generation life

Navigating retirement with confidence

The evolving retirement income landscape

For financial adviser use only

A word from our CEO

For millions of Australians, superannuation sets people up for a good life in retirement.

But there's another side to the superannuation story. Those who watch their retirement spending because they really need to, because they're constantly threading together a knot of worries – can they live the lifestyle they want, can they pass money onto their children – will they run out of money?

The Government's recent Retirement Income Review (2019 - 2020), which we quote extensively in this publication, echoes those concerns. As an industry, we've done a great job of helping people save for retirement – but we have a lot of work to do to help retirees spend their savings well – to help them enjoy the present and not spend their time worrying about their future.

The good news is that the momentum is beginning to turn on this issue. Government policy is now focused on fostering more innovative retirement income products.

At Generation Life we're working on this challenge with financial advisers all the time. What kind of information, services and products do your clients need to navigate retirement with smiles on their faces, rather than worry in their minds. Our view is that the solution is one that is powered by markets, tuned to client needs and calibrated by financial advisers. You can read more about it in this publication.

There's still a lot of work to do to get the retirement income challenge right. But if we can deliver the right solutions, the people who benefit are our parents, our children and ourselves – there's a lot of people whose life will be better if we crack this retirement income problem in the same way we've cracked the savings problem.

I hope you enjoy the publication and that it starts some conversations that make a real difference to the lives of those who've worked so hard for so many years.

Please get in touch if there's anything the team at Generation Life can do to help.

Grant Hackett OAM
CEO, Generation Life
March, 2022

Throughout this publication we refer to the Retirement Income Review which was conducted between 2019 and 2020, with the final report and findings issued on 20 November 2020. The review covers the state of the retirement income system and how it will perform in the future as Australians live longer and the population ages. Source: The Australian Government the Treasury, https://treasury.gov.au/publication/p2020-100554

How to spend in retirement

Australia excels at a lot of things and one of these things is our ability to save for our retirement.

According to the Government's Retirement Income Review (RIR), in mid-2019 we had around $2.9 trillion in our superannuation accounts (RIR page 117) – that's roughly one and half times the value of our annual gross domestic product ('GDP'). By 2038 we're projected to collectively have well over 10 trillion in our national retirement savings funds.[1]

Thanks to industrious citizens, government policy, a resilient economy and good share market returns we have met the challenge of saving for the future.

On the other hand, we're not so good at managing how we spend that money - how we help our citizens enjoy their retirement. As the Retirement Income Review puts it: "the system focuses on the accumulation of savings for retirement, but insufficient attention is given to how people can best use their savings to support their living standards in retirement." (RIR page 54).

Regret risk

Over the past 20 years financial advisers have introduced their clients to new and useful jargon:

- **Investment risk:** The effect investment volatility can have on their capital and level of income
- **Longevity risk:** The risk clients will outlive their savings
- **Inflation risk:** The risk that inflation will increase the cost of living and the client's retirement income does not keep pace with inflation.

There's also a different challenge facing many retirees today that is less well understood. There is a high risk that many will live an unnecessarily constrained retirement due to anxiety about how to spend their retirement savings. As Deloitte's Dynamics of the Australian Superannuation System report says, "Retiring members will need more guidance and/or advice to help them manage drawing down their retirement savings over time. They will need to manage the conflicting elements of not drawing down too quickly and risk outliving their savings due to increasing longevity, and at the same time not drawing down too slowly so a significant proportion of their superannuation remains when they do eventually pass away and so have lived more frugally than was necessary."[2] This living 'more frugally' is called **regret risk**, as retirees feel a sense of regret in their later years from being overly frugal or conservative.

This regret risk is very real. It falls to financial advisers not just to help fund the retirement of their clients but to ensure that retirement is enjoyable and fulfilling. They should aim to reduce the risk that their clients will pass away thinking – "I regret not spending more when I first retired. I could have enjoyed my retirement more than I did."

The skimp

So why are so many retirees consciously or subconsciously skimping on purchases and experiences that would make retirement more pleasurable? Interestingly, when it comes to retirement saving a whole array of forces are deployed to help them:

- Government policy mandates or supports accumulation for retirement via compulsory superannuation and tax policy
- Employers are part of the system – capturing (and sometimes augmenting) Super Guarantee ('SG') contributions but also working with superannuation funds to boost saving via education and information in the workplace
- The Australian superannuation sector is sophisticated, competitive, and multi-layered – and every layer wants people to save more into superannuation.

Conversely, there is little 'institutional' support for a smart or well-planned spending regime to date. Without this kind of institutional support many Australians arrive at retirement with significant capital but no ability to manage that capital effectively. They're in a constant battle with themselves about how long they'll live, how much money they'll need to fund their lifestyle over that time and so how much they can afford to spend today.

Their reward for 40 years of saving is not less financial uncertainty. It's more.

Holding on too tight

In some recent research conducted for Generation Life by CoreData, one Adelaide-based financial adviser highlighted the psychological tensions of managing retirement spending. "The global financial crisis ('GFC') taught me that even high net worth clients worry about running out of money. There are a lot of misconceptions out there about how much you need – and how long it'll last too."[3]

As the adviser suggests, one key area of uncertainty is life expectancy. There are others. According to the Retirement Income Review, many Australians over-estimate the money they'll need in late retirement to fund medical costs (RIR page 444, 489-490).

