FRONTIER ADVISORS

Breakout session A – Room 3

Thursday, 8 June 2017

FRONTIER ADVISORS

Investing for Income

Presented on: Thursday, 8 June 2017

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Why income?

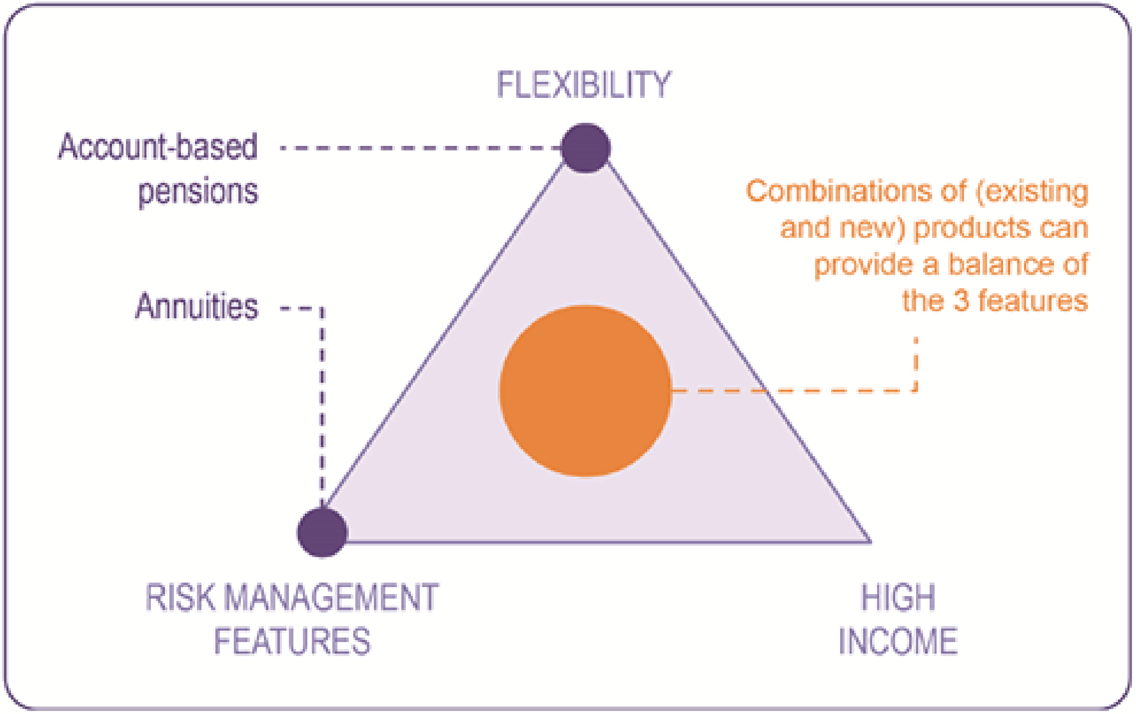
Reason 1

Objective of superannuation:

To provide income in retirement to substitute or supplement the age pension.

