Supply Side Resistance to Lifetime Annuities

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Abstract:

The Annuity Puzzle is that lifetime annuities are not utilized in retirement as often as might be expected. The literature invariably provides demand side explanations: bequest motives, liquidity preferences, crowding out by social security and family insurance, unattractive investment returns, poor money's worth particularly for those with lower life expectancies and solvency concerns. On closer examination, none of these are found to adequately explain the puzzle, so the accepted view has come to be that a considerable proportion is due to behavioural biases and misunderstandings.

Overcoming behavioural biases and misunderstandings is likely to require a significant advances in the provision of financial advice. The tension between ensuring that advice is both appropriate and affordable is widely recognised, with the current focus in Australia being on simplification and financial technology.

On the other hand, supply side limitations to alternative products have barely been explored; particularly the possibility that it too is due to behavioural biases and misunderstandings. There is evidence of general resistance to change that could be explained by the interests of trustees and advisors to increase the size of their funds under management, and fees. The paper concludes by identifying challenges to trustees, advisors, regulators and academics.

1 Introduction

This paper examines supply constraints on the provision of lifetime annuities,[1] particularly in the Australian market, and suggests that these constraints go a long way to explain the annuity puzzle. The annuity puzzle is that, in many countries, lifetime annuities are not utilized by retirees as often as might be expected by standard utility arguments.

The demand side explanations for the puzzle have been intensively discussed (Brown et al, 2008; Holzmann, 2015; O'Meara et al, 2015; Peijnenburg et al, 2016; Retirement Income Review, 2020, Villiers-Strijdom, 2021). These authors cover bequest motives, liquidity preferences, crowding out by social security and family insurance, unattractive investment returns, poor money's worth particularly for those with lower life expectancies, solvency concerns and behavioural biases and misunderstandings.

There are however other potential explanations that arise from supply side limitations and which have not been adequately explored either in the literature or in practice. This paper therefore revisits the behavioural biases and misunderstandings that have been identified as inhibiting the demand for annuities but with a focus on the supply side. It then does the same for the supply side explanations, but with a lens that focuses on conflicts of interest and the possibility of complacency. To what extent do behavioural biases and misunderstandings amongst product providers and regulators inhibit the offering of lifetime annuities?

There are two challenges to academic research implicit in this question. The first is articulated in Caplin (2021): "When choices involve navigating trade-offs, how can one separate out utilities and beliefs and thereby identify mistakes?" He sets out the challenges of creating the necessary data and models. The first question leads to suggestions for further research into the motives and beliefs of product providers and regulators. But the second is more fundamental: to what extent do we bring our own biases and misunderstandings to the formulation of the research questions and methodology? The second question requires greater rigour in argument and self-examination as to motives and assumptions. In particular, do utility models need greater elaboration to take into account the real or perceived needs of retirees? While there is insufficient space for much rigour, this paper suggests evidence that should be considered in understanding and possibly correcting the annuity puzzle.

2 Demand side explanations

This section looks at the demand side explanations that are most frequently given, and suggests that they can at least partly be explained by the myopia of the providers (and sometimes regulators) rather than the potential buyers. It seems to

[1] This paper refers to all products that offer an income for the remainder of life as lifetime annuities, regardless of whether risks are guaranteed, pooled, nominal or linked, on one life or many, or enhanced for those in poorer health. Rawlinson (2020, p11) has a useful table of how product providers guarantee or pool investment and longevity risks.

me that this myopia goes some way to explain the paradox that an industry that is otherwise very ready to innovate, fails to provide better products for poor and middle income people.

2.1 Materiality

The first argument to consider is whether the increase in consumption provided by lifetime annuities is material. There are those in the industry who feel that it is not, and their possible reasoning needs to be explored.

From an individual's perspective, the argument for the purchase of lifetime annuities is that "you cannot take it with you". To maximise consumption in retirement, retirees should spend their capital, and lifetime annuities provide that the capital is spread exactly over one's lifetime. The same argument applies to a couple where the lifetime annuity should be on both lives. From the wider family's perspective lifetime annuities insure the family estate against retirees living too long, and to capital that would otherwise not become available until bequeathed.

