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Where to next on retirement?

The Retirement Income Challenge

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Introduction

Accumulating super is one issue, but ensuring Australians are able to spend their income optimally through retirement is another. This need presents an opportunity for super funds to provide better retirement income solutions for members. The prize is happy customers for life.

While the opportunity is profound, regulatory uncertainty is making some funds cautious, although most funds are forging ahead anyway.

These challenges were debated by CEOs and senior executives from the super industry at two roundtable discussions hosted by KPMG in Sydney and Melbourne in February 2016.

The events were facilitated by Paul Howes, KPMG Partner, Head of Wealth Management Advisory, and Jeremy Cooper, Chairman, Retirement Income at Challenger. This paper seeks to capture the key themes and outcomes of the discussions.

Retirement income – why now?

It was readily accepted that the vital topic for the super industry in 2016 is the shape of funds' retirement income offerings. This results from the ripple effect of the 2014 Financial System Inquiry along with the fact that members approaching and in retirement now represent half of total superannuation fund benefits.

Regulatory landscape

Regulatory changes are likely to release blockages on products, coupled with guidance on best practice. Clear guidelines for retirement income products would benefit consumers, reducing some of the risk factors when making decisions. However, any regulatory intervention isn't expected to produce a highly formulaic, prescriptive model for products. Instead, funds will face a world where they have to develop a clear retirement income philosophy. The government looks unlikely to prescribe this; unlike the accumulation phase with MySuper.

This environment presents both a challenge and an opportunity for industry leaders to develop world class retirement income frameworks for their members.

The challenge for the super industry

The superannuation industry is currently very good at the first part of retirement savings – investing the money in accumulation and building it up.

The second part – giving members' money back to them in a way that meets their needs and deals with the unique risks and challenges they face in retirement, needs a lot more work.

It was at this point in the discussion that all participants declared that they were up for the challenge of being in the retirement income space. Nobody could see a world where some funds opted out and only did accumulation.

How does a fund measure success in providing a retirement income solution? This a question that the industry has not successfully answered. It is likely that a balanced scorecard approach is probably the best fit. It might involve assessing how well the fund does according to the following criteria:

- **Are member retirement income goals being addressed?**
- **Addressing risk aversion. How well does the member sleep at night?**
- **Simplicity. Do members understand the proposition?**
- **Time diversification (e.g. bucketing) to meet spending goals**
- **Liquidity generally and for emergencies**
- **Allocation to growth assets**
- **Bequest motive**
- **Longevity risk protection**
- **Optimising Age Pension taxation and social security benefits**
- **Dealing with cognitive decline**

Even glancing at this list highlights how many moving parts an optimal retirement income plan must address. Many of the goals are potentially in conflict with each other. The relative importance of each goal is also highly idiosyncratic as between different retirees.

Life expectancies add to the confusion

The uncertainty surrounding retiree lifespans is a core factor in developing a retirement income strategy. Partly because average life expectancies have increased dramatically in recent decades, many people underestimate how long they might live. They can't determine in advance how long they need their retirement savings to last. This tends to lead to a 'self-insurance' mentality where they underspend out of an excess of caution. Retirement income products need to help people better spend down their savings safely. A well-designed product, or combination of products, could enable more spending in the early years of retirement when members are generally more active.

No one-size-fits-all solution

Default products work well in accumulation where most members can be regarded as relatively generic. However, the diverse needs of retirees, and their need for often conflicting outcomes (e.g. growth, but with a high level of security and the ability to access liquidity) can make defaults unworkable. Even the diverse range of account balances, occupations and socio-economic factors can make standardisation problematic.

Ideally, retirement income products should take into account the member's circumstances. That is, whether they are single, married, a homeowner, a non-homeowner and how much they will be relying on the Age Pension. Most people enter retirement as part of a household. This has a major impact on the role that an individual retiree's super balance plays in the overall household retirement plan.

As things currently stand, large super funds see retirement solely through the prism of their member and his or her account balance. In many cases, this will be only part of the overall retirement plan for that member. By contrast, the self-managed fund is an excellent example of a vehicle that knows everything about its members' (typically a household) assets and objectives. The challenge for large funds is how to gather the necessary data and quickly employing the most appropriate new technologies.

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Looking beyond investment returns

Super funds have traditionally seen themselves as being about providing products to members. The products typically provide attractive long term investment returns. Many of the incentive sets and reward mechanisms have focused on how successful these products have been in growing member wealth and attracting and retaining members. These incentives cause difficulties in moving to a retirement income-centric approach. It is a move from a wholesale world where there is potentially more interaction with employers than members, to a retail world. Providing retirement income to individual members is a retail exercise. This can potentially be quite a big cultural hurdle to overcome.

The advice equation

Super funds recognise that members generally prefer in-person advice (at least initially), but as some funds have hundreds of thousands of members, cost and scalability is an issue.

Robo-advice, website access, emails, phone calls, guidance and information all offer ways to improve retirement outcomes. The tech-savvy younger generation wants immediate answers at their fingertips. While robo-advice is mooted as the panacea for all advice issues, funds need to ask themselves whether it is right for their members and in which circumstances.

The nature of the advice itself is also under question. Funds should generally advise retirees on how to structure their affairs, how to connect with Centrelink, what strategies could help them optimise retirement income (such as working longer) and how their spending needs typically shift with age.

Should aged care be in the equation?

Aged care is a major issue for many Australians. Super funds are starting to ask whether there is a way to integrate aged care solutions into a retirement income framework.

The complexities of the current aged care system mean there is a window of opportunity – particularly when it comes to planning ahead, rather than only looking for solutions when something goes wrong.

Aged care links to the issue of cognitive decline and the role superannuation funds can play in mitigating associated risks. Perhaps this should be considered within a retirement income framework.

Summary

Super funds are debating the viability of retirement income products and whether it is best to dive in, wait for legislative changes, or just stick to current strategies. The issues of scale, product complexity, customisation and member advice underpin the hesitation currently being displayed by the industry. But there is movement. Some funds are well underway in building out their retirement income frameworks.

Getting the philosophy right first; developing a strategy second; considering the product suite third; and lastly assessing how they integrate with the marketing and member administration systems is the most sensible path to a successful retirement income future. Somewhere along the way, funds will also need to develop a way to assess how well they are meeting the diverse needs of their retired members. As the famous management consultant Peter Drucker once said: "*What gets measured gets improved*".

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