We asked how 2,500 planners formulate retirement income advice

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Abstract

This paper provides an update of some research that the Retirement Incomes Working Group (RIWG) has been undertaking into the provision of financial advice to pre-retirees and retirees. Following on from a survey conducted in 2017 (to which the respondents were individual advisers), the authors conducted structured interviews with representatives of planning firms. Interviewers took the opportunity to ask follow up questions where clarification was needed and built a picture of the provision of advice to retirees across the industry.

The objective of the research was to understand the financial planning methodologies used by planners in Australia in a retirement incomes context.

The paper reports on the findings of the interviews, considers some issues that arose during the interviews and suggests some next steps, and in particular, suggests avenues where the actuarial profession may be able to contribute to designing robust methodologies and approaches.

Keywords: Financial advice; risk profile questionnaire; asset allocation; retirement planning; retirement capital management; lifetime income streams.

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1 Introduction

1.1 Objectives and background

The objectives of this paper are:

- to report to Institute members on research conducted under the auspices of the Institute's Retirement Incomes Working Group (RIWG) into financial planning methodologies used by planners in a retirement incomes context;
- to consider issues arising from current financial planning practices; and
- to consider what role the Actuaries Institute, or individual actuaries, can play in the future development of financial planning methodologies and approaches for pre-retirees and retirees.

The paper follows on from a survey that RIWG conducted of individual financial planners; the results of that survey were previously reported and are available on the Institute's website[1].

The next step taken by the RIWG was to arrange structured interviews with about a dozen financial planning organisations of various types. The questions addressed during the interviews are those listed in the Appendix. The structured interview process allowed the same questions to be addressed as were considered in the individual Financial Adviser Survey but the interview format allowed follow-up questions to clarify the responses where appropriate.

Some interviews were conducted in person, others via telephone. Usually there were two members of RIWG present at each interview. Interviews were not recorded but written interview notes were prepared by one of the authors and (in cases where two interviewers were present) reviewed by another. Where, in the paper below, comments are attributed to interviewees in quotation marks, those comments have been reconstructed from interview notes and the words used may not have been the exact words used by the respondents but we have endeavoured to correctly capture the meaning of the comment.

We should mention that the focus of our research was purely technical. Issues such as the remuneration or governance of advisers are outside the scope of this paper.

This paper proceeds as follows.

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[1] Adviser retirement methodology survey results, by the Retirement incomes Working Group, Actuaries Institute, 2017. See https://www.actuaries.asn.au/Library/Reports/2017/FinancialAdviserSurveyResultsAug2017.pdf.

Section 1.2 provides a brief description of the respondents. We promised all respondents complete anonymity so we have not included the names of any respondent or organisation in this paper. Therefore the description of the respondents and their organisations is necessarily somewhat general in nature.

Sections 2 to 4 describe the picture of the financial planning process that emerges from the structured interviews. Section 2 deals with risk profile questionnaires and the approach taken to recommending an asset allocation. Section 3 deals with some technical aspects of the preparation of Statements of Advice (SOAs) that may be of interest to the actuarial profession including, for example, commentary on the mortality assumptions underlying the calculation of life expectancy and the nature of projection calculations provided in SOAs. Section 4 is motivated by the current focus by government on developing default retirement-phase products (sometimes referred to as Comprehensive Income Products for Retirement (CIPRs) or MyRetirement). It reports on current adviser and client attitudes to existing income stream products, the general views of advisers on clients protecting themselves against longevity risk and the features of future income stream products that advisers and clients might see as being most desirable.

In Section 5, we discuss a number of the issues arising in Sections 2 to 4 of the paper, with a focus on what the actuarial profession may be able to contribute.

Section 6 provides a high-level summary of conclusions.

1.2 Respondents

There were eleven (11) respondents in total drawn from planning practices associated with two of the major banks, the private wealth arm of another major bank, a mix of independent and superannuation fund-owned firms and franchises, and two sole practitioners. The sole practitioners operated as authorised representatives of an external licensee. One participated in a peer support network of like-minded practitioners. In all, the respondents represented approximately two and a half thousand active financial planners.

About 500 planners were identified as salaried, with the rest fee-charging. Fees were a mix of dollar and per FUM fees, though we did not enquire into the details of the various remuneration and pricing systems employed.

The positions held by the individual spokespeople covered roles in leadership, executive management roles, planning process development, compliance, technical services, planning and para-planning.

2 Risk profile questionnaires and asset allocation

In this section we consider the methodologies underlying advice to retiree and pre-retiree clients in relation to asset allocation. Asset allocation is an important explanatory factor for investment performance; for example, in the context of large pension fund investment performance, asset allocation has been found to contribute more to the variance of outcomes than market timing or stock

selection[2]. Of course, in a retirement planning context, other issues are also important such as the drawdown strategy, inflation risk and longevity risk. Asset allocation is one means by which advisers might equip the portfolio with the necessary attributes. One would expect planners to go to some trouble to recommend appropriate asset allocations to their clients.

2.1 Methods for determining risk profile

Question 3 of the structured interviews (see Appendix) asked interviewees what methods their organisations used to ascertain the risk profiles of their clients.

It is fair to say that risk profile questionnaires (RPQs) dominated the response. No interviewees mentioned any of the other specified risk profiling techniques (though many mentioned conversations between adviser and client and reference to situational risk tolerance as a source of validation or potential adjustment to the assessed risk profile). All but one of the large firms use RPQs in some form. Of our 11 interviewees, all but two stated that they use RPQs at least as a key component of the process of determining the asset allocation to be recommended to the client.

Question 4 in the structured interviews asked how many questions there were in the firm's RPQ. Where RPQs were used, the numbers of questions varied from 8 to 16.

However, there are subtle differences of approach between the firms. For example, one large firm permits its more senior and experienced advisers to proceed without an RPQ, where the adviser is already very familiar with the client's knowledge, background and preferences; in most firms however an RPQ is a requirement.

In some firms, the risk profile is determined by an "add up the points" approach to determining asset allocation, and the process ends there. However more typically advisers will have at least two opportunities to discuss the implications of the asset allocation that flows from the RPQ with the client:

- Firstly during the initial conversations with the client, when discussing "Fact Find"[3] items such as age, objectives, income and current wealth, the conversation leverages the adviser's general knowledge and experience and the adviser's understanding of the client's needs and objectives, and

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[2] Determinants of Portfolio performance, by Gary P Brinson, L Randolph Hood and Gilbert L Beebower, Financial Analysts Journal July/August 1986, pp 39-44. See https://www.cfapubs.org/doi/pdf/10.2469/faj.v51.n1.1869.

[3] A "Fact Find" is a questionnaire provided by the adviser to the client to determine the client's personal circumstances, income, expenses, assets, liabilities, financial objectives, investment experience and attitudes to investment risk.

- Again when the cash flow and investment projections have been performed using an asset allocation consistent with the client's risk profile.

In both cases there is the opportunity to allow some level of departure from the asset allocation that corresponds to the RPQ result, though in some firms this is normally limited to a departure of not more than one risk band.

