Business School

29th Superannuation Colloquium

Never Stand Still | Business School | Risk and Actuarial Studies

Supply Side Resistance to Lifetime Annuities

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The annuity puzzle

- Behavioural biases, misunderstandings and vested interests
- Demand side exaggerations
- Supply side explanations

- To what extent could vested interests and provider and regulator biases and misunderstandings explain lack of supply, and discouragement of demand?

Bounded Rationality

- Behavioural biases
  - Utility models suggest a role for lifetime annuities
  - Absence of annuity demand blamed on framing, risk aversion, myopia …
- Misunderstandings
  - … value for money, longevity risks
- Personal interests
  - Commissions and funds under management
  - Complexity needs an explanation

Demand side exaggerations

- Materiality
- The bequest motive
- The precautionary motive/liquidity preferences
- Annuities are too risky
- Poor value for money
- Advice is too expensive

Immateriality doesn't apply

- CIPR Consultation suggested + 30% from annuities
  - ASFA's response questioned this – without explanation
- For shorter expectancies, life annuities pay more and insure more risk, so where are the enhanced annuities? (>30% of market in UK)

LIFE EXPECTANCY IN YEARS (1)	ANNUITY INCOME AT 4% INTEREST (2)	YEARS TO 95% PROBABILITY OF SURVIVAL (3)	RATIO OF (3) TO (1) (4)
30	6%	44	1.5
20	7½%	32	1.6
10	12½%	20	2.0

Bequest motive doesn't apply

- Little evidence of actively planned bequests in mid-market
- Little survey evidence of bequests being high priority
- Evidence that bequest motive rationalises precautionary motive
- Bequest motives continue to be emphasised by industry (and academics)

Precautionary motive overblown

- Concerns about medical costs and aged care overblown (outside USA)
- Precautionary savings / liquidity requirements / buffer should be spent in emergencies and then rebuilt
- Theoretical and heuristic suggest buffer of 3 months to 2 years of spending
- Industry suggests $200,000 = 8 years of spending for those on the Age Pension

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Annuities are not risky

- Clearly a framing problem
  - When seen as a consumption plan, risk is reduced both for individuals and the wider family
  - Statement "annuities are risky" is nevertheless repeated by advisors and institutions
- Concerns about the solvency of the annuity provider are valid but are overblown as they apply to all financial institutions
- Reputational concerns for the provider can be managed at the point of sale

Advice is too expensive

- Members do need personal assurance
- The scope and cost of advice blown out:
  - Choice of fund and investments (exit vs voice)
  - Complexity of tax and means tests
  - Intrusive regulation of financial advice
- System (compulsion, choice and complexity) seems designed to maximise opportunities for incumbents to extract fees
- Industry super slow to offer income illustrations

Supply side explanations

- Industry is conflicted because of threat to income
- Inappropriate financial metrics
- Regulatory complexity
- Managerial complacency

Industry is conflicted

Pot size (excluding Lump Sums)	Number of annuity sales			Number entering drawdowns		
	Regulated advice	Pension Wise guidance	No advice or guidance	Regulated advice	Pension Wise guidance	No advice or guidance
< £10,000	26%	540%	96%	2,665	914	2,536
£10,000 - £29,000	19%	54%	44%	8,336	2,835	7,243
£30,000 - £49,000	16%	51%	44%	9,451	2,049	5,347
£50,000 - £99,000	14%	81%	49%	14,595	2,146	5,761
£100,000 - £249,000	10%	104%	51%	13,377	1,224	3,293
≥ £250,000	3%	43%	18%	11,360	499	1,862
All pot sizes	**7,548**	**10,739**	**12,851**	**59,784**	**9,667**	**26,042**

https://www.fca.org.uk/publication/data/retirement-income-underlying-data-2019-20.xlsx

- Advisors lost commissions, and now lower FUM and fees; because no longer a need to advise on amounts to drawdown or investments
- Funds lose FUM, either in insurers or retirees drawn down faster (because they leave no bequests)

Inappropriate financial metrics

https://yourir.info/e4600e4db4d0cc89-nab.asx-3A492724/NAB_2018_Half_Year_Results_Summary.pdf

KEY LONG TERM OBJECTIVES[7]

NPS	COST TO INCOME RATIO	ROE	EMPLOYEE ENGAGEMENT
Positive and #1 of Australian major banks for our priority segments	Towards 35%	#1 of Australian major banks	Top quartile

[7] Refer to key risks, qualifications and assumptions in relation to forward lo… …ts on page 7

More profitable?
A. Customer who costs $70 pays $100, or
B. Customer costs $30 and pays $50.

If you choose B, you close rural branches, and discourage lower income clients (i.e. those who might want annuities)

More profitable if CoC 10%?
A. $100m project that earns 20%
B. $300m project that earns 15%

If you choose A, you avoid foreign markets, sell Australian insurance subsidiaries, and avoid capital hungry products like annuities.

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Regulatory complexity

- Cynical capture by incumbents
- Regulatory and industry inattention
  - Ongoing demand for more guidance
  - Shift of onus from industry to regulators
- ATO confuses mortality credits with additional contributions

Managerial Complacency

- Significant issue in literature
  - Berle and Means (1932) 25,000+ citations
  - Jensen and Meckling (1976) 100,000+ citations
- “Superannuation is biggest and among the best in the world”
  - Little evidence that funded pensions makes a significant difference
  - Compare Netherlands/Belgium; UK/France; Australia/NZ
- ‘Rivers of gold’ from contributions
  - SG debate

Challenges

If there are supply side obstacles:

- Trustees and advisors: focus on clients not size
- Government: simplify and give data to advisors
- Academics: investigate supply side more thoroughly