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Guide to Retirement Income

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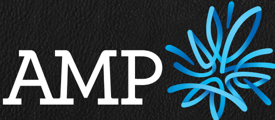

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Moving beyond uncertainty on retirement incomes

A global pandemic represents a real challenge for those giving advice around retirement incomes, but there are plenty of strategy sign posts available.

Barely six months after the Federal Treasurer, Josh Frydenberg, received the recommendations of the Retirement Income Review (RIR) and amid the continuing impacts of the COVID-19 pandemic there has rarely been a more important time for financial advisers to be delivering clear messaging around retirement incomes.

Indeed, one of the key recommendations contained in the RIR final report was the need for both education and advice around retirement incomes – how much is really enough and how retirement incomes adequacy can be achieved?

The COVID-19 pandemic has also delivered some important lessons around how those approaching retirement should position themselves for handling the unexpected – something which makes AMP Limited's advice around sequencing risk both timely and important.

As the AMP article states – the COVID-19 outbreak has delivered investors, and particularly pre-retirees, a serious wake-up call.

With the Federal Budget only a matter of weeks away, there will be many eyes on how much of the RIR recommendations will be reflected in policy as we move further into 2021 and, thereafter, an election year.

Getting the settings right has never been more important.

Mike Taylor,
Managing Editor

Advice

Advice and education are retirement income keys

Mike Taylor writes that amid the confusion about retirement income adequacy, advice is a key ingredient for people finding and accept the right settings for them.

If there has been one constant with respect to Australia's retirement income system it is that many Australians have a very poor appreciation of how much money they will need to achieve a comfortable retirement.

Successive industry surveys over the past two decades have revealed two outcomes of this ignorance around retirement incomes – fear among those aged around 50 that they will not have accumulated enough to fund a comfortable retirement or, alternatively, a naïve belief that they do have enough when they do not.

Now, the picture has been further clouded by debate around the future of the superannuation guarantee (SG) and whether the May Federal Budget will deliver on the next rise in the SG to 10% or whether it will pause the rate at the current 9.5%.

Then, too, there has been the agitation amongst members of the Government's backbench for allowing people to access superannuation for home ownership which has further clouded the issue notwithstanding the fact the RIR panel pointed to the compulsory nature of superannuation sitting alongside the Age Pension as the crucial pillars of the system.

It is this policy doubt and an associated continuing lack of appreciation of the fundamentals of adequacy which helped inform one of the key observations of the Government's Retirement Income Review (RIR) released in late 2020 which pointed to the need to improve understanding of the retirement incomes system.

"Complexity, misconceptions and low financial literacy have resulted in people not adequately planning for their retirement or making the most of their assets when in retirement," it said. "Adding to complexity is the interaction with other systems, such as the aged care and the tax systems. People need better information, guidance and good, affordable advice tailored to their needs."

"A major misunderstanding is the view that 'retirement income' involves the return from investing superannuation balances rather than drawing down those balances to fund living standards in retirement."

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Advice

Chart 1: Income poverty rates of retirees

Source: Analysis of ABS Survey of Income and Housing Confidentialised Unit Record File, 2017-18.

It was on this basis that the RIR panel argued that the Government needed to define a clear objective for the retirement income system to "guide policy, improve understanding and prove a framework for assessing performance of the system".

Integral to what the RIR panel was suggesting was the availability and affordability of good financial advice around the concept that the retirement income regime is not simply about just superannuation or the age pension, but about a combination of both together with savings and assets held outside of superannuation.

Importantly, the RIR panel's final report reflected many of the submissions put by the industry that the system is not broken and that it needs tweaks rather than major reform.

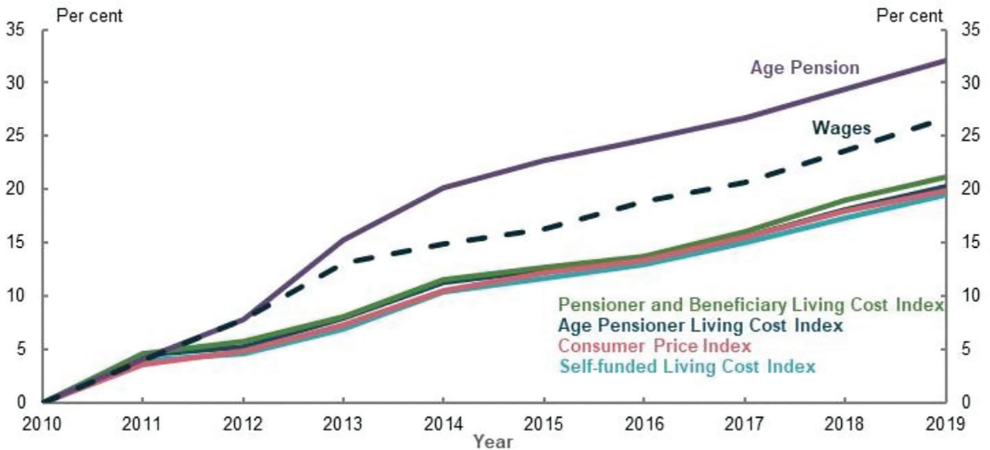
This was evidenced by the submission filed by actuarial research house, Rice Warner which pointed out that the "Australian superannuation system depends on the three pillars of the Age Pension, compulsory superannuation and voluntary superannuation".

