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# Retirement investment strategies – key issues to consider


Presented by

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# Questions?

**Please ask questions through the Q & A pod** not on the chat pod.

Not Answered Questions will be emailed to you along with the **webinar recording**

# Theme of today's session

Retirement is a trigger to seek advice about finances – not a trigger to wind up the SMSF!

Issues for consideration:

- Investment strategy requirements for retirement
- Retirement risks and how to navigate them
- Latest ATO SMSF investment statistics

# Benefits of SMSFs in retirement phase

RPIS – has no 10% upper limit

Exempt current pension income (ECPI)

No CGT in pension phase

Flexibility in taking pension payments – frequency, couples, etc

SMSF pensions paid from bank account – no need to sell down assets to pay pension payments

# Investment strategy requirements

# SMSF investment strategy requirements

| | |
|---|---|
| SMSF trustees required to regularly review and formulate an investment strategy that gives regard to all the circumstances of the fund, including: | The risk and likely return from the fund's investments, having regard to its objectives and expected cash flow requirements |
| | The diversification of fund investments |
| *References:*<br>*SISR 4.09(2)*<br>*SISA 52B(2)(f)* | The liquidity of the fund's investments, having regard to its expected cash flow requirements |
| | The ability of the fund to discharge its existing and prospective liabilities |
| | Whether the fund trustees should hold a contract of insurance that provides insurance cover for one or more members of the fund |

# SMSF investment strategy requirements

- Should be in writing and tailored to fund and member circumstances
- Regular review must happen at least annually (not set and forget!)
- Significant events may require strategy to be reviewed more regularly than on an annual basis:
  - Market correction
  - When a new member joins/departs the fund
  - Starting a pension
- Document that review has been undertaken and any decisions made arising from the review

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# Broad investment ranges (0% – 100%)

- Investment ranges are not compulsory but preferred (ATO view)
- Broad investment ranges between 0% - 100% not a valid approach (ATO view)
- Investment strategy must articulate:
  - How you plan to invest your super to meet your retirement goals, or
  - Why you require broad ranges to achieve your investment strategy requirements
- Check with your SMSF auditor. Some prefer 0% – 100% ranges but others don’t!

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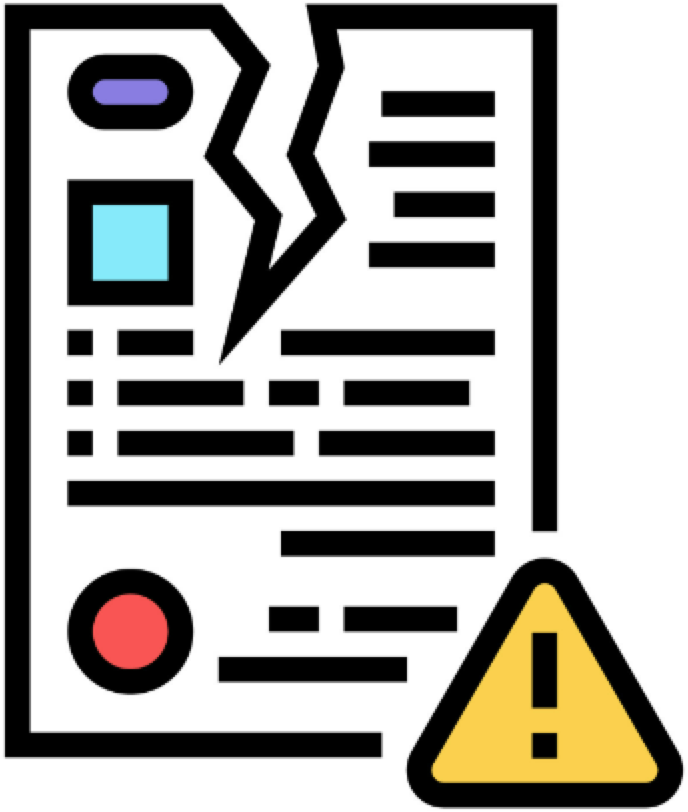
# Breaching the requirements

- Investment strategy is an operating standard [SISR 4.09(1)(a)]
- SMSF auditor will check whether investment strategy meets the requirements
- Penalty for breach of operating standard = $31,300 (100 penalty units x $313) for each individual trustee or corporate trustee
- Additional administrative penalty of $6,260 for each individual trustee or corporate trustee can also apply
- Another good reason to go for a corporate trustee structure!



