The New Super Landscape
– What Lies Ahead for Wealth Managers
SEMINAR

Institute of Actuaries of Australia

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Pensions and Affordability

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The impact of the baby-boomers

- Australians like to retire “early” even if they have few assets!
- The forthcoming bulge in retiree population will increase consumption over a 50 year period (2010 – 2060)
- This large voting block has high expectations and will demand more services and benefits
- Improvements in longevity will increase consumption (particularly health costs) without a corresponding increase in productivity – therefore, net drain on country (unless fertility/immigration moderates this)

Age Pension

- The national Age Pension is set at 26% MTAWE means-tested and funded from tax revenue (PAYG)
- The benefit is available for males from age 65 and females from age 63 (increasing to 65 in 2014)
- Single person’s benefit is $13,315 p.a. (paid fortnightly and indexed half-yearly to average male earnings)
- Married couple benefit is $22,240 p.a.

Value of Age Pension

- Standard Rate of Age Pension (Real Terms)
  - 1996: $441.26 per fortnight
  - 2006: $512.10 per fortnight
  - 2020: $585.24 per fortnight
    (assuming the pension increases by 1.0% p.a. above CPI)

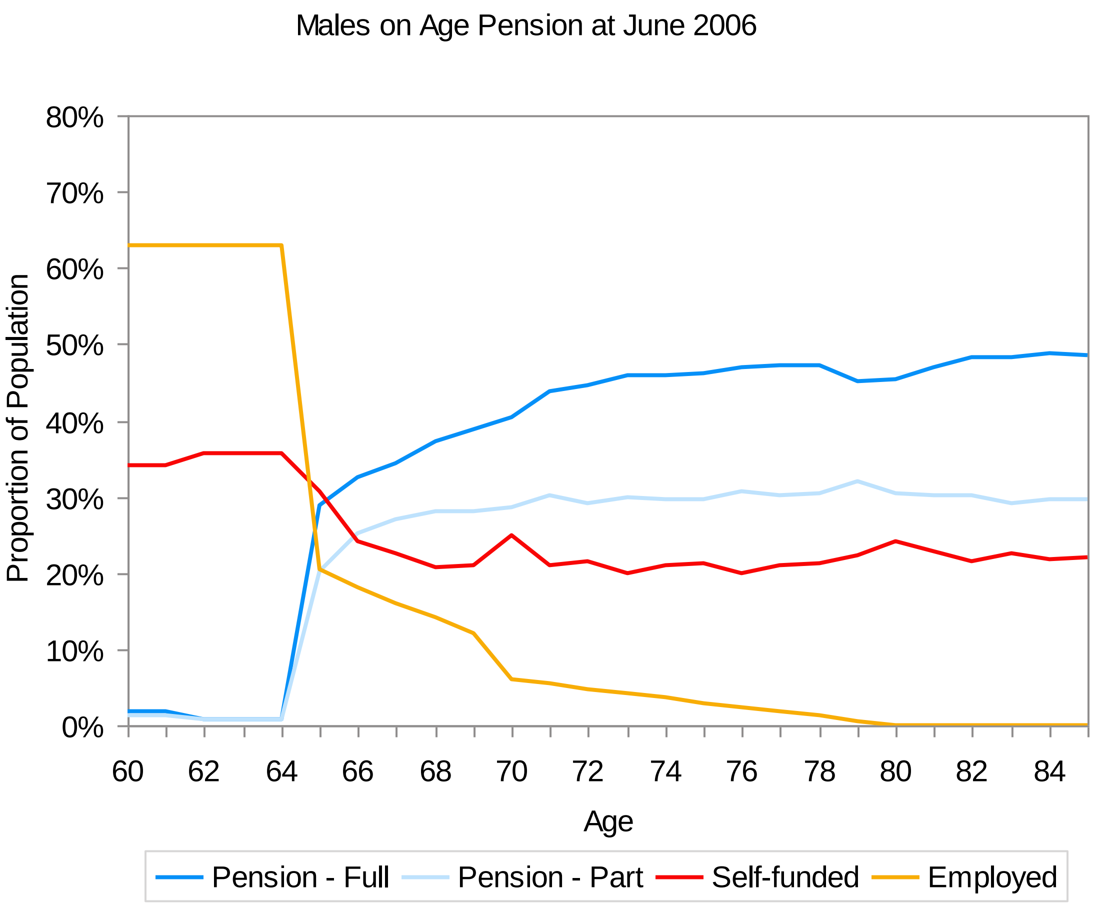
- Purchasing Power of Age Pension has increased by $71 per fortnight (2006 Dollars) from 1996 to 2006 (increase of 16%)

- If the Pension continues to grow at 1% p.a. above CPI, the purchasing power will increase by a further $73 per fortnight (2006 Dollars) from 2006 to 2020.

