OPTIMUM PENSIONS

Planning for Retirement with Confidence

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Redesigning Retirement

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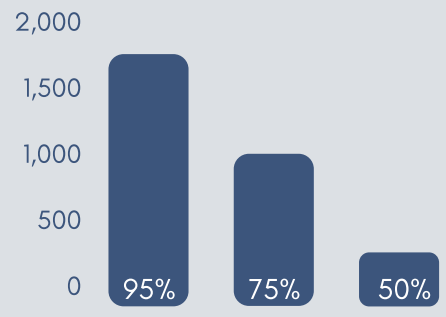
PLANNING FOR RETIREMENT WITH CONFIDENCE

Nobody knows exactly how long they will live, so when it comes to retirement planning there is no crystal ball to determine how long your savings need to last.

The 'degree of confidence' regarding how long you and your partner will live is a new concept in superannuation and financial planning, but it is critical to understanding how long your retirement income needs to last.

The main metric quoted by the media and financial planners to determine retirees' possible planning horizons is average life expectancy. In other words, an estimated lifespan based on 50% confidence. This is often the starting point for a retirement plan. Why? The simple answer is because this is the figure quoted by the software that financial planners typically use [1].

CHART 1: HOW CONFIDENT DO YOU WANT TO BE THAT YOUR RETIREMENT PLAN CAN LAST AS LONG AS YOU LIVE?

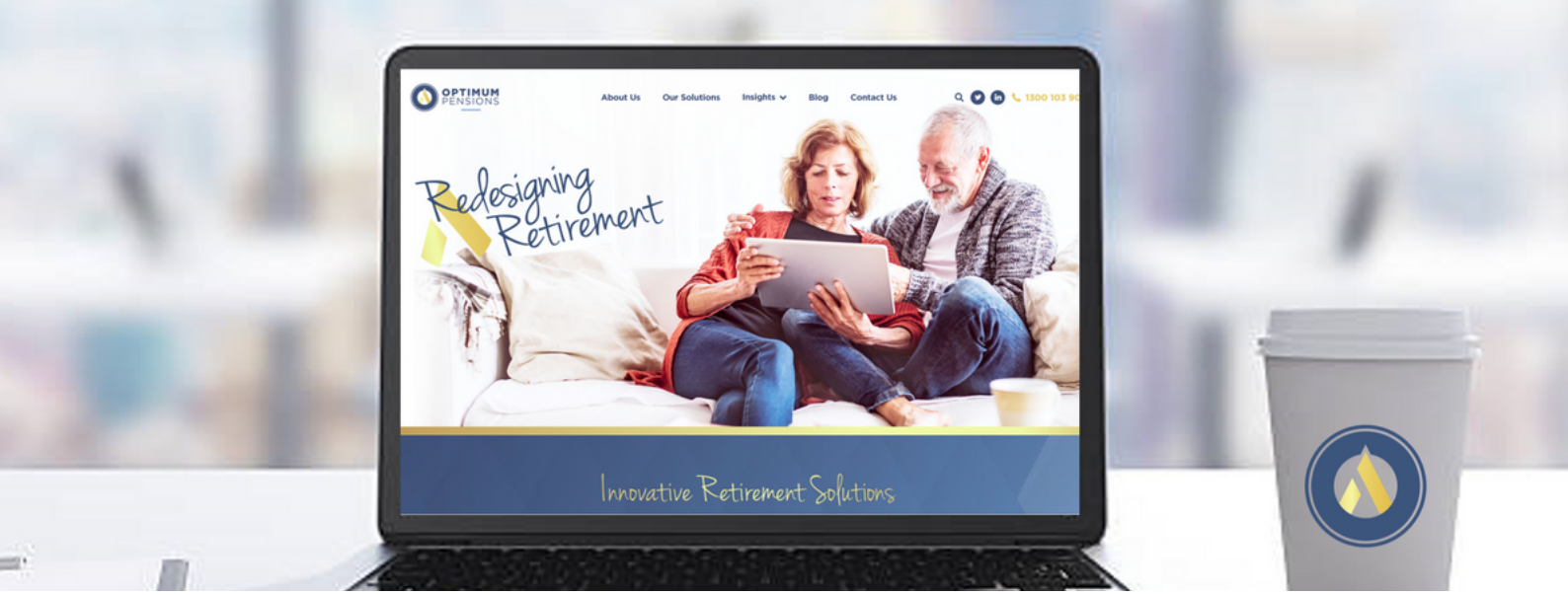


Confidence level selected (3050 respondents)

Prudent financial planners know that approximately half of the population will live longer than average, and consequently might add a few years to the estimate provided. However, if a financial plan is designed on this basis, what happens if the retirement income reduces or even runs out? It may mean retirees fall back on the Age Pension, which is less than a 'modest' standard of living according to the Association of Superannuation Funds of Australia (ASFA) Retirement Standard.