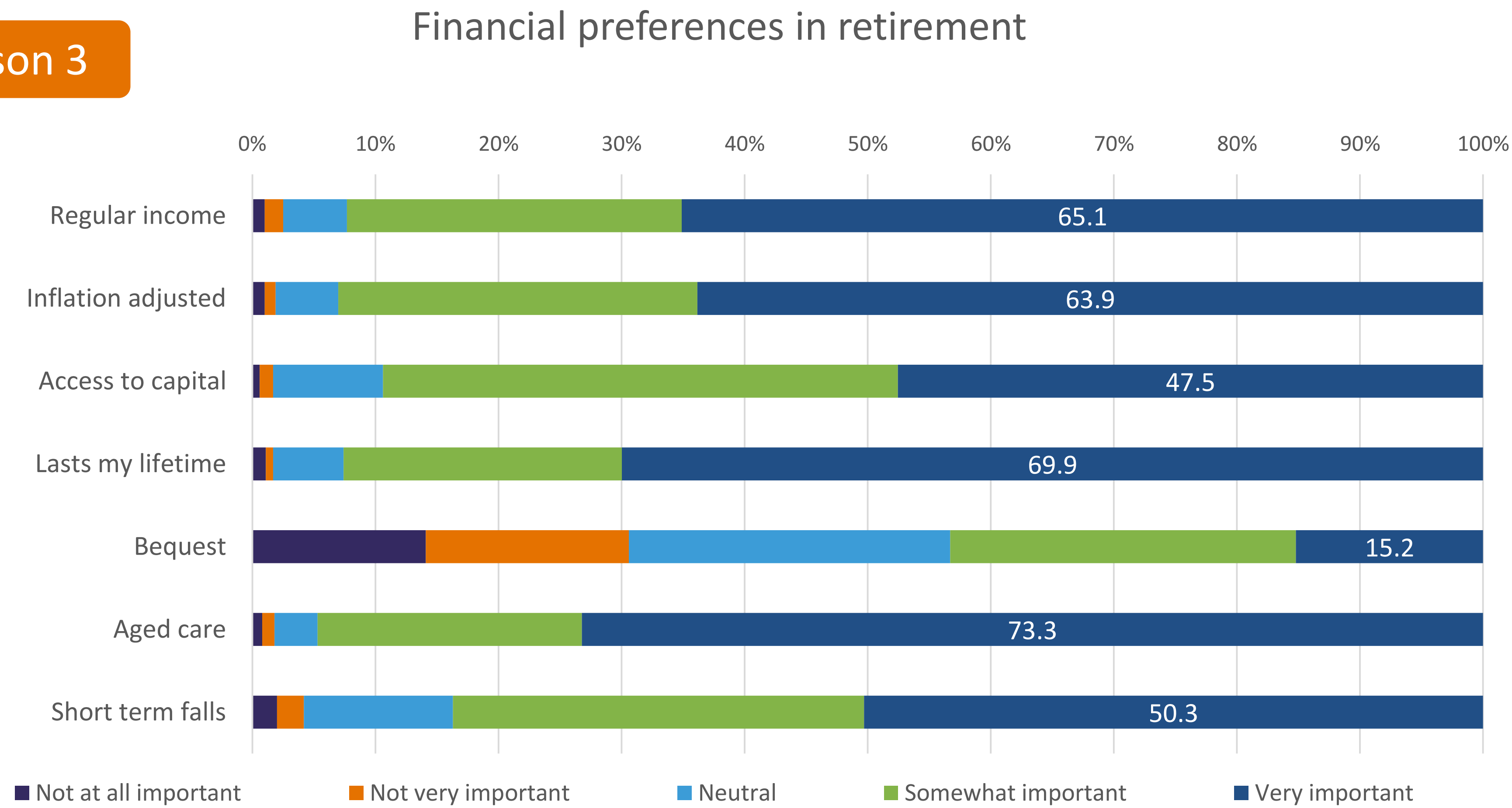
Why income?

Reason 2



Why income?

