FIDUCIARY INVESTORS SYMPOSIUM
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Asset/liability analysis for DC members

Adequacy of your investment options to fund a comfortable retirement income

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Three bugbears and a suggestion

- Bugbear #1: Lifecycle funds distract from proper engagement
- Bugbear #2: SRM is the wrong measure of risk
- Bugbear #3: Deterministic retirement calculators don't cut it
- Change the conversation:
  - from product → advice (not necessarily advisers)
  - from account balance → retirement adequacy

Bugbear #1: Lifecycle funds distract from proper engagement

Analysis: Estimate the optimal life cycle glide path (*ex ante*) for different types of member.

Optimisation objective: Achieve adequate of retirement income, subject to:

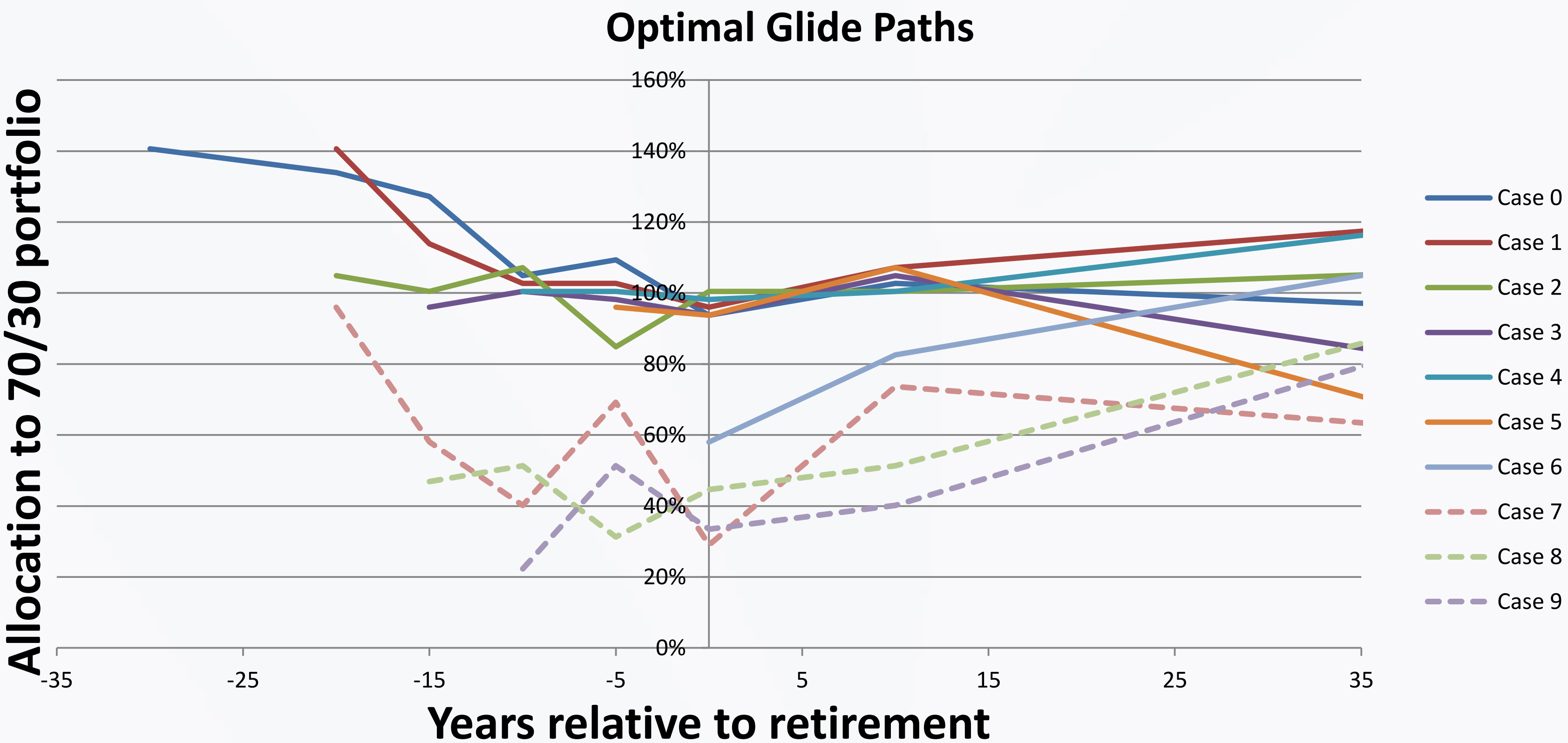
- heavy penalty when ASFA Modest level is not achieved
- modest penalty when ASFA Comfortable level is not achieved

Age pension taken into account.