The first objection to the purchase of annuities is that not every family needs to consume capital. Families may want to exploit their accumulated capital more productively than an annuity provider. These arguments are valid for wealthy individuals that manage their own money (whether in SMSFs or not), particularly those with their own businesses, while capital could also be used to invest in housing for younger generations. They do not apply however to the considerable financial assets that are held in financial institutions as this money is not being put to better personal use. Over $500bn is currently held in large APRA regulated superannuation funds (APRA, 2021) in respect of people over 65, and there is further investment in mutual funds and deposits in banks.

Trustees and others in the retirement industry are usually sufficiently wealthy not to want to draw down their capital in retirement. This can mean that they are unable to see the needs of those low and middle income markets who would benefit from lifetime annuities. I have lost count of the number of times I have been told that investment returns are adequate to live on in retirement. Such arguments often assume Australia's high dividend yields and that lifetime annuities cannot benefit from equity type investments. As discussed in 2.5 below, the investment assumption is false, and the dividend yields thus irrelevant.

This myopia is also evident (although perhaps less so) with the repetition of many industry participants (Productivity Commission, 2013, p227) that the Age Pension crowds out lifetime annuities. The validity of the argument depends on what one considers as material, and may limit the demand for lifetime annuities for less wealthy couples with long life expectancies[2]. Perhaps the best indication of

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[2] Ignoring expenses and profit margins, an annuity provider would give an annual payment that spreads the annuity premium over the expected lifetime. They would be able to enhance the annual payment (expressed as a percentage of the premium) by about two thirds of the investment return. See https://www.actuaries.digital/2018/02/20/the-asher-approximation/. Thus the improvement factor increases with reduced life expectancy and lower interest rates.

materiality of the potential additional consumption from superannuation assets is modelling from the Retirement Income Review (2020, p435) that one third of superannuation benefits will eventually be paid as bequests. This number is consistent with various calculations below that suggest an improvement of some 30% in potential consumption for many retirees.

2.2 The bequest motive

The second objection is similar, in that it is suggested that many retirees will reduce their consumption in order to leave a bequest. The reasoning behind the objection is, however, largely incoherent. If people have charitable bequest motives it would often make more sense to make specific provisions rather than rely on a benefit that declines with advancing age as capital is being used up. If the intention is to provide capital to children or even grandchildren, the same applies. Life annuities insure families against long-lived parents consuming more of the families' capital. If the motivation was altruistic concern for the family, there would be strong arguments for the purchase of a lifetime annuity to cover the reduced consumption and gifting the remaining capital immediately it became available. This is because the likely heirs are much more likely to be liquidity constrained when their parents reach retirement age than a quarter of a century later. They may are also be likely to prefer a certain amount now, rather than an uncertain amount later.

The bequest motive may of course not be altruistic, but the promise of a bequest may be used as a means of ensuring support from children. Silverstein et al (1995) show that there are a wide range of reasons why adult children will support their parents, and expectations of an inheritance are not unknown. Given that most Australian retirees own their own homes, and the value normally exceeds their financial assets, the promise of an inheritance out of the home should normally fulfil this role – to the extent that is exists.

There is also evidence that this is Howe most people feel anyway. The Retirement Income Review (2020, p436) shows that most people do not rank leaving a bequest highly. Caplin (2021) shows that even when they do cite it as a reason not to spend capital, better questions can be used to show reluctance to drawdown assets is really driven by the precautionary rather than the bequest motive.

Again it might be suggested that decision makers in the finance industry are projecting their own situations on to superannuation members who do not want to leave bequests. It is therefore to be welcomed that the Retirement Income Covenant Position Paper (2021) specifically states that trustees should not consider bequests, although this has not found its way into the proposed legislation.

2.3 The precautionary motive/liquidity preferences

The Retirement Income Review (2020) confirms that the precautionary motive is significant reason for reluctance to buy annuities, but – as it suggests – the reasons are not coherent, and they observe (p444) confusion about this point in "press articles, surveys and some submissions". Australian retirees do not face the risk of significant health or aged care cost blowouts thanks to relatively good government support. Fulford (2015) explores the need for precautionary savings from a variety of angles and suggests target buffers of between three and twenty months of consumption – even for retirees facing the uncertain medical costs in the USA.

Public discussion of precautionary savings is seldom this specific, and so can often reinforce a sense of nameless dread rather than create financial security. For Australian retirees, good financial planning suggests having sufficient insurance and a buffer of perhaps one year's expenses for unforeseen medical, maintenance or family related costs. There should also be a margin between income and regular expenses that allows for additional luxuries or gifts, and that can be used to rebuild the buffer when it is used for unforeseen expenses.