Reason 3

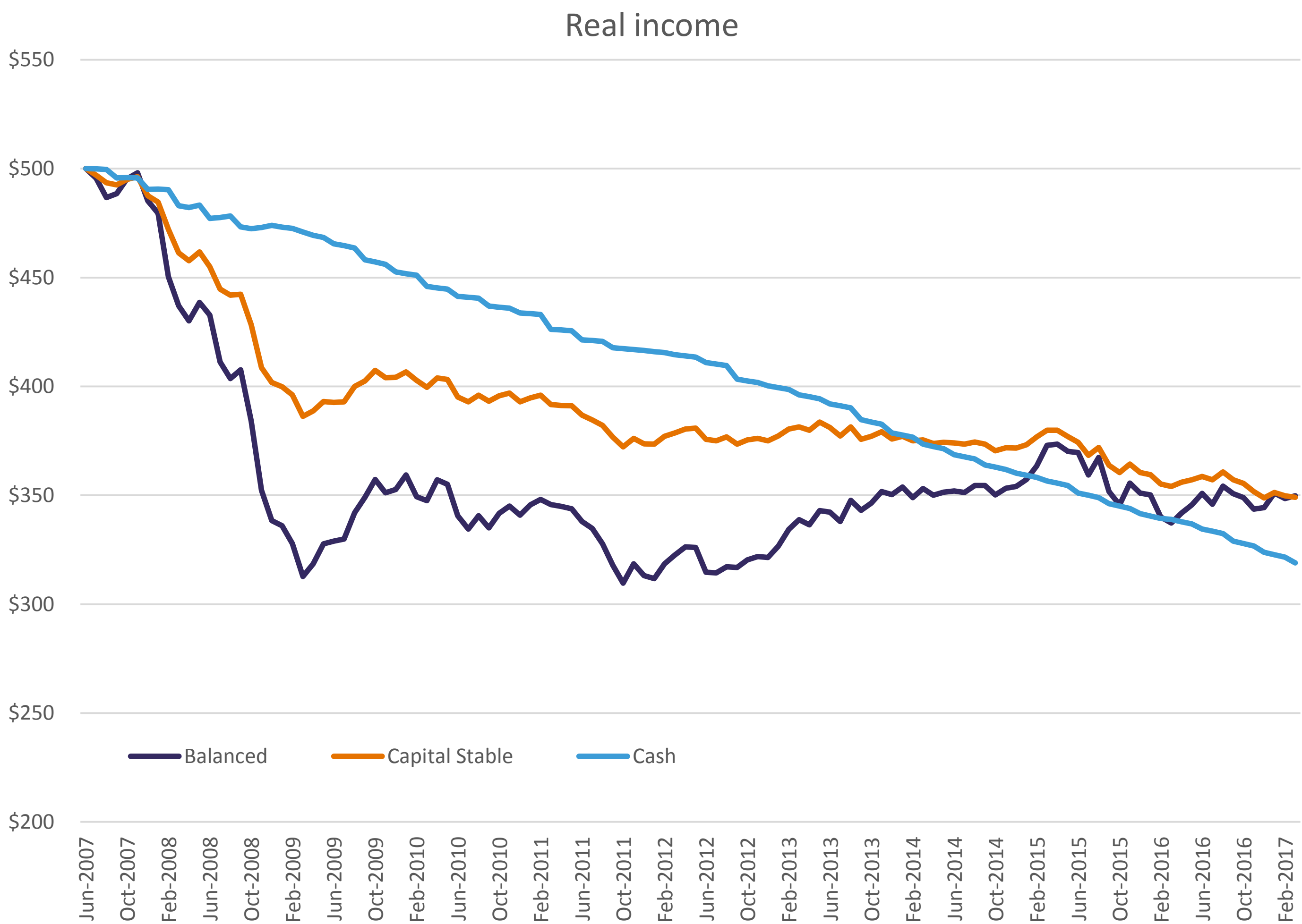


Source: Retirees' Needs and Their (In)Tolerance for Risk, National Seniors Australia, March 2013

Account based pension

- Invest in similar options to accumulation
- Drawdown set percentage of assets every year