In other words, Rice Warner was pointing to the reality of voluntary superannuation contributions alongside the SG.

It said that, as a consequence, the impact of any proposed changes would need to be considered carefully because changes in one area could impact on the others – "for example, adjusting the taper rate on the Age Pension will determine how much pension is lost from higher superannuation benefits".

Rice Warner also raised the issue of home ownership in the retirement incomes equation, but in the context of retirees not needing to pay rent and therefore holding an asset which can be used in later life to supplement income (through

Chart 2: Increase in the value of price indices, wages and the age pension since 2010



Source: Analysis of (ABS, 2020e) (ABS, 2020q), and data provided by the Treasury

home equity release) or to pay for aged care services.

The issue of aged care and how it is paid for has also become more complex as a result of the recommendations of the Aged Care Royal Commission, particularly around capital financing.

It is factors such as the Aged Care Royal Commission which prompted the RIR panel to point to the multi-dimensional nature of the system and suggest that a starting point needs to be understanding the interaction of those dimensions.

"What constitutes an 'adequate, equitable, sustainable and coherent' retirement income system needs to be clear and preferably legislated. Suggestions of the elements to be covered include:

ADEQUACY: The system should ensure a minimum standard of living for retirees with limited financial means that is consistent with prevailing community standards. The system should facilitate people to reasonably maintain their standard of living in retirement.

EQUITY: The system should target Government support to those in need. The system should provide similar outcomes for people in similar circumstances.

SUSTAINABILITY: The system should be cost-effective for taxpayers in achieving adequate retirement outcomes. The system should be sustainable and robust to demographic, economic and social change.

COHESION: The system should have effective incentives to smooth consumption and support people in taking personal responsibility for their retirement incomes. The system should interact effectively with other systems. The system should not be unnecessarily complex for consumers.

How to prepare your clients for the next market correction

Sequencing risk can have a big impact on clients entering retirement. Fortunately there are ways advisers can help.

The COVID-19 outbreak delivered a serious wake-up call to investors last year, particularly for anyone nearing retirement. And while markets look to have recovered much of the ground lost, we're still working through the longer-term impact of the global pandemic.

While we can't predict the next significant market fall, we can agree there will be one. So it's important to consider the impact it could have on your clients entering retirement and how you can structure their investments.

A significant market correction will probably mean a change of plans. Do your clients:

- delay retirement (if they can)
- look to part-time work to supplement income
- accept a more modest lifestyle in retirement
- consider downsizing to replenish their capital (if they can)
- roll the dice and take on more risk in the hope of a short-term recovery?

Time isn't on their side

For clients most exposed to this sequencing risk, it's the order of returns that's important, not the average return. A market fall simply has more impact on investors who have accumulated more wealth.

A 30-year-old who has accumulated $50,000 in superannuation and experiences a market fall of 30% would see a reduction of $15,000. And time is on their side. They have 30 plus years of contributions and market growth to recoup this loss.

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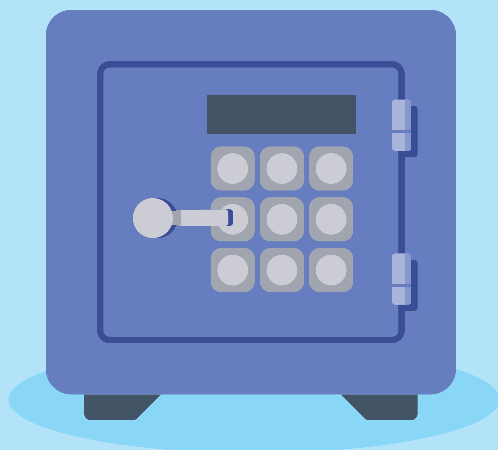

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A pre-retiree with $750,000 would see $225,000 wiped from their super. Contributions are no longer an option and as they'll soon be drawing down on their capital, they can't wait for markets to recover.

Let's say a client retires on $750,000 and needs $37,500 to live on, equating to a 5% drawdown. If there's a market fall of 30%, they would need to draw down 7.15% of their retirement savings. This means they would eat into their capital more quickly, reducing the time they have either to wait for a market rebound or take on greater risk with their remaining wealth.

Changing the conversation

In the accumulation phase we're used to advising clients to maximise risk to build their wealth. But we need to start asking clients some new questions when they're moving into retirement.