Financial commentators have long talked about U-shaped retirement spending patterns (high in early years, then dipping, then rising again due to health costs).

The Retirement Income Review suggests this is close to a myth. "… while health spending increases as a proportion of overall expenditure for people between ages 55-80, it remains a relatively small share of total expenses in retirement. This is largely due to public expenditure on health absorbing much of the cost of ageing. The same applies for the cost of aged care services." (RIR page 26).

Analysis paralysis

Many retirees hold on too tight to their retirement savings because of complexity. Peter Rowe, General Manager of Optimum Pensions, argues, "In later life, we're asking retiree clients to navigate too many course changes. They face a once-in-a-lifetime employment upheaval, then a segue into managing the interaction of the super, tax, social security, and aged care systems. All that uncertainty leads to excess caution in their spending."

To help Australians make better decisions about their retirement spending we need more education and better retirement income options. We can start by acknowledging that retirement income planning is not just difficult for ordinary Australians – it's difficult for experts as well.

The decumulation dilemma

It shouldn't surprise us that the average Australian retiree has trouble optimally managing their retirement income. In an award-winning paper on the Decumulation Paradox[4], the three authors observe… "behavioral biases and predispositions prevent individuals from making optimal spending decisions in retirement".

'Loss aversion' is a concept that explains why we feel losses more acutely than gains. The paper suggests retirees feel this even more acutely – they're hyper-loss-averse. They're also prone to the Endowment Effect. That's an emotional attachment to something they own – such as retirement capital – that prevents them from exchanging it for some other value, like regular income – even if that exchange is more rewarding.

It's no wonder that Nobel Prize winner Bill Sharpe called decumulation "the hardest, nastiest problem in finance,"[5] arguing it's much more difficult than the contribution and investment decisions made during asset accumulation. Decumulation requires asset allocation decisions and decisions on how much to withdraw from your capital given deep uncertainty about how long you'll live. These decisions will be different because each retiree has their own set of objectives and attitudes to risk.

The Retirement Income Review (RIR pages 18, 23, 36) highlights the real-life results of this uncertainty. Many people:

- Only draw down the Government mandated minimum from their account based pension
- Feel they can only afford to draw the income from their retirement capital, rather than seeing the underlying capital as money they can spend
- Invest to protect, rather than grow their capital

As a result, the Retirement Income Review argues, most retirees die with the bulk of their wealth intact (RIR page 36) – but with crimped lifestyles. Retirees are saving their retirement savings, not spending them.

Left behind

David Orford, an actuary, and Managing Director of Optimum Pensions, also suggests that many of the assumptions about retirement planning are based on people who reach retirement with their accumulation plan intact. That's not always the case.

"There will always be a cohort of people who retire with less capital than they expected," he says. "That's not just people who have made poor investment decisions or been affected by a market crisis. It is those whose assets have been depleted by complex family issues or unexpected health or employment issues. These people are at a much higher risk of being forced into a sub-optimal retirement lifestyle and a series of major financial decisions they're just not equipped to handle."

Using your assets

In what is good news for retirees and those soon to retire, the Government's Retirement Income Review is clear on what is needed to address the decumulation dilemma.

