

Manager, Retirement Income Framework
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600

superannuation@treasury.gov.au

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Submission on the Retirement Income Disclosure Consultation Paper

Hannover Life Reassurance of Australasia Ltd is a member of the Hannover Re group, the fourth largest reinsurer in the world. Established in 1966, the group is present on all continents with over 100 offices and more than 3300 staff globally. In Australia, Hannover Re provides life reinsurance services to both the retail and superannuation group insurance markets. Whilst transacting all lines of insurance business, the group has a dedicated, cross disciplinary longevity team, with expertise built over more than 20 years.

Hannover Re provides and supports longevity risk solutions across the globe and has been particularly active in the underwritten annuities and pension block markets. Transacting in these markets, we have built a substantial database of experience on which to draw upon in developing retirement income solutions for the Australian market.

Hannover Re is grateful for the opportunity to provide feedback on the Retirement Income Disclosure Consultation Paper and is committed to developing retirement income solutions to support Australians in retirement. Hannover Re would be pleased to meet with Treasury to discuss this submission, and other elements of the development of the Retirement Income Framework.

[Hannover Life Re of Australasia Ltd.](http://www.hannover-re.com)

100 Barangaroo Avenue, Tower 1, Level 33, Sydney NSW 2100, Tel.: +61 2 9251 6911, Fax. +61 2 9251 6862, www.hannover-re.com.au,

[Board of Directors](#) Peter Gaydon (Chairman), Claude Chèvre (Deputy Chairman), Susan Everingham, Gerd Obertopp (Managing Director), Robert Swil, Ulrich Wallin, Robert John Wylie

[Registered office](#) 100 Barangaroo Avenue, Tower 1, Level 33, Sydney NSW 2000, ABN 37 062 395 484

Member of the Hannover Re Group

Feedback regarding the proposed disclosure metrics, their presentation and calculation

The proposal to provide a disclosure fact sheet is supported by the findings of the ‘*Supporting retirees in retirement income planning*’ study from the Behavioural Economics Team of the Australian Government (BETA). The proposed retirement income fact sheet disclosure metrics are appropriate, and speak to the characteristics that are relevant to consumers. Hannover Re supports the proposal to provide a simple retirement income disclosure fact sheet, in order to assist in overcoming the behavioural bias that results from being provided with complex legal and financial information via the quite technical, however legally necessary, Product Disclosure Statements.

As we know, behavioural factors contribute to the low acceptance of annuities, with rational explanations unable to solve the annuity puzzle – the question of why people annuitize significantly less money than they should optimally. Understanding these behavioural biases and framing the retirement income disclosure fact sheet using a behavioural economics lens will assist the consumers’ understanding of their likely future income and risks.

In principle, we agree that the fact sheet should be standardised for a 67 year old (linked to age pension qualification or something similar) male and female, to ensure that the messaging to the consumer is relatable.

In regards to each of the proposed metrics, we have provided our general commentary, which highlights that, whilst we are supportive of consistent disclosure metrics, these metrics need to be flexible enough to provide a clear and simple summary for most types of retirement products. In addition, a clear explanation of longevity risk needs to be communicated.

Prior to making a final determination regarding the metrics, consideration should be given to how potential product designs would be represented under the proposed metrics as the current framework could be quite subjective, in particular the income variation metric.

Importantly, we expect that this fact sheet should apply to all retirement products including ABP’s, otherwise the risks of ABP’s and the benefits of longevity products will not be compared.

A further consideration for the fact sheet is whether it should be product specific (i.e. deferred life annuity) or solution specific (80% ABP and 20% deferred life annuity). We expect that the fact sheet should be flexible enough to accommodate both options and allow the provider discretion on how they present an example CIPR solution.

Income

Proposed approach: Expected retirement income

For all retirement income products, expected retirement income should be presented numerically and with an income graph using average real annual income from a \$100,000 investment, over the period from retirement (currently age 67) to age 97. Income presented should be net of fees and taxes.

Hannover Re supports the presentation of income net of fees and taxes, along with the use of \$100,000 as a benchmark. Presenting income both as fortnightly and annual amounts, indicating 'take home pay' would appear the most simple and therefore best approach.