There was clear evidence from the interviews that firms believe the RPQ should not be the sole determinant of asset allocation decisions. One firm cited one of its prominent senior advisers who is well known for his view that RPQs alone are not a sufficient basis for recommending an asset allocation: the client's financial position and objectives also need to be taken into account. One of the sole practitioners eschewed RPQs completely in favour of the client's cash flow needs. Several respondents emphasised the need for the client to be satisfied with the recommended asset allocation and made it clear that discussion of the alternatives with the client was a key part of the advice process.

One firm noted that some of its clients had trouble understanding the questions in the RPQ.

Perhaps the two most interesting responses from large firms were from those that had moved away from the RPQ as a methodology for determining asset allocation. One of these two firms stated that they still ask RPQ-style questions in their Fact Find, but they do not use the "add up the points" approach to determine asset allocation. Instead, they ask the client explicitly what the client deems to be an appropriate asset allocation, and the adviser reviews the client nominated asset allocation in conjunction with the client's responses in the Fact Find. Effectively the firm partially delegates the asset allocation decision to the client, though there is a conversation between adviser and client, especially in circumstances where the client's nominated preferred asset allocation does not appear to the adviser to be consistent with the client's response to the risk tolerance questions in the Fact Find.

The other firm also acknowledged that until recently it had followed an "add up the points" style of RPQ to determine recommended asset allocation, but the firm saw that in many cases, clients whose account balances had suffered during market downturns then complained that the risks they were undertaking had not been satisfactorily explained to them. The firm had lost sufficiently many cases before the Financial Ombudsman Service (FOS) that they had a strong inclination to settle whenever a similar complaint was lodged. So the firm now included a significant educational component in its advice process and asks the client to nominate his or her own asset allocation in the light of their new knowledge of the consequences of their choices.

2.2 Mapping from risk profile to asset allocation

Question 5 of the structured interviews specifically addresses the issue of whether the recommended asset allocation automatically follows the asset allocation suggested by the RPQ process.

The majority of interviewees do use an RPQ and do use the results of the RPQ as a starting point to produce a potential asset allocation for the client. However

there are slight variations in the comments provided by interviewees as to how automatically the RPQ-to-asset-allocation mapping is adopted by advisers. Very commonly interviewees said that the asset allocation flowing from the RPQ was usually the asset allocation recommended to the client but there were a variety of qualifications. For example:

- "most advisers would stick to the asset allocation from the RPQ but more senior advisers might depart from this based on their knowledge of the client";
- "if the adviser wants to go outside the asset allocation from the RPQ, they have to justify and defend the alternative they want to recommend, and seek signoff which may or may not be forthcoming";
- "there is flexibility to amend the asset allocation from the RPQ after discussion with the client ….. usually a client already has an asset allocation so the discussion is more about how the RPQ relates to their existing asset allocation";
- "the client is consulted to ask whether they are happy with the asset allocation and the client can agree to depart from it…. Also the adviser can suggest to depart from that asset allocation based on experience or based on the client's target objectives";
- "the adviser talks the client through the implications especially considering the client's goals; advisers have scope to deviate based on conversations with the clients around the client's objectives and needs";
- "the firm tends to follow the RPQ for superannuation clients but often clients outside super have their own existing assets which they wish to retain …. a lot depends on individual circumstances and the RPQ asset allocation is just a guide".

In summary, the RPQ is a very widely used (though not universal) instrument for assisting advisers to produce a recommended asset allocation. However there are differences in the way the RPQs are applied. There is also a general appreciation of their limitations. There is some evidence of firms starting to pass the asset allocation decision back to the client rather than relying robotically on the RPQs. Where the adviser uses an RPQ, the asset allocation that flows from the RPQ is usually the asset allocation recommended to the client. However in almost all cases there is an implied requirement to test it in some way and flexibility for advisers to make an alternative recommendation.[4]

Question 6 of the structured interviews asked how difficult it would be (in terms of compliance effort) for an adviser to recommend an asset allocation other than the allocation consistent with the RPQ. The great majority of responses were to

[4] We have interpreted the frequency of comments about checking the result with the client as indicating this as a necessary part of the process.

the effect that departures were possible but for compliance purposes had to be justified:

- "Advisers can depart from the RPQ but need to be able to demonstrate that this is appropriate for the client after discussion with the client. There is no constraint from the firm on advisers to follow the RPQ asset allocation in any way";
- "Compliance gives advisers the chance to make appropriate decisions – their catch cry is 'freedom within boundaries'. Where there is a departure, the SOA highlights the difference and identifies the client as (for example) a 'Growth' client based on the RPQ but then gives reasons for any departure."
- "Asset allocation is client determined but if the adviser suggests an alternative asset allocation after discussion with the client following modelling work, the departure is not difficult but will be documented";
- "It is possible to depart from the RPQ-based Strategic Asset Allocation (SAA) but there is extra compliance effort";
- "the adviser can easily depart from the RPQ asset allocation but must be able to justify it; Compliance is becoming more stringent in the documentation that they require to support variations";
- "Compliance is not overly onerous as long as the justification is meaningful";
- "There is extra compliance effort but it's possible. The reason for departure would need to be explained, justified and documented."
- "There is extra compliance effort but it's possible. Departure cannot be 'adviser-led'; the adviser can 'educate but not direct'. The adviser must document any departure."
- "The customer has to be satisfied with the investments and sign off on all transactions."

In several cases the adviser had complete discretion on this issue.

2.3 Appropriateness of asset allocations from risk profile questionnaires

Most responses to this question suggested that the interviewees believed that the RPQ-derived asset allocations were reasonable most of the time:

- "Reasonably often to frequently";
- "Under the old 'add up the numbers' approach to asset allocation, some clients may have ended up with a higher risk asset allocation than they should have had – advisers always had the right to vary the recommended asset allocation but 90% didn't hold the necessary follow-up discussions with the client";
- "Reasonably often to sometimes" – however the adviser noted that the firm had a "defensive bias";

- "Frequently. Mismatches do not occur more than 10% of the time."
- "The advisers who use RPQs find that the asset allocations from the RPQs are usually appropriate;
- "Pretty spot on a lot of the time (between 'reasonably often' and 'frequently');
- "Asset allocation is frequently right. Our clients are mass market so there are fewer times where the asset allocation from the RPQ may be inappropriate;
- "Frequently. If the client has a good knowledge of investments, usually the adviser will run with the result of the RPQ. It is more difficult if clients have existing assets (for example, an investment property) and an associated asset allocation as there may be reasons to retain assets that are already held".

2.4 Do asset allocations change near retirement?

This question (number 10 of the structured interviews) produced quite a variety of answers.

- "Yes, due to sequencing risk, changing risk profiles and also attempting to manage risk (especially inflation risk) as the client enters pension phase";
- "Asset allocations and risk profiles do change but it's not mainly a matter of age, it's more the general level of pessimism/optimism that changes over time, people tend to be more risk averse when the news is bad and the market is down."
- "You should get more cautious once your assets are at a level which can comfortably provide the target lifestyle – why take risks, in that case, to 'shoot the lights out'?"
- "Some advisers recommend more conservative asset allocations near retirement, some clients just want their assets to be safe, including those who invest in cash. Better educated clients know they should still target some growth."
- "Yes changes in asset allocation can occur due to changing client risk profiles or as a result of conversations with the adviser. There is a longer-term trend towards taking more asset risk in retirement as people realise that they are living longer".
- "No the asset allocation doesn't change much. The point is that there is still a long-term investment horizon so why should the asset allocation change?"
- "Asset allocations shouldn't change much. Retirees without the benefit of financial advice sometimes adopt overly conservative asset allocations. Lifecycle funds are trying to protect members from the downside. We need to look more into annuities as a retirement product."
- "No. At retirement age the retiree is still investing for the long term."
- "Asset allocations can change. In particular, where a client has operated within a particular risk profile since he/she was 30, but as they approach retirement they find that their circumstances (wealth, marital status, etc) have changed, a change of risk profile may be appropriate. MySuper funds are often transitioning from high allocations to growth assets at younger ages to lower allocations at older ages but these assume that each member is "average". The options are designed to cater for the

majority. It is not desirable to adopt too low a % allocation to growth assets."

