mine super

Analysing the Comprehensive Income Products for Retirement (CIPRs) Framework

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Reforming Retirement Income

A timeline of reviews and reforms

2010	2014	2016	2017	Feb 2018	May 2018
Super System “Cooper” Review	Financial System “Murray” Inquiry	The Proposed CIPR Framework Discussion Paper	Treasury Laws Amendment (Innovative Superannuation Income Streams) Regulations 2017	DSS Position paper – Means Test Rules for Lifetime Retirement Income Streams	Retirement Income Covenant Position Paper – Stage one of the Retirement Income Framework

Financial System “Murray” Inquiry

MyRetirement

- Noted a 15% to 30% uplift in retirement income was possible
- Introducing CIPR – Comprehensive Income Products for Retirement

CIPR Discussion Paper

Development of the framework for CIPR

- Proposal of a non-mandatory default-style retirement solution
- Actuarial Certification Tests (ACTs) implied preferences that industry had concerns around
  - Being risk agnostic
  - Place no value on any residual benefit
- Ignore Age Pension

DSS Means Testing

For lifetime retirement income streams

+ Clarification and certainty of means testing treatment
+ Removal of non-guaranteed solution loophole (favourable if included in ABIS)
+ Analysis suggests no incentive to use lifetime income stream products
  - Means testing rules advantage ABIS relative to lifetime income stream products due to deeming income rules
  - ABIS provides benefits with respect to residual benefits and access to capital
+ Need for consumer protection – impaired product safety net

Retirement Income Covenant Position Paper

Stage one of the retirement income framework

- Retirement income covenant – supportive
- Principles-based CIPR design – supportive
- Retirement income objectives need to be developed and quantified!

- We use Member's Default Utility Function (MDUF v1) as a case study to measure the benefits

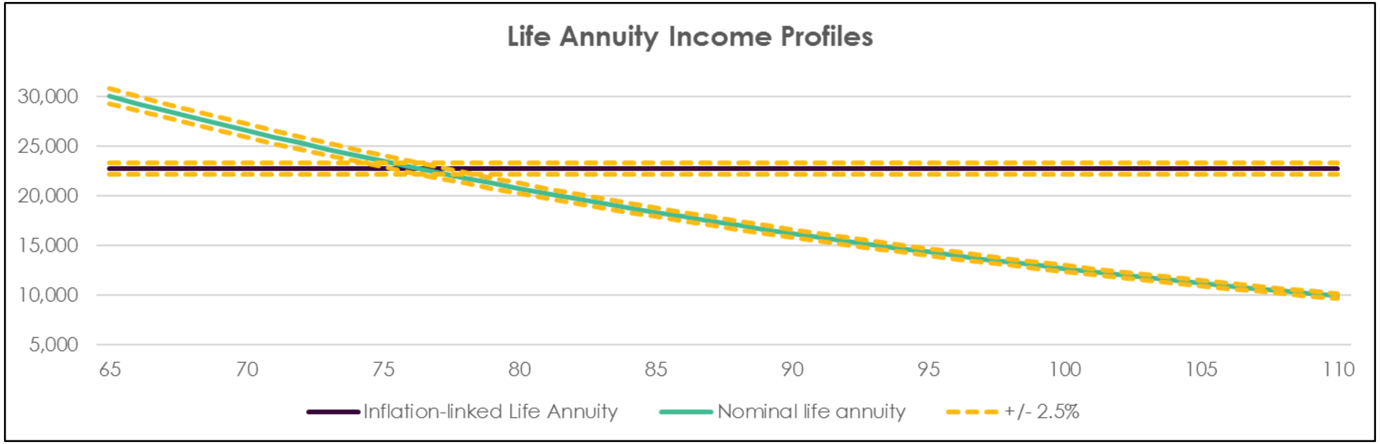
Analysis of CIPR

Summary

- “Broadly constant” annual expected income, flexibility around:
  - Income stream numeraire (real or nominal)
  - Whether to incorporate Age Pension
- Flexibility in expected income design (±2.5% of first year income)
- Many areas of personalization (implicit and explicit)
- Aim for simple disclosure and comparison across product offerings