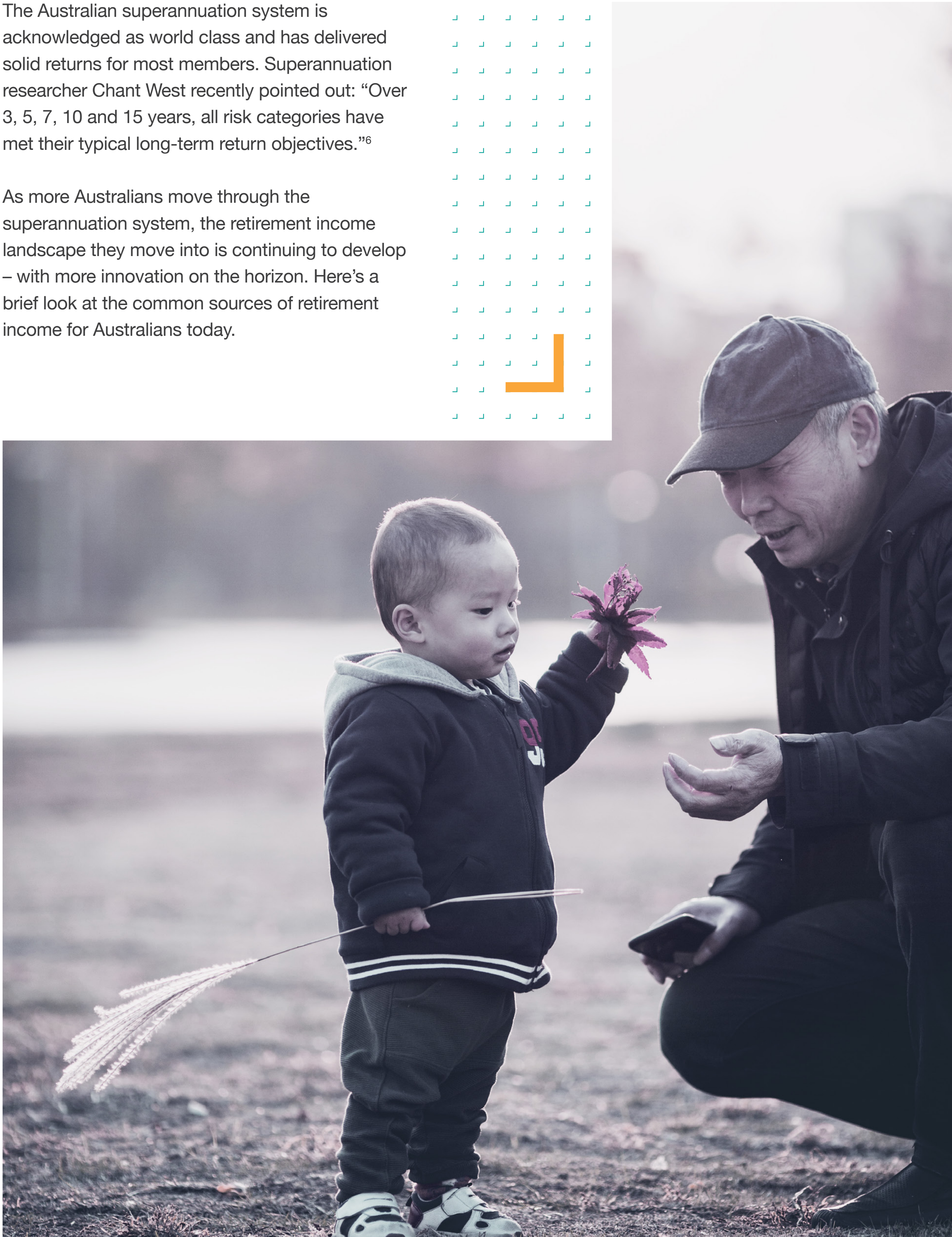
"A range of measures could help people have the confidence to use their assets more effectively, including focusing retirement planning on income streams rather than balances, more tailored and more accessible advice and guidance, and advancing the concept of the Retirement Income Covenant May 2018, so funds guide members into effective retirement strategies." (RIR page 19).

In later parts of this publication, we'll look at some of those strategies. But first, let's canvass the current environment.

The retirement income landscape

The Australian superannuation system is acknowledged as world class and has delivered solid returns for most members. Superannuation researcher Chant West recently pointed out: "Over 3, 5, 7, 10 and 15 years, all risk categories have met their typical long-term return objectives."[6]

As more Australians move through the superannuation system, the retirement income landscape they move into is continuing to develop – with more innovation on the horizon. Here's a brief look at the common sources of retirement income for Australians today.



Retirement income sources

	Upsides...	Consider this...
Age Pension	• Regular income - if eligible • Excellent counterweight to more volatile income sources like investment-linked account-based pensions or lifetime annuities • Even a part-pension brings valuable additional benefits (i.e. reductions in local council rate fees, a reduction in vehicle registration costs, access to the pharmaceutical benefits scheme and other concessions.)	• Must meet both assets and income tests to qualify • Pension amount is adequate – but not generous • Real value can be eroded by inflation • Income is taxable – even after age 60 • There is the possibility that the Government may change eligibility and income criteria as the ageing population continues to grow
Account-based pension ('ABP')	• Wide choice of investment options • Access to capital • Government-mandated minimum income payment • Earnings are tax-free within the account • There is no tax on income paid from an ABP after age 60 • Balance of portfolio can be passed on via the estate	• Financial advisers need to carefully manage capital withdrawal and income levels to ensure clients don't outlive their money or pass away with large unplanned legacies • Assessable under the income and assets tests – access to Age Pension impacted by market movements and/or depletion of funds • Investment decisions need to balance volatility (risk of losing money) with required income (investing so conservatively that the ability to generate adequate income is reduced) • Investment decisions also need to consider drawdown rates and rebalancing portfolios in different market conditions • The Government's transfer balance cap limits the amount that can be transferred into an ABP
Traditional fixed income lifetime annuities	• Earnings are tax-free within the lifetime annuity • There is no tax on money paid from a lifetime annuity if clients are over age 60 and the lifetime annuity was set up with superannuation money. In all other cases there may be tax concessions on your regular payments • Regular income, at specific levels (indexed to CPI or flat), guaranteed for life • Social security treatment may make Age Pension more accessible • If nominated, a spouse (reversionary) beneficiary receives an income on the primary member's passing	• The Government's transfer balance cap limits the amount of superannuation money that can be transferred into a tax-free retirement income stream like a lifetime annuity • Guaranteed fixed income strategy means returns, and therefore income, can be low – especially in a low interest rate environment • Income payment is fixed • Access to capital, but with penalties • A Death Benefit may be payable depending on the annuity's design
Equity release products (reverse mortgages)	• Gives asset rich, cash poor retirees access to a regular income or a lump sum payment • Retiree can stay in their home • Regulation means retirees can't get into negative equity (owe more than house value) • Government Pension Loan Scheme is a safe (if limited) version of equity release	• Income can affect eligibility for Age Pension • Can affect the ability to pass housing related wealth onto family

It's time to take another look at lifetime annuities

Australians love the Age Pension, but the take up of private pensions – lifetime annuities – is limited. This defies the experience in some other jurisdictions (lifetime annuities are heavily used in countries like Chile and Switzerland) and the views of retirement income specialists around the globe.