Not only is it not necessary to keep all financial assets in liquid form (as through an account based pension), it is risky, as declining powers make older people vulnerable to financial abuse – as Adams et al (2014) show, not least by family members.

The retirement industry again display their inability to envisage the financial situation of lower and middle income retirees. Australian Super suggested that lifetime annuities under $250,000 would be "unlikely to receive value for money."[3] Willis Towers Watson suggest a threshold of $150,000.[4] For someone on the Age Pension, $150,000 is six times their annual expenditure. Putting aside a year's expenses (about $25,000) for contingencies, the other $125,000 could allow for a 30% percent or more increase in spending.

2.4 Annuities are too risky

Even where a choice is offered, members will often be discouraged by inappropriate advice. On inquiring about lifetime annuities, the author and one of his colleagues have separately been told by financial advisors that they are "too risky" – given the money is lost on death. As Brown et al (2008) showed fairly conclusively, when annuities are framed as an investment, they do appear risky; their benefits are as consumption plans.

Another element of risk is covered by Li et al (2021), who show that potential annuitants are rational in reducing their exposure to the product because of the possibility of insurer insolvency. Unlike the previous risk, this is a risk that is down-played by product providers. The risk of institutional failure however is not limited to annuity providers, and appropriate regulation should ensure relatively level playing fields. The effectiveness of the regulation needs to be publicised.

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[3] https://treasury.gov.au/sites/default/files/2019-03/c2018-t285219-Australian-Super.pdf

[4] https://www.willistowerswatson.com/en-AU/Insights/2018/08/ciprs-and-small-retirement-balances-super-outcomes

2.5 Poor value for money

Guaranteed annuities are frequently said to offer poor investments based on the underlying internal rate of return and as unsuitable for people with lower life expectancies. Both these disadvantages can be addressed by product ideas that have been around for decades.

As explained in Actuaries Institute (2021a), it is possible to completely separate the investment and longevity insurance elements of an annuity. Variable annuities have been offered to members of the US TIAA/CREF pension funds since the fifties (Weil and Fisher, 1974). There is therefore no reason why lifetime annuities should offer poor value for money. In spite of the obvious advantages of investment linked annuities it is remarkable that SIS Regulations 1.05 and 1.06 did not permit such annuities until July 2017. This does raise the questions as to why were they not permitted, and why did industry not lobby more actively for them.

The mistaken view that lifetime annuities must be unsuitable for people with lower life expectancies is often repeated. The medical and administrative technology required to tailor premium rates (or longevity credits) to an individual's life expectancy has been available since the early nineties to my knowledge, and has been available to Australian companies for at least a decade. It has been used successfully in the UK where enhanced life annuities made up 28% of the market by 2014 according to Gatzert and Klotzki (2016). They summarise 15 papers that have attempted to discover why there is a lack of supply in countries outside the UK, but none of the reasons raised are credible. Underwriting risks or costs are, for instance, mentioned in 7 of the papers – but accepting risk is central to the insurance business, and the costs are similar to those in underwriting life insurance. They are also more affordable in that they will come out of the single annuity premium as against require capital investment in the case of annual premium life insurances where the costs can only be recovered over time.

LIFE EXPECTANCY IN YEARS (1)	ANNUITY INCOME AT 3% INTEREST (2)	YEARS TO 95% PROBABILITY OF SURVIVAL (3)	RATIO OF (3) TO (1) (4)
30	5.3%	44	1.5
20	7%	32	1.6
10	12%	20	2.0

Table 1: Increase from consumption of capital

The potential improvement in consumption that enhanced annuities can offer to those from lower socio-economic groups or in poor health needs to be emphasised. Not only are they likely to have lower balances because of their lower incomes or forced earlier retirement, but their mortality risk is higher. As illustrated in the table above, an investment return of 3% on capital could be increased to 5.3% if the capital was annuitised where life expectancy was 30 years, but an annual return of 12% would be available to a person with a 10 year life expectancy.