Analysis of CIPR

Base case for income targeting should be in real terms



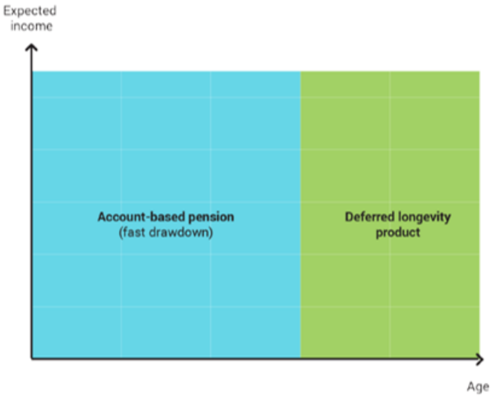
Targeting nominal rather than real income introduces:

+ Large expected drop in real income over the long term
+ Potential for large variability in real retirement outcomes, as this risk has been transferred from super fund to the retiree

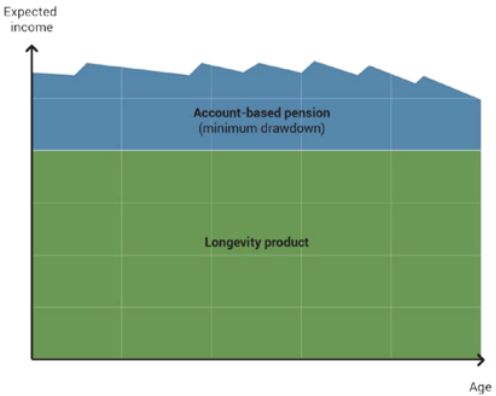
Analysis of CIPR

Only ‘the cut’ structure meets the tests

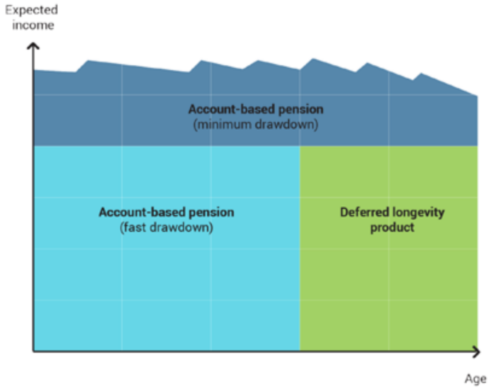
The Cut



The Stack

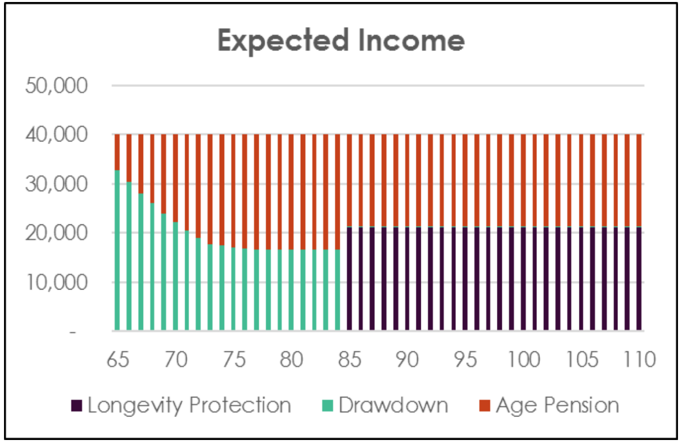


