This communication is for Wholesale Clients only, as defined in subsection 761G(7) of the Corporations Act 2001 (Cth) (the 'Act') and must not be relied on by anyone else.

MEETING THE RETIREMENT INCOME CHALLENGE

By TAYLEE LEWIS

Australia's superannuation industry is at a tricky inflection point. Twenty-five years since the introduction of the superannuation guarantee, funds are adept at helping workers accumulate retirement savings. **Now the challenge is to become expert at converting those savings into a durable income stream for members as they retire**.

While the retirement income problem has been widely acknowledged across the industry, few funds have developed a robust solution. It is a difficult thing to do against a backdrop of regulatory uncertainty and extremely challenging global investment markets.

Global growth rates are below trend, interest rates are hovering near record lows, and volatility is tipped to rise. All this at a time when valuations across major asset classes are inflated from a decade of monetary stimulus post the global financial crisis, and traditional diversification strategies have lost their resilience as bond and equity markets start to move in concert.

Catering to the needs of retirees in such an environment "creates an interesting problem" and multi-asset and fixed income portfolios have an increasingly important role to play, according to Edinburgh-based Standard Life Investments investment director and multi-asset investment specialist David Bint.

Super funds need to offer retirees a solution that meets a number of sometimes competing goals: capital preservation throughout the retirement phase, a sufficient level of income generation, and flexibility to allow them to sometimes draw a different level of income.

"Retirees need a solution that will provide an income, focus on a low-risk outcome, as well as help them cope with the specific problems associated with the early years of drawdown," Bint says. In March 2011, Standard Life Investments launched an Absolute Return Global Bond Strategies (ARGBS) Fund aimed at combating some of these challenges.

Standard Life Investments is a $475.3 billion (£277.9 billion)* global funds management business and a market-leader in the provision of multi-asset, absolute return funds.

The ARGBS Fund aims to achieve returns similar to those investors could expect from a long-term investment in global bond markets, but with lower risk. The flexible mandate and careful portfolio construction also gives the Fund the potential to perform in a wide range of market conditions, helping insulate the portfolio against market shocks.

The ARGBS Fund has been well received by institutional investors here in Australia and has over $2.4 billion*(£1.4bn) in assets-under-management globally with a strong performance track record behind it.

One of the biggest challenges for funds in looking after the interests of members in the decumulation stage is striking a balance

DAVID BINT

between capital growth and income.
As retirees start drawing down on their super savings pot, the impact of market volatility is amplified.

Bint says that by being invested in a broad range of strategies, the ARGBS Fund is designed to produce a positive return regardless of whether bonds are benefiting or not benefiting from the market environment.

"By being unconstrained we can play both sides of the market. Absolute Return Bond Funds are extremely flexible products. They can be long, short, or market neutral by pairing different positions together.

"ARGBS is an 'all-weather product' that operates within a low volatility ratio – of between 2 to 4 per cent. Whatever product you are going to use for retirement savings, the whole solution needs to be very low volatility," Bint says.

In April 2017, Standard Life Investments partnered with locally listed investment management firm Challenger to launch the Challenger Absolute Return Global Bond Strategies (ARGBS) Fund into the Australian retail market.

The Challenger ARGBS Fund aims to provide a positive return in all market conditions. It is targeting an initial distribution of 2.5 per cent per annum, paid quarterly.

Challenger Chief Executive, Distribution, Product and Marketing, Richard Howes, says the new fund plays an important role and is a great addition to Challenger's range of retirement income products.

The pressure to deliver retirement income solutions is being felt by pension funds all over the world, but is a particularly hot-button issue in Australia ahead of the introduction of a new comprehensive income product for retirement (CIPR) framework.

Details of the Turnbull Government's planned CIPR framework, currently the subject of industry consultation, are yet to be finalised. However super funds are already hungry for tools that can help them deliver a combination of capital growth and income.

Sunsuper head of product Shane Mather hopes the new CIPR framework will be "principles-based, solution-agnostic and member focused" to give funds the flexibility to develop best products for their members.

"What must be avoided are any changes that create a narrow framework and limit innovation," Mather says.

Frontier Advisors head of member solutions David Carruthers says that with retirement income clearly under the spotlight, now is an ideal time for super funds to look at their member base and consider what products will be able to meet retiree income needs going forward.

"If super funds start to take an income focus then they will value assets which provide a level of income or a more certain level of income a bit more highly".

Retirees need a combination of income, flexibility and risk management, he says.

Carruthers notes that a growing proportion of funds have up to 20 per cent of their assets in pension phase, with this ratio set to substantially increase over the next five to 10 years.

"The objective of superannuation is to take a retirement income, therefore it's hard to argue that funds shouldn't provide one," Carruthers says.

Frontier Advisors is currently encouraging some of its superannuation fund clients to "explicitly change the objective" of many of their options from an inflation relative benchmark to an income target.

"At the minute if you look across the industry, most, I'm probably talking 90 per cent of funds have all got these CPI + targets," Carruthers says.

"Those kinds of objectives might be good for accumulation but once you get into retirement, it makes less sense when you know the objective of the member is to take a retirement income."

Carruthers is advocating that super funds offer at least one pension phase option targeting income, but argues that "it may be sensible down the track to have a range of options that target different levels of income".

A 2016 research report produced by Standard Life Investments highlighted that low volatility multi-asset strategies can be particularly valuable for investors who want to avoid the possibility of a bad outcome in retirement. Multi-asset strategies "provide a number of benefits through lower risk and more predictable returns", the report found.

Bint says that while there is no single product that will "save or solve" all of the issues associated with developing retirement products, income outcomes must be the industry's focus.

australia.standardlifeinvestments.com/fixedincome

*Source: Standard Life Investments as at 31 December 2016, based on an exchange rate of $1.71