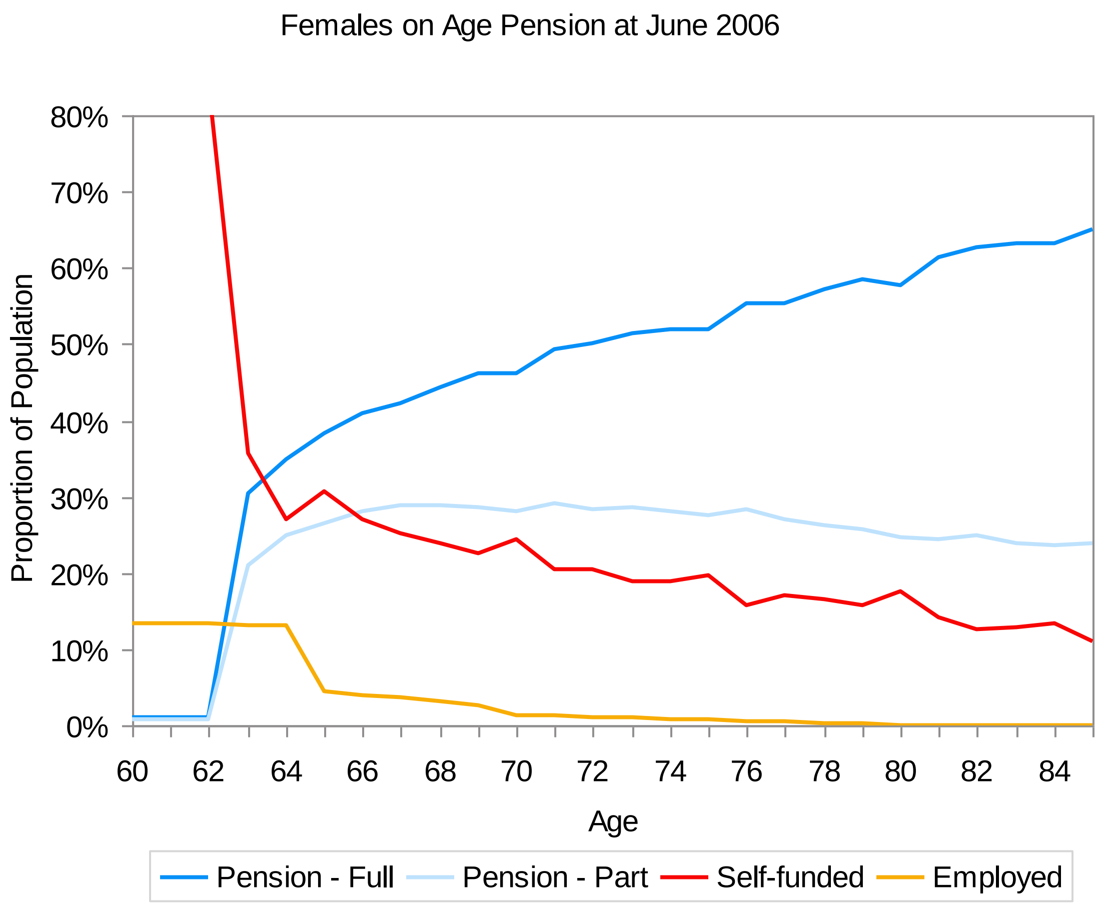
Retirement Policy

- Government objective is to increase levels of self-sufficiency in retirement
- Currently pensioners are taxed very favourably
- …but there is no
  - Pooling of investment risks (no guarantees)
  - Pooling of Longevity risks
  - Advice on expenditure needs in retirement