Take two types of member at different points in their careers

Case	Age	Description	Current asset value	Contributions per annum
0	35	Mr Awote as he progresses through his career saving a 12% and receiving 1%pa real wage rises and 3% real on investments	10,000	6,630
1	40		50,000	6,936
2	45		90,000	7,242
3	50		140,000	7,650
4	55		200,000	8,058
5	60		270,000	8,466
6	65		360,000	8,874
7	45	Mr Manager with similar progression and returns	170,000	14,025
8	50		270,000	14,790
9	55		390,000	15,555

Optimal results do not resemble typical lifecycle funds



Observations confound received wisdom

1. Different members (at the same age) need different investment strategies.
2. Some optimal strategies do not exhibit the downward glide path used by most lifecycle funds.
3. Interplay of retirement adequacy objectives with availability of age pension has a big impact.
4. Well funded members lock in adequacy, while poorly funded members should not lock in penury.
5. Static SAA may well be suitable over many years.

Bugbear #2: SRM is the wrong measure of risk

Two examples to demonstrate:

Mr Young Guy

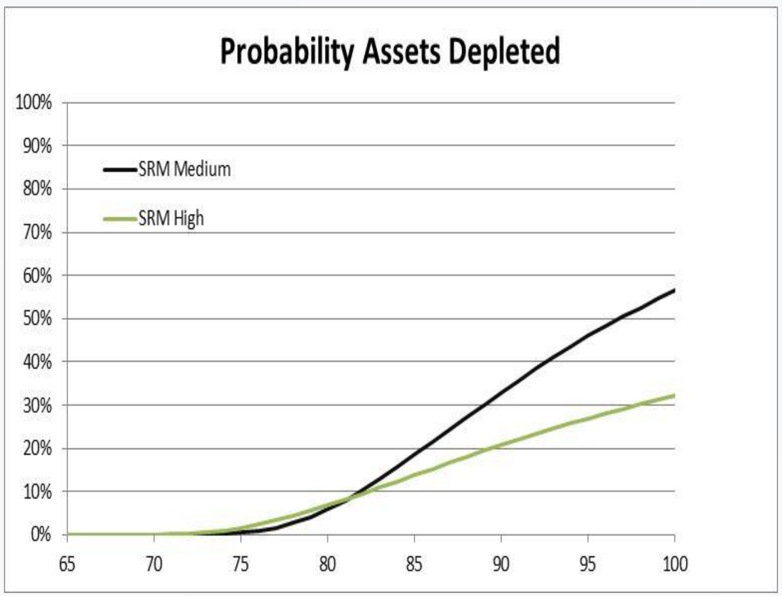
- Just started work
- Invests in a fund with a medium SRM
- His mate invests in a fund with a high SRM

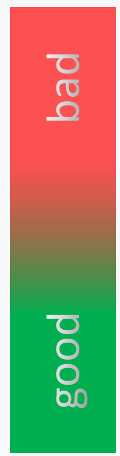
Mr Mature Man

- Age 50, looking at saving more as children left school
- Advised to be safer with his savings and move from a high SRM to a medium SRM strategy