- "My 'gut feel' is that at the point of retirement there is often a shift down in riskiness of investment portfolios. There is a psychological impact from not having money coming in any more. Lifecyle superannuation fund asset allocations may not be a bad thing, otherwise people's younger risk profiles will persist through to retirement. The lifecycle approach is good for members who are not engaged. There is still a "30-year timeframe" at retirement and the advisers use bucket strategies to try to minimise fear that would otherwise grip their clients. There is a "cost of fear". Advice is an art as well as a science."
- "Yes asset allocations change but mainly because at the point of retirement, many clients will have specific objectives for part of their funds that may mean that those funds have to be more conservatively invested, e.g. to gift a lump sum for the grandchildren's education, or to their children for a business or property purchase. As these expenditures are made over time the risk profile reverts to that applicable specifically to the income stream."
- "Yes asset allocation can change due to changing risk profile, sequencing risk and other reasons. Clients need to be migrating assets into defensive mode to get ready for pension mode. If they have been 100% growth they need to shift so that 15% will be defensive assets. Also they should become less adventurous as they get older.

In summary, there is a continuum of views ranging from those who took account of post-retirement in the initial investment horizon to the slightly more numerous who appeared to segment the horizon into time to and time after retirement, though they did not necessarily see retirement of itself as the major reason for change in asset allocation. Accumulated wealth, the experience gained to date and wariness of sequencing risk might be just as significant.

3 Some aspects of Statements of Advice (SOAs)

3.1 Life expectancy

Not all respondents were able to give very authoritative answers to Question 12 of the structured interview, which asked about the duration of projections in the SOA relative to life expectancy of the retiree. Perhaps this is because the duration of cash flow projections is not specifically related to life expectancy in all cases: sometimes projections may be carried out to a specific age at the choice of the adviser (such as 90 or 95) and in other cases projections are carried out for specific durations such as 20 or 25 years.

The planning firms use particular software to support the advice process, most commonly Xplan, Coin on Midwinter. Often where life expectancies are referred to in projections or SOAs it is the life expectancies from the software provider that are used. Typically it seems that those life expectancies are sourced from the latest Australian Life Tables, with no allowance for future mortality improvements. Most respondents to Question 13 (the source of the mortality assumptions) simply

referred to their software providers, though some suggested that they believe the ultimate source used by the software providers was Australian Life Tables.

Here are some sample responses to the question about what life expectancy was used for the purpose of determining the duration of cash flow projections post retirement:

- "We use the mean life table life expectancy (provided by software vendor) and projections test whether funds survive to this age. If there are two clients, the software uses the longer of the two life expectancies. Modelling only works at household level, not individual level, so there is no allowance for change in the cost of living when one spouse passes away. Firm is constrained by what the software provider provides."
- "Some advisers use ages 90, 95 or 100 in their projections. Most advisers use the life expectancy as per the software. The adviser determines what goes in the SOA."
- "The firm mandates certain projections depending on the purpose of the advice and the age of the client. For ABPs the firm mandates projections for life expectancy."
- "We project to life expectancy unless the adviser specifically requests something different."
- "We often project balances for 20 years, sometimes 30 years."
- "Generally projections are for life expectancy plus a margin. Some advisers take into account family history in selecting a projection timeframe."
- "You need to consider projecting beyond life expectancy – it is preferable to project to age 100."
- "Advisers use Xplan. Xplan uses projections to life expectancy although advisers can override the projection term and require a different term. Some advisers might project for 5 additional years."
- "Our firm uses Coin which models to life expectancy. The adviser can choose a shorter or longer projection period if they wish."
- "Normally plans are constructed for a 20- or 25-year term. Sometimes the client wants the projection to go to some specific age such as 90 or 95 (the age they think they will survive to). The firm may sometimes project to age 100. Life expectancy is not especially identified in the financial plans."

3.2 Determining spending goals

Question 15 of the structured interviews focused on the spending goals of the client(s), in particular whether the spending goals differentiated between "wants" and "needs" or were expressed as a single figure, whether the client would simply ask "how much can I afford", and whether allowance was made for potential changes in spending needs as the client ages. Common themes in the responses included the need to distinguish between regular spending requirements and irregular needs; the fact that many clients do not have a very specific idea of their spending needs; and that no single approach will be appropriate to cover all clients because clients are very diverse in terms of their financial situations, financial literacy, and the state of their retirement planning.

Excerpts from the responses are as follows:

- "Generally spending goals are a single regular income figure supplemented by additional one-off purchases (new car, travel, renovation etc.)".
- "Usually spending needs are expressed as a single income figure but often the clients don't know how much they are spending. Post retirement spending expectations are usually related to pre-retirement spending. Once retirement starts they get a better idea of what they want to do and how much this means they will need to spend."
- "Usually a single income figure. Some clients have little idea of what they need so the adviser asks them to bring in their financials to analyse what they are spending. Often retirees underestimate. If someone says "I need $100K in the first 5 years then $70K" then advisers would model that but typically advisers model a fixed real income. That does tend to mean that there is an implicit margin for later years when spending needs might be lower.
- "A lot of clients will specify a single income figure. Other clients will say they want to retire on a specified % of their pre-retirement income. Some will specify 'routine living costs of $X p.a. plus I need $5K for a holiday and $20K for a new car' etc. Advisers don't usually change the consumption target although sometimes the adviser might want to change the target for some reason. People's spending tends to diminish as they age but then often the client will need funds for a Refundable Accommodation Deposit (RAD) or for Daily Accommodation Payments (DAP)."
- "More advisers are using 'bucket strategy' approaches. The firm's advisers now offer annuities as part of the retirement approach and more clients are taking a partial annuitisation but still not a lot."
- "There can be a range of approaches, some clients will have a single figure, others will differentiate between wants and needs, others will ask the adviser what can they afford. They reference the ASFA comfortable benchmark but find that a lot of clients regard that as much too low for their needs."
- "Clients usually do not have a specific spending target, they may not have a clear idea of how much they need to spend to achieve their target lifestyle. Many retirees do expect to need less as they get older and do fewer things but technological advances may mean that older people will be physically capable of doing more (e.g. travel time to London may be cut dramatically, self-driving cars etc.). Spending in the first couple of years of retirement is generally higher than the longer term due to travel, buying a car, or buying a caravan. Then they go back to about what they were spending before."
- "If the prospective client is still in accumulation phase, the adviser can have a full conversation covering the various possibilities in relation to wants, needs, financial resources and target lifestyle. The clients' grasp of their spending needs varies as does the assignment they pass to their adviser. Some clients have very little idea how much they need. Some just ask the adviser to tell them how much they can afford to spend and their attitude is 'tell us how much we can spend and we'll make it work'. Advisers have access to ASFA standards for modest and comfortable lifestyles. The firm also makes MoneySoft available to clients (MoneySoft is

an app that the client can use to categorise debits and credits in multiple bank accounts), which helps identify where money is spent. But some clients are not prepared to put in the effort, or have privacy concerns etc."

