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Developing effective rules of the market for life annuities

Prepared by Anthony Asher

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Abstract

Research over the last three decades has concluded that life annuities should play a greater role in defined contribution (DC) retirement funds. That their role remains limited presents an "annuity puzzle", which is frequently, but unsatisfactorily, explained by limited demand due to financial illiteracy and behavioural biases. Suppliers and regulators are, however, also boundedly rational, not necessarily moved by members' interests, and may be conflicted. This paper investigates the market structure – and its main underlying narrative – that underlies the limited use of lifetime annuities in Australia by analysing published views and interviews with knowledgeable insiders. The narrative is that of financialization, which contributes to a narrow focus on liquidity and accumulation, conflicts between financial incentives and fiduciary duties, and a naïve view of regulation. The regulatory framework setting market rules is found to be intimidating overly complex, sometimes intrusive and dysfunctional. Trustees are restricted in their ability to innovate by investing in new products or by engaging more closely with members. Suggestions are made as how to shift the investment mindset and on designing more effective market rules.

Key words: annuity puzzle, financialization, market design

JEL codes: D14, G41, J32

1 Introduction

This paper is predicated on the assumption that trustees[1] of defined contribution (DC) funds should actively promote guaranteed and variable life annuities ((V)LAs) to their members. The benefits of these are convincingly demonstrated by Horneff et al. (2009), after allowing for investment, longevity and expense risks.

The limited take up of LAs creates an annuity puzzle. Brown et al. (2008) found that individuals prefer LAs when presented to them in a consumption rather than an investment frame. This suggests that the puzzle is not so much a failure of demand but of supply. Brown et al. (2008) conjectured that this market failure might be explained by the investment frame being "the dominant frame in the market"; it is simpler, and adequate for the accumulation phase. Brown et al. (2008) also suggested that providers are afraid that resources invested in converting members to a consumption frame would benefit competitors, and that sales staff are conflicted by incentives to recommend products other than LAs. Another potential explanation, given by Benartzi et al. (2011), is that US trustees do not promote LAs because they cannot meet onerous regulatory requirements to judge the solvency of annuity providers.

The Australian superannuation industry provides a useful context to investigate these suggestions. It is a prime example of a large DC system with limited use of LAs, where Bateman et al. (2017) have confirmed that members prefer annuities when presented within the consumption frame. The Australian government is also engaged in a sustained campaign to encourage the supply and take-up of LAs, as described in Australian Treasury (2021a). That Position Paper has led to a legislated

[1] For simplicity throughout the paper, "funds" is used to describe retirement, pension or superannuation funds offering DC retirement benefits, "trustees" used to describe the responsible governing body, who are governed by fiduciary duties, and "members" for beneficiaries. Those receiving retirement benefits are described as "retirees".

“Retirement Income Covenant” (RIC), which is a requirement for trustees to develop a retirement strategy for their members. Some trustees have made it possible for members to use LAs, but take-up has continued to be limited: anecdotally less than 10% of members are using them even in these funds. The regulators’ review of trustee responses has found a "variability in the quality of approach taken and a lack of urgency in embracing the intent” of the initiative (APRA and ASIC, 2023).[2]

The research questions addressed in this paper are therefore the extent to which the anaemic responses to government initiatives are reflective of agency conflicts, myopia or misunderstanding perhaps arising from the investment frame, regulatory obstacles, or other reasons that have not yet been identified by previous research. Discovering the answers is complicated by the possibility of “motivated reasoning” (Kunda, 1990). If committed to a particular course of action, people may ignore relevant information and find rationalizations for their resistance to change (Jermias, 2001). Sah (2017) notes how advisors facing agency conflicts are especially vulnerable to rationalizing. To the extent that trustees do face regulatory obstacles, further questions arise as to the motivation and frames of the regulators, who necessarily must rationalize their actions in the light of the policies of the government at the time. If that is not difficult enough, Ford et al. (2008) make the case that change agents themselves are also subject to myopia and rationalization.

To find answers, I use two strategies. The first is to interrogate the public positions of market participants and regulators for their underlying reasoning. Developments in Australia provide a novel source of data in that there have been three major investigations into the industry and four major government discussion documents that have led to hundreds of submissions from interested parties. Given the possibility that the public positions can veil the underlying motivations, a second strategy has been to interview 31 knowledgeable industry insiders. Some are employees of the trustees and others are consultants involved in the provision of post-retirement products and services. To be able to better probe for true underlying motivations, the interviews were strictly anonymous – not even recorded – so as not to imperil relationships with employers and potential clients. Section two outlines the collection of the data surveying the public submissions and describes the selection of interviewees and the interviews. It also includes a case study that highlights the benefits of LAs, and the failure of the system to address it.

Section three of this paper applies these strategies to explore the agency risks faced by fund members. A prominent theme from the interviews was that there are people within the management of trustees who are motivated to increase funds under management and actively resisted encouraging drawdowns of any sort. They often exercise an effective veto on plans to raise the priority of marketing life annuities. It appears that trustees are also influenced by financial advisors, who are not interested in LAs because they are not required by most of their clients who do not need to consume their capital, and they give rise to lower fees from those clients who might benefit. Trustees are reluctant to upset advisors who are invariably a potential source of new members.

In exploring the themes that arose, it became evident that, despite government’s intentions, the trustees operate in a market that is inhospitable to the promotion of LAs. Part of the problem lies with the real difficulties of providing the advice necessary for members to choose them appropriately, but these difficulties are exacerbated by regulatory frictions. Section four of this paper reports on trustee concerns and the obstacles they face in developing a retirement income strategy that addresses members’ needs. Regulation is found to be excessively complex and intrusive, so undermining trustees’ sense of agency.

[2] These are the two most relevant regulators: APRA is the Australian Prudential Regulation Authority and ASIC the Australian Security and Investment Commission, which regulates financial services and products.

These explanations are however not adequate to explain why some trustees have begun providing LA options to their members but with little take up. Section five takes a step back to consider the overall framing of the superannuation system. It considers evidence that the investment frame is part of the broader narrative of financialization, which is shared by an appreciable number of members, trustees, service providers and regulators. On the one hand, financialization focusses on investment returns, and neglects the possible advantages of LAs. On the other hand, Braithwaite (2008) suggests that financialization leads to excessive regulatory complexity. This is because it encourages private markets, of which Australian superannuation is a prime example. These require regulatory oversight, but this has taken the shape of "rituals of comfort" given a widespread and inadequate view of motivation, corporate purpose and the role of regulation. This section sketches a broader narrative incorporating the insights of MacIntyre (1981), Braithwaite (2008) and Ostrom (2010), which could provide the way for market participants to collaborate on developing more effective market rules and their appropriate enforcement. Such a narrative would integrate individual and social purposes and recognise the limitations of financialization.

The final section summarises the findings and proposals. This paper makes three main contributions to annuity puzzle research. Firstly, it confirms the conjecture of Brown et al. (2008) that annuity suppliers are indeed reluctant to promote LAs. Secondly, it identifies regulatory obstacles that have not previously been highlighted. Finally, it suggests that the investment frame identified by Brown et al. (2009), and the regulatory obstacles facing trustees can be traced to the ubiquity of the financialization narrative.

2 Collecting information

This section sets out how data was collected from government consultations and the interviews, and a public case study. The aim was to identify underlying narratives rather than obtain a representative sample of opinion.

2.1 Consultations

Australian Treasury (2016) sets out the Government's initial proposal to "require superannuation fund trustees to pre-select an option for members to receive their superannuation benefits in retirement" that included longevity insurance. The complete set of responses to the proposal are no longer available from the Treasury website, but nine, which were found on organizations' websites, are shown in Table A1 in the Appendix. The responses were clearly negative, and the Government appeared to accept the view articulated by the Actuaries Institute that the "market and legislative rules were immature" and that the focus should be on developing a governance framework for retirement.

The Government current proposals for the governance framework (the RIC) are set out in Australian Treasury (2018, 2021a and 2021b). In response to the call for public comment, there were 56 submissions to the 2018 consultation and 66 to the first 2021 consultation, of whom 29 organizations made further submissions to the second.