Account based pension



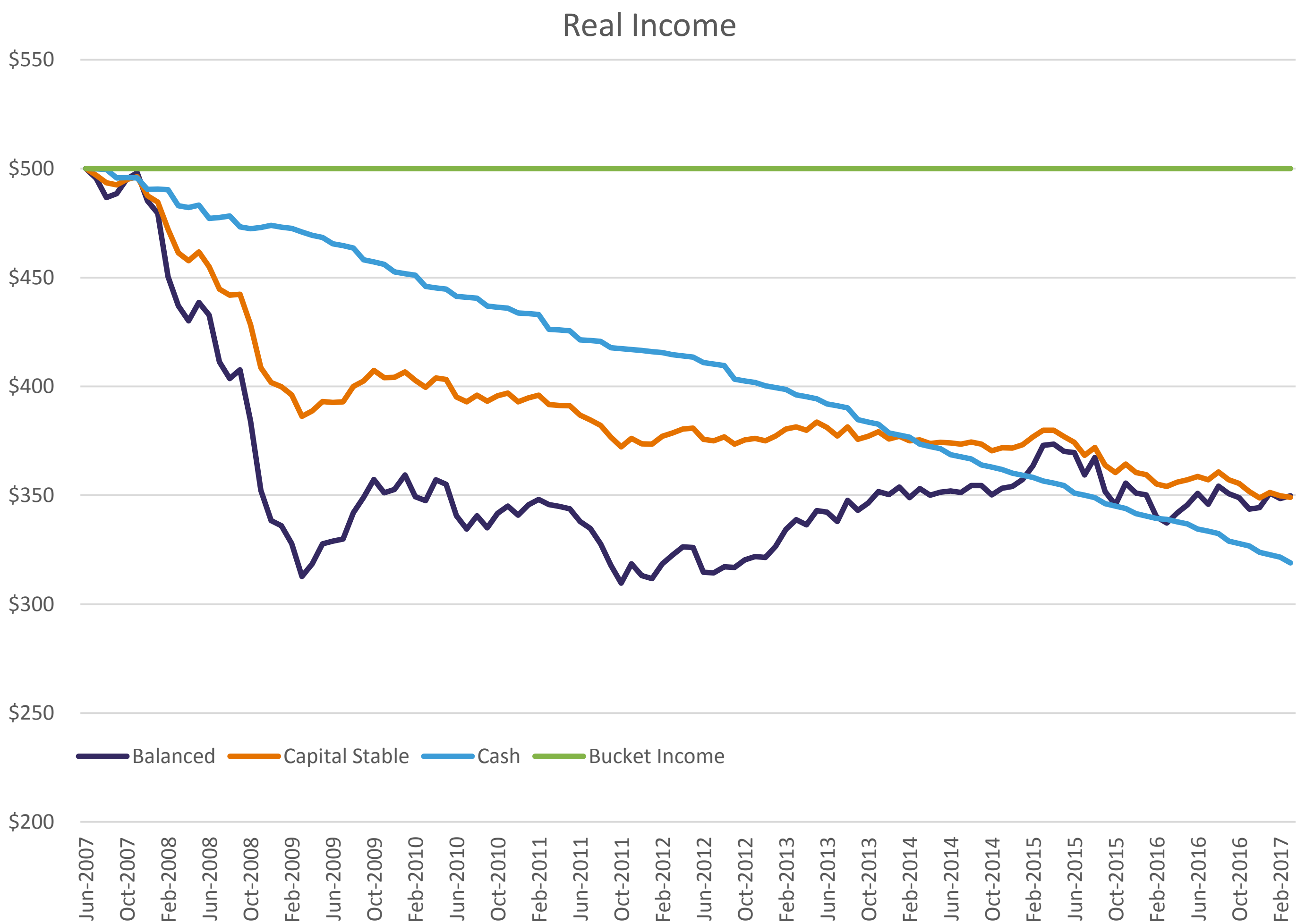
	Income	End Value
Balanced	$42,283	$70,731
Capital Stable	$46,312	$70,024
Cash	$48,383	$63,581

Bucketing approach

Source: Australian Catholic Super

- 2-3 years of pension payments invested in cash bucket.
- Remainder invested in growth bucket to provide longer term appreciation
- Cash bucket topped up from growth bucket

Bucketing



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Balanced	$42,283	$70,731
Capital Stable	$46,312	$70,024
Cash	$48,383	$63,581
Bucketing	$59,000	$44,879