- "Spending goals are generally prioritised between wants and needs. Some clients want 'as much as is thought to be viable' and still others expect their needs to change as they get older (less travel etc). Also some retirees may be paying school fees for their grandchildren so their needs will reduce as the school fees are no longer required."
- "Most clients know their regular spending needs and also have some idea about additional wants. In particular they know what additional one-off expenses they will incur for travel, a caravan or for special projects. Usually clients want to simplify their affairs as they get older."
- "Some wealthier retirees can't spend the income that their retirement account earns and the money becomes part of their bequest."
- "About half of our clients have a simple total spending goal without disaggregation. The other half distinguish between annual routine needs and special one-off expenditures on items such as travel and holidays; the latter tend to be more luxury items."
- "Spending needs may change over the duration of retirement, with less entertainment and travel expenses amongst older clients but a partial offset in higher health expenses."

3.3 Ascertaining sustainable expenditure

Question 16 of the structured interviews focussed on how the advisers ascertained the sustainable level of spending that they could advise clients to spend without undue risk of running out of money and having to fall back entirely on to the age pension. All or nearly all firms use cash flow projections to an advanced age to test spending levels. Here are the edited responses:

- "We use the projections produced by Midwinter, which allow for Social Security, asset allocations, etc. We make it clear to the client that the model is a projection based on assumptions and that the continuous planning model entails regular review."
- "We use Xplan to do model projections for say 20, 25 and 30 year timeframes. We model a variety of options (e.g. sell house to provide additional retirement income). We allow for age pension."
- "Advisers tend to base this on what the clients tell them they need and then analyse whether this amount is sustainable or not. Prospera shows how retirement income varies as a function of retirement age. Some advisers use the ASFA/Westpac 'modest' and 'comfortable' spending targets."
- "Sustainable spending is routinely determined as part of the planning process and is identified in the SOA. Often there is a mismatch between client requests and the sustainable spending. Any mismatches are visually presented via charts in the SOA."
- "A rule of thumb is that the client can afford to spend 5% of their asset base pa. The spending levels are confirmed by projections within AdviceOS to check how long capital lasts."

- "Advisers project the balance of the client's ABP together with any age or service pension entitlements. They look at the retiree's current spending. They do projections and look at how long it takes a specified spending level to erode their assets. Obviously there is a minimum of the SIS minimum, at least for superannuation balances. Also usually the intention is to review the plan regularly, e.g. at 6 or 12 monthly intervals."
- "Prepare cash flow projections showing investment income, expenditure etc. Then discuss with the client how to maybe reduce spending a little if assets would expire before the client passes away."
- "Adviser uses cash flow modelling and looks at the expiry date of assets but a key point is that whether assets will last until death depends on how long the clients live, which is unknown in advance."
- "Advisers perform cash flow projections using Xplan. They tend to leverage off paraplanners. The projections are deterministic on the basis of the investment returns provided by the Adviser Research Team. Projections allow for ages of the clients, superannuation balances, basic details of their personal finances and show how long their financial assets will last for a given set of spending intentions."
- "Lifestyle is determined by discussion with the client. The software produces life expectancy and income available. The client may assume that they will achieve a better return than the standard earnings assumption."
- "Perform alternative cash flow projections according to whether spending is (for example) $80Kpa, $100Kpa, $120Kpa, and look at the amount of capital left at age 95. Sometimes the firm makes projections that allow for spending to grow at inflation less 1%pa or 1.5%pa to allow for likely declining real spending requirements due to ageing. They do want their clients to be able to spend appropriately - there is no point in being the 'wealthiest person in the cemetery'!"

3.4 Methodology for advising on drawdown

Questions 17 and 18 of the structured interviews were concerned with the advice provided to clients on how they should manage their retirement capital including how much they could afford to spend.

While some interviewees focussed their remarks on a single advice framework, it was common for responses to mention that a range of possible approaches might be possible depending on the client's circumstances and wishes.

Here are some sample responses.

- "Time segmentation (bucket strategy). We tend to recommend cash up to say $10K, and fixed interest investments up to say 2 years' worth of spending. Then the 2 to 5 year bucket is a mix of 'income certainty' and higher yielding. Assets in the 2 to 5 year bucket are not considered 'at risk': they are invested conservatively. For the long bucket, we look at risk profile and objectives. There is also the opportunity for rebalancing between the 'income certainty' and 'lifestyle' buckets according to the performance of the respective asset classes."

- “It can be bucket strategies or alternatively, accept the client’s income requirements and focus on portfolio construction. Personally I’ve never used annuities – they are just a punt on how long you’ll live and represent poor value”.
- “The approach to advice on retirement spending can be any of the options including SIS minimum, ‘sustainable withdrawals’, time segmentation approach, or floor and upside. A lot of clients stick to the SIS minimum.”
- “The comprehensive personal advices provided can vary across any of the options identified in the question depending on the client's situation.”
- “Accept what client said as ‘budget’ and focus on portfolio construction.”
- “Generally drawdown is impacted by SIS minimum. Advisers don't use the 4% rule. Some advisers use bucket strategies.”
- “We don’t favour standard time-based bucket asset allocation approaches because they appear to force the client to adopt an inappropriately conservative asset allocation - clients don't need a separate cash pool since a standard asset allocation has embedded cash and short-term cash flows already. You don't need more than 1-3 years in defensive fixed interest assets.”
- “It really depends on the client. There is no single answer. It depends on client needs.”
- “It depends on the client’s goals and needs. If the client doesn't specifically state what they want, the adviser may suggest the statutory minimum withdrawal rates. They would investigate what that would look like allowing for the age pension. If the minimum isn't enough to meet the clients' needs, the adviser may tell the client how long their money is likely to last and compare that with the client's life expectancy. Education plays a role and some advisers are more savvy at different stages of retirement.”
- “All clients with money in superannuation are advised that they must withdraw at least the SIS minimum. The methodology requires a cash bucket of 1-2 years' cash. There is no systematic management of the cash bucket according to the state of equity markets but the adviser may discuss with the client where the money to buy a new car (for example) should come from. Normally income from the core bucket replenishes the cash bucket.”
- "You could see our approach to retirement investment as a bucket strategy but it is not very time-specific.”

3.5 What is covered in SOAs?

Question 19 of the structured interviews asked about what was included in the firms SOAs with specific reference to:

- Cash flow projections
- Inclusion of non-superannuation assets and income
- Assistance with determining retirement goals and objectives
- Risk tolerance assessment
- Estate planning
- Tax

- Social welfare (age pension) implications

Typically interviewees said that all of the above matters were at least touched on in their firm's SOAs. A few comments by interviewees shed some additional light on the content of SOAs:

- "There is a strong bias to ABPs for High Net Worth (HNW) clients. Sometimes a re-contribution strategy is implemented. For certain client couples (where the older client is eligible for the age pension, but the younger client is not yet eligible) a withdrawal from the older client's balance and contribution to the younger client works for Centrelink purposes. Also downsizer contributions may be considered, as may be reverse mortgages. The Pension Loans Scheme is very interesting but only 5,000 have been taken up. The asset test changes have caused a lot of work designed to improve age pension entitlements."
- "Sometimes the treatment of estate planning is cursory, other times the adviser is a serious expert in the area."
- "The strategy will be reviewed from time to time and is not 'set and forget'."

