Obstacles in Life Annuity Market

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25 November 2025

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Agenda

- Recap: Supply side obstacles (Colloquia 2021 and 2023)
  - The annuity puzzle goes beyond lack of demand
  - Trustees are conflicted, complacent and constrained
- Orford research project – advisor views
- Priorities and paradigms
  - Clients' interests
  - Current adequacy of funds
  - Complexity
  - Changing the paradigm

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RECAPITULATION

Demand side explanations do not stack up

Brown, J.R., Kling, J.R., Mullainathan, S., Wrobel, M.V., 2008. Why don't people insure late-life consumption? A framing explanation of the under-annuitisation puzzle. American Economic Review, 98(2), 304-09

Absence of demand cannot be blamed on:

- Behavioural biases - framing, risk aversion, myopia
- Misunderstandings - poor value for money, longevity
- Precautionary motives
    - Of which bequest motive shown to be a rationalization

We know how to address them so that people choose lifetime annuities

Puzzle is why providers do not explain benefits of annuities as consumption plans

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Supply side explanations

Asher, Anthony, Supply Side Resistance to Lifetime Annuities (November 22, 2021). Available at SSRN: https://ssrn.com/abstract=3981196

- Managerial complacency
  - Shirking
  - Fiduciary duty, size or profitability?
- Regulatory complexity
  - Too difficult to make progress
- Advisors are conflicted

ADVISOR RESEARCH PROJECT

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Supply side interviews

- UNSW project sponsored by Orford Foundation
- AA interviewed 20 advisors
  - Strictly anonymous to get frank answers
- Fifty minute interview on obstacles
  - Their clients
  - Determining spending
  - Approach to risks
  - Product knowledge
  - Issues at older ages
  - Other …

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Client information

	Average	Minimum	Maximum
Age distribution			
Under 60	25%	<5%	75%
Between 60 and 75 – transitioning	40%	10%	100%
75 to 90 – retired and slowing down	33%	<5%	80%
90+ – mainly house/home bound	**2%**	<5%	10%
Level of wealth			
Full Age Pension	**7%**	0%	50%
Part Age Pension	**25%**	5%	85%
Self-supporting < $2m financial assets	38%	5%	80%
> $2m household financial assets	30%	0%	90%
Type of fund			
SMSF	23%	0%	60%
Retail	62%	0%	96%
Industry, Corporate or Government	15%	0%	100%
How many clients do you have?	**134**	65	330

But 20% of 60 year olds will live beyond 90

A third already qualify for Age Pension

134 * 15,000 advisors is 2 million households

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Findings: Priorities and paradigms

Advisors are not really conflicted

- Evidence that UK advisors discourage lifetime annuities

Pot size (excluding Lump Sums)	Annuity sales as % of drawdowns			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 - £249,000	14%	68%	47%	8,336	2,835	7,243
≥ £250,000	3%	43%	18%	11,360	499	1,862
All pot sizes	**13%**	**111%**	**49%**	**59,784**	**9,667**	**26,042**

9x more likely to buy annuity

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

- **But** the conclusion that Australian advisors are conflicted is difficult to sustain:
- Conflicted commissions have all but disappeared
- Most advisors charge for work done – indirectly related to funds under advice

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Advisors are not really conflicted

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What are their priorities?

What is your speciality?

- Holistic (9) - Retirement (7) - Investment (3) - SMSFs (1) - Estate planning (1)

Service:	“Incredible gift to serve all these clients”
Education:	“Even difficult to explain salary sacrifice”
Counselling:	“Some clients very defensive and terrified of making decisions”
	“Delicate conversation - work longer or cut expenses”
	“Radical - sell/give property away is life shattering"
Beyond investment:	“Others think all we do is buy and sell shares”

As would be expected from professionals
… noting that many doctors, lawyers, accountants and even actuaries have been known to overservice or overcharge

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But compliance a burden and distraction