Wade Pfau is the author of Safety-First Retirement Planning and professor of retirement income at the American College of Financial Services. In his view, "The lifetime annuity puzzle is just that — if you're trying to fund your retirement, the lifetime annuity is a very efficient way to do that. People love social security, and they love pensions, but now that they might have to build their own pension with a lifetime annuity, they seem to not want to do that as much as academics think they should."[7]

Let's discuss why lifetime annuities should form a big part of the discussion between financial advisers and clients working on a retirement income strategy.

Inbuilt discipline

Residential property and superannuation are the largest components of most Australians' household wealth (RIR page 76). Forced saving is a core element of their success. Yet in retirement, Australians manage 'dis-saving' all by themselves.

Lifetime annuities provide a form of financial discipline – helping retirees spend in a disciplined and realistic fashion – and reducing financial anxiety in the process. Martin Neil Baily and Benjamin H. Harris of the Brookings Institute put it this way: the alternative to a lifetime annuity is to "hoard the money and keep it in case you live into your late 90s… The problem with that is all the foregone spending that would make you happy in retirement. Hoarding your money and hoping you don't live too long is a terrible way to retire."[8]

It's all about discipline. Superannuation funds are experts at aggregating investments and leveraging tax advantages, compulsory contributions and 'time in market' to benefit members. Similarly, lifetime annuities provide a disciplined structure that helps retirees optimise returns, lock-in income and manage longevity.

Putting capital to use

As has been recently recognised in the Retirement Income Review, many retirees will find it difficult to fund a long and enjoyable retirement if they draw only on investment income. Lifetime annuities help break down the artificial distinction between capital and income that bedevils the retirement income strategy of many Australians. Annuitisation converts both principal and returns into a periodic stream of payments – and does it efficiently.

Social security treatment

The Retirement Income Review pointed out the crucial role the Age Pension plays in the lives of many retirees (RIR page 18). It also noted the value of the additional benefits – "Retirees receive health, aged care and other government services worth more than the maximum rate of the single Age Pension." (RIR page 18). Just as importantly, government pensions provide an excellent offset to more volatile investment-linked income sources and a backstop for longevity risk.

For all these reasons – and because many retirees feel they are owed a pension after decades of paying tax – access to the Age Pension is important to many retirees. Fortunately, policymakers looking to increase the use of income streams have granted lifetime annuities concessional treatment within the social security system.

It's better in the pool

Perhaps the most important benefit of lifetime annuities is what actuaries call pooling. Without pooling, any individual seeking to self-insure their potential longevity needs to budget for living a very long time. However, if they 'pool' their longevity uncertainty with others they need only pay for average longevity. To put it another way, we experience mortality individually but lifetime annuities price it collectively.

The Organisation for Economic Co-operation and Development ('OECD') recently emphasised the importance of pooling when managing the global retirement income challenge. "The ability for a collective retirement income arrangement to pool risks and smooth funding shocks over time can significantly mitigate the risks that individuals would otherwise bear on their own. This increases the certainty that they will be able to receive a reasonable level of retirement income for life. The mitigation of the risk at the individual level allows higher retirement incomes to be paid…"[9]

This crucial concept underpins the value of lifetime annuities for retiring Australians. Lifetime annuities cost-effectively insure retirees against running out of money – to ensure their retirement income the same way they insure their car.

The asset allocation imperative

Longer life expectancies are changing the ways retirees and their financial advisers think about asset allocation across both superannuation and retirement income portfolios. The need to fund longer life spans (RIR page 25) makes growth-oriented portfolios more appropriate, but for many older Australians taking on higher investment risk in later life feels counter-intuitive.

Putting lifetime annuities into a retirement income portfolio can help alleviate this concern. Properly structured investment-linked lifetime annuities create an income base that meets the profile of specific costs by rising and falling in line with market conditions. By linking the overall retirement profile to a client's spending habits and retirement expectations, advisers are free to create a client portfolio with a risk level that matches their expected income requirements across the whole of their retirement income portfolio including their account-based pension and Age Pension entitlement.

Investing in lifetime annuities also removes the temptation clients may have to over-react to market falls by moving capital into asset classes that offer a sub-optimal risk/ return trade-off – such as cash. A lifetime annuity provides comfort with income adjusted in line with portfolio returns, while being guaranteed to provide a level of income throughout the investor's lifetime. This can be important during high anxiety periods such as market corrections and elevated market volatility, and a client is not left to focus on a fluctuating account balance. To understand how serious an issue this can be, consider the cost in capital and potential performance suffered by those who withdrew their superannuation early during the COVID-19 pandemic. According to the McKell Institute, early withdrawers gave up a collective $4.7 billion in retirement savings.[10]

History suggests that if retirees can be convinced to invest in lifetime annuities that capture market-based returns, the long-term rewards outweigh short-term volatility. According to Chant West, growth superannuation fund returns since 1992 average over 8% per annum.[11]

The missing link – investment-linked lifetime annuities

The Australian lifetime annuity market has traditionally been dominated by fixed income, or 'term' lifetime annuities. On one level this occurred because legislation favoured the development and distribution of these products. These lifetime annuities also offered clients the valuable financial and psychological benefits of a life-long, guaranteed income. Additionally, these traditional lifetime annuities that enjoyed concessional social security treatment and tax-free status had to guarantee both an income for life and the level of income. This type of lifetime annuity is expensive to manufacture and constrains investment outcomes, particularly in a sustained low interest rate environment.

