Submission

to

Treasury Retirement Income Policy Division

concerning

Comprehensive Income Products for Retirement

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Ms Jenny Wilkinson
Division Head
Retirement Income Policy Division
The Treasury
Langton Crescent
PARKES ACT 2600
By email mailto:superannuation@treasury.gov.au

Dear Ms Wilkinson,

COMPREHENSIVE INCOME PRODUCTS FOR RETIREMENT

1. Mutual Pensions Pty Ltd (MPPL) welcomes the opportunity to make a **confidential** submission in response to the 15 December 2016 Discussion Paper entitled *"Development of the framework for Comprehensive Income Products for Retirement"* (the Paper).

2. This submission contains: -

a. an initial comment covering aspects that may not be covered in other submissions;

b. background information on MPPL, its product and the difficulties and impediments it has faced in trying to establish a longevity protection scheme for Australian retired people;

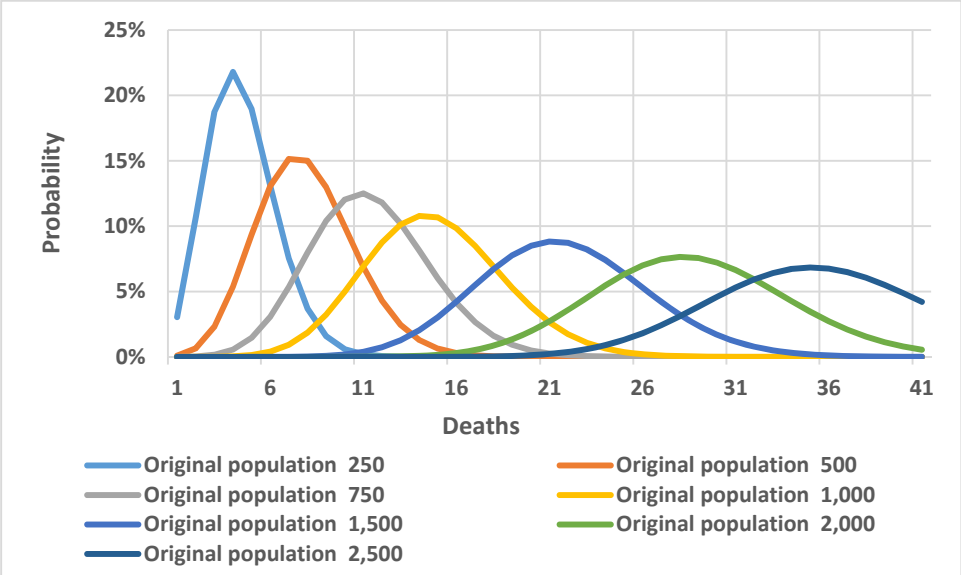
c. suggestions for immediate action to facilitate it and other organisations helping to achieve this;

d. general comments on the Paper and

e. detailed answers to the individual questions posed in the paper.

Initial comment

3. While the focus of the Paper is on individual actions of funds, longevity protection, particularly for smaller funds, is better provided where there are economies of scale and large numbers of lives involved to smooth distributions. This counsels cooperation between funds or the use of third party providers. To illustrate the problem, the following chart shows the distribution of deaths of various populations of males aged 67 experiencing Australian Life Table mortality rates.



4. When one considers that the people likely to take up the offer of a CIPR are a subset of the subset of fund members who are of retirement age, it quickly becomes apparent that only large funds will be able to efficiently offer CIPRs. For this reason, MPPL urges the government to consider and facilitate the cooperation of funds or the use of third party pools as it finalises the CIPR framework.

Background

5. Since 2007, MPPL has been working on a Group Self Annuitisation (GSA) concept. This has involved: -

a. benefit design;

b. lodgement of a patent application;

c. preparation of a draft Product Disclosure Statement (PDS);

d. software development dealing with data collection and storage and calculation algorithms and

e. presentations to superannuation fund executives and trustees.

6. Presentations have drawn considerable interest for the concept, but no commitments to its use. The main impediments to uptake have been: -

a. pressure of other work;

b. legislative impediments and uncertainty

c. uncertainty about member uptake and

d. a reluctance to be first mover.

Product description

7. MPPL's product is the Mutual Pension® overlay, which sits atop an Account Based Pension (ABP). In return for accepting restrictions on drawings and forfeitures on death, participants are entitled to share in distributions arising from forfeitures of deceased other participants. Participants can pursue whatever investment policies they wish.

8. There is considerable flexibility in the drawings and forfeitures to apply, but,once these have been established, very limited scope to change them.

9. In principle, Mutual Pension® overlays can work within a single fund or across a number of funds. The multi fund mode provides an opportunity for smaller funds to "harness the power of averages"® and provide longevity protection that they might not be able to provide alone.

Legislative impediments and uncertainty

10. The legislative impediments and uncertainties faced by Mutual Pension® overlays hinder, complicate or render uncertain the operation of the GSA that is the Mutual Pension® overlay and, no doubt, other GSAs. In particular,: -

a. the requirement of ITTA 97 Regulation 292.25.01 that transfers from reserves in excess of 5% of a member's balance are treated as Concessional

Contributions therefore exposes members to the risk of excess concessional contribution tax;

b. SIS Regulations 5.08(1), 5.04(2) and 6.21 cast some doubt on whether balances at death can be forfeited;

c. while SIS Regulation 6.30 exempts pensions from the requirement of Regulation 6.34 to rollover of funds on request, the exemption does not extend to ABPs casting doubt on whether it applies to an ABP subject to a Mutual Pension® overlay and any other GSA based on an ABP;

d. it is not clear that superannuation funds have the authority to draw on their reserves to transfer to another fund in the context of the multi fund Mutual Pension® overlay and

e. even if multi fund transfers are permitted, it is not clear whether they would be assessable and deductible under the ITAA and whether they would attract Goods and Services Tax, which would be unrecoverable by the receiving fund.,

Immediate recommendations

11. It is MPPL's suggestion that the government announce the specific barriers to the establishment of GSA based longevity protection that it will address and remove. This will enable the industry to get on with the task of designing such systems, without having to wait for draft legislation to know which specific barriers will stay and which will go. This will break the "chicken and egg" cycle that has so far inhibited innovation in this important policy area.