Endowment approach

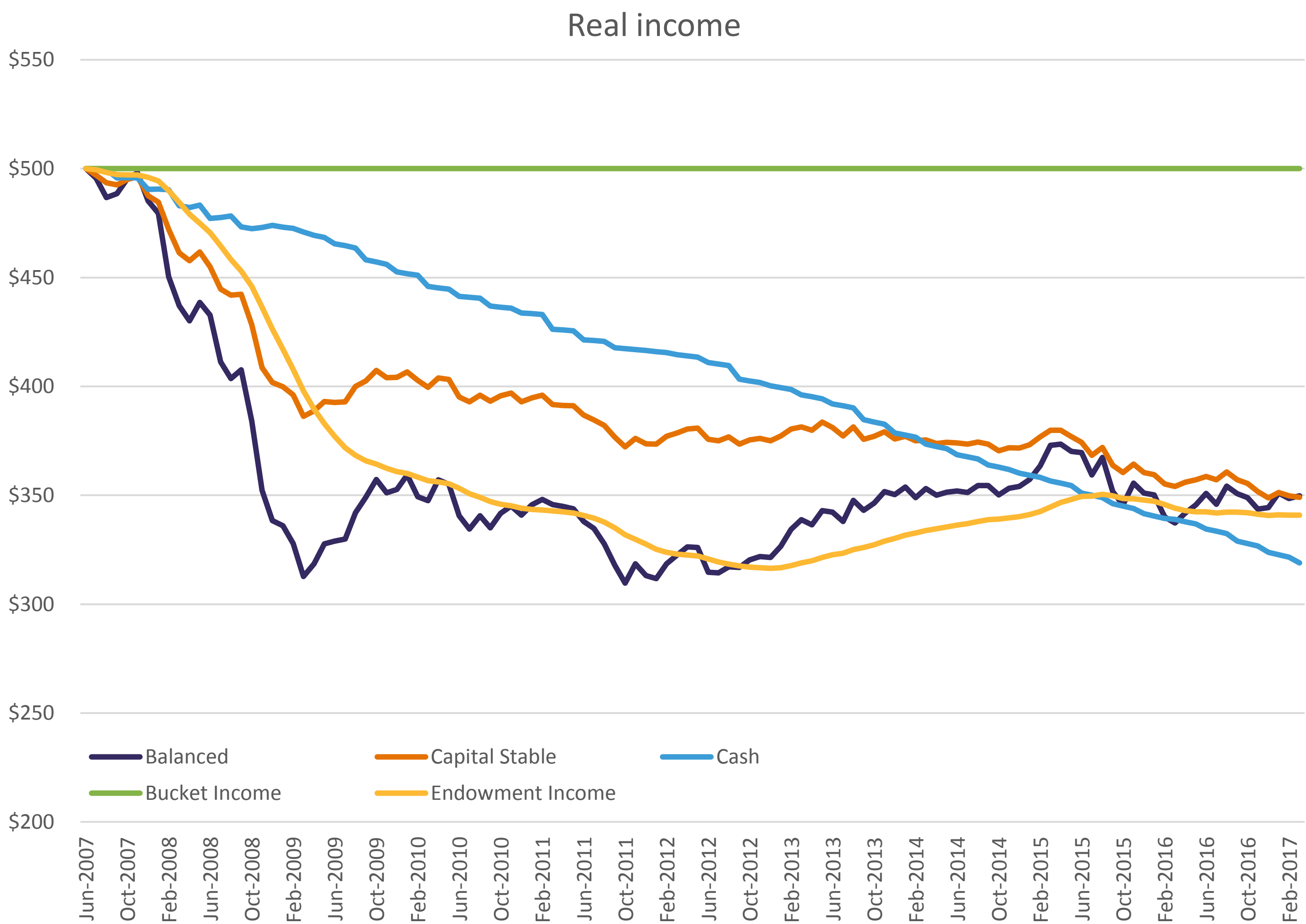
- Desire to have a degree of stability built into the spending rules
- Hybrid (Yale) Model

Prior year's distribution adjusted for inflation

+

Distribution rate * prior year's market value

Endowment



	Income	End value
Balanced	$42,283	$70,731
Capital stable	$46,312	$70,024
Cash	$48,383	$63,581
Bucketing	$59,000	$44,879
Endowment	$42,972	$68,974