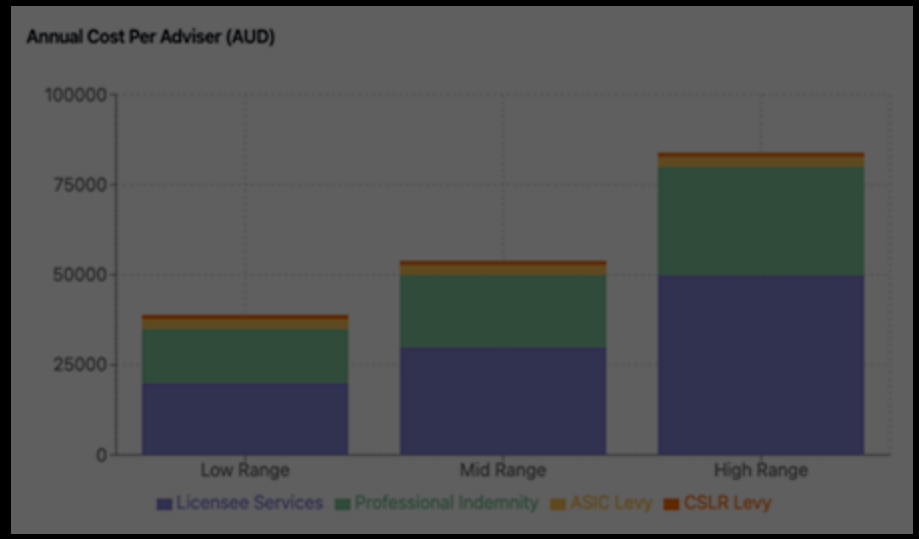
"Advisors are buffeted from start to finish
- Undermined by free advice
- Regulatory overheads over $50k pa"

"Doctors do not give 90 pages of advice"

See next slide for regulatory changes 2010 to 2021 from FSC/KPMG

FSC recommendations could save 35% of costs

https://fsc.org.au/resources-category/2299-kpmg-the-cost-profile-of-australia-s-financial-advice-industry-final-research/file?utm_source=chatgpt.com



https://www.adviserratings.com.au/news/the-true-cost-of-advice-why-your-financial-adviser-isnt-getting-rich

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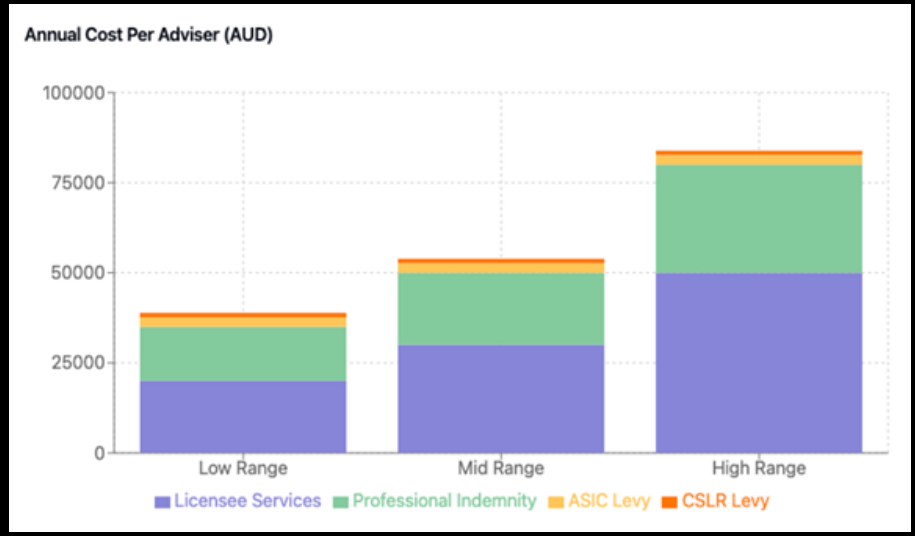

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Australian Advice landscape: Key inquiries, review and reforms 2010-2021

2010

Future of Financial Advice Reform package announced

Future of Financial Advice Reform package was issued in April 2010 for consultation in response to the issue of the Parliamentary Joint Committee on Corporations and Financial Services Inquiry into financial products and services in Australia, otherwise know as the Ripoll Report (November 2009)

ASIC Report 224: Access to financial advice in Australia

ASIC Research Report into "Access to Financial Advice in Australia"

2012

Corporations Amendment (Future of Financial Advice) Act 2012 and Corporations Amendment (Further Future of Financial Advice Measures) Act 2012 and associated regulations