# Retirement income covenant (RIC)

- RIC commenced on 1 July 2022 for APRA regulated funds
- Trustees required to develop a retirement income strategy for members in retirement
- Trustees must ensure members are covered by a strategy that balances the objectives of:
  - Maximising a member's expected retirement income
  - Managing the expected risks (ie, longevity, investment and inflation risks), and
  - Providing flexibility to access capital required during retirement
- SMSFs excluded from RIC but trustees should factor this into the fund's investment strategy (if they're not doing this already)

# Retirement income strategy requirements – APRA funds

Retirement income strategy must address how APRA fund trustees will assist members who are retired or approaching retirement to achieve and balance the following objectives (SISA 52AA):

a) To maximise expected retirement income (net of tax) over retirement

b) To manage expected risks to the sustainability and stability of retirement income over retirement:

   i. Longevity risks

   ii. Investment risks

   iii. Inflation risks

   iv. Any other risks

c) To have flexible access to funds over retirement

Similar themes to the SMSF investment strategy requirements

# Retirement investment strategy for SMSFs

- SMSF investment strategy must consider the impact of paying benefits to members and risks involved in fund investments
- Retirement investment strategy objectives differs to accumulation phase strategy
- Key considerations for professionals assisting SMSF members as they enter retirement:
  - How to balance cashflow objectives whilst managing risks
  - How to communicate the compliance of the SMSF investment strategy in retirement for the fund auditor
  - Pension planning and maximising ECPI
- SMSFs better placed than APRA funds to tailor a retirement investment strategy for members (as don’t have a large cohort of members)

# Creating a retirement investment strategy

Accumulation vs retirement investment strategy objectives differ:

| Accumulation phase | Retirement phase |
|---|---|
| Regular contributions, compound returns | Regular benefit payments and possible lump sums |
| Investing for growth, long term | Investing for growth … but |
| Liquidity generally not required | Liquidity required to make payments |
| No sequencing risk (no withdrawals) | Manage sequencing risk |

When developing a retirement investment strategy:

- Same investment strategy for all fund members?
- Investments to manage growth vs sequencing risk vs liquidity needs
- What cashflows are required
- Superannuation savings, non-super savings, age pension?

# Retirement risks and how to navigate them

# Understanding risks to the retirement strategy

SMSF investment strategy focuses on market risk having regard to the cashflow objectives:

- Risk involved in making, holding, and realising, and the likely return from the investments
- Composition of the investments, including the extent to which the investments are diverse

When assessing whether investments will achieve objectives, must also consider longevity risk:

- Retirees expected to live longer
- Future outcomes are not ‘risky’ if we know about them and can plan with certainty

What will future returns be? How long will you live? How much will cost of living rise?

# Risk 1 – budgetary risk

Expenditure patterns can vary considerably during retirement:

- Active years (60s to early 70s)
- Passive years (early 70s to early 80s)
- Frailty years (early 80s onwards)

How to manage this risk:

- Recognise spending habits will change overtime
- Develop a budget for client's retirement spending – determine the non-negotiables vs lifestyle expenses
- Understand what benefits clients may be eligible for which could help reduce costs (ie, age pension, CSHC, etc)
- Have sufficient cashflow to fund any unforeseen expenses later in life

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Risk 1 – budgetary risk

# Cost of living in retirement?

ASFA retirement standard budget for retirees aged 65 to 84 (March qtr 2024)

| Status | Modest lifestyle | Comfortable lifestyle |
|---|---|---|
| Single | $32,915 | $51,630 |
| Couple | $47,387 | $72,663 |

ASFA retirement standard budget for retirees aged 85 + (March qtr 2024)

| Status | Modest lifestyle | Comfortable lifestyle |
|---|---|---|
| Single | $30,669 | $48,492 |
| Couple | $43,891 | $67,050 |

Note: figures in each case assume retiree(s) own their own home and are relatively healthy

Risk 1 – budgetary risk

# How much super is needed in retirement?

Super balances required to achieve a modest and comfortable retirement at age 67:

| Status | Modest lifestyle | Comfortable lifestyle |
|---|---|---|
| Single | $100,000 | $595,000 |
| Couple | $100,000 | $690,000 |

Source: ASFA retirement standard, 2024

Note: all figures in today's dollars using 2.75% AWE as a deflator and an assumed investment earning rate of 6%.