2.2 The interviews[3]

The RIC Legislation passed in 2021 required funds to develop a "retirement income strategy" by July 2022. My preliminary analysis of the strategies published by the superannuation funds – confirmed by APRA and ASIC (2023) – suggested, however, that there remained a reluctance to offer life

[3] UNSW ethics approval given for project HC220856

annuities to members. The intention of the interviews was to explore this resistance to change in the context of their retirement strategies, which includes product offerings as well as assistance to members in choosing and implementing their retirement benefits. Representatives from trustee employees and their advisors were asked for their views on the attitudes of trustees to LAs, and their opinion of some alternative product designs and delivery (advice) methods.

A total of 43 employees and consultants were approached; 27 were known to the investigator professionally. The remainder were contacted through LinkedIn or referrals. To limit any personal pressure to participate, the recruiting initiative was made through a university administrator. Three people refused to be interviewed, and nine did not reply. Of those interviewed, 18 were or had been in the employ of a superannuation trustee, 3 worked for insurers and 10 were consultants or had other professional interests in the subject. 17 were actuaries.

Interviews were either face to face or online, and used the questionnaire found in appendix 2. The interviews were strictly anonymous, and not recorded, to encourage the frank expression of opinion, and no written documents were produced that could allow a third party to identify the interviewees.

2.3 Data analysis

A Thematic Analysis – as described by Braun and Clarke (2012) – was applied separately to the submissions and interviews. The submissions covered a wide range of issues responding to elements of the discussion papers that were not relevant to the research questions. They were therefore coded with reference to perspectives on obstacles to LAs and their introduction. For the interviews, given that they were not recorded, the notes taken at the interviews were used as codes for identifying themes. The codes were analysed in the first instance with reference to the suggestions in previous literature of agency conflicts, misunderstanding and regulatory obstacles. The codes were then reviewed inductively for motivations that had not been previously considered.

While the consultation papers often asked specific questions, many of the responses did not respond directly to the questions. Similarly, interviewees were reluctant to answer all the questions, and most preferred to give their own views of the reasons for the limited market in LAs. This had the advantage of eliciting a wider range of alternative perspectives, which was the intention, but made analysis of the answers more difficult. Given also that neither sample can be considered representative, answers are not analysed separately, but grouped by theme in the sections that follow.

2.4 Widow case study

The case study was not initially a planned element of this project but appeared in a Sydney Morning Herald (2023) money column during the analysis.

> *"My husband and I received a part pension, but he passed away and I now have all the assets but no pension. I am 88 and own my own home. I have $680,000 in savings and $180,000 in shares. My income is $25,000 p.a. Is there anything I can do to get a part pension?"* [4]

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[4] Australian Bureau of Statistics (2022) reports that the average Australian aged 74 and over had $400,000 in financial assets – 40% in superannuation and 30% in banks. The widow in the case study is therefore wealthier than normal and appears to have a greater proportion of her assets saved in banks. Her reported income of 2.9% of her assets is likely to be a weighted average of share dividend yields (5%), and bank term deposits where the rate was only 1% in 2022. She may have no superannuation given she refers only to savings and shares.

The advice given in response was:

> *"A major factor to be considered when drawing up a will is what effect a legacy could have on a beneficiary. As you have learnt, a widow can lose her pension if all the money was left to her instead of being judiciously spread among family members.*
>
> *Just keep in mind that the full pension for a single home owner is $28,000 a year and your portfolio is already giving you almost as much and will almost certainly grow. An aged pension appears out of the question but you would certainly qualify for a Commonwealth Seniors Health Card."*

Subsequent discussions with financial advisors suggested that the response was not untypical, but it is nevertheless surprising. It is possible to get a guaranteed, inflation-linked, annuity rate of approximately 12.5% for an 88-year-old woman, so a small portion of her assets could easily be applied to generate four times as much income should she want it. While some caveats (particularly related to health) would be necessary, it would have seemed incumbent on any advisor to suggest the possibility of a LA in these circumstances.

The case study provides convincing evidence that LAs could make a significant difference to many older Australians, but that the industry is failing to make their advantages known.

3 Agency conflicts

Turning to why this is so, agency problems not only figure in the literature but also in the interviews. Agency conflicts are commonly described as "conflicts of interest" as in Sah (2012). Misunderstandings may arise, however, if this term is used purely for situations where an agent or trustee faces a conflict between their interests and the interests of parties to whom they owe a fiduciary duty, which is prohibited by the common law. The Financial Services Royal Commission (2019) distinguishes between this prohibited conflict and the unavoidable conflict between the interest of trustees in charging higher fees, which it describes as being "in collision" with the interests of members.

While not specifically asked, twelve interviewees spontaneously offered the view that the trustees' desire not to lose funds under management (FUM) was a significant driver of their failure to become enthusiastic about LAs. One concern was that assets might be transferred to an insurer if a guaranteed annuity was purchased. Some trustees apparently did not want to "shake the tree" in case members withdraw a lump sum if they were notified of their entitlements to benefits.

This motivation was not apparent in the submissions reviewed. However, a media release in response to the Retirement Income Review (2020), by industry body ASFA (2020), provides some confirmation of such a motivation. ASFA's sole concern was to continue its campaign to increase compulsory superannuation contributions to 12% of earnings. The Review – in line with all other published modelling – found an increase to be unnecessary because LAs would provide a similar uplift to retirement benefits, while increasing compulsory contributions would reduce working-life income.

The responses to the consultations were assessed for their overall attitude to LAs. Table 1 classifies the responses by type of organization and confirms that organizations lean one way or other, largely depending, it would seem, on their interests. Insurers, investment managers and consultants, who would be involved in providing LAs were generally positive in their response to the idea that LAs should be more actively promoted. Financial advisors were not, largely arguing that superannuation funds did not have the wherewithal to provide the advice necessary to ensure that members were not disadvantaged. Union opposition was largely because they feared that LA providers would charge too much to their members.

Table 1: Submissions to Consultations on Retirement Incomes

Submissions from:	**CONSULTATIONS**			**RESPONSE TO LAs**
	2018	**2021a**	**2021b**	
Insurers and Investment Managers	14	14	5	Generally Positive
Industry Consultants	7	5	1	
Researchers	3	4	2	
Superannuation Funds	8	7	4	Mixed
Industry Associations	7	5	5	
Professional Bodies	3	7	4	
Member Representative Bodies	3	6	4	
Individuals/Small self-managed funds	8	12	2	Generally Negative
Financial Advisors	2	3	2	Negative
Unions	1	2	2	
TOTAL	56	66	31	

The interrogation of responses to government policy has apparently not been used to understand public views on LAs in the past. In their analysis of 259 different consultations in various other fields, Pagliari and Young (2015) find significant “interest group plurality” but – unsurprisingly – responses from the regulated entities tend to dominate – particularly in more complex areas. This domination is also evident here.

3.1 Trustee duties

Much of the law governing the duties of trustees is concerned to reduce these agency risks. Donald (2020) explores how trustee duties are variously influenced by “contributions of the law of trusts, contract, statute or tort”. He points out that the other influences can “modify and in some cases eclipse the traditional equitable principles related to trusteeship.” The traditional principles are too paternalistic to be used unamended in the case of retirement funds but are retained in the need for trustees to act in the best financial interests of the members. These fiduciary duties are summarised by the need for the trustee to “exercise its powers under the trust honestly, carefully, diligently, impartially and loyally.”

Best financial interests can readily be translated into attempting to achieve higher, risk adjusted, investment returns, and so offering LAs may seem against members’ interests if it is interpreted as recommending low yielding underlying investments. Two or three interviewees needed clarification that VLAs, which give investment freedom, were also being considered, confirming that this interpretation is still commonly made.

