

WORDS MEREDITH BOOTH

# So boomers WON'T GO BUST

AS THE SECOND WAVE OF BABY BOOMERS APPROACHES RETIREMENT, THE SCOURGE OF LONGEVITY RISK REQUIRES MORE FLEXIBLE SOLUTIONS.

 Retirees spending money like there's no tomorrow is the horror story financial planners dread.

Mercer director of commercialisation Ric Lamont relates a recent tale all too typical of Australians' willingness to ignore longevity risk.

"One client was expecting to fully draw down their retirement portfolio at a rate that would extinguish all super assets by age 83," Lamont says. "After some basic probing, her financial adviser established that both of her parents were still alive and active in their 90s.

"Her most likely scenario was that she would outlive her savings by a good 10 years. After that, she would be back on the age pension and looking at selling the home to free up capital to live on.

"In this case, there was an opportunity to intervene and an appropriate plan was created."

Longevity risk remains high for more than half of Australians who will live longer than expected and therefore face the real risk of running out of money. So says Mercer senior actuary Dr David Knox, who has projected that more than half of the Baby Boomers retiring now will live into their 90s and beyond and face the distinct possibility of a shortfall in their income.

On average, 50 per cent of retirees will outlive their savings by more than five years and one-quarter of Australians will outlive their savings by 11 years, he says.

The global wealth and superannuation consultant's research shows a looming income crisis that reinforces recommendations the 2014 Murray Inquiry made. Overwhelmingly, these suggested a need for government to encourage a suite of MyRetirement products for Australians to ensure they have an income for life.

The problem for the last half of the Boomers, who will be retiring in the next decade, is that spending will not necessarily dip as they age, with travel and lifestyle costs in early retirement switching to aged care and medical costs later in life.

Lamont says Boomers' experiences are the test case for self-funded retirement products but have not been supported by the system, which is yet to clarify its means-testing framework for the age pension to encourage more MyRetirement products onto the market.

He says there is a dearth of options outside insurance-based annuities, which offer a fixed income throughout retirement but no growth because returns are locked in at today's rates.

"Product markets have been largely silent on longevity risk solutions. It's going to [require] system change," Lamont says. "The industry's starting to lose a little bit of patience; it was almost out of character for the Actuaries Institute to enter debate."

The institute's retirement strategy group head, Andrew Boal, stepped into the spotlight in September, calling on the federal government to act quickly on rules for means testing so financial services companies and super funds could get on with developing products that would address the growing longevity problem.

Entering the market ahead of government measures is Mercer's LifetimePlus retirement



product, a world-first pooled risk solution that ensures income for life and grows as people age.

First launched in 2014, LifetimePlus has been updated to include 35 per cent of its underlying investments in growth assets and more flexibility for retirees to opt out should their circumstances change.

“The principles are fairness and flexibility,” Lamont says. “If something unfortunate happens and you need to pull all your money out in the first two years, there’s no contribution to the pool. You receive all your invested capital back.”

“Beyond that, you start to receive greater levels of income because you’re a longer-term investor. The returns continue to increase and, accordingly, capital you get back at the end decreases over time.”

Eventually, for those who live a very long time, the capital withdrawal value will be zero, even though the fund continues to pay an increasing income as long as they’re alive.

#### JUST THE BEGINNING

Knox says Australia is at the peak of Boomer retirements and the world is watching how Mercer’s longevity product succeeds.

“We’re not aware of anything like it in the world and Mercer is a global company,” he says. That’s because Australia is five to 10 years ahead of the US and UK, because we got out of defined-benefit schemes earlier and we have a compulsory system. “Unlike some European countries, we haven’t had that practice of everyone buying an annuity; 93 per cent of Australians are on account-based pensions.

He says the product is targeted at people with at least \$200,000 at retirement and has no real upper limit.

“Some might argue that people with high balances don’t face longevity risk,” Knox says. “Our experience, and that of many advisers we speak to, is that the balance alone is irrelevant. If a retiree has spending expectations that exceed the ability of their balance to support them deep into retirement, they face longevity risk.”

#### FAIR, SUSTAINABLE RETIREMENT INCOME

Patricia Pascuzzo, founder and executive director of independent think tank the Committee for Sustainable Retirement Incomes (CSRI), says it is critical that government clarify means testing for the age pension to ensure retirement income providers are not discouraged.

Means testing for the age pension at the moment doesn’t envisage innovative retirement income products and that discourages their development, Pascuzzo says.

CSRI’s mission is to progress government policy to encourage adequate incomes through all the years of retirement for all Australians on a fair and fiscally sustainable basis.

“The fact is that many Australians are having a lot of difficulty managing their longevity risk,” Pascuzzo says. “We’re seeing a lot of evidence of pensioners living overly frugally because they are unsure how long they’re going to live and 1 in 5 are drawing down on their super at an unsustainable rate.”

To ensure an adequate income of about 60 per cent to 70 per cent of pre-retirement levels, people earning the median need to save 12 per cent of their income for 35 years and those earning more actually need to be saving more, she says.

“Clearly, the majority of people are not putting enough away for an adequate retirement income,” she observes. “This highlights the importance of making the most efficient use of their super balance and all their assets, including their house, in retirement, given that many are not going to be self-sufficient and will still be reliant on the age pension.”

“You’ve got more and more people who aren’t living with the peace of mind in retirement that they could have if they had been given better support in the lead up and during retirement.”

“There is a worrying tendency among women to put their funds in a bank account and live very frugally, when a more sophisticated system would give them more peace of mind.”

Pascuzzo says there’s a major challenge ahead for financial advisers, to raise Australians’ financial literacy and provide advice to more people more cost-effectively.

“Financial planners should be thinking about fintech if they are not already – having online access to information and tools that will encourage people to take advice,” she says. “I would also say to those planning to offer solutions, you shouldn’t underestimate the importance of creating a reliable and supplementary source of income for people who are on the full age pension.” ■

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