Understanding behavioural patterns (loss aversion, overestimation of low probabilities & underestimation of high probabilities, time preference, anchoring effects & mental accounting) is a prerequisite to avoid misjudgements, especially for annuity products. Typical misjudgements are the underestimation of one's life expectancy and viewing annuities as an investment.

Available evidence posits that consumers evaluate annuities using a narrow "investment frame" that focuses on risk and return, rather than a "consumption frame", that considers the consequences for lifelong consumption. Traditional annuities considered under an investment frame seem to be quite unattractive – exhibiting high subjective risk without high returns. There is evidence available that when a life annuity is framed in terms of consumption, meaning consumers are told how much a product would ultimately allow the purchaser to consume and for how long, 72% of respondents prefer a life annuity, compared to 21% when framed in terms of investment features (Brown, 2008).

Hannover Re therefore supports the focus on expected retirement income, thereby setting a consumption frame, whereas the duration of the expected retirement income should also be stated clearly.

In respect to presenting expected income both numerically and graphically, the BETA study found that a text table - using words rather than numbers alone - was consistently the most effective approach in highlighting income, and led to significantly improved comprehension, clarity, decision making ease and confidence. Adding a graph introduces complexity to what is intended to be a simplified approach, hence it would be anticipated that the best approach would not involve the use of an income graph, rather presenting income in a text format.

Further, showing income over a period of 30 years, ceasing at age 97 may inadvertently lead consumers to underestimate longevity risk – it is presumably not the intention to reflect that an "income for life" ceases at age 97. Income should be reported until death and if the income runs out earlier, this should be clearly indicated. Potentially this could be shown using two outputs – average income and age/years it runs out, if at all.

It would also be prudent in this section to educate the consumer in respect of life expectancy, as consumers consistently underestimate this. Included within the fact sheet should be an explanation of how current life tables underestimate life expectancy and how one could get a better idea of their own life expectancy.

The above could be linked to an online portal to help consumers estimate their personal life expectancy after answering a few questions. This could provide a guide for consumers and their advisers to understand their specific risks. Having the consumer undertake a few underwriting questions via an online form would add enormous value to help them to assess which type of products are appropriate for them. For example, this could be hosted by ASIC MoneySmart or provided as a behind the scenes API that super fund's own websites could utilise.

Income variation

Proposed approach: Calculating income variation

For all retirement income products, income variation should focus on negative or downside variation measured against expected first year real income. The model measures downside income variations and the size of variations.

Products with risk mitigation strategies, protection factors, or conservative investment strategies, create fewer downside variations and therefore have lower risk scores.

We agree that the elements that make up income variation are sound and appropriate for understanding how the income might change for consumers. However, we do not think having one overall score is appropriate. We can see a number of circumstances where two different products produce vastly different risk outcomes but in aggregate have the same score.

We feel that three or four standard sensitivities are appropriate to show the impact on income from:

- Personal Life Expectancy - which could be standardised across the industry for 10%-20% difference in life expectancy targeting the 5th and 95th percentiles
- Investment Returns – the actual changes should be standardised across the industry for different investment classes and should allow for upside and downside risk
- Inflation – as above

In addition, this section could provide commentary to disclose other elements such as that the income is for life or until the balance runs out and whether there are any guarantees on the investment returns.

Consideration should also be given for where the consumer has investment choice (e.g. ABP, Unit Linked Annuity). In these cases the investment return sensitivity could be dialled up or down depending on the consumer's choice. In this case, the sensitivity should provide for different investment strategies such as growth, moderate and defensive and highlight that the product allows for consumer choice.

An objective score for each of the above sensitivities could be then displayed which will allow for a more objective comparison across different retirement products.

The use of 5th and 95th percentiles to determine the appropriate magnitude of the sensitivities will allow for appropriate variation to allow for objective comparisons.

Noting the above, the number of sensitivities, the appropriate magnitude and the resulting scores will need to be developed through consultation with industry and the AGA – we would welcome the opportunity to participate in this process.

Further, it is noted that the final wording for this section will be drawn from academic research and consumer testing on how best to describe these concepts. We agree with an approach based on evidence and consumer testing is most beneficial and look forward to these findings and the proposal that follows.

