



Investing for different phases of retirement

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What are the phases?

- Accumulation (pre-retirement)
- Transition to Retirement
- Active years
- Sedentary years
- Frail years



Accumulation

- The goal is to maximise the benefit at the point of retirement
- Investments need to be heavily skewed towards growth assets
- Franking credits make Australian equities particularly attractive



Transition to Retirement

- Should commence late in career
- Shift to part-time work – is it available?
 - From age 60 if white collar
 - From age 50 if blue collar
- Live off lower earnings until full retirement



Investing while transitioning

- When will work cease permanently?
- What are the capital needs at the point of retirement?
- Gradually shift prospective lump sum benefit into cash
- Live off lower employment earnings until full retirement



Characteristics of retirement

- Salaries cease so superannuation contributions stop too
- Tax is lower above age 60
- Social security becomes available from age 65 (or 67 or 70)
- Minimum pension withdrawals must be made each year
- The member takes on all risks including liquidity, inflation and longevity
- Investment strategies are extremely flexible in account-based pensions
- Lifetime annuities and other products provide protection but these guarantees come at a cost



Needs of the newly-retired

- Four buckets used for different purposes:
 - Lump sum for immediate expenditure
 - Liquidity Pool for pension payments over the next few years
 - Nest Egg for emergencies
 - Growth Pool for later years in retirement
- Retirees need to find products to place these funds. Clearly, a single investment strategy cannot cater for all these requirements
- Asset pools must be separated and matched to liabilities



Allocation of retirement benefit

Account balance	Lump sum	Liquidity	Nest egg	Growth
<100,000	ALL	-	-	-
100,000 to 200,000	75,000	25,000	50,000	-
200,000 to 400,000	75,000	45,000	50,000	130,000
400,000 to 600,000	75,000	75,000	50,000	300,000
600,000 to 1m	100,000	120,000	80,000	500,000
1m to 2m	150,000	150,000	100,000	1,100,000
>2m	150,000	150,000	200,000	1,500,000



Low retirement benefits

Account balance	Lump sum	Liquidity	Nest egg	Growth
<100,000	ALL	-	-	-
100,000 to 200,000	75,000	25,000	50,000	-
200,000 to 400,000	75,000	45,000	50,000	130,000
400,000 to 600,000	75,000	75,000	50,000	300,000
600,000 to 1m	100,000	120,000	80,000	500,000
1m to 2m	150,000	150,000	100,000	1,100,000
>2m	150,000	150,000	200,000	1,500,000



Wealthy retirees

Account balance	Lump sum	Liquidity	Nest egg	Growth
<100,000	ALL	-	-	-
100,000 to 200,000	75,000	25,000	50,000	-
200,000 to 400,000	75,000	45,000	50,000	130,000
400,000 to 600,000	75,000	75,000	50,000	300,000
600,000 to 1m	100,000	120,000	80,000	500,000
1m to 2m	150,000	150,000	100,000	1,100,000
>2m	150,000	150,000	200,000	1,500,000



Middle-income Australians

Account balance	Lump sum	Liquidity	Nest egg	Growth
<100,000	ALL	-	-	-
100,000 to 200,000	75,000	25,000	50,000	-
200,000 to 400,000	75,000	45,000	50,000	130,000
400,000 to 600,000	75,000	75,000	50,000	300,000
600,000 to 1m	100,000	120,000	80,000	500,000
1m to 2m	150,000	150,000	100,000	1,100,000
>2m	150,000	150,000	200,000	1,500,000



Adequacy of Age Pension

	Modest lifestyle - single	Modest lifestyle - couple	Comfortable lifestyle - single	Comfortable lifestyle - couple
ASFA value	\$23,175	\$33,358	\$42,158	\$57,665
Age Pension	\$21,912	\$33,036	\$21,912	\$33,036
Difference	\$1,262	\$322	\$20,245	\$24,629

[illegible]



Age Pension Benefit Impact of Income Test

Category	Assets	\$0	\$100,000	\$200,000	\$300,000	\$400,000	\$500,000	\$750,000
	Income	\$0	\$6,000	\$12,000	\$18,000	\$24,000	\$30,000	\$45,000
Home owner	Individual	\$21,913	\$20,941	\$17,941	\$14,941	\$11,941	\$8,941	\$336
	Couple	\$33,036	\$33,036	\$30,624	\$27,624	\$24,624	\$21,624	\$14,124
Non home owner	Individual	\$21,913	\$20,941	\$17,941	\$14,941	\$11,941	\$8,941	\$1,441
	Couple	\$33,036	\$33,036	\$30,624	\$27,624	\$24,624	\$21,624	\$14,124