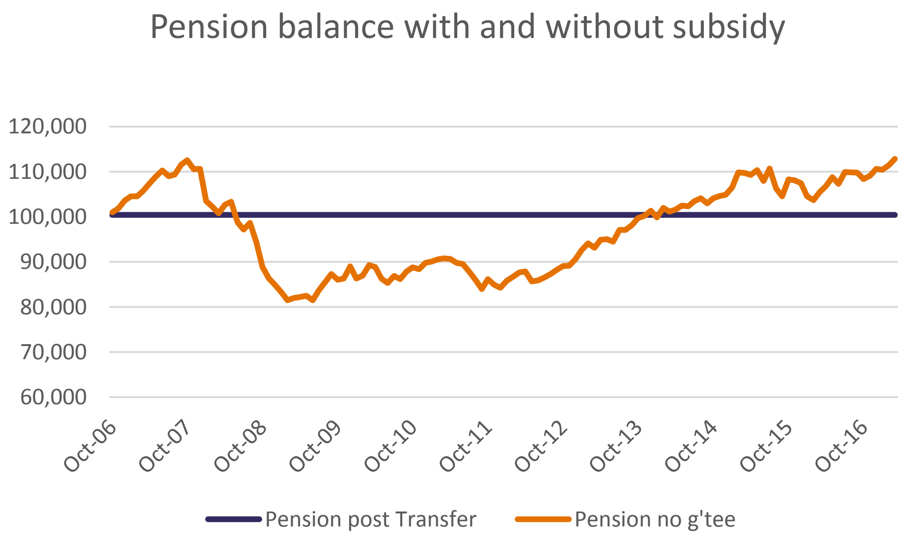
Investment annuity idea

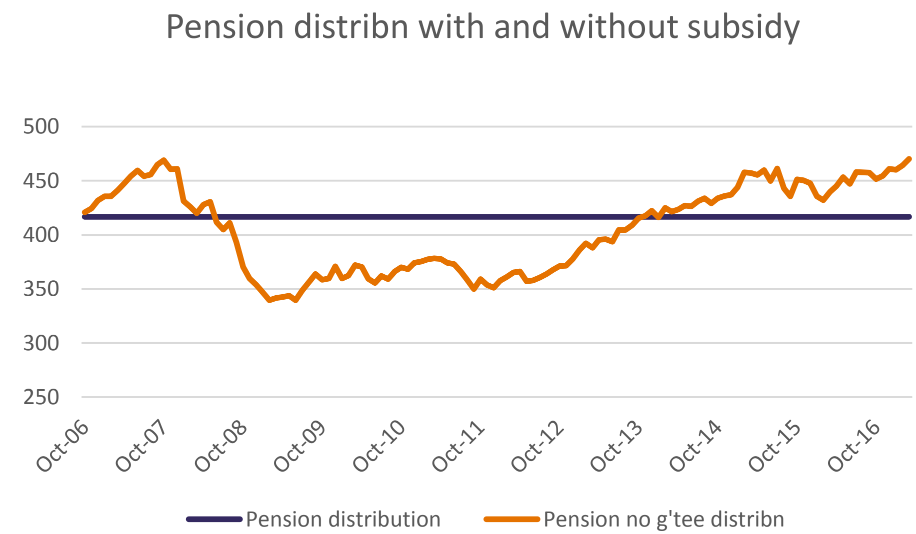
- Objective is to provide member with guaranteed CPI linked pension
- Why not explore the potential to bring the annuity product in-house with capital backing provided by accumulation members?
- If the Accumulation Balanced Pool has an objective to return CPI + 4%, why can't it offer a return of CPI +2.5% to the Pension Balanced Pool?