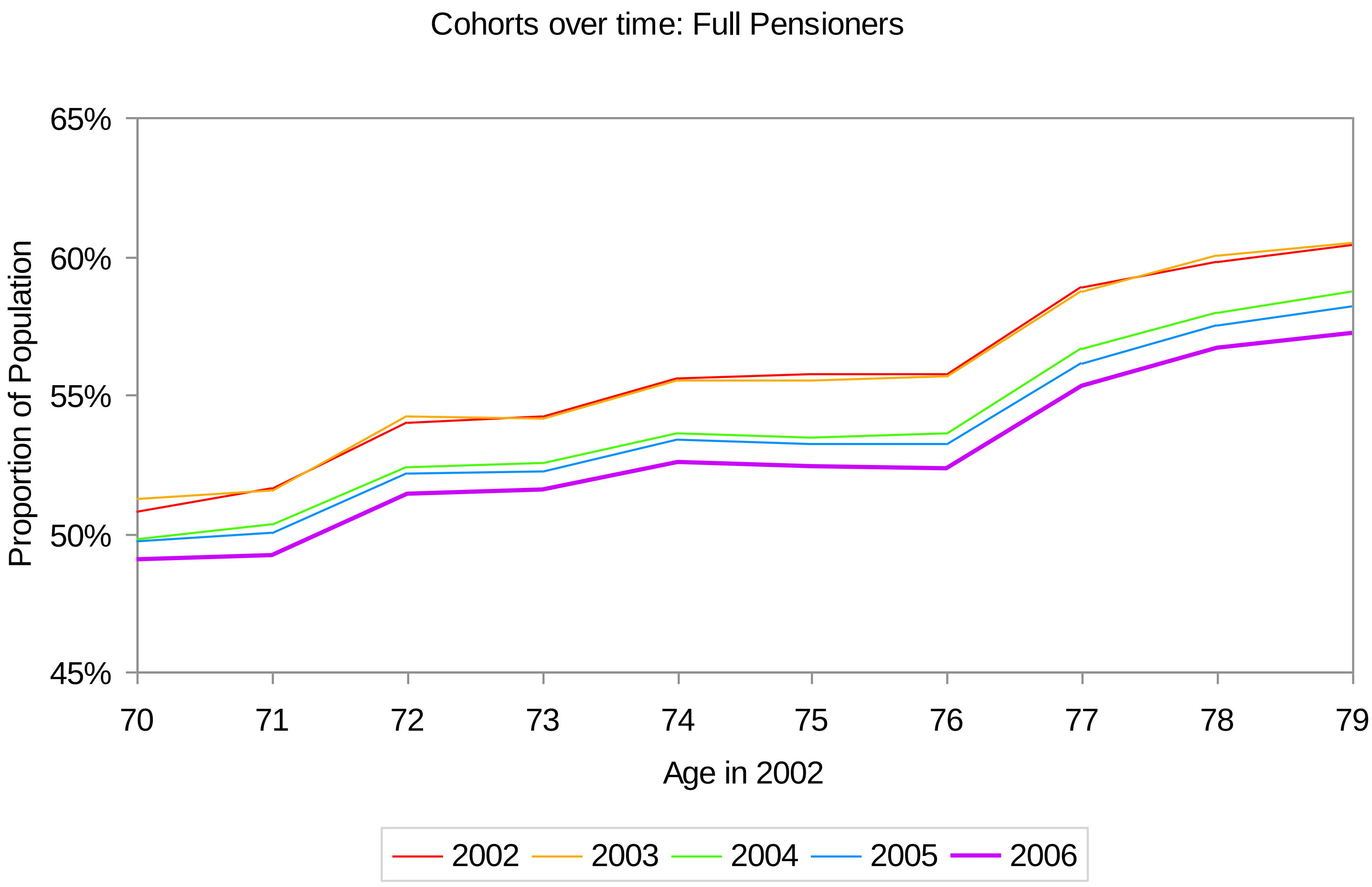
Age Pensioners: 2006 - Males



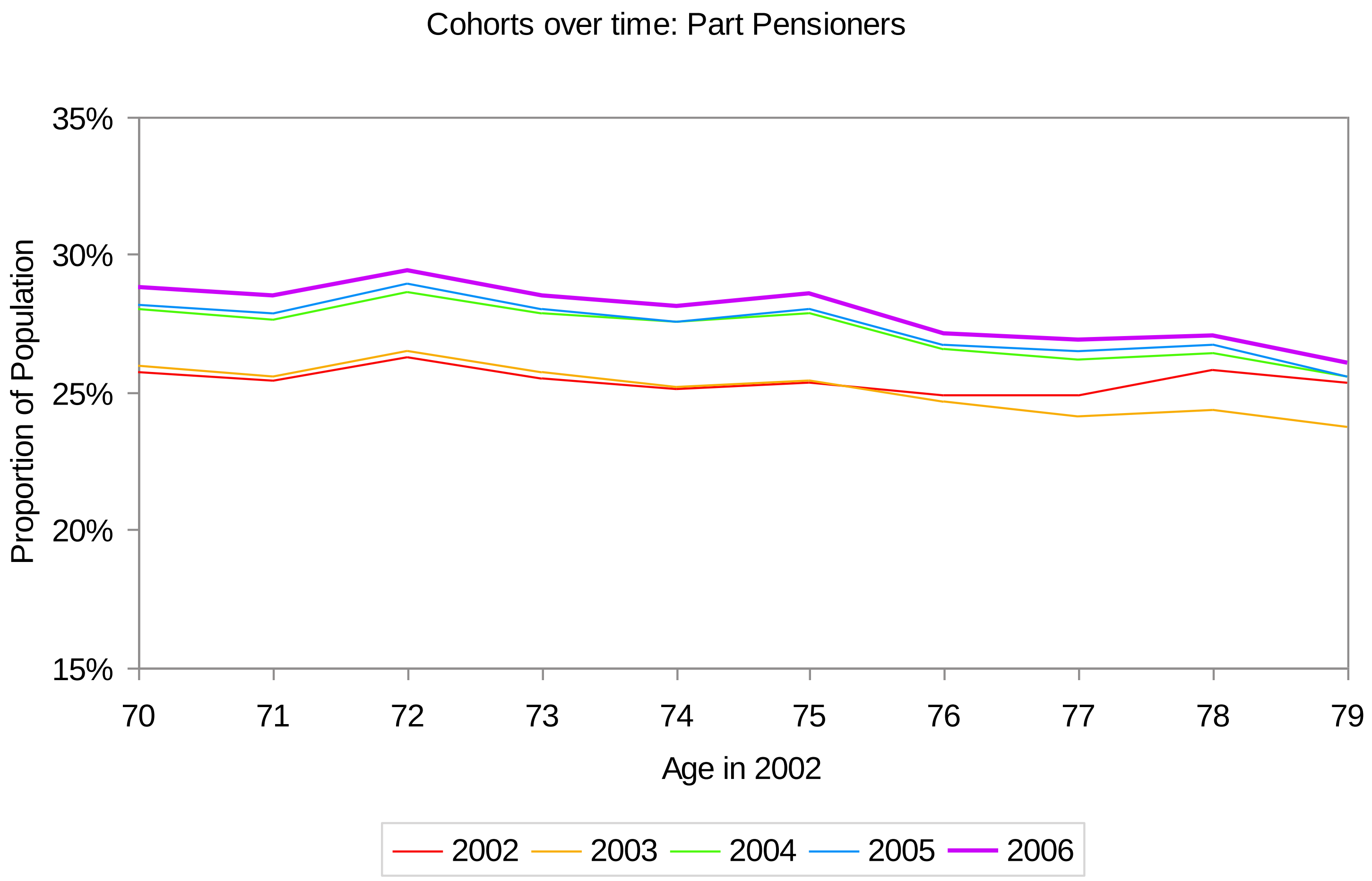
Age Pensioners: 2006 - Females



Cohorts over time: Full Pensioners



Cohorts over time: Part Pensioners



Background to past retirement decisions

Before the Budget changes, there were three broad groups:

- Most retirees take lump sums as their benefit is below the tax-free threshold of $135,590. Those accumulating super up to $200,000 are almost all full Age Pensioners (unless married to someone with a better benefit or owning investment properties outside superannuation).
- A smaller group retires with $200,000 to $500,000 in superannuation. They seek to maximise their Age Pension entitlement and to draw-down their benefit via allocated pensions (or a lifetime annuity).
- The smallest group (more than $500,000 superannuation) seek tax-minimisation policies and they will usually invest in a term allocated pension.

The wealthier baby-boomers will have higher numbers in the latter two groups

Budget Impact

- Many people will defer consumption of retirement benefits
- More people will take their retirement benefit as a pension rather than a lump sum
- More people will save earlier through co-contribution and salary sacrifice
- Tax concessions on contributions have been capped at about 50% of previous levels for older workers

Are the Budget changes sustainable?

- $500M in initial annual cost
- Retirees will pay taxes during retirement – particularly GST
- On death, up to 15% of benefit will be paid as a death duty
- Maximum deductible contributions in future will be relatively low @ $50k p.a.

Growth in superannuation assets

Year	All Assets ($ billion)	Pension Assets ($ billion)	Pension Assets %
2005	765	181	24
2010	1,219	337	28
2015	1,764	551	31
2020	2,343	797	34

Three Distinctive Phases of Retirement

Active ***Ages 60 to 75***	***Passive*** ***Ages 65 – 85***	***Frail*** ***Ages 75 to 100***
Continuation of lifestyle but more time for leisure, travel and family Some part-time work Increased expenditure on leisure. Majority are still nett savers Housing upgrade	Shift to more passive activities; travel is closer to home Some unpaid charitable work Increased expenditure on health. More frugal lifestyles. Housing down-sizing	Restricted mobility means leisure activities are limited Reduced contribution to economy and society Increased expenditure on health and aged care Retirement village or nursing home

Expenditure in Retirement

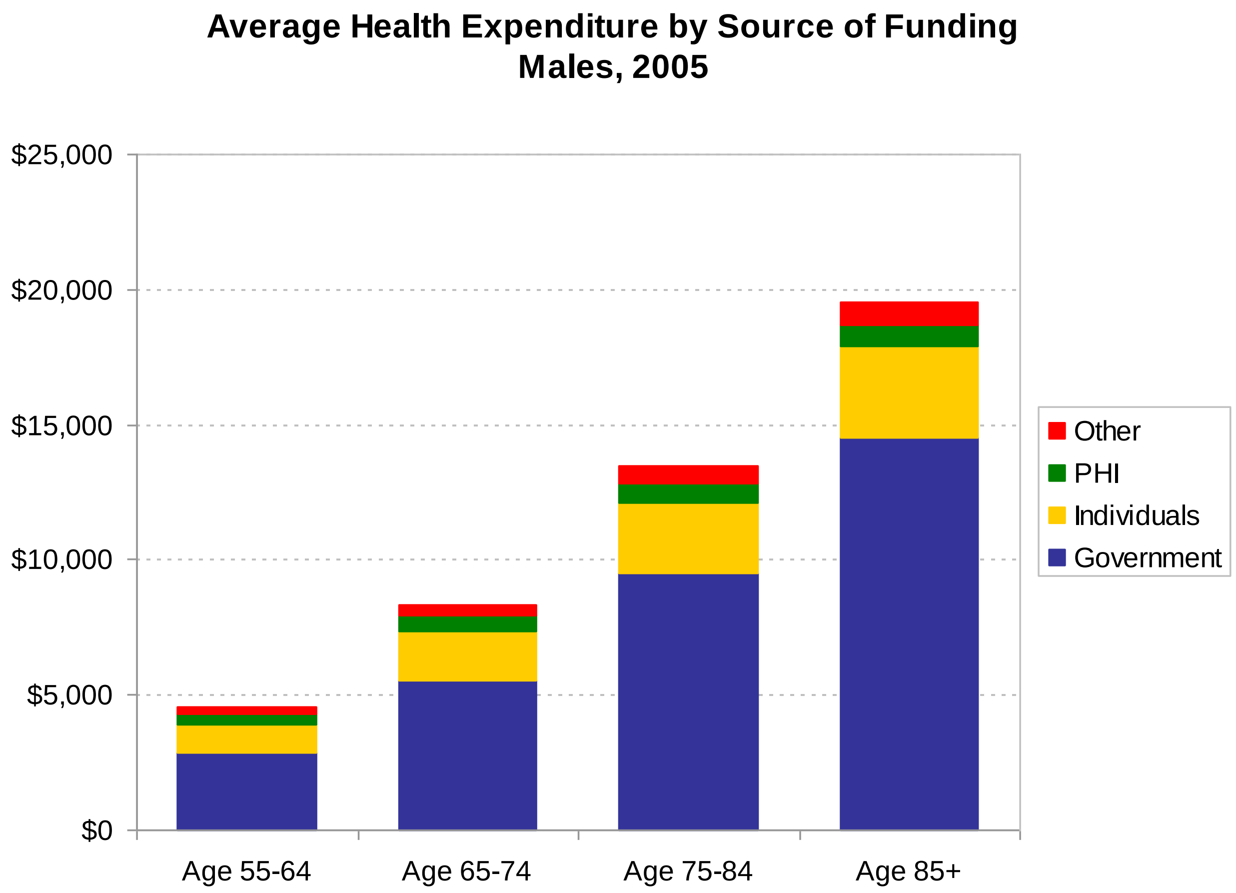
- Highest in Active phase – particularly if spare time and money is used to help (middle-aged) children
- Consumption decreases in Passive Phase, but many retirees run out of superannuation and fall back on Age Pension
- Costs rise in Frail Phase, though there are significant government subsidies for health expenditure

