

## TIME TO MAKE SUPER SYSTEM FIT FOR PURPOSE IN RETIREMENT

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Australia's retirees are living longer, saving more and becoming increasingly self-reliant, according to new Challenger research

The research report *Retirement really is different* highlights:

- The superannuation system was conceived for 55-75 year-olds, but today's retirees are typically living into their late 80s, more than 9 years longer than when the superannuation guarantee system was established just 26 years ago;
- By 2030, more than \$1.3 trillion of super savings will move into the retirement phase as increasing numbers of Australians retire;
- Super is moving from supplementing the age pension to substituting it for an increasing proportion of retirees, with only 42% of over-65s on a full pension. This is forecast to decrease as super increasingly reduces the need for government assistance.

"Our super system is more mature than most people realise. It's doing the first part of its job, allowing people to accumulate assets through their working lives, with typical household super wealth at retirement in the \$350,000-\$500,000 range and increasing," said Jeremy Cooper, Chairman, Retirement Income at Challenger.

"This wealth was accumulated to provide income in retirement, but the system is not yet set up to do this next phase successfully by providing pooling mechanisms to reduce the risk of running out of money in retirement.

"Government has embraced the need for change and is steadily working through reforms aimed at developing the retirement phase, including a framework for Comprehensive Income Products for Retirement (CIPRs)."

The report demonstrates that financial risks and challenges in retirement are substantially different from the accumulation phase of super. It calls for these to be considered by the Financial Adviser Standards and Ethics Authority (FASEA) in its consultation on standards and training for financial advisers.

## **Why retirement risks are different**

**There is usually no income other than an age pension entitlement:** This makes it a fundamentally different proposition from accumulating savings and introduces new risks.

**Retirees are exposed to longevity risk:** the risk that they outlive their savings because of increasing life expectancies. Longevity risk also has another dimension: the uncertainty of how long people will live. A 65-year old female only has a 5% chance of dying in the year of her life expectancy (currently 90). This makes planning around retirement income needs all the more complicated.

**Market risk takes on a new dimension - sequencing risk:** when drawing on a portfolio, the sequence of returns matters. A retiree's ability to recover from poor investment returns (or take advantage of lower market prices) is generally limited because strategies available in the accumulation phase (take more risk; keep working and contribute more) are generally not available.

**Household expenditure is funded by individual savings:** yet the predominant way people approach the financial challenges of retirement is by sharing them with another person. Around 70% of people start retirement in a couple household. We accumulate retirement savings individually, but generally spend it jointly.

**Inflation becomes a significant risk:** Recent low inflation rates, following an extended period of inflation at 'average' rates, does not make it any less likely that inflation could deviate strongly from the mean during a lengthy retirement.

**Importance of cash flows:** retirees say that they want a 'retirement pay cheque' and yet most retirement plans are based on investment returns and capital accretion, rather than regular, stable income.

**Cognitive decline:** sound retirement income planning and advice involves the recognition that there is a high likelihood that at some point along the way, one or both members of a retired couple will suffer cognitive impairment or dementia.

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### **About Challenger**

Challenger Limited (Challenger) is an investment management firm managing \$77\* billion in assets. It is focused on providing customers with financial security for retirement.

Challenger operates two core investment businesses, a fiduciary Funds Management division and an APRA-regulated Life division. Challenger Life Company Limited (Challenger Life) is Australia's largest provider of annuities.

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