Interestingly, the submission of the Law Council of Australia (2017) opined that the “passive nature of the trustee obligation – typically a trustee is administering a trust that has been settled by another sponsor – hence the obligation to create a ‘suitable product’ is not one currently known to trust law.” Australian Treasury (2021b) seems to accept this analysis and says that the purpose of the RIC legislation was to address a gap in the obligations of trustees to provide for the needs of members in retirement. This is, therefore, no longer an issue in Australia, but may well be in other jurisdictions.

3.2 Overcharging and over-servicing

Providers, which could include the trustees or life insurers, both serviced by financial advisors, may overcharge for the services, or provide more services than are in the interests of members. Failing to recommend LAs in order to increase FUM can be seen as analogous to both.

3.2.1 … by LA providers

Dushi and Webb (2004) use utility measures to demonstrate that LAs are often not attractive but base their analysis on an assumption that they are “actuarially unfair” particularly for those with lower life expectancies. O’Meara et al. (2015) find this view is widely held in Australia. Given the size of the market, it is not yet possible to evaluate the money’s worth ratio given by the LAs currently sold by the life insurers. The lack of data makes it impossible to make allowance for the selection effects that arise because those buying the LAs may be healthier and from socio-economic groups with mortality much lower than the average. Fairness would be enhanced by offering enhanced annuities – as discussed in section 3.3.3 below.

Fear that LAs offered by life insurers would represent an excuse for charging excessive fees to members, and to offer poor value to those with shorter life expectancies, seems to underly opposition to LAs in the submissions, particularly by some trade unions and union appointed trustees.

Guaranteed LAs should be easy to compare, but Harrison (2012) estimated that UK retirees were worse off by between 5% and 10% on average for failing to “shop around” for the best annuity rates available to them. The UK’s abandonment of compulsory LAs appears to have been driven partly by the perception that this was unfair.

Doubts about value for money were confirmed by interviewees, eight of who expressed the view that “annuity” was “a dirty word given the absence of a death benefit” which are seen to benefit the provider. The problem was illustrated by research undertaken by one fund that had found that members were not concerned about bequests, but felt that the absence of a death benefit was so unfair that they would not consider a LA. It is not clear whether an explanation that the benefit was to the pool of surviving members would make a difference. Certainly, however, the LAs that have been introduced in Australia invariably offer a return of a significant proportion of the premium in the first few years to address this perception.

3.2.2 … by advisors

Advice and advisors loomed large in the replies to the interview questions: present in one in eight of the coded cells. As is clear from Table 1, trustees are generally in favour of extending their services by being able to give more advice. For the moment, however, few can afford to offend the financial advisors who are a source, or potential source, of new business.

Australian Treasury (2022) lists decades of financial advice and mis-selling scandals and outlines the increase in its regulation, which have included bans on conflicted remuneration. But the collision of interests remains. Considerable evidence corroborates the conjecture of Brown et al. (2008) that the incentive structure for financial advisors is inimical to recommending LAs. Altschwager and Evans (2021) confirm this in their interviews with Australian financial advisors.

As the Retirement Income Review (2020) put it:

> *… financial advisers may have an incentive to recommend retirement products that require an adviser’s frequent involvement, such as an account-based pension, rather than a ‘set and forget’ product, such as a lifetime annuity or other longevity risk management product.*

Table 2 shows telling statistics from the UK on LA purchase. Regulations allow members to cash in their "pension pots" at retirement: the so-called UK "pension freedom". In making their decisions, members can obtain professional financial advice, or use state funded free "guidance". Those receiving regulated professional advice are almost 90% less likely to take LAs (13% vs 111%).

Table 2: The impact of financial advice on UK Annuity sales

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**

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

The case study described above provides further evidence. Many advisors do not even consider the possibility that clients might benefit from LAs. Interviewees confirmed that advisors were unenthusiastic about LAs because of their historical focus in investments. Comments included the view that advisors:

- "pride themselves in managing volatility"
- "see their job as preventing people running out"
- "want more investment options."

The submission of the Association of Financial Advisors (2021) held that "retirement incomes will be maximised by a total investment in high growth assets." The ability of advisors to increase returns is debatable, but there is little evidence to show that they are systematically able to outperform the market. Indeed, Hackethal et al. (2012) find underperformance in a large German sample, Linnainmaa et al. (2021) find the same for Canadian advisors, while Mullainathan et al. (2012) find their sample of US advisors underperform in their personal portfolios in the same way as their clients'.

In the author's initial attempts to publish the case study in an industry magazine, he was told that the assumption "the annuity will yield 12.5% was on shaky ground." It is likely that person concerned did not understand that the yield effectively included a return of capital. The process however reflects a reluctance to engage with LAs.

It would however be unfair to financial advisors to suggest that their personal interests always stand in the way of their clients' interests (Eriksen et al., 2022). Most of their clients must be wealthy to afford their fees and can live off investment income without drawing on capital. They also cannot be blamed for not selling appropriate products that are not available to them or their clients, or which are poorly promoted. There may be something of a vicious circle: product providers do not attempt to introduce LAs because they think advisors do not want them, while advisors must deprecate them because suitable LAs are not approved by the advisors' employers.

3.2.3 … by compliance professionals

The Australian Law Reform Commission (ALRC, 2022, 2023) expose the overwhelming and unnecessary complexity of the regulatory framework under which trustees labour, which also suggests over-servicing. It will be shown later that the framework includes direct obstacles to the sale of LAs as well as a quagmire that inhibits all innovation.

At this point, it can however be noted that the complexity has created work for "armies of compliance staff" within regulated entities, regulators and the consultants that serve them both. Members of the legal, accounting and actuarial professions have contributed to and benefit from the complexity – an issue that appears to be seldom raised or acknowledged. No explicit mention arose in the interviews nor can be found in the submissions.

The operating mechanism is however clear. Almost half the submissions, which would have largely been prepared by compliance staff, wanted more detail as to regulators' objectives. As with advisors, it may be the case that those asking for more regulatory detail are not necessarily conscious they are advancing their own interests.

3.3 Complacency

Given the uncertainty about their duties, limited incentives, the opposition of financial advisors and the regulatory difficulties discussed later in this paper, it is perhaps not surprising that trustees demonstrate a lack of enthusiasm for developing LAs. One might, nevertheless, expect trustees to be in the process of ongoing development of suitable information, administration systems and products to assist members in receiving their benefits. This section confirms the complacency found by APRA and ASIC (2023).

3.3.1 Poor response to RIC

In answer to the question as to whether the Retirement Income Covenant legislation was being effective, only 7 interviewees responded positively. Eight of the respondents believed that LAs needed to be compulsory if any progress was to be made, with a further two suggesting that they should be the default, and another three that there was a need for further tax or means test incentives. Comments included:

- "Good at explaining why we can't do much"
- "Not doing a good job, but nothing to see here"
- "The RIC is really important, but giving lip service"
- "Many retirement strategies are a plan to have a plan"
- "Other priorities, like turning a big oil tanker"
- "Funds are not advisors, staying in their box."

Other comments related to experience of trustees' ignorance of the issues, stemming apparently from a failure to inform themselves:

- "Neither board nor management understand the issues (with calculators)"
- "Do not understand retirement risk"
- "Not always aware"
- "LAs are outside their competence."

One comment, that the "Age Pension may be enough", is perhaps more widely shared but begs the question why there should be a superannuation system at all. However, if combined with the view that LAs offer poor value for money, Dushi and Webb (2004) show that LAs do not increase utility in the US, and the same might well apply in Australia.

3.3.2 No encouragement for drawdowns

It can be estimated[5] that at least 25% of the 2.7 million members over 65 (holding up to a third of the $640bn held by members in large superannuation funds) are not taking advantages of the tax concessions given to those drawing on their balances. In the absence of further information, one should assume that such people are uninformed and need help in completing a simple four-page document to obtain even a lump sum benefit. Certainly, one interviewee said that his employer has a good response from writing to members about this issue. Some other interviewees were relatively confident that members were informed, but most seemed unconcerned at the unnecessary tax being paid by members.