12. There may be impediments not identified by MPPL, but identified by other submissions. It is important that the government's intentions in respect of all impediments be known to the industry.

13. The impediments that MPPL has identified and which it seeks clarification or rectification are: -

a. there should be no impediment to forfeiture of funds on death within the rules of a GSA scheme;

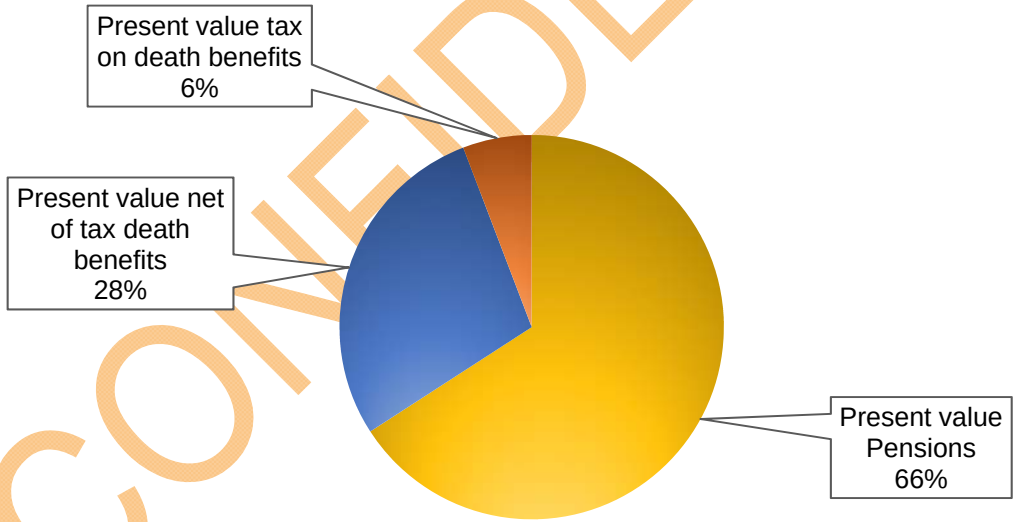
b. there should be no impediment to distribution of reserves created by the operation of a GSA scheme **within** a superannuation fund;

c. there should be no prevention of or taxation of transfers of reserves created by the operation of a GSA scheme **between** participating superannuation funds and

d. there should be no right for a member to transfer or commute funds subject to a GSA scheme out of that scheme except in circumstances where the funds are transferred to another GSA scheme with no less stringent forfeiture requirements.

General comments

14. MPPL supports any proposal that concentrates the use of superannuation funds on the provision of retirement income rather than intergenerational family transfers. It notes that, even allowing for some future increases in longevity, a strategy of minimum drawdown of an ABP "wastes" over a third of the funds set aside for retirement by a male aged 65 as shown in the following chart.



15. MPPL thinks the "soft default" option suggested in the Paper is appropriate, but believes that the industry will start with quite conservative steps involving a low proportionate forfeiture. It may be that, as time passes, CIPRs move to a less conservative stance.

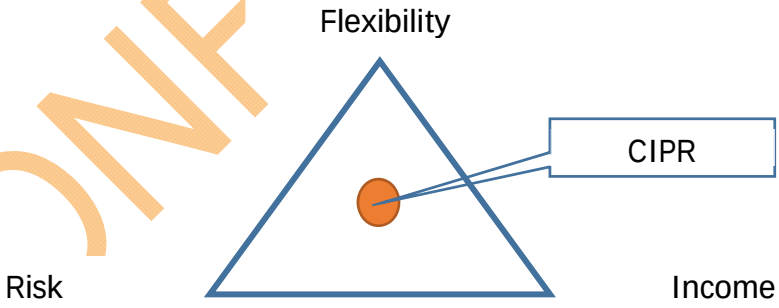
16. Even if CIPRs are conservative, removal of the impediments mentioned in paragraph 13 above will allow the development of advice distributed products across the spectrum from limited forfeiture to full forfeiture.

17. MPPL considers that the Paper is quite prescriptive considering that the framework in current contemplation. This framework is effectively limited to protecting trustees who voluntarily use their best endeavours to produce and offer a product in the best interests of the majority of their members but still attractive to those members. However, MPPL acknowledges that the principles now being developed will potentially have wider application as public policy and public opinion develop in this area.

18. MPPL supports principles based regulation and favours encouraging innovation by avoiding prescriptive regulation in favour of choice and disclosure. Regulatory oversight, it believes, should be directed primarily to solvency and truthfulness and ensuring sound processes.

19. MPPL acknowledges that much of the complication of superannuation documentation stems from an abundance of caution amongst trustees and their advisers. It strives to use plain English in its documentation and not to err on the side of too much detail.

