

# POST-RETIREMENT MARKET TRENDS IN AUSTRALIA

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# INTRODUCTION

It is projected that the number of Australians over the age of 65 will increase by 75% over the next 20 years, from 3.3 million in 2012 to 5.8 million in 2032 and that post-retirement assets will grow from around \$300bn today to \$1.3trn by 2032\*. These statistics represent a challenge, but the expected scale of post-retirement assets also represents an opportunity for innovation.

The demographic, fiduciary and commercial arguments supporting the case for increased innovation in the Australian post-retirement market are well publicised. Until recently, however, this aspect of the Australian market has remained relatively underdeveloped. With attention slowly shifting from Stronger Super, the industry now appears to be tackling the post-retirement conundrum with a renewed sense of energy. In doing so, it is encouraging that industry dialogue has been shifting toward a focus on the ultimate goal of members: an adequate and sustainable income stream in retirement.

As with MySuper, we expect the Government will have an important role to play in reshaping the post-retirement legislative and regulatory landscape. Their involvement will no doubt heavily influence the type of product and strategy innovation we see in this area.

A growing wealth of research on post-retirement issues is helping to broaden our understanding of the challenges individuals will face (whether they realise it or not) in drawing down their savings throughout retirement. The debate is ongoing, however, one thing is clear: it is increasingly evident that post-retirement product design requires consideration of a more complex set of factors than exists in the accumulation phase. To be comprehensive, post-retirement products will need to extend beyond investment design to encapsulate a broader set of solutions including member engagement, service delivery and advice (among other things).

\* Source: Dynamics of the Australian Superannuation System (The next 20 years) – Deloitte

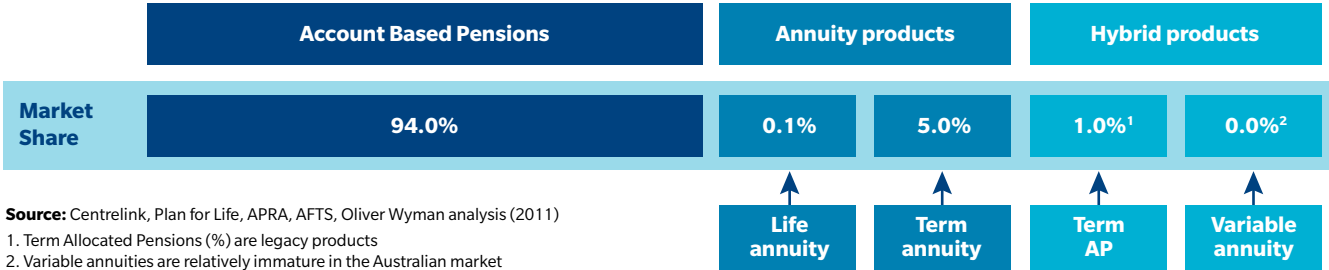
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Given this backdrop, it is paramount that superannuation providers understand where the industry is today, where it is headed, and assess the challenges and opportunities that may lie ahead. To assist, this paper aims to outline the current landscape and highlight any observable trends. Given the emerging nature of these trends we have refrained from attempting to gauge the effectiveness of the solutions discussed.

## STRUCTURE OF AUSTRALIAN RETIREMENT MARKET

As illustrated by the diagram below, the vast majority of Australians who access their retirement savings via an income stream do so under an Account Based Pension (ABP) structure. The underlying assets of an ABP typically remain fully exposed to investment markets (with a diversified mix of asset classes) and encompass both the institutional and Self-Managed Super Fund (SMSF) sectors. While some cash may be accessed on or in retirement, periodic withdrawals are generally managed by the individual through these tax effective vehicles. Annuities and hybrid products (investment solutions that include an underlying guarantee), have long been alternative options available to pensioners. However, the take up of these products by members continues to be relatively low.

Figure 1: Allocation of retirement savings in Australia



Source: Centrelink, Plan for Life, APRA, AFTS, Oliver Wyman analysis (2011)  
 1. Term Allocated Pensions (%) are legacy products  
 2. Variable annuities are relatively immature in the Australian market

# TRENDS IN ASSET ALLOCATION

- The average exposure to growth assets for default pension options is 57%.
- 51% of funds do not change their default strategic asset allocation from accumulation into pension.
- Retail funds are much more likely to change their strategic asset allocation compared to Industry funds (59% vs. 43%).
- When a strategic asset allocation does change, the average growth exposure falls from 67% to 46% in retirement.
- Innovation is occurring with some funds across both product and service offerings.

