

31 January 2014

Budget Policy Division
Department of the Treasury
Langton Crescent
PARKES ACT 2600

email: prebudgetsubs@treasury.gov.au

Dear Sir/Madam

Pre-Budget submission for 2014-2015

As the sole professional body for actuaries in Australia, the Actuaries Institute represents the interests of its members to Government, the business community and the general public. We are committed to providing independent and expert advice on public policy issues where there is uncertainty of future financial outcomes.

Actuaries assess risks through long-term analyses, modelling and scenario-planning and provide expert comment on a broad range of business-related issues including enterprise risk management, finance and investment, prudential regulation, retirement income policy, general insurance, life insurance and health financing.

Summary of recommendations

We recommend the Government:

- ▶ Remove barriers to allow our ageing Australian population to better manage their longevity risk
- ▶ Take a more holistic risk management perspective to improve natural disaster resilience
- ▶ Supplement existing budgetary material with a risk framework to improve understanding of the risks and uncertainties surrounding forecast estimates.

Regulatory arrangements for retirement income streams

The Assistant Treasurer, Senator the Hon Arthur Sinodinos, issued a media release on 14 December 2013 which stated that:

“On the measure relating to deferred lifetime annuities, the Government will soon consider the unnecessary barriers to the development of longevity insurance products, as part of a broader review of the regulatory arrangements for retirement income streams.”

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The Actuaries Institute would like to see retiring Australians have increased choice in relation to the retirement income products they are offered and considers the removal of current impediments to product innovation an essential element of such a review, as well as ensuring that appropriate safeguards are in place to protect consumers as well as the Federal budget.

In our Pre-Budget Submission for 2013-2014, we referred to the White Paper "Australia's Longevity Tsunami. What should we do?" released by the Actuaries Institute in September 2012. The report emphasises the urgent need for retirement policy reform in the face of Australia's steep and continuing rise in life expectancies. The key risk identified by the Institute is 'longevity risk' (ie. the financial risks associated with the uncertainty of the period of remaining life).

By 2050, almost 25% of the population will be aged over 65 compared to 14% now. Significantly, the 'baby boom' generation started to reach age 65 in 2011 and over the next 15 years more than 4 million more baby boomers are expected to reach age 65. The current limited range of income products that pool longevity risk, including the unavailability of pure longevity protection in the form of a deferred lifetime annuity (DLA) and other innovative guaranteed retirement income products is a major consumer issue for the growing number of baby boomers who are retiring each year. An increased choice of income products that pool longevity risk would allow consumers to choose products that best suit their needs in retirement.

While the Superannuation Guarantee (SG) system is still far from mature, as it was only introduced in 1992 and did not reach 9% until 2002, Australians are now retiring with more superannuation savings than previous generations.

The Institute's White Paper explores some important ways in which Government can address the problems associated with longevity risk, including a discussion on how post-retirement financial services products – and the Government's approach to their regulation – could contribute to the solution. There are a number of areas where structural changes in the current retirement incomes rules can mitigate some of the financial risks associated with longevity risk and unpredictable increases in life expectancy. These changes include:

- ▶ **Providing greater incentives to individuals to take the majority of their retirement benefits as an income stream.**

Currently there is no tax payable on lump sums drawn from superannuation funds for members aged 60 and over, although there are some tax incentives for assets to remain invested in the superannuation system in retirement. There is therefore potential for people to draw all of their retirement funds at the earliest opportunity, spend these savings, and then fall back on the Age Pension. Whilst there is little



evidence that a material number of retirees do this, there is a case for the Government to consider providing greater incentives for post-retirement assets to be used to provide an income stream. In particular, retirees should be incentivised to protect themselves against their own longevity.

▶ **Linking changes in the Age Pension eligibility age to improvements in life expectancy.**

We recognise that the previous Government acted to increase the qualifying age for the Age Pension to age 67. This increase is to be phased in over six years, commencing from 1 July 2017. Over the longer term, we suggest that the Government consider increasing the Age Pension eligibility age in line with increases in life expectancy.

▶ **Extending the MySuper regime to include post-retirement solutions with “intelligent defaults” that provide retirees with secure income streams.**

In particular, we propose that if a person has retired from full-time employment and does not choose a specific retirement product (e.g. they are already in a MySuper default superannuation product), then they are placed into an income stream product that allows flexibility and control of capital in the earlier retirement years, and then provides some form of pooling of longevity risk (possibly a guaranteed income product) in later years to supplement the Age Pension.