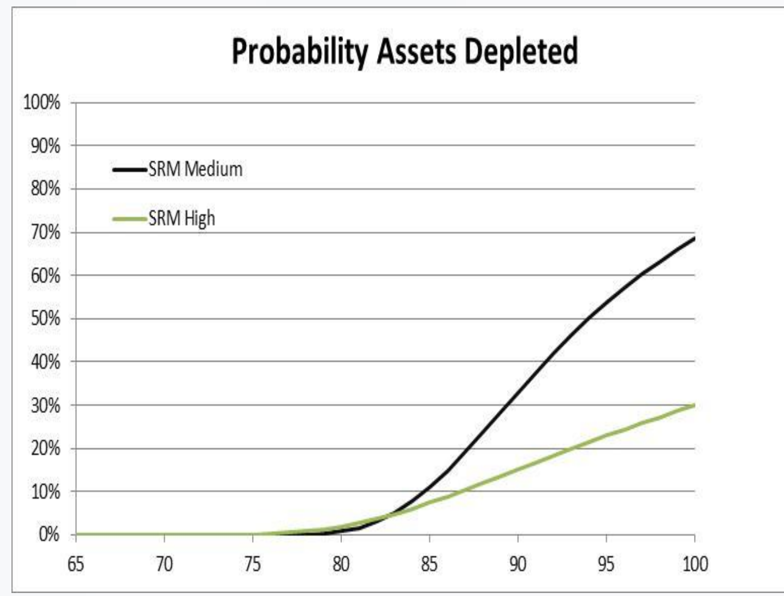
Medium SRM is riskier than High SRM!

Mr Young Guy





Mr Mature Man



The move to lower the SRM has significantly <u>increased</u> the risk of an inadequate retirement income for both.

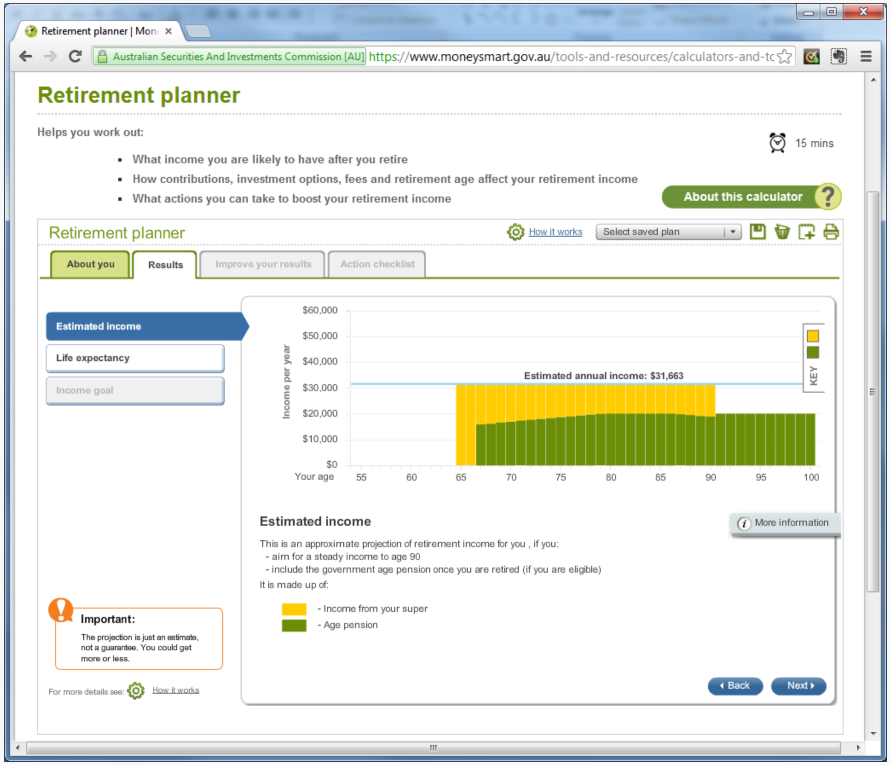
What are the lessons?

1. SRM does not reflect the risks of funding retirement... and yet this is superannuation's primary purpose!
2. If members are not provided that information, will trustees be breaching their responsibilities?
3. Lower investment risk doesn't necessarily mean safer retirement income...

    how confusing for members!