Given the growing pool of assets flowing into the retirement space and the dominance of ABPs, it is appropriate to question whether ABPs are fit for purpose – do they help members to convert their superannuation savings into an adequate and sustainable income stream in retirement?

Despite the importance of these questions, there appears to be a dearth of information on standard industry practice within the pension space, compared to the wealth of information available on default accumulation options. In the analysis that follows, we aim to explore the following:

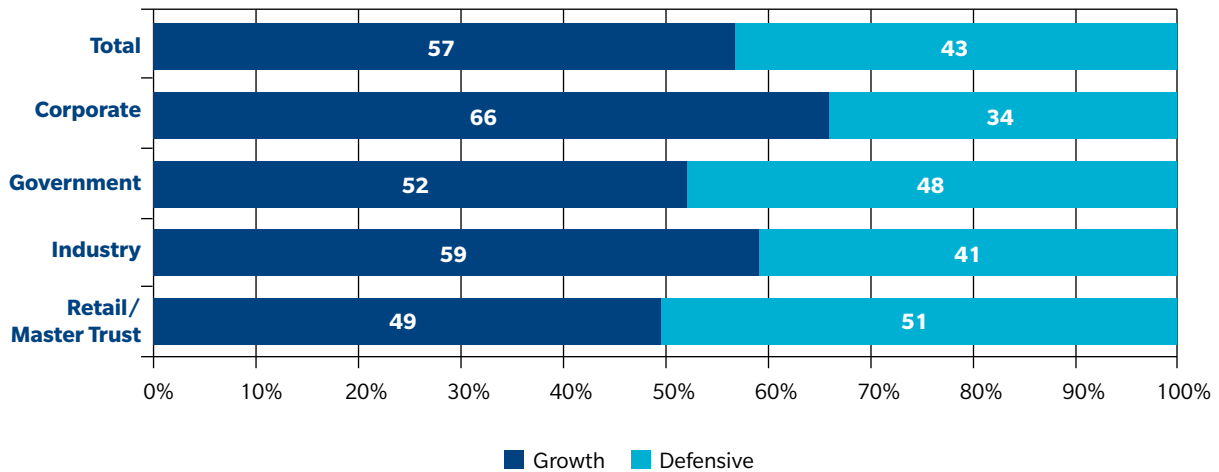
1. What does the asset allocation for the average default account based pension option look like?
2. Do funds change the asset allocation between accumulation and pension options, and if so how?

**Note:** All data has been sourced from the SuperRatings’ strategic asset allocation survey as at 31 March 2014. The data is self-reported by funds in the categories provided by SuperRatings.

## WHAT IS THE AVERAGE ASSET ALLOCATION FOR DEFAULT PENSION OPTIONS?

Chart 1 illustrates that, across the surveyed universe, the average default pension option has a 57% exposure to growth assets. Corporate funds have the highest exposure to growth assets at 66% and Retail funds the lowest at 49%.

