Draw down under

A pick-and-mix retirement product being created by super funds in Australia would appear to offer tailored and sophisticated outcomes for retirees. David Rowley reports

Summary
- A positive consensus has greeted the proposal for the AU$2 trillion Australian superannuation system to adopt a Comprehensive Income Product for Retirement (CIPR). The proposal will lead to super funds designing their members a product with flexible elements of a drawdown pension, deferred, lifetime, fixed-term annuities or group self annuity products, all offered through a single portal. The final details are due at the end of the 2016, with the 116 active default super funds expected to soon have a CIPR.
- The CIPR proposal was devised from a 2014 review to combat what is referred to as a 'lump sum mentality', whereby half of all retirees treat their superannuation balance as a cash windfall, rather than an income stream.
- Take up of CIPR has not met expectations, with the blame put on the difficulties in communicating its complexities. However, this could change in July 2017, when deferred annuities will gain the same tax exempt status as a pension in Australia.

The consensus that has greeted the proposal for the AU$2 trillion Australian superannuation system to adopt a Comprehensive Income Product for Retirement (CIPR) is significant. Disagreement and bitterness between the interests of the big bank super funds (backed by the Liberal party) and those of the not-for-profit industry funds (backed by the Labour party) is common, but both have registered their approval.

The appeal of a CIPR is its flexibility, which means that no one retirement plan is likely to look the same as another. The proposal was devised from a 2014

review to combat what is referred to as a 'lump sum mentality', whereby half of all retirees treat their superannuation balance as a cash windfall, rather than an income stream. The proposal will lead to super funds designing their members a product with flexible elements of a drawdown pension, deferred, lifetime, fixed-term annuities or group self annuity products, all offered through a single portal. The final details are due at the end of the 2016, but what is highly likely is that all 116 active default super funds will soon have such a product.

Funds like the idea, as it is a government endorsement to help them in their efforts to hold onto a greater number of retirees. The government likes the idea of reducing the reliance on a means-tested state pension, while members should appreciate the innovative and flexible solutions. The CIPR is likely to be offered on a negative consent basis, but members will still be able to take some of their balance as a lump sum.

Jeremy Cooper, the author of the groundbreaking Cooper review of superannuation in 2010 and chairman of Challenger, the main provider of annuities in Australia, simply explains how it will work. "If each person's wealth is 100 different jelly beans and each glass is an option (such as cash, growth, annuities), then the members works out how many jelly beans they put in each glass and once they have got to 100 that is your CIPR."

Clever advice and guidance will make such choices a success and the Australian Prudential Regulatory Authority (which performs roles similar to The Pensions Regulator) will be watching poor outcomes closely.

Griffith University professor of finance, and a retirement product adviser to super funds, Michael Drew, believes trustees and executives are going to be pushed outside of their comfort zone. "Trustees will need to articulate and action a set of investment beliefs that will need to include drawdown rates; sequencing risk; liability-driven investing (aged care, medical costs, bequest motive); and pooling (annuities, mortality credits) and/or account based design," he says.

To this list of challenges he adds the smart 'nudges' that help members understand the retirement income challenge they face.

However, the first key battle is retention in a system where members can change funds as easily as Brits change insurance through a price comparison website. Funds also risk losing members who opt for cash alone or who choose a self managed super fund route. For this reason Jana senior consultant Matthew Griffiths describes the 'post-retirement pot' as a battleground in which the CEOs of super funds could lose their jobs if they do not meet retention targets. One fund, Sunsuper, has gone as far as to offer a tax rebate worth up to AU$2,400 for those members who choose a pension rather than a lump sum. The rebate was normally awarded to the scheme directly and benefited all members.

New product

Before the idea of a CIPR, the typical pension product for a superannuation fund was income drawdown from a conservative growth fund made up of 50 per cent equities and 50 per cent defensive assets. The approach taken by the AU$6 billion Australian Catholic Super may become more typical in the future. It splits a new retiree's fund into an interest-bearing cash account equal to two times their desired annual income. The rest goes into a more aggressive growth fund with shares, property, infrastructure and bonds. Dividends and interest payments generated from this account are paid into the cash bucket each quarter.