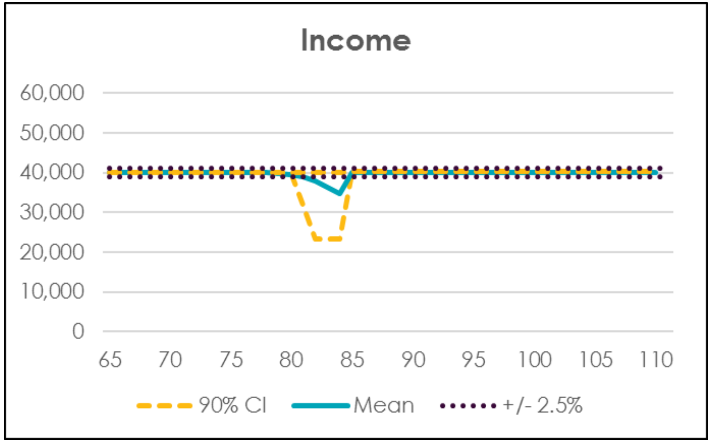
The Wrap



Analysis of CIPR

‘The cut’ structure incorporating Age Pension

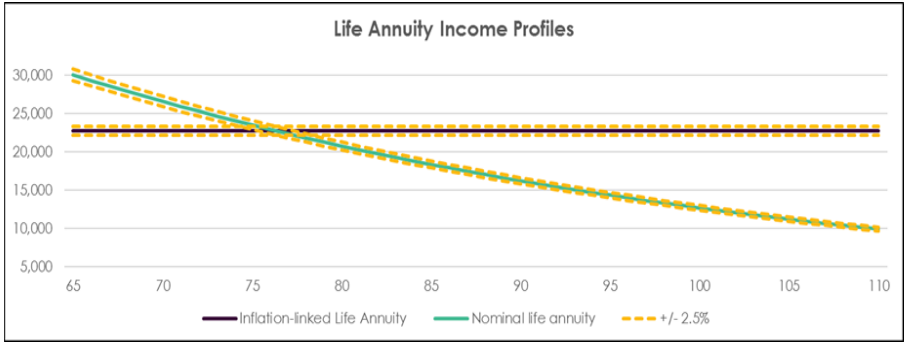


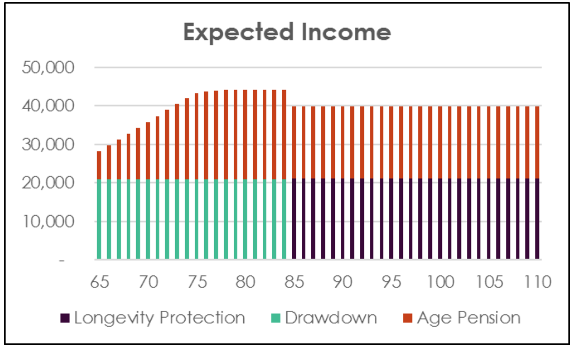


Analysis of CIPR

Volatility of income

- ±2.5% flexibility, relative to first year of income, is largely irrelevant compared to the income variability which comes from:
  - Choice of nominal or real income
  - Choice of whether to incorporate Age Pension

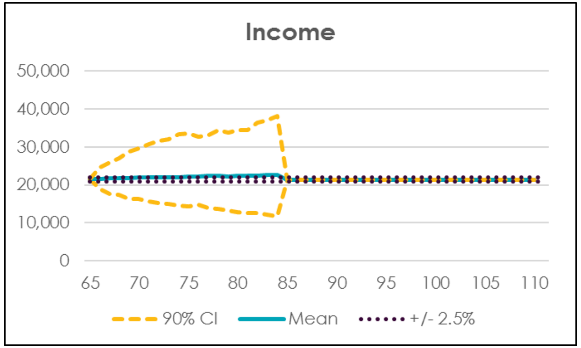


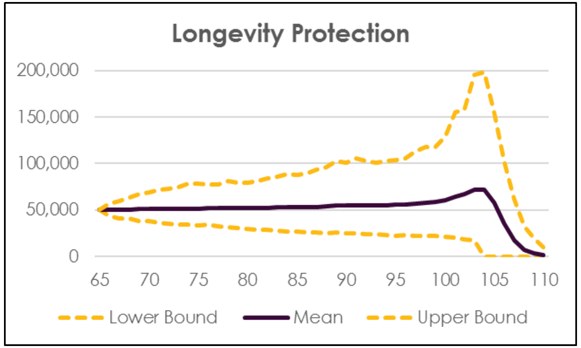


Analysis of CIPR

Volatility of income (continued)