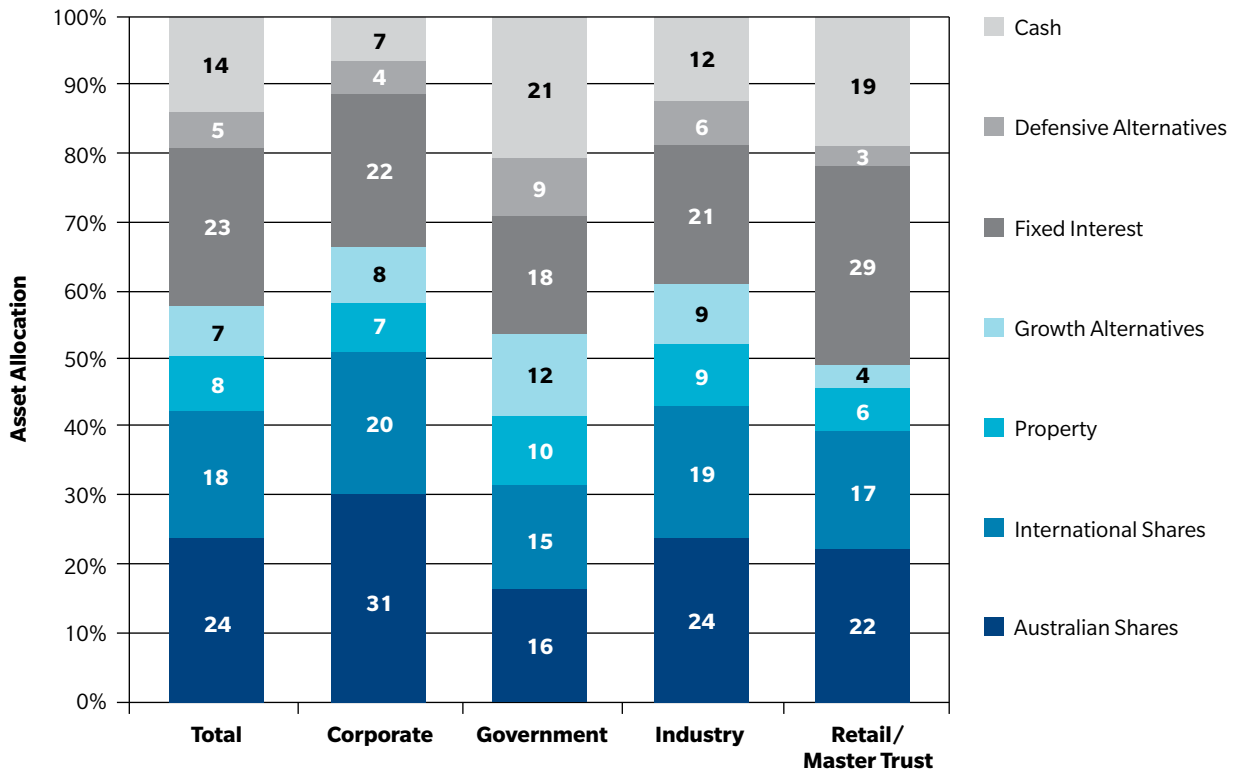
**Chart 1:** Growth and Defensive Asset Allocation for Default Pension Options



Looking further into the underlying asset allocations (Chart 2) highlights several trends:

- Within growth allocations, Government and Industry funds have higher than average exposure to property and growth alternatives. Conversely, Retail funds have a higher reliance on equities as a proportion of their overall growth assets.
- Within defensive allocations, Government funds have a much larger proportion of funds invested in cash as opposed to fixed interest, whereas Corporate funds have higher allocations to fixed interest. As with the growth allocation, Retail funds have a lower exposure to alternatives on average and a commensurate higher exposure to cash, compared to their industry fund counterparts.

**Chart 2: Average Asset Allocation for Default Pension Options**



**DOES THE ASSET ALLOCATION CHANGE BETWEEN ACCUMULATION AND PENSION PHASES?**

There is a widely held view within the industry that most funds have not yet innovated their post-retirement option(s) and generally replicate their accumulation strategic asset allocation(s). To test this established view, we have compared the default accumulation options against the default pension options for the 101 funds that provided data on both.

Table 1 illustrates that roughly half the universe of funds assessed do initiate a change in asset allocation, while the rest retain the allocation of their accumulation default.

**Table 1: Proportion of Change between Default Accumulation and Pension Option Asset Allocations**

	TOTAL
Change	49%
<i>Lifecycle</i>	15%
<i>Other</i>	34%
No Change	51%
<b>Total</b>	<b>100%</b>

Note: 'Other' relates to those funds that employ a static allocation approach but reduce the growth asset exposure of their default option between the Accumulation and Pension phase.

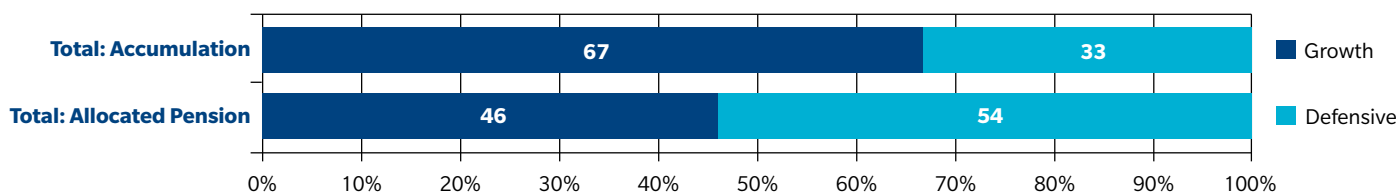
Drilling down a little deeper we can see that on average 6 out of 10 Retail funds amend their strategic asset allocations, compared to around 4 out of 10 Corporate or Industry funds.

