Challenger
Balancing retirement income risks

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Balancing retirement income risks: member thoughts

The ultimate measure of success for a lifetime of superannuation savings, will be enjoying the best possible lifestyle in retirement. Ideally, this matches the lifestyle enjoyed while working.

Generating the income for retirement from accumulated savings is a challenge that comes with additional risks to the retiree. This is why the Retirement Income Covenant will, from July 2022, require super funds to have a strategy for their members that aims to maximise retirement income, while managing these risks. Taking into consideration the wants and needs of members will be crucial for getting the balance right. A "comfortable retirement" means different things to different people and how confident Australians feel about achieving this goal and the risks they are willing to take varies widely.

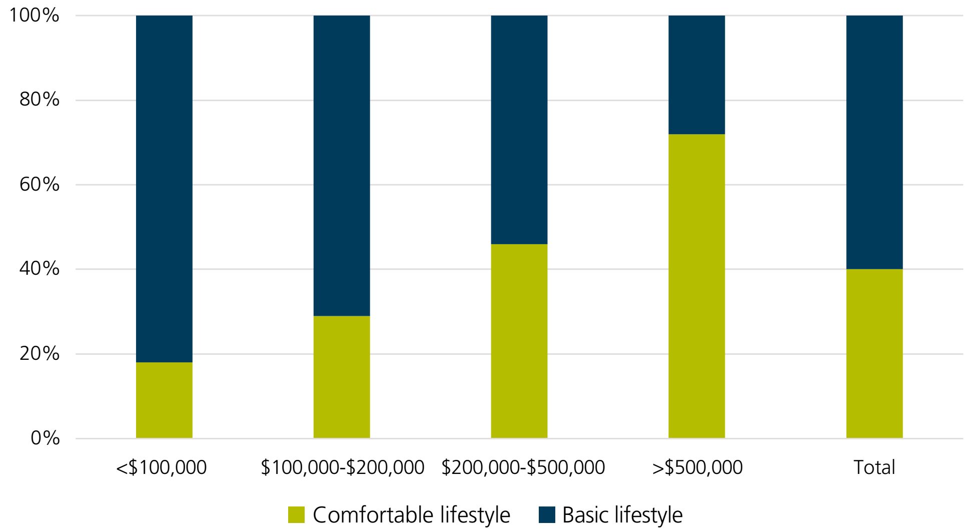
Super funds will need to gather insights on their own members about retirement. Challenger has done research which provides some useful insights on how fund members feel about their retirement strategy, and in particular, their level of interest in a retirement solution that balances the risks in retirement. This might vary across funds but is intended to be a useful starting point for your consideration.

The goal: maximising retirement income

Maximising income makes sense as a financial goal. However, that isn't necessarily how people think about financing retirement. Peer comparisons are common, and global measures often look at a replacement rate[1] rather than an absolute level of income. This is because, to the retiree, sustaining a similar lifestyle in retirement is more important than trying to improve a lifestyle in retirement. One way to measure this is to consider what sort of lifestyle they expect in retirement.

A recent survey of over 3000 Australians aged over 45, found that only 40% expected to have a comfortable (or better) lifestyle in retirement. Sixty percent thought they would be meeting basic expenses with maybe a little extra. What is surprising about this variation is that it is not completely dependent on their level of savings. As can be seen in Figure 1, nearly one in five (18%) of those with less than $100,000 in super thought that they would have a comfortable lifestyle. In addition, 28% of those with more than $500,000 were expecting a lifestyle close to meeting their basic needs.

Figure 1: Expected lifestyle in retirement by super balance



There was also a trend concerning expected comfort and age. Older people were more likely to report an expected comfortable lifestyle in retirement. Only 35% of people under 55 expected a comfortable retirement, compared to 46% for those over 65. Partially this is related to wealth, older people have more savings. But those over 70 with less than $200,000 in savings, were more likely to describe their lifestyle as comfortable, than younger people with the same amount. The majority (54%) of those who said they were already retired considered their lifestyle to be comfortable.