As expenditure varies from year to year, a traditional lifetime annuity can only be used as a building block

Summary of income needs in retirement

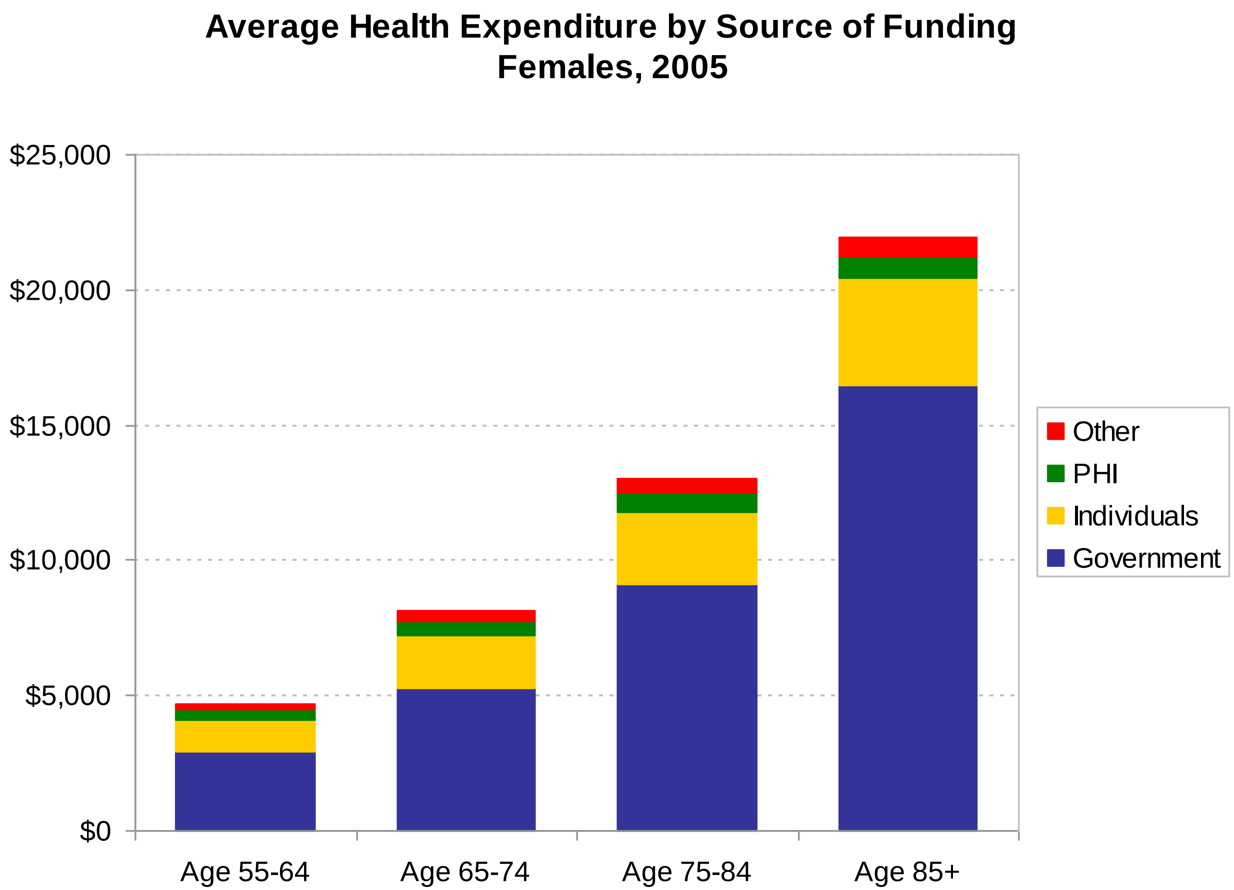
- Expenditure in Active Phase is less than 75% of salary at retirement
  - Costs associated with working have ceased
  - Mortgage has been paid off
  - Some discretionary spending on children
  - Replacement of white goods and car – and an expensive holiday
- Expenditure in Passive Phase reduces
  - Lifestyle becomes more frugal
  - Pensioners become more conservative (no scope to recover from losses)
- Expenditure in Frail Phase grows
  - Health costs spike
  - Aged care and accommodation needs change
  - Decision-making is diminished.