Three Distinct 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 net savers • Housing upgrade or renovation	• 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 dependency on health and aged care expenditure • Retirement village or nursing home



Active years of retirement

- These currently lie within the range 55 to 75
- They will (gradually) start at ages 67/70 and might extend to 75/80
- Many retirees have little superannuation so spend all their benefit during this period
- Can we substitute part-time work during this period?



Income Needs in Active Years

- Replacement of white goods and car – and an expensive holiday
- Expenditure in Active Phase <75% of retirement salary
- Costs associated with working have ceased
- Mortgage has been paid off
- Some discretionary spending on children



Sedentary years

- From age 75/80 when the mind and body begin to slow down significantly
- Reduction in expenditure
- Down-sizing home makes sense – but not economically
- **Lifetime annuities make sense from the start of the sedentary period**



Frail years

- From about 85 when mind and body have declined significantly
- Retirees should not be making active investment decisions at this age



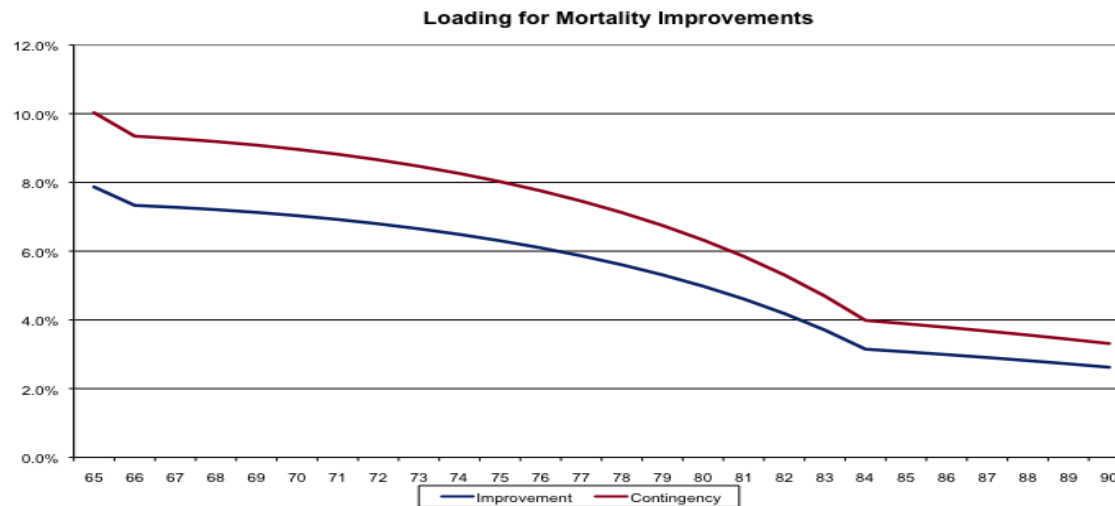
Investing the Growth Component

Asset Class	Expected GROSS 10 year return	Value add from franking credits	Total Return
No guarantees			
Australian shares	8.5%	1.7%	10.2%
Balanced Fund	6.5%	0.5%	7.0%
Guarantees			
Life Annuity	4.5%	-	4.5%
Cash	3.5%	-	3.5%



