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Felipe Araujo
executive director
and general manager
Generation Life

Preventing 'regret risk'

There's never been more Australians entering retirement than right now. Due to the complexities and uncertainties of retirement, there's also never been a greater need for sound financial advice offering retirees financial freedom in retirement.

According to Natixis Investment Managers' recent Global Retirement Index, 2022 is the hardest year to retire due to the perfect storm we're enduring of difficult markets, low rates, and inflation.

"Those who step out of the working world run the risk of taking retirement distributions from an already depleted pool of assets," the report stated.

"At the same time, it's likely they will have to take greater risks with their portfolio to make up the ground they've already lost. Both will make it hard to preserve retirement savings and make it harder to attain a secure retirement."

The pain is two-fold, as retirees already face significant challenges, including those posed by longevity risk. All these factors are causing retirees to live too frugally in the early years of retirement and feeling the regret of having done so in their later years, Generation Life executive director and general manager Felipe Araujo[01] says.

"Many retirees don't feel confident enough to spend their savings in the early years of retirement and really enjoy their lifestyle while they're still active and able to enjoy it the most," he explains.

"Once they reach their later years, they feel a sense of regret from being overly frugal or conservative in the early years as they've now reached a point where they are no longer able to enjoy the lifestyle they desired. This is known as 'regret risk'."

It's this particular risk that Generation Life is trying to combat, working closely with financial advisers to make sure their clients have not only a financially secure retirement, but also one that is enjoyable.

However, when it comes to investment products for this client segment, options have been limited. This is especially the case in recent years as annuities have lost their sheen, their popularity waning in the face of a prolonged low-rate environment.

"Financial advisers have therefore found it difficult to recommend an annuity which will provide a return on their client's investment with the flexibility they need to tailor their investment to their client's changing needs and risk profiles," Araujo says.

"As more Australians move into the retirement income system, the need for a wider range of lifetime choices becomes more pressing."

This is why Generation Life has launched LifeIncome, an investment-linked lifetime annuity offering 23 different investment options and reversionary and death benefits. Advisers can switch their clients out of and into the different options at almost any time as their income needs change or their appetite for risk shifts.

The options complement just about any manner of portfolio, including diversified, core and satellite or single sector portfolios, built with passive or active sector funds. And catering to a growing need, clients can also gain exposure to several ESG funds.

Further, the allocation to growth assets varies across all investment options; gone are the days of lifetime annuities only providing an exposure to fixed interest that can't be altered.

"Historically the stigma of traditional annuities has been poor returns because of all-time low interest rates, but there is also the lack of flexibility. Once a traditional annuity is set, there is no ability to influence the investment outcome in the longer term," Araujo says.

"The new era of lifetime annuities also gives the opportunity to gain exposure to growth assets, which means the potential for greater longer term growth income."

LifeIncome has the potential for higher overall returns and therefore higher income payments over the life of the annuity, decreasing the likelihood of 'regret risk' down the track.

Research also shows that the bulk of retirees' spending is done in the earlier years of their retirement, so LifeIncome has a LifeBooster feature which enables clients to receive more income in those days.

"By applying LifeBooster, an investor's starting income can increase by as much as 71% when compared to if no LifeBooster rate was applied," Araujo says.

"This feature allows financial advisers to help their clients more closely align their income with their spending patterns over their retirement journey and avoid experiencing regret risk in the later years."

LifeIncome differs from a traditional lifetime annuity in several ways, but one of the most significant is the flexibility and choice it provides.

With a traditional lifetime annuity, the investment outcome is pre-determined at the annuity's commencement and can't be adjusted if markets change or the client's attitude to risk changes. Where investment choice is provided, a portfolio can be built to match the client's risk profile and to complement the portfolio that has been built in the client's account-based pension.

The adviser can take a whole of portfolio view across the account-based pension and the investment-linked annuity with respect to investment strategy, Araujo notes.

"Historically the adviser had to give up the defensive part of the account-based pension to allocate to a lifetime annuity. Now the adviser can allocate across both income stream products with complete flexibility," he says.

Clients can switch between investment options at almost any time and make these switching decisions with regards to the lifetime annuity and the account-based pension, Araujo reinforces.

"Markets change, attitudes to risk change – you should be able to change your investment strategy within your lifetime annuity," he says.

But while it might seem straightforward, Araujo says the increasing complexity of the retirement income landscape requires an education piece like never before. As the cost of living rises, the likelihood that financial advice will become even further out of reach is high, and while retirees with a lifetime of accumulated wealth on their side might be best placed to afford professional advice, most are looking to maximise their retirement income in any way they can.

However, Araujo points out that it's likely that over the next decade financial advisers will become even more important as the issues involved in optimising retirement income are complex and multilayered - very few individuals will be able to manage that process by themselves.

"In the new retirement income landscape, financial advisers will need to teach their clients that sophisticated products such as investment-linked lifetime annuities can deliver tangible benefits - income they can rely on and income that makes a difference to their lives," he says.

This will include balancing income, access to capital, risk, social security, and estate planning considerations so that clients benefit from the optimal mix.

"Through the development of LifeIncome, Generation Life aims to help financial advisers with a very important component of their client's retirement income plan and provide a unique opportunity for ongoing advice," Araujo concludes. **FS**

The quote

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Watch the video on www.fsitv.com