Health Expenditure: Source of Funding



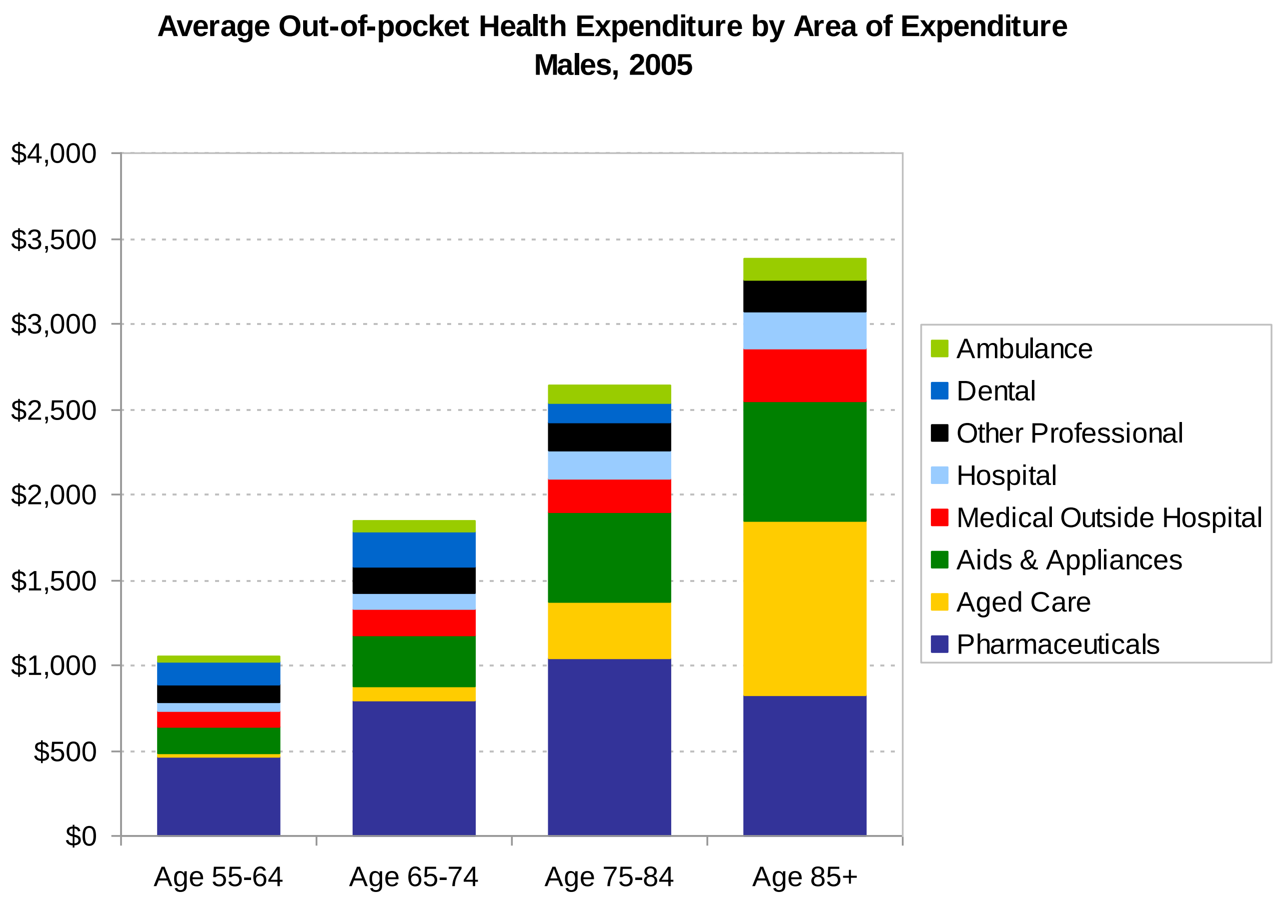
Source: AIHW

Health Expenditure: Source of Funding



Source: AIHW

Health Expenditure: Individuals



Source: AIHW

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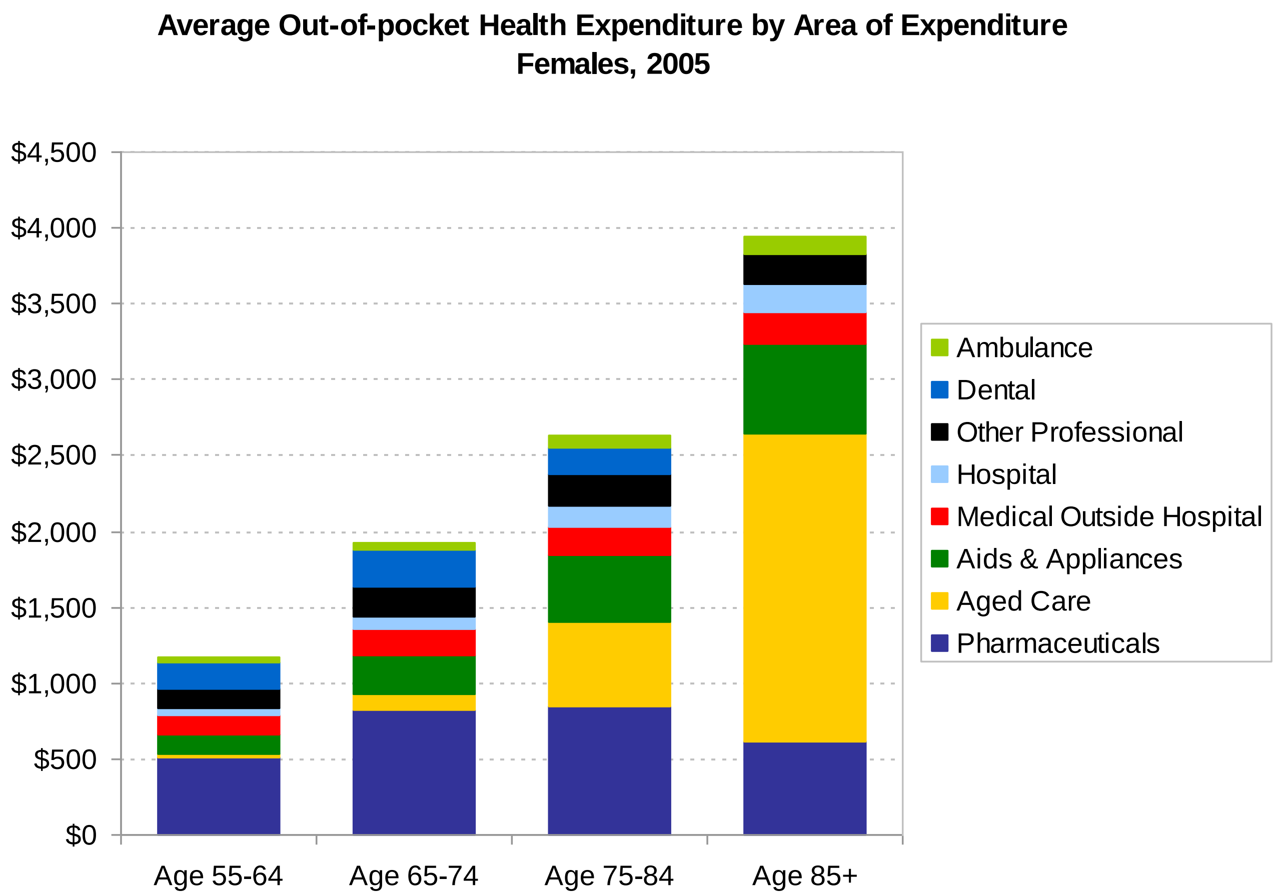
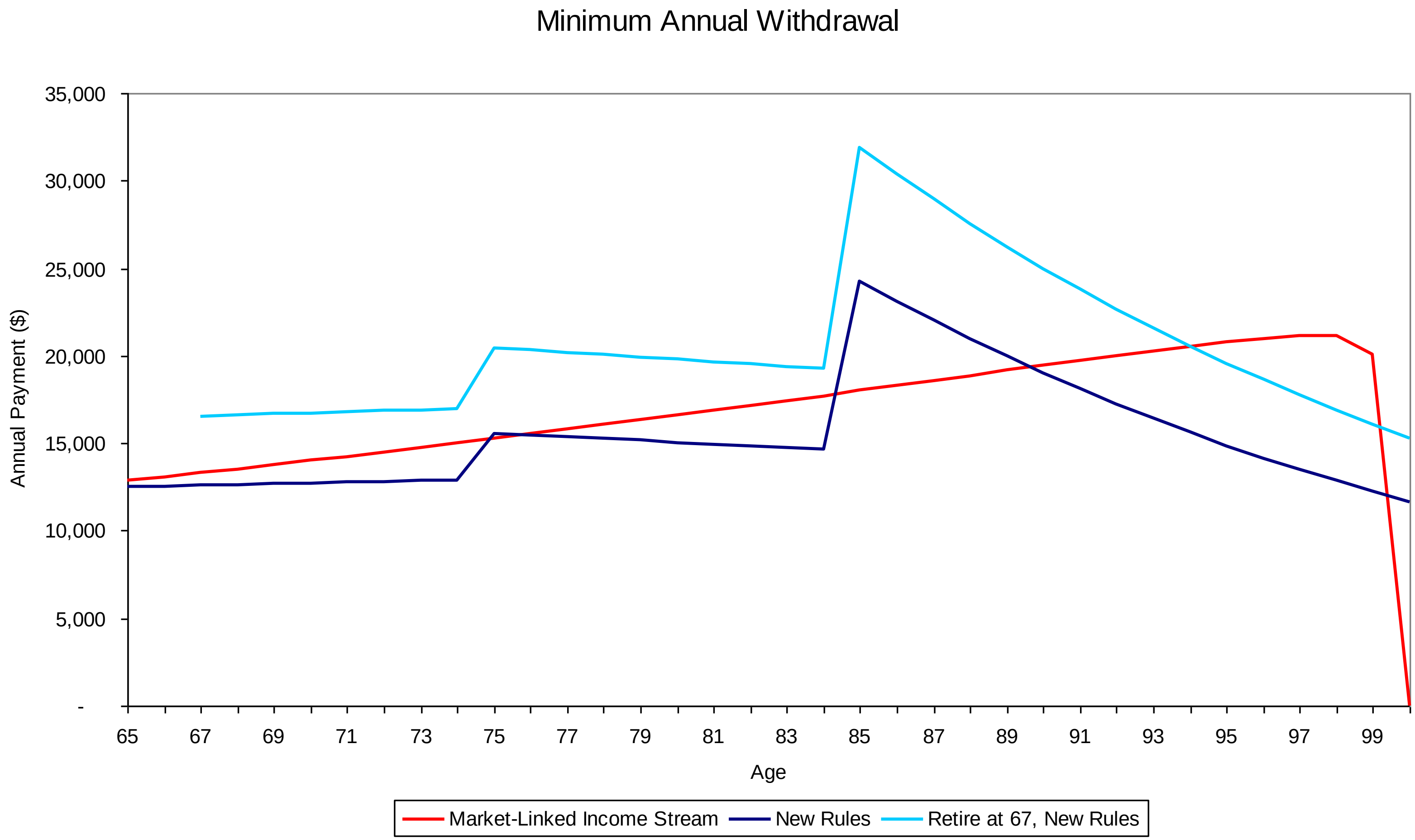