3.3.3 No enhanced annuities

As discussed earlier, the fairness of annuity rates is a concern, particularly for those with lower life expectancies, because of poor health or lower socio-economic status. As illustrated so clearly in the case study, older retirees, with their lower life expectancies, benefit more from better LA rates. Those in poor health and lower income earners are likely to be more in need of enhancements. Given that most trustees charge such groups higher insurance premiums before retirement, it seems grossly unfair not to recognise the potential benefits of LAs for such people.

The medical and administrative technology required to tailor premium rates (or longevity credits) to an individual's life expectancy has been available in the UK for over two decades and was used by 28% of the LA market in 2014 (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. For instance, seven of the papers mention underwriting risks or the costs thereof – but evaluating risk is central to the insurance business, and the costs are like those in underwriting life insurance. The costs are also more affordable in that they come out of the single LA premium as against requiring capital investment by the life insurer, which is the case with annual premium life insurance.

Some interviewees were asked about trustee attitudes to underwriting annuities, and eight responded that it might be considered, but "not yet". Another comment was that they had been tried in the nineties and advisors found them too complex and so had "moved on". The industry body, ASFA (2017), demonstrating what appears to be a wilful ignorance, warns that LAs would "not be appropriate for a member with a significantly shortened life expectancy".

3.3.4 Limited member data

Interviewees were asked whether trustees were collecting data on member behaviours and satisfaction. As APRA and ASIC (2023) found, results were mixed. One explanation raised five times in interviews was the funds were more interested in their Net Promotor Score (NPS) than in measures of behaviour or of retirement satisfaction. The NPS is usually collected after the member has interacted with the fund and so is weighted towards the "user experience" of the interaction. The consequence appears to be that trustees have placed a higher priority on such items as providing access to fund balances using mobile phones, than substantive improvement in their products.

[5] Using APRA's Annual Superannuation Bulletin (Table 7c, d and 8a) for balances in accumulation rather than drawdown accounts (in funds with more than 6 members). Allowance has been made for the 650,000 people who are employed and necessarily have an accumulation account.

3.3.5 Little enthusiasm for digital advice

A final example is provided by ASIC (2021), a survey of trustee management. "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 Trustee concerns

One of the conjectures of Brown et al (2008) was that funds are reluctant to invest in changing members' frame because they are as likely to aid competitors as themselves. This was partly confirmed in the interviews. Only nine out of the 31 interviewees answered positively when asked the question on whether an early mover would obtain a competitive advantage – and a further five thought it possible.

While there was little enthusiasm for the potential upside, the risks of developing LA products were very salient. It seems that the main concerns derive from the irreversibility of the LA decision, and thus turns quickly to the provision of information and advice to ensure that the decision is appropriate. The Productivity Commission (2018) identifies these central concerns, having had the benefit of the submissions to Australian Treasury (2018). This section suggests that both these issues are overblown by some in the industry and appear to reflect the investment frame. There are however other more legitimate concerns stemming not least from regulation.

4.1 Irreversibility

The apparent irreversibility of the decision to take an LA, leads to concern about the loss of flexibility and that families will not enjoy the asset after death. The two are closely related, with Caplin (2021) showing that even when people do cite bequests as a reason not to spend capital, better questions show that it is rather a precautionary motive that drives the reluctance to commit to draw down assets.

4.1.1 The precautionary motive

The Retirement Income Review (2020) recognises the precautionary motive as an obstacle but suggests that there are no coherent reasons to hold everything in liquid form, and they observe confusion in "press articles, surveys and some submissions". The question to ask is what proportion of financial assets should be liquid? Eleven of the interviewees mentioned "bucketing strategies" where a proportion of assets were in a liquid bucket. The two who gave a proportion that should be so allocated, suggested two years of expenditure.

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 of the USA. Australian retirees do not face the risk of significant health or aged care cost blowouts thanks to government social insurance for these costs (McRae et al., 2013). Not only do less-liquid assets earn lower returns, but it is also risky to have immediate access to significant balances, because their declining powers make older people vulnerable to financial abuse (Adams et al., 2014).

The confusion identified by the Retirement Income Review is evident in the public submissions made by major industry participants. Australian Super (2018), a trustee, suggested that LAs under $250,000 would be "unlikely to receive value for money", although it is not clear why VLAs should be significantly more expensive than the drawdown products it offers. Willis Towers Watson (2018) suggest a threshold of $150,000 on the grounds that, if annuitized, 70% of a pensioner's income would still be insured through the Age Pension. From a consumption frame, however, for someone on the maximum Age Pension of $25,000, $150,000 is six times their annual expenditure. Twelve other submissions suggested minima of $100,000 or more. The exception was RGA Australia (2018), a re-insurer with experience in the UK LA market, which suggested a lower limit because 60% of UK sales were below $100,000.

It appears this desire for liquidity obscures the nature of the decision to invest a portion of retirement savings in a LA. It may appear to be the largest irreversible financial decision of a lifetime. Delaying the decision may be sensible, but the costs increase over time – growing to the 75% reduction in consumption for the 88-year-old in the case study. The consequence is that the decision not to buy a LA is also the largest financial decision of a lifetime, and each delay represents a small, but cumulative, irreversible loss.

It is not obvious what causes the confusion. One possible explanation is that decision-makers are usually sufficiently wealthy not to want to draw down their capital in retirement[6] and find it difficult to envisage the financial situation of lower and middle-income retirees. Daley and Coates (2018) have shown, for instance, that the Australian Superannuation Funds Association (ASFA) sets lifestyle targets for retirement that are significantly higher than those enjoyed by most Australians – before or after retirement. Secondly, there is the investment frame, or lump sum mindset, that sees the accumulation of assets – rather than the support of living standards in retirement – as the objective of the superannuation system (Retirement Income Review, 2020).

4.1.2 The bequest motive

Evidence for a bequest motive is limited. The Retirement Income Review (2020) shows that most Australians do not rank leaving a bequest highly. The bequest motive seems to provide a reason not to annuitize but, where such a motive exists, it would make more sense to make specific provisions rather than provide a bequest that declines with advancing age. On the other hand, LAs insure families against long-lived parents consuming more of the families' capital can benefit children financially.

The bequest motive may of course not be altruistic, because parents can use the promise of a bequest 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 one. Given that most Australian retirees own their own homes, and the value usually exceeds their financial assets, the promise of an inheritance out of the home should fulfil this need.

4.1.3 Possible mitigation

Irreversibility does not have to be absolute. The author worked for a life insurer that was prepared to provide surrender values to annuitants who provided evidence of good health. The surrender basis provided for changes in investment conditions and costs – and a margin for loss of future profits, although this can be seen as unfair. If the product issuer is underwriting the health of new entrants and offering enhanced LAs, they would have the technology to offer surrenders even to those in poor health. Flexibility would, admittedly, not be completely restored for those whose health had deteriorated and thus had reduced surrender values.

4.2 Providing advice

Common cause in the submissions was that members need advice before choosing a LA, but advice is costly, as confirmed by Australian Treasury (2022). Advice and advisors were also mentioned 73 times in the interviews, interviewees underlining the need for "holistic advice" and suggesting that "advisors are key to this market", with about 10% suggesting that the advisors were either against

[6] Australia's imputation system leads to higher dividend yields and many advisers advocate living off dividends. For instance, see https://strongmoneyaustralia.com/dividend-investing-aussie-early-retirees/

LAs or “had moved on” to an investment focus. The advice should cover “contributions, investment, insurance, retirement adequacy …”. Internationally, Holzmann (2015) and MacDonald et al. (2017) make the same points.

An underlying assumption is that more complete advice would lead to more people choosing LAs. The evidence presented in section 3.2.2 above is that this is unlikely if the advice is given by independent advisors – at least in Australia and the UK.

4.2.1 What advice?

There are differences in the submissions as to what trustees should provide. Trustees can and some do provide comprehensive advice – at a cost to members. Others felt that advice went beyond their remit and their capacity. The results of Alserda et al. (2019) suggest that there is sufficient heterogeneity in member investment risk preferences to justify offering investment choice and some method of guiding members by highlighting the trade-off of investment and longevity risks against expected payments. One might argue that the trustees should be able to limit themselves to this information and contract out of any further responsibility. Whether they should offer advice beyond this is beyond the scope of this paper.