2.6 Advice is too expensive

Given all this, it is expected that many retirees should invest a significant proportion of their financial assets in lifetime annuities. In order to do so, however, most will probably need financial advice to help make the decision, or at least someone to offer them comfort that such a decision is reasonable. Such advice can be one off, and should probably be made available by, or with the assistance of, their superannuation fund. Asher and De Ravin (2020) sets out what is needed, and how the Consumer Data Right offers opportunities to do so at reduced cost.

It is clearly easier said than done. Some of the difficulties are inherent in the retirement process itself, but they are complicated in Australia by choice and the regulatory complexity with which advice is surrounded. The complexities that arise from giving members choice of fund and the option to take a lump sum benefit are not often appreciated in Australia. Choice means that funds have to attract members by innovation, marketing and selling. It is evident that most innovation has occurred in differentiating products and services for marketing reasons. It is also clear that selling, particularly, raises costs and creates significant mis-selling risks that require regulation. The consequence for demand for annuities is that members approaching retirement will not pay for advice that they regard as too expensive and untrustworthy, and so are unable to make the appropriate decisions to seek lifetime annuities.

But it is not that members are not receiving advice in the form of defaults and implicit recommendations from their superannuation funds. The default is to leave their assets in the accumulation stage. Asher (2021) calculates that some $100bn is held in accumulation accounts by people over 60, who would save tax by moving into drawdown phase. The implicit advice not to take a lifetime annuity is given by the majority of funds.

3 Supply side explanations

Holzmann (2015) does address the role of supply side restrictions, pointing out that while 60% of defined benefit members of US pension funds take annuities when they are the default offer, only 20% of DC even offer lifetime annuities. Even fewer Australian superannuation funds have offered even the guaranteed annuities that have been available from two insurance companies over the past decade, and none to date appear to offer any annuities as defaults.

3.1 Industry resistance

ASFA (2017) is the industry's response to a Treasury Discussion Paper on appropriate post-retirement products and illustrates the Australian industry's resistance to the idea of lifetime annuities. All of the possible demand side explanations are repeated, and emphasised as valid concerns rather than questioned. The focus is on the risks of lifetime annuities to members and funds, with no consideration of the even greater risks of the current lump sum and account based pension arrangements. It questions, without justification or alternative calculations, the estimate that lifetime annuities are likely to increase incomes "up to

30%”. It also is displays what appears to be a wilful misunderstanding of the possibility of enhanced annuities. Similarly, the response dismisses joint life annuities as merely saving administration costs, while they actually provide a benefit more targeted to the needs of couples. Single life annuities would mean the loss of 50% of income on the death of the first, while the Age Pension for instance, recognises that living expenses of a single person are about two thirds of that of a couple.

ASFA’s media release in response to the Retirement Income Review is even more telling.[5] Its sole concern is to continue its long running campaign to increase the compulsory “Superannuation guarantee” to 12%, which the Review – in line with all other published modelling – found to be unnecessary. Increasing compulsory contributions is indeed likely to reduce the consumption of most people in the years when they are most liquidity constrained. It is difficult to conclude that the industry is not more concerned with increasing funds under management than with members’ interests. The sale of lifetime annuities reduces funds under management because more capital is paid to members while they are alive rather than at death.

To be fair, there are exceptions. Challenger has been an active seller of lifetime guaranteed annuities for two decades albeit without huge success. It has only begun offering investment linked annuities this year and still does not offer enhanced annuities. The Actuaries Institute (2012) reported that two life insurance companies were offering variable annuities with guaranteed minimum withdrawal benefits, and a third subsequently followed. They appear all to have been withdrawn them after they failed to gain traction in the market. They were complicated and expensive products, and did not seem to be sold with any great enthusiasm. One reason may have been the concern at potential investment losses; life companies apparently lost some $15bn during the GFC through failing to hedge their portfolios (Actuaries Institute, 2012).

Although the legislation has permitted the sale of investment linked lifetime annuities since 2017, and there has been much discussion and encouragement to introduce lifetime annuities, the first products (From QSuper and Challenger) have only become available this year. It is expected that there will be further development but it is still not clear whether members will obtain sufficient disinterested information to buy appropriate levels of life annuities.

3.2 Inappropriate financial metrics

One cluster of explanations for industry resistance is that they are not sufficiently profitable because they require excess capital, and there is inadequate risk free government stock to back them. Holzmann (2015) is not alone in calling for government support for annuity providers in the form of issuing long term debt suitable for matching annuities and preferably swap arrangements to allow hedging of mortality risks.