Pension Members	• Benefit from receiving a guaranteed stable annual return (higher than that offered by annuity providers)
Accumulation Members	• Benefit from keeping margin between their long term expected return (CPI + 4%) and the return they provide Pension members (CPI + 2.5%)

Investment annuity idea – modelling – pension option

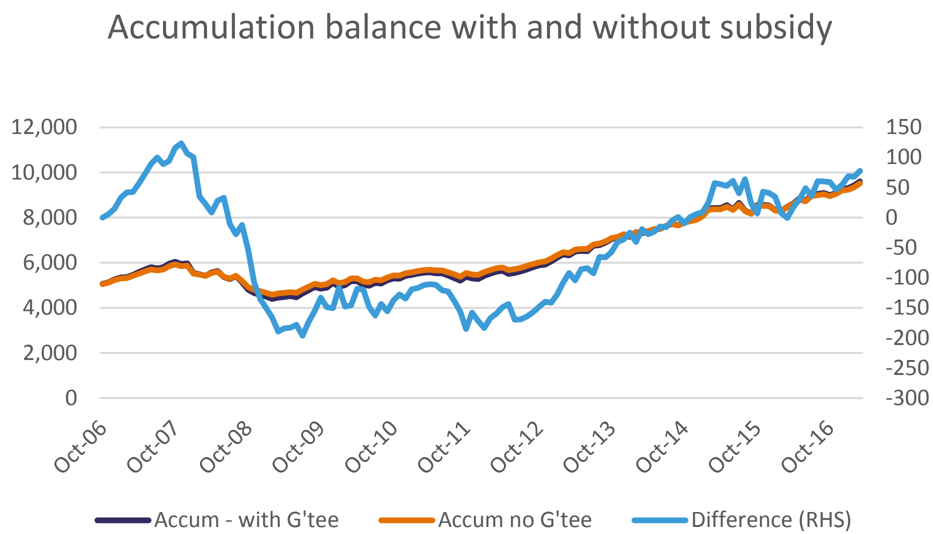
- Assuming:
  - $6 billion Fund with $1 billion of Pension Assets
  - Accumulation Pool guarantees Pension Pool returns of 5% p.a.
  - Pension Pool distributes 5% p.a.
  - Underlying Pension assets invested in a diversified portfolio
  - If market returns over 5%, excess returns flow to Accumulation Pool
  - If market returns less than 5% Accumulation Pool subsidises Pension Pool to guarantee the 5% return





Investment annuity idea – modelling – accumulation option

- Through the worst of the GFC, subsidisation costs the Accumulation Option around $200 million, which is eventually earned back in subsequent years and is ahead presently



- In this simple model:
  - Pension members benefit from steady distributions and protection of member balances regardless of market conditions
  - Accumulation members benefit in the long term from the margin they are paid for providing the guarantee to pension members