Chart 1 shows how over half of the people who have used the Optimum Pensions Lifespan Calculator to help estimate their personalised life expectancy and explore the question, "How confident do you want to be that your retirement plan can last as long as you live?" selected a confidence level of 95%, seeking a high degree of confidence they will not run out of money.

Wouldn't you?



HOW TO BE MORE CONFIDENT IN YOUR RETIREMENT PLANNING

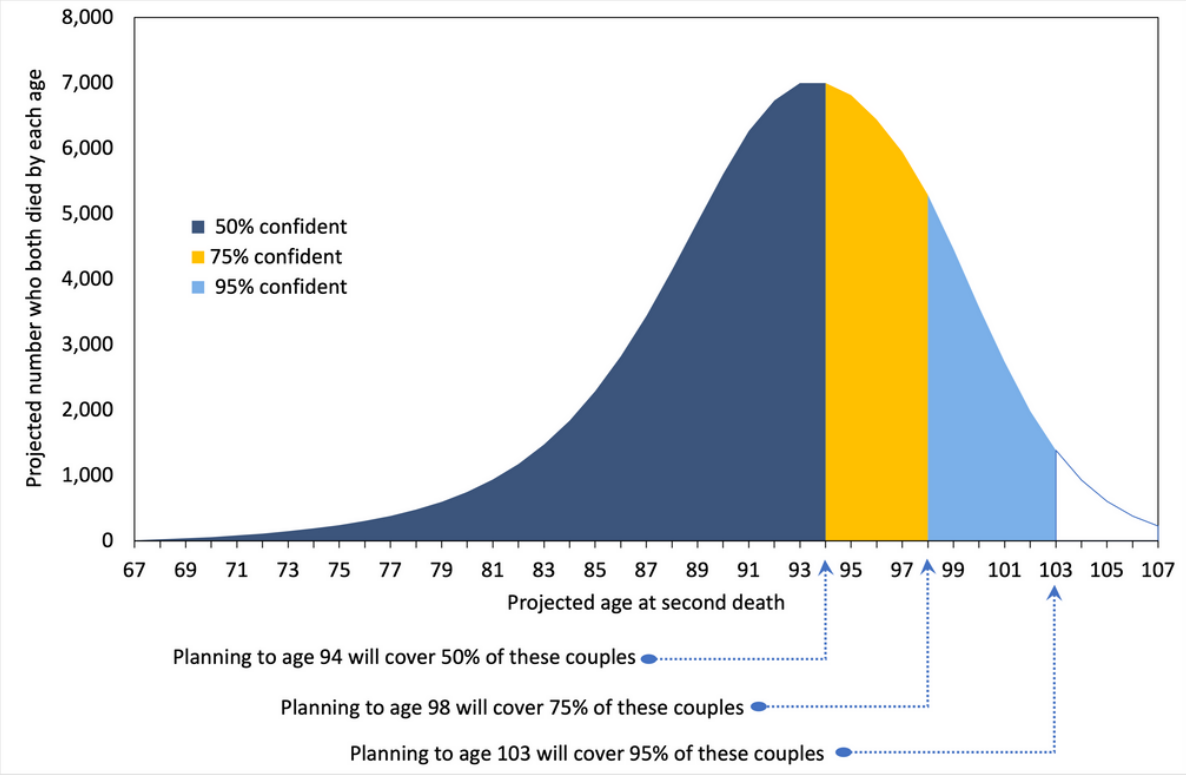
In order to have a higher degree of confidence that your retirement income will last as long as you do, your financial plan (in years) has to have a greater chance of covering your whole potential future lifespan. The challenge is that you can never know precisely how long you will live, so you will need to consider the range for how long people like you are likely to live.

Chart 2 illustrates the projected range for the lifespans of a large group of 67-year-old couples entering retirement [2].

The colouring indicates how many of these individuals would be covered if using different planning horizons.

- **95% confidence** represents a high chance that this planning horizon will cover the lifespans of this couple.
- **75% confidence** represents a reasonable chance that this planning horizon will cover the lifespans of this couple.
- **50% confidence** represents a 50/50 chance that the planning horizon will cover the lifespans of this couple.

CHART 2: RANGE OF LIFESPANS: CONFIDENCE LEVELS - 100,000 COUPLES AGED 67 YEARS



While the average life expectancy for a 67-year-old male is only 85 years, a 67-year-old couple has two chances of beating the average and needs to plan for longer than that. The plan should also allow for expected increases in Australian lifespans generally, as published by the Australian Government Actuary.

What are the consequences of choosing a higher degree of confidence?

Table 1 shows, for different confidence levels, the balances required at retirement to fund an income of $25,000 per annum, which increases with inflation, for a theoretical couple, both aged 67 at retirement.