[5] https://www.superannuation.asn.au/media/media-releases/2020/media-release-20-november-2020

These calls need to be seen against the backdrop of the Australian financial sector's use of two inappropriate measures of profitability: return on equity (ROE) and the cost to income ratio (CIR)[6]. Both metrics reduce involvement in otherwise profitable investments with comparatively low ROEs or high CIRs.[7]

Although the problems with ROE are taught in first year economic and finance courses, my experience with final year and graduate students shows that these too require intellectual effort. An example may therefore be helpful at this point. CIR's are easier to understand. Ignoring all other considerations, including returns on capital, which is more profitable:

a) a customer who gives rise to costs of $70 and pays you $100, or
b) a customer who gives rise to costs of $30 and pays you $50?

The answer is clearly (a) as you make a profit of $30 against only $20 for (b). But (a) has a CIR of 70% as against 60% for (b).

Of course, it is possible that these metrics are used merely as indicators and the companies are really trying to maximise the real measure of profit such as economic value added (EVA). There are however suggestions that this is not the case.

- The larger banks have closed branches in rural areas that sometimes have been replaced by community banks.[8] Such community banks have proved economical despite not having the advantages of scale of the larger banks and the same ability to diversify risks from the local area.
- The Australian financial sector is noticeably absent from Asian markets, despite our locality advantage and the presence of many Asian immigrants with knowledge of the foreign markets. It is not that these markets have not offered opportunities – as evidenced by the success of European and American companies in those markets. The explanation may well be a high degree of complacency, but inappropriate metrics are likely to have played a role.
- The sale by the large Australian financial groups of their life insurance subsidiaries to foreign companies provides further evidence of the use of inappropriate metrics and perhaps a clue as to the motivation. The sale followed revelations in the Royal Commission into Financial Services of different types of profit gouging, which can be explained by management having excessively high profit targets. The financial groups have become accustomed to high ROEs and low CIRs in their banking and traditional life insurance business. These high

[6] These have been included in the financial objectives of the banks for some years. The worst offender was probably NAB, for which ROC and CIR account for two of four main objectives. See p4 of their 2018 Half Year Results Summary https://yourir.info/e4600e4db4d0cc89-nab.asx-3A492724/NAB_2018_Half_Year_Results_Summary.pdf

[7] The various problems of ROE are covered in Stern et al (2001). See p 9 on the perverse impacts of ROE. For CIR, Burger and Moormann (2008)

[8] https://www.weeklytimesnow.com.au/news/opinion/community-banks-can-replace-closed-branches/news-story/3b47f6a5571cd39124ad753ae91303f2

ROEs represent oligopolistic rents that management have attempted to justify as expressing the "cost of capital". This is not true, but the arguments used to justify the sale of their life insurance subsidiaries applies with even greater force to the provision of lifetime annuities.

Financial companies where the management have a more clear-sighted view of the cost of capital and more appropriate financial metrics, such as Challenger in Australia and Berkshire Hathaway in the USA have no difficulty in selling insurance at a profit. For well capitalised companies, the sale of guaranteed annuities priced at a yield that approximates that on government stock, represents cheap finance. There are no significant financial reasons why companies should not offer guaranteed annuities, let alone the investment linked pooled longevity risk products that require minimal capital.

3.3 Industry is conflicted because of lost advisor income

While incumbent superannuation funds may resist life annuities because of the loss of funds under management, financial advisors face considerably greater losses if their clients buy lifetime annuities that are simple "set and forget" products. There is little need for annuitants to receive ongoing financial advice and so financial advisors are strongly incentivised to find reasons why their clients should not buy them. Altschwager and Evans (2021) confirm this in their interviews with Australian financial advisors. And given the reliance of many funds and insurers on the goodwill of financial advisors, there is reluctance to introduce suitable products.

If there was any doubt as to the influence of advisors, the Actuaries Institute (2020) tells of evidence from the UK. Unusually, the UK is one of the countries that has moved away from compulsory lifetime annuities for the second pillar of their retirement system. Pension fund members are allowed encashment of their "pension pots" at retirement, the so-called UK "pension freedom". But retirees do face a significant disincentive in that any lump sum payment in excess of 25% of the balance is taxed at the person's marginal rate. State funded free "guidance" is available.[9] By 2019, only 12% of retirees were buying lifetime annuities.[10] 54% took a lump sum but 89% of these were withdrawing less than £30,000. For those not taking lump sums, 13% of those who took

professional advice bought an annuity, but this rises to 54% of those receiving the independent state funded guidance (and 41% with no apparent advice or guidance).