20. MPPL appreciates the way the triangular drawing on page 16 of the Paper

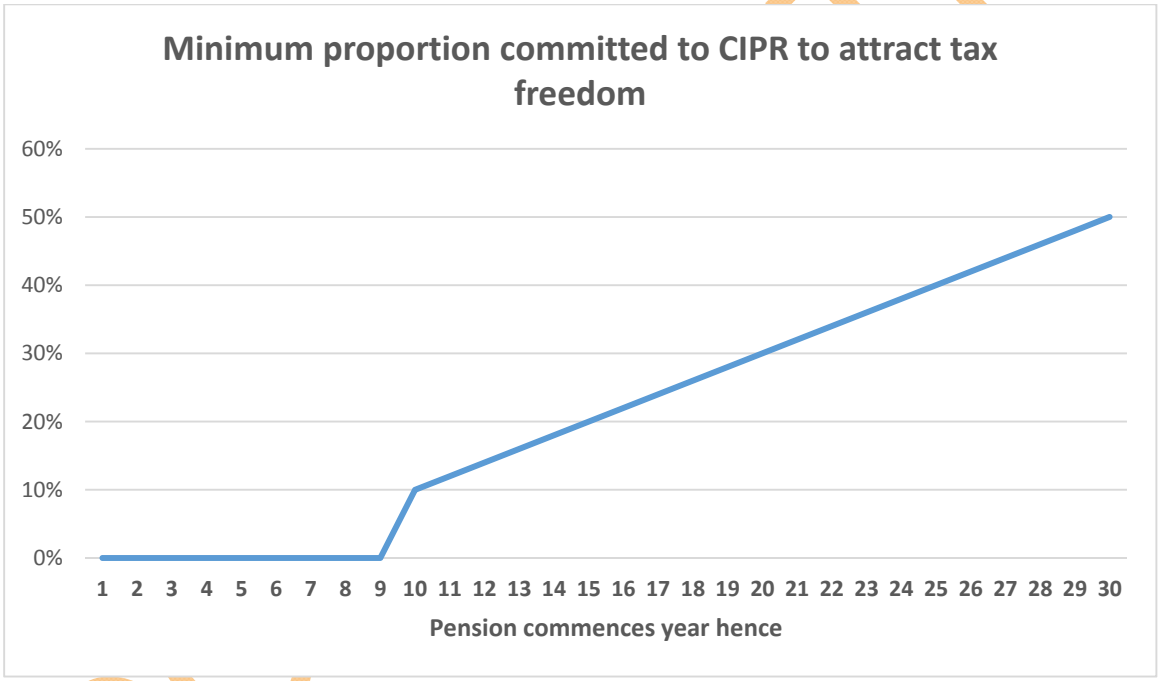


highlights the mutual exclusivity of the three policy objectives. It suspects that initially, trustees will produce CIPRs reasonably close to one of the points of the triangle and later move closer to the middle but that advice distributed options will appear everywhere on the triangle.

21. MPPL is certain that trustees will give earnest and informed consideration to the appropriate position in the triangle for the bulk of their members and hopes for a range of innovative solutions.

22. The Paper questions which trustees should offer CIPRs and whether it should, after a time, be mandatory for all trustees to offer CIPRs. The second question is at odds with the "central focus" of the Paper (page 8) that there would be no obligation on trustees to offer CIPRs. MPPL's view is that there is enough appetite for trustees to offer CIPRs without compulsion.

23. The problem is going to be whether the members see them as sufficiently attractive, not whether funds offer them. There could be an element of tax suasion if required. For example, there could be a 25 year phase in period starting 10 years hence to restrict the tax freedom on investment earnings to people committing say 50% of their funds to CIPRs, as set out in the chart below.



24. MPPL is pleased to note that its product, the Mutual Pension® overlay, meets the CIPR objectives.

Detailed answers

25. The remainder of this submission comprises detailed answers to specific questions raised in the Paper. Where appropriate, the answers are illustrated by references to how the Mutual Pension® overlay handles the situation.

A. Designing 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?	Consideration of the issues raised on page 13 for a typical member group. Ensuring that they consider what, if any, guarantees are involved. Having the default CIPR as a subset of a broader retirement product. For example, a Mutual Pension® overlay currently allows specification of the pension drawn, the proportion paid on death of member or spouse, the investment degree of aggression and the flexibility choices made. A CIPR would select default values for these parameters to obviate the member having to make a decision.
2. Are there any lessons from defined benefit schemes that can be applied to the CIPRs framework?	The wind back of defined benefit funds was largely due to funds and ultimately employer sponsors being unwilling to underwrite risk. The lesson here is that the funds must facilitate the exchange of risk between members, not take on the risks themselves. They do not have the capital to do otherwise.
3. Do you agree with the proposed three minimum requirements of a CIPR? What are the alternatives?	Agreed that the three components of income level, maintenance of real income and flexibility are important, but note that they are as indicated in the diagram on page 16 of the Paper, mutually exclusive.