Source: AIHW

Problems with Lifetime Annuities

- APRA requires extremely high capital reserves for any investment in growth assets (reserves can be 20% of purchase price)
- Longevity is a real issue for insurers:
  - It is likely that mortality rates above Age 60 will continue to fall significantly.
  - It is possible that people will live beyond the current limits of life (from 110 to 150 or more).
  - People buying annuities are select lives, so terms need to be conservative
- Members are accustomed to taking on investment risks during the accumulation phase. Few appear to trust a life company enough for their retirement needs
- Annuities appear to offer poor value due to the current (lengthy) cycle of low interest rates and high equity returns

Allocated Pension Payments from initial benefit of $250,000



Time Horizon for Retirees

- 65 year old males will live 18 years on average
- 60 year old females will live 25 years on average
- 50% of these will outlive their life expectancy!
- Therefore, they need to keep most of their super in a long-term investment strategy

Time Horizon for Retirees

Age of Survival for 65 year olds

% Surviving	Females	Males
90	74	71
80	79	75
70	83	78
60	86	81
50	88	84
40	91	87
30	93	90
20	96	93
10	100	98

Assumptions:

1.5% mortality improvement
ALT00-02

Building a Retirement Vehicle - liquidity

- Retirees will need to draw a small portion of their July balance

  4% to age 65

  5% to age 75

  6% to age 85

- They should keep this (and any additional funds needed for consumption) in a Cash Account

- The Cash Account <u>within the super fund</u> should have access to ATM and debit card.

- **Many pensioners will not need separate bank accounts!**

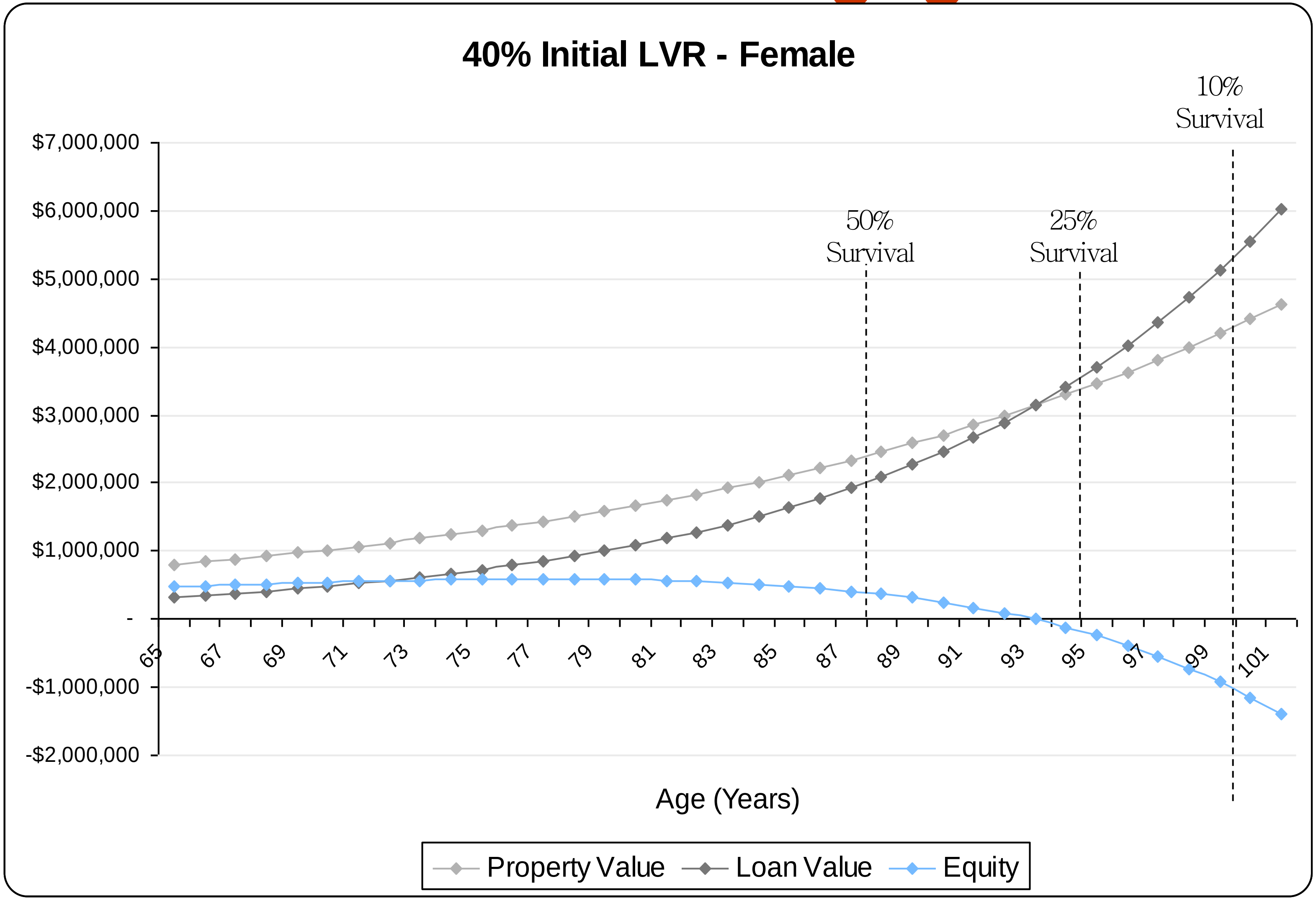
- **Many pensioners will not need to complete tax returns!**