3.6 Alternative projections

It seems that the great majority of SOAs are prepared on the basis of a single, deterministic projection for each strategy considered. Other projections, though, may be kept in the client file. The following comments are of interest:

- "Only one projection is prepared. We are working with {a prominent firm of consulting actuaries} around probabilities of achieving target returns. We quote the probability of achieving the target returns over specified periods."
- "Monte Carlo methods are available if the adviser wishes to use them and if so, projections will show the 5th, 25th, 50th, 75th and 95th percentiles."
- "For each alternative strategy presented, only one projection would be presented. The projection would use assumptions that are within the reasonable range but very much at the bottom end of the reasonable range."
- "Only a single projection is prepared. More are likely to confuse the client. Assumptions tend to be set on the conservative side: adviser should plan for the worst and the client will be upset if investments under-perform the stated target."
- "Routinely advisers include only one projection in the SOA; there is no requirement to do more."
- "Usually only one projection is included in the SOA unless some downside scenarios are also presented. Otherwise it would be too confusing for the client."
- "Most of the time projections are 'central estimate' only. The firm makes it clear that projections are only estimates. Advisers make it clear that over 15-20 years, projections can only be a guideline. Some customers (engineers!) may want 5 scenarios and the middle one will be the standard central estimate, or projections based on different portfolio choices."

- "Alternatives are described as 'optimistic' and 'pessimistic'. Clients won't 'get' probabilistic descriptions."

3.7 Stochastic asset models

When interviewees were asked whether they saw a greater role for stochastic projection methods in future, the responses varied from reasonably enthusiastic to firmly opposed, with an emphasis on the communication aspects thereof.

- "We see the value in stochastic methods as a way of communicating risk and variability and are trying to persuade Midwinter to move in this direction."
- "We are seeing more use by advisers of the Monte Carlo model option available within Xplan. Historically advisers have been caught out "you said I would have $X to spend every year for my lifetime" and probability statements tend to avoid this risk."
- "We do not make use of stochastic methods and see no likelihood of a change."
- "I generally don't use stochastic methods but some very good advisers do use stochastic methods, sometimes involving market shocks etc. However I doubt whether the typical client understands the work that has been done for them in this area. In AdviceOS you can input a variety of alternative assumptions to produce a form of scenario analysis. Alternatively sometimes we use of the confidence/probability material that is supplied by a third-party investment adviser."
- "Challenger promoted stochastic methods as a means of supporting immediate annuity sales. That is when advisers were exposed to stochastic approaches. Otherwise the advisers are not very exposed to the concepts and practices of stochastic methods."
- "We can see the benefit of stochastic approaches but have no current intention of adopting stochastic approaches more often.
- "No, it only confuses the client."
- "Our firm is currently looking at a probabilistic projection tool but it has not been launched yet. The tool is intended for advisers rather than clients and would need to be accompanied by a change management programme. It is envisaged that the tool would assist with RPQ follow-up discussions for example by illustrating upsides and downsides of different asset allocations. We will still do RPQs but now we can look at questions such as what asset allocation maximises the 95th percentile result. The tool will also assist with the development of portfolios and support the conversation between adviser and client."
- "Yes, I expect more use of stochastic models. To an extent, we already use them. I expect more transparency as stochastic models become more widely available. Our toughest customers are engineers and doctors, who demand a more scientific approach to their planning."
- "No. We advise on sustainable spending using tables that show the date when investment assets will fall to zero as a function of spending level."

4 Lifetime income products

As noted above, the structured interview questions around the subject of lifetime income products were only added at a relatively stage of the research, at the suggestion of some RIWG members who thought that in the context of all the developments in the CIPR/MyRetirement space, we should be giving additional consideration to income streams. For this reason, these questions were only discussed with seven of our 11 interviewees.

4.1 Current perceptions

Question 22 inquired about client and adviser perceptions of currently available income stream products. Consistent with the relatively low take-up of these products in the market, in general the message coming back from interviewees was that clients and advisers are not favourably disposed to currently available products, especially at current interest rates. The two key issues mentioned repeatedly were current annuity rates, and access to capital. Here are the responses.

- "Older clients think of the old days of defined benefits and would love that. But they think of interest rates of 7%, 8%, or 9%. They are not interested in current returns of 2% or 3% being locked in for the duration of their lives. The income is too low. But in principle they love the idea."
- "The problem is poor returns. Annuities are not popular in the current low interest rate environment. Current products are quite innovative, for example the protected capital products and the availability of a guaranteed cash value."
- "Clients wouldn't have a view. I am generally opposed to the use of annuities due to lack of access to capital. It's the client's money and they should be able to access it. You can achieve low returns securely via a conservatively invested ABP and not forfeit access to capital."
- "I am not a huge fan of annuities. Our Guide to SOAs requires advisers to limit the amount annuitised to not more than 50% of the client's assets, as a diversification measure and to preserve some access to capital."
- "This varies greatly by adviser. Some advisers understand and believe in lifetime annuities and use this to frame a positive story for the client but others will look at the price of the longevity cover and think that there is an implicit insurance premium that the client may not want to pay. There are a lot of flows from the adviser group to Challenger and CommInsure though."
- "Existing products have a place and the firm already distributes Challenger Liquid Lifetime and Term Annuities. Annuities are considered hand in hand with the retirement planning process and hand in hand with traditional portfolio advice. Customers have different views. Probably annuities will become more relevant in future. Interaction with future products with social security and aged care needs to be clarified."
- "Access to funds is important, for example if the client wants to go into a retirement village. However at current annuity rates, Term Deposits can give a superior outcome. Bonds yield 4.5% to 5%. Returns from annuities don't excite people. They have other needs for their money. Our firm wants to give people tools to make good decisions."

4.2 Do clients want longevity protection?

The next question asked whether in principle, clients would like longevity protection, and if not, why not? Whilst most interviewees acknowledged that in principle, clients would appreciate longevity protection, the reasons they gave previously (see Section 4.1 above) meant that this did not imply that in practice clients would currently buy annuities.

- "Yes. Even if they could get an annuity of 5% of the purchase price, clients would annuitise for at least half of their assets. But interest rates are at an historical low. Advisers can't really suggest annuities."
- "Yes they would like longevity protection so annuities would be an easy sell but at the right price."
- "Yes clients value longevity protection but they do want acceptably high returns."
- "It is hard to advise clients on longevity projection. The cost is a significant factor."
- "Yes but the importance varies a lot by client, and different advisers take very different attitudes to annuities."
- "Longevity protection comes at a cost. There needs to be education by adviser to client 'future proofing will cost you $X'. Some clients will pay, others won't. Products that don't allow access to capital where required will suffer."
- "The firm does not believe that their clients especially value longevity protection. Maybe it would have greater value for blue-collar clients. Annuities are a constraint; if you box people in it's harder for them to cope with unexpected needs. People don't have that much concern about longevity; they just adjust to their circumstances."

