance arrangement upholds the guarantee.

For example in Japan in between 1997 and 2003 after a protracted period of low interest rates, a number of life insurers failed, jeopardizing the retirement incomes of retirees who had purchased a guarantee with those counterparties. Annual incomes of guarantee holders were reduced however, Japan's Policyholder Protection Fund honoured guarantees so that retirees were not left without income.<sup>9</sup>

The UK and the US have implemented pension benefit guarantee schemes to ensure that in the event of counterparty insolvency that pension benefits will continue to be paid, up to a specified maximum amount.

In the case of the US, the Pension Benefit Guaranty Corporation (PBGC) acts as guarantor for employer-sponsored pensions. In 2014, the PBGC announced in their annual report that as a result of the number of pension plans struggling to remain solvent in the economic environment that the medium-term solvency of the PBGC was also in doubt at current premium levels.<sup>6</sup>

The pressures that governments and funds face in upholding retirement guarantees in a low interest environment and the risks retirees face in terms of reduced or cancelled retirement benefits underscores the importance of flexibility in retirement. Even if the current low interest rates do not persist, the economic environment of the last 10 years shows that investment markets can shift remarkably and often in ways that cannot be predicted decades in advance. This lesson is of critical importance when planning the long-term structure of a retirement system and underpins AustralianSuper's belief that flexibility for members should remain at the core of Australia's retirement system.

### **Appropriateness for low income workers**

The UK experience provides some interesting insights into:

- i) The value of annuities or retirement guarantees more generally for low income workers
- ii) How appropriate workers with low balances consider these products to be for them.

In the UK, annuities were considered to be poor value for retirees with low balances. This was in part driven by the fixed costs of a product and the proportion of a low

---

<sup>6</sup> Management's discussion and analysis of results of operations and financial position – Pension Benefit Guaranty Corporation Annual Report 2014

account balance absorbed by these costs. As a result, smaller balances typically attracted lower annuity rates than accounts with larger balances. This outcome raises questions about the value of a product for a member with a low balance relative to a member with a much larger balance.

It is reasonable to measure the appropriateness of a product for a specific cohort of members by the take up of that product when the cohort has flexibility to choose the product or not. Workers in the UK, including low income workers in particular, have resoundingly spoken regarding the appropriateness of annuities since the UK's reforms:

- i) In the 12 months post-reforms, of those accessing their retirement funds only 5% have opted to purchase an annuity, a reduction of 70% compared to pre-reform years.<sup>7</sup>
- ii) The value of annuities purchased since the changes have increased by 69%, suggesting that those choosing an annuity have large balances relative to the UK average.<sup>8</sup>
- iii) Despite concerns in the UK at the time of reforms that the removal of mandatory annuitisation would lead to retirees withdrawing their entire lump sum to spend on luxury lifestyle products, only 6% of those accessing retirement funds since reforms have opted to take a full lump sum.<sup>9</sup>

These statistics indicate that retirees in the UK are cautious but have overwhelmingly decided that annuitized products are not in their best interests particularly in the low interest rate environment.

This underpins AustralianSuper's belief that retirement products with guarantees are typically suitable only for members with large balances and therefore our concern that a CIPR will not be right option for the majority of AustralianSuper members. Furthermore, AustralianSuper's projections indicate that average member balances will not increase dramatically over the next decades and thus AustralianSuper is unlikely in the foreseeable future to have a majority of members for which a CIPR is appropriate

---

<sup>7</sup> Institute and Faculty of Actuaries – Freedom and Choice: Public attitudes 1 year on Survey Report

<sup>8</sup> KPMG – Freeing the future? Market impacts on the pension freedom reforms, <https://home.kpmg.com/content/dam/kpmg/pdf/2015/09/freeing-the-future-v2.pdf>

<sup>9</sup> Institute and Faculty of Actuaries – Freedom and Choice: Public attitudes 1 year on Survey Report