Pricing for Longevity – an example

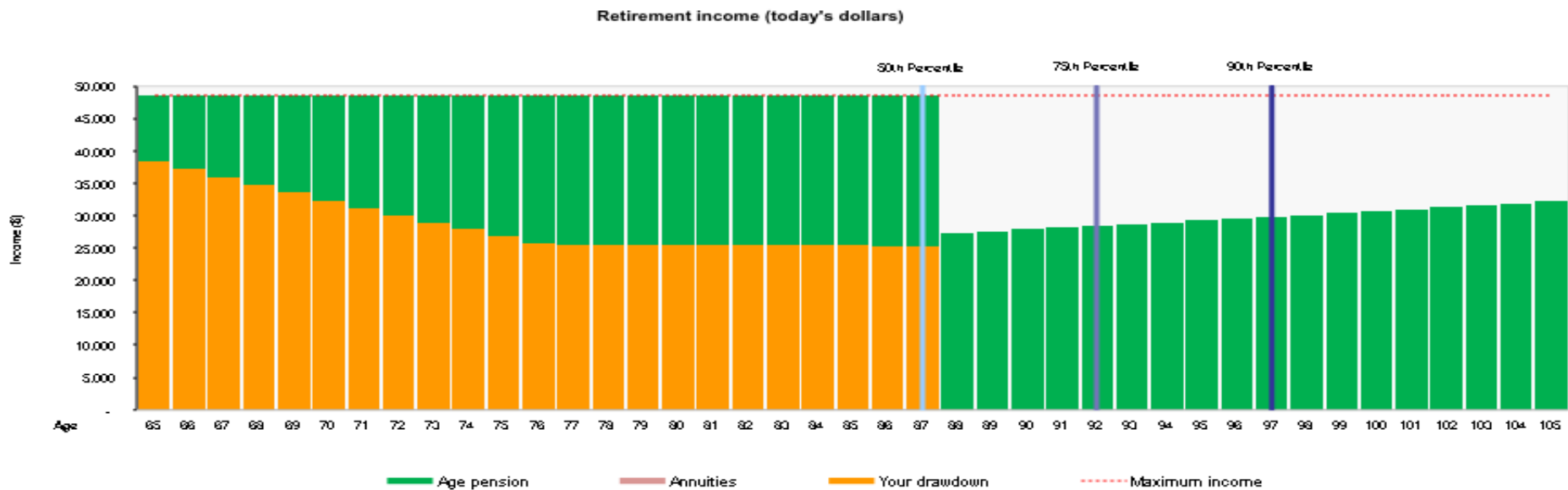
- Current realities make annuities problematic at accepted retirement ages (60 – 65)
- Higher allowance for mortality improvements



- Greater interest rate and reinvestment risks because of long life expectancies
- Selling annuities to 65 year olds today like selling them to 45 year olds in the 1970's