Receiving professional advice thus appears to reduce the likelihood of choosing an annuity over a drawdown arrangement by 75% to 80% - the impact being higher for those larger balances. While there may be a selection effect, it seems likely that advisors are biased against annuities. The enthusiasm for exercising pension freedoms generated by the industry appears to have led to many making decisions

[9] https://www.pensionwise.gov.uk/en/appointments

[10] https://www.fca.org.uk/data/retirement-income-marketdata

they regretted later. The Financial Conduct Authority's review into the pension freedoms found that "around half of our full encashment cases might have followed a different path as a result of seeing our examples". As they put it:

> *Many respondents had a 'penny drop' moment during these discussions, which made them start to question whether they had acted too hastily, without understanding all the facts.*[11]

The views of the financial advisors obviously colour the views of their shareholders and suppliers, and their numbers make them influential politically. While decades of financial mis-selling scandals have led to increased regulation and reduction in their numbers over some periods, it is not clear that the perversity of their remuneration structures has yet been fully addressed.

3.4 Regulatory complexity

The question that then arises is why regulators have not addressed this conflict effectively. They have certainly been involved in the regulation of advice, but it seems that their intervention has been to make it more complex rather than more appropriate, so one might ask whether the complexity has been partly driven by regulatory capture.

It seems to be generally recognised that the regulation of financial advice has failed to improve quality but has increased expense. It is unfair to blame ASIC for all the complexity, much of which is in the primary legislation of which the Corporations Act (2001), while Hanrahan (2018) points out that new regulations are "often made in response to relentless industry pressure on governments and regulators to supply black-letter prescriptive rules and guidelines that allow compliance risk to be managed internally by firms using a check-box approach" which can also be seen in ASIC (2021), their summary of responses to consolation on the cost of advice.

Industry pressure for more details and prescription, but that also complains at excess and the regulatory burden may seem a contradiction. At least two forces may be at work. The first is described by John Kay as:

> *...regulation that is at once extensive and intrusive, yet ineffective and largely captured by financial sector interests. Such capture is sometimes crudely corrupt, as in the US where politics is in thrall to Wall Street money. The European position is better described as intellectual capture. Regulators come to see the industry through the eyes of market participants rather than the end users they exist to serve, because market participants are the only source of the detailed information and expertise this type of regulation requires.*[12]

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[11] https://www.fca.org.uk/publication/market-studies/retirement-outcomes-review-interim-report-annex3.pdf

[12] http://www.johnkay.com/2012/07/22/finance-needs-stewards-not-toll-collectors

A less sinister explanation that could be called regulatory inattention is that the responses to regulatory consultations are made in a hurry, frequently the fruit of compromises by different authors, and thus inadequate consideration. My experience with the drafting a response to ASIC with a group of actuaries was that the practitioners involved preferred a principle based approach when it was an option that was suggested to them. (Asher, 2018).

Most people would appear to agree. The Australian Law Reform Commission (2021) is a factsheet headed "Unnecessary complexity in Australia's financial services laws". It finds that the laws are "unnecessarily prescriptive", "complex and unwieldy", inconsistent and "obscure the norms of behaviour that the law seeks to uphold." They report that there are "83 different legislative instruments as well as a substantial number of regulations" Involved. While apparently radical, my preferred solution is to abolish most if not all of the current regulations and return to the simple approach apparently preferred by Justice Rares (2014):

> *"The Parliament gave the quietus to the elegantly simple s 52(1) of the Trade Practices Act 1974 (Cth) that prohibited a corporation from engaging in conduct, in trade or commerce, that was misleading or deceptive or likely to mislead or deceive. One is now confronted with several Acts prohibiting such conduct."*

He calls for "urgent reconsideration" of the prescriptive approach. Hayne (2019) makes similar arguments, although he points out that the process of simplification will be difficult and time consuming. It needs to set out the "fundamental norms" and should not attempt to legislate for all details.