4.3 Desirable features of future products

The final question of the structured interviews asked what features of a future lifetime income stream product might make the product more palatable than currently available products. There were few specific new suggestions; perhaps it will be difficult to design more attractive products, or perhaps product design was not a core skill of our interviewees. Here are the responses.

- "Most clients would want indexed income."
- "Nothing springs to mind. There is genuine interest in what products might emerge from the current review but advisers are adopting a 'wait and see' attitude. Relevant factors will include: social security treatment; tax treatment; indexation availability; protected term; access to capital; and availability of different payment intervals."
- "Hard to answer. The premise of the question was that annuities are 'good'. You can replicate an annuity without losing access to capital."
- "Access to capital is an important feature."
- "I liked an old ING policy called Money for Life, which incorporated actual investment performance into the calculation of future annuity payments. The cost would still need to be reasonable however."
- "Maybe a combination of insurance and lifetime annuity. Some products combine insurance and investment. Clients can go into transition to

retirement phase, switching down from 5 days a week to two days then retire fully. The products should blend with a phased approach to retirement. The client could still pay an insurance premium to age 65, and products could have built in benefits for aged care. A bigger issue is the social security environment."
- "The most critical concern is access to capital if they have a need. People don't like reverse mortgages. Australians are frugal. People are sensible in their approach to spending. Marketing of products tends to aim at people's fear."

5 Issues for consideration

This research provides some valuable insight into how planners work with their clients when formulating retirement income advice.

In carrying out the research we have identified a number of issues that warrant further consideration. The current methodologies arguably fail to highlight some key risks in retirement. Failure to emphasise and address these risks has the potential to cause clients to fail to meet their long-term retirement goals. These issues are mirrored in (and to some extent caused by) the tools that planners are using.

As a result, there could be questions around whether the current methodologies will always meet the best interests duty imposed on planners under the FoFA reforms.

These issues are outlined in Sections 5.1 to 5.8 below.

5.1 Risk Profiling and asset allocation

Risk Profile Questionnaires probe a client's "subjective risk tolerance". As such they can only be part of understanding a client's risk appetite. Situational risk tolerance ("risk capacity"), goal-implied risk and income resilience needs are others. Moreover, there is considerable questionnaire literature that addresses such issues as the number and structure of questions necessary to ensure statistical validity. This literature would tend to cast doubt on the quality of the RPQ as we understand its current use, although one RPQ in particular (the Finametrica tool) is claimed to meet the statistical validation tests developed in the literature. While we acknowledge the trade-offs inherent in financial planning, the need to limit client interview times in a busy practice, and that practitioners do not have sole reliance on RPQs, there is nonetheless an obvious question: is there an over-reliance on an imperfect tool, especially since it seems to determine the client's asset allocation in a majority of cases?

We note the development, in a group superannuation context, of a "Members' Default Utility Function" (MDUF) by David Bell and a group of collaborators

working at MineWealth[5]. The objective is to identify a group utility curve that is assumed to apply to each member of a particular group superannuation scheme. The curve is intended to assist trustees of a fund in making trade-offs on behalf of their members under conditions of uncertainty. Economists have long used utility functions to make optimal decisions under uncertainty. If it turns out to be possible to estimate and reliably parameterise a stable utility curve at an ***individual client*** level, then it is conceivable that utility function could be applied to produce optimal solutions to questions such as the ideal asset allocation for the client or the right rate at which a retiree client might want to spend down. However considerable efforts would need to be devoted to establish the validity, practicality and robustness of the "utility curve" approach, and even if theoretically optimal solutions could be developed to practical problems, comprehensible methods of communicating the rationale for planning recommendations to clients would need to be developed.

5.2 Life expectancy

It would appear that the existing software used by advisers uses the latest Australian Life Tables, without any allowance for future mortality improvements. Failure to make allowance for mortality improvements is likely to understate the client's life expectancy.

It would be much more appropriate if allowance were made for the fact that life expectancy is continuing to improve over time – either at the 125 year or 25 year rate of improvement[6].

Another reason why advisers should be wary of using standard mortality tables is that the people who consult with advisers are typically the more affluent members of our society and are likely to experience lighter annuitant mortality. We note in passing that as yet, no mortality table has been published for

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[5] See, for example, an introductory presentation on MDUF version 1, which is available at http://www.aist.asn.au/media/973912/introductory_presentation.pdf (downloaded 3 May 2018).

[6] The introduction to Longevity Bulletin 10 from the Institute of Actuaries U K (dated July 2017) said:

> "In high-income countries, life expectancy has increased steadily for decades, with only a few exceptions – for example, during times of war or pandemics. However, the rate at which life expectancy is improving in the United Kingdom has slowed significantly in recent years. The drivers behind this change are still being debated and possible explanations include an increase in deaths due to dementia and Alzheimer's disease. If it continues, this trend could have a significant impact on pension funds and insurers, as well as policymakers and government." and "The increase in death rates among US white males has been linked to the rise in substance abuse and suicides."

Australian annuitant experience– although we understand that the Actuaries Institute is working on developing such a table.

Spreading a client's available assets to be converted to income over a number of years – such as life expectancy – even with the addition of a few years – is applying an average assumption to planning for an individual. Determining sustainable spending based on this could potentially be misleading if the client erroneously believed that the computed spending level is assured of being sustainable. Advisers and their licensees should acknowledge that a predictable number of every adviser's clients will live well beyond the average, and those who outlive most of their cohort may find that their available drawdown (calculated as the inverse of life expectancy, or more actuarially, a life annuity factor at an appropriate rate of real interest) declines as they become elderly.

Advisers cannot afford to be complacent about longevity risk, and clients should be made aware of the risks of the "$1/\bar{a}_{x+t}$" drawdown method. If the methodology allows for survivorship to the 80th survival percentile, the residual 20% probability implies that the consequences of longevity (a decreased living standard) will impact approximately 20% of the adviser's clients.

A projection showing the chance of being alive for each year to age 110, for a client and their partner – separately and in combination – can be instructive in demonstrating the risks of longevity. A recent international paper[7] showed that people at age 65 years substantially under-estimated their life expectancy.

A standardised longevity assumption also makes no allowance for an individual client's genetic inheritance, lifestyle and state of health.

5.3 Could the tools used by planners be improved?

Many of the comments provided by interviewees indicate they rely heavily on the approach that is built into the software tools they use.

Nearly all firms use cash flow projections to test sustainable spending levels. The projections allow for retirement age, social security, superannuation balances, asset allocation and expenditure, but they do so using deterministic assumptions. Income needs are also often reduced to a single figure. Such processes give no insight into the range of possible outcomes, nor into the confidence one might have that reality may turn out to be "worse" than the illustrated outcome.

Clearly, if a projection is based on average assumptions then about half of the planner's clients will live longer than their assumed lifespan. Likewise, half will see long-term investment returns that are lower than the fixed return assumption, although there was a suggestion from some interviewees that some of the investment return assumptions were set somewhat conservatively.