1 That is, the income available in retirement expressed as a proportion of such income available during working years.

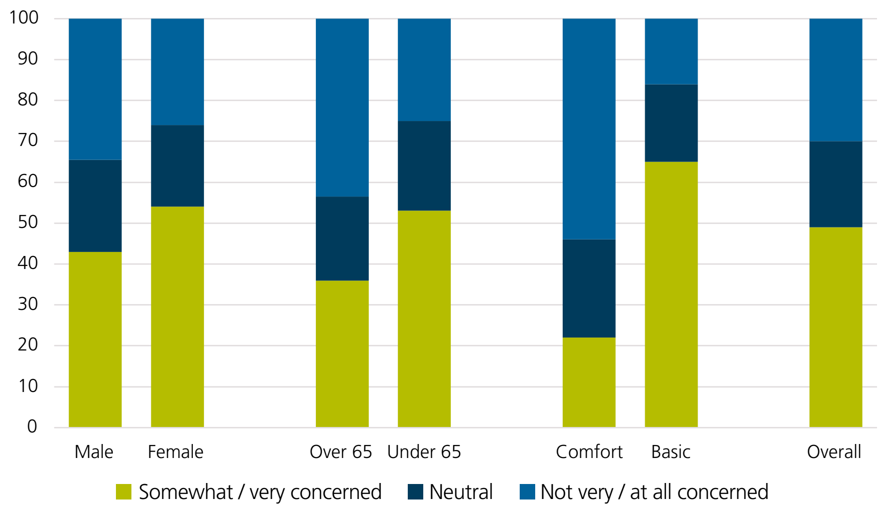
Managing risks to retirement income

The average super fund member does not think about retirement risks in the same way as super professionals. Many don't know what longevity risk means or how it should be managed. Instead, there is the (one-sided) concern that they might outlive their savings.

Many more people reported being very or somewhat concerned about outliving their savings and not having enough money to live on compared to those who were not concerned. Forty nine percent reported concerns compared to the 30% who were not very, or not at all concerned. The rest were neutral in regard to concerns.

There were some clear distinctions across groups that reported higher levels of concern. While people with less savings worried more, Figure 2 highlights that women, people under 65 and those expecting a basic lifestyle are more likely to be concerned about outliving their retirement savings.

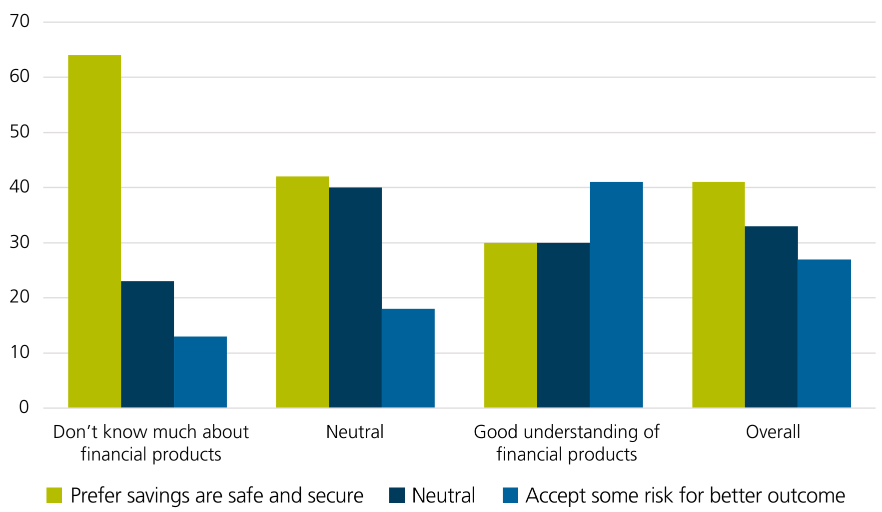
Figure 2: Variation in concerns about outliving savings



When it comes to taking risks with their savings, respondents tended to prefer safety and security with their savings. On a 10-point scale, where 4-6 were considered neutral, 41% expressed the preference for safety and security, with only 27% saying they would take some risk with their savings in order to get a better outcome.

A key indicator of the willingness to accept risk was the level of knowledge about financial products. Those who said they had a good knowledge and understanding of financial products were more likely to take risks. The pattern can be seen in Figure 3 with people's own assessment of their financial knowledge rated on a similar 10-point scale.

Figure 3: The impact of financial product knowledge on taking risk



This has an implication for funds looking to assist their members in retirement. Unless the members have good knowledge and understanding of financial concepts, it is likely that a safer option will be preferred by members in retirement.

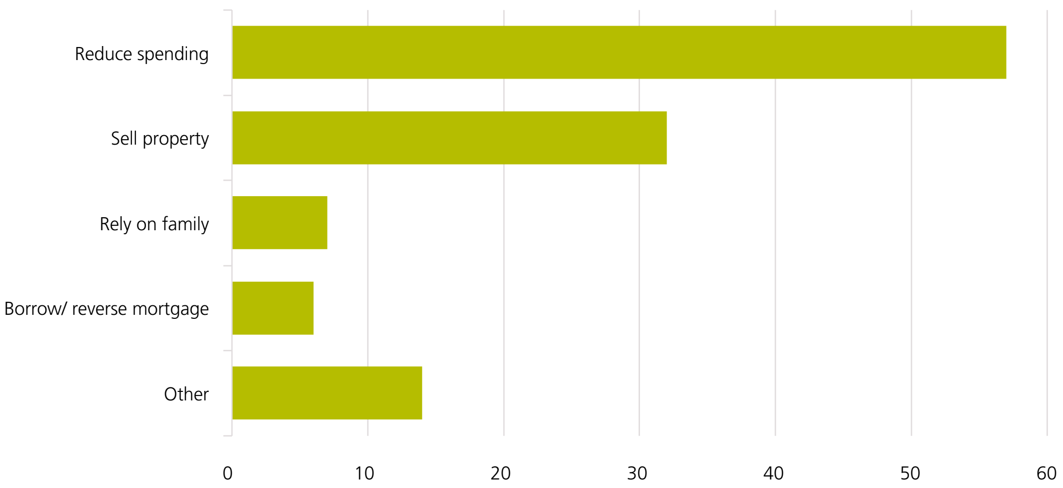
Members already have their own 'Plan B'