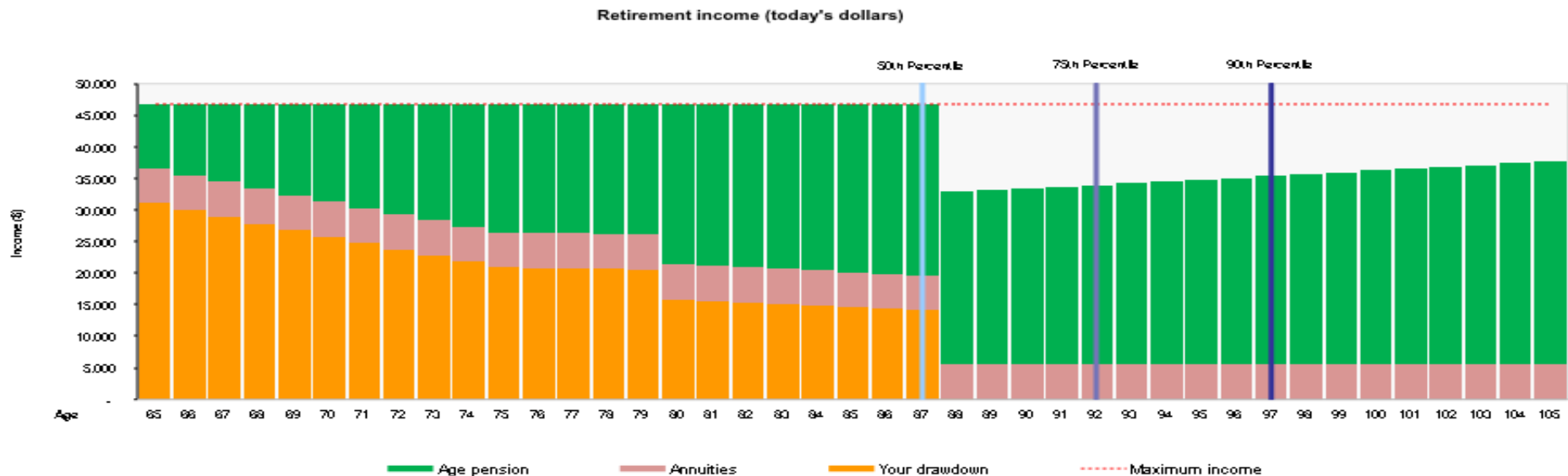


ABP to life expectancy





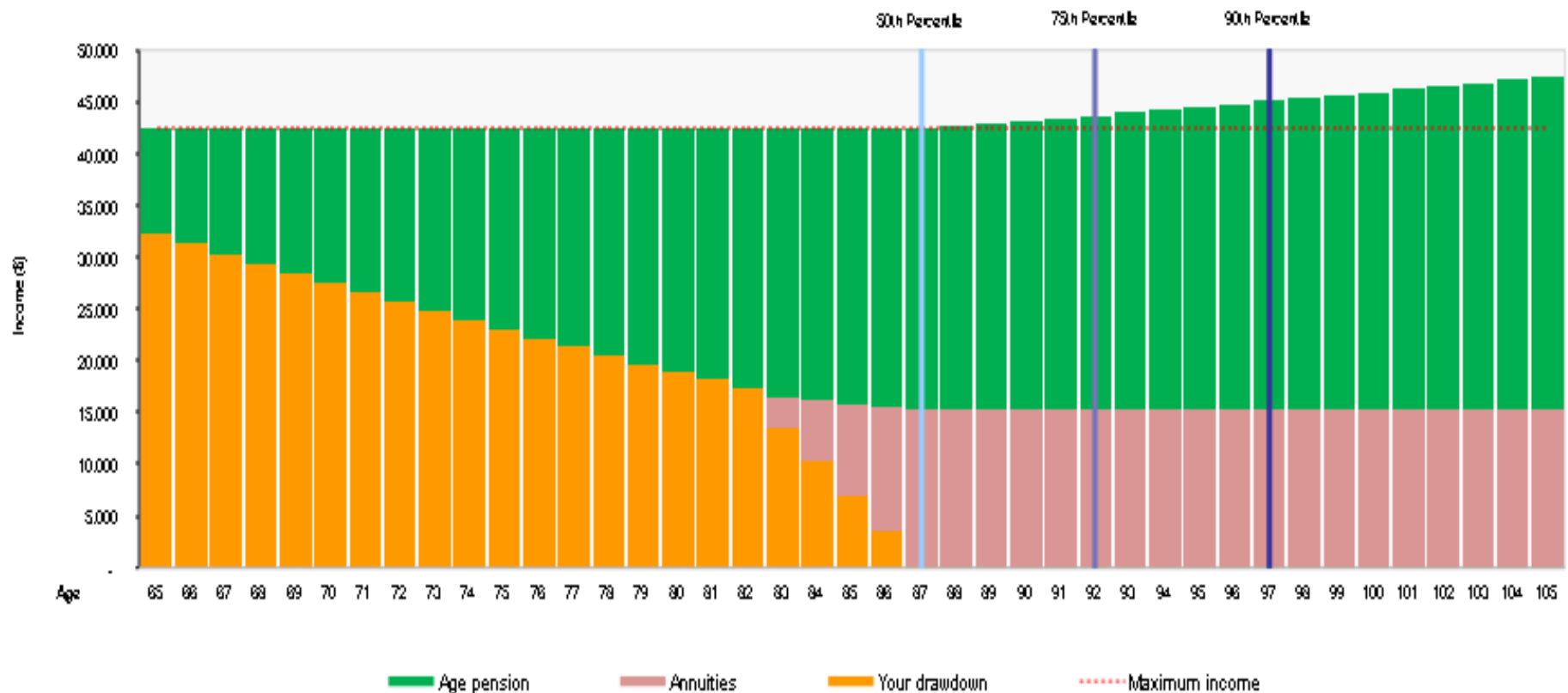
ABP to life expectancy (but 25% of capital to indexed annuity with capital return)





ABP to life expectancy – hold 25% of capital to buy lifetime annuity later in life

Retirement income (today's dollars)





Summary

- Super Funds do not assist members well with their retirement plans
- Members should put money in different buckets rather than have one strategy
- A default retirement product could be developed – but it would need to use several buckets not one strategy
- Funds would need to segment members as those with small or high balances would not be suited for this