As more Australians move into the retirement income system, the need for a wider range of lifetime choices becomes more pressing.

Money, that's what I want

A long-lasting, low-rate environment has reduced the attractiveness of fixed income lifetime annuities. Since 2001, the yield on 10-year Australian Government Bonds has fallen from over 6% to around 2%.[12] Traditional fixed income lifetime annuities are predominantly exposed to cash and fixed interest securities so therefore are linked to interest rates. Those that invest in fixed income securities have struggled to deliver attractive returns – and to pay attractive levels of income. One retiree-focused adviser from the Gold Coast canvassed in our CoreData research summed it up: "When interest rates go back to 7%, then I'll buy them."

Similarly, the requirement to guarantee the quantum of regular income – and the product issuer's cost associated with insurance contracts and liability-matching strategies that underpin that guarantee – are significant and place further pressure on returns. This is a point raised by the Organisation for Economic Co-operation and Development ('OECD') in its recent Pensions Outlook[13] paper – there is a tension between higher retirement income and guaranteed retirement incomes.

Fortunately for Australian retirees, the legislative reform around Innovative Superannuation Income Streams put in place in 2017 now offers retirees more choice in how they annuitise part of their retirement income. That option (one familiar to many retirees overseas) is the investment-linked lifetime annuity.

Regular income – not fixed income

The key element of an investment-linked lifetime annuity is that it moves from providing a guaranteed level of income to providing a guaranteed but variable income.

The most important element of this change is the potential for higher overall returns and therefore higher income payments to the client during the life of the lifetime annuity. You can read more about this on page 19.

Under these return assumptions, the investment-linked lifetime annuity could deliver a lot more income over the term of the lifetime annuity – albeit at the cost of more variability in income payments. For some retirees, that additional income could be the missing link when it comes to upgrading their retirement lifestyle and combating regret risk. Also, an income stream that grows over the medium to long term can combat the impact of inflation on their spending power.

Obviously, the accompanying income variability is something that needs to be explained, managed, and budgeted for, by financial advisers when they work with clients on an overall strategy.

More income now with smaller increases later

The Retirement Income Review told us that retirees' spending doesn't increase in real terms through their retirement; "The rate of growth of spending in retirement will influence whether a retiree's income is adequate for all their retirement years. The evidence points to retirees' needs growing in line with prices." (RIR page 35). Further, research conducted by the Grattan Institute in 2019 suggests spending tends to slow at around the age of 70, and decrease rapidly after 80.[14]

By enabling an investor to receive more income in the earlier years of retirement, they are able to more closely align the income generated with their spending over their retirement journey.

What if an annuity could provide more income now, when your client is more active and wants to spend it, with more moderate increases over time?

Generation Life has stepped up to this challenge with a new and innovative lifetime annuity, known as LifeIncome. LifeIncome is designed to optimise your client's retirement income and complement other retirement solutions such as an account-based pension. A key feature of LifeIncome is LifeBooster, which enables your client to receive more income in the earlier years of their retirement. Your client receives more money upfront, which is accounted for by more modest growth in income over time.

Your clients can choose between two LifeBooster rates, enabling them to optimise their starting income while aligning to their longer-term retirement goals and objectives.

...spending tends to slow at around the age of 70, and decrease rapidly after 80.

What we know about the spending habits of retirees

- Spending is highest in the earlier years of retirement, when a retiree is healthier and more active. Many retirees may have a 'bucket' list of purchases and experiences that they have been looking forward to 'ticking off' in retirement.
- What retirees spend their money on changes as they get older.
- Retirees generally over-estimate their future health costs.

Age Pension treatment

To incentivise innovative income stream products, government policy has been adjusted to give investment-linked lifetime annuities the same concessional social security treatment afforded to fixed income lifetime annuities. This creates an opportunity for advisers to integrate income generated from a lifetime annuity and the Age Pension into a retiree's overall strategy.

Sequencing risk and investment-linked lifetime annuities

Interestingly, investment-linked lifetime annuities, which may have significant allocations to growth assets, can be a more effective way for retirees and their advisers to manage sequencing risk but also maximise the growth required in their income streams. Outside a lifetime annuity, protecting against this risk means:

- forgoing higher long-term returns through a conservative asset allocation
- bucketing strategy (using a cash bucket to fund income payments) and a growth bucket to grow capital, or
- using expensive insurance strategies.

By purchasing an investment-linked lifetime annuity, retirees can avoid the worry they have with an account-based pension; that a market correction is going to erode their capital base or that their overly conservative portfolio limits their ability to grow or maintain their income over time. With an investment-linked annuity, investors can remain fully invested in an appropriately risked portfolio and not worry.