▶ **Removing the impediments that discourage older workers who want to work.**

In particular, encourage workforce participation by changing the means test, and consider introducing an increased Age Pension or a lump sum payment for people who continue to work past the Age Pension age.

▶ **Removing legislative barriers preventing innovation in the development of post-retirement income stream products such as annuities (including deferred lifetime annuities).**

There are a number of well documented legislative and taxation barriers to innovation in the annuities market. We suggest that the drafting should be in broad terms rather than linked to the characteristics of specific products.

Further information on these changes can be found in the full report at this link: <http://www.actuaries.asn.au/Library/Submissions/Opinion/2012/AI-WP-Longevity-WEB050912>.

Improve Natural Disaster Resilience

The significant natural peril events in Australia during recent years, in particular 2010/2011 have highlighted the importance of improved natural disaster resilience. We welcome the



Federal Government announced plans to establish a Productivity Commission Inquiry this year into national disaster funding arrangements. We believe the actuarial profession can contribute significant value to the issues being examined under such a review.

As discussed in previous submissions, we believe there is benefit in taking a more active, preventative and holistic risk management perspective to natural disasters (e.g. bushfires, cyclones and floods). Although the availability and the accuracy of flood mapping continue to improve, affordability of flood insurance remains a key issue for households and small business. We recommend the review and implementation of mitigation options aimed at protecting land and property from natural disasters. This could include revising building codes, planning rules, building dams and levies, and potentially undertaking relocation and renovation of existing properties. These approaches are more likely to be cost-effective in the long term compared with the current approach of post-event funding of natural disaster-related losses.

Improve Understanding of Budget Estimate Uncertainty

Many government forecasts, including those used for the budget, do not recognise the uncertainty and risks inherent within them. Without an adequate description of these uncertainty and risks, the users of budget forecasts can form unrealistic expectations of forecast certainty. This may then create significant problems for users, as well as reputational damage to political parties and associated public institutions responsible for such forecasts, particularly when events outside of their control cause material revisions in forecasts and large deviations in actual results down the track.

The reality is that budget forecasts represent single point estimates of a multitude of uncertain economic, financial and budgetary variables. As highlighted over recent years, such estimates can be subject to considerable uncertainty, as they are driven and influenced by a range of economic, social, financial, policy and political factors. The private sector has dealt with many of these problems based upon recent advancements in the field of Enterprise Risk Management, which have enabled business leaders to understand in a structured way the risks and uncertainties in their business forecasts, so that they can make more informed decisions. The Actuaries Institute and its members have been at the forefront of such developments.

We believe that it is critical for the government to supplement existing budgetary material with a risk framework built upon the well-established and widely accepted principles of risk management. Doing so would also provide a structured framework in which alternative policies could be considered not just in terms of their expected impact on future budgets, but also in terms of their beneficial or detrimental impact in terms of risks and uncertainties. It would shed light on policies that seek to reduce costs by increasing risks which are not otherwise accounted for. It would also enable people to differentiate between the risks that are under the control of the government, versus those that are not, thus helping to



manage expectations in advance and to move the public discourse away from short term political point-scoring when forecasts go astray.

Ultimately the goal would be to create a more robust and resilient budget that is balanced over the long term, which means understanding, assessing and managing the risks associated with the drivers of forecasts. Many of these risks also relate to other topics of considerable importance which the Actuaries Institute has previously advocated and as noted above, such as the impact of the longevity tsunami, and natural disaster resilience. This would help move the public debate towards more positive discussions around how to make the budget more resilient over time, and subject to less risk and uncertainty, rather than on just focusing on headline central forecasts that are likely very uncertain and which hide important risks. We are not necessarily advocating full communication of such uncertainties and risks in headline numbers, but rather that relevant uncertainty and risk information should be generated and made publically available. We would be happy to help work with Treasury in order to explore how this might work in practice.

The Institute would be pleased to discuss any of these recommendations in more detail. Please do not hesitate to contact our Chief Executive Officer, David Bell, on (02) 9239 6106 or email david.bell@actuaries.asn.au if you wish to discuss the matters raised in this submission.

Yours sincerely

Daniel Smith
President

cc The Hon Joe Hockey, MP - Treasurer
The Hon Arthur Sinodinos, Senator – Assistant Treasurer