FoFA legislation was enacted in June 2012. This Act introduced requirements for financial advice in regards to a new best interests duty, ban on conflicted remuneration, fee disclosure statement and opt-in obligations for ongoing advice fees. The Act had a soft commencement of 1 July 2012

ASIC Regulatory Guide 244: Giving information, general advice and scaled advice

ASIC RG: 244 provided guidance and set expectation regarding giving information, general advice and scaled advice including the better outcome test

ASIC Regulatory Guide 175 Licensing: Financial product advisers – conduct and disclosure

ASIC RG: 176 was updated to provide guidance on ASIC's expectations for meeting the best interest duty

ASIC Regulatory Guide 200 Advice for super fund members

ASIC RG 200 was withdrawn given the guidance issued in RG244.

2013

ASIC Regulatory Guide 245 Fee disclosure statements

ASIC RG 245: outlines expectations regarding the fee disclosure obligations

2014

Corporations Amendment (Streamlining of Future Financial Advice) Act 2014 and Corporations Amendment (Streamlining Future of Financial Advice) Regulation 2014

From 1 July 2012Amendments made to FoFA law to remove the catch all from the safe harbour best interest duty test, removed the fee disclosure statement requirement for clients pre 1 July 2013, removed op in obligations in regards to ongoing dee disclosures and exempted general advice from conflicted remuneration in some circumstances. These regulations were disallowed November 2014

Tax Laws Amendment (2013 Measures No.3) Act 2013 as at 1 May 2014

Amendment to the Tax Agent Services Act 2009 and related regulations to create a new class to apply for tax (financial) advisers

Corporations Amendment (Future of Financial Advice) Act 2012 and Corporations Amendment (Further Future of Financial Advice Measures) Act 2012 and associated regulations

Compulsory commencement of FoFA was 1 July 2013

ASIC Regulatory Guide 246 Conflicted and other banned remuneration

SSIC RG246 designed to provide guidance for meeting FoFA's conflicted remuneration provisions

2015

Corporations Amendment (Financial Advice) Regulation 2015

Provided clarity regarding basic banking products and general insurance – in regards to the best interest duty test

Financial System Inquiry – Final Report, November 2014

An inquiry into the Financial Systems was held in 2014 known as the Murray Inquiry and Report. The report made a number of recommended changes to the system for the Government's consideration

Corporations Amendment (Statements of Advice) Regulation 2014 (SOA Regulation)

Changes to SOA requirements applied from 1 January 2016 to update for FoFA obligations

Corporations Amendment (Revising Future of Financial Advice) Regulation 2014

Revised Regulations were made in December 2019 to amend those disallowed. These regulations applied from 16 December 2014

2016

ASIC Register of Financial Advisers

Public register of Financial Advisers including qualifications and professional memberships

Review of Retail Life Insurance Advice (Trowbridge Report)

March 2016 release of the Trowbridge Report which provided a report of Life Insurance Advice advice remuneration practices and made recommendations for change

Registration with the Tax Practitioners Board commences

Those seeking to leverage the transitional TASA requirements, were to register with the Tax Practitioners Board from 1 January 2016

Corporations Amendment (Financial Advice Measures) Act 2015

Changes made to clarify FoFA requirements commencing 19 March 2016 including extending the time period for issuing of Opt-in notices from 30 to 60 days and modified the best interest duty for basic banking products, exempted basic banking products and training ad education from conflicted remunerations

2017

ASIC Class Order 15/923

Record-keeping obligations for Australian financial services licensees when giving personal advice

Corporations Act 2001 by the Corporations Amendment (Professional Standards of Financial Advisers) Act 2017

Act introduced in March 2017 to raise the education standards and training requirements of financial planners/advisers

ASIC Report 515 Financial Advice Review of how large institutions oversee their advisers

ASIC REP616: A review of how large institutions oversee their advise

Corporations Amendment (Professional Standards of Financial Advisers) Act 2017 established the Financial Adviser Standards and Ethi

April 2017 - Esta

2018

ASIC RG 175: Licensing: Financial product advisers – conduct and disclosure

ASIC clarifies the use of restricted terms under S923A "Independent", "impartial" and "unbiased" in regards to financial advice

Corporations Amendment (Professional Standard

Financial Advisers)

Legislates restricti

can call themsel

planner/a

2019

FASEA Consulted on standards

Over the course of 2018, FASEA consulted on standards

Royal Commission into Banking and Financial Services

Inquiry ran for most of 2018 and resulted in a report of findings into the banking, superannuation and financial services industry. The Report made recommendations for change in regards to adviser conduct and remuneration to the Government

TPB Registration for Financial Planners and Advisers

New professional obligations to apply to tax financial advisers including requirements to register with the Tax practitioners Board (or supervising responsible manager), maintenance of appropriate Continuance Development training and compliance with the Code of Ethics

LIF commencement

Commencement of LIF in regards to Life insurance sales and commissions.