The fund has marketed this approach to members with the example of Amy, a 65 year old who has a balance of $300,000 and who chooses an annual income of $24,000. Her cash account starts at $48,000 and her growth assets at $252,000. After one year, her cash balance reduces to $25,400 (minus $24,000 plus $1,400 interest), but her growth assets rise to $304,500 due to favourable market returns. At this point some growth assets are moved to cash, leaving $68,000 in cash and $261,300 in growth. So after one year Amy's total assets rise to $329,900.

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The plan at present lacks an insurance product that would help Amy sleep better at night, if returns are not this favourable, but some in the industry describe such products as "halfway to an annuity" and better value.

Rice Warner managing director Michael Rice, one of the most prominent actuaries in Australia, has not endeared himself to annuity providers by frequently pointing out that it is much cheaper (and easier) to hire an actuary to design such a product than pay the profit margin embedded in an annuity. He also reasons that with a state pension and 85 per cent of retirees owning their own home, the security of assets and income that an annuity provides is already catered for.

He sees annuities as appropriate for those aged 80 plus, when annuity contracts offer better value and protection from fraud – a growing

number of academic studies have measured the extent to which retirees are more easily fooled by financial scams as they age and the extent to which their financial decision making worsens.

Products that use fixed term or lifetime annuities have not started well. VicSuper, a government employee fund based in Melbourne, launched a CIPR-inspired product that combined an investment fund with a choice of either lifetime or fixed-term annuities in June 2015. Take up has not met expectations and the blame has been put on the difficulties in communicating its complexities. However, this picture could all change in July 2017, when deferred annuities will gain the same tax exempt status as a pension in Australia. Such annuities are likely to be triggered around age 75-80 and receive a much higher endorsement from the industry.

The full variety of what a CIPR could look like is illustrated by the Brisbane based Energy Super, which has AU$6 billion in assets with 48,000 members. It is offering the Mercer LifetimePlus group self annuity alongside its more conventional investment fund. LifetimePlus works by receiving a portion of a retiree's assets and pooling them with others of a similar cohort. The product delivers quarterly investment returns, a half-yearly bonus for as long as a member stays alive or stays within the fund, and capital returns paid half-yearly after 15 years of membership. It should work out cheaper than an annuity and more aspirational in the way it rewards members who live the longest.

A word should also be made of trends amongst retirees. Michael Bysouth, a financial adviser with Yellow Brick Road, probably the best known independent financial adviser firm in Australia, sees the growing strength and reputation of superannuation working against it. He is seeing a rising proportion of people entering retirement with debts.

"People are consciously making a choice to spend on property or to look after their family as they are less worried about the debt because they can see their superannuation account holds enough money to pay it off," he says. "Twenty years ago, people did not have any confidence in their superannuation, so they were focusing on paying off the debt before retirement."

Written by David Rowley, a freelance journalist

What are the lessons for the UK?

By the standards of Australian superannuation, the UK public is too often kept in the dark about the relative performance of their pension schemes and the value for money of their fees. To ensure against mis-selling, particularly at the start of the crucial decumulation stage, it is likely that the UK regulators will be forced to bring greater transparency. However, once you make performance and fee more easily accessible, it is logical that you must offer the choice to switch. In Australia, members were given the right to switch funds in 2005 and greater regulation for transparency has gone hand-in-hand. Rating agencies also help the public and IFAs in their choices by taking performance information to create league tables of funds. On the same principles of public transparency, it is proposed that MySuper funds will have to provide visual online modelling tools for their CIPRs to enable comparison of products.

Such openness breeds competition and innovation. If the UK were to adopt a similar system to CIPR then it would be welcomed by actuaries excited at the possibilities of product design (and particularly those frustrated at not being able to design defined ambition products).