	It will be important to measure the expected qualities, not guaranteed qualities as to require guarantees introduces risk to the trustees and hence cost to the members.
4. How important is achieving a minimum additional level of increased income to the introduction of the CIPRs framework?	It may not be possible to achieve a higher level of income in a lifetime annuity for a younger retiree. The reason is the necessary conservatism of investment policies. It will not be possible to **guarantee** a higher level under a GSA scheme. It will nevertheless be desirable to demonstrate an expected higher income.
5. How should income efficiency be defined?	The higher level of income is a by product of the avoidance of system leakage on death. It may be better to measure the forfeiture. It should be noted that some measures of the efficacy of GSA arrangements are based on the subject person surviving and all other members experiencing assumed mortality. These measures are necessarily dependent on the number of other members. Returns from GSA plans will also depend heavily on the investment assumptions used. While one can standardise the assumptions for comparative purposes, the actual experience will differ.
6. What minimum level of increased income should be required; that is, what should be the	As noted in the Paper, there is a trade off between the level of drawings and the maintenance of drawings. It is less pronounced where longevity risk pooling exists, but it is nevertheless present.

minimum level of income efficiency? How should guaranteed products be accounted for?	There are dangers in making this definition too prescriptive because of this trade off. If substantial forfeiture exists and fees are reasonable, a CIPR is "by inspection" superior to an ABP. This argues for the forfeiture being the measure. Also, note that forfeiture measures the public policy aim of avoiding intergenerational wealth transfer.
7. Which indexation option best achieves the goal of increasing standards of living in retirement?	A GSA plan can only reduce longevity risk. It has no effect on inflation risk or investment risk. Therefore specifying an indexation option is of little use. Income needs can be argued to fall in early retirement and then rise for those who survive into old age. This, again, highlights the dangers of being too prescriptive. MPPL's preference is that this is a matter best left to the trustees. We note that, in the context of a Mutual Pension® overlay, it is possible to adjust the drawing regime to change the later expected real income levels. It is also possible to set a drawing regime that provides a maintenance of real income for almost any desired period, but this is, in both cases, dependent on the earnings and mortality assumptions being realised and this is not guaranteed.
8. Are there comparability benefits from specifying which indexation option would be required of a CIPR?	Not unless the assumptions concerning the selected index are specified.

9. What elements/types of flexibility are most valued by individuals in retirement, and does flexibility need to be provided for through a CIPR?	MPPL makes no comment on what is most valued, but points out that flexibility to draw lump sums at will strains the bonds of mutuality allowing selection against the longevity insurer or other members. A Mutual Pension® overlay has the opportunity for unlimited variation in the drawing plan as specified at the outset and limited flexibility to vary drawings later and to make ad hoc drawings, the latter being subject to a test that the member's medical condition has not deteriorated. This means a period certain guarantee can be incorporated. Flexibility can be preserved by manipulating the proportion of funds held in ABP mode, without the Mutual Pension® overlay. Flexibility comes at cost of the other two points on the triangle in diagram 4 of the Paper.
10. To what extent should savings outside superannuation be used to meet unexpected costs in retirement?	It is not clear whether chart 2 of the Paper relates to retired households or all households and in any event, its composition might differ with age. It is likely that CIPR forfeiture on death will be limited with some element of ABP remaining, so some flexibility to meet unexpected costs will be automatically provided.
11. Is the proposed structure of a CIPR appropriate?	Yes. Note that in the Mutual Pension® overlay model, the third party provider does not hold any members' funds. This would probably apply to many, if not all, GSA plans.

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 already partner with a number of third party providers. To the extent that the trustees pass any risk to the third party provider, there is a risk to the trustees that the third party is unable to bear that risk.

In one extreme case of a lifetime annuity, the trustees are at risk of the third party failing to deliver after taking the longevity and investment risks.

In the other extreme, the trustee is at risk of a GSA provider botching the administration, nothing more.

In both cases, the mitigant is the trustees' due diligence processes.

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

While the purpose of the CIPR concept is to provide a simple default option suitable for most members, which suggests only one offering, the difference between the needs of coupled and single persons is so great as to render separate versions for each conjugal condition necessary. This is unless the distinction between these groups can be made within the CIPR.

Members who want bespoke solutions should be able to access a broader range of CIPR compliant options from a menu provided by the fund after personal advice. It would be convenient if the CIPR were part of that range.

In the Mutual Pension® context, the CIPR might be a Mutual Pension® overlay

- utilising **30%** of the member's ABP
- drawing **125%** of the ABP minimum applicable to the **30%** component

with

- **25%** forfeiture on death before **5** years
- **50%** forfeiture in death **5** to **9** years
- **100%** forfeiture **thereafter** with
- a **10%** of balance withdrawal at the end of year **6**.

Numbers and words in **bold face** above would be set by the trustees after consideration of their membership and be the same for all members opting for the CIPR. Not all of the options need to be used, for example, forfeiture could be constant. Other options could be considered, too. For example, increasing the rate of drawdown after a nominated period.

While this appears complex, it would not necessarily be so and any complexity is faced by the trustees in designing the CIPR, not the members in deciding whether to use it.

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

The offerings may differ by conjugal condition and perhaps gender and, less likely, age bands.

Another differentiator might be the member's Social Security status at the outset (full pension, part pension or no pension). Note this status may change on death of a spouse. Account balances and conjugal and home ownership statuses could be used as approximate proxies for the Social Security status.

It would be for the trustees to determine the boundaries of the classes of members parameters of the CIPR offered those members. Part of the

determination of the boundaries would be whether Social Security status is sufficiently available and provable.

B. The regulatory settings for trustees

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

This answer relates only to GSA arrangements, which are hampered in the intra fund and general context by

- legislative uncertainty whether some or all benefits in ABP mode can be forfeited on death,
- the requirement that internal distributions of reserves above 5% of a member's balance be assessed against the concessional contributions cap and
- legislative uncertainty about preventing members transferring out of a fund.

Uncertainty about the permissibility and income and goods and service tax treatment of inter fund transfers impedes the offer of GSAs with inter fund pooling. Such pooling is important to allow smaller funds the benefits of scale in longevity protection.

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

Yes. There needs, however, to be protection for those with poorer life expectancies. Words like "appropriate to people with normal or longer life expectancies" may be used.

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?

Any ongoing fund which currently produces a lump sum at retirement (defined benefit or accumulation) is a candidate for a CIPR, perhaps unless it already has a pension option.