Access to underlying capital

Proposed approach: Access to Capital

For all retirement income products, consumers should be presented with information on the maximum amount they could withdraw at any time if they wanted to stop using the product. This amount would vary depending on what type of product they have purchased and the capital access schedule.

Australians want to retain personal choice, control and flexible access to their superannuation funds, with many comments received in the BETA study in this regard. Some participants described explicitly that they require flexible access to lump sums for planned or unplanned purchases through retirement.

Whilst CIPR's are intended to offer this flexibility, this is not well understood, with many of the BETA study participants indicating that whilst they are attracted to the financial security afforded by the CIPR, they would not purchase a CIPR as they do not want to give up control of their funds. Hence, it is indeed important to highlight this access to the maximum amount of capital available for withdrawal in the fact sheet.

In respect to the presentation of this, Option B – Table would appear the most appropriate, noting again BETA study findings.

Please note that the example chart and table provided seem to infer that a deferred life annuity has a withdrawal value at age 67.

Death benefits and reversionary benefits

On death

Should your spouse or partner live longer than you, this product will pay them:

X% of the income above/no ongoing income

AND/OR

The remaining amount available for withdrawal in the table/graph above at the age of death

AND/OR

A lump sum death benefit of \$x,000

Noting that the majority of consumers enter into the retirement phase as a member of a couple, in order to facilitate adequate retirement planning it is important to document the death and reversionary benefits remaining available to a living spouse in the event of a members death, along with any life insurance payments available. As noted, depending on the product, one (or more) of the three individual components: reversionary benefits, remaining commutable value and life insurance components may apply, and should indeed therefore be detailed on the disclosure fact sheet. The proposal to detail these by way of a text box is most suitable, given the evidence available supports this approach as being the most effective in communicating the facts in a simple, concise manner.

Future Considerations

The documented future considerations (lifetime engagement, advice framework, post purchase engagement, reporting requirements, intra-fund product comparisons and income variation risk measure consultation) are appropriate.

A further future consideration we would like to add, is educating the consumer in respect to life expectancy: consumers consistently underestimate their life expectancy. Evidence shows that annuity take up rate increases when the consumer has a greater understanding of their potential life expectancy. (Rub, 2018)

As described above, this could be linked to an online portal to help consumers estimate their life expectancy after answering a few questions. This could provide a guide for consumers to understand their specific risks. Having the consumer undertake a few underwriting questions would allow them to assess whether these products are appropriate for them.

We look forward to contributing to the development of the future considerations in due course. We note the intention for further consumer testing as a next step, we believe this to be appropriate and we look forward to seeing the results of testing.

Conclusion

In concluding, with the Financial System Inquiry findings and the Productivity Commission's Inquiry report commenting on members struggle to find the right retirement product, coupled with the noted low engagement contributed to by complex, hard to compare products, we support the intention to provide a retirement income disclosure fact sheet. We believe that the standardised metrics as described above if, presented correctly will achieve the aim of better informing consumers about their likely future income and potential risks. As mentioned, we also believe that educating consumers about life expectancy would also assist consumers to make more informed, and more appropriate choices.

What must also be borne in mind is the members need for flexibility, choice and control. This, coupled with disengaged members reticent to make complex financial decisions, along with a lack of available simple, relevant information, almost demands the existence of a standardised disclosure framework. The retirement income disclosure fact sheet will likely form a key piece of the disclosure framework.

We thank Treasury for the opportunity to comment and contribute to the continued development of The Retirement Income Framework. We look forward to seeing further development, and contributing further in due course. As mentioned, we would welcome the opportunity to meet with Treasury for further discussion.

Yours Sincerely,

A handwritten signature in black ink, appearing to be 'TP', with a long horizontal line extending to the right.

Tracy Peterson
Longevity Solutions Manager
Hannover Life Re of Australasia Ltd

References

- Brown, J. K. (2008). *Why Dont People Insure Late Life Consumption: A Framing Explanation of The Under-Annuitization Puzzle*. Cambridge, MA. : National Nureau of Economic Research.
- Rub, J. S. (2018). *Nutzen und Akzeptanz der lebenslangen Rente* . Ulm: Institut fur Finanz- und Aktuarwissenschaften .