It seems clear however that many members are either unwilling or unable to take advantage of information and advice. The Work and Pensions Committee (2022) reports that retiring members are not taking advantage of government funded free advice nor the ability to withdraw money from their accounts to pay for advice themselves. As reported above in section 3.2.1, UK members also pay for not shopping around for the best value.

4.2.2 Exposure to litigation

Given their understanding of the irreversibility of the decision and of the failure of the market to provide a fair deal, it is perhaps not surprising that trustees are relatively unenthusiastic for LAs. As the Law Council of Australia warned in its submission to the CIPR consultation (see Appendix 1): “The advent of class actions cannot be underestimated as an impediment to innovation.”

Australian Treasury (2016) had raised the possibility of a “safe harbour” for trustees that offered a LA product and contracted out of further responsibility for the decision – in order to protect themselves against litigation. Submissions were quite sharply divided on its merits, with most responses in favour. Those against were largely of the opinion that appropriate holistic personal advice was only possible if provided by a licensed professional advisor.

4.3 Costs

To add to the usual costs of innovation, eight interviewees expressed concerns about the internal capability of funds and concern about cost overruns. In many cases the trustees rely on outside administrators and custodians, and they are apparently “pressured on fees”, and “have no money to invest in low payoff options”. The problem is exacerbated by the past failure of LAs in the Australian market and the risk of insufficient uptake and of having to administer a small portfolio for many years. The Productivity Commission (2018) reflects the views of at least eight of the submissions to Australian Treasury (2018) in discussing this “legacy products” issue. As one interviewee put it: “Previous longevity products have failed, so why should ours be different?” Concern about these costs is likely to be universal in that all trustees have a fiduciary duty of care.

4.4 Regulatory causes

The Australian superannuation industry with its mandatory contributions is, to a large extent, a creature of legislation. One might therefore expect to find some causes of market failure in the legal setting of the rule of the market.

4.4.1 Obstacles

Regulators seem to have, inadvertently, directly obstructed the marketing of LAs. Australian Treasury (2016) identified two important regulatory obstacles that were being addressed at that point: restrictions on the ability to offer VLAs and inconsistencies with means tests. Further obstacles were identified in the interviews. Of most concern in the interviews and the submissions were restrictions on the information and advice that trustees could give to members. Also on the list – explicitly mentioned by 15 interviewees – was the recently introduced "members' best financial interest duty". This extends the duty of care to manage costs covered in the previous section by creating an obligation to document reasons for all expenditure and has made trustees "scared of fines." Kocis (2020) expresses the view that the introduction was more about (party) politics than concern to strengthen regulation – illustrating some of the constraints which regulators work under. There were a few other direct interventions by regulators that had inhibited the development and promotion of LAs, which cannot be mentioned without identifying the interviewees.

Five interviewees also mentioned the need for retirees to provide for aged care costs. These are always covered by means tested subsidies, but another disincentive emerged in considering the case study. At her age, the widow would have a high probability of needing to go into residential aged care. The funding and subsidy rules give a significant advantage to those who can make a significant cash deposit to cover costs of accommodation, which goes to nullify the consumption advantages of LAs. Funding aged care would also be an issue in other countries, and the effect of such funding on the annuity puzzle would need to be investigated.

The number of regulatory obstacles that emerged during this research indeed suggests that regulatory intrusion may play a significant role in other jurisdictions. Benartzi et al. (2011) reports that US trustees do not promote LAs because they cannot meet onerous regulatory requirements to judge the solvency of annuity providers. Hurman (2023) reports that there are also legal issues relating to tontine type annuities and the "application of tax, equality and discrimination laws." Nielson (2012) records prohibitions of inflation linked LAs and VLAs in Canada.

4.4.2 Intrusion

Apart from direct obstacles, Australian Treasury (2022) reports that trustees are concerned about falling foul of regulatory complexity. Interviewees often suggested that the implication was that "funds are reluctant to expand their offering and scared by fines". "It is expensive to offend, and trustees are frozen with fear, especially of giving advice." In similar vein, "trustees are terrified of ASIC", which is always "on your shoulder." They did however express the opinion that it was the "ASIC legislation at fault – not staff. Same in UK."

This growing complexity is distracting and enervating. The ALRC (2022) reports that: "There is a level of consensus among stakeholders that the law has become unmanageably and unnecessarily complex." While the total costs are difficult to measure, ALRC (2023) quote the Macquarie Group as having calculated the direct cost of its compliance at $1bn annually and growing at 19% p.a. "Trustee time is consumed by regulatory imposts" as suggested by one interviewee. Nine others mentioned regulatory priorities that meant that LAs and retirement issues were always demoted to the "third priority".

The problem is aggravated by the existence of two regulators with consequent overlaps and potential inconsistencies, with the ALRC (2023) noting the difficulties of "achieving the clear divide".

One interviewee felt that “there is competition between APRA and ASIC to show who is more active.” The UK also has two regulators, with a different split of responsibilities but the same problems as recognised by the Work and Pensions Committee (2022). In the USA, there is the problem that LAs are offered by life insurers, who are regulated at state level, unlike pension funds that are regulated federally.

Faced with concerns about misleading members, doubts about the demand, difficulties in navigating complexity, and explicit limitations on their powers, it is not surprising that fear of regulatory intrusion means that many trustees are “waiting for the regulator”.

5 Shifting the financialization narrative

Some trustees have overcome the obstacles and introduced LAs but with apparently little enthusiasm. In attempting to explain this lack, this section revisits the investment frame that Brown et al. (2008) regard as dominating the market. Many observers such as van der Zwan (2014) would situate the frame in the wider narrative[7] of financialization. As a narrative, financialization has many different interpretations and applications, but there is agreement that it’s consequences can be seen in the spread of private DC pensions, and so it would not be surprising to see it reflected in attitudes to LAs.

Financialization is perhaps captured in the popular saying “money is power”, which transfers agency from people to impersonal and privatised markets, where funds are directed by investors into their most efficient uses. It includes the views that maximising shareholder value is the main aim of business and the main motivating force of management. The effectiveness of self interest in free markets is seen as the root of our current prosperity. This section considers two of its strands that go towards explaining the obstacles identified above and – perhaps more importantly – developing ideas for change. The first strand is a narrow focus on maximising investments and includes the cult of the equity and what Keynes (1936) called the “liquidity fetish”, which make LAs seem unattractive. The second is a reductionist view of corporate purpose with its emphasis on financial incentives rather than fiduciary duties, and its belief in extrinsic rather than intrinsic motivation. Tasked with supervising newly privatized markets, regulators have neglected their roles in developing appropriate rules of the game and acting as umpire, and rather developed “rituals of comfort” giving rise to the excessive regulation identified above (Braithwaite, 2008).

Table 4 attempts to capture the main differences in the narrative of financialization and a traditional view that recognises the roles of ethics, law and intrinsic and social motivation that will be discussed in this section. While few people would entirely reject the real insights in both these narratives, failure to recognise the tensions and the greater potential for change in the traditional, “virtue theory” narrative, is likely to bedevil communication between and within organizations, and make it difficult to agree on changes.

[7] She uses the terms narrative, theory, and discourse and links them to allied ideologies, but narrative seems adequate for this paper. See section 5.1.

Table 4: Conflicted economic narratives

	FINANCIALIZATION	VIRTUE THEORY
Sources of Motivation	Self-interest: greed and fear	Personal vocation to fulfil social purpose
Purpose of Business. (Trustee Companies are Businesses.	Purpose of business is to make a profit. Beneficiaries are customers	Purpose is to provide for relevant members' interests
Addressing Agency Problems	Align incentives	Fiduciary duties
Purpose of Regulation	Efficiency	Fair dealing
Method of Regulation	• Maintain competition • Auditing of process	Restorative justice
Market design	Evolution	Rules of the Game

5.1 Relevance of narrative

Deriving as it does from behavioural finance, referring to an investment frame suggests a cognitive failure that can readily be corrected. But the narrative of financialization is more difficult to dislodge. In their research on banking, Seabrooke and Tsingou (2021) describe how "intellectual capture" may arise in "professional ecologies" of industry, regulators and academics that interact to create a "collective mindset" and "dominant consensus".