The Paper mentions the possibility of SMSF members purchasing a CIPR from another provider. While this is possible, some trustees may desire the longevity protection of a GSA and the investment freedom of a SMSF. SMSFs present particular problems to providers of GSAs. These relate to security over assets that are due for forfeiture and compliance with the GSA drawing and other conditions. These problems are soluble and GSAs present an attractive addition to SMSFs. For this reason, they should be able to avail themselves of CIPRs.

MPPL recognises that "mass customisation" is an oxymoron in the context of SMSFs limited to four members. At present, with CIPRs not offering any advantages to trustees other than those associated with the safe harbour provisions, there is no need for SMSFs to offer them. However, against the possibility that a future government may legislate to confer tax or other benefits on CIPRs, SMSFs should have the authority to offer CIPR compliant benefits.

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?

A CIPR should be offered by all funds offering a MySuper option. This is consistent with need to have a default option that provides the best result for the majority of members. One would expect trustees to share this view so compulsion may not be an issue.

Whether there needs to be compulsion depends on the uptake. If there is to be such a requirement, it should be attached to MySuper funds after, say, three to five years.

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?

The variety of potential CIPR products and the broadness of the proposed requirements render "black letter" processes difficult to apply. APRA and, to a lesser, but still significant, extent, the Actuaries' Institute will both rely on "black letter" processes.

While there is the possibility of a spectrum of compliance, from just meeting the minimum requirements to "over meeting" them, there would seem to be no commercial advantage to a trustee in just meeting the minimum needs. If this be true, there is no incentive for trustees to "push the envelope" in determining whether their offering is CIPR compliant.

In this context, a "principles based" process is more appropriate. This argues for a trustee determination with an expectation or requirement that due process be demonstrated.

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

It would be appropriate for actuaries to provide third party certification but not necessary. It may well be that trustees would prefer this than making a decision themselves. If this were so, an actuarial certificate could be deemed due process.

	For the reason that there is unlikely to be any pressure to certify barely or non complying products, there is no need for further regulation. The Actuaries' Institute would, no doubt, nevertheless issue a guidance note or standard for its members.
21. Should there be ongoing re-authorisation/re-certification requirements for CIPRs? If so, how and how often should this be done?	CIPRs should be subject to the same re-authorisation / re-certification timetable as MySuper funds.
22. What should the consequences be if a CIPR no longer met the minimum product requirements? Is it possible to avoid creating legacy products?	The current legislative raison d'être of CIPRs is to provide a safe harbour for trustees for actions at the time the member commenced the CIPR. For this reason, there is no consequence of a CIPR no longer meeting the requirements. It would simply cease to be a CIPR and the safe harbour no longer available in respect of future members. It will be difficult to avoid legacy products such as those of an annuity provider which gets into difficulties. It is important to note that, once difficulties occur, allowing any optional actions by members is fraught. For example, giving pensioners a choice of transfer to a new pension provider or cashing out a lump sum where the original provider was in difficulty would be an invitation for selection against other members of the arrangement.

D. Facilitating trustees to offer a CIPR

23. How can the framework facilitate trustees providing an easier transition into retirement for	The CIPR aim can be paraphrased as "likely to be in the best interest of most members of the fund except those with a less than normal life expectancy".

individuals, and what else can be done to meet this objective?	Trustees need to be protected if they use words to this effect and recommend members seek their own advice when offering the product. With this protection, trustees should be free to issue mass communications to their entire membership who are age qualified for the product. The exact words should be standard but in plain English.
24. To which members would it be most appropriate for trustees to offer a CIPR? All members or only MySuper members?	The default MySuper option will be the trustee's design of that they think is best for most members. It will be on offer to all members. Those who are disengaged may accept it. Those with varying degrees of engagement and advice may not accept it as they consider their circumstances or preferences different from the bulk of the members. Following this logic and precedent leads to CIPRs being offered to all members. Engagement in one's superannuation is probably correlated to one's account balance. A strong uptake of a default option at the commencement of one's career may not carry forward to the retirement stage.
25. In what circumstances should trustees not offer a CIPR to certain members?	Clearly a CIPR is, as indicated in the Paper, unsuitable for people with a terminal illness. But there are many small steps away from death's door. Is a diagnosis of a disease with a 40% five year survival probability to be regarded as terminal? It certainly is contraindicative of a CIPR.

Given the definitional difficulties above, CIPRs should be offered to all members with the text of the answer to question 23 prominent in the offer and leave the member to make the judgement.

Note that the Mutual Pension® draft PDS recommends people see a medical practitioner before commencement. As well as the reputational advantages for the funds, this has a wider public health benefit of possible earlier diagnoses.

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

No. For the same reason as CIPRs should be available to all. It is too hard to draw the line. The caveat about the need to disclose the life expectancy issue remains.

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?

The current proposed framework is intended to permit trustees to offer a product to their members. Trustees are best placed to judge when and how often they will approach members with the necessary information. The content of the information that they provide is a matter for regulatory consideration and the subject of question 30 in the context of standardising disclosure.

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?

As indicated in the answer to the previous question, the framework is a permission not an obligation. This matter is therefore best left to trustees, with no need for prescription.