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[7] Subjective expectations of survival and economic behavior (2014), by Cormac O'Dea and David Sturrock. Institute for Fiscal Studies Working Paper W18/14. See https://www.ifs.org.uk/uploads/WP201814.pdf, downloaded 7 May 2018.

When asked, many firms appeared not to favour stochastic projections. Some firms made it clear that a proportion of their advisers had an ability to incorporate probabilistic projections into the final SOAs (in some cases using material from a third-party provider other than their main software supplier). Some responses noted that there was demand from a small proportion of their client base (generally from clients in quantitative occupations) for probabilistic output. From an actuarial perspective it is difficult to see how an adviser could answer questions like "how much can I spend with 90% confidence?" without more sophisticated projection tools.

Projections are usually made to life expectancy and some years beyond. However the software tools typically offer the capability to make projections to the end of the Australian Life Tables age range in order to show a complete picture of financial outcomes from now to a future year in which a client's death might occur. Extending the age range over which projections are performed would tend to highlight the longevity risk to clients.

In real terms the income from an Account Based Pension is projected to decline, especially at older ages, if the client is drawing income at the minimum rates. The full extent of this reduction may not be revealed unless projections are made for longer terms than life expectancy.

Naturally the projection should also show income from the Age Pension as this will continue to be a source of income to many Australians for decades to come. An assumption that the current Age Pension eligibility, payment rates and thresholds will remain the same might be optimistic, but it is difficult to see what specific alternative assumption would carry much credibility.

From an actuarial perspective, ideally there would be some technique to show what happens to a client's projected income over time with unknown but varying investment returns. Monte Carlo simulations offer one way to do this, but some of the responses from our interviewees suggested that stochastic analyses provoke incomprehension and anxiety in clients rather than helping to educate them. For example, we wonder whether using a series of investment returns from the past for the investment options chosen for the client might be a more comprehensible way of demonstrating variability. Or should an adviser simply give the client high level results from stress testing models such as "You can be 90% confident of achieving your essential spending needs".

In addition to the methodology issues highlighted in Sections 5.1 to 5.3 above, there are some broader background issues that are worth considering. These are addressed in Sections 5.4 to 5.8 below.

5.4 Longevity risk and the "best interests" duty

As part of the FoFA reforms, from 1 July 2013 advisers have a duty to keep the objectives, financial situation and needs of clients paramount when providing personal financial advice.

At present, most Australian retirees are self-insuring their longevity risk. Interviewee comments made it clear that they regarded low annuity rates and

limited access to capital as key reasons for the low uptake of lifetime annuities in Australia. However, a more subtle and indirect contributing factor may be that planners (and the tools they use) focus on average assumptions. Focussing solely on averages results in less attention being paid to the key risks, including the investment, inflation and longevity risks. One component of the "best interests" duty may well be to ensure that these risks are satisfactorily addressed in the SOA.

5.5 Overspending risk and "scoping" the SOA

Based on the interview responses, a significant proportion of advisers appear to leave it to the client to determine how much they spend in retirement yet respondents noted that many clients don't have an accurate understanding of their aggregate spending needs nor a strong grasp of what they spend their money on. For all but the wealthiest retirees, the client's budget is crucial. Unless the expenses can be reliably estimated, the resulting retirement plan is likely to be ineffective.

Our interviewees indicated that at least some of the time, their advisers accept what the client says about their spending and then the adviser focuses on portfolio construction. Perhaps this is a function of the fact that it's wealthier clients (who preserve or even grow the real value of their capital) who are more likely to use financial planners. But for advising the mass market, it is of paramount importance to include robust estimates of amounts likely to be spent each year in retirement, as well as drawdown strategies and parameters in the scope of advice.

It's not always possible to scope out key issues that would impact the client's outcome. As noted in ASIC Report 279 (para 129) "Some clients have difficulty in determining the scope of advice that they need … and advisers should help their clients … to decide on an appropriate scope of advice in the circumstances. [ASIC] expects advisers to consider what scope of advice would be in the best interest of the client in the circumstances..."

5.6 Client education

There were many interviewee comments that indicated that education of the client is an important part of the process. This is to be expected: the regulatory, tax, Social Security and product environments are complex. Generally our impression was that the educational process was relatively informal, and arose from conversations between client and adviser at several stages of the advice process, as well as from client reading and understanding the final SOA.

What was most interesting however was that a small number of firms appear to have embedded an education piece into the advice process via an online Fact Find process. Such firms have expanded the Fact Find to include an educational component as well as the simple "question and answer" format. A better-informed and more engaged client presumably makes a better advised and a more satisfied client.

5.7 Adviser education

A number of responses indicated that firms were well aware that their advisers had a range of different levels of education, training and experience. They made it clear that some advisers, for example, use relatively more sophisticated approaches than others in areas such as giving the client an indication of probabilities of outcomes instead of a single deterministic projection. As noted above, a focus on a single central estimate projection may result in an inadequate client and adviser understanding of relevant risks, which may result in unhappy clients (and related remediation costs) when markets turn down.

Whilst FoFA reforms include strengthened requirements for adviser education, the actuarial profession might consider whether it can offer material to assist advisers to better understand key aspects of the advice problem where actuaries are professionally very familiar such as the technical bases of projections and use of projection techniques to produce a deeper understanding of key retirement risks.

5.8 **Are current retirement income products suitable for retiree needs?**

In principle, the most obvious solution to the longevity risk is longevity products (lifetime pensions or annuities and deferred annuities). Such products avoid the need for retirees to self-insure some or all of the risks they face.

In general advisers seem well aware of lifetime annuities as a means of offsetting the longevity risk BUT they say that the current products are expensive. Advisers also want their clients to have access to capital. One licensee requires that not more than 50% of a client's available assets are invested in lifetime income streams. The balance could be invested in an Account Based Pension – from which a client could withdraw money for lumpy expenses such as house renovations. Thus the objectives of "Cash, Access and Legacy" could be met from the ABP running alongside the lifetime income stream.

Superannuation changes effective 1 July 2017 have allowed a much wider range of lifetime income stream products to become available, including investment linked products that can avoid having to lock in low interest rates when buying longevity protection products.

Attitudes toward lifetime products may evolve as new products enter the market and are no longer constrained to provide a guaranteed fixed level of income for life. Guarantees carry a cost for clients because annuity providers need to meet the cost of capital associated with the risks accepted.

6 Conclusion

This research has given us significant insight into the practical methodologies and tools being used by financial advisers when formulating retirement income recommendations. There is a heavy reliance on Risk Profiling Questionnaires despite growing sentiment that there only go part of the way to determining an appropriate asset mix for a particular client.

Most advisers use projection tools that take into account the age pension, spouse, and all superannuation and non-superannuation assets held by the household. Year by year projections are carried out for a fixed timescale, often to life expectancy plus a margin.

However, the authors have identified a number of issues, particularly that some key risks seem to be masked or downplayed in the tools that advisers are using. Potentially this may cause some clients to fail to achieve their long-term retirement objectives.

In the post-retirement space recovery from an error is hard if not impossible, as there are unlikely to be future contributions to offset any loss. Assets built up over a lifetime are being consumed.

Many actuaries work in the financial planning and product development sectors. These roles entail a natural use of actuarial skills, not only in terms of applying Control Theory to managing insurance businesses but also in using mathematics to demonstrate various personal financial planning strategies to clients and illustrating the risks inherent in various strategies.