While it is unhelpful to search for universal uniformity in narratives, there is evidence of intellectual capture in trustees and regulators alike. Australian Treasury (2021a) repeats industry rationalisations as to why members will not buy LAs: poor value particularly for those with lower life expectancies, excessive liquidity needs, and the need for costly advice, much of which is not relevant to LAs. This may help explain that, while the annuity puzzle was identified in the eighties (Friedman and Warshawsky, 1990) and the Australian Government has ostensibly been in favour of LAs since then (Bateman et al., 1993), little progress has been made in identifying underlying problems. While looking for intellectual capture, in the spirit of Zingales (2015), one might note the role of academics in giving credence to demand side explanations of the puzzle and failing to consider the mindset of the providers or regulators.

North (1991) writes of how change in market structure depends on an interplay between ideology and an existing institutional framework. Akerlof and Snower (2016) highlight the importance of the underlying narrative in "focusing attention", "motivating action" and developing "social norms" that lead to institutional change. It should be noted that their use of the term "narrative" is closer to the idea of ideology and that they apply it to the Bolshevik narrative that underlay the economic development of the Soviet Union. It can be contrasted with Shiller's (2017) use of the word to refer to transient "narrative epidemics" of fashionable theories and current economic conditions. Whether the term is narrative, frame, ideology, mentality (Rocha et al., 2010), mental model (North, 2016), framework, theory or model (Ostrom, 2010), there is widespread recognition of its importance in creating, and resisting, change.

5.2 Narrow focus on balances

A narrow focus on superannuation balances is related to over-optimistic expectations of equity returns, and a failure to consider adequately how lump sums contribute to post-retirement consumption.

5.2.1 Cult of the equity

Central to the switch from DB to DC is the assumption that members will have greater retirement benefits if they are able to enjoy the equity risk premium (ERP). It certainly seems that trustees see maximising investment returns as their main objective and the main criterion for choosing their funds. This can be confirmed by viewing their websites[8].

The ERP is not relevant to the annuitization decision when VLAs are available, but over-optimism can make them seem less attractive. Keynes (1936) commented on the over-optimism of many stock market participants, and surveys confirm it remains rampant. Natixis (2023) surveys retail investors and financial professionals in 14 markets and finds that the investors expect a return of 12.8% on average against the more moderate finance professional expectation of 9%. Australian professionals come in just below 7%, which is in line what the Superannuation funds are projecting in their marketing material, but investors average 12.5%. This optimism also seems to underlie ASIC's Moneysmart calculator [9], which allows users to increase their expected long-term return to an impossible 20% p.a.

Table 3 shows how higher anticipated investment returns reduce the value of annuitization. Working in real terms, an annuity calculated at 2.5% p.a. interest will provide an annual payment of more than double the investment return. If real returns were 10%, the value of spreading capital over a lifetime drops to an increase of only 10% in expenditure and is arguably immaterial.

Table 3: Value of annuitization at different yields (25-year term)

1. Real Investment Yield p.a.	2.5%	5.0%	7.5%	10.0%
2. Real Annuity Return	5.4%	7.1%	9.0%	11.0%
3. Absolute Difference (2-1)	2.9%	2.1%	1.5%	1.0%
4. Enhancement (3/2)	117%	42%	20%	10%

Damodaran (2020) provides a comprehensive discussion of the nature and size of the equity risk premium, suggesting a total return that may vary somewhere between 5% and 7.5%, which is in line with those of the investment professionals in the Natixis survey – if one allows for inflation. While the value of annuitization may be as little as an enhancement of 20% in consumption for young retirees using a high ERP, the benefits are clearly material with the lower anticipated returns that are more appropriate for the risks faced by retirees, and for those with lower life expectancies.

Enthusiasm for equities is not however universal, nor necessarily persistent. Gelepithis (2019) shows that the equity cult that had previously been adopted by DB trustees in the UK, has comprehensively changed in the past 30 years. She suggests, suggestively, that financial professionals played a central role in the change by focussing on the liabilities that fund assets ought to be meeting. This is equivalent to considering income need rather than capital balances.

5.2.2 The lump sum mindset

Keynes (1936) observed that overoptimism goes with the liquidity fetish, resting on a belief that the best returns require instant liquidity in order to avoid market downturns. As he points out, only the quickest to respond can benefit from liquidity, and they pass losses on to others. The desire for liquidity is also linked to the fear of irreversibility discussed earlier. Together they contribute to the

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[8] For example, see https://www.australiansuper.com/, https://aware.com.au/, https://www.cfs.com.au/

[9] https://moneysmart.gov.au/retirement-income/retirement-planner

collective lumpsum mindset that has been widely observed by many including Rocha et al. (2010) and the Retirement Income Review (2020). The position is aggravated by the industry's marketing of savings as a "nest egg", which is now widely recognised as an obstacle to annuitization (Productivity Commission, 2018; Hocking, 2021).

It appears that the precautionary motive is the main underlying factor in this mindset. Changing the mindset may be best achieved by addressing the underlying motive and clarifying the benefits and risks of liquidity. Trustees need to understand, and members need to know, firstly, that liquidity of two years of expenses is likely to be more than sufficient to cover unexpected expenses. Such a contingency buffer will be required throughout life and should be drawn down in times of difficulty and then replenished. The enthusiasm for bucketing strategies expressed by interviewees seems to go towards making this point. The suggestion in Australian Treasury (2023) to allow for an explicit "capital reserve" also follows the same lines.

Secondly, an argument can be made for a specifically designed post-retirement investment strategy, which has been shown by Horneff et al. (2009) and others to increase utility. The question was included in the questionnaire: two interviewees reported on specifically designed options and another reported a new option was being developed. A further 5 felt that there should be specific retirement options, but the remaining 23 did not see a need. The question is however beyond the scope of this paper because VLAs could conceivably be designed to mimic any investment strategy.

An obvious way of shifting the mindset is to provide members with regular illustrations of their likely income in retirement. One Australian trustee, CBUS (2022), has shown that providing benefit illustrations increased all elements of members' engagement with the fund and the frequency of additional contributions. There is no evidence yet as to whether the illustrations will achieve the intended reduction in the taking of lump sums, but the attempt seems worthwhile.

5.3 Broadening purpose

Trustees and regulators may share – or at least be influenced by – a narrow focus on equity returns and lump sums, but the financialization narrative can also narrow their view of their own responsibilities. The financialization lens filters out all but financial perspectives on business organizations, and as Kocis (2020) recognises, the Australian best financial interests' duty falls into this trap.

5.3.1 Purpose or profit

Trustees are invariably companies, and one mantra of financialization is that the duty of directors is limited to the maximization of profits. Cheffins (2020) shows that the influence of this belief, while sometimes dominant, has varied considerably over time – and should not be ascribed to Milton Friedman or other prominent proponents. Its influence over trustees and regulators at any one time is real enough but may well not be dominant. Drucker (1954) has long been the source of an alternative narrative that businesses serve the needs of their clients in the first instance. Belinfanti and Stout (2018) suggest a more holistic alternative that considers the "public purpose" of organizations and its responsibilities to other parties. They write in the context of law and practice in the USA, but the debate is international.

Others come to similar conclusions from different starting points. MacIntyre (1981) is the main source of a literature developing traditional virtue theory to provide a coherent alternative to financialization. Human flourishing requires "practices" that not only produce external goods but that develop excellence in specific areas that include the virtues of prudence, justice, self-control etc. Rocchi et al. (2021) explore the practice of financial services, identifying its "specific excellence" as meeting the purpose of providing a "bridge" for finance to be applied where and when it is most useful. LAs can be seen as a manifestation of this specific excellence in optimising the value of retirement income.