**Table 2: Proportion of Change between Default Accumulation and Pension Option Asset Allocations per Fund Type**

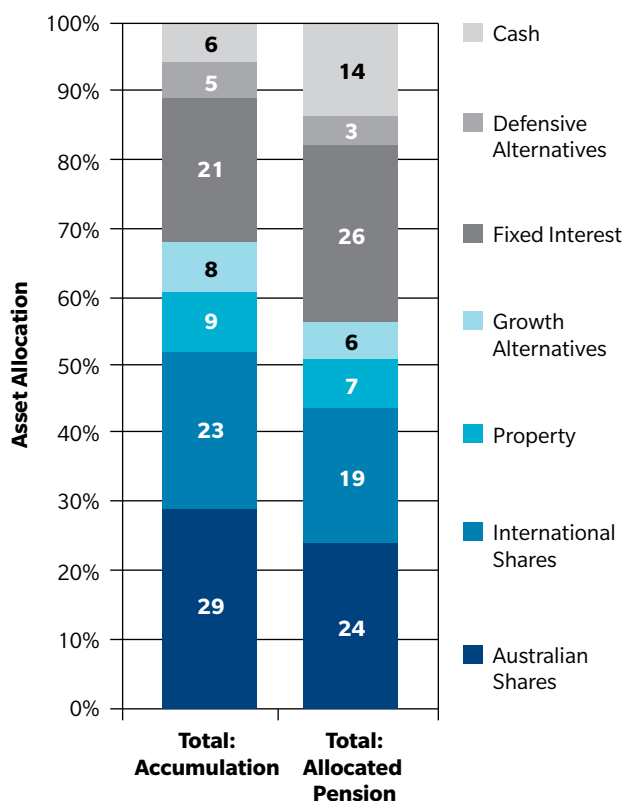
	CORPORATE	GOVERNMENT	INDUSTRY	RETAIL
Change	43%	57%	43%	59%
Lifecycle	14%	14%	10%	24%
Other	29%	43%	33%	34%
No Change	57%	43%	57%	41%
<b>Total</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>

Leaving aside the 51% of allocated pension providers that do not alter their asset allocation, among the remaining 49% there is a definite trend toward reducing the exposure to growth assets for their pension members. Excluding the 15% of funds that adopt a lifecycle offering, the average exposure to growth assets falls from 67% to 46% on average (moving from accumulation to allocated pension). We note the appropriateness of this level of decrease in growth assets is outside the scope of this paper, not least because this will depend on a range of factors such as the specific membership characteristics of each fund and whether it is intended for use as a default solution or provided to members following the provision of tailored advice.

**Chart 3: Change in Growth and Defensive Asset Allocation**



**Chart 4: Average Asset Allocation of Default Accumulation Option vs. Pension Option**



It is also interesting to observe how the average strategic asset allocation shifts from the accumulation to the pension phase beyond the high level growth/defensive split. This is shown in chart 4 for the 101 funds that provided asset allocation information to SuperRatings for both their accumulation and pension default investment options.

We observe only moderate changes when looking beyond the overall growth/defensive split:

- Within growth assets, the proportion invested in equity, property and alternatives remains broadly constant (with equity accounting for around 75% of the growth allocations within both accumulation and pension options)
- Within defensive assets, the proportion of fixed interest assets falls marginally from 65% to 60% to make way for a higher cash allocation.

In summary, we have found that roughly half the industry currently tailors their post-retirement investment strategy, and that this is predominantly achieved through adjustments to the overall growth/defensive split. Government and Retail funds appear more likely to tailor their investment solutions relative to Corporate and Industry funds. We note that the amount of pension assets under management tends to be much larger for Retail and Government funds (relative to Corporate and Industry funds), which may at least partly explain this trend.

Given the differing needs of pension members relative to those in the accumulation phase, we expect pension asset allocations will continue to evolve over time as scale allows for increasingly tailored investment solutions.

# INNOVATION TRENDS

Simply looking at the asset allocation of default pension options does not capture a complete picture of the emerging innovation in post-retirement solutions. Further innovation is evident when we look ‘under the bonnet’, or consider broader structural changes in the services funds are providing their members. A wider range of solutions are beginning to emerge as the industry shifts its focus from accumulating wealth to providing an income in retirement, and as appreciation grows for the varied (and often conflicting) objectives that are important to consider in post-retirement design. For example, annuity or hybrid products which have not been very popular historically, are now receiving renewed (though still limited) interest.