Bugbear #3: Deterministic retirement calculators don't cut it

- MoneySmart: A very nice calculator from ASIC
- But no account of the *impact* of investment risk
- Users would believe that there is NO risk, an even worse situation



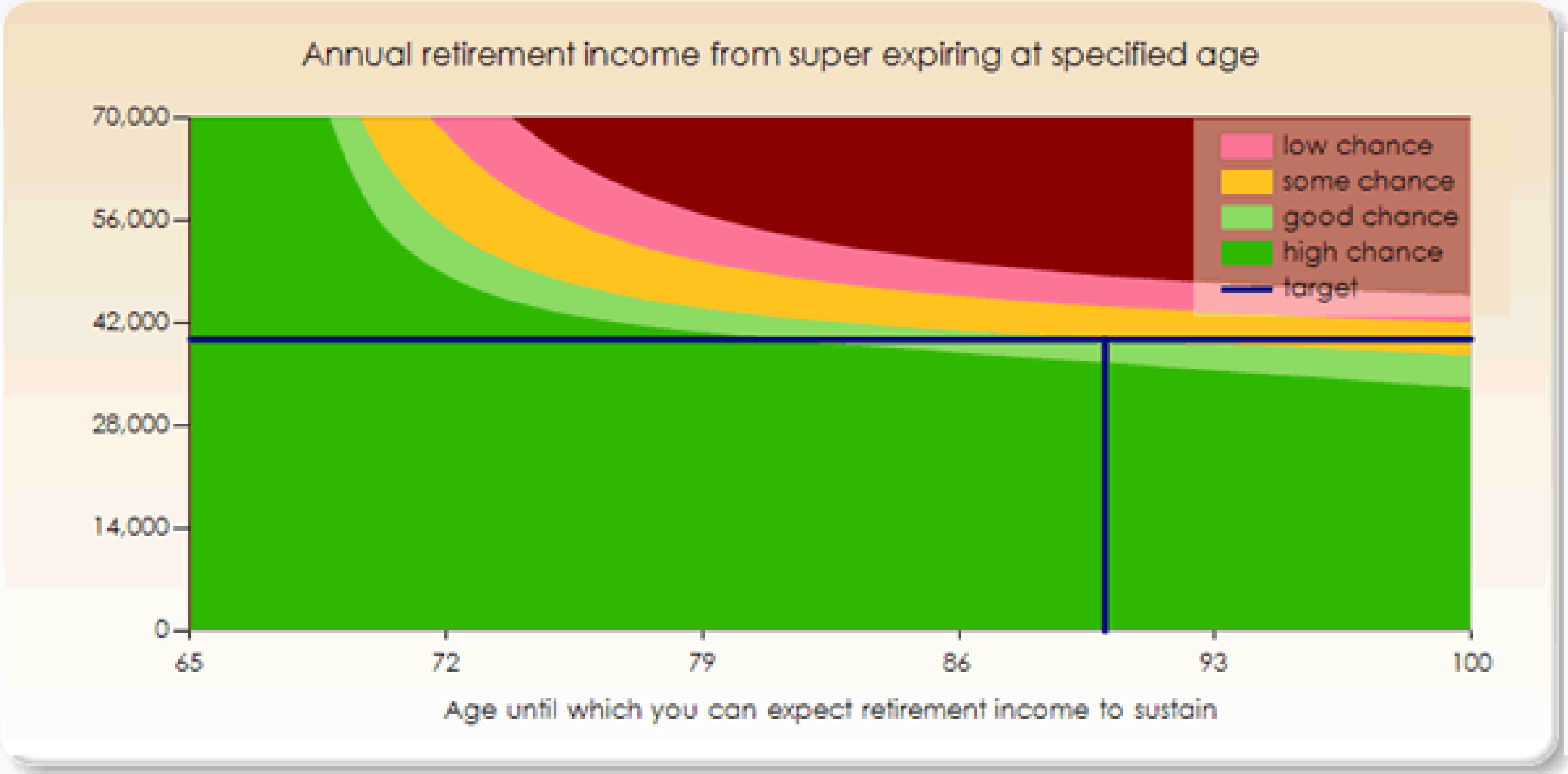
Change the conversation

Tell your members:

- What retirement income they have a good chance of sustaining until old age
- The chance of obtaining a specified target retirement income (expressed in everyday language)
- The impact of saving more
- The impact of changing investment strategy

Trustees should engage members at this level...
why not add this to annual reports?

