



Centre for pensions
and superannuation



AUSTRALIAN
SCHOOL OF BUSINESS™
THE UNIVERSITY OF NEW SOUTH WALES

Session 5

Policy Recommendations for DC Pension Design

The Payout Phase

**Comments: Hazel Bateman (Centre for Pensions and Superannuation,
University of New South Wales, Australia)**

November 2010



Centre for pensions
and superannuation



AUSTRALIAN
SCHOOL OF BUSINESS™
THE UNIVERSITY OF NEW SOUTH WALES

Approach

1. OECD key design ideas
2. What else may be important?
3. What can be learnt from Australian policy design and proposals?



OECD key design ideas for DC payouts

1. At least partial annuitization
2. Coherence between DC payouts and overall retirement income system
3. Balance between protection against longevity risk and liquidity/flexibility → program withdrawal + deferred annuity
4. Pay attention to supply side



The 3 pillars of Retirement Income Policy in Australia

1. Public Age Pension

- General revenue, PAYG, 27.7% average male earnings, means tested
- Eligibility: Residency and age → 65 (male), 64 (female); 67 from 2017
- Coverage: around 75% (60% full rate)

2. Superannuation Guarantee

- 9% employer contribution, coverage 95%+
- DC, individual accounts, private superannuation/pension funds
- Benefits → CHOICE lump sum, program withdrawal, annuity

3. Voluntary superannuation and other saving



Payouts from DC retirement saving, Australia, 2009

- **Lump sum:** invest outside the superannuation system.
 - 48% retirement payouts (by assets)
- **Income stream:**
 - 52% retirement payouts (by assets)
- **Account-based pension:** program withdrawal. Tax incentives for (age-based) minimum annual withdrawal. [Around 95% of income streams, by assets]
- **Annuity:** available as fixed term, lifetime, with escalation, with reversion to a beneficiary, with a guarantee period, residual capital value. [Around 5% term annuity, negligible life annuity – 29 new policies in 2009]



Centre for pensions
and superannuation



AUSTRALIAN
SCHOOL OF BUSINESS™
THE UNIVERSITY OF NEW SOUTH WALES

1. At least partial annuitization of DC payouts

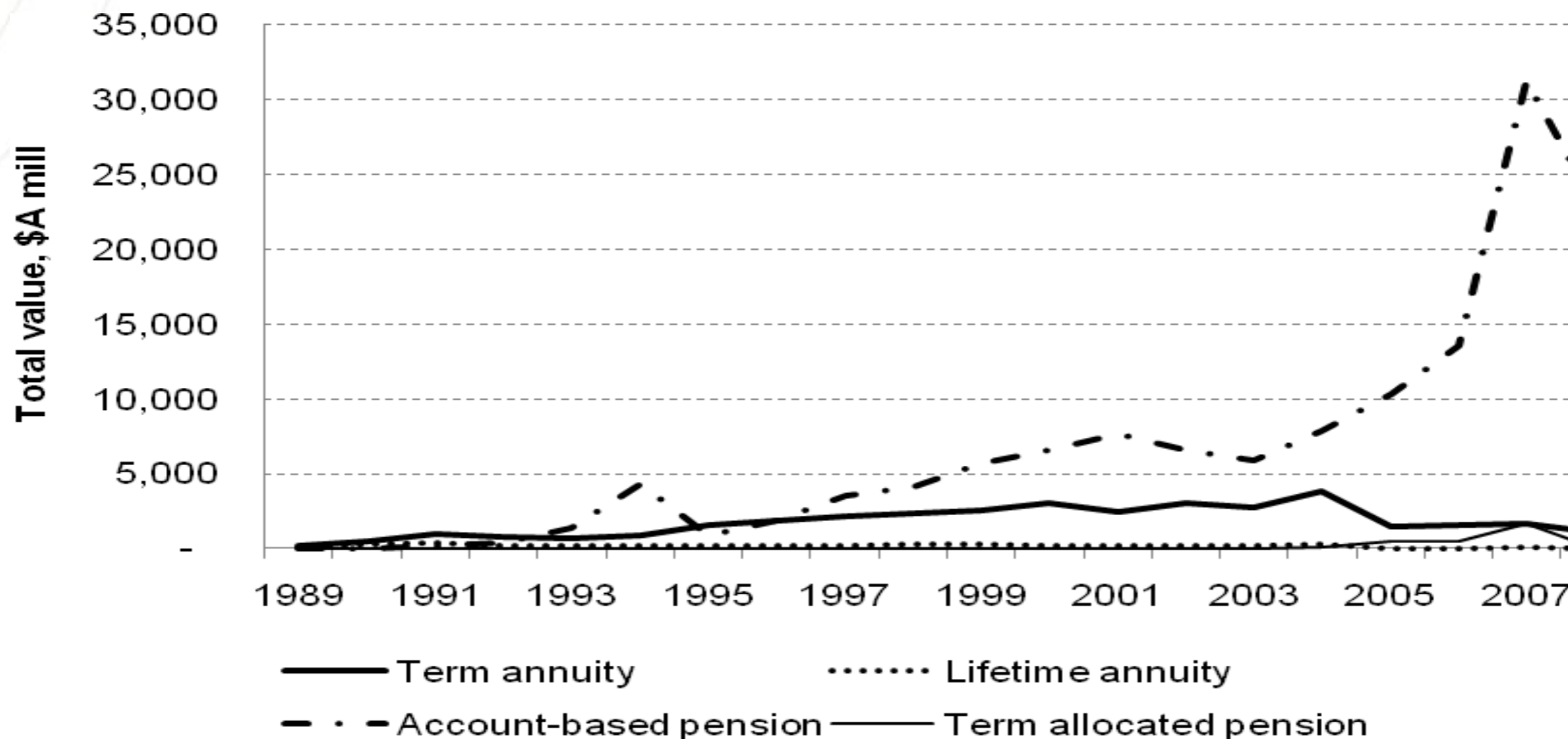
- Mandatory or voluntary?