When things change

Given ever-higher life expectancies[15], Australians can expect a retirement that spans multiple investment cycles. An investment-linked lifetime annuity helps to manage these cycles. The sustainability of, and the potential of, long-term growth in income helps a retiree deal with significant changes in their circumstances: desire to help family, the passing away of a partner, birth of grandchildren, pursuing travel and other plans, a change in health or living arrangements.

Investment-linked lifetime annuities help retirees manage these market changes because the asset allocation underpinning the lifetime annuity can be changed. Through regular consultation with their financial adviser retirees can fine-tune their lifetime annuity investment strategy at any time to better meet their needs.

The table on page 14 provides a snapshot view of the key features of an investment-linked lifetime annuity (see page 8 for a similar review of other options).

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	Upsides...	**Consider this…**
Investment-linked lifetime annuities	• Broader diversification of investments • Earnings are tax-free within the lifetime annuity • There is no tax on money paid from a lifetime annuity purchased with superannuation money after age 60. In all other cases there may be tax concessions on your regular payments • Investment-linked structure allows for higher – and growing – income due to higher potential returns than the fixed income alternative • An income is guaranteed for life • Social security treatment may make the Age Pension more accessible • If a spouse (reversionary) beneficiary is nominated, they receive the income on the death of the primary owner • Where investment choice is offered, clients can react to different market conditions	• The Government's transfer balance cap limits the amount of superannuation money that can be transferred into a tax-free retirement income stream like a lifetime annuity • Investment-linked structure means an income is guaranteed – but the level of income will vary from year to year • No access to capital after the cooling-off period (in the case of Generation Life LifeIncome, a statuatory 14-day cooling-off period and a 6-month cooling-off period applies) • A Death Benefit may be payable depending on the annuity's design • While it may cost more than an account-based pension, remember an individual seeking to self-insure their potential longevity needs to budget for living a very long time. However, if they 'pool' their longevity uncertainty with others they need only pay for average longevity

The role of the adviser – Who's going to help me?

Financial advisers play a crucial role in building client wealth. Their technical expertise – advice on asset allocation, security or manager selection, tax optimisation – are a boon to the ordinary investor. But they play an equally crucial role in training clients to invest with more discipline:

- To invest in superannuation and other assets in a holistic fashion – with a broader portfolio view.
- To explore investment opportunities to suit differing risk appetites and objectives.
- To stay invested during periods of market turbulence (anecdotal evidence suggests early withdrawals from superannuation during the COVID-19 pandemic were significantly lower amongst advised investors).

It's likely that over the next decade financial advisers will become even more important. The issues involved in optimising retirement income are complex and multi-layered. Very few individuals will be able to manage that process by themselves.

Once again, financial advisers provide more than technical skill – they help clients avoid self-defeating behaviours. In the Decumulation Paradox paper cited earlier, Taylor, Halen and Huang say, "Financial advisers can and should help retirees overcome these biases and improve the quality of their life."[16]

Financial advisers are ideally placed to explain the investment processes and also help clients spend their retirement savings and manage family and estate planning issues, ensuring their clients' sense of obligation to their children doesn't reduce their own living standards.

Demystifying retirement income products

Australian investors' use of platforms, managed funds and sophisticated Self-Managed Super Fund ('SMSF') investment strategies is now taken for granted. The reality is that these products are widely and effectively used because financial advisers have educated clients on why and how to use them and have tailored portfolios that deploy them strategically.

In the new retirement income landscape, financial advisers will need to repeat that success. They will need to teach their clients that sophisticated products like guaranteed lifetime annuities, investment-linked lifetime annuities and equity release products can deliver tangible benefits – income they can rely on and income that makes a difference to their lives.

The easiest person to fool is yourself

Behavioral finance suggests investors often confuse perception and reality. Recent events have more weight than remembered ones. Losses hurt more than gains excite. That's why financial advisers need to coach their clients in areas like:

- Life expectancy and their retirement income strategy – their spending patterns, income requirements and asset allocation.
- The right amount and mix of guaranteed, government-sourced, or market-based income.
- Adjusting a retirement income approach over time. People and laws change and markets move so retirement income strategies shouldn't be set-and-forget.

Over the next decade, financial advisers will need to balance income, access to capital, risk, social security and estate planning considerations so that clients benefit from the optimal mix.

The whys and why nots

For some retirees, investment-linked lifetime annuities will be the obvious 'better mousetrap' when it comes to meeting their retirement income needs. Others will need to find out more about the product. Research from CoreData has identified the big questions most retirees want to understand.

You're taking my money?

Thanks to preservation, most superannuation fund members understand having their superannuation sequestered and given time to grow. Locking away the capital that funds their retirement income feels less intuitive, with many survey respondents concerned about 'losing' their money if they pass away earlier than expected.

It's such a common concern one US economist gave it a nickname. "I call it the bus problem," says Olivia S. Mitchell, from the Wharton School of the University of Pennsylvania. "They're afraid they're going to buy a lifetime annuity and walk outside and get hit by a bus. The reality is you also might live to be 105 years old."[18]

To assuage this concern, advisers and their clients need to discuss the reality of ever-rising life-expectancies – and how to pay for it. Actuaries Institute research from 2020 highlights that enhanced income stream products might be at least part of the solution: "Modelling shows a 15-30% increase in retirement income by using an appropriate allocation to suitable lifetime income streams."[19]

"They're afraid they're going to buy a lifetime annuity and walk outside and get hit by a bus."

