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The Role of Deferred Group-Self Annuitisation Products for Retirement

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Introduction

Retirement is an area of significant regulatory focus

- + The literature suggests that the optimal targeted income is not constant (inverse 'U' shape)
 - There is a utility cost in targeting constant income at early and very late ages
- + However the regulatory environment, particularly Treasury's work on CIPR:
 - Focuses on constant income for life in retirement
 - In this presentation we focus on constant income and DGSA in a CIPR design context





Retirement Income Covenant

CIPR Framework

- + Requires 'broadly constant' annual income streams for life
- + 'The Cut' structure might be the only one that meets the CIPR design test
- + 'Trustees would need to give members the option to include a reversionary benefit'



+ Deferred longevity products could potentially play a significant role in CIPRs



Product Challenges

Different types of deferred longevity products

- + DLA: Deferred Life Annuity
 - Guaranteed investment return and mortality outcome
- + ILDLA: Investment-linked Deferred Life Annuity
 - Allow exposure to growth asset, no investment guarantee
 - Guarantee mortality outcome
- + DGSA: Deferred Group-Self Annuitisation
 - Allow exposure to growth asset, no investment guarantee
 - Sharing mortality outcome, not mortality guarantee



Product Challenges

Different types of deferred longevity products

Product features	DGSA	ILDLA	DLA
Individual longevity risk protection	\checkmark	\checkmark	\checkmark
Systematic longevity risk protection	×	\checkmark	\checkmark
Exposure to growth asset	\checkmark	\checkmark	X
Inflation risk protection	\checkmark	\checkmark	\checkmark
Profit margin	Optional	X	X
Operational simplicity	X	X	\checkmark
Product features flexibility	\checkmark	X	X
Asset ownership	\checkmark	\checkmark	X



How DGSA works





Pool size

+ Individual longevity risk cannot be diversified in a small pool





(b) pool size = 10



(a) pool size = 1,000

Systematic longevity risk

+ What if we allow for expected mortality improvements amongst members in the pool?





(b) 20% mortality improvement



(a) no mortality improvement

Investment risk

+ Trade-off between potential upside and variability of income associated with asset mix





(b) 80/20 growth/defensive



(a) 50/50 growth/defensive

Flexible deferral period

+ Impact of deferral period on DGSA payments





(b) 20 years deferred



(a) 15 years deferred

Flexible death benefit

+ Trade-off between level of income and death benefit (peace of mind)





(a) with death benefit

(b) without death benefit



Flexible death benefit (con't)

+ Trade-off between level of income and death benefit (peace of mind)



(a) with death benefit



(b) without death benefit



Illustration: single homeowner male with \$500K at retirement











We use Member's Default Utility Function (MDUF v1) to assess the design

Retirement Strategy	Risk-Adjusted Income	Risk-Adjusted Residual Benefit	MDUF v1 Score	Welfare Gain (no residual benefit motive)	Welfare Gain (residual benefit motive = MDUF v1)
80% ABP + 20% DGSA	\$37,468	\$37,215	9,725	\$1K	\$26K
80% ABP + 20% ILDLA	\$37,719	\$35,109	9,175	\$7K	\$11K
80% ABP + 20% DLA	\$37,406	\$33,563	8,771	-	-



Would CIPR add value to the status quo?

Retirement Strategy	Risk-Adjusted Income	Risk-Adjusted Residual Benefit	MDUF v1 Score	Welfare Gain (no residual benefit motive)	Welfare Gain (residual benefit motive = MDUF v1)
80% ABP + 20% DGSA	\$37,468	\$37,215	9,725	\$108K	-\$10K
ABIS with MDD	\$32,534	\$38,686	10,109	-	-



Would CIPR add value to the status quo?

- + CIPR would add value if:
 - Members' preference is to focus on the income side and place no value on residual benefit, access to capital and liquidity
 - DGSA component is properly designed assuming pool sizes are sufficient etc.
- + CIPR would not add value through the lens of MDUF v1 due to:
 - Means-testing rule advantages ABIS due to deemed income in comparison to lifetime income streams products
 - Limited 'compensation' for forgoing residual benefits in lifetime income stream products.
- + Note that a different set of preferences to trade-off between incomes and residual benefits would produce different results in the value-add assessment.
- + Encourage trustees to invest in developing a sensible set of preferences to assume on behalf of their default members. This might mean a different set of preferences reflected to those in MDUF v1 and thus different assessment results.



Practical Consideration

From consumers behavioral perspective, DGSA is likely to be accepted

- + Only small allocation (12% -15%) to DGSA (DLA requires higher allocation)
- + The majority still sits within account-based pension (ABP)
- + Flexibility in providing additional features such as reversionary benefit/death benefit further peace of mind



Practical Consideration

Product design complexity due to tailored underwriting





Practical Consideration

Other challenges

- + Members' consent: pool size issues and impact on variability of member's outcome if sufficient scale cannot be achieved.
- + Disclosure given product complexity
- + Need for consumer protection impaired product safety net
- + Timing for CIPR implementation at least 3 years given the development of DGSA type product is only at an embryonic stage



Conclusion

- + DGSA is a strong candidate product as part of retirement solution.
- + We encourage trustees to invest in understanding member's preferences and incorporate them when designing CIPR.
- + The cost of developing DGSA and the benefit to members can then be assessed properly.









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