The fact that the same savings are required for both couples and singles reflects the impact of receiving the Age Pension

Risk 1 – budgetary risk

# Annual ‘safe spend’ amount

| Amount of retirement savings (couple, M/F, age 67) | 90% confidence spend (1 in 10 chance run out by life expectancy) | Confidence can afford spend 3 years longer than life expectancy (LE+3) | Confidence can afford spend 6 years longer than life expectancy (LE+6) |
|---|---|---|---|
| $200,000 | $51,100 | 84% | 78% |
| $400,000 | $58,700 | 85% | 78% |
| $600,000 | $64,700 | 84% | 76% |
| $800,000 | $69,300 | 83% | 73% |
| $1,000,000 | $73,200 | 82% | 71% |
| $1,200,000 | $77,700 | 82% | 72% |
| $1,400,000 | $82,700 | 82% | 72% |
| $1,600,000 | $87,800 | 83% | 73% |
| $1,800,000 | $93,600 | 83% | 74% |
| $2,000,000 | $99,700 | 83% | 75% |
| $2,200,000 | $106,400 | 83% | 75% |
| $2,400,000 | $113,000 | 83% | 75% |
| $2,600,000 | $119,700 | 84% | 76% |
| $2,800,000 | $126,600 | 84% | 77% |
| $3,000,000 | $133,800 | 84% | 77% |
| $3,200,000 | $141,100 | 84% | 78% |
| $3,400,000 | $148,600 | 84% | 78% |
| $3,600,000 | $156,400 | 84% | 78% |
| $3,800,000 | $164,000 | 84% | 78% |

Analysis completed using Challenger Retirement Illustrator at 19 March 2024.

Assumptions:

- Retired couple, age 67, homeowners, all savings in super
- ABP savings invested in 50% growth risk profile
- ‘Safe’ level of retirement spending is based on a 90% chance that the spending amount (indexed annually for CPI) will be sustainable to 6 years beyond life expectancy (LE)
- Income to meet annual spending sourced from ABP income and age pension

Source:

- ‘How much can a client afford to spend in retirement?’, Challenger Tech, April 2024

# Risk 2 – longevity risk

Risk of outliving your savings and running out of private financial resources

People are living longer!

Longevity risk complicates the budgetary process (ie, clients draw min pension to self-insure against this risk)

How to manage this risk:

- Overestimate life expectancy. Avg retirement age is 56.3 years which means finances must stretch for another 30+ years!
- Ensure portfolio has adequate exposure to growth assets – can't remain 100% conservative
- Holistic retirement modelling can help