29. What is the best way to communicate the offer of a CIPR to members? Will warnings/pre-

Communicating information about the CIPR in a fund initiated conversation approaches too close to personal advice. The best communication is an email

conditions when offering a CIPR be effective? If so, which warnings/pre-conditions are necessary? If not, what is the alternative?	or mail out as members approach each birthday after meeting a condition of release and with annual statements for the subset of members who have met or will soon meet the age based condition of release. The communication should draw attention to the PDS and display the words mentioned in the answer to question 23. It would be appropriate to mention the CIPR in a member initiated conversation with the appropriate use of the words of that answer. MPPL agrees that the specific preconditions mentioned on page 36 of the Paper should appear in the PDS, with the exceptions that • Item a) should suggest consideration only. There may be good reason why a member would not want to consolidate; • Item c) need not refer to assets outside of superannuation; • Item d) needs not to be restricted to terminal illness, it applies to reduced life expectancy generally and • Item e) raises definitional questions and intrudes on personal decision making. Note that it is also true that people with very large balances or external assets may choose to self insure longevity risk.
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?	Trustees should be required to issue a short form PDS akin to that required for MySuper accounts. This would be prescriptive. A long form PDS should be permitted to more fully describe the product, provided that its existence is referred to in the short form PDS.

One would expect funds to produce promotional and educational material for advisers. This content should be neither prescribed nor misleading.

Competition

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

Comparison of annuities and GSAs is difficult.

For annuities, the comparison can use the Moneys' Worth Ratio (MWR) based on nominated life tables and discount rates. The MWR is the ratio of the present value of expected future income to the cost. While the MWR of an annuity is sensitive to the discount rate used, the relative attraction of two annuities is less so.

The value of an annuity also depends on the credit rating of the provider. This rating should be stated.

For GSAs the MWR is fraught as it depends on the assumptions concerning mortality of other members, the earnings rates achieved by the subject member and, as it affects distributions, the earning rates achieved by other members. The efficacy of the longevity protection of a GSA can probably be ranked by the MWR assuming standard mortality in both the present value and distribution calculation and assuming the same discount and earning rate. However, the investment efficacy of different GSAs will differ with the investment strategy offered, rendering the MWR an ineffective overall ranking device.

GSAs may be amenable to a comparison of fees for members with particular balances and of particular ages, but to the extent that any fees are distribution based, they are sensitive to distribution assumptions.

While the forfeiture proportions of a GSA at various ages are important determinants of whether a GSA is attractive to an individual, the fact that one person's forfeiture is another person's benefit renders forfeiture proportions a poor measure of value for money.

To summarise the MWR is a good comparator amongst annuities and GSAs, but not necessarily between them.

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

CIPRs are essentially default products and it is very hard to foster competition in defaults. In this context, it should be noted that MySuper competition is assisted by informed involvement of employers and unions.

The aim should be to inspire competition in advice based retirement products first and let the benefits of this competition devolve on the narrower soft default CIPS market.

The first step in fostering broader competition is to identify and announce the barriers to GSAs that will be removed and when they will be removed. These should include: -

- income and goods and service tax free transfers of longevity forfeiture reserves between members and funds. These would be unlimited in

amount subject to the proviso that the method of determining the reserves is fair,
- unequivocal prevention of transfer out of GSA products and
- clear provision for forfeiture of benefits on death under the rules of the GSA.

This would allow funds to define longevity products for advice based distribution, which will benefit members and funds. Funds would not have to wait on the detail of CIPR as it is highly likely that a subset of these products would fit the finally adopted minimum product requirements of CIPRs.

MPPL's response to question 34 below suggests that transfer between GSA products should be permitted with protection for other members. This will foster competition.

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

Yes, both. CIPRs meeting the framework will be part of a broader suite of retirement products available under advice. It makes no sense to exclude them from advice based distribution. It also makes no sense to prevent people seeking advice about CIPRs.

Fees and pricing of CIPRs

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

There is no need for such regulation other than the Paper's suggestion that there be no differentiation between fees paid by existing and new members. Even in this, MPPL warns, care would be needed if funds were allowed to have multiple CIPRs.

As implied in the Paper, it is hard to identify, much less regulate, fees and profit margins in annuities and defined benefit products.

Preventing or limiting administration fee increases either indexed or not, for GSAs carries the risk of rendering them unprofitable, leading to their collapse.

While MPPL has suggested legislative prohibition against transfer **out** of GSA products, this suggestion is in the context of the broader universe of GSA products. There should be no prohibition on transfer **between** one GSA product to another provided the new product has no lower forfeitures than the old product. This condition is, of course, necessary to prevent selection against the other members. It would also provide protection for members against later fee increases.

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?

At present, with CIPRs being an option with protection for trustees, there is no need for trustees to label any other product as CIPR compliant. However, if the Government wishes to build awareness of the concept, it should permit trustees to label compliant products as such.

If this were done, there would be two possible levels of product namely: -

- Compliant, being any product that meets the requirement but is not protected by the safe harbour provisions and

- Registered compliant, being a product for which the trustees seek to claim the safe harbour.

F. Other matters

Labelling

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

"MyRetirement" is better than CIPR, but "MyPension" may be better still.

Portability

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 for GSAs. The general premise is that portability in pursuit of lower fees and different investments should be permitted. For the obvious reason of selection against other members portability of longevity protection should not be permitted if it envisages the possibility of lower forfeiture..

In context of a Mutual Pension® overlay, there is no reason why a member of one fund could not transfer his or her balance to another fund and the overlay continue to apply. Indeed the Mutual Pension® draft PDS contemplates this.

A transfer from any GSA to any other GSA should be permitted provided there is no lesser degree of forfeiture involved in the new GSA.

Because the interrelationship between investment and longevity protection in annuities, both immediate and deferred, it is hard to see portability working with these.

Term certain guarantees

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

It should be discretionary.

As the Paper notes there is a tradeoff between death protection and longevity protection. The trustees are best placed to judge the greatest benefit for the greatest number of members.