+ ±2.5% flexibility, relative to first year of income, is largely irrelevant compared to the income variability which comes from:
  - Investment variability of underlying portfolio
  - Mortality experience for non-guaranteed pooling solution





Analysis of CIPR

Cost of not incorporating Age Pension

Retirement Strategy	Risk-Adjusted Income	Risk-Adjusted Residual Benefit	MDUF v1 Score	Welfare Gain (with MDUF v1 residual benefit motive – i.e. MDUF v1)	Welfare Gain (no residual benefit motive)
$200K					
Incorporating Age Pension ($30K)	$30,034	$27,661	7,228	$15K	$48K
Not incorporating Age Pension ($8K + Age Pension)	$27,849	$25,454	6,652	-	-
$500K					
Incorporating Age Pension ($39K)	$37,299	$23,739	6,204	$8K	$146K
Not incorporating Age Pension ($20K + Age Pension)	$30,665	$22,660	5,921	-	-
$1M					
Incorporating Age Pension ($54K)	$38,268	$16,018	4,186	$7K	$35K
Not incorporating Age Pension ($42K + Age Pension)	$36,670	$15,036	3,929	-	-

+ Risk of over-insuring against longevity risk

Analysis of CIPR

Not allowing personalisation based on balance

Age Pension Eligibility	3 Flagship CIPR Balance Cohorts
Full Age Pension	$0 - $250K
Part Age Pension	$250K - $600K
No Age Pension	>$600K

+ Allows personalisation based on gender, age and other underwriting factors for the pricing of longevity components
+ Maximum three CIPRs for three balance cohorts despite the wide range
+ Personalisation inconsistently applied:
  - Balance (specifically the interaction with Age Pension) will need to be incorporated in re-cutting CIPR given tailored pricing for longevity policy
  - Balance might already be used in the pricing of the longevity policy (given negative relationship exists between wealth and mortality)

Analysis of CIPR

Overall, will CIPRs improve member outcomes?

Retirement Strategy	Risk-Adjusted Income	Risk-Adjusted Residual Benefit	MDUF Score	Welfare Gain (with residual benefit motive – i.e. MDUF v1)	Welfare Gain (no residual benefit motive)
$200K					
Base Case CIPR	$30,034	$27,661	7,228	-$15K	$9K
ABIS with MDD rules	$29,612	$29,803	7,788	-	-
$500K					
Base Case CIPR	$37,299	$23,739	6,204	-$105K	$105K
ABIS with MDD rules	$32,534	$38,686	10,109	-	-
$1M					
Base Case CIPR	$38,268	$16,018	4,186	-$234K	$15K
ABIS with MDD rules	$37,581	$49,414	12,912	-	-

+ Overall value-add through an MDUF v1 lens is negative compared to ABIS applying MDD

Analysis of CIPR

Other considerations

- Additional concerns around:
  - CIPR certifications and disclosure
  - Fee disclosure
  - Implications of members’ consent: opt-in vs opt-out
  - Need for impaired product safety net
  - Timing

Analysis of CIPR

Progression of CIPR development

Basic CIPR

- Low cost
- Basic product (constant real income goal ignoring Age Pension)
- Welfare cost (no Age Pension or personalisation)
- Expected low take-up
- Supplied by Government body e.g. Future Fund

Proposed CIPR: Consultation Paper

- Higher cost
- Basic product (constant real income goal ignoring Age Pension) with complex design rules
- ACTs imply preferences
- Welfare cost (see previous submission)
- Expected low take-up

Principles-based CIPR: Position Paper

- Higher
- Complex product (incorporates Age Pension and many elements of personalisation)
- Assumed “generic” preferences
- Welfare cost (see submission, because not maximizing benefits of personalization and dynamic strategies)
- Expected to outsource, hence disincentive for funds to encourage take-up

Best Practice Personalised Solutions

- High cost
- High complexity
- Incorporates individual preferences
- Significant welfare benefit
- Financial advice - scale challenged
- Technology-enabled solutions – in the future

Conclusion

+ Great that retirement outcomes is firmly on the agenda
+ A retirement income covenant is a good idea
+ We are concerned that CIPRs will not achieve intended effect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