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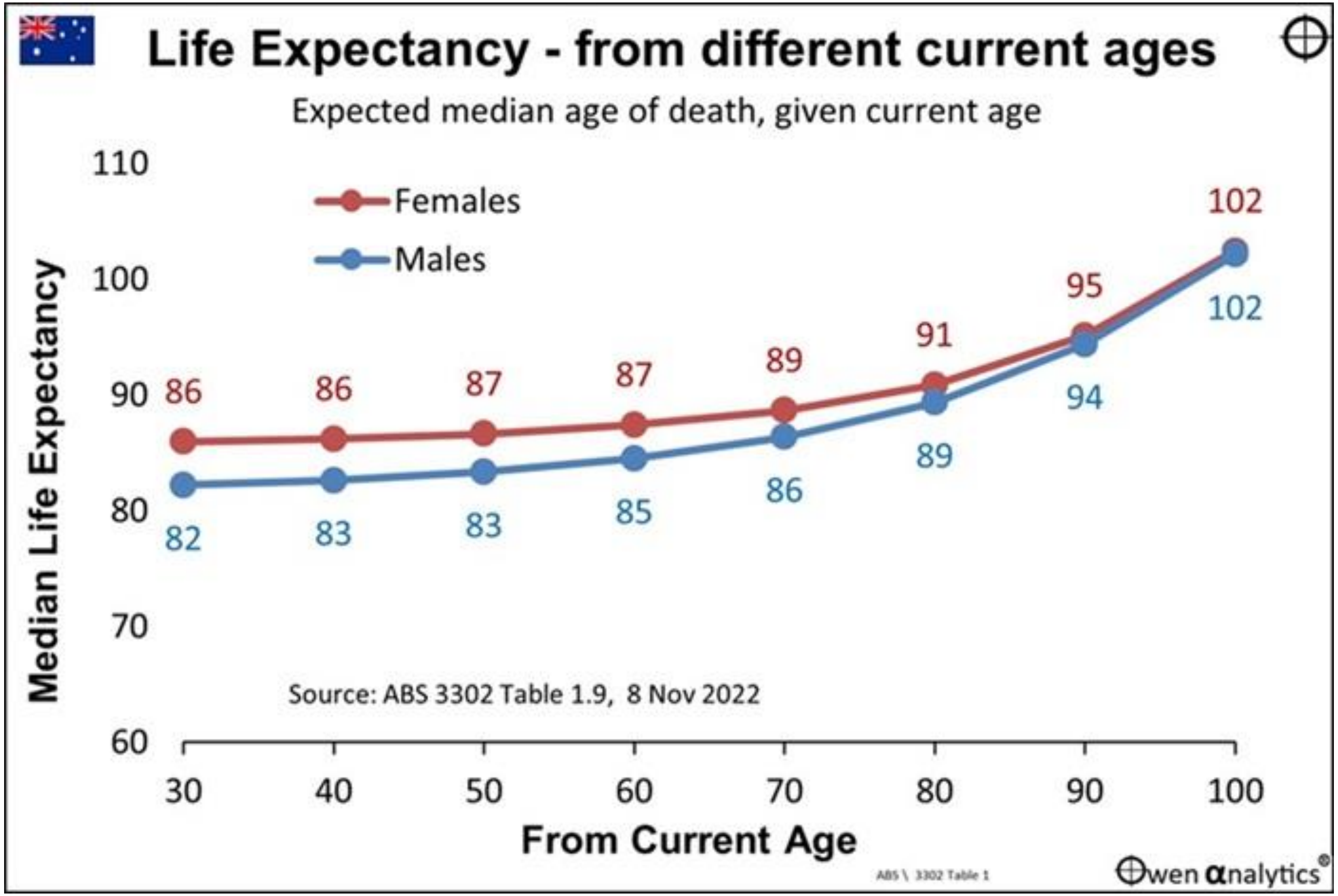
Risk 2 – longevity risk