FASEA – Standard 5 – Work and Training (Professional year), Standard 7 – CPD requirements

FASEA requirements applied to new planners/advisers from 1 July 2019

ASIC & APRA Joint Letter to RSEs on Oversight of Fees Charged to Member Accounts

The regulators outlined expectations of trustees in relation to advice fees charged from member accounts

Treasury Laws Amendment (Design and Distribution Obligations and Product Intervention Powers) Act 2019

Sets requirements for product issuers and distributors to ensure their products are targeted at the right market

Treasury Laws Amendment (Ending Grandfathered Conflicted Remuneration) Act 2019 No. 87, 2019

The Act removes the grandfathering provisions created in relation to commissions (pre FoFA commencement in 2013)

2020

ASIC Report 626 Financial advice: What consumers really think

ASIC Rep 626 provides research finding regarding consumers view of financial advice including barriers and consumer perceptions

FASEA Code of Ethics Standard

Commencement of FEDEA Code of Ethics: The FASEA Code of Ethics sets out the principles and core values that lays the foundations for a true profession to emerge

Financial Sector Reform (Hayne Royal Commission Response – Better Advice) Bill 2021 (Better Advice Bill)

Government issue Better Advice Bill for consultation to support the Royal Commission Recommendation 2.10 to establish a single disciplinary system for financial advisers

Treasury Law Amendment (Measures for Consultation) Bill 2021 Compensation Scheme of Last Resort; Financial Services Compensation Scheme of Last Resort Levy Bill 2021; Financial Services Compensation Scheme of Last Resort Levey (AFCA Fees) Bill 2021; Financial Services Compensation Scheme of Last Resort Level (Collection) Bill 2021

The proposed legislation will establish the Compensation Scheme of Last Resort (recommendation 7.1) and the Financial Accountability Regime (recommendations 3.9, 4.12, 6.6, 6.7 and 6.8

Financial Sector Reform (Hayne Royal Commission Response—Advice Fees) Regulations 2021

Made May 2021 and applies from 1 July 2021 – regulation to support compliance obligations in regards to record keeping for Ongoing fee arrangements

Financial Sector Reform (Hayne Royal Commission Response No. 2) Act 2021

Obligation to prohibit super trustee for deducting advice fees without consent, advises to obtain client prior written consent to deduct ongoing fees and to renew arrangement annually apply from 1 July 2021.Royal Commission recommendation 2.1,3.2, 3.3

ASIC Consultation Paper 332 Promoting access to affordable advice for consumers

ASIC Consultation Paper seeking submission regarding actions ASIC may take within current legislative settings to facilitate affordable advice and enhance assessability

ASIC & APRA Follow Up Letter to RSEs on Oversight of Fees Charged to Member Accounts

Follow up to the 2019 letter as well as increased expectations on implementation of the above act

Westpac Case High Court decision regarding personal advice

Australian Securities and Investment Commission v Westpac Securities Administration Limited [2019] FCAFC 187 – The Westpac case clarified the distinction between general and personal advice and the need to ensure financial services covered by their AFSLs are provided efficiently, honestly and fairly.

45 changes in 11 years and more to come …

One must doubt regulatory capability:
Politics?
Structure?
Philosophy?

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Current adequacy of funds

How do you determine how much spending to recommend?