In the contest of a Mutual Pensions® overlay, members can effectively choose any term certain, but note the longer the term certain the lesser the longevity benefit. Trustees would bear this in mind in setting the parameters of their Mutual Pension® overlay offered as CIPR.

Cooling off period

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

The standard 14 day period should apply.

This is not being offered under advice or any hard sell.

Having a long cooling off period is not conducive to careful consideration and decision.

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

a. joint CIPRs for couples

b. collective defined contribution schemes?

c. aged care refundable accommodation deposits?

a. Joint CIPRs for couples is a step too far from the personal nature of superannuation and the tax issue raised in the Paper is relevant. However, nomination of a partner and different forfeiture in GSA or reversionary annuities should be available. Mutual Pension® overlays already contemplate this and deal with the issues of death and divorce.

b. Collective defined benefit schemes' apparent advantage lies in the smoothing of returns. However smoothing, in a climate of annual "mark to market" accounting, is a one way process involving creation of positive reserves in good times, and running them down, but not creating negative reserves, in bad times. This means non competitive returns at the time that markets are running and people are chasing return. They offer little, if any, in addition to GSAs.

c. As the Paper notes, there is now an alternative to lump sum funding. Age care admission is often indicative of increased mortality risk. This would enable families to remove funds from longevity protection as this need decreases, pay the aged care bond and then bank the unused refund on death. This is to the detriment of other participants. An alternative, not currently permitted, nor favoured by MPPL, would be for the fund to pay the bond and receive the unused refund. This would only give the family the benefit of the used bond, not the whole bond.

26. I thank you for the opportunity to make this submission and invite you to contact me should you need to discuss any aspect of it.

Yours sincerely,

Dennis E Barton FIAA
Director

Press release about submission

Mutual Pensions Pty Ltd has made a confidential submission to the Treasury investigation into Comprehensive Income Products for Retirement (CIPR or MyRetirement))

The essence of the proposed MyRetirement framework is that superannuation fund trustees can offer, without breaching advice rules, a product that offers some longevity protection. The idea is that trustees make available an arrangement that they think best enables the bulk of their members to get some longevity protection.

The protection will be available when the product meets three criteria

- Minimum level of income exceeding account based pensions
- Broadly constant real income for life
- Flexibility for access to lump sum

Longevity products only produce more money than Account Based Pension (ABPs) when one lives longer than one's life expectancy, but the knowledge that the protection is there allows less frugality. Pensioners benefit from longevity protection at the expense of their children's inheritance and there is a clear tradeoff of lump sum flexibility and certainty of income. To this extent the criteria are mutually exclusive.

Such protection is clearly needed in that the Account Based Pension of a standard mortality couple, both aged 67 will be spent 63% on minimum drawdown pensions, 31% on non dependent kids and 6% in tax. Any degree of longevity protection better focuses the superannuation tax concessions on retirement income not intergeneration wealth transfer.

The Treasury paper seeks comments on 40 questions, which seems a lot for a framework offering protections for trustees producing a voluntary product. It is reasonable to expect some future scope creep for MyRetirement.

Superannuation funds will produce a range of MyRetirement products. This, argues Mutual Pensions, makes it important that trustees have discretion and freedom to innovate. Regulators should be concerned, it submits, that funds use due process and tell the truth, not with the details of the fund's solution to the longevity problem.

Mutual Pensions submits that it is important that the government identify the particular barriers to efficient longevity protection that it will remove. Without this specificity, the industry cannot get on with the design of new products. Furthermore, the risk is

that until the industry gets into detailed planning, not all impediments will be identified. “This chicken and egg cycle has gone on since as early as 2007 and that is far too long” said Mutual Pensions director Dennis Barton, adding “Mutual Pensions identified specific barriers that it would like to see removed in its submission. For example, the rules that treat distributions from reserves as Concessional contributions have to go.”

The Mutual Pensions submission warns of trying to bridge the differences between annuities and group self annuitisation products such as the Mutual Pension® overlay. The former have longevity guarantees, for which the members must pay, and more conservative investment policies. The latter lack the guarantee of longevity protection, distributing only what is forfeited by dying members, but offer better investment options. This renders comparisons difficult.

Mutual Pensions lauds the idea of “soft default” option of some degree of longevity protection. The soft default works by allowing trustees to say “We think this is best for most of our members” and assumes members will say “Ok, I will have some of that offering”. Mutual Pensions warns however, that it will be interesting to see retiring members' responses to the "soft default" concept. It is one thing to accept the default, as many people do, when balances are zero or low at the start of one's working life, it may be something else to do so when one has a balance of half a house.

Formal MyRetirement products which protect trustees against breaching advice rules, may have a slower than expected takeup. However, the accompanying lifting of legislative shackles on longevity protection products will allow individual fund members to tailor their superannuation to meet their needs.

The Treasury Paper stresses that MyRetirement is not suitable for people with terminal illness. Mutual Pensions agrees with this, but points out in its submission that there are sometimes many small steps to death’s door and MyRetirement may be unsuitable for people with a reduced life expectancy, not just those with terminal illnesses.

Ends

Mutual Pensions Pty Ltd has developed the Mutual Pension® overlay, a group self annuitisation service to “harness the power of averages®”to provide longevity protection for Australian superannuation fund members.

Dennis Barton (0417937854) is its founding director,

Article for The West Australian

"Further super changes coming"

The federal government is engaging in the next steps in increasing the efficiency of superannuation.

The Treasury has released a paper "Development of the framework for Comprehensive Income Products for Retirement" and is seeking comments on it by 28 April 2017.