You can find charts showing a projection for each of these amounts at the end of this article.

TABLE 1: LUMP SUM REQUIRED AT DIFFERENT CONFIDENCE LEVELS [2]

FOR A CONFIDENCE LEVEL OF...	AGE MONEY NEEDS TO LAST UNTIL...	AMOUNT REQUIRED AT AGE 67 YEARS...	PROBABILITY OF ONE SPOUSE STILL BEING ALIVE AT THAT AGE...
50%	94	$463,000	48%
75%	98	$506,000	22%
95%	103	$553,000	4%

THE VALUE OF A LIFETIME PENSION

Not surprisingly, to support the same income for more years requires a larger balance. To be 95% confident that their planning horizon can cover their whole lifespan, the couple needs almost 20% more superannuation at retirement than a couple who is satisfied with being 50% confident.

One alternative solution to having to save much larger amounts for retirement is to buy an efficient and effective lifetime income stream that guarantees continued income no matter how long either spouse lives. The cost of such an income for this 67-year-old couple would be approximately $497,000 based on pricing for an investment-linked annuity and using the same return and inflation assumptions as above [3].

CHART 3: RETIREMENT BALANCES NEEDED TO ACHIEVE HIGHER DEGREES OF CONFIDENCE

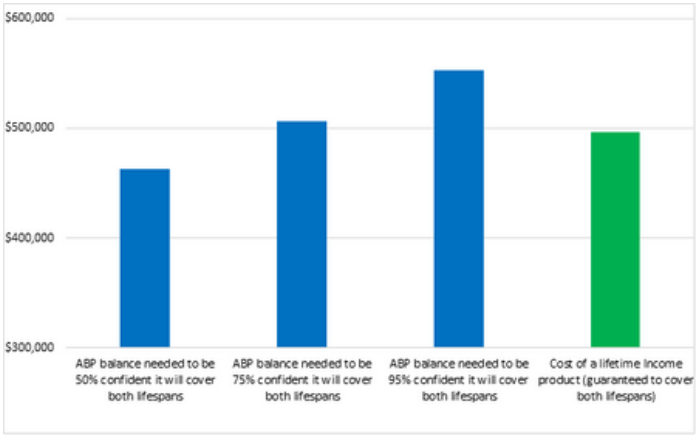


Chart 3 illustrates that an alternative to having a higher retirement balance to provide a higher degree of confidence is to use a 'lifetime' retirement product with 100% confidence that your income will "last for life". This reduces the need to save as much for retirement. [4]

THE MAGIC OF POOLED LONGEVITY RISK.

Pooled longevity risk might be the answer. The crystal ball and missing ingredient in the retirement planning landscape. Lifetime income products use pooling to share the longevity risk and as a result, less funds are needed to ensure the security of each person's retirement income until the end of their days. This grants peace of mind to cover the cost of anything unexpected and most importantly, the opportunity to enjoy a fulfilled and comfortable retirement.

END NOTES

[1] Actuaries Institute's "We asked how 2,500 planners formulate retirement income advice",2018.

[2] Assumptions:

- "Australian Life Tables 2015-17 with the 25-year improvement factors. The 25-year improvement factors allow for exptected future reductions in mortality rates that reflect the reductions we have seen over the past 25 years. For example, by the time a current 65 year old reaches age 75, the mortality rate for a 75 year old male is projected to be around 34% less than it was when the tables were produced.
- Investment return net of fees, tax of 5.5% per annum and future inflation of 2.5% per annum.
- Ignores the Age Pension (which might be received in addition).

[3] The pricing for the investment-linked annuity comes from the provider of investment linked annuities who will be launching the product in early 2022.

[4] The first 3 bars are based on the Australian Life Tables or ALT (which includes people who are disabled or who have never worked) whereas the bar on the right is based on mortality rates for lifetime annuitants e.g. people who have worked all their lives, looked after themselves health-wise – and have better health than the average.

OPTIMUM PENSIONS

Optimum Pensions was launched in 2017 with a single mission - to help Australians lead a comfortable retirement. The Optimum Pensions innovative retirement income solutions are specifically developed to address longevity risk and provide greater peace of mind for all retirees; no matter how long they live.

The Optimum Pensions, award-winning LifeSpan Calculator builds confidence around personal life expectancy and retirees' possible retirement planning horizon.

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CHART 4: 50% CONFIDENCE: $463,000 IS NEEDED TO LAST UNTIL AGE 94 (SPENDING $25,000 P.A.)