- Start with current spending … which is generally sustainable
- Use proprietary or personal software to model until mid-nineties at least
- In some cases, there is overspending:
  - Some just point out the problem and suggest cutting expenditure or working longer

  "I am careful to give options and not advice"
  - Others are more direct and strongly urge lower spending

  "If this other client can live off $40,000 per year, why can't you?"
  - "Irrelevant – OK to rely on the Age Pension" (plus pensioner concessions)
  - One can downsize or sell holiday home or access reverse mortgage
  - No one suggested using lifetime annuities

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Changing the paradigm

- Most interviewees still only thought of guaranteed lifetime annuities and saw them as low-risk investments

- Only three saw the investment linked products as ABPs plus bonuses

"Reverse of life insurance"

"Like an ABP with a guarantee + free money from Centrelink + access to Pensioners Concession Card" (worth about $2,000 to $5,000 in reduced prices depending on state of residence)

- No one seemed to appreciate that lifetime annuities give better value as people age.

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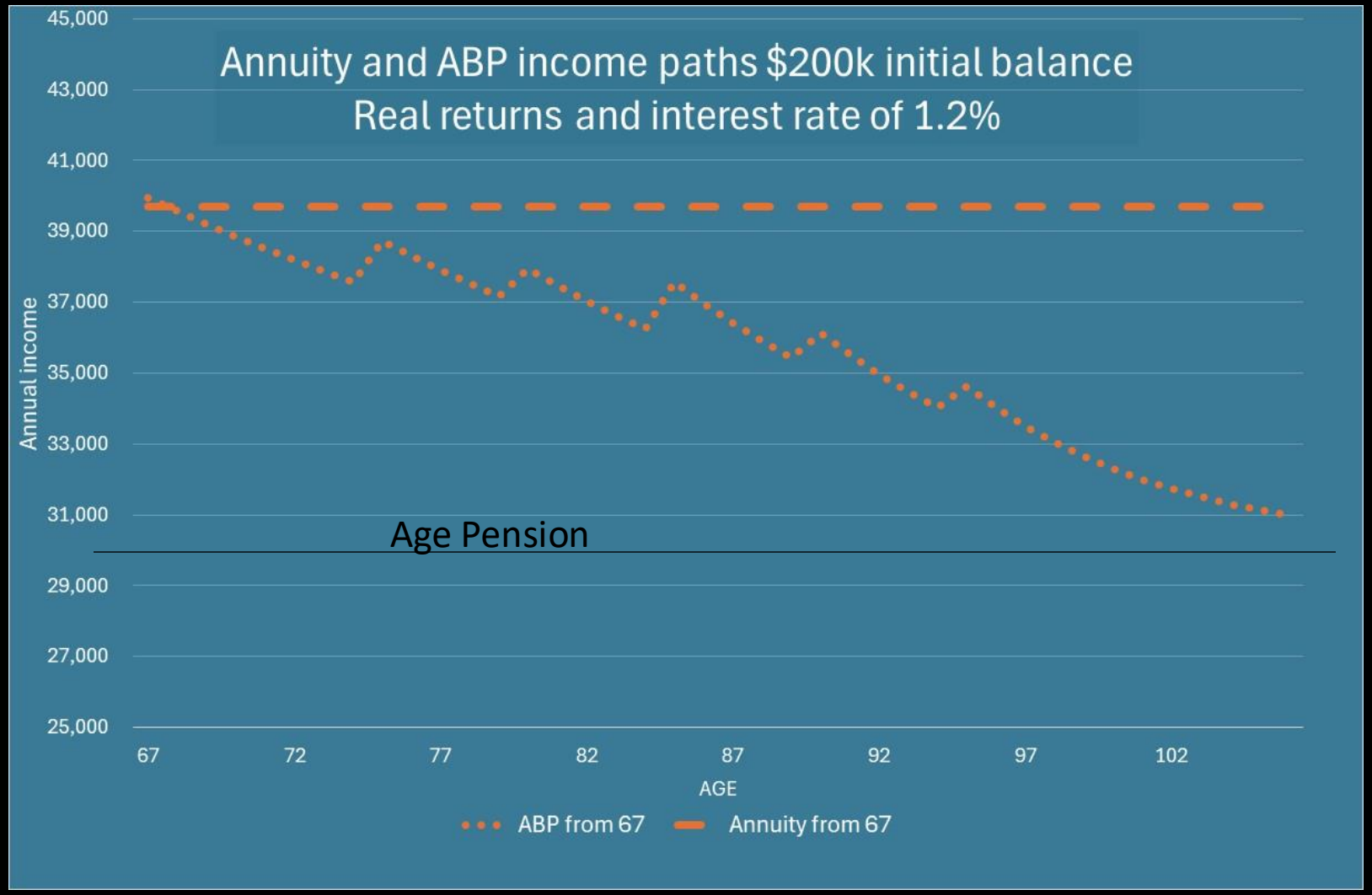
Changing the paradigm



The annuity will always provide a greater income than the ABP with the difference increasing with age.

