A recipe for retirement

In the absence of a single silver-bullet solution to meeting clients' retirement needs, advisers will continue to have to mix and match products to achieve the best result. But as Simon Hoyle reports, the recent Conexus Financial Post Retirement Conference heard that help is at hand.

Nicolette Rubinsztein, general manager, retirement and advocacy, Colonial First State

Creating the optimal retirement solution for a client is a complex juggling act of trading off goals and objectives and matching them to the implementation options, or products, available.

A resounding message from the 2015 Post Retirement Conference, held in March by Conexus Financial, the publisher of *Professional Planner*, is that there is still no single silver-bullet product solution to this task. A financial planner's job, for the foreseeable future at least, will remain one of striving for the best fit by mixing and matching products to individual clients' needs – taking into account their risk tolerance, income needs, and longevity.

Nicolette Rubinsztein, general manager of retirement and advocacy for Colonial First State, says modelling carried out by CFS and EY has shown that "combining products in retirement can provide a better outcome for customers that using a single product".

The line-up of products at the adviser's disposal currently includes account-based pensions, lifetime annuities and variable annuities; and Rubinsztein says she is confident that the necessary legislative and taxation changes can be made to allow the launch of deferred annuities, which will extend further the range of options available to advisers and their clients.

CFS worked with EY to analyse the retirement product market to determine how the various product options stack up, how advisers can begin to assess the trade-offs they must make in meeting clients' goals, and how to mix and match existing products to achieve those goals.

COMBINING PRODUCTS IN RETIREMENT CAN PROVIDE A BETTER OUTCOME FOR CUSTOMERS THAT USING A SINGLE PRODUCT

"It all starts with the client's needs," says Steve Nagle, a partner with EY.

"Advisers should consider the outcomes of various product combinations against a wide range of economic scenarios and individual circumstances, including longevity, health or sickness and capital access requirements.

"The use of good financial models can help to make this process manageable. At the same time, advisers need to be able to communicate the various options to their client, taking into account alternative scenarios and the required outcomes."

Advisers need to address a range of factors, and Steve Nagle says EY's retirement modelling focuses on three key ones: income (taking into account amount, increases and security); longevity of the client and of the income (and any gaps between them); and the need to access capital for large, unforeseen expenses.

"In the accumulation phase, the ability to work provides a 'shock absorber' against market changes," Nagle says.

"Once in retirement, the 'shock absorber' of being able to work longer disappears. Risk and risk appetite are therefore different in the retirement stage. At this point, it is no longer as meaningful to focus on a drop in account balance. Instead, the degree of income reduction when assets are depleted becomes more important. The other key consideration is the time at which assets will be depleted, which depends on returns and draw-down."

A major challenge for financial planners is balancing contradictory or competing goals – for example, achieving a given level of income, and making it last for the retiree's expected remaining lifetime.

"Trading off two things is an easier conversation than taking on three or four at once, so it can be useful to try and break

Paul Rogan, chief executive, product and distribution, Challenger

goals down into pairs," Nagle says.

"A good process is to work on two of the retiree's most important competing goals first – for example, income level and expected income longevity.

"By illustrating the possibilities and likelihood of achieving the desired levels, the adviser can gain agreement to a draw-down schedule as a starting point.

"From there, the discussion can move on to the remaining goals, which might include the level of longevity protection purchased through a lifetime annuity versus the liquidity available. Where this alters the plan, the adviser and client can then revisit the initial goals, maybe now balancing one of these against a different goal, and fine-tune that trade-off."

A term mentioned numerous times at the Post Retirement Conference was "stochastic modelling" as a way of forecasting a range of possible outcomes from investment portfolios and asset allocations.

But the results produced by this modelling can be quite complex and "as with any model, are only as good as the assumptions they are based on", Nagle says.

"Another technique is simply to model well-chosen scenarios – such as weak, average and strong markets, or a retiree living to their expected lifespan, or this plus 10 more years," he says.

"In many cases, this type of modelling is easier to understand and communicate to clients.

"It can often be a challenge to keep the client engaged during this process. Using a financial model that can seamlessly switch between the pairs of goals and effectively illustrate the trade-offs can therefore be highly valuable."

Nagle says technology will enable advisers to base decisions on increasingly more sophisticated models and to "better support goal-based discussions with their clients".

"This technology may also help advisers provide real-time advice to their clients and implement effective strategies for wealth maximisation, by automating much of the 'what if' trial-and-error process. There is a key role for robo-advisers to play here, with their application relevant across a range

Mix and match not right for all

An approach of combining products isn't necessarily right for all individuals.

"If you've got $1 million and you want an income of $50,000 per annum, a straight account-based pension [means] you can live off the investment earnings of that, effectively, and preserve your capital," says Nicolette Rubinsztein, general manager of retirement and advocacy for Colonial First State.

"So it's more [suited to] people that are going to have to eat into their capital to sustain their income in retirement. That is really, very broadly speaking, this $200,000 to $1 million range of account balances.