# Median life expectancy table

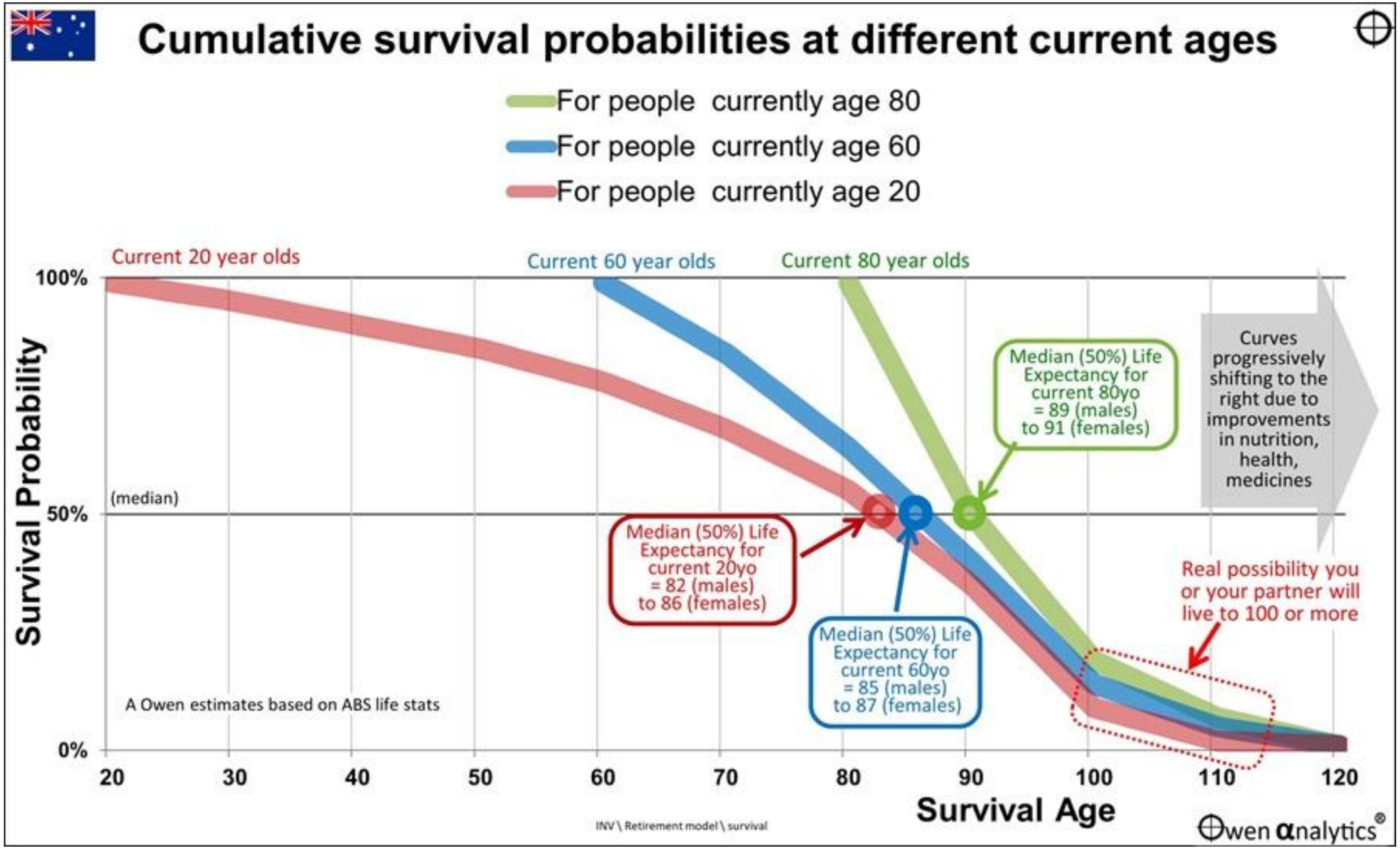



Sources:

- ABS 3302, life expectancy tables, 2020 – 2022, Table 1.9, 8/11/22
- 'How to not run out of money in retirement – 4 big problems with life expectancy tables', Owen Analytics, 6/6/24

Risk 2 – longevity risk

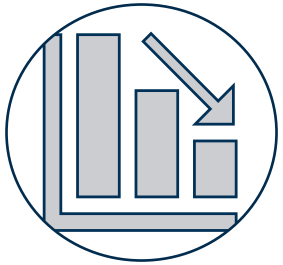
# Cumulative survival probabilities




Sources:

- ABS 3302, life expectancy tables, 2020 – 2022, Table 1.9, 8/11/22
- 'How to not run out of money in retirement – 4 big problems with life expectancy tables', Owen Analytics, 6/6/24

# Risk 3 – investment and sequencing risk



Investment risk is the uncertainty and risk of a loss in retirement savings

Sequencing risk is how investment losses can be magnified if they are poorly timed with your retirement plans

For eg, retiree needs cashflow to fund retirement but markets are volatile → order and timing of returns is unfavourable!

How to manage this risk:

- Retirees to seek advice to create a retirement income strategy
- Cashflow bucket strategy can help
- Keep approx. 3 – 5 years of pension payments in cash
- Reduce discretionary spending during poor market returns
- Holistic retirement modelling can help (ie, future returns, lifespan outcomes, age pension, super and non-super investments, compare alternative strategies, etc)

