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MEDIA RELEASE

FSI super recommendations herald a ‘retirement revolution’

8 December 2014, Sydney - Challenger Limited welcomes the FSI’s Final Report as heralding a ‘retirement revolution’, and agrees that the retirement phase of superannuation would benefit greatly from appropriate structure in the form of pre-selected retirement products for members which deliver stable income and longevity protection.

Challenger Chief Executive Officer Mr Brian Benari said “This is a clarion call for real change, change that’s needed to address retirees’ justifiable fear of outliving their savings. As a retirement income specialist Challenger is uniquely positioned to play a key role in the FSI’s retirement revolution.

“As observed by the FSI, the account-based pensions (ABPs) which currently account for 94% of the retirement income stream market don’t protect retirees against outliving their savings, and should be paired with longevity risk products.

“We strongly endorse the FSI’s idea for trustees to pre-select products as a practical remedy to the systemic and acute over-reliance on ABPs as a singular retirement solution, and agree with the FSI’s view that their “dominance” can be explained “in part, [by] behavioural biases.

“Notably, the FSI suggests that super funds partner with life insurers to provide longevity protection, citing guaranteed annuities as a cornerstone risk management product. As shown by our recent announcement with VicSuper, such partnerships are already on super funds’ radar, and are likely to increase in number in light of the FSI’s recommendations”, said Mr Benari.

The FSI’s Recommendation 11 would require super fund trustees of all APRA-regulated super funds to pre-select for its members a comprehensive income product for retirement (CIPR) while they’re still in the accumulation phase of superannuation, enabling a ‘seamless transition’ to retirement. CIPRs would have prescribed minimum features including a “low cost” and “regular and stable income stream, longevity risk management and flexibility”.

As an early advocate of income layering using annuities and account-based pensions, Challenger endorses the FSI’s view that complying CIPRs will likely require “a combination of underlying products” to provide these features as well as flexibility for members, and notes its example of “an account-based pension paired with a pooled product that provides longevity risk protection”, such as a life company-provided guaranteed annuity.

“Today’s partial annuitisation strategies already reflect the prescribed requirements of a pre-elected CIPR, inferring widespread adoption of retirement income model portfolios similar to those developed recently by Mercer and Zenith. These strategies combine annuities with account-based pensions to deliver longevity protection and income certainty”, said Mr Benari.

“Moreover, because annuities are capital-backed, prudentially regulated hard promises, they fully meet the FSI’s prescribed requirements around income and longevity protection. Super fund trustees selecting annuities to comply with CIPR requirements wouldn’t be leaving anything to chance. Members would receive guaranteed outcomes from today rather than just hoping to receive best-efforts, or ‘expected outcomes’ in the distant future”.

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Adoption of the FSI's Recommendation 11 could provide a substantial boost to the Australian annuity market. As observed by the FSI and Organisation for Economic Co-operation and Development (OECD), "The lack of a significant market for products with longevity risk protection sets Australia apart from most other developed economies [the annuity market] is only 0.3% per cent of GDP, compared with 28.8% in Japan, 15.4% in the United States and more than 40% in some European countries".

"As the FSI observes, Australia has a lot of catching up to do when it comes to effectively providing longevity risk protection to super fund members. By supporting Treasury's program to remove the impediments to the introduction of DLAs, the FSI is recognising that they're the "lowest hanging fruit" in the reform tree", said Mr Benari.

"As a specialist and market leader in retirement incomes, Challenger looks forward to being part of this consultation process as well as a broader reform program aimed at ensuring Australian retirees finally achieve financial security in retirement".

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Notes:

RECOMMENDATION 11 – Require superannuation trustees to pre-select a comprehensive income product for members' retirement. The product would commence on the member's instruction, or the member may choose to take their benefits in another way. Impediments to product development should be removed

Key retirement income points from the Final Report include:

- Recognition that the objective of the superannuation system is not lump sum wealth creation, but "to provide income in retirement to substitute or supplement the Age Pension." (p95)
- That the dominant retirement product, the account-based pension is part of, not a complete, retirement solution. (p117).
- The dominance of account-based pensions can be explained in part by behavioural biases. (p 119)
- Greater use of products that pool longevity risk could significantly increase retirement incomes. (p123)
- Behavioural biases support a requirement for super trustees to pre-select a comprehensive income product (CIPR) for members' retirement.(p117)
- A CIPR could include an account-based product and another product with longevity risk protection (p127)
- A CIPR would like be a combination of products enable to retirees to balance the three desired features of retirement income products (high income, risk management and flexibility). (p121)
- That pooling longevity risk gives retirees greater confidence to live comfortably, mitigating the widespread problem of "excess frugality" whereby they only draw the minimum from their account-based pensions due to fear of premature depletion (p121)
- That private provision of longevity risk protection could benefit taxpayers and the broader economy it would shift some of the longevity risk borne by Government, as the provider of the Age Pension, to the private sector. Assets underlying products with longevity risk protection could be invested with a longer time horizon, helping to fund long-term investments and develop the corporate bond market in Australia as funds seek more investments that provide a steady flow of income.(p122)
- Support for the review of retirement income stream regulation being undertaken by Government, which is examining ways to reduce or remove barriers to developing a market for DLAs. (p125)
- Recognition that longevity risk is not covered in ASIC's RG146 qualifications for superannuation advisers. (footnote 56 p119)

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