Taking up MacIntyre's (1981) critiques, Lea (2012) argues that financialization has undermined the position of "professionals" within organizations who are more focussed on the "core" business purpose – as being service to clients – and, although he does not use the concept, the specific excellence of retirement financing. Holzmann (2015) seems to be making the same point in pension systems worldwide when he suggests that "Capital market product innovations and the crowding out of actuaries by financial economists has changed the landscape." Day (2004) shows that the work of actuaries was open to some criticism, but as one interviewee pointed out, the development of LAs "needs actuaries".[10] Another pointed to the need for greater expertise: "Need right trustee boards with adequate knowledge."

The need for a purpose is widely appreciated, as illustrated by the support that has been given to the recent legislation setting out an explicit purpose for superannuation that includes providing an income, as set out in the Explanatory Memorandum (2023). This is encouraging, but will need reinforcing, and greater percolation into business education, which has often failed in this respect (Khurana, 2010).

5.3.2 Affirming fiduciary duties

That the agency problem can be addressed by affirming fiduciary duties has been central to commercial law for four millennia, being found in the code of Hammurabi, the Jewish and Christian bibles, as well as Roman, Chinese and English law (Johnston, 2005). The academic literature of Economics and Finance that follows the spirit of Jensen and Meckling (1976), however, is focussed on financial incentives while fiduciary duties are largely ignored. A strand of this literature, such as Alces (2009), explicitly rejects fiduciary duty as a "myth" in the context of directors' duties. It is perhaps significant that fiduciary duty was not coded once in the interviews – perhaps because it was felt to have minimal persuasive power.

Affirming fiduciary duties – as against profit maximization – is necessary for accepting that the purpose of superannuation goes beyond maximising member balances. It will not however be sufficient if trustees are not persuaded that offering LAs are in the members' best interest.

5.3.3 Activating responsibility

To become active promotors or LAs, trustees need not only to be fully persuaded of their benefits, but to be aware of their responsibilities and their own powers to make changes. Sah (2017) finds that the activation of professional and moral norms needs to play a central role in addressing agency risks. He notes how outsiders imposing training, second opinions and disclosure even when backed by sanctions can fail to overcome biases and proposes rather the activation of professional and organizational norms. Sun et al (2022) confirm that people are likely to act more responsibly when seeing it as leading to an improvement in their moral self-image.

Such activation may be encouraged by the new performance-based approaches to regulation, described in Willis (2023), which spell out a duty to design products that meet customer needs and to explicitly monitor their success in doing so. These are the "consumer duty" in the UK and the "Design and Distribution Obligations" (DDO) in Australia. The Australian experience is currently not that promising, falling short of the UK and South African approaches as described in Schmulow et al. (2021). There, the regulator meets with companies to hear their reflections on the success of their target market strategies. The DDO and associated Target Market Determination (TMD) were

[10] Noting that the interviewee and author are both actuaries with an opinion that actuaries are stewards of this specific excellence.

mentioned by three interviewees. This is encouraging as 15 interviewees thought that the RIC had created a positive impetus towards the development of new products in that it "strengthened champion's hands against internal naysayers." Another 8 acknowledged an impact but expressed doubt as to whether it had changed trustees' attitudes towards new product development.

While Australian Treasury (2021a) can be faulted for repeating industry rationalisations for why they do not market LAs, the new RIC legislation may be the appropriate approach. It reinforces the trustees' fiduciary duty to act in the best interest of members and makes salient those needs addressed by VLAs. It also provides a reason for those tasked with supervising trustees to question their rationalisations and lack of action.

5.4 Regulatory capitalism

Intrusive regulation undermines trustees' agency and fails to activate their fiduciary responsibilities. The regulatory intrusion identified above, however, requires explanation in an era dominated by narratives of free markets. Writing from within the financialization narrative, Merton and Bodie (2005) suggest that endogenous institutional change has led to the development of markets that are more effective, and regulatory policy needs primarily to avoid interfering in innovation. Their view of evolutionary forces of change, however, undermines intentional changes. Hodgson (2016) makes the useful distinction between "agent insensitive" and "agent sensitive" institutions with the latter being those "in which the reigning equilibria or conventions can be significantly altered if the preferences or dispositions of some agents are changed…" Such changes appear to be required to develop an annuity market.

A clear description of the role of governments in market design, comes from what might seem an unlikely source. Milton Friedman (1982) writes:

> *The existence of a free market does not of course eliminate the need for government. On the contrary, government is essential both as a forum for determining the "rules of the game" and as an umpire to interpret and enforce the rules decided on.*

Braithwaite (2008) finds that rather than fulfil the more difficult umpiring functions of penalising and expelling players, regulators have taken to making new rules giving rise to "regulatory capitalism" with its plethora of both international and local regulators.

5.4.1 Rituals of comfort

Braithwaite (2008) suggests that the newly spawned regulations governing privatized markets were captured by rent seeking producers and became "palliatives to placate spooked publics who needed to be helped to learn how to trust the efficiency of markets." Regulators created complex rituals of audit and documentation giving rise to the "audit society" (Power, 1997). Politicians, regulators and consumers draw comfort that something is being done, while consultants and larger companies draw a different type of comfort from the creation of work for the one group and new barriers to entrants for the other.

Braithwaite (2008) says: "Ritualism means acceptance of institutionalised means for securing regulatory goals while losing focus on achieving the goals or outcomes themselves." This is illustrated by a legal case raised in the interviews[11], where one issue in the final appeal was not

[11] See paragraph 4 of Westpac Securities Administration Ltd v Australian Securities and Investments Commission [2021] HCA 3, https://eresources.hcourt.gov.au/downloadPdf/2021/HCA/3,

whether the advice given was good but the obscure legal question of whether it was "personal advice" or "general advice". To avoid being seen as offering personal advice, one interviewee reported that their fund was reducing the amount of member data that they held. Partly because of this case, Australian Treasury (2022) has suggested that the concept of personal advice be scrapped and replaced by a requirement that good advice be given.

It is to be hoped that this idea, and the insights of the ALRC (2022, 2023), are taken seriously by regulators and politicians.

5.4.2 Polycentricity

The similar solutions offered by Braithwaite (2008) and Ostrom (2010) are both derived from extensive field work. Neither are entirely despondent about regulatory capitalism, but both aim to encourage an alternative narrative to financialization. Ostrom argues in her Economics Nobel lecture, that the aim should be to develop policies that "bring out the best in people" rather than assume that we must create systems that "force (or nudge) entirely self-interested individuals to achieve better outcomes." Braithwaite's "responsive regulation" is also based on a "strength based" philosophy that encourages agency and purpose for the majority of actors assumed to be at the bottom of his regulatory pyramid. Higher up the pyramid are increasing strictures on those Ostrom (2011) identifies as displaying "opportunistic behaviour". Too often, however, as found by the Financial Services Royal Commission (2019): "the law has not been obeyed, and has not been enforced effectively".

Both Braithwaite and Ostrom suggest empowering significant other players in the process of market regulation. Braithwaite writes of privatised regulation and of the "countervailing power" of NGO lobbying, and the possibility of giving them additional funding; Ostrom of self-organized polycentricity, her point being that different centres of power need their own base.

Two institutional changes have been suggested to develop alternative centres of power. Pension scheme trustees could be elected so that they were more independent of financial service and established union interests, and more accountable to their members. Donald and Le Mire (2019) suggest that the democratic election of at least some members of trustee boards would boost the quality of governance and provide an independent input into the industry. Regulators and trustees could initiate democratic election processes.