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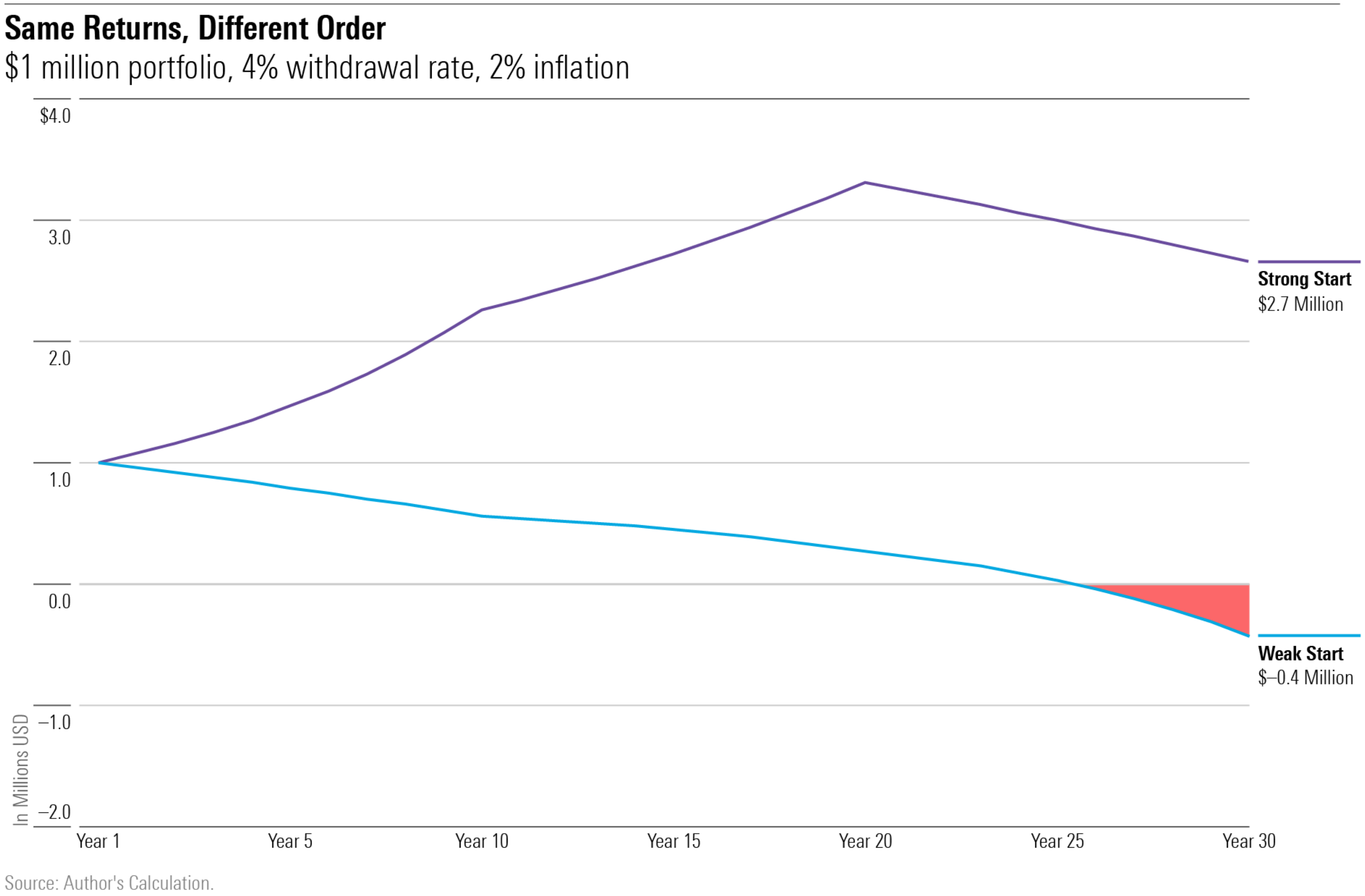
Risk 3 – investment and sequencing risk

# Different sequence of returns




Assumptions:

- Strong start = 10 years of 12% returns, followed by 6%, then break even in final decade
- Weak start = 10 years of low/no returns, followed by 6% returns and finishing with 12%

Source:

- '[Sequence Risk During Retirement]', Morningstar, John Rekenthaler, 16/2/24

# Risk 4 – inflation risk

The risk you face when the value of an investment is not keeping up with inflation

High inflation can pose significant risks if majority invested in cash (and bonds)

How to manage this risk:

- Understand impact of inflation on purchasing power
- To maintain purchasing power, investment return must increase by at least the rate of inflation
- Ensure portfolio has adequate exposure to growth assets