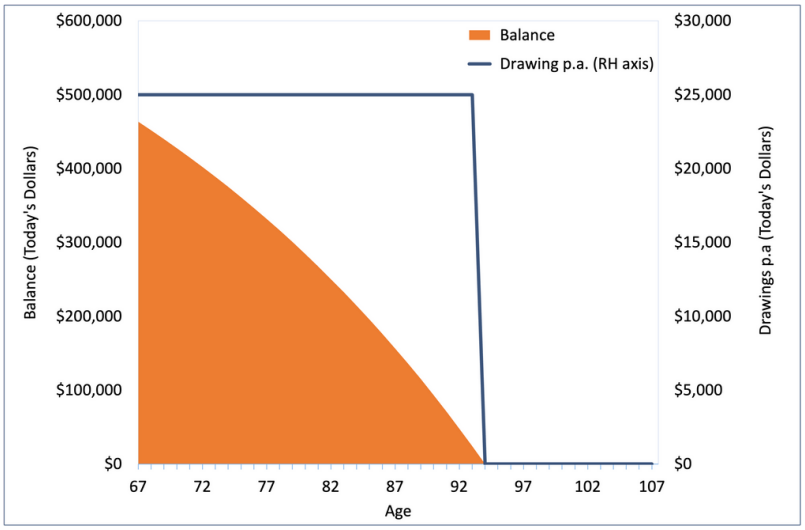


CHART 5: 75% CONFIDENCE: $506,000 IS NEEDED TO LAST UNTIL AGE 98 (SPENDING $25,000 P.A.)

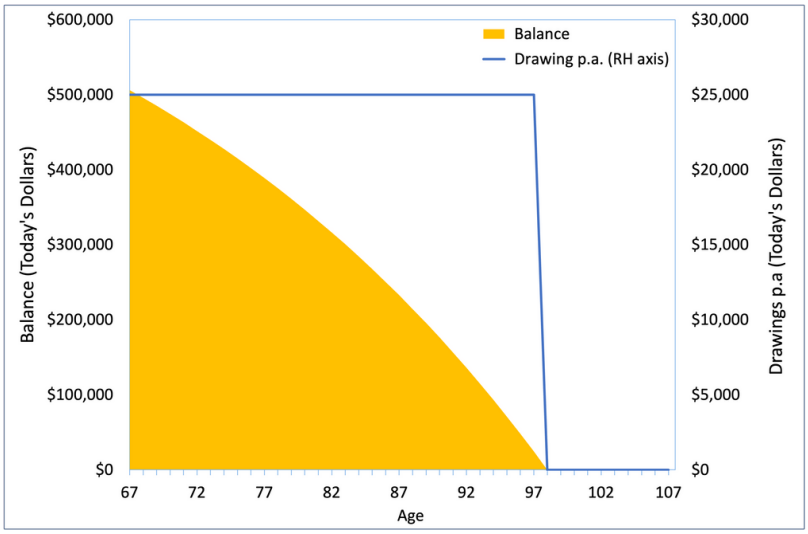
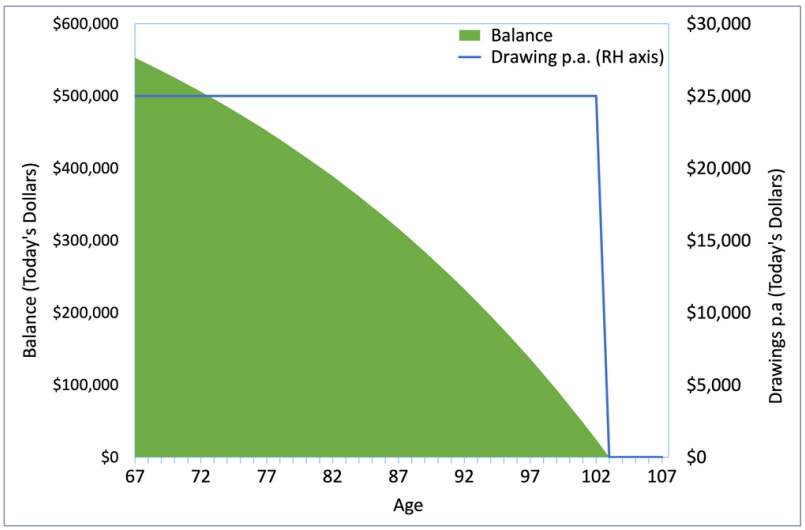


CHART 6: 95% CONFIDENCE: $553,000 IS NEEDED TO LAST UNTIL AGE 103 (SPENDING $25,000 P.A.)



ABOUT THE AUTHORS

DAVID ORFORD

David, an actuary, founded Financial Synergy, which became Australia's leading provider of superannuation administration software. After successfully selling the business to IRESS in 2016, he is now devoting his time to researching and creating innovative retirement solutions, and directing The Orford Foundation.

JIM HENNINGTON

Jim is a recognised thought leader on retirement income strategy and modelling. An actuary, he is involved in product design and developing modelling tools to make Optimum Pensions' products accessible to superannuation funds, financial planners and retirees.

FOR MORE INFORMATION

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