Most of the people who expect a comfortable lifestyle are not concerned with running out of savings. They are also wealthier than average. This suggests that people adjust their lifestyle if they are concerned about running out of money.

The respondents were asked directly what their plan was if they ran out of savings. The majority of people (57% overall) said that they would adjust their lifestyle by changing their spending habits. This proportion was consistent across the population. One difference was that more people (41%) with over $500,000 in super said they would sell property instead of adjusting their lifestyle. As shown in Figure 4, only 32% of the total population said they would take this approach if required (more than one option was possible).

In the 'other' category a majority of the comments refer to surviving on the age pension, while comments from people with a defined benefit pension indicate that their income could not run out as it was 'for life'.

Figure 4: Plan for when savings have run out

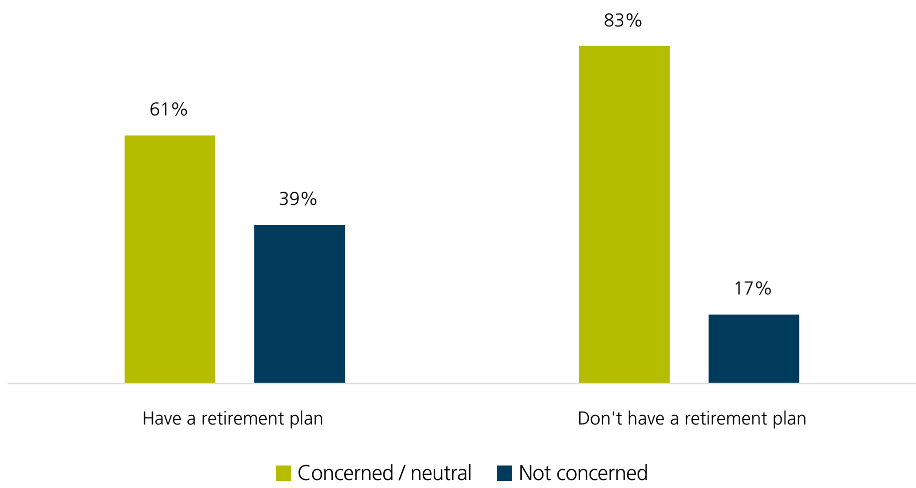


These results echo the observation that retirees are inclined to spend less of their money so that it will last longer. However, accepting a lower lifestyle merely avoids longevity risk rather than managing it, and is not likely to be the best outcome for retirees. Managing longevity risk can sustain a higher lifestyle for the retiree. The trade-off, however, is a smaller estate for the next generation who inevitably receive the unused assets from the retiree having a lesser lifestyle.

Reducing the concerns of retirees

An abundance of concerns will reduce anyone's happiness and retirees are no different in this regard. Those who were most optimistic about the future were more likely (51%) to have no concerns about outliving their savings, compared to only 11% of those who were pessimistic about the future. Pessimism and concerns tend to go together, and these attitudes can be difficult to change.

Figure 5: Plans and concerns about outliving savings



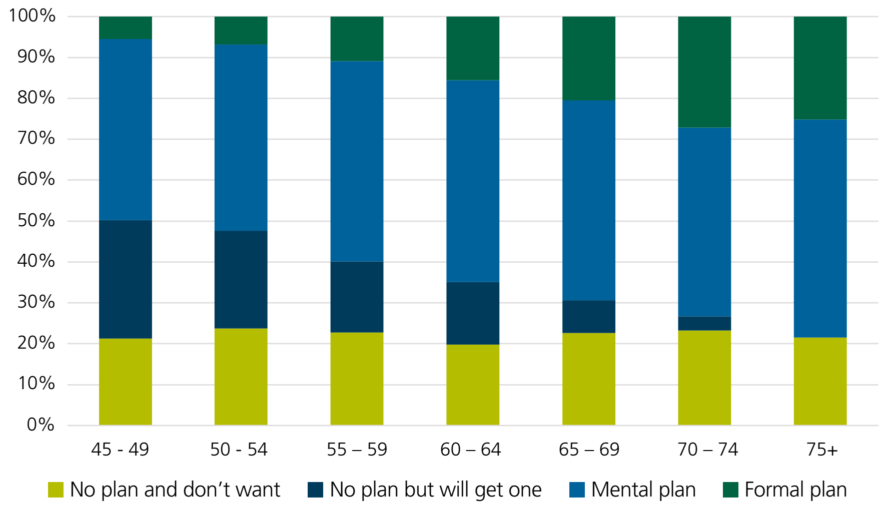
Making a plan is a practical option to reduce retiree concerns. Those who said they had a financial plan (whether or not it was a formal plan) tended to have lower concerns. As Figure 5 shows, 39% of those people with a plan were not concerned about outliving their savings. This compares to only 17% of those without a plan who were not concerned.