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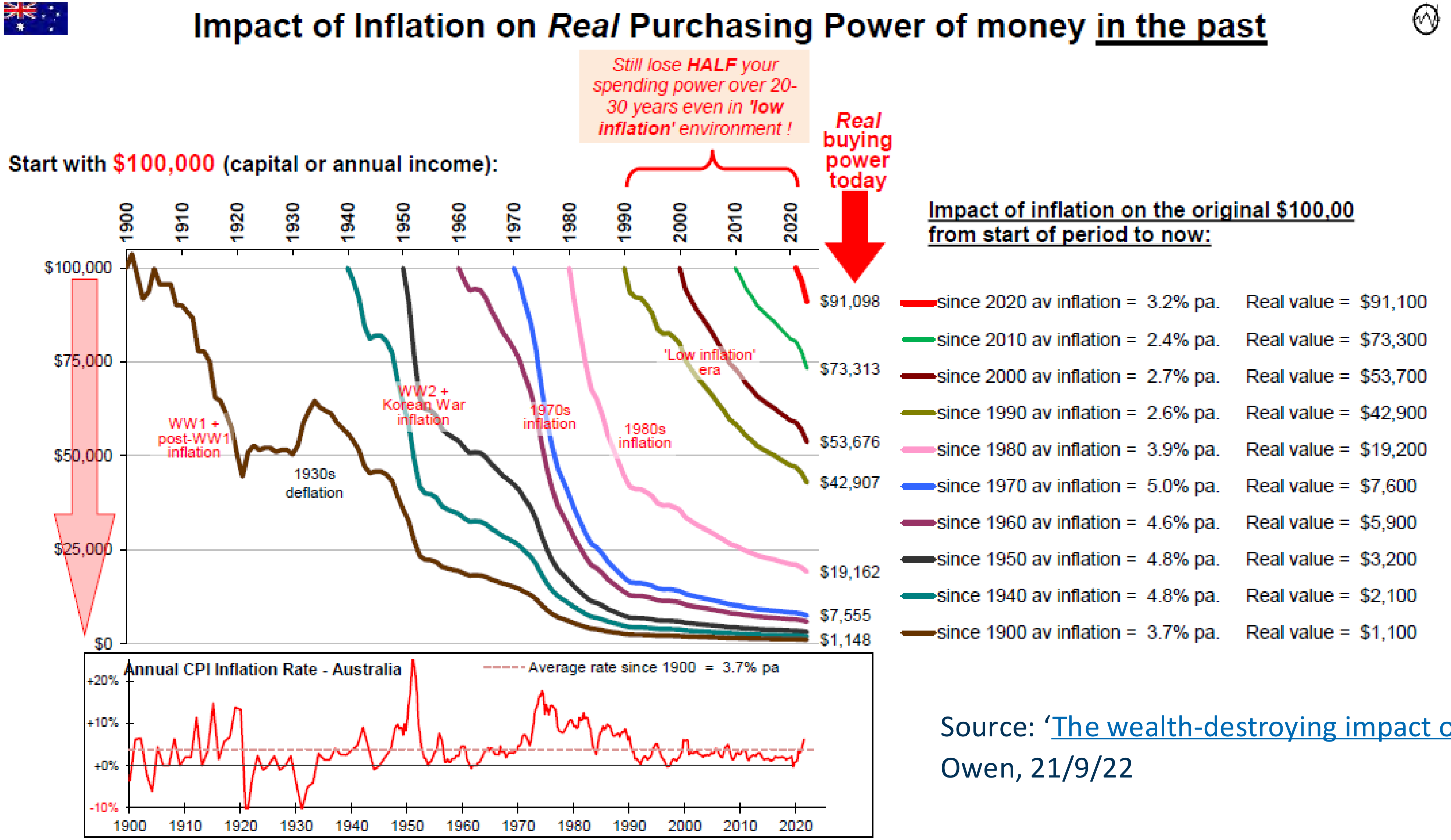
Risk 4 – inflation risk

# Impact of inflation on real purchasing power




Source: '[The wealth-destroying impact of inflation](#)', Ashley Owen, 21/9/22

# Risk 5 – liquidity risk

How easily fund assets can be converted to cash to meet fund expenses and/or pension payments

Remember – pension payments must be made in cash! Liquidity of fund assets to pay the pension?

Greater risk for funds invested in one asset (ie, property) and/or have an LRBA and cashflow is critical

How to manage this risk:

- Careful management – must be part of retirement income strategy
- Have sufficient cashflow on hand
- Insurance cover – can help boost member's account balance and retain asset without selling it
- Introduce new fund members?

# Risk 6 – legislative risk

Risk that legislative changes may occur and negatively affect your super or investments

It represents a long-term risk to retirees

Division 296 tax a prime example!

How to manage this risk:

- Not always possible but could employ strategies to manage this risk
- Eg: equalizing super balances, consider other concessional (non-super) tax structures (ie, trusts, insurance bonds, etc)