Something to remember you by

Many retirees want to leave money for the children. Peter Rowe from Optimum Pensions says this attitude is hardwired in many Australians because many benefited from their parents feeling the same way.

Retirees who could benefit from the income certainty of a lifetime annuity are therefore reluctant to lock some potential inheritance away from their children. "One way to address that bequest focus is to strategically allocate how various assets are handled on their death," says Peter.

"Many retirees will be more comfortable buying an income stream through a lifetime annuity if they know any property assets (or the rump of any account-based pension) will be passed to their children."

Cost factors

Lifetime annuity costs are multi-layered. There's the cost of a guarantee (if any), investment management fees and, where relevant, fees paid to insure against the client outliving their capital.

Retirees can better understand the cost-benefit equation for lifetime annuities if they have access to quote engines, calculators and other tools that show them the benefits of the risk pooling as discussed earlier – and the potential income they can harvest from these products over the long term.

According to Benjamin H. Harris, from Northwestern University's Kellogg School of Management, the value proposition of a lifetime annuity also needs to be positioned correctly – and that value proposition is all about uncertainty. "[Life expectancy is] a massive source of uncertainty when it comes to financial planning," he says. "There's really no way to deal with it other than a lifetime annuity."[20]

Income you can rely on

For some retirees the variable nature of the income paid from investment-linked lifetime annuities will be a concern. Advisers already manage this issue with account-based pensions.

Retiree clients will also be reassured when they understand that investment-linked lifetime annuities (such as Generation Life LifeIncome) commit to an annual income amount at each annual review. This means the client and their financial adviser can budget for that income through the following year.

By implementing a comprehensive retirement strategy – the adviser can use different retirement income sources to meet different needs: regular expenses, discretionary expenses, luxuries and an income for life.

Part of the solution: The LifeIncome lifetime annuity

Retirees who might benefit from including an investment-linked lifetime annuity in their retirement strategy include those who:

- want a retirement income strategy that locks in a range of income streams and ensures that some of that income continues until their passing
- want to maximise their chances of getting the Age Pension and associated benefits
- want a regular income but are prepared to live with some variability in that income in exchange for potentially higher income that grows at a rate above inflation
- are comfortable investing in growth assets to generate higher income
- want to work with a financial adviser over the long-term.

Generation Life's new LifeIncome investment-linked lifetime annuity is designed for retirees with these needs – and adds a feature that retirees in overseas markets have lapped up; LifeBooster.

Here's a guide to how LifeIncome works.

Taking out a lifetime annuity

- Clients who are over 50 years of age can invest in LifeIncome. Your client must have access to their preserved superannuation benefits.
- Clients can choose to also add their spouse as their reversionary (known as a Reversionary Beneficiary). This means that when the client passes away, the regular income payments are automatically transferred to their spouse. The client gets peace of mind that their spouse will be looked after.
- In addition to the statutory 14-day cooling-off period, there's an additional six months in which clients can change their mind.
- No withdrawals after this extended cooling-off period.

Income

- When Generation Life establishes your client's LifeIncome, their first year's income ('Annualised First Year Income') is determined and then converted into Guaranteed Annual Income Units ('Income Units').
- Your client's Annualised First Year Income is converted into Income Units by dividing their Annualised First Year Income by the unit price of their chosen investment option(s) on their LifeIncome commencement date.
- Annual income is based on the performance of the retiree's chosen investment option(s).
- Income is paid monthly or fortnightly.
- LifeBooster is a key benefit of LifeIncome that allows clients to 'bring forward' future income into earlier years. Clients receive more income at the point in retirement when they're more active and most likely to enjoy it.

Social security

- LifeIncome enjoys the same concessional social security treatment under the assets and income tests as traditional fixed income lifetime annuities.
- This means investing in LifeIncome may help financial advisers access the Age Pension and additional benefits for their clients sooner.

Investment approach

- A range of investment options are available on the investment menu, including single sector investment options, traditional diversified models and outcome based mulit-asset funds.
- Clients and their financial advisers can use diversified funds, mix diversified and specialist funds (core and satellite) or craft a mix of sector funds in line with advisers' model portfolios.
- Clients can hold more than one investment option and switch between them to match their evolving retirement goals and objectives.

Investing sustainably

Given the importance of investing wisely to support a long-term retirement income, it's understandable most annuity investors are focused on the mix of risk and return that suits their needs.

However, another factor that is important to many potential annuity investors is responsible or sustainable investing. Or investing using an ESG lens - that is, investing in funds that apply Environmental, Social and Governance considerations when selecting assets.

Morningstar data suggests than in the year ending December 2020, a fifth of the funds flowing into retail investments were flowing into 'sustainable investments'. That means that over $20 billion of retail investor money across Australia and New Zealand is held in those assets.[21]

To meet the needs of investors focused on responsible or sustainable investing, the LifeIncome lifetime annuity offers three funds that use those philosophies to select investment assets.

We establish and manage reserves to ensure that there is always an income for life.