Data on the number of pension providers introducing these types of post-retirement innovations is relatively scarce. However, anecdotally it appears an increasing number of funds are investigating how they can better align their product and service offering with the needs of retiree members.

## PRODUCT INNOVATION

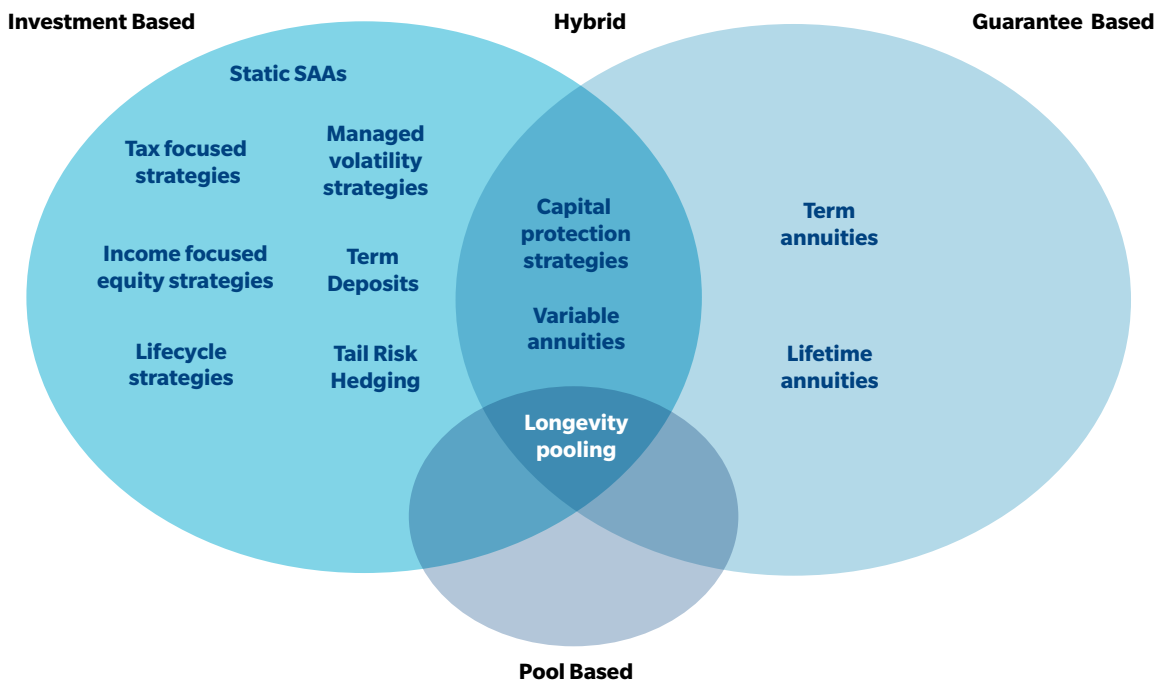
Figure 2 outlines some emerging post-retirement innovation (including available products and conceptual ideas) that aim to enhance the options available to retirees. Some of these have existed

in Australia for some time but improved research and advice in this area is helping members better understand the role these strategies can play in tackling the risks they face in retirement.

Traditionally, it has been intuitive to consider the various post-retirement solutions as existing along a spectrum from pure investment based products through to guarantee based products (annuities for example). This relatively simple categorisation is still valid today, however, the line is increasingly blurred. The emergence of products that sit somewhere in between both ends of the spectrum has been a key focus of recent innovations in the post retirement space. Much of this innovation is focused on assisting retirees manage longevity risk, the importance of which is becoming increasingly well accepted by the industry.

Variable annuities and capital protected products are some examples that have been available in the market place for some time. It has been suggested by some that an alternative approach to tackling this integral issue would be to leverage the scale of the superannuation industry to provide some form of longevity risk pooling. Others have focused on the need for the Government to remove the regulatory constraints currently preventing the development of deferred annuities.

**Figure 2:** Post-retirement Innovation



Detail on the different risks in post-retirement and how they interact with each other is outside the scope of this paper. However, a comprehensive post-retirement strategy must at a minimum balance those risks that dominate the early stages of retirement (sequencing risk), with those that dominate the latter stages of retirement (longevity risk). This crucial dual objective is driven by the need to have an income in retirement that is both adequate and sustainable. We believe all the above strategies can play a role in post-retirement design depending on the particular circumstances and preferences of a superannuation fund's membership. A 'one-size-fits-all' solution is unlikely to be uncovered.