In reality the lines will fluctuate but the difference will stay the same – ignoring Age Pension changes

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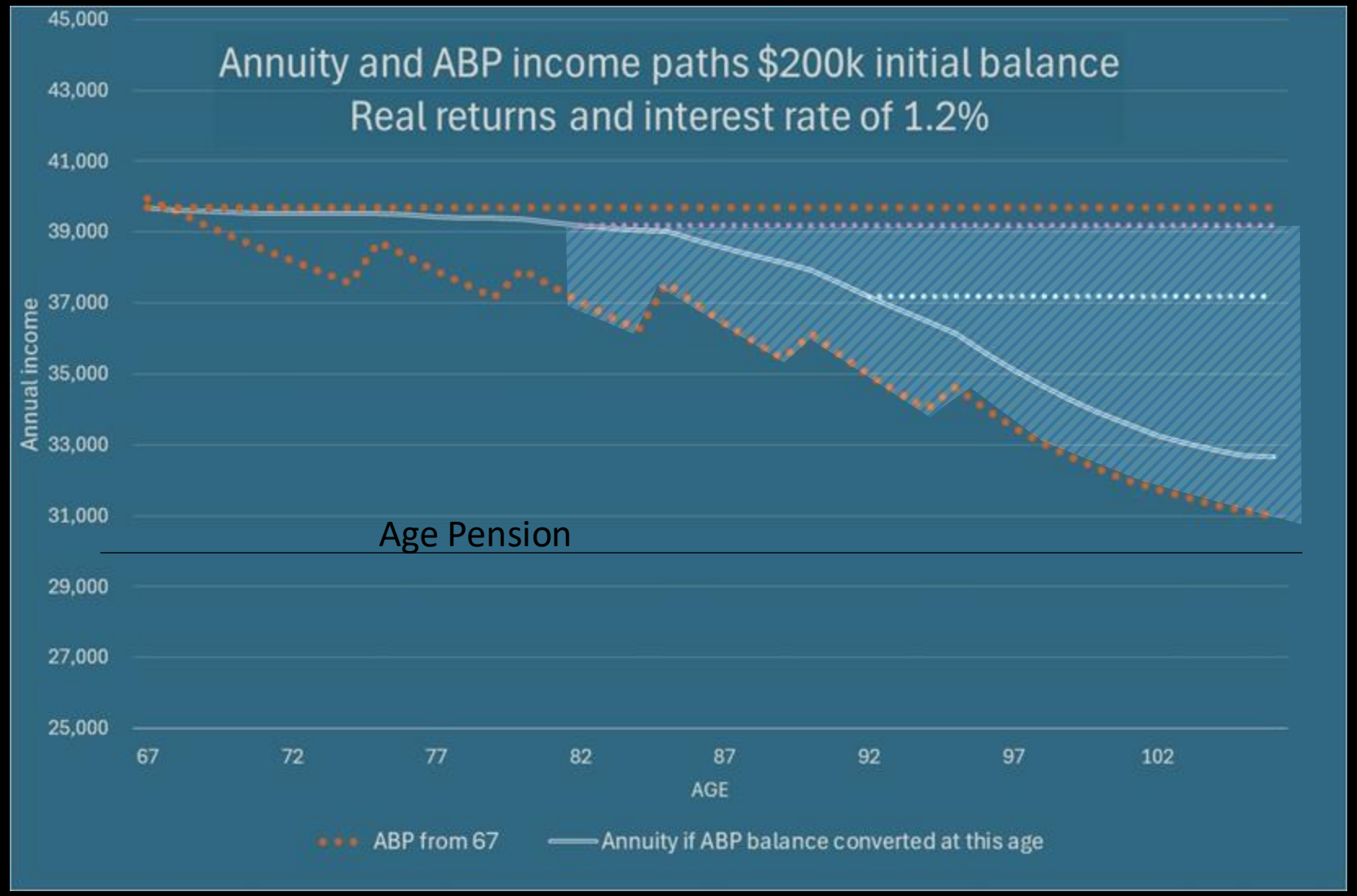
Changing the paradigm



The shaded area represents the gain from longevity bonuses for an investment linked annuity taken at age 82 for a single woman.