Lesson from Australia - beware voluntary annuitisation, even with incentives



Lessons from Australia: voluntary annuitisation + withdrawal of tax/transfer incentives → disappearance of annuity market

Value of private retirement income streams, 1989-2009





2. Extent of annuitisation differs by retirement system design

- What about other public support – health, pharmaceuticals, aged care; home ownership; other forms of support? and/or
- Missing – indication of adequacy (aggregate target replacement rate, retirement income?)

Lesson from Australia – potential difficulty of a general rule with means tested public pension (role of public pension changes in long and short run)



3. Balance between protection against longevity risk and liquidity/flexibility using key building blocks – lump sum, program withdrawals, life annuities → suggests program withdrawals + deferred life annuity

Lesson from Australia: beware barriers to product development

- Deferred and variable annuities are NOT on the menu (poor policy coordination, regulatory barriers)
- Small, immature market for hybrid products (costs)
- Financial advisors favour active management (program withdrawals)
- Means tested public pension insures against longevity, inflation and investment risk (crowding out)



4. Pay attention to supply side: market participants, availability of financial instruments to hedge risks, private/public provision

Lesson from Australia: don't neglect supply side

- Long term neglect → 1 life annuity provider in 2010
- Recent (Henry) tax review put supply side on policy agenda, recommending:
 - Government issue long term indexed bonds
 - Government produce a longevity index
 - Eliminate regulatory barriers to product development
 - Consider public sector provision of longevity products (eg. deferred and immediate life annuities)



Centre for pensions
and superannuation



AUSTRALIAN
SCHOOL OF BUSINESS™
THE UNIVERSITY OF NEW SOUTH WALES

What else? Don't ignore the demand side of the market - Policy design, regulatory provisions and industry response MUST facilitate consumer buy-in

- Government/regulators - avoid policy complexity
- Industry/providers/regulators – care with information provision → key comparative information, clearly present insurance tradeoffs of different product features
- Improve financial literacy/access to advice → facilitate consumer understanding, decision making

Australia: few lessons → complex policy; consumer unfriendly financial product disclosure; lack of integrated retirement saving literacy initiatives BUT information provision/disclosure on policy agenda (Cooper, Super System Review, 2009-10)