- How does their wealth provide a stable income and what level of risk will deliver this income? What are their spending habits in retirement? What does a comfortable retirement mean and could they accept a lower income?
- What's their health like and how long can they expect to live for? How long will their income need to last and will they need to make significant withdrawals in the future?
- How are they structuring their investments? What assets are supporting their short-to-medium term needs? How are they managing their risk to isolate growth assets so they have time to recover losses from any market correction? Are they maximising access to government assistance?

At what can be a challenging time in clients' lives, they need advice and advisers need retirement solutions to support that advice. By working together we can map a way through the complexity to help Australians live their best life in retirement.

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Ian Parsons
Senior Retirement Manager, AMP

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Most retirees do not underspend or bequeath super

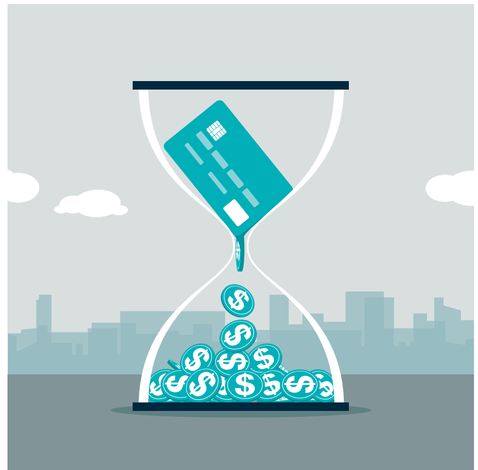
Research has found that 80% of people aged 60 who died between 2014 and 2018 had no superannuation in the period of up to four years before their death, Jassmyn Goh finds.

Most Australians use up their superannuation in retirement, contrary to claims that retirees underspend, according to the Association of Superannuation Funds of Australia (ASFA).

The association's chief executive, Martin Fahy, said the majority of Australian retirees ran out of super well before the end of their lives and there was not a systemic problem with retirees underspending or bequeathing their super.

ASFA's latest research found:

- The proportion of the population with superannuation drops sharply with increased age;
- 80% of people aged 60 and over who died in the period 2014 to 2018 had no super at all in the period of up to four years before their death;
- For those aged 80 plus, over 90% had no super in the four-year period before their death;
- For the age 80 plus group, only 5% had more than $110,000 in superannuation in the period of up to four years before their death;
- Even in the case of those who died aged 60 to 69, less than half had any super at all; and



- Men were more likely to have superannuation than women. For those who died in the period 2014 to 2018 only 15% of females aged 60 plus at death had any superannuation compared to around 25% of men.

"The main challenge for the Australian superannuation system is to deliver higher superannuation balances at retirement," Fahy said.

"The solution for ensuring adequacy of retirement incomes is moving the superannuation guarantee to 12%."

Super gender gap widens

Contrary to popular belief, the gender gap in superannuation widened 2% in 2020 from 2016 as the early release of super payments had a larger impact on women, Jassmyn Goh finds.

The superannuation gender gap widened to 18% as the early release of super scheme during the COVID-19 pandemic had a greater impact on the average woman's super balance, according to Colonial First State (CFS).

CFS' latest research said the gender gap had widened 2% from 16% in 2016, contrary to the belief that the country was inching towards closing the gender super gap.

"While more men accessed their super early during the pandemic, the impact on average super balances of women was more pronounced (21% compared to 18% for men) because of the lower starting balance for women," its *'Retirement Realities'* research said.

"The data also showed that men were approximately 20 percentage points more likely than women to sacrifice their salary into super (61% compared to 39%)."

The research also found its members aged under 30 took almost one-third of all early super release payments to total $1.5 billion. It said 41% of those members were yet to start rebuilding their super savings.

CFS general manager, Kelly Power, said: "The gender gap in the Australian superannuation system is a real issue that sees women financially disadvantaged. Coronavirus has pushed us back even further, creating greater urgency for solutions to the retirement realities challenging Australians, particularly women.

"The super industry and the government must unite to create a system that closes the gender gap for good. Specific measures such as mandating super contributions on paid parental leave and removing the $450 per month threshold for superannuation to be paid will improve the retirement savings adequacy for low-income earners and casual workers, many of whom are women."

The research also found that women between the age of 50 to 64 years who sought financial advice made a 199% higher average voluntary contribution in 2020 than women who did not seek advice. Advised males were 85% ahead of the non-advised.

"It's encouraging to see that female members recognise the importance of super as they approach retirement. With help from their adviser, they can contribute extra to their super from any spare cash, including any inheritance or dividend payments, or sale of property," Power said.

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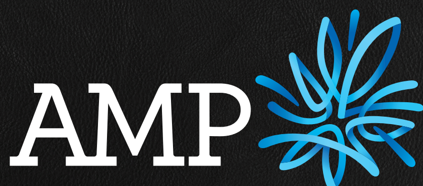

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