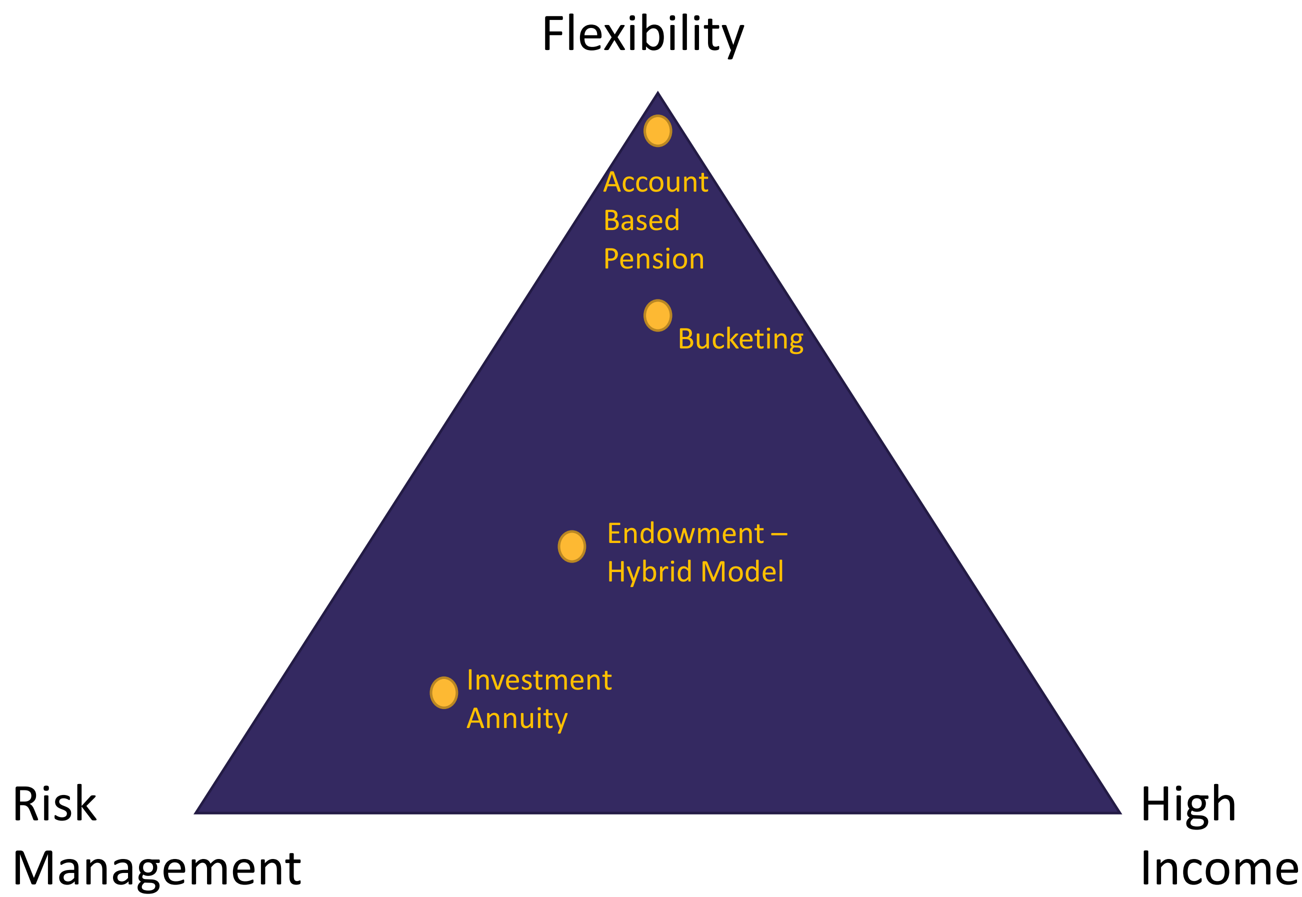
Investment annuity idea – details and variations

- More detailed modelling/thought could involve:
  - Stress testing in a high inflation environment
  - Practical implementation concerning accumulation members transitioning into retirement
  - Implementing via a product rather than the entire accumulation balance being used to provide the guarantee to pension members
  - Varying the accumulation/pension ratio and its impact on accumulation balances
  - Governance rules around periodic review of guarantee rate
  - Incorporating lump sum withdrawals and flexibility for members
- Variations could involve:
  - Introducing some market sensitivity return to the pension guarantee. For example instead of a CPI + 2.5% (~5%) guaranteed return, CPI + 1.5% + 20% of underlying pool return

Comparing the different approaches

	Account based pension	Bucketing approach	Endowment model	Investment annuity
Advantages	• Least complex approach • Well understood by market participants • Internal administration and back office systems set up to implement • Offers a high level of flexibility for the member	• Could help members visualise their account in an intuitive way • Could assist advisors communicate with members • Offers a reasonably high level of flexibility for the member	• Offers reasonably stable pension distributions • Can be customised via an intuitive formula to adjust stability of distributions customised to each member	• Novel idea • Offering a tidy solution aligned with the pension and accumulation cohorts • Could allow members to gain profits/margins that would otherwise accrue to annuity providers
Disadvantages	• Least income-targeted approach. Income is largely a passive by-product of the investment function	• Introduces complexity with minimal difference in modelled outcomes • Requires amendments to back office and administration arrangements	• Requires amendments to back office and administration functions	• Still at brainstorming stage. Details to be ironed out • A number of hurdles to be overcome • Will require amendments to back office and administration functions

Comparing the different approaches



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