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Risk 6 – legislative risk

# Summary of key changes to super

| Year | Legislative change (list not exhaustive!) |
|---|---|
| 1/7/2002 | Compulsory cashing introduced |
| 10/5/2006 | New cap on undeducted contributions applies from 10/5/2006 to 30/6/2007 of $1m and generally $150k pa thereafter. Compulsory cashing abolished |
| 1/7/2007 | Better super reforms |
| 7/7/2010 | Borrowing laws amended (LRBAs) |
| 1/7/2012 | Div 293 tax introduced |
| 1/7/2013 | Excess contribution laws introduced |
| 1/7/2014 | Changes to insurance in super rules |
| 1/7/2017 | Major super changes: $1.6m pension TBC commences, TRIS earnings no longer tax-free, NCC cap lowered to $100k (from $180k), bring forward rule introduced with NCCs limited to TSB, CC cap reduced, Div 293 threshold reduces to $250k (from $300k) |
| 2020 | COVID-19 early release scheme |
| 2021 | MySuper stapling, annual super performance test, tougher obligations on trustees to act in the best interests of members |
| 1/7/2022 | All employees now eligible to receive SG contributions regardless of how much they earn |
| 2024/2025 | Div 296 tax?? |

# All too hard? Time to wind up?

- No need to wind up if retiring – SMSFs can provide a tailored retirement investment strategy for members
- But at some point, clients may also want to retire from their trustee duties
- Clients should have an exit plan – need to invest with the end in mind. For eg:
  - How to deal with members benefits
  - Liquidity of fund assets, etc

# SMSF investment statistics

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# SMSF overview highlights

SMSFs hold $876 billion in total assets, or roughly 25% of the total $3.5 trillion in super assets (at 30 June 2023)

There are over 610,000 SMSFs (at 30 June 2023)

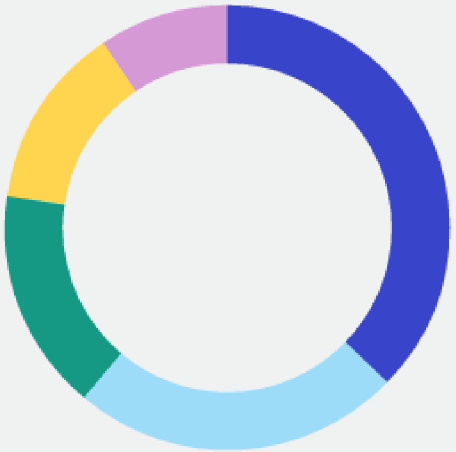
There are more than 1.13 million SMSF members (at 30 June 2023)

65% of SMSFs have existed for more than 10 years (at 30 June 2023)

*Source: ATO Self-managed super funds: A statistical overview 2021–2022, 7 Feb 2024*

# Asset allocation highlights

## The top 5 assets held by SMSFs



These make up **74%** of **all SMSF assets**

- Listed shares – **28%**
- Cash and term deposits – **18%**
- Unlisted trusts – **12%**
- Non-residential real property – **10%**
- Limited recourse borrowing arrangements – **7%**

*Source: ATO Self-managed super funds: A statistical overview 2021–2022, 7 Feb 2024*

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# SMSF asset allocation by fund phase

| Asset type | Accumulation phase | Retirement phase |
|---|---|---|
| Listed trusts | 5.0% | 6.5% |
| Unlisted trusts | 11.0% | 12.9% |
| Other managed investments | 4.9% | 6.5% |
| Cash and term deposits | 18.0% | 17.7% |
| Debt securities | 0.6% | 1.5% |
| Loans | 0.6% | 0.7% |
| Listed shares | 18.7% | 32.5% |
| Unlisted shares | 1.9% | 1.1% |
| Limited recourse borrowing arrangements | 16.2% | 1.4% |
| Non-residential real property | 10.3% | 9.7% |
| Residential real property | 7.2% | 4.5% |
| Collectables and personal use assets | 0.1% | 0.0% |
| Other assets | 3.0% | 2.9% |
| Crypto-currency | 0.3% | 0.0% |
| Overseas shares | 1.6% | 1.4% |
| Overseas residential real property | 0.1% | 0.0% |
| Overseas managed investments | 0.2% | 0.2% |
| Other overseas assets | 0.3% | 0.3% |
| **Total Australian and overseas assets (%)** | **100%** | **100%** |

Key highlights:

- Similar asset allocations across both phases
- But SMSFs in retirement phase favour listed shares, and
- Accumulation phase funds held greater % in LRBAs

*Source: ATO Self-managed super funds: A statistical overview 2021–2022, 7 Feb 2024*

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# Wrap up

Ensure your clients SMSF investment strategy meets the rules

Factor in retirement risks when creating clients' retirement income strategy

SMSFs can provide a tailored retirement investment strategy for members

SMSFs can be a great tool if trustees are able and willing!

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# Thank you

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