Super funds will take over all income streams for their members on retirement

Building a Retirement Vehicle - investment

- Balance of assets needs to be in a long-term investment vehicle
- Australian shares are good value as imputation credits can be used and there is no CGT for pensioners
- Retirees need calculators to work out how to spend their income over time

Reverse Mortgages



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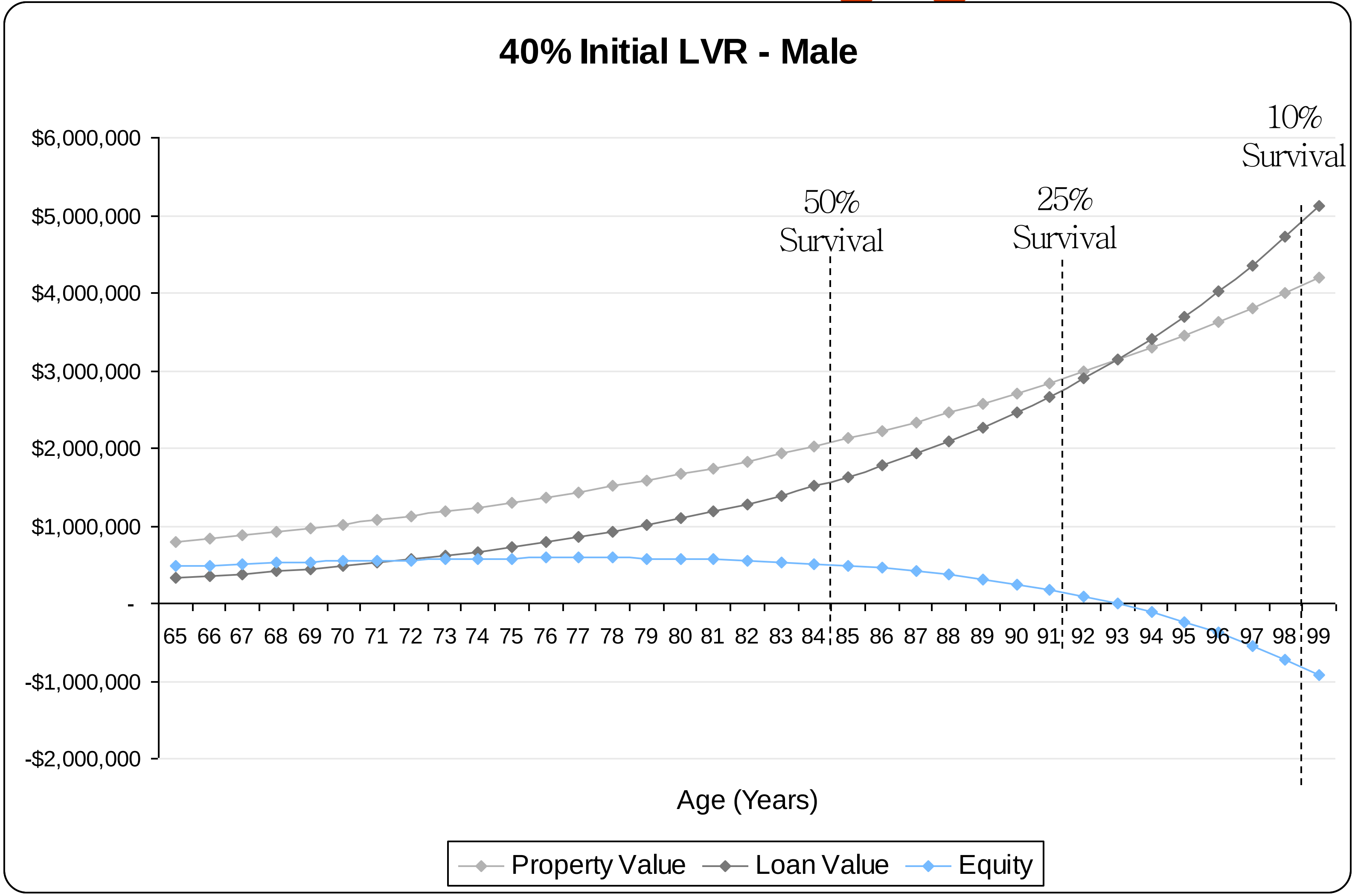