A retirement plan does not necessarily need to be formal and the research indicates people approach planning in different ways. The respondents were asked if their retirement plans were formal plans, for example a plan documented via a spreadsheet or online tool, or simply a mental plan. Nearly half (47%) indicated a mental plan but only 13% said they had a formal plan. On the flip side, 22% said that they had no plan and did not want one. There were 17% who said that they didn't have a plan but intended to get one.

This pattern changes with age. While people at younger ages are putting off a plan, but intend to get one, people over 70 were twice as likely to have a formal plan. Indeed, the mental planners and those who don't want a plan were consistent across ages as can be seen in Figure 6.

In addition, those who were retired were less likely (4% v 17%) not to plan. Instead they were more likely to have a formal plan (26% v 13%) in place.

Figure 6: Retirement plans at different ages



An appealing balanced solution

Having a retirement income strategy that improves outcomes for fund members is a good objective. However, practical application will require a solution that has member appeal.

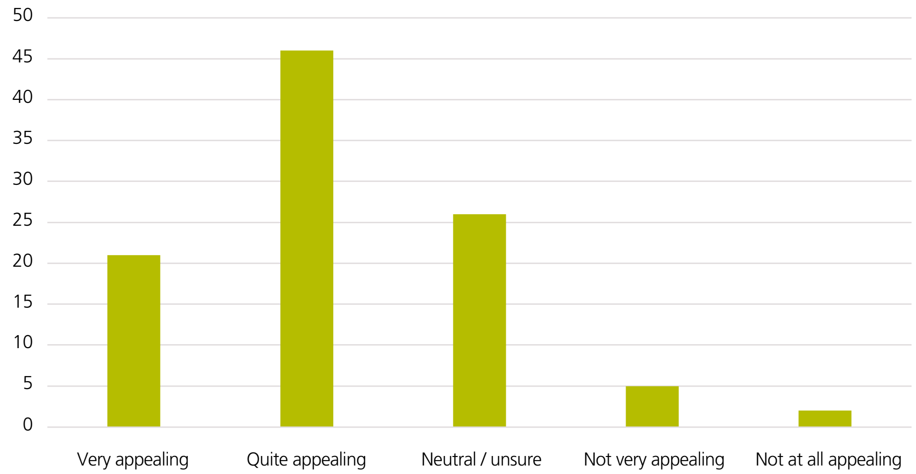
As part of this research, the survey proposed a theoretical retirement income product that blended different forms of income payments in a way that is likely to be consistent with the Retirement Income Covenant. This theoretical product was appealing to a range of people.

The concept was described to participants as:

> A retirement solution that helps you get the most out of your superannuation savings by delivering an income stream that may be made up of three components:
>
> I. An income stream that is guaranteed for as long as you live
>
> II. Regular payments that you receive from your superannuation balance, which may go up and down with the market performance and may run out over time
>
> III. For those that are eligible, the government aged pension

Sixty-seven percent of respondents thought that this was an appealing product and 62% thought that it was either quite or very relevant. Only 7% saw no appeal and 11% did not think it was relevant. The appeal was broadly similar across different segments of the population. People who were more likely to find it appealing were those concerned about outliving their savings, expecting a basic lifestyle and those open to paying for financial advice.

Figure 7: How appealing is the blended retirement solution?



A solution that balances risks will appeal to members

A majority of fund members are concerned about outliving their savings. Those without a plan are more likely to be concerned. Super funds will need to develop a retirement income strategy to help their members manage this concern by managing the risk of running out of money. Having a plan will help reduce members concerns, and having better knowledge leads to a higher acceptance of investment risks. Taking more investment risk can lead to better investment returns. If a fund can reduce member concerns so they take on those risks, it can lead to a better outcome for members.

The study highlights that members have an interest in a solution that balances their risks in retirement. While some will be able to manage the risks themselves, having a holistic solution available will be appealing to the majority. In considering how a retirement strategy could work for their members, taking a simple approach and avoiding financial jargon should help members find the best solution for their retirement income needs.

For more information or to have a discussion on how Challenger can work with you on your decumulation strategy, please contact the Challenger Institutional Partnerships team at challenger.com.au/institutional

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