There are a number of areas where individual actuaries, or the profession collectively, may be able to add value to the financial advice process. For example, actuaries might:

- Assist with the production of education and reference materials on key topics such as:
    - Life expectancy, including joint life, health status and including probabilities
    - Risk profiling tools that take into account the other long term risks that retirees face
    - Reference materials to help clients make informed trade-offs such as lifestyle vs income security vs leaving an inheritance
- Work with licensees and/or industry bodies to help develop methodologies to assess and rate retirement income products – fees, pricing, risks, outcomes etc.
- Work with licensees, industry bodies and software providers to determine what the software tools need to do and assess the extent to which existing tools achieve that and how to bridge any gaps.
- Work with licensees to design and test a full spectrum of "model income plans" that their advisers can then match to the preferences and financial situations of any retired household.

Abbreviations

AA	Asset allocation
ABP	Account Based Pension
ASFA	Association of Superannuation Funds of Australia
CF	Cash Flow
CIPR	Comprehensive Income Product for Retirement
DAP	Daily Accommodation Payments (at an aged care facility)
FOS	Financial Ombudsman Service
HNW	High Net Worth
RAD	Refundable Accommodation Deposit (paid on entry to an aged care facility)
RIWG	Retirement Incomes Working Group (of the Actuaries Institute)
RPQ	Risk Profile Questionnaire
SAA	Strategic Asset Allocation
SIS	Superannuation Industry Supervision
SOA	Statement of Advice (sometimes referred to as a “financial plan”)

Appendix Questions covered by structured interviews

1. Which of the following best describes the licensing/employment status of your advisers? [Salaried advisers of a bank; self-employed as an authorised representative of a "big 6" dealer group; self-employed representative of an independent licensee; salaried (other)].

2. Approximately how many advisers work at your firm?

3. What method does your organisation use for determining the investment risk profile of clients? [Risk profile questionnaire; risk tolerance line method; life cycle approach; sensitivity analysis approach; other].

4. How many questions are there in your organisation's Risk Profile Questionnaire?

5. Do you use the results of the Risk Profile Questionnaire to map clients to an asset allocation? [Yes, and that's usually the asset allocation recommended to the client; typically only as a starting point; no].

6. How difficult is it from a compliance point of view in your organisation for an adviser to recommend an asset allocation other than the asset allocation determined from the Risk Profile Questionnaire? [Very difficult/not possible; possible but with some additional compliance effort; advisers have some discretion to vary slightly from the asset allocation derived from the Risk Profile Questionnaire; advisers can recommend the asset allocation they deem best for the client regardless of Risk Profile Questionnaire results].

7. Who designs the approach to retirement advice (asset allocation and retirement capital management) within your organisation? [Advisers have full discretion; planning firm provides a preferred methodology that advisers tend to stick to; planning firm provides a preferred methodology that advisers must stick to; licensee/dealer group provides a preferred methodology that advisers tend to stick to; licensee/dealer group provides a preferred methodology that advisers must stick to].

8. What does your organisation see as the main objective of portfolio construction for retired clients? [Generating the highest returns subject to risk tolerance; ensure the client can maintain a given level of spending; ALM around retirement cash flows; other].

9. Currently, how often do you think that the asset allocation that flows from the risk profile questionnaire is the one that you believe is appropriate for the client taking into account their income, assets, personal circumstances and investment objectives? [This never happens in practice; rarely; sometimes; reasonably often; frequently; always].

10. Do asset allocations typically change for clients near retirement? [Yes, due to changing client risk profiles; yes, due to sequencing risk; yes, for other reasons; no].

11. What do your advisers do if the client's risk profile seems to be sub-optimal for achieving their investment/retirement goals? [Stick closely to the asset allocation that follows from the risk profile; discuss the situation with the client and attempt to persuade them to adopt an allocation other than the allocation that flows from the RP Questionnaire but try to stay within ONE risk band of the one from the RP Questionnaire; discuss the situation with the client and attempt to persuade them to adopt an allocation other than the allocation that flows from the RP Questionnaire but try to stay within TWO risk bands of the one from the RP Questionnaire; ignore the risk profile – provided that the client is prepared to sign a statement confirming the asset allocation that is discussed and agreed on, it doesn't matter what the Risk Profile Questionnaire said].

12. What is the period for which financial plans are usually constructed? [For average or median life expectancy; for average or median life expectancy plus a margin of ONE to FIVE years; for average or median life expectancy plus a margin of SIX or more years; life expectancy is stochastically modelled; up to a fixed age; case by case].

13. How do you determine your clients' life expectancies? [From published averages; from published averages allowing for improvements in mortality; from a software package; discuss this with the client and agree on a suitable age for planning; other].

14. What do your advisers do if the client would only be able to achieve their target retirement lifestyle if high asset returns are achieved in future? [Invest in growth assets to give a reasonable probability of meeting target objectives, notwithstanding the probability that this allocation runs the risk that assets may expire more quickly than if a cautious allocation were adopted; invest according to risk profile and let the client make the spending decisions; encourage the client to reduce their target and goals to be more in line with what they can afford based on their assets; a mixture of the first and third responses above].

15. The spending goals of retired clients are generally: (more than one response acceptable): [a single income figure, prioritised between wants and needs; as much as is thought to be viable; expected to change as clients get older; other].

16. How does your organisation ascertain what level of lifestyle is sustainable given a client's asset levels and financial situation? Please mention any software tools that your organisation uses.

17. Which of the following methodologies do your advisers usually use to manage retirement capital and spending (multiple selections permitted)? [Stick to the SIS minimum pension withdrawal rates for account-based pensions; "safe withdrawal rate" e.g. take 4% of the asset balance at retirement and index that to inflation; time segmentation approach

("bucket strategies"); "floor and upside" e.g. invest in a guaranteed income stream to provide an income "floor" and invest remaining investments in a growth portfolio; accept what the client says their spending needs are and focus on portfolio construction; other].

18. Please comment on your responses to Question 17.

19. Which of the following are usually included as part of the advice process/service (multiple answers permitted)? [Realistic cash flow projections, include non-superannuation items; assistance with setting realistic goals and objectives for retirement; situational risk tolerance assessment; compare alternative strategies; include wider implications such as tax, estate planning and social security implications].

20. Where Statements of Advice (SOAs) include alternative projection reflecting more or less favourable potential outcomes than the main estimates, how are those alternatives determined and characterised? [N/A – projections are central estimate only; "optimistic" and "pessimistic" or similar, without any quantification of the assumptions used; they are characterised in quantitative terms (probabilities and percentiles) but these alternatives are not themselves derived form a stochastic model; the alternative projections show probability lines determined from a stochastic model; other].

21. Is your organisation likely to make greater use of stochastic models in future to show clients the range of outcomes and their confidence level of achieving a particular outcome? [Yes; no (please comment on obstacles); unsure; we already do this].

22. What do your advisers and clients think of currently available lifetime income stream products?*

23. Do you perceive that in principle, clients would like to have longevity protection? If not, why not?*

24. What might attract advisers to recommend better longevity products (e.g. market linked annuities, GSAs)?*

*Note that questions 22 to 24 were added part way through the interviews, so only about half of the interviewees were asked these questions.