Whether it be a focus on income, tax effectiveness or loss aversion we are seeing many product providers innovate to develop investments that are deemed attractive for retirees. Examples include tail risk hedging, managed volatility, convertibles or the use of absolute return focused or CPI linked products. These innovations mean that an accumulation and post-retirement option may have the same high level strategic asset allocation, but look markedly different in terms of the underlying investments and asset management styles.

Given the general bias of the Australian market towards investment based solutions, it is understandable that post-retirement product innovation has initially been focused on this area. However, we expect to see more broad based innovation as the industry continues to recognise that investment solutions alone are unlikely to adequately arm most members against the risks they will face in retirement.

For example, recently we have seen some super funds partner with insurance providers in an effort to satisfy demand from members for more choice. This more expansive approach is representative of a steadily changing mindset across the industry; from one that is focused on "saving for retirement" to one that emphasises the importance of "retirement income".

## SERVICE INNOVATION

While post-retirement product innovation might capture more headlines, technology advancements are helping to revolutionise how funds service their membership base, which will become increasingly important.

Service innovation is broadly based around the theme of delivering members more tailored solutions as efficiently and effectively as possible. A key driver of innovation in this area has been the challenge that the rise in SMSFs pose to traditional funds.

Some examples of the service innovations are as follows:

### **Power to Consumers: Direct investment options**

Whether it is on a stand-alone basis or in partnership with third parties, we have seen an increase in the number of super funds introducing direct investment options. This provides existing members with a facility to directly purchase shares, term deposits, exchange-traded funds, infrastructure and property within the super fund structure. A clear advantage for the member is the ability to access unlisted assets not available within a SMSF structure. This innovation has been a direct response from super funds to the increasing popularity of SMSFs.

### **Entering the Digital Age: Interacting with consumers online**

A number of providers have invested in developing new technology. These innovations have enabled members to have instant access to their superannuation fund via online portals, mobile devices or (in the case of some retail funds) through traditional online banking sites. This goes hand in hand with retirement planning tools having an increased focus on income adequacy and sustainability and with the use of gamification to drive engagement and action among members.

### **Increasing Flexibility: Bolt-on SMSF servicing**

SMSF or traditional super fund – increasingly this doesn't need to be a mutually exclusive choice. The emergence of SMSF servicing solutions provide members the freedom of running their own superannuation account, while retaining the scale benefits of an institutional fund and receiving assistance with the management of required administration and compliance functions.

### **Connecting Consumers to the Experts: Access to financial advice**

Up to 50% of members currently do not access financial advice in the lead up to retirement\*, despite it being identified as a key determinant of successful outcomes. Not all super funds have in-house financial advice or a planning business. That said, we have seen recent joint ventures and referral deals between super funds and financial planning organisations to help address this gap. This innovation in service delivery signals the increasing intent of funds to provide tailored financial advice to their members. We expect further innovation in this area, including the provision of scaled advice.

\* Source: Investment Trends Pty Ltd: Retirement Income Report, November 2013.



## CONCLUSION

In terms of product innovation, the industry cannot afford to search for a 'silver-bullet' retirement income solution to meet the needs of all retirees. The 'wealth accumulation' mindset (so prevalent historically) does not readily apply to the post-retirement phase. Our growing appreciation of this is helping the industry understand that a mix of products or strategies is likely to be required by most retirees.

Inevitably, this changing approach will challenge the role that funds have to play as providers of solutions to an ageing workforce. Areas such as financial advice, member education and communication will be crucial for super funds (from both a fiduciary and commercial standpoint) as they seek to help members effectively navigate their retirement years. The Government clearly has a role to play in ensuring innovation in the post-retirement phase is not stifled by restrictive legislation or the lack of important investment assets such as long-dated government bonds. Continued engagement between the Government and the superannuation industry will be important to ensure that innovative ideas are fostered through a post-retirement market that is conducive to the development of suitable strategies and products.

Ongoing research of the dynamics specific to the post-retirement phase should ensure we continue to see more innovative and targeted products and services for retirees. It is important that super funds understand their membership base and ensure the products and services they make available to their retiree members are fit for purpose.

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