"The one that we used in the example [at the Post Retirement Conference] is someone who has $379,000 and is aiming for a level of income of $41,000, which is the ASFA[-defined] "comfortable" level of retirement. For that kind of person...by combining products you can give them a better outcome in retirement."

Rubinsztein says "our modelling was very supportive of deferred annuities as part of this retirement income puzzle, and you'll have seen Treasury consultation on that".

"We are expecting to hear back in the middle of this year the outcome of that consultation," she says.

"Hopefully [we will get] some of the tax and legislative changes we need in Australia to make sure deferred annuities can be offered."

The essential result of the EY modelling is that a mix of 25 per cent of annuities and 75 per cent account-based pension can deliver a good result.

"Until a deferred annuity becomes available, you would use that lifetime annuity," Rubinsztein says.

"The way the thinking has evolved is you would replace some of your defensive asset allocation with an allocation to an annuity. So Zenith, the research house, have constructed model portfolios using annuities. Normally you'd have a 60 per cent allocation to growth assets and 40 per cent allocation to defensive assets in retirement, say; so from that 40 per cent they have taken 20 per cent and allocated it to an annuity.

"The overall risk ends up the same – 60-40 – because you're effectively saying your annuity is a fixed-interest exposure. So instead of having 40 per cent allocation to fixed interest, you've got 20 per cent allocated to your annuity and 20 per cent allocated to fixed interest. Overall you still end up with a 60-40 allocation.

"If you did have a conservative client, you might do 50-50, or something different; you would just take an allocation out of the 50 per cent fixed-interest allocation and put that into the annuity."

Steve Nagle, partner, EY

Simon Hoyle, editor, *Professional Planner*; **Nicolette Rubinsztein**, CFS; **Steve Nagle**, EY

of rule-based analysis."

For now, a significant advance in retirement solutions is the inclusion of annuities on platforms and wraps to enable more seamless management and implementation of mixed-product solutions.

Peter Chun, general manager of product for Colonial First State, told the Post Retirement Conference that the use of annuities on the CFS platform had already justified their inclusion: 20 per cent of advisers who use CFS First Choice have used annuities in the past 12 months. Research from Investment Trends shows that 17 per cent of advisers that use BT Wrap (including Essentials) had used annuities; and so had 10 per cent of the users of Asgard eWrap (including Infinity).

Rubinsztein says that as CFS refines its approach it will make support tools available, such as calculators.

"You will need modelling tools to be able to work out what's optimal for your client," she says.

"We're also doing some more work right now with EY on some particular case studies and trying to give a bit more guidance on what the optimal allocation might be to an annuity, depending on your client's circumstances."

A solution that doesn't require a client to put all of their capital into an annuity is appealing to advisers, Rubinsztein says.

"There's also the issue of low rates in the markets," she says.

"That's why looking at it as only a portion of your allocation, and also seeing it as only a replacement for some of the defensive part of the portfolio, makes it a lot more palatable from the financial planning point of view." P

Retirement really is different

A key theme that emerged from the PRC was that retirement is distinctively different from the accumulation phase that precedes, and demands different investment solutions.

Paul Rogan, chief executive of product and distribution for Challenger, told the Post Retirement Conference that "'retirement is different' is becoming more of a mantra for the entire industry".

He said that at its simplest, an individual's accumulation goal is to "seek the highest return to maximise wealth", whereas the same individual's retirement goal is to "sustain a living standard while spending down assets over an unknown length of time".

"There's been a number of presenters today who have given different perspectives on that," Rogan said.

"You heard from Daniel [Farley] from SSGA today say that inflation is a major risk."

"Clearly, in research [by Investment Trends], which was only in November last year, inflation is one of the highest risks that retirees worry about."

Farley also articulated another kind of risk: "Basement risk", or the risk that running out of money would force elderly parents to move into the basements of their children's houses.

Rogan said that not being a burden to their children was "something [retirees] worry about quite significantly."

Rogan said advisers need to understand that their own attitudes towards capital protection and preservation are not necessarily the same as their clients'.

"A little bit more than 70 per cent of retirees were really concerned that their investment value doesn't decline," Rogan said.

"Compared with advisers at that point in time...50 per cent [said the same thing].

"So whichever way you cut that, you've got to admit there's an expectation gap in terms of advice and what's happening."

Rogan said the gap was due, in part, to the fact that retirees are far more risk-averse than is generally thought.

"This requires us to change our thinking [from] accumulation – investing for retirement and creating wealth through risk-adjusted return maximisation – to investing in retirement for income to live on in that retirement," he said.

However, retirees' risk tolerance and risk capacity is emerging as a hotly debated topic, with other research suggesting that, far from retirees being uniformly risk-averse, each individual has a different risk profile that changes little over the course of their life.

In other words, risk-averse retirees were probably also risk-averse accumulators; and accumulators with a high tolerance for risk will carry that characteristic into retirement.


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