1 March 2024

Senator Andrew Bragg | Chair
Senate Economics References Committee
By email: economics.sen@aph.gov.au

Sydney
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Dear Senator

Inquiry into Improving Consumer Experiences, Choice and Outcomes in Australia's Retirement System

APRA welcomes the invitation of the Senate Economics References Committee to make a submission in this Inquiry.

APRA is an independent statutory authority established under the *Australian Prudential Regulation Act 1998* (APRA Act). APRA is responsible for the prudential regulation and supervision of financial institutions and for promoting financial system stability in Australia. APRA also serves as Australia's resolution authority. As Australia's prudential regulator, APRA oversees all insurers (life, general and private health), superannuation funds (excluding self-managed superannuation funds) and authorised deposit-taking institutions (banks and credit unions) operating in Australia.

APRA's primary role in relation to superannuation is to drive trustees to deliver better outcomes for members while ensuring the prudential soundness and safety of the sector. In insurance, APRA's primary role is to ensure that all insurers have the financial resources to pay valid claims received from policyholders as and when they fall due.

To do this effectively, APRA promulgates and supervises enforceable prudential standards, including those relating to strategic management, risk management, governance and investment governance as well as enforcing legislative obligations. For insurance, APRA also sets minimum capital requirements within the prudential framework.

Influencing improved retirement outcomes for Australians is a supervisory priority for APRA in 2024. Key to promoting good outcomes for superannuation members in retirement is ensuring that trustees have in place retirement income strategies. APRA is undertaking work on both the retirement income covenant and the role the insurance industry plays in supporting better outcomes for Australians in retirement including providing protection against key risks, such as longevity risk.

The potential impact of a change in climate on the Australian financial system is also a focus for APRA. Severe weather events over recent years has been acutely felt in many regions of Australia and climate change may increase the severity of these events. In addition to the significant hardship this causes for residents and their communities, this has also resulted in significant increases in insurance premiums with implications for the ongoing accessibility and affordability of insurance in many areas. This also has the potential to impact the outcomes consumers experience in retirement.

To better inform policy decisions, on behalf of the Council of Financial Regulator (CFR) agencies, APRA is leading the design and delivery of the Insurance Climate Vulnerability Assessment (CVA) project with major Australian General Insurers (GIs).

Through this piece of work, we are analysing the impact that a changing climate could have on the affordability of insurance products over a longer-term time horizon to enable steps to be taken sooner to mitigate against potential future risks.

Background information in relation to APRA's work on the retirement income covenant; superannuation death benefits; insurance products in retirement; and affordability and availability of insurance, including the potential impact of climate change on premiums can be found at Attachment A.

Further details on APRA's work in relation to insurance and superannuation are outlined in APRA's 2023-24 Corporate Plan and APRA's 2024 publication of its Supervision and Policy Priorities.

APRA recognises the importance of the issues the Committee is exploring for the Australian community and looks forward to assisting the Committee with its work on this Inquiry.

Yours sincerely

Carmen Beverley-Smith
Executive Director, Superannuation

Attachment A

Retirement income covenant

In 2022, the *Superannuation Industry (Supervision) Act 1993* (SIS Act) was amended to include a retirement income covenant (RIC), requiring trustees to have a strategy to assist members in or approaching retirement.

The RIC is principles-based, providing trustees with the flexibility to decide how best to assist their members to meet their retirement income needs – which may include helping members to access services, products and solutions outside their fund.

Aligned with the ultimate purpose of the RIC, the strategies put in place by trustees are expected to improve how members of the Australian community manage their superannuation in retirement.

Over the first half of 2023, APRA and the Australian Securities and Investments Commission (ASIC) conducted a thematic review, examining the progress made by 15 trustees, responsible for 16 industry, retail, corporate and public sector superannuation funds, in implementing the RIC over the prior year. Together the 15 trustees covered around half of the accounts and benefits of members aged 45 and above in APRA-regulated superannuation funds.

The thematic review considered how trustees:

- identify and understand members' needs in retirement;
- assist members with information, financial advice and product offerings; and
- execute and oversee their retirement income strategy and assess whether the intended outcomes were being achieved.

Findings from the thematic review were published in an information report in July 2023.[1] and showed that trustees had focused most of their efforts on expanding the assistance and support available to members in or approaching retirement. It also highlighted variability in the quality of approach taken. The thematic review also found that there was a lack of progress and insufficient urgency from trustees in embracing the RIC to improve members' retirement outcomes.

Following the thematic review, APRA engaged with industry to ensure the observations set out in the information paper were well understood and expectations for improvement were clear.

In November 2023, a self-assessment survey was released for all trustees to assess progress against the findings released in the information report.

APRA is reviewing all trustee responses and will use insights from the self-assessment survey to inform its entity-specific and industry-wide supervisory strategies on retirement, including subsequent consideration of how we bring transparency to the performance of retirement products. Findings will continue to be shared with industry as this work progresses.

Superannuation death benefit claim complaints

APRA is engaging with trustees to better understand the causes of the unacceptable delays in paying death benefit claims. Through this supervisory engagement, APRA is focused on trustees' oversight of third-party service provision and risk management practices. APRA is also working closely with ASIC and the Australian Financial Complaints Authority (AFCA).