To give an indication of the prolixity of the regulation, the appendix to this paper gives a 183 word quotation from an ASIC regulation which purports to explain the meaning of reasonable, but is circular in its argument. Ironically, it also requires advisors to exercise judgement.

A new review of the cost of financial advice will be conducted in 2022.[13] As a suggestion to begin the huge process of reviewing all the regulations governing financial advice, might it be possible to carve out the advice given to people in the process of retiring? Let the legislation define the fundamental norm. This should be something along the lines: members should have disinterested advice when choosing how to apply their superannuation benefit. Then let funds and financial advisors develop their own way of providing such advice subject only to the requirement that they ensure, to the best of their ability, that such advice is competent and disinterested. Collaboration between funds and advisors should also be carved out of competition prohibitions – on condition that the results are all made

[13] https://ministers.treasury.gov.au/ministers/jane-hume-2020/speeches/address-12th-annual-financial-services-councils-life-insurance

public. Such an experiment should obviously be carefully monitored, but could provide significant lessons for other aspects of financial services legislation.

3.5 The roles of the ATO

It has been pointed out in Section 2.5 that regulations prohibited the sale of appropriate annuities until their revision in 2017. The ATO has unfortunately continued to obstruct the introduction of appropriate instruments. A particular problem is the misunderstanding that the mortality credits that effectively transfer the balances of members who dies, to those who survive, are equivalent to new contributions.[14] It is hoped that this misunderstanding can be resolved and a variety of more innovative products made available.

On the other hand, Asher and De Ravin (2020) make the suggestion that the ATO could also be central to an initiative to improve and reduce the costs of financial advice. The ATO has access to almost all the personal and financial information that members need to make decisions on their decisions on what products to buy, how much to spend, both before and after retirement - and when to retire. This could be made available to all members either directly, or for use by funds and advisors, at minimal cost.

3.6 Complacency

Finally, there may be a level of resistance to change and managerial complacency most famously identified by Jensen and Meckling (1976) as an agency cost analogous to shirking. It is not inconsistent with a myopia that fails to see the needs of low and middle income people particularly those in poor health. This complacency is perhaps also exemplified in the report in ASIC (2021): “148 of 215 respondents said they do not provide digital advice and do not intend to in the future.” With the opportunities currently available, this is surely extraordinary?

4 Conclusion

There is evidence that supply side obstacles play a significant role in the poor sales of lifetime annuities. Decades of research on the demand supply explanations of the annuity puzzle have failed to find valid reasons why retirees should not choose lifetime annuities to enhance their retirement consumption and protect themselves from longevity risks. The conclusion is often that buyers suffer from behavioural biases. On the other hand, little attention has been given to supply side explanations of why lifetime annuities are not enthusiastically offered, or the obstacles placed in their way by inappropriate regulation. It appears that they too can be subject to behavioural biases.

The challenges identified in this paper are to:

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[14] See the letter to Treasury from the Actuaries Institute, https://www.actuaries.asn.au/Library/Submissions/2021/20210719Submission.pdf

- trustees and advisors to put the interests of their members and clients ahead of objectives to maximise funds under management and fees,
- regulators to facilitate appropriate advice by simplifying regulation and providing ATO data
- academics to consider supply side issues more thoroughly.

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Appendix: Extract from ASIC Regulatory Guide 175: Licensing: Financial product advisers—Conduct and disclosure

Inquiries where information is incomplete or inaccurate

RG 175.322 If it is reasonably apparent that information about a client's relevant circumstances is incomplete or inaccurate, an advice provider must make reasonable inquiries to obtain complete and accurate information: s961B(2)(c). What is needed to comply with this requirement will vary depending on the circumstances, including the nature of the advice.

RG 175.323 An objective standard exists for the obligation to identify whether the information the advice provider has obtained on the client's relevant circumstances is incomplete or inaccurate. Advice providers need to exercise judgement in doing this. The relevant standard of conduct required depends on whether something is 'reasonably apparent'.

RG 175.324 Whether something is 'reasonably apparent' will be judged by reference to what would be apparent to someone with a reasonable level of expertise in the subject matter of the advice sought by the client, and that person exercised care and objectively assessed the information given to the advice provider by the client: s961C.

RG 175.325 An objective standard also applies to the obligation to make inquiries to obtain complete and accurate information. The relevant standard is making 'reasonable inquiries'.