The difference for advice in retirement

Aaron Minney | Challenger | 09 May 2018

There is a wave of activity at present dealing with how Australian retirees manage their savings in retirement, including the advice they should be receiving. Some, like the Royal Commission, are grabbing headlines, while others such as FASEA's proposed requirements for advisers, and the development of a new product for the retirement stage of super, are little known beyond industry experts.

One of the key challenges is to meet the needs of the mass of people moving into retirement who will need advice focused on managing their portfolio to fund spending, instead of building up the portfolio value.

SUPER IS WORKING

The Australian super system is now at least 25 years old. While the industry funds kicked off before then with the 1986 Accord Mk VI, it was in 1992 that saving through super became compulsory for employees. This helped the many baby boomers now retiring with a decent super balance. Recent APRA data highlights that many super funds have average retired member balances of over $300,000 (at June 2017). And the average retirement balance will increase further in coming years as subsequent retirees have more time to compound their super contributions.

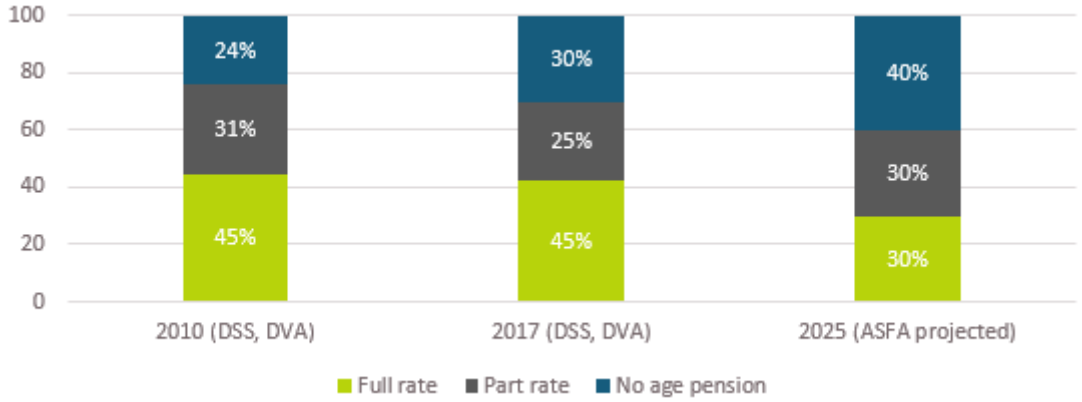
This creates a fertile environment for advisers who understand the needs of retirees and can relate to them. Projections by ASFA estimate that 40% of retirees will be self-funded by 2025, compared to only 24% in 2010. Figure 1 (over page) shows the increase in self-funded retirees and the reducing reliance on the age pension over time. Most will need help in the form of advice to manage (i.e. spend) their retirement savings appropriately.

Proposals for super funds to develop Comprehensive Income Products for Retirement (CIPRs) will go some way to lessening the need for advice. Nonetheless, the growth in the number of retirees and the increasing proportion needing advice will underpin growing demand for suitable retirement advice.

THE RETIREMENT CHALLENGE

The goals of a portfolio *IN* retirement are very different from the goal of saving *FOR* retirement. In the absence of a regular pay cheque, retirees need their investments to negotiate not just market and inflation risks also present in the accumulation phase, but also risks such as sequencing risk and longevity risk. Few retirees will have saved so much, or spend so little, that the risk management techniques relevant in the accumulation phase will solve all their issues in retirement.

Figure 1: Trend of decreasing reliance on age pension 2010 & 2025
Proportion of eligible population on the age pension



Source: 2010 & 2017 - Challenger calculations based on data from ABS, DSS and DVA; 2025 - ASFA *Myths that super will come up short*, November 2017.

Success or failure of a retirement plan

One of the biggest challenges in providing advice for retirement is the lack of a clear success measure. In accumulating assets, there is one goal: create the largest possible pool of savings. This provides a clear success measure and well-known steps to improve the ultimate outcome, including: asset allocation; saving more; reducing costs; minimising taxes; contributing (working) for longer; right down to the typical competition to get better investment returns. Practitioners are well accustomed to working in this paradigm.

Understanding the rate and direction of retirement spending provides a broad segmentation of retiree goals. In retirement, typically, there are different forms of expenditure to plan for:

- Everyday living costs which requires predictable and regular cash flows. These can be further divided between needs (essential expenditure) and wants (discretionary expenditure);
- Emergency or lumpy items (financial assistance for an adult child or renovating a bathroom);
- Late life expenses which might be incurred; and,
- Bequests for the estate.

Success will often involve meeting all four objectives, making success much more difficult to measure in retirement. Retirement advice also calls for a focus on the lengthy time horizons involved. Retirees who start spending in year 1 of retirement need to know how that is going to affect the availability of income in year 20 and beyond.

The difference for advice in retirement

The predominant focus of advice, historically, has been building wealth for investors during the accumulation phase. Retirement advice has often focused on tax strategies and estate planning. Advice encompassing spendable cash flows, the sustainability of retirement savings, mitigating longevity risk, cognitive decline and aged care has been the exception, rather than the rule.

But a key challenge with many Australians now retiring with significant super balances is that the advice they need is how to spend that over their remaining lifetime. As highlighted in a 2017 National Seniors Australia survey, only a very small minority of older Australians want to leave everything for the next generation.

This is consistent with the approach taken by the government with some of its recent changes to superannuation. The government clearly wants tax-advantaged superannuation wealth to be spent down by retirees, rather than being preserved for the next generation. The $1.6m transfer balance cap is designed to be enough to provide $100,000 a year across an average retirement, but only if all capital is consumed. The age pension taper rate clearly contemplates a reduction in accumulated savings through retirement. As means reduce via spending, support from the government increases through the age pension.

Retirement advice therefore needs to go beyond portfolio management to include advice on managing the required cash flows through retirement. This includes consuming capital to create a higher standard of living for retirees. After all - that's what super is for!

[For more on retirement spending needs and patterns, see "Understanding the rate and direction of retirement spending" - Ed.]

Aaron Minney is Head of Retirement Income Research at Challenger.