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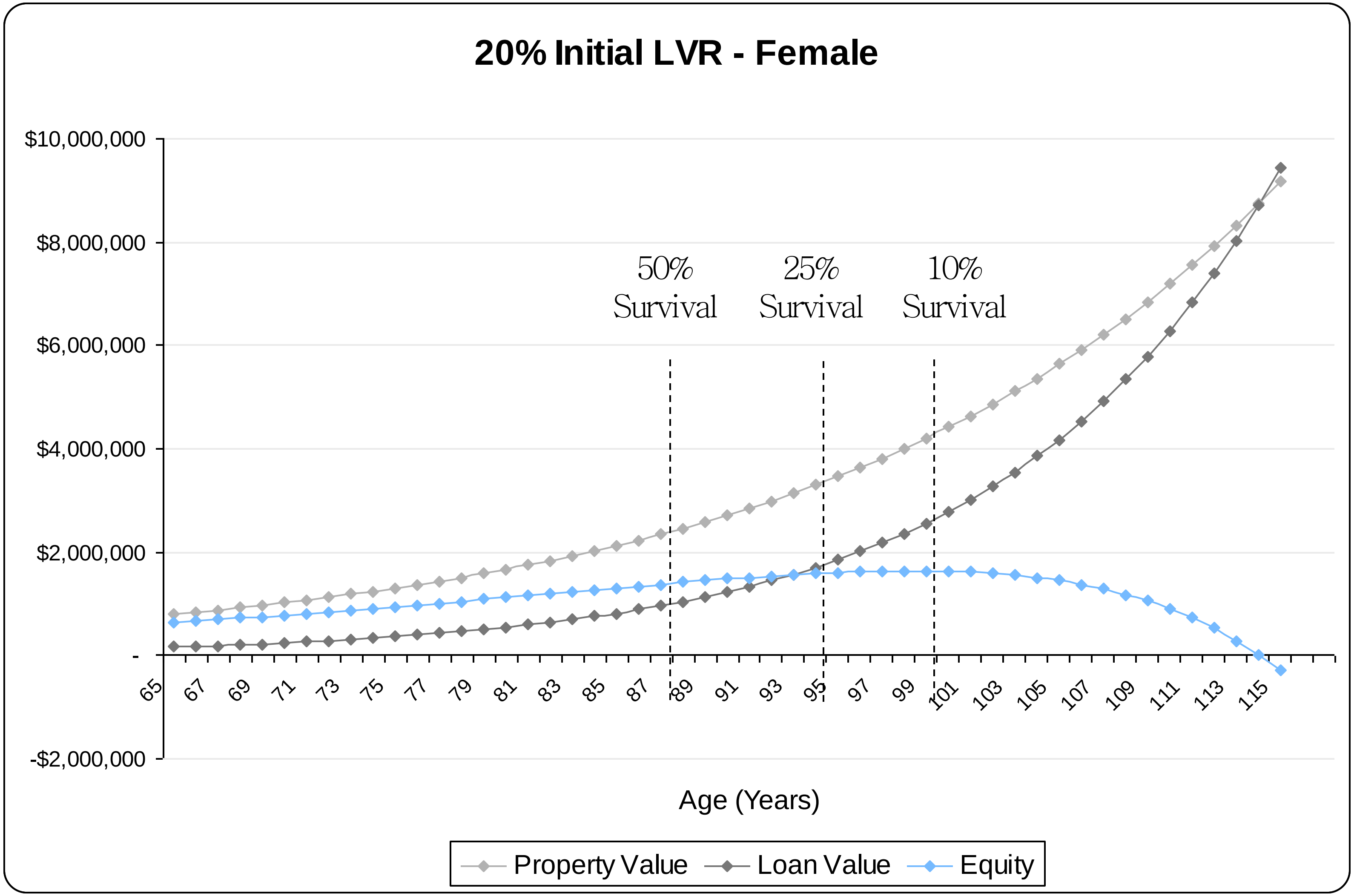

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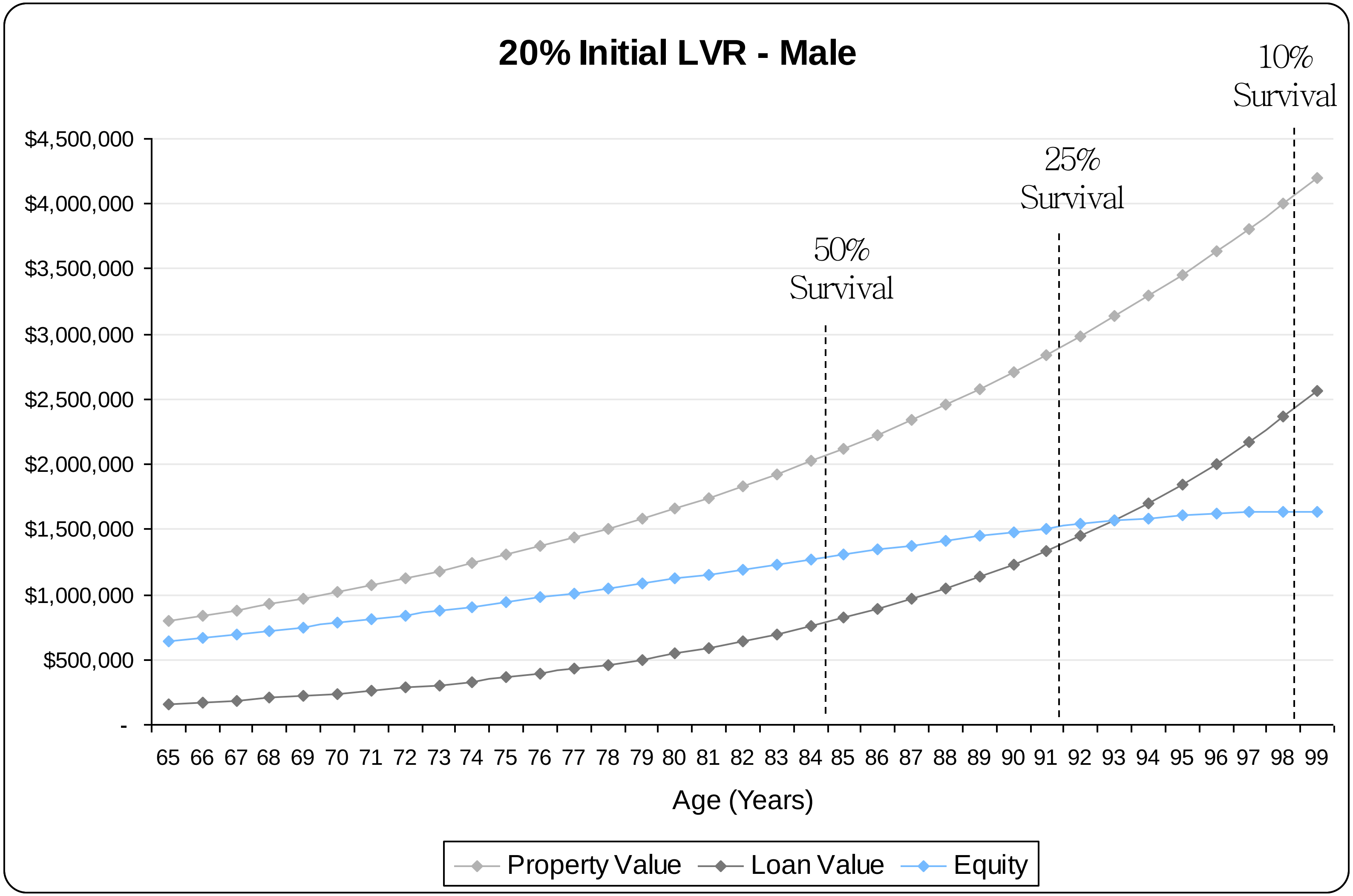

Risks for Retirees

- The greatest risk is living too long. Many pensioners live well for the first 15 years of retirement but then run out of superannuation.

- Managing their cash flow – retirees are probably unaware of the different phases of retirement and expenditure patterns

- Adapting lifestyles - retirees need to make long-term decisions about health, aged care and accommodation

- Estate planning – this is a lottery when you have no idea how much money is needed for consumption over the retirement years. Further, the treatment of death benefits when on pension is still unclear.

Opportunities for superannuation funds

- Providing de-facto banking service for pensioners
- Retaining members at retirement
- Investing in aged care facilities, retirement villages, medical research

Questions?