The benefit of starting at 67 is only $500pa.

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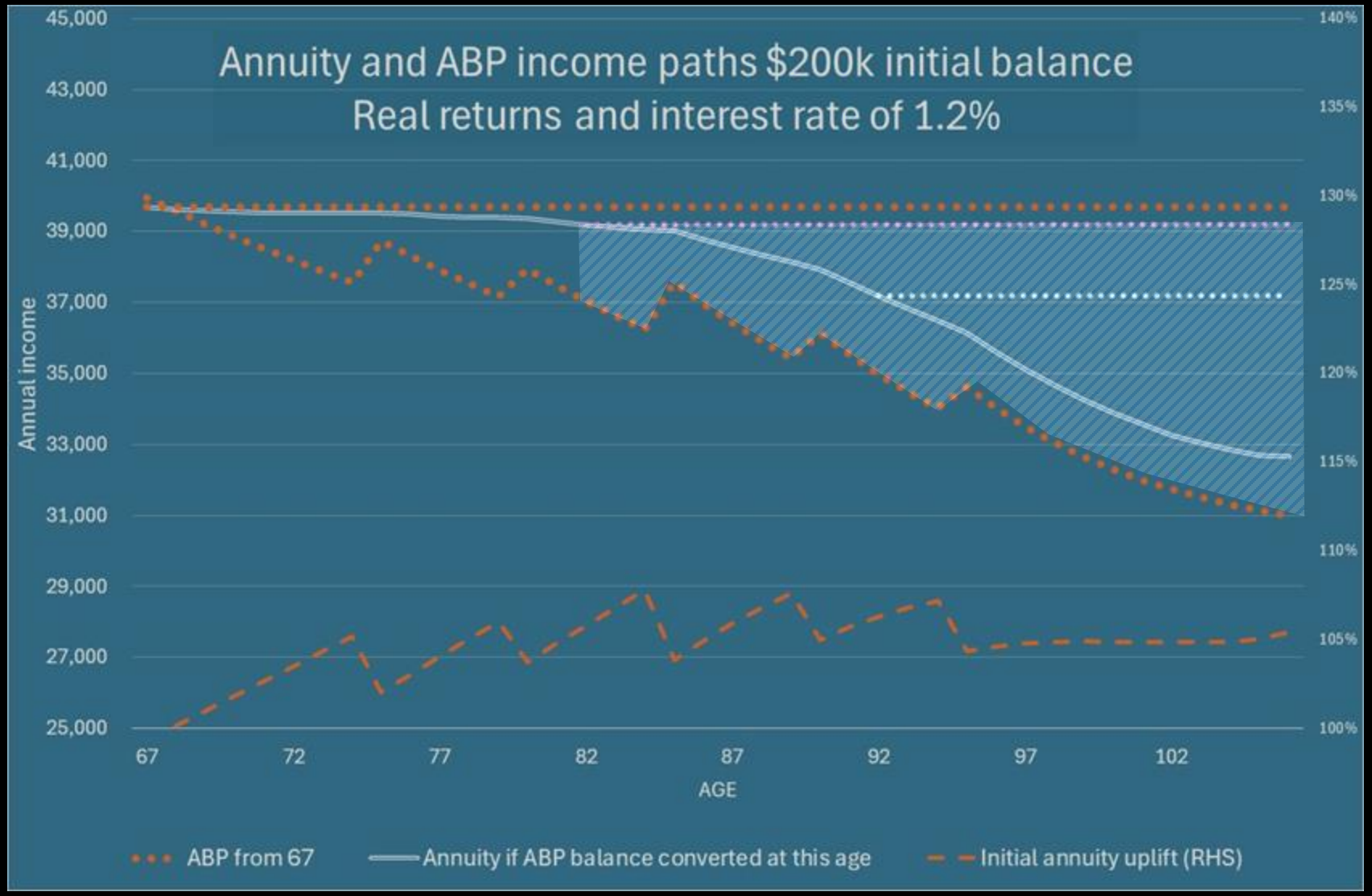
Changing the paradigm