The second proposal addresses the related problem of the power of large corporations and consultants to lobby both government and international regulatory institutions. As with Pagliari and Young (2015), Georgiou (2004) confirms that the lobbying process is not only dominated by larger bodies but also that much of lobbying is behind closed doors. In Australia, the process includes requests for submissions from the public, which can be confidential. They are prepared in a matter of weeks, largely in isolation from one another and followed by opaque deliberations. Where multiple agencies or departments are involved, differences of opinion can sometimes only be resolved at cabinet level where there is minimal time for deliberation. Braithwaite (2008) emphasises the importance of "deliberative" organizations and "nodes of governance", which should invite the most "vigorous and contentious contestors". The nodes can include large institutions, industry and professional bodies and workshops called by regulators. All market participants should have an opportunity to initiate change within these nodes.

5.5 Some possible rules of the market

If regulatory capitalism originates from the need to regulate private markets, failure in the market for LAs can be framed as a problem in formulating rules of the market. Some suggestions are explored below.

5.5.1 Repackaging

Interviewees felt that the language used to describe of LAs was too technical, carried too much negative "baggage" or failed to distinguish from other "pensions". From a marketing perspective, one comment was that "it was too tempting to describe the engine". General agreement that the focus should be on income, and some hope expressed that there should be more consistency. Given the propensity of marketing departments within industry – and government – as develop catchy brand names, there seems little likelihood of obtaining industry wide consistency. There does however seem to be a growing awareness of the need to change the frame from lump sum to income.

5.5.2 Creating competitive pricing

One way of addressing concerns about value for money, would be to recognise that guaranteed LAs are a commodity to the extent that they are directly comparable. Members could obtain the best guaranteed annuity rates if all members were able to access the same on-line application form, and able to choose the best offer from different providers. Nielson (2012) reports that this has been effective in Chile and is available through a Canadian commercial quotation system. In the UK, providers of enhanced annuities use the same application form[12] - ensuring competitive pricing. Non-guaranteed LAs that relied on trustee discretion in determining payment rates or the distribution of return would not be as easily compared. A qualitative comparison could however be made.

Such a market would need government facilitation in that trustees and insurance companies might be found to have infringed competition policy if they collaborated in setting it up. To the extent that trustees are motivated to protect FUM, they are likely to oppose such a development but might be reluctant to do so publicly.

5.5.3 Extending compulsion

For every argument for mandating contributions before retirement, there would seem to be an analogous argument for part of the benefit to be taken as a LA. Requiring trustees to offer lifetime products would face less opposition, and eleven respondents suggested that there should moreover be a default into such products. A default is however problematic because members must at least provide the trustees with their bank account details. A penalty could perhaps be applied if members did not respond to the default offers and failed to begin their drawdown before a particular age.

One insight from research reported in the interviews was that many members in their sixties had various alternative sources of funding that meant they were reluctant to begin drawing down their superannuation until later. The sources included their and their spouses' earnings and retrenchment benefits as well as other less tax efficient investments. Long joint life expectancies for married members also mean that the benefits of LAs are less material in those years. As members age however, the financial benefit of LAs increases and retirees' ability to manage other investments declines. Even if drawdown, LAs or both are not compulsory, targeted communication to members that continued well beyond their retirement date would seem desirable. This could be compulsory.

6 Conclusion

The evidence gathered above supports the conjectures of Brown et al. (2008) that a narrow investment frame, reinforced by industry interests, has contributed to the annuity puzzle. There is also evidence of myopia to the extent that potential annuity providers are not aware of the needs of lower and middle-income members, and indications of a fear of change and of complacency. The

[12] file:///C:/Users/z3149143/Downloads/RHF.pdf

puzzle also extends to a failure to develop investment instruments appropriate to backing the assets of the retirement phase. However, it also became apparent that there are significant regulatory obstacles to the promotion, if not the design, of LAs.

The systematic reasons for this extended puzzle can be traced to a narrow financialization narrative, that sees wealth as the measure and driver of economic activity. On the one hand, this neglects the social purpose of organizations, overemphasises liquid lump sums and leads to an overoptimistic expectation of equity returns. On the other hand, financialization leads to ineffective and increasingly complex rituals of regulation and a failure to design markets that reduce inefficiency and rent seeking.

But there is space for all participants, including those in research, practice and regulation, to contribute to shifting narratives. Perhaps the priority should be in clarifying the need for liquidity so that trustees and members can see the benefits of establishing a regular income to replenish their contingency buffers. Regulators need to appreciate and reduce the impact of detailed and intrusive regulation. All market participants can participate in moving regulation to a more responsive approach, and in the design of a more effective market in LAs.

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Appendix 1

Table A3: Submissions to Australian Treasury (2016)

Actuaries Institute	https://actuaries.asn.au/Library/Submissions/2017/010617SubmissiontoTreasuryonCIPR(Final).pdf
ASFA	https://www.superannuation.asn.au/policy/submissions/2017
Council on the Ageing	https://cota.org.au/wp-content/uploads/2017/11/COTA-Submission-to-Treasury-on-CIPRs-June-2017.pdf
Financial Planning Association	https://faaa.au/wp-content/uploads/2017/07/2017_07__07_FPA-submission-to-treasury-on-CIPRs-discussion-paper-FINAL.pdf
Financial Services Council	https://fsc.org.au/resources-category/submission/1033-20170707-fsc-cipr-framework/file
Law Council of Australia	https://lawcouncil.au/publicassets/5fe9ed80-8022-e811-93fb-005056be13b5/3311%20-%20Development%20of%20the%20Framework%20for%20Comprehensive%20Income%20Products%20for%20Retirement.pdf
Morningstar Australasia Pty Ltd	https://assets.contentstack.io/v3/assets/blt4eb669caa7dc65b2/blta4b061835835bcff/620d8321081d740d60da0dc2/CIPR_comment_letter.pdf
National Seniors Australia	https://nationalseniors.com.au/uploads/National%20Seniors%20-%20Comprehensive%20Income%20Products%20for%20Retirement%20June%202017.pdf
Rice Warner (Consultants)	https://www.ricewarner.com/wp-content/uploads/2017/11/Treasury-submission-CIPRS.pdf

Appendix 2: Supply side questionnaire

This research investigates reasons why – in the past – trustees of Australian superannuation funds have not provided members approaching retirement with a range of suitable income streams products, and whether these reasons still apply. Employees and advisors will be asked for their views as to the obstacles that trustees face, and their opinion of some alternative product designs and delivery (advice) methods.

The research is particularly significant at this time as trustees are developing advice models and product offerings in terms of the retirement income strategies that they have recently developed to meet the requirements of the Retirement Income Covenant legislation. If successful, it will provide regulators and trustees with viable options to introduce new retirement income products and advice models.

1. Is the trustee13 happy with its own offering of the following?

a. Calculators
b. Investment options for products
c. Longevity options for products

1A. If the answer to any of the questions above is negative, are there plans for development? If not, why not?

a. Internal development with own staff or consultants?
b. Outsourcing or recommending other providers to members?

2. Does the trustee offer members access to calculators/advice on the following? If not, why not?

a. How much to save/spend (which involves looking at family assets and liabilities) and when they should expect to retire?
b. The trade-off between liquidity and consumption in retirement (how much of their balance to annuitise)
c. The trade-off between consumption risk and return (leading to choice of investment and the rule/algorithm for how to respond to actual investment volatility)
d. The implications for bequests (which may involve a return to b and c)?

3. Is the trustee happy that the process of retirement as simple and supported as possible? If not, why not?

a. What reminders are sent to members about retirement before and after 65?
b. Are the forms and processes for moving to the drawdown phase simple and sufficiently secure?
c. Is the information available to members provided in a way that they are not overwhelmed, but can go as deep as they want?
d. Is there a process for ensuring that partners, family and carers are involved as and when desirable? (For bequests particularly)

4. Is the trustee measuring indicators of whether members are making informed and wise decisions? If not, why not?

[13] Consultants will be asked for the first four questions: “Are trustees in your opinion …”

a. The usage of calculators and on-line advice?
b. Investment and longevity choices, and rates of retirement and drawdowns
c. Satisfaction in retirement
d. Complaints

5. How, in your opinion, has the Retirement Income Covenant legislation changed the view of trustees?

6. Do you think some funds will be able to gain a competitive advantage in any of the areas mentioned above?