To date, it is clear that there are multiple factors that contribute to delays – including insufficient trustee oversight of resourcing and processing of claims; lack of timely response to issues identified; and time required to validate correct beneficiaries and their identities.

Where APRA has concerns that the requirements of the prudential framework are not being met by trustees, or where a trustee fails to adequately respond to supervisory action, APRA will consider further action and use of powers.

APRA does not monitor claims processing times in real time, however, APRA does receive monthly updates from the AFCA including relating to unacceptable delays in processing death benefits, insurance claims and related complaint handling. These updates allow APRA to see trends in complaints over a retrospective time horizon and helps to inform APRA's supervisory work and identification of system-wide issues.

[1] Information Report: Implementation of the retirement income covenant: Findings from the APRA and ASIC thematic review, July 2023.

Life insurance products in retirement

Australia's retirement income system is comprised of three main components: means tested age pension; compulsory savings via superannuation; and voluntary savings both within and outside of superannuation. Together these support Australians through their retirement.

APRA sees the potential for life insurers to play a broader role in providing longevity solutions (protection against the risk of outliving savings) to retirees as part of an overall retirement income strategy. While there are longevity products offered in the Australian market by life insurers, the take up has been low. According to APRA's statistical publication, for the 2023 financial year, around 600,000 member accounts took out lump sum payments and around 200,000 member accounts opened a pension account upon retirement or reaching age 65 (noting a member can take a lump sum and open a pension account). Lifetime annuities are included in the pension accounts and make up less than one per cent of the total member accounts.

Life insurance is an important part of the system supporting retirees as, under Australian law, life insurers are the only private sector stakeholder able to offer products with capital-backed guaranteed income streams that provide protection against longevity risk. Such capital-backed guaranteed income streams can complement other product options available to retirees. Currently only a small number of life insurers participate in this market, offering a limited number of options for consumers.

Supply and demand drivers, product design and pricing, as well as access to advice, also impact the longevity products market. APRA has heard from stakeholders that absent material demand, the incentive for insurers to offer these products is limited. Demand is driven by several factors, including but not limited to retirees:

- having a bequest motive;
- valuing flexibility and not wanting to 'lock' their retirement savings into longevity products;
- not appreciating the value of longevity products; and
- not having access to the appropriate advice and hence not aware or fully understanding longevity products.

Factors that contribute to the supply of products include:

- insurers focusing on other risk products where there is more demand;
- elements of the capital framework that may be constraining relative to overseas jurisdictions, resulting in unattractive pricing; and
- not part of the overall group strategy (noting most life insurers in Australia have an overseas parent).

Given the guaranteed and long-term nature of longevity products, it is crucial that product providers hold sufficient level of capital to provide adequate protection for policyholders. This is especially important when life insurers are under pressure during volatile and stressed market conditions (e.g. large changes in interest rates, inflation rates and equity markets etc.). APRA is engaging with industry to understand any specific areas of the capital framework that may be constraining relative to overseas jurisdictions and gather information about the potential impact of changes on policyholder protection.

We note the correspondence from the Committee dated 9 February 2024 inquiring about living benefits products. APRA is aware of such specialised long-term health and aged care insurance products being available in other jurisdictions, however there are currently no such products offered in Australia. If products of this nature were to be offered in Australia, in principle, they would be subject to the same regulatory requirements as other life or health insurance products as relevant to the specific product.

Insurance affordability and accessibility

Over the last four years, the average household premiums for Australians have increased markedly. APRA data shows that the average written premium for home insurance for the June 2023 quarter was 38 per cent higher than the June 2019 quarter. This impacts the ability of Australians to afford insurance cover and therefore increases the number people under insuring or deciding not to take out any insurance at all – ultimately resulting in a significant protection gap.

This insurance protection gap is a complex challenge that requires sustained action and a collaborative approach across all levels of government, regulators, industry and consumers. Increasing severity and costs of natural disasters, changed reinsurance pricing and appetite settings for natural disasters in Australia, together with supply chain disruptions and skills shortages are all factors that have contributed to significant increases in insurance premiums.

APRA’s focus over recent years in the insurance industry has been on how insurers achieve an appropriate balance between their financial health to be able to pay policyholders claims and enabling access to affordable and well-designed insurance.

This is done in a range of ways, from our supervisory approach; prudential policy settings; and through the collection and publication of data to help policy makers and insurers alike better understand the insurance landscape.

Climate Vulnerability Assessment

As well as our focus on access and affordability challenges in the present term, APRA is conducting analysis over a longer time horizon to ensure we understand the potential impact of climate changes and how risks, challenges and opportunities may develop. Through the Insurance CVA, Australia’s five largest GIs will quantify how climate change may impact the affordability and availability of household insurance under two long-term climate scenarios.

These scenarios each have differing economic, emissions and temperature pathways, resulting in different climate-related transition and physical risks. Common economic variables will be provided to the participating insurers to support comparability of the insurers’ results.

This project is being coordinated with the help of the Insurance Council of Australia, and is expected to be completed during the 2024-25 financial year. The outcomes of the project will also support the identification of areas where future mitigation actions can deliver significant benefit for the community.