"Have to plant the idea. Not at retirement: scary and overwhelming"

The bottom line show that the immediate benefit of adding longevity bonuses is an increase of 5% to 10% but the benefit grows rapidly

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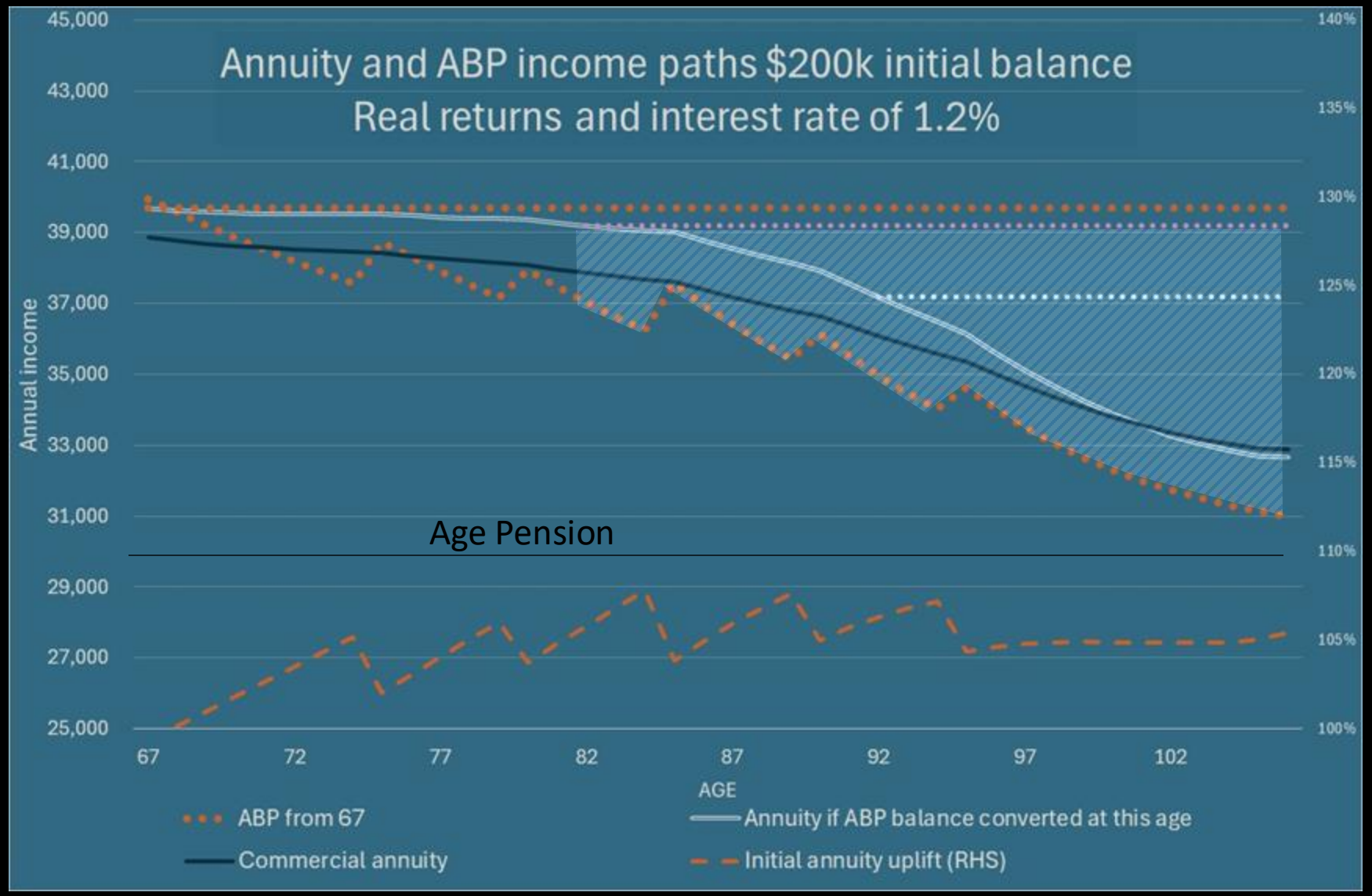
Changing the paradigm



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