For example, show how risk leads to uncertain sustainable income levels

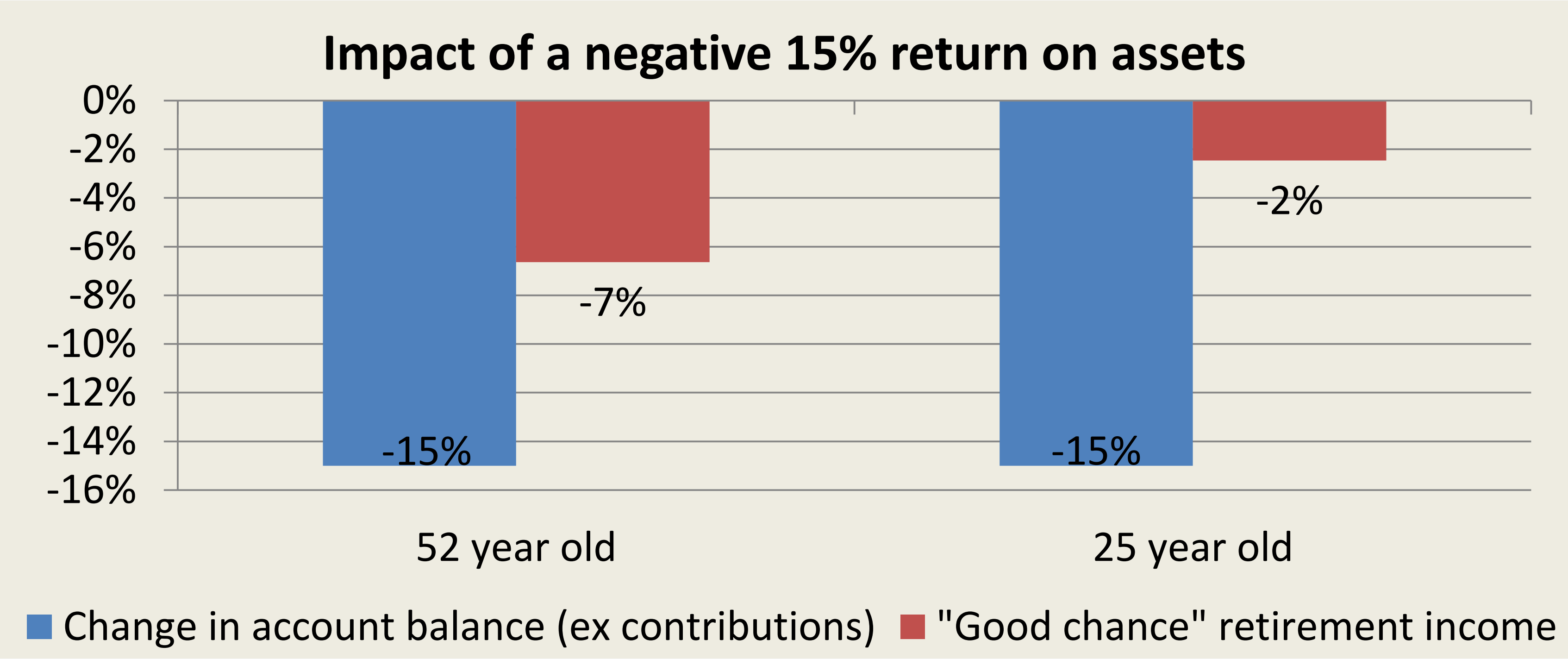


Lose the obsession with annual returns

What happens to these two members after a year of poor returns?

Age at start of year	52 year old	25 year old
Account balance	$300,000	$20,000
Contributions per annum	$50,000	$10,000
"Good chance" retirement income assessed at start of year	$67,800	$54,300

Which conversation is more relevant?



Be relevant to DC members

- DC members need their own "actuary in a box"
- Funds should report tracking to retirement adequacy
- Engage with all members, including the young
- Nudge to higher saving and more appropriate investment options
- Change the conversation from account balances → retirement adequacy