Death Benefit

- When your client invests in LifeIncome, a Death Benefit Period is determined based on their age and gender.
- The Death Benefit is paid if the client passes away within the Death Benefit Period (income payments are then made to a spouse where the spouse has been nominated as a Reversionary Beneficiary).
- The Death Benefit is calculated at the time of the retiree's passing. In broad terms it aims to equate to the initial investment minus income paid out and an allowance for fees and mortality factors. It may be higher or lower than this objective depending on actual returns.

Longevity risk

With LifeIncome a regular income will be paid to your client for the remainder of their life, regardless of how long they live. Generation Life establishes and manages reserves from which your client's regular income is paid. These reserves pool your client's investments with the investment of all other investors and are based on the life expectancy of your clients and other investors. A proportion of the reserves is reinsured to address the possibility that your client or other investors live longer than the life expectancy assumptions used to calculate the reserves.

Generation Life has appointed Hannover Life Re of Australasia Ltd ('Hannover') as the reinsurer for LifeIncome - a subsidiary of Hannover Rueck SE, part of the Hannover Re Group worldwide. Hannover Re Group is known for very strong insurer financial strength ratings.

Please note: investors in LifeIncome are not a party to the arrangements between Generation Life and Hannover. Refer to the Product Disclosure Statement for further information.

A once-in-a-lifetime (lifetime annuity) experience

For most Australian retirees, investing in a lifetime annuity will be part of a retirement income plan structured with a financial adviser. Together they'll consider a range of factors before deciding how much to allocate to an investment-linked lifetime annuity like Generation Life's LifeIncome. Those factors include:

- Other sources of income and the regularity, predictability, and tax-effectiveness of that income
- The amount of potential income the lifetime annuity can generate
- Age Pension accessibility
- The right asset allocation for the lifetime annuity given the impact that has on future growth of income and its volatility from one year to the next
- Single life or also protecting the spouse with a reversionary nomination.

This decision is an important one and it may take a series of client-financial adviser meetings to arrive at the right approach. To help, financial advisers can use the Retirement Income Optimiser, Generation Life's interactive planning tool available in the Adviser Online portal. Also available are other tools that offer guidance on:

- Lifetime annuity market effects – how annual income would move in different market conditions.
- A quote calculator – exploring how much income can be generated for a given investment.

Easier and simpler

Some retirees love the stimulation of managing their retirement savings. Others want the money to 'look after itself' so they can replace full-time work with full-time lives. Fortunately, whilst a lifetime annuity might appear complicated, in the case of LifeIncome, the day-to-day experience is satisfyingly simple.

Fortnightly or Monthly

Income paid to bank account

30 June each year

The coming year's annual income is determined by multiplying the Guaranteed Annual Income Units by the unit price of the investment option(s) chosen. In other words, the annual income available is linked to the performance of the chosen investment option(s) in the previous year.

Annually

Clients and their financial adviser receive an annual statement detailing:

- Income payments made in the previous year
- Income to be paid in the new financial year – both an annual total and the regular income amount
- Death Benefit estimate
- A Centrelink Schedule.

When required

Clients can change the investment strategy underlying their LifeIncome lifetime annuity by switching between investment option(s).

Talking about Generation Life

Generation Life is an Australian company established nearly 20 years ago. More than $2.5 billion has been invested with Generation Life to date. Generation Life holds a life insurance licence and is regulated by the Australian Prudential Regulation Authority ('APRA').

Our services to financial advisers and their clients are underpinned by three key strengths.

Innovation

Generation Life is a leader in the investment bond market in Australia, capturing greater than 40% market share of inflows on a one year rolling average[22] (Plan for Life 2021 Investment Bonds report) in a fast-growing sector by developing products that help investors fund key lifetime events and needs – including children's education and the transfer of wealth between generations. Our LifeBuilder and ChildBuilder investment bonds have attracted significant funds by offering clients an alternative or supplement to superannuation – they are highly tax-effective and capital is accessible. Unlike superannuation, they offer more contribution flexibility and have no upper limit on balances.

We have taken a similarly innovative approach to clients' retirement income needs through LifeIncome.

Generation Life is proud to be shaping the retirement income landscape with LifeIncome, applying our innovative approach to clients' retirement income needs, enabling Australians to focus on enjoying retirement with the confidence of an investment-linked income guaranteed for life.

Support

We believe strategic, selective and carefully managed relationships deliver the best results for our clients.

- We work constantly with financial advisers to develop and enhance our products. LifeIncome was developed in consultation with financial advisers around Australia.
- Relationships with leading actuarial companies (Optimum Pensions), Economists and Consultants (Deloitte) and reinsurer (Hannover) underpin many of the key elements of LifeIncome.
- Our investment options leverage the expertise of leading global and domestic fund managers.

Markets

At Generation Life we design innovative products that use the power of financial markets to generate greater wealth – and better lifestyles – for ordinary Australians. That's why our investment bonds and our LifeIncome lifetime annuity offer multiple investment options.

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Postal address

GPO Box 263, Collins Street West

Melbourne VIC 8007

Email

enquiry@genlife.com.au

Enquiries

Investor services: 1800 806 362

Adviser services: 1800 333 657