The paper builds on the MySuper base. MySuper is the simplified default superannuation process used while one is building towards retirement. The paper likely to result in something called "MyRetirement" addresses the retirement stage.

MySuper was a response to the cost and complexity of superannuation offerings and the complexity of financial advice regulations. To understand it, it is necessary to look at those regulations.

The advice regulations distinguish between "general" advice and "personal" advice. Personal advice can only be provided by a financial planner and must take into account the particular circumstances of the person being advised. General advice is essentially limited to the provision of facts. Against these definitions, it was hard for superannuation funds to suggest what their members should do.

Under the compulsory superannuation regime, employers are required to make a contribution to their employees' superannuation funds. The first question that arises from that requirement is what fund? The obvious answer is that specified by the member. But, what if the member does not specify a fund? This raises the concept of the default fund. The default fund is either chosen by the employer or specified by an industrial award.

However, once in a default fund, the member faces further choices about investment strategy and insurance arrangements. Funds, within themselves, generally set up

default investment options, but these varied across funds. Some took the view that the default investment could not lose any money and so was very low risk and low return. Others took the view that superannuation is a long term investment and went for growth at the expense of short term volatility.

In the absence of any statement from the member, they joined the default investment option of the employer's default fund. The absence of a statement may well have been a reasoned decision that the default was the best for the person concerned. Many people entered default options, giving rise to concerns that people were "unengaged" in their superannuation.

Combining the disengement and the inability of superannuation funds to give advice lead to the oxymoronic concept of "mass customisation". MySuper is the culmination of this. It is each superannuation funds' idea of what best suits most members.

Three major reports touching on superannuation this century, Cooper, the Henry Tax Review and the Murray Financial System Inquiry identified the fact that superannuation could do better in the retirement phase. Many people invest their superannuation lump sums in an account based pension and draw the minimum possible pension. This is understandable, as they do not know how long they will live and whether their money will last. This often leads to a frugal lifestyle and a large inheritance for the children.

A consequence of this drawdown strategy is leakage out of the superannuation environment. Mutual Pensions Pty Ltd has published that a couple both aged 67 following that strategy could expect that 63% of the payments made by the fund be directed to children, 6% back to the government in taxation and 31% to their estate. So a third of the money saved using tax concessions for retirement funding is not used for its intended purpose. It is used as a tax efficient intergenerational transfer tool.

There is consensus in the three reports and the industry general that some sort of longevity insurance will increase the efficiency of the system. Longevity insurance works by people committing to forfeit all or part of their superannuation on death in return for a share in the distribution of the forfeitures of those who die before them.

There a two main types of longevity insurance – annuities and mutual pensions (or Group Self Annuitisation schemes).

Annuities are a promise by an institution to pay a pension while ever the nominated person or people are alive. They are effectively a bet that pays off if one dies before the institution paying the pension goes broke. In the Australian regulatory context, that is unlikely, so an annuity can be regarded as a guaranteed income. To provide

this guarantee, the institution prices the annuity conservatively and invests conservatively. This makes the annuity low risk, low return.

In contrast, a mutual pension is not guaranteed but can adopt more appropriate investment strategies. The participant in a mutual pension is making a bet that pays off if other participants die earlier.

In both cases, one has greater certainty of income in old age and one can be less frugal in retirement.

The next stage of the government's superannuation progress is to encourage the use of longevity protection. There are two strands to this, removing barriers to providing this protection and removing barriers to marketing and distributing it.

Mutual pensions are possible under present law, but could be made more efficient with some changes. The government intends to do this. Annuities starting now are possible and from July this year, funds set aside for annuities deferred to a later age will not suffer income tax.

The final barriers to address are those to the efficient distribution of longevity protection. This is the reason for the latest government paper.

The problem the paper seeks to address the conundrum into which the advice legislation puts trustees of superannuation funds. They cannot currently explain and recommend longevity to their members except in the context of giving "personal advice". Many funds are not equipped to give personal advice, it is costly and many fund members do not seek it. The government's approach is to say that any superannuation offering approved longevity protection (currently called a "Comprehensive Income Product for Retirement (CIPR)" and likely to be called "MyRetirement") to its members will not be prosecuted for giving "personal advice". It uses the term "safe harbour" from prosecution.

In current contemplation is the voluntary provision by funds of longevity protection for which the safe harbour from prosecution may be available. The paper however hints that this may only be a first step.

The 57 page paper seeks comment on 40 particular questions covering the definition of a CIPR, how trustees will be regulated in connection with the CIPR, making sure the CIPR meets minimum requirements, helping trustees offer CIPRs, other longevity protection arrangements not covered by the CIPR system and other matters.

The paper suggests a CIPR should provide an income higher than the minimum drawdown account based pension, provide a broadly constant inflation adjusted

income for life and have flexibility for lump sums and bequests. Clearly, any arrangement that involves forfeiture will meet the higher income test. The other two tests however are mutually exclusive. The more flexibility, the less forfeiture and therefor the lower the income of survivors.

The paper canvasses the issues of exact definition and who will decide if a CIPR is within the definition. This is likely to be a complex matter given the wide range of possible options and the fundamental differences between annuities and mutual pensions. It is to be hoped that the rules and processes are flexible and not overly prescriptive.

Paradoxically, the paper considers completion between CIPRs. This is strange as it is mainly about an off the shelf product to which the “disengaged” can be directed. One wonders whether the disengaged will bother to compare the options.

It is likely that longevity protection will grow up outside the CIPR system. It is in this area that the competition will occur